

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

CONSUMERS ILLINOIS WATER COMPANY)
Petition for (1) issuance of a Certificate of Public)
Convenience and Necessity (“Certificate”) to)
operate a water supply and distribution system and) **Docket 00-0366**
sewage collection system in Lake County;)
(2) approval of accounting entries related to)
acquisition of facilities; (3) approval for application)
of rates.)

INITIAL BRIEF OF CONSUMERS ILLINOIS WATER COMPANY

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TABLE OF CONTENTS

	<u>Page</u>
I. NATURE OF THE CASE.....	1
II. BACKGROUND.....	1
III. SUMMARY OF POSITION.....	3
IV. CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY	4
V. APPLICATION OF VILLAGE RATES	7
VI. DETERMINATION OF WATER NET ORIGINAL COST	9
A. Position of CIWC.....	9
1. The Contracts	9
2. Determination of Original Cost.....	10
3. Original Cost Net of Contributed Plant.....	13
B. Position of the Staff.....	13
VII. DETERMINATION OF SEWER NET ORIGINAL COST.....	18
A. Position of CIWC.....	18
B. Position of the Staff.....	23
VIII. CONCLUSION.....	26

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INITIAL BRIEF OF CONSUMERS ILLINOIS WATER COMPANY

I. NATURE OF THE CASE

This proceeding was initiated to review a Petition filed by Consumers Illinois Water Company (“CIWC”) on May 17, 2000, seeking: (i) issuance of a Certificate of Public Convenience and Necessity (“Certificate”) to serve the area of the Ivanhoe Club Subdivision (“Ivanhoe Club”), (ii) approval of certain accounting entries related to the Ivanhoe Club facilities and (iii) approval of rates for water and sewer service to be provided by CIWC in the Ivanhoe Club area.

II. BACKGROUND

Public water and sewer utility service is presently provided for Ivanhoe Club by a water system (“Water System”) and a sanitary sewer system (“Sewer System”) owned by Bank Popular, Illinois, as Trustee under a Trust Agreement dated December 1, 1986 and known as Trust Number 1250 (the “Trust”) and Thorngate Country Club, Inc., as sole beneficiary under the Trust (collectively, “Thorngate”) and Ivanhoe Club Mutual Water and Sewer System, Inc. (“Mutual Services”). [CIWC Ex. 1.0, p. 3.]

The Water System consists of reservoirs; wells; aquifers; treatment facilities; distribution mains; valves; hydrants; service lines from the distribution main to the curb stop, meters; and related equipment. The Sewer System consists of purification lagoons; storage stations; chlorinating facilities; groundwater monitoring wells; force mains; comminutors; lift stations; pumping equipment; aeration equipment; collection lines (including the 12 inch effluent line from the lagoon system to the irrigation pump station); manholes; and such other equipment and facilities used to provide waste water treatment services to the Ivanhoe Club. [CIWC Ex. 1.0, pp. 3-4.]

Thorngate operates the Water System and Sewer System, and owns the portions of the Water System and Sewer System which are on its property (the “Club Property”). Mutual Services owns the portions of the Water System and Sewer System which are installed throughout the residential property adjacent to the Club Property (“Residential Property”). Together, the Residential Property and Club Property comprise the Ivanhoe Club. [CIWC Ex. 1.0, p. 4.]

Thorngate is, among other things, in the business of owning and operating a country club facility and is not expert in the business of providing water and sewer utility service. Thorngate is not familiar with the provisions of the Safe Drinking Water Act or Clean Water Act, and has concerns with respect to its future ability to comply with those Acts. For these reasons, Thorngate has indicated its desire to transfer ownership and control of the Water System and Sewer System to CIWC. [CIWC Ex. 1.0, p. 4.]

The members of Mutual Services are two homeowners associations which serve residences within the Residential Property (referred to jointly as the “Homeowners Associations”). Aside from the portions of the Water System and Sewer System located within

the Residential Property, Mutual Services has no utility property. Like Thorngate, the Homeowners Associations have requested that CIWC acquire ownership and control of the Water System and Sewer System. [CIWC Ex. 1.0, pp. 4-5.]

Subject to issuance of an Order granting the relief requested by CIWC in this proceeding, CIWC will acquire the Water System and Sewer System from Thorngate and Mutual Services, pursuant to the two agreements submitted in this proceeding as CIWC Exhibits “C” and “D,” respectively. [CIWC Ex. 1.0, p. 5.]

III. SUMMARY OF POSITION

As will be discussed, there are certain matters in this proceeding which are not in dispute, including CIWC’s: (i) request for issuance of a Certificate; and (ii) proposal to adopt initially for Ivanhoe Club the water and sewer rates in effect in the Village of Mundelein (“Village”). CIWC and Staff also agree that, if the Village implements new rates during the first ten years following the Acquisition, a rate filing submitted by CIWC to adopt such rates should not be automatically suspended. Instead, the Commission should consider the information provided by CIWC in supplemental annual reports (“Reports”) discussed herein and with the tariff filing. Tariffs filed to implement new rates of the Village would be suspended only if the Commission concludes, based on the available information, that suspension is warranted. CIWC’s request for a Certificate and proposal to apply water and sewer rate of the Village will be discussed, respectively, in Sections IV and V below.

Certain issues related to determination of the original cost of the water and sewer facilities acquired by CIWC from Thorngate are in dispute. With respect to water facilities, CIWC’s position is that, as required by Accounting Instruction 18(B) of the Uniform System of Accounts for Water Utilities (83 Illinois Administrative Code 605) (“USOA-Water”), the value

of land provided by Thorngate in return for construction of the water system (a portion of a 38 acre parcel discussed below) should be considered in determining the water system's original cost. CIWC believes that, under the circumstances shown by the record, the best measure of the value of the exchanged land is the estimated original cost of the water system constructed by developers in return for the land. Staff, on the other hand, takes the position that only Thorngate's cost for the exchanged land should be considered, and that, in determining the original cost of the water system, the value of the land exchanged for construction of the water system should be disregarded.

The other matter in dispute relates to contributions-in-aid-of-construction ("CIAC" or "contributed plant") for the sewer system. CIWC's position is that, as was also proposed on direct by Staff, the cost of contributed plant should (in accord with the Commission's normal practice) be included in Plant-in-Service, and then deducted from rate base on a separate line item. CIWC believes that the net effect of contributed plant on the original cost of utility plant (and, therefore, rate base) should be zero. Although Mr. Sant adopted this position in his direct case, Mr. Sant later abandoned this approach and proposed to deduct contributed plant from a Plant-in-Service balance which does not include contributed plant. As will be discussed, the effect of Staff's approach would be to deprive CIWC of the opportunity to earn a reasonable rate of return on the full amount of its investment in Plant-in-Service. The issues regarding water and sewer net original cost will be discussed below in Sections VI and VII, respectively.

IV. CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY

It is undisputed that the Certificate requested by CIWC should be granted. As Mr. Rakocy, President of CIWC, explained, the public convenience and necessity require that CIWC operate and maintain a public water supply and distribution system and a sewage collection system for Ivanhoe Club. Aside from Thorngate and Mutual Services, no municipal

corporation or other entity owns a water supply and distribution system or sewage collection system within, or within a reasonable proximity to Ivanhoe Club, or is authorized to do so, or is able to render public water and sewer utility service to Ivanhoe Club. [CIWC Ex. 1.0, p. 5.] CIWC has the technical, financial and managerial ability to operate and maintain a public water supply and distribution system and a sewage collection system for Ivanhoe Club, without adverse financial consequences for existing customers. [Id.] Also, as Mr. Rakocy explained, CIWC's proposal represents the least-cost means of providing adequate and reliable service to customers. [CIWC Ex. 1.0R, p. 11.]

As discussed above, Thorngate does not have the knowledge or experience needed to assure future compliance with water quality requirements. [CIWC Ex. 1.0, p. 5.] Also, the financial strength of the CIWC system will assure that the Ivanhoe Club system will have an enhanced ability to attract necessary capital at competitive rates. As a part of CIWC, customers in the Ivanhoe Division will also benefit from improved service. The Ivanhoe Division will benefit from state-of-the-art laboratory facilities maintained in Illinois by CIWC. Also, CIWC's customer service personnel at the corporate headquarters will be available to customers served by the Ivanhoe Division. The center is a single facility established to handle all customer inquiries statewide. Through CIWC's state-wide employee base of trained professionals, the Ivanhoe Division will be better able to respond to natural disasters and other emergencies. The CIWC system has approximately 100 employees statewide, including numerous experts and professionals in every facet of water service. CIWC's state-wide resources can be brought to bear in emergency situations to assist the Ivanhoe Division. [CIWC Ex. 1.0, pp. 5-6.]

As Mr. Rakocy indicated, existing customers also will benefit from the expansion of CIWC's system to serve the Ivanhoe Club. Although the Ivanhoe Club area itself is small, the

acquisition of this area represents CIWC's first opportunity to provide service in Lake County, a region which has significant growth potential. [CIWC Ex. 1.0, p. 6.] Through customer growth, CIWC can achieve long-term cost savings from the realization of economies of scale and operating efficiencies that result from the spreading of common administrative/management costs over a wider customer base. Growth through acquisitions also will enhance the Company's ability to fund increasing infrastructure needs driven by aging plant, technology changes and increasingly rigorous water quality requirements. [Id.]

Staff witness King also recommended that the proposed Certificate be granted. [Staff Ex. 2.0, p. 8.] Staff witness King found no reason to dispute Mr. Rakocy's position that CIWC has the financial and managerial ability to operate and maintain a public water supply and distribution system and a sewage collection and disposal system for Ivanhoe Club, without adverse financial consequences for existing customers. [Staff Ex. 2.0, p. 5.] Mr. King also testified that, in his opinion, the most cost-efficient method for providing water and sewer service to the customers in Ivanhoe Club is to receive service from a large utility, such as CIWC. [Id., p. 6.] Mr. King noted that CIWC has 100 years of experience in operating water systems and has on-staff engineers, managers and certified operators. [Id.] Mr. King stated that CIWC could maintain lower water rates by spreading the cost of office facilities, employee time, billing, and overhead over a large customer base. [Id.] Mr. King also noted that CIWC is owned by a strong national firm, Philadelphia Suburban Corporation, which suggests that resources for operations and plant facilities are available if needed. [Id.] Mr. King noted that CIWC's water and sewer systems are well-maintained and that CIWC is financially and operationally able to provide reliable service to Ivanhoe Club. [Id., pp. 6-7.]

V. APPLICATION OF VILLAGE RATES

Under the terms of “Declaration of Covenants, Conditions and Restrictions for the Mutual Water and Sewer System of Ivanhoe Club,” a document terminated by the Agreements, the charges for water and sewer service to customers within Ivanhoe Club are presently based on the charges for such services imposed by the Village, as those charges are amended from time to time. [CIWC Ex. 1.0, p. 7.] Under the Agreements, CIWC would, subject to the approval of the Commission, continue this approach for the first ten years following acquisition of the Water System and Sewer System. Following the first ten years, the water and sewer rates in effect for Ivanhoe Club would be those established by the Commission. [Id.] To implement this approach, Mr. Rakocy indicated that the Commission should approve filing of the Tariff Sheet marked as CIWC Exhibit “F (Revised),” which shows the current rates of the Village. [CIWC Ex. 1.0, p. 7.]

Staff witness Sant agreed with CIWC’s proposal to implement the current rates of the Village. [Staff Ex. 1.0, p. 11.] Mr. Sant, however, indicated that, to adopt new rates implemented by the Village, CIWC should be “required to follow the provisions of Article 9 of the Public Utilities Act” [Id.] Mr. Sant further suggested that, with its ICC Form 22 Annual Report, CIWC should be required to file each year for the Ivanhoe Club area a “supplemental annual report” (“Report”) showing an operating statement and balance sheet. [Id.] The Report would provide an opportunity for Staff to monitor the rate of return realized for Ivanhoe operations. [Id.]

As Mr. Rakocy explained, at the current Village rates, the rates of return realized by CIWC on water and sewer rate base, respectively 2.62% and -2.15%, are each far below the level accepted by the parties in CIWC’s pending rate case of 9.3% (Dockets 00-0337, 00-0338 and 00-0339 (consolidated)). [CIWC Exs. G (Rev.), H (Rev.); 1.0R, p. 9.] Under the circumstances,

Mr. Rakocy explained that it is highly unlikely that a future increase in rates placed into effect by the Village could cause CIWC to earn an excessive rate of return. [Id., pp. 9-10.] Mr. Rakocy further indicated that CIWC should not be required to incur the substantial cost of a rate proceeding (at least \$50,000) to adopt new Village rates for the approximately 200 customers which may ultimately exist in Ivanhoe. [Id., p. 10.] Because rates cannot exceed the level set by the Village, there would be no way for CIWC to recover the required rate case costs. As a result, a requirement that CIWC pursue a costly rate filing to implement rates of the Village as contemplated by the Agreement would have the effect of freezing rates at the current level for ten years. A requirement of that such rate filings be pursued with no prospect of rate case cost recovery would clearly create a disincentive to acquisition of a small system, such as Thorngate's. [Id., p. 10.]

In response to Mr. Sant's position, Mr. Rakocy acknowledged that CIWC would file the Reports showing actual rates of return for the Ivanhoe water and sewer rate bases. [CIWC Ex. 1.0R, p. 10.] In the unlikely event that either the water or sewer overall rate of return exceeds the applicable level allowed in CIWC's immediately preceding rate case, CIWC proposes that the rate producing the higher return be reduced to an appropriate level and that revenues contributing to earnings above the last-allowed level be refunded to Ivanhoe ratepayers over a six-month period. The necessary changes to language of the Water and Sewer tariff sheets marked as CIWC Exhibit F (Pages 2 and 6 of the Exhibit for Water and Sewer Tariffs, respectively) are shown in CIWC Exhibit "F (Revised)". [Id.]

In response to this proposal, Mr. Sant noted that, under Section 9-201 of the Public Utilities Act, the Commission need not automatically suspend a rate filing. [Staff Ex. 3.0, p. 12.] As stated by Mr. Sant, "assuming CIWC provides quality and informative supplemental Annual

Reports, it is possible the Commission will not automatically suspend an order if and when a rate increase is proposed.” [Id.]

As Mr. Rakocy indicated, CIWC believes that this is a reasonable approach. [CIWC Ex. 1.0SR, p. 12.] Under the circumstances of the present case, CIWC is acquiring a property in which it is expected by customers that the water and sewer rates in effect will match those in effect in the Village. [Id.] CIWC’s agreement with Thorngate anticipates that this rate approach will be maintained for 10 years, after which rates will be set by the Commission at the level deemed appropriate. CIWC has agreed to provide the Reports which are expected to demonstrate that application of the Village’s rates in the Ivanhoe Club area does not provide an excessive return. CIWC has further agreed that it would reduce rates and provide customer refunds in the event that an excessive return is realized. Under these circumstances, CIWC believes that Mr. Sant’s suggestion that the Commission should examine the information provided, and not automatically suspend a rate filing is appropriate. [Id.]

VI. DETERMINATION OF WATER NET ORIGINAL COST

A. Position of CIWC

1. The Contracts

Under an Amended and Restated Memorandum of Contract (“Amended Contract”), dated December 21, 1990, Thorngate agreed to provide water and sewer services for Ivanhoe Club in accordance with the Declaration of Covenants, Conditions and Restrictions For the Mutual Water and Sewer System of Ivanhoe Club (“Declaration”). [CIWC Ex. 1.0SR, p. 4.] The Declaration is also dated December 21, 1990. Under these documents and the original real estate agreement dated November 9, 1987, Thorngate conveyed 38 acres of land to Ivanhoe Club's Phase 2 developers and agreed to construct the sewer system (on its property and in the residential areas). Thorngate also agreed to provide water and sewer utility service, using its

property and that owned by Mutual Services. [Id.] In return, Thorngate received from the Phase 2 developers \$3.5 million in cash, the water system and other infrastructure projects. [Id.] Thorngate also contracted to receive an Access Fee of \$12,000 from the purchasers of each lot in Phase 2. Copies of the Amended Contract and Declaration were submitted in evidence as CIWC Exhibits 1.1SR and 1.2SR, respectively. [Id.]

2. Determination of Original Cost

Accounting Instruction 17(c) of the USOA-Water, which is quoted by Mr. Sant (Staff Ex. 1.0, p.6) and discussed by Mr. Rakocy (CIWC Ex. 1.0R, p. 3), indicates that, in the case of acquired plant, the utility plant accounts are to be stated on the basis of original cost, which should be “estimated if not known.” The Instruction further indicates that the records of the entity from which a water system is acquired should be used to determine the system’s cost. [CIWC Ex. 1.0R, p. 3.] Under the Instruction, however, the predecessor’s records are to be used only if the original cost of facilities can be determined by reference to the records. [Id.] Mr. Sant acknowledged that, where the original cost cannot be determined (i.e., “known”) by analysis of the predecessor entity’s records, use of an estimate is appropriate. [Tr. 39.]

At the time of his Direct Testimony, Mr. Sant believed that the cost of the water system at Ivanhoe Club could be determined from a review of Thorngate’s accounting records. [Staff Ex. 1.0, pp. 6-7.]. As both Mr. Rakocy and Mr. Ackman, General Manager and Chief Operating Officer of Thorngate, explained, however, the accounting entries identified by Mr. Sant are only for the sewer system. There are no costs at all for the water system in the accounts identified by Mr. Sant. [CIWC Ex. 1.0R, pp. 3-6 (Rakocy); 2.0R, p.4 (Ackman).] Mr. Sant ultimately agreed that, at the time of his Direct Testimony, he misunderstood the make-up of Thorngate’s accounts, and now understands that the accounts contain no cost data for the water system. [Tr. 42.]

The determination of original cost for acquired water utility plant is made in accordance with Accounting Instruction 18 of the USOA. [CIWC Cross-Exam. Ex. 1.] As Accounting Instruction 18(A) indicates, in pertinent part:

All amounts included in the accounts for utility plant acquired as an operating unit or system, shall be stated at the cost incurred by the person who first devoted the property to utility service.

[CIWC Cross-Exam Ex. 1, p. 1.] CIWC and Staff agree that, under the circumstances here, the entities which first devoted the water system to public service are Thorngate and Mutual Services. [Staff Ex. 3.0, p. 4.] Mr. Rakocy and Mr. Sant indicated that the collective investment of Thorngate and Mutual Services in the water system should be reflected as the system's original cost. [CIWC Ex. 1.0R, p. 4 (Rakocy); Staff Ex. 3.0, p. 4, Tr. 35 (Sant).] As Mr. Rakocy explained, however, Mutual Services is an entity formed solely to hold title to certain portions of the water (and sewer) systems which are located in residential areas. Accordingly, as is undisputed, the relevant investment is that of Thorngate. [CIWC Ex. 1.0SR, p. 4.]

As indicated above, Thorngate exchanged 38 acres of land in return for the water system (and cash and other infrastructure items). [Staff Ex. 3.0, p. 6 (Sant); CIWC Ex. 1.0SR, p. 5 (Rakocy).] The consideration provided by Thorngate for the system was therefore, "other than cash." In this circumstance, Accounting Instruction 18(B) of the USOA-Water states as follows:

When the consideration given for property is other than cash, the value of such consideration shall be determined on a cash basis (emphasis added).

[CIWC Cross-Exam. Ex. 1, p. 1.] This principle is confirmed by the last sentence of Accounting Instruction 18(A) which indicates that, as used in Section 18, the term "cost" has the meaning stated in Definition 9 of the USOA-Water. [CIWC Cross-Exam. Ex. 1, p. 1.] Definition 9 also indicates that the value of consideration "other than cash" constitutes the "cost" of acquired plant. [CIWC Cross-Exam. Ex. 1, p. 2.] Thus, as Mr. Rakocy indicated, the original cost of the

water system is equivalent to the value of the portion of the 38 acres of land which Thorngate transferred to the Phase 2 developers in return for the water system. [CIWC Ex. 1.0SR, p. 6.]

As Mr. Rakocy explained, there is no basis to determine a precise value for the applicable portion of the land exchanged. [CIWC Ex. 1.0SR, p. 8.] A reasonable estimate, however, can be developed. As Mr. Rakocy indicated, the cost to the Phase 2 developers of constructing a water system of the type constructed at Ivanhoe Club at the time of its construction is a reasonable estimate of the value which should be assigned to the applicable portion of the land. [CIWC Ex. 1.0SR, p. 8.] To determine the estimate, CIWC first surveyed the entire Ivanhoe system, and then estimated the present day cost of building a similar system. [CIWC Ex. 1.0R, p.2.]. Using Handy-Whitman Indices, CIWC trended the estimated present day costs back to the approximate date of construction to determine an estimated original cost of the water facilities. [Id.] In this manner, CIWC estimated that the cost incurred by the Phase 2 developers to construct the water system was \$1,624,987, and that applicable depreciation is \$256,504. As shown in Exhibit H (Revised), the estimated net utility plant for the water system is \$1,368,483. [CIWC Ex. 1.0SR, p.8.]. Mr. Rakocy's testimony indicates that this amount, "is the best available evidence of the original cost of the water system at the time that it was first devoted to public service." [Id.] This amount is also the best available evidence of the value of the land exchanged by Thorngate for construction of the water system. [CIWC Ex. 1.0SR, p. 8.]

CIWC's evidence with regard to the value of the land exchanged for the water system is undisputed. Mr. Sant acknowledged that he has no information at all about the land's value. [Tr. 36.] Thus, CIWC's evidence regarding the value of the consideration provided by Thorngate in return for the land is reasonable and should be accepted.

3. Original Cost Net of Contributed Plant

As noted above, Thorngate receives Access Fees in the amount of \$12,000 for each lot in Phase 2 in return for its commitment to provide water and sewer service. Mr. Sant proposed that total Access Fees in the amount of \$1,080,000 be allocated between the water and sewer rate bases as the appropriate respective amounts of water and sewer contributed plant. [Staff Ex. 1.0, p.7.] As Mr. Rakocy indicated, CIWC accepts Mr. Sant’s proposed levels of water and sewer contributed plant using the Access Fee approach (in lieu of the CIAC balance which CIWC had estimated). [CIWC Ex. 1.0SR, p. 10.] Accordingly, as shown in CIWC Ex. 1.3SR, the net original cost for the water system proposed by CIWC is as follows:

Description (A)	Per <u>Company</u>
Utility Plant in Service	\$1,624,987
Less: Accumulated Depreciation	<u>(264,504)</u>
Net Utility Plant-in-Service	1,368,483
Deduct:	
Contributions in Aid of Construction	<u>(483,840)</u>
Net Original Cost Plant:	<u><u>\$884,643</u></u>

B. Position of the Staff

Staff witness Sant and CIWC agree that Thorngate exchanged land for the water system, cash and other infrastructure items. [Tr. 35 (Sant); CIWC Ex. 1.0SR, p. 5 (Rakocy).] Mr. Sant, however, takes the position that the appropriate original cost of the water system is not the value of the land at the time of the exchange (as required by Accounting Instruction 18(A) (Tr. 39)), but is instead limited to the cost of the land to Thorngate. [Staff Ex. 3.0, p. 6-8.] Mr. Sant maintains that, because Thorngate realized a profit in selling its land (i.e., the cash proceeds

exceeded Thorngate's book costs), Thorngate "has no . . . investment in the 38 acres of land nor the water system." [Staff Ex. 3.0, p. 9.] For this reason, Mr. Sant concludes that the net original cost of the water system is zero. [Staff Exs. 3.0, p. 9, Sch. 7 (Revised).]

As Mr. Rakocy indicated, however, Mr. Sant's position is not logical or correct. [CIWC Ex. 1.0SR, p. 7.] The cost of the land to Thorngate represents the amount of the original purchase price paid by Thorngate, plus capitalized improvements. [Staff Ex. 3.0, pp. 6-8; CIWC Ex. 1.0SR, p. 6.] At the time of the exchange for the water system, however, the value of the land had increased.¹ Thorngate paid for the water system, not with the "cost of its land exchanged" but with the value of its land exchanged. [Id.] In the transaction, the value of Thorngate's 38 acres of land was equivalent to the sum of: (i) the amount of cash received by Thorngate; and (ii) the value of the water system and other infrastructure which the Phase 2 developers agreed to construct. [Id., p. 7.] As Mr. Rakocy explained, Mr. Sant's suggestion that the value of the land should be reduced by the amount of cash received is illogical. There is no basis to subtract the amount of cash received in determining the value of Thorngate's payment to the Phase 2 developers. [Id.] Contrary to the position of Mr. Sant, the fact that the value of the land at the time of the exchange for the water system exceeded its cost does not suggest that Thorngate had no investment in the water system. [Id., p. 7.] Accordingly, Mr. Sant's position is baseless.

Ultimately, even Mr. Sant seemed to recognize the importance in this proceeding of the value of the land exchanged by Thorngate in return for the water system. On cross-examination,

¹ As Mr. Ackman explained, Thorngate's business is to convert rural, undeveloped, unincorporated properties to living environments with a golf course surrounding and setting. The effect of this transformation is to increase the value of land held by Thorngate. [Tr. 72-73.]

Mr. Sant testified initially that the value of the land exchanged was unimportant. At transcript page 36, the following exchange occurred:

Q. In your opinion, the value of the land exchanged for the water system is not the pertinent issue, is that correct?

A. That is correct.

[Tr. 36.] (emphasis added)

Three pages later, however, after Mr. Sant had an opportunity to review Accounting Instruction 18, Mr. Sant gave the following testimony:

Q. Would you please refer to Accounting Instruction 18B, does that instruction state: When the consideration given for property is other than cash, the value of such consideration shall be determined on a cash basis?

A. Yes, that's how it reads.

Q. Under the Uniform System of Accounts, when the consideration given for utility property is something other than cash, the value of that consideration is pertinent; is that correct?

A. That appears to be correct.

[Tr. 39.] (emphasis added)

Mr. Sant also suggested that the Phase 2 developers may have recovered costs associated with the water system in connection with the sale of lots, thereby (presumably) making those costs inappropriate for use in estimating the exchanged land's value. In this regard, Mr. Sant stated that Mr. Rakocy provides no support suggesting that the developer is foregoing cost recovery. [Staff Ex. 3.0, pp. 4-5.]

With respect to this position, we note first that Mr. Sant has absolutely no basis to suggest that the Phase 2 developers recovered any portion of water system construction costs through the

sale of lots. Mr. Sant acknowledged that he has no documents, records or workpapers which indicate that Phase 2 developers recovered costs associated with the water system and/or sewer system through prices for lot sales, customer contributed plant or tax write-offs. [Tr. 40.]

Moreover, as Mr. Rakocy explained, the Phase 2 developers received land (and Thorngate's agreement to build the sewer system) in return for their cash and the agreement to construct the water system and other infrastructure. [CIWC Ex. 1.0SR, p. 5.] As Mr. Sant recognizes (Tr. 35), the developers were paid for construction of the water system by the receipt of land provided by Thorngate. Thus, the Phase 2 developers were compensated by Thorngate for the cost incurred in building the water system for Thorngate's use, and, as a result, the Phase 2 developers did not forego cost recovery. [CIWC Ex. 1.0SR, p. 5.]

Furthermore, as discussed above, the Phase 2 lot prices include the \$12,000 Access Fee payable to Thorngate for water and sewer service (which both CIWC and Staff propose to reflect as a rate base deduction). [CIWC Ex. 1.0SR, p. 5.] For Mr. Sant's position to be accurate, it would be necessary to assume that, having already been paid to construct the water system (through the transfer of land), the Phase 2 developers would seek further compensation for the cost of the water system through inclusion of the cost in the price of lots. [CIWC Ex. 1.0SR, p. 5.] It would be necessary to further assume that the buyers and sellers of the Phase 2 lots agreed to prices which reflected recovery of water system costs once through Access Fees charged to lot purchasers, and again through a portion of the purchase price charged to lot purchasers. There is, however, absolutely no basis for either assumption. [Id., p. 6.]

In his testimony, Mr. Sant makes reference to certain prior Orders in which the Commission determined that costs born by a developer but recovered through lots sales, customer contributed plant or tax write-offs in the form of land development costs should not be

considered in establishing original cost. [Staff Ex. 3.0, p. 4.] As noted above, however, there is no evidence showing that a situation of the type described exists in this case. Accordingly, the cases referenced by Mr. Sant have no relevance in this proceeding.

Because of Mr. Sant's view that the value of the land exchanged by Thorngate for the water system should be disregarded, he proposes a \$0 balance of Utility Plant-in-Service. [Staff Ex. 3.0, Sch. 7 (Rev.).] Mr. Sant also reflects as a contributed plant the portion of total Access Fees which is allocated to water operations (\$483,840). [Id.] Accordingly, Staff's calculation of net original cost is a negative balance of (\$483,840). [Id.] In a footnote, however, Staff suggests that this balance should be increased to \$0 for rate base purposes. [Id., FN 2.]

The effect of Mr. Sant's calculation is to exclude from rate base the original cost of the water system in its entirety. [CIWC Ex. 1.0SR, p. 9.] As discussed above, the Net Utility Plant-in-Service consistent with the original cost of the water system at the time it was first devoted to public service is \$1,368,483, as compared to Mr. Sant's calculation of \$0. [Id.; Sch. 7 (Rev.).] As Mr. Rakocy indicated, under these circumstances, CIWC would have no incentive to acquire or operate a small system, such as that of Ivanhoe. If there is little or no rate base assigned to a utility operation, there is no opportunity to earn a profit. [CIWC Ex. 1.0SR, p. 9.]

The purchase price for the Ivanhoe Club system is below the original cost. [Tr. 84.] The Commission has recognized in past orders, however, that, when a small water system property is acquired for a purchase price below original cost, the full original cost of property at the time it was first devoted to public service should be recognized in rate base. This is particularly true in circumstances where a failure to recognize the full original cost would result in a remaining rate base which is either low or a negative amount. The Commission has recognized that, in such circumstances, it is necessary to recognize the full original cost of property acquired in order to

provide a proper incentive for acquisitions, such as the one in the present case, which are in the public interest. As the Commission recognized in Rollins Sewer and Water Company, Docket 83-0693 (Oct. 30, 1984), a failure to recognize the original cost of property as first devoted to public service would raise “yet another disincentive or impediment” to the acquisition of a small water system. The Commission also recognized this point in Consumers Illinois Water Company, Docket 88-0045 (Oct. 12, 1988).

For the reasons discussed, the net original cost of the water system should reflect the amounts shown on CIWC Ex. 1.3SR and set forth above.

VII. DETERMINATION OF SEWER NET ORIGINAL COST

A. Position of CIWC

As noted above in connection with the water system, the USOA indicates that the original cost of an acquired system should be determined from the accounting records of the predecessor company, if the original cost of acquired plant can be “known” from a review of those records. [USOA-Accounting Instruction 17(C); Staff Ex. 1.0, p. 6; CIWC Ex. 1.0R, p. 3.] CIWC and Staff agree that, where the original cost cannot be “known” from a review of the accounting records, the USOA requires use of an estimate of original cost. [CIWC Ex. 1.0R, p. 3 (Rakocy); Tr. 39. (Sant).]

As Mr. Rakocy explained, Thorngate’s accounting records (set forth as Staff Ex. 1.0, Sch. 3; Tr. 42) do not provide complete or clear information regarding the original cost of the water or sewer facilities. [CIWC Ex. 1.0R, p. 3.] Thorngate is not now nor has it ever been a regulated entity or public corporation. [Id.] For this reason, Thorngate does not keep its books in accordance with the USOA and has not maintained separate accounts for the water or sewer systems. All of Thorngate’s accounting entries associated with the water and sewer systems are

contained within the books and records of Thorngate's country club operation. There are no separate accounts. [Id.; CIWC Ex. 2.0R, p. 4.]

The available sewer system accounting entries are shown on Staff Ex. 1.0, Sch. 3. [CIWC Ex. 1.0AS, p. 3.] From these entries, Mr. Sant derived the amounts shown on Staff Ex. 1.0, Schedule 6, for Land and Land Rights (Acct. 353) and Structures and Improvements (Acct. 354), which when added together total \$2,277,925. [CIWC Ex. 1.0AS, p. 3.] This is the amount set forth on Mr. Sant's Exhibit 3.0, Sch. 7 (Rev.) as sewer Plant-in-Service. Thorngate's accounting records, however, do not indicate what is included in the Plant-in-Service balance reflected by Mr. Sant. [CIWC Ex. 1.0AS, p. 3.] As Mr. Sant acknowledged, aside from Staff Exhibit 1.0, Sch. 3, there are no accounting records, studies, workpapers, analyses or any other document indicating the content of the two accounts shown on the Schedule. [Tr. 42.]

As Mr. Sant indicated, the sewer system at Ivanhoe Club includes such items as force mains, gravity mains and services, pumping equipment, treatment and disposal equipment and receiving wells. [Tr. 46-47.] Mr. Sant further indicated that the Uniform System of Accounts for Sewer Utilities (83 Ill. Admin. Code 650) ("USOA-Sewer") requires that the original cost of sewer plant be recorded in the appropriate account shown on Staff Exhibit 1.0, Sch. 1, p. 2 (e.g., Force Mains-Account 361, Services-Account 363, Pumping Equipment-Account 371, Treatment and Disposal Equipment-Account 380 and Receiving Wells-Account 370). Although Mr. Sant agreed that facilities in all of these categories are present in the Ivanhoe system (Tr. 46-47), there is no available accounting data for any of the relevant USOA accounts. [Tr. 47-48.] As Mr. Sant acknowledged, Thorngate's accounting records contain data only for Accounts 353 and 354. [Tr. 48.]

CIWC concluded that, although the limited accounting entries shown on Schedule 3 are available from Thorngate's records for the sewer system, it is not possible to determine what the entries represent or whether the entries cover all of the installed sewer facilities. [CIWC Exs. 1.0R, p. 4; 1.0AS, p. 3.] Indeed, Mr. Ackman confirmed that the costs for many capital projects completed for sewer operations (installation of equipment to transfer water flow from the sewer system to sprayer irrigation fields; replacement of up to seven grinder pumps and other projects) are not reflected in the two accounts considered by Mr. Sant. [Tr. 73-75.] As Mr. Ackman explained, Thorngate does not maintain separate books for its water or sewer system (Tr. 75), and the costs for the sewer system could be capitalized in Thorngate's golf course accounts other than those used by Mr. Sant, such as the account for the "grounds and greens" department. [Tr. 66-67.]

Even if the two accounts used by Mr. Sant included all of Thorngate's capitalized sewer system costs (and they do not), that still would not mean that the two accounts properly show the original cost of all of the sewer facilities. As Mr. Rakocy indicated, sewer plant facilities have an original cost whether that cost was capitalized for accounting purposes by Thorngate or not. [CIWC Ex. 1.0AS, p. 3.] Even if Thorngate did not capitalize the cost of contributed or non-contributed sewer plant, the original cost of that plant should be reflected under the USOA-Sewer as Plant-in-Service. [Id.]

As the above discussion makes clear, Thorngate's records do not provide complete or clear information regarding the sewer facilities. [CIWC Ex. 1.0R, p. 3.] Furthermore, as indicated above, Accounting Instruction 17(C) of the USOA indicates that where the original cost of facilities cannot be determined from the accounting records, use of an estimate of original cost is required. [CIWC Ex. 1.0R, p. 3 (Rakocy); Tr. 39 (Sant).]

Because the available accounting records are inadequate, CIWC performed a survey of the Ivanhoe system and developed an estimate of the present-day cost of the system. [CIWC ex. 1.0R, p. 2.] As discussed above, CIWC trended the estimated present-day costs back to the approximate date of construction to determine an estimated original cost, net of depreciation. [Id.] As Mr. Rakocy indicated, CIWC also estimated a level of customer contributed plant. [Id., p. 3.]

As shown on CIWC Exhibit “H (Revised),” page 2, the level of sewer utility Plant-in-Service estimated by CIWC is \$2,795,805, and applicable depreciation is \$649,329. Thus, the original cost of Utility Plant-in-Service, net of depreciation is \$2,146,477. [CIWC Ex. H (Rev.), p. 2.] As in the case of the water system, CIWC accepted Staff’s proposal to adopt as the appropriate level of CIAC an allocation of the total balance of Access Fees which Thorngate will ultimately receive (in lieu of the balance of CIAC which CIWC had estimated). [CIWC Ex. 1.0SR, p. 12, 1.0AS, p. 4.] As shown on Mr. Sant’s Schedule 7 (Revised) and CIWC Exhibit 1.3SR, the agreed level of CIAC for sewer operations is \$596,160. Thus, net original cost for sewer operations based on the estimated original cost developed by CIWC (using Staff’s proposed level of CIAC) is as follows:

<u>Sewer Net Original Cost</u>	
Utility Plant-in-Service	\$2,795,805
Less: Accumulated Depreciation	(649,328)
Net Utility Plant-in-Service	2,146,477
Deduct:	
Contributed Plant in Aid of Construction	<u>(596,160)</u>
Net Original Cost Plant	<u><u>\$1,550,317</u></u>

[CIWC Ex. H (Rev.), p. 2, adjusted to reflect Staff's proposed level of CIAC Staff Ex. 3.0, Sch. 7 (Rev.)]

As will be discussed, however, CIWC agreed to accept as an alternative, the level of net original cost developed by Staff for sewer operations; provided that Staff's proposed level of Utility Plant-in-Service is adjusted to include contributed plant. [CIWC Ex. 1.0AS, p. 4.] As will be discussed, Staff properly deducts contributed plant on Schedule 7 (Revised) in calculating sewer net original cost. [Staff Ex. 3.0, Sch. 7 (Rev.).] Staff's Plant-in-Service balance, however, does not include the contributed plant which Staff proposes to deduct. [CIWC Ex. 1.0AS, pp. 1-2.] When adjusted to include contributed plant in the amount of \$596,160, the level of Plant-in-Service determined from Thorngate's accounting records is \$2,874,085, which compares favorably to CIWC's estimated Plant-in-Service balance of \$2,795,805. [CIWC Ex. 1.0AS, p. 4.]

For this reason, as Mr. Rakocy indicated, CIWC would accept the adjusted Staff result based on Thorngate's records, detailed as follows on CIWC Exhibit 1.3SR:

Description (A)	Per Company
Utility Plant-in-Service	\$2,874,085
Less: Accumulated Depreciation	<u>(1,179,310)</u>
Net Utility Plant-in-Service	1,694,775
Deduct:	
Contributions in Aid of Construction	<u>(596,160)</u>
Net Original Cost Plant:	<u><u>\$1,098,615</u></u>

B. Position of the Staff

In his Direct Testimony and Exhibits, Staff witness Sant included as an element of Plant-in-Service Staff's calculation of the cost of contributed plant. [Staff Ex. 1.0, Sch. 4; CIWC Ex. 1.0AS, p. 2.] As Mr. Rakocy explained, this approach is appropriate because, under the USOA and in rate cases, the balance of contributed plant is included in Plant-in-Service and then deducted from rate base as a separate line item. [CIWC Ex. 1.0AS, p. 2.] Mr. Rakocy noted that this approach has been used in past rate proceedings of CIWC, including, but not limited to, Dockets 99-0288 and 97-0351. [Id.]

At the time of his Direct Testimony, Mr. Sant believed that the two accounts shown on Schedule 3 contained cost data for both water and sewer operations. [Tr. 42.] As shown on Schedules 2 and 4 which accompany Mr. Sant's Direct Testimony (Staff Ex. 1.0), Mr. Sant's determination of the original cost of water utility Plant-in-Service, \$1,256,017 (Schedule 2), is the sum of: (i) the two balances allocated by Mr. Sant from the accounts on Schedule 3, \$669,301 and \$102,876; and (ii) Mr. Sant's allocated balance of contributed plant in the amount of \$483,840. [Staff Ex. 1.0, Schs. 2-4; Tr. 40-41.] Similarly, for sewer operations, Mr. Sant added together to determine his Utility Plant-in-Service balance: \$2,101,908, the sum of the two allocated sewer plant amounts from Schedule 3 (\$1,305,140 and \$200,608, respectively); and (ii) contributed plant in the amount of \$596,160. [Staff Ex. 1.0, Schs. 2-4; Tr. 42-43.] Thus, as Mr. Rakocy indicated, Mr. Sant initially included contributed plant in determining the Plant-in-Service balances. [CIWC Ex. 1.0AS, p. 2.]

In preparing his Rebuttal Testimony, Mr. Sant discovered that CIWC was correct in pointing out that the accounts on Schedule 3 do not contain water system costs. [Tr. 42.] In Schedule 7 which accompanied Mr. Sant's Rebuttal Testimony (Staff Ex. 3.0), however, Mr. Sant continued to reflect for water operations the balance of contributed plant as

Plant-in-Service. [Staff Ex. 3.0, Sch. 7; Tr. 45.] For sewer net original cost, however, Mr. Sant's Schedule 7 omitted (without explanation) the CIAC component of Utility Plant-in-Service, and included only balances of the two accounts shown on Schedule 3. [Staff Ex. 3.0, Sch. 7; Tr. 43-44.] By means of this omission, Mr. Sant reduced the balance of sewer Plant-in-Service by \$596,160 from \$2,874,085 to \$2,277,925. [Tr. 43-44; CIWC Ex. 1.0SR, p. 11.]

As Mr. Rakocy's Surrebuttal Testimony indicates, CIWC believed that Mr. Sant's unexplained omission of the cost of contributed plant in calculating the original cost of sewer (but not water) Plant-in-Service was an inadvertent error. [CIWC Ex. 1.0SR, p. 11.] As discussed above, Mr. Rakocy further indicated that, if the apparent error were corrected, CIWC would accept Staff's calculation of sewer Utility Plant-in-Service. [Id., p. 12.]

Subsequently, however, Mr. Sant submitted a data response (marked as CIWC Exhibit 1.1ASR) in which he indicated his belief that CIAC "should be excluded from Utility Plant-in-Service." [CIWC Exs. 1.0AS, p. 2; 1.1ASR.] Later, Mr. Sant submitted Supplemental Rebuttal Testimony (Staff Ex. 5.0) which purported (for the first time) to explain his approach. [Staff Ex. 5.0, pp. 3-4.] With the Supplemental Rebuttal filing, Mr. Sant also included a revised version of Schedule 7 in which the cost of contributed plant was for the first time excluded from both water and sewer Plant-in-Service. [Staff Ex. 5.0, Sch. 7 (Rev.); Tr. 44-45.] In the Supplemental Rebuttal, Mr. Sant abandoned the position he took in the data response (that CIAC should be excluded from Plant-in-Service) and maintained that, after the filing of Direct and Rebuttal evidence by both CIWC and Staff, he "realized that the Plant-in-Service totals already included contributed plant." [Staff Ex. 5.0, p. 4.]

As stated in his Supplemental Rebuttal, the sole basis for Mr. Sant's new position is a belief that all sewer system construction costs are reflected in the two accounts shown on Schedule 3. [Staff Ex. 5.0, pp. 4-5.] The record, however, demonstrates that this is not the case. In this regard, CIWC and Staff agree that all of the available information from Thorngate's accounting records is set forth on Mr. Sant's Schedule 3. [CIWC Ex. 1.0AS, p. 3 (Rakocy); Tr. 42 (Sant).] As explained above, however, there is absolutely nothing which indicates the content of the two accounts shown on that Schedule. The lack of available accounting information is undisputed:

Mr. Rakocy: “. . . the components of the sewer plant covered by the accounting records [Schedule 3] cannot be determined from Thorngate's account records.” [CIWC Ex. 1.0AS, p. 3.]

Mr. Sant (responding to a question on cross-examination):

Q. Aside from Schedule 3, you have no accounting records, studies, work papers, analyses or any other documents indicating the content of the two accounts shown, is that correct?

A. That is correct. [Tr. 42.]

Mr. Rakocy noted that, if the cost of contributed plant is excluded from Mr. Sant's calculation of Plant-in-Service, there is a significant discrepancy between Mr. Sant's sewer Plant-in-Service result based on Schedule 3, \$2,277,925 (Schedule 7, Revised)), and the estimated original cost of the entire sewer plant as surveyed by CIWC, \$2,874,085. [CIWC Ex. 1.0AS, p. 2.] Moreover, as discussed above, Mr. Ackman, Thorngate's General Manager and Chief Operating Officer, testified expressly that capitalized sewer system costs are recorded in accounts other than those shown on Schedule 3. [Tr. 66-67, 73-75.] Thus, Mr. Sant's position is wholly unsupported.

Mr. Sant acknowledged that, for sewer operations, he did not include contributed plant as a component of Plant-in-Service. [Tr. 50-51.] In this circumstance, as Mr. Rakocy explained, the deduction on Schedule 7 (Revised) for contributed plant is being made from a Plant-in-Service balance which does not include contributed plant. [CIWC Ex. 1.0SR, p. 11.] Such a deduction is clearly inappropriate. [Id.] If Mr. Sant's approach were adopted, the effect would be to deny CIWC an opportunity to earn a rate of return on a portion of the original cost of utility plant used and useful in providing service. Such a result would be confiscatory and contrary to law. Illinois Bell Telephone Co. v. Commerce Comm., 414 Ill. 275, 286, 111 N.E.2d 329 (1953) (rates must be sufficient to cover operating expenses and provide a reasonable return on the investment in property devoted to public service).

VIII. CONCLUSION

For the reasons discussed, the Commission should approve: (i) the Certificate requested by CIWC in this proceeding; (ii) the proposed application in Ivanhoe Club of the water and sewer rates of the Village; and (iii) the net original cost proposed by CIWC for water and sewer facilities, as reflected on CIWC Exhibit 1.3SR.

Respectfully submitted,

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