

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

ILLINOIS-AMERICAN WATER)
COMPANY, AMERICAN WATER)
WORKS COMPANY, INC., THAMES)
WATER AQUA US HOLDINGS, INC., and THAMES)
WATER AQUA HOLDINGS GmbH)
) Docket No. 06-0336
Joint Application For Approval of Proposed)
Reorganization and Change In Control of)
Illinois-American Water Company)
Pursuant To Section 7-204 of the Illinois)
Public Utilities Act.)

JOINT APPLICANTS' PRE-TRIAL MEMORANDUM

I. INTRODUCTION

For nearly 60 years, American Water Works Company, Inc. ("American Water" or "AW") was one of the largest publicly-traded water companies in the United States, with its shares listed on the NYSE. In 2003, Thames Water Aqua Holdings GmbH ("Thames GmbH") and its parent, RWE Aktiengesellschaft ("RWE"), acquired American Water. That transaction was approved in an order issued by the Commission in Docket 01-0832, which was affirmed by the Illinois Appellate Court in Cities of Pekin & Peoria v. Illinois Commerce Comm'n, et al., Case No. 3-03-0113 (3d Dist., Oct. 29, 2003).

On April 21, 2006, Thames GmbH, Thames Water Aqua US Holdings, Inc. ("TWAUSHI"), American Water, and Illinois-American Water Company ("Illinois American Water" or "IAWC") (collectively "Joint Applicants"), pursuant to Section 7-204 of the Illinois Public Utilities Act ("PUA"), 220 ILCS 5/7-204, filed a Verified Application requesting that the Illinois Commerce Commission ("Commission") approve (i) the sale by Thames GmbH of up to 100% of the shares of common stock of American Water in one or more public offerings and (ii) prior to the closing of the initial public offering ("IPO"), the merger of TWAUSHI with and into

American Water, with American Water being the surviving corporation (the transactions set forth in (i) and (ii) are hereinafter collectively referred to as the "Proposed Transaction").

Following the Proposed Transaction, American Water will be a publicly traded company that will own operating subsidiaries, including IAWC. The Proposed Transaction is in the public interest, and will result in the continued and seamless provision of reliable service by IAWC to all of its customers at rates approved by the Commission.

This Pre-Trial Memorandum sets forth the Joint Applicants' position on those contested issues in this proceeding properly before the Commission, pursuant to the Case Management Order, Section 11(a). The list of acronyms and terms required by Section 11(b) of the Case Management Order is set forth in Attachment A hereto.

II. SUMMARY OF JOINT APPLICANTS' POSITION

As a result of the Proposed Transaction, American Water would become the largest publicly-traded water company in the U.S. As such, American Water, through American Water Works Service Company, Inc. ("Service Company"), will be able to apply extensive resources and expertise in support of its subsidiaries, including IAWC. No material change in American Water's operations as they relate to IAWC will result from the Proposed Transaction and the Proposed Transaction will not adversely impact IAWC's provision of service and will produce benefits for IAWC's customers. The Proposed Transaction will provide American Water with direct access to the public equity and debt capital markets in the U.S., maintaining American Water's ability to finance investments in the infrastructure of its subsidiaries, including IAWC. The Proposed Transaction will not impair the ability of American Water or IAWC to raise necessary capital on reasonable terms. In fact, the Proposed Transaction should enhance IAWC's ability to attract capital on reasonable terms and maintain a balanced capital structure, as compared to the circumstances IAWC would face under continued ownership by RWE.

Joint Applicants have demonstrated that the Proposed Transaction meets the requirements of Section 7-204 of the PUA. To the extent that Staff of the Commission ("Staff") raised concerns in Supplemental Direct Testimony that Joint Applicants have not satisfied the requirements of Section 7-204(b)(4) of the PUA, Joint Applicants have now addressed those concerns through their Rebuttal Testimony. Joint Applicants have shown that AW will be financially sound following the Proposed Transaction and IAWC will be able to continue to attract capital on reasonable terms and maintain a reasonable capital structure.

As will be discussed, the Staff testified that the findings required by Section 7-204 should be made. Furthermore, Joint Applicants, have entered into Stipulations with the Utility Workers Union of America, AFL-CIO, and UWUA Local Union Nos. 640, 500 and 405 (together "UWUA") and the Office of the Illinois Attorney General ("AG"), under which the concerns of those parties have been resolved. Those Stipulations are supported by the evidence and should be approved.

The allegations made by the Village of Homer Glen ("Homer Glen"), the City of Champaign ("Champaign") and the City of Urbana ("Urbana") relate to IAWC's present level of service and lack evidentiary support. These parties present no evidence that IAWC's ability to provide service would be affected by the Proposed Transaction. Moreover, AW and IAWC have addressed the allegations of these parties where appropriate. Similarly, the issues raised by Homer Glen with regard to Dockets 05-0681/06-0094/06-005 (consol.) ("Docket 05-0681") and Docket 06-0196 are also not related to the Proposed Transaction. Because Joint Applicants have shown that the Proposed Transaction meets the requirements of Section 7-204, and no party has shown otherwise, the Proposed Transaction should be approved.

III. APPLICABLE STATUTORY AUTHORITY

The Application is being filed pursuant to Section 7-204 of the PUA, which requires Commission approval for transactions that result:

in a change in ownership of a majority of the voting capital stock of an Illinois public utility; or the ownership or control of any entity which owns or controls a majority of the voting capital stock of a public utility; or by which 2 public utilities merge, or by which a public utility acquires substantially all of the assets of another public utility . . .

220 ILCS 5/7-204(a). In approving a proposed reorganization under Section 7-204(b), the Commission is required to find and, for the reasons stated below, the Commission should find in this proceeding, that:

- (1) the Proposed Transaction will not diminish IAWC's ability to provide adequate, reliable, efficient, safe and least-cost public utility service;
- (2) the Proposed Transaction will not result in unjustified subsidization of non-utility activities by IAWC or its customers;
- (3) costs and facilities are fairly and reasonably allocated between utility and any non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by IAWC for ratemaking purposes;
- (4) the Proposed Transaction will not significantly impair IAWC's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;
- (5) IAWC will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;
- (6) the Proposed Transaction is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction;
- (7) the Proposed Transaction is not likely to result in any adverse rate impacts on retail customers.

Section 7-204(c) of the PUA further requires the Commission to rule on: (1) the allocation of any savings resulting from the proposed transaction; and (2) whether the Joint Applicants should be allowed to recover any costs incurred to accomplish the Proposed

Transaction, and if so, the amount of costs eligible for recovery and how such costs will be allocated.

IV. DISCUSSION OF CONTESTED ISSUES

The contested issues properly before the Commission in this case are whether the Proposed Transaction meets the requirements of Section 7-204(b)(1), (b)(4) and (b)(7) of the PUA. The Joint Applicants' position on these contested issues are set forth below.

Joint Applicants note that an agreement was reached between AW and the UWUA resolving the issues of concern to the UWUA. This agreement is reflected in Stipulation Exhibit A. Joint Applicants have filed a Motion for Leave to file Stipulation Exhibit A, and will support inclusion of the terms of Stipulation Exhibit A in the final order in this proceeding.

An agreement was also reached between Joint Applicants and the AG resolving all issues raised in this proceeding by the AG. This agreement is reflected in Stipulation Exhibit B. In accordance with the terms of Stipulation Exhibit B, the AG agreed to withdraw the testimony of its witness, Mr. Scott Rubin, from this proceeding. Therefore, this Pre-Trial Memorandum does not address the testimony filed by Mr. Rubin. Also, in accordance with Stipulation Exhibit B, Joint Applicants agreed to modify their Rebuttal Testimony. The Joint Applicants have filed a Motion for Leave to File Stipulation Exhibit B and Revised Rebuttal Testimony, in which evidence responsive to matters solely raised by Mr. Rubin has been removed. Certain portions of the rebuttal evidence responsive to Mr. Rubin, however, are also responsive to or cross-referenced in connection with the assertions of other witnesses. That rebuttal evidence has been modified to eliminate reference to Mr. Rubin as a witness in this proceeding, but to retain the substantive portions of the testimony that respond to other witnesses. Joint Applicants will support the Motion for Leave to file and inclusion of the terms of Stipulation Exhibit B in the final order in this proceeding.

A. The Proposed Transaction Meets the Requirements of Section 7-204(b)(1)

1. Joint Applicants Have Demonstrated That the Proposed Transaction Will Not Diminish IAWC's Ability to Provide Adequate, Reliable, Efficient, Safe and Least-cost Public Utility Service

- **Joint Applicant Testimony:** Terry Gloriod (IAWC Exs. 1.0, pp. 3-4, 7-11; 1.0R, pp. 2-31; 1.1R; 1.2R; 1.3R; 1.0R-REV, pp. 2-25¹; 1.0SR, pp. 2-19; 1.1SR; 1.2SR); Ellen Wolf (IAWC Ex. 2.0, pp. 8-9).

The Proposed Transaction will result in a publicly-traded company that is focused on the water and wastewater business in the U.S. As a publicly-traded company, American Water will be better positioned to focus on maintaining, developing and growing the water and wastewater business of its subsidiaries, including IAWC, and on the needs of customers and employees. (IAWC Ex. 1.0, p. 7.)

The Proposed Transaction would result in American Water becoming the largest publicly-traded water company in the United States. (IAWC Ex. 1.0, p. 4.) As such, American Water will be able to apply extensive resources and expertise in support of its subsidiaries, including IAWC. (IAWC Ex. 2.0, p. 8.) American Water will be able to provide benefits to IAWC in the form of technical water and wastewater management expertise, reduced costs through mass purchasing agreements, the sharing of relevant experience, and access to advanced research and development. (*Id.*) American Water's Service Company will continue to provide IAWC with expert service in the areas of customer service, accounting, administration, customer service, engineering, finance, human resources, information systems, operations, risk management, water quality and other services under the Services Agreement in place with

¹ Joint Applicants' Motion for Leave to File the Revised Rebuttal Testimonies of Mr. Gloriod and Ms. Wolf is pending. Summary citations to Revised Rebuttal Testimony are provided for convenience. Citations in the text of this Pre-Trial Memorandum are to the original Rebuttal Testimonies.

IAWC. (*Id.*) The provision of these services will not be diminished by the Proposed Transaction. (IAWC Ex. 1.0, p. 7.)

Moreover, the Proposed Transaction will not adversely affect IAWC's policies with respect to service to customers, employees, operations, financing, accounting, capitalization, rates, depreciation, maintenance, or other matters affecting the public interest or utility operations. (IAWC Ex. 1.0, p. 7.) IAWC will continue to provide safe, adequate and reliable service in fulfillment of its obligations under Illinois and federal law. (*Id.*)

2. Staff Witness Marr Has Agreed that the Proposed Transaction Meets the Requirements of Section 7-204(b)(1)

Staff witness Marr testified that, based on the information provided by Joint Applicants in testimony and data responses, he found "no reason to dispute the Joint Applicants' assertion that the proposed reorganization will not diminish the ability of IAWC to provide adequate, reliable, efficient, safe, and least-cost public utility service, as required by Section 7-204(b)(1) of the Act." (ICC Staff Ex. 1.0, p. 7.)

3. The Service Concerns Raised by Homer Glen Witness Mary Niemiec Are Resolved and Unrelated to the Proposed Transaction

- **Joint Applicant Testimony:** Terry Gloriod (IAWC Exs. 1.0R, pp. 4-6, 10-12, 16-21; 1.0R-REV, pp. 2-16; 1.0SR, pp. 2-4, 6-8.)

Ms. Niemiec asserts that, based on findings made by a witness retained jointly by Homer Glen and the AG in the proceedings in Docket Nos. 05-0681 and 06-0196, IAWC is not providing adequate, efficient and least cost utility service to Homer Glen. (HG Exs. 1.0, pp. 7-8; 2.0, pp. 2-3.) IAWC and the AG have entered into a Stipulation in Docket 05-0681 ("Docket 05-0681 Stipulation"), which addresses issues raised by Ms. Niemiec (and resolves the AG's concerns related to the joint witness' testimony). (IAWC Ex. 1.0SR, p. 2.) In addition, in Docket 06-0196, all matters at issue, including the issues raised by the AG's and Homer Glen's

joint witness, were resolved. Thus, the issues raised by Ms. Niemiec have been addressed in other proceedings.

Furthermore, Ms. Niemiec's allegations are unrelated to the Proposed Transaction and are irrelevant to this case. (IAWC Ex. 1.0R, p. 16.) Ms. Niemiec and certain residents of Homer Glen filed testimony regarding the issues she describes in Docket 05-0681, and Ms. Niemiec also has filed testimony in Docket 06-0196. (*Id.*) In both proceedings, IAWC responded to the testimony of Ms. Niemiec and the other Homer Glen witnesses. IAWC also responded to Ms. Niemiec's and other Homer Glen witnesses' testimony in Docket 06-0196 (in which, as noted above, there are no longer any contested issues). (*Id.*)

As IAWC's evidence in those proceedings discusses, many of Ms. Niemiec's concerns were baseless. (IAWC Ex. 1.0R, p. 18.) To the extent that customers in Homer Glen, or elsewhere, raised valid concerns, IAWC has demonstrated that it has already taken appropriate steps. As a result, IAWC has fully responded to the matters referenced by the Homer Glen witnesses in testimony filed in Docket 05-0681 and 06-0196. (*Id.*) IAWC's position in those proceedings is not affected by the Proposed Transaction. (*Id.*) After the Proposed Transaction, IAWC will remain subject to the Commission's jurisdiction in both proceedings. (*Id.*) For the reasons discussed by IAWC's witnesses in the two proceedings, Ms. Niemiec is incorrect in suggesting that IAWC is not currently providing adequate, efficient and least cost utility service to Homer Glen residents. (*Id.*)

The Proposed Transaction in this proceeding does not affect IAWC's responsibility to provide adequate, efficient and least-cost service, or IAWC's position in Dockets 05-0681 and 06-0196. The Commission's ability to enter appropriate orders in those proceedings is entirely unaffected by the Proposed Transaction. (IAWC Ex. 1.0R, p. 20.)

Ms. Niemiec also expresses concerns about high levels of unaccounted-for water ("UFW") in Homer Glen. (HG Exs. 1.0, p. 6; 2.0, p. 6.) Mr. Gloriod explained in detail (IAWC Ex. 1.0R, pp. 6-12) that the levels of UFW in Homer Glen are not excessive, that with regard to UFW, levels in the range of 15-20% are viewed as acceptable by the American Water Works Association ("AWWA") and other regulatory authorities, and that IAWC is already taking steps to address levels of UFW both system-wide and in Homer Glen.

Moreover, in recent tariff filings for IAWC's Chicago Metro service districts served by purchased Lake Michigan water (which include Homer Glen), IAWC has designated a maximum level of UFW ("UFW Tariff Maximum") for those service areas. (IAWC Ex. 1.0R, pp. 10-11.) This UFW Tariff Maximum caps the level of UFW that IAWC can recover through its Purchased Water Surcharge Rider. (*Id.*) The UFW Tariff Maximums range from 12% to 14%, within the range specified by the AWWA. (*Id.*) In addition, in accordance with Section 8-306 of the PUA, 220 ILCS 5/8-306(m), IAWC filed, prior to year-end 2006, tariffs establishing a maximum percentage of UFW to be considered in the determination of rates for all its service areas. (*Id.*) For areas not subject to the purchased water tariff, IAWC specified in the tariffs a 15% level of UFW, also within the AWWA range. (*Id.*) Thus, there is no basis for Ms. Niemiec's concerns.

Finally, Ms. Niemiec also states that Homer Glen is "seriously considering" acquiring its water system from IAWC by condemnation due to service-related concerns. (HG Ex. 2.0, pp. 5-6.) However, the desire of Homer Glen to acquire a part of IAWC's system by condemnation has no bearing on the approval of the Proposed Transaction. (IAWC Ex. 1.0SR, p. 6.) To begin with, no such condemnation action has been commenced. (*Id.*) Moreover, whether or not municipalities seek such condemnation is not related to the Proposed Transaction. (*Id.*)

4. The Service Concerns Raised by Champaign Witness Paul Berg Are Resolved and Unrelated to the Proposed Transaction

- **Joint Applicant Testimony:** Terry Gloriod (IAWC Exs. 1.0R, pp. 16-21; 1.0R-REV, pp. 16-21; 1.0SR, pp. 8-16; 1.1SR; 1.2SR.)

Mr. Berg alleged that the Proposed Transaction will cause IAWC's service to decline, and he points to staffing levels, issuance of boil orders in Champaign, and concerns about hydrant maintenance as support for that allegation. (Champaign Exs. 1.0, pp. 4-6; 2.0, pp. 1-5.) However, the service issues raised by Mr. Berg are unrelated to the Commission's consideration of the Proposed Transaction under the standards of Section 7-204 of the PUA. (IAWC Exs. 1.0R, p. 22; 1.0SR, p. 8.) The Proposed Transaction relates only to the ownership of common shares of IAWC's parent, yet Mr. Berg states, at line 50 on page 3 of his Direct Testimony, that "Champaign's primary interest is not in who owns the water company." (IAWC Exs. 1.0R, p. 22.) Nothing in Mr. Berg's testimony suggests that Proposed Transaction would not meet the approval standards under Section 7-204. (*Id.*) Further, nothing related to the Proposed Transaction affects IAWC's ability or need, if any, to respond to or address any of the issues raised by Mr. Berg. (*Id.*)

Mr. Berg's specific allegations regarding service are also baseless. Mr. Berg alleges that following the purchase of AW by RWE, a significant reorganization of personnel caused jobs to be relocated and service to deteriorate in Champaign. (Champaign Exs. 1.0, p. 4; 2.0, pp. 1-2.) In fact, the personnel reorganization that was done in 2004 was aimed at consolidating management into regions and did not impact field service personnel. (IAWC Exs. 1.0R, p. 22; 1.0SR, pp. 8-9.) Moreover, there is no evidence to support Mr. Berg's allegations of a deterioration in service and no basis for Mr. Berg's allegations that IAWC's service will deteriorate as a result of the Proposed Transaction. (IAWC Ex. 1.0R, p. 22.) The concerns Mr.

Berg alleges with regard to boil orders and fire hydrants are related to events that happened in 2005 and not to the Proposed Transaction. (*Id.*)

The allegations regarding boil orders have also been raised in two other Commission proceedings, Docket 05-0681 and Docket 05-0599, and are being addressed in those proceedings. After the Proposed Transaction, IAWC will remain subject to the jurisdiction of the Commission and the terms of the Commission's final orders in Dockets 05-0681 and 05-0599. In particular, Docket 05-0599 is focused entirely on Champaign's concerns regarding boil orders, and so there is no reason to address those issues in this case. As the evidence in Docket 05-0681 has demonstrated and the evidence in Docket 05-0599 will show, there is no ongoing problem with boil orders or system pressures in Champaign. The issuance of boil orders is overseen by the Illinois Environmental Protection Agency ("IEPA"), whose regulations require that a boil order be issued if system pressure drops below 20 psi, unless alternative procedures allowing for the collection of extra water quality samples are followed. (IAWC Ex. 1.0R, p. 23.) IEPA has required IAWC, however, to issue boil orders rather than using the alternative procedures. During the summer of 2005, the Champaign West Water Treatment Plant experienced numerous power supply interruptions, which caused a pressure drop in the system when electric motors dropped offline. (*Id.*) Even though the pressure drops were of short duration, the IEPA boil order regulations required that IAWC issue a boil order, which IAWC did. (*Id.*) Such boil orders had never before been issued in Champaign, and Champaign mistakenly assumed them to be a result of some failing on the part of IAWC. (*Id.*)

Moreover, after extensive monitoring and review of the system following these brief power supply interruptions, IAWC made certain improvements to its facilities and switched a portion of its pumping system to an internal power source powered by a diesel generator so as to

insulate its system from the AmerenIP power supply. (IAWC Ex. 1.0R, pp. 23-24.) Since these improvements were made, no boil orders have been issued in Champaign relating to power interruptions, despite the fact that some additional nineteen power supply interruptions have occurred. (*Id.*)

With regard to hydrant maintenance, in 2006, all fire hydrants were inspected in the Champaign District and there is no evidence of any malfunctioning hydrants. (IAWC Ex. 1.0R, p. 24.) IAWC will inspect fire hydrants in its Champaign District (and throughout Illinois) on an annual basis in accordance with Commission rules. (*Id.*) In fact, the Champaign District enjoys the highest possible Insurance Services Offices ("ISO") fire protection rating for a water system, so there are no fire safety issues. (*Id.*, p. 25.)

Mr. Berg's recommendations relating to service issues (Champaign Ex. 1.0, pp. 8-9) are unrelated to the Proposed Transaction and should not be considered in this proceeding. With regard to his recommendation that IAWC develop a capital investment plan for Champaign, Mr. Berg does not provide any connection between this recommendation and the Proposed Transaction. Moreover, the terms of an existing franchise agreement between IAWC and Champaign ("Champaign Franchise Agreement") provide: "the parties shall seek input from one another in the compilation of their respective five year capital improvement plans and in scheduling improvements". (IAWC Ex. 1.0R, p. 26.) The Champaign Franchise Agreement also requires IAWC to annually provide a copy of its five-year plan to the Director of Public Works. (*Id.*) With respect to Mr. Berg's allegations that IAWC is not abiding by the Champaign Franchise Agreement (Champaign Ex. 2.0, pp. 4-5), Mr. Gloriod agrees that although capital planning information has been provided, it has not been provided in strict accordance with the timeframe specified in the Champaign Franchise Agreement. (IAWC Ex. 1.0SR, pp. 13-14.) As

Mr. Gloriod indicates, however, IAWC will provide capital planning information on a timely basis in the future. (*Id.*)

With regard to the recommendation regarding system pressure, as discussed above, there is no concern with system pressure and boil orders, and Mr. Berg does not show how his allegations in this regard are related to the Proposed Transaction. With regard to his recommendations about annual hydrant inspection and flow tests (Champaign Ex. 1.0, pp. 8-9), again, the recommendation is also unrelated to the Proposed Transaction and is unnecessary. To begin with, annual inspections are already required under Commission rules. (IAWC Ex. 1.0R, p. 26.) In addition, in the Docket 05-0681 Stipulation, IAWC has agreed to conduct specific fire flow tests for the Champaign District within one year of an order being entered in that docket. (*Id.*) Furthermore, the Champaign Franchise Agreement contains numerous provisions related to hydrants, including section 3.3B: "The Company shall maintain its fire hydrants and shall, at regular intervals, test the operation of hydrants consistent with the standards provided by the Illinois Commerce Commission and Insurance Service Office or their successors"; and Section 3.6: "The Company will supply the fire Department of the City information relative to fire hydrant location, inspection and testing within the City." (*Id.*) Thus, Mr. Berg's concerns are already addressed by existing Commission rules and the Champaign Franchise Agreement.

5. The Service Concerns Raised by Urbana Witness William Gray Are Resolved and Unrelated to the Proposed Transaction

- **Joint Applicant Testimony:** Terry Gloriod (IAWC Exs. 1.0R, pp. 27-30; 1.0R-REV, pp. 21-25; 1.0SR, pp. 16-19; 1.1SR.)

Mr. Gray alleged that the Proposed Transaction will cause IAWC's service to decline, and he raises concerns about staffing levels and hydrant maintenance as support for that allegation.

(Urbana Exs. 1.0, pp. 4-7; 2.0, pp. 1-5.) However, the issues raised by Mr. Gray are unrelated to

the Commission's consideration of the Proposed Transaction under the standards of Section 7-204 of the PUA. Nothing in his testimony suggests that Proposed Transaction would not meet the approval standards under Section 7-204. Further, nothing related to the Proposed Transaction affects IAWC's ability or need, if any, to respond to or address any of the issues raised by Mr. Gray. (IAWC Ex. 1.0R, p. 27.)

There is no basis for Mr. Gray's allegations that IAWC's service will deteriorate as a result of the Proposed Transaction, and Mr. Gray provides no evidence or analysis to support his contentions that the Proposed Transaction will result in a deterioration of IAWC's service. (IAWC Ex. 1.0R, p. 27.)

With regard to Mr. Gray's concern about staffing levels (Urbana Ex. 1.0, pp. 4-5), as discussed above, the personnel reorganization that was done in 2004 was aimed at consolidating management into regions and did not impact field service personnel. (IAWC Ex. 1.0R, p. 22.)

With regard to Mr. Gray's concern about hydrant maintenance, this concern is unfounded. Urbana is part of IAWC's Champaign District. As stated above, in 2006, all fire hydrants were inspected in the Champaign District system (which includes Urbana) and there is no evidence of any malfunctioning hydrants. (IAWC Ex. 1.0R, pp. 27-28.) IAWC will continue to inspect fire hydrants in its Champaign District (and throughout Illinois) on an annual basis in accordance with Commission rules. (*Id.*) In his testimony, Mr. Gray asserted that Urbana inspected 150 IAWC hydrants and found many in need of maintenance. (Urbana Exs. 2.0, pp. 2-3; 2.01). As Mr. Gloriod indicated, however, IAWC participated in the inspection and determined that all but one of the 150 hydrants were operational (the one remaining hydrant was being removed from service). (IAWC Ex. 1.0SR, pp. 16-17.) Furthermore, IAWC is not aware of any hydrant in Urbana that, at present, requires repair. (*Id.*)

Moreover, in the Docket 05-0681 Stipulation, IAWC has agreed to conduct specific fire flow tests for the Champaign District (which includes Urbana) within one year of an order being entered in that Docket. (IAWC Ex. 1.0SR, p. 18.) Furthermore, IAWC's franchise agreement with Urbana ("Urbana Franchise Agreement") contains numerous provisions related to hydrants, including section 3.3B: "The Company shall maintain its fire hydrants and shall, at regular intervals, test the operation of hydrants consistent with the standards provided by the Illinois Commerce Commission and Insurance Service Office or their successors"; and Section 3.6: "The Company will supply the fire Department of the City information relative to fire hydrant location, inspection and testing within the City." (*Id.*) Moreover, the Champaign District (including Urbana) enjoys the highest possible ISO fire protection rating for a water system, so there are no fire safety issues. (IAWC Ex. 1.0R, pp. 29-30.)

Mr. Gray's recommendations relating to service issues (Urbana Ex. 1.0, pp. 9-10) are unrelated to the Proposed Transaction and should not be considered in this proceeding. With regard to Mr. Gray's recommendation that IAWC develop a capital investment plan for Urbana, Mr. Gray does not provide any connection between this recommendation and the Proposed Transaction. Moreover, the terms the Urbana Franchise Agreement provide: "the parties shall seek input from one another in the compilation of their respective five year capital improvement plans and in scheduling improvements". (IAWC Ex. 1.0R, p. 30.) The Urbana Franchise Agreement also requires IAWC to annually provide a copy of its five year plan to the Director of Public Works. (*Id.*) With respect to Mr. Gray's allegations that IAWC is not abiding by the Urbana Franchise Agreement (Urbana Ex. 2.0, p. 5), Mr. Gloriod agrees that although capital planning information has been provided, it has not been provided in strict accordance with the timeframe specified in the Urbana Franchise Agreement. (IAWC Ex. 1.0SR, p. 19.) As Mr.

Gloriod indicates, however, IAWC will provide capital planning information on a timely basis in the future. (*Id.*)

With regard to the Mr. Gray's recommendation regarding lost water or UFW, he provides no evidence that UFW in Urbana is excessive. As discussed above, AW and IAWC are taking steps to address UFW in their operations, and the level of UFW recoverable in rates was addressed through the tariff filing made in accordance with Section 8-306 of the PUA, capping UFW for IAWC's service areas. The actions being taken generally by IAWC concerning lost water are equally applicable to Urbana. Therefore, there is no basis for Mr. Gray's recommendation.

B. The Proposed Transaction Meets the Requirements of Section 7-204(b)(4)

1. Joint Applicants Have Demonstrated That the Proposed Transaction Should Enhance IAWC's Ability to Attract Capital on Reasonable Terms and Maintain a Balanced Capital Structure

- **Joint Applicant Testimony:** Ellen Wolf (IAWC Exs. 2.0, pp. 6-17; 2.0R, pp. 1-9; 2.1R; 2.2R (Revised); 2.3R; 2.4R; 2.5R; 2.6R; 2.7R; 2.0R-REV, pp. 1-9.)

The Proposed Transaction will not impair the ability of IAWC to maintain a reasonable capital structure that is representative of other utilities. IAWC's capital structure will not change as a result of the Proposed Transaction. Following the Proposed Transaction, the capital structure of IAWC will be consistent with the provisions of Section 6-103 of the PUA. (IAWC Ex. 2.0, p. 16.)

In fact, the Proposed Transaction should enhance IAWC's ability to attract capital on reasonable terms and maintain a balanced capital structure, as compared to the circumstances IAWC would face under continued ownership by RWE. (IAWC Ex. 2.0, p. 10.) During the time that RWE has owned American Water, RWE has provided IAWC with debt capital (through American Water Capital Corporation ("AWCC")) on reasonable terms. (*Id.*) For the future,

however, under continuing RWE ownership, American Water's operations and access to capital may become increasingly restricted due to changed circumstances affecting RWE. (*Id.*) Should that occur, continued RWE ownership may lessen IAWC's future ability to provide cost-effective service. (*Id.*)

RWE has revised its core business focus to be on the European power and energy markets, where historically its roots lie. (IAWC Ex. 2.0, pp. 10-11.) In order to maintain its position among Europe's leading integrated electricity and gas companies in response to fierce competition, growing customer needs, and rising costs both for energy production facilities and many other energy production inputs, RWE is forced to concentrate on its power and energy markets. (*Id.*) As a result of these developments, RWE's ability to maintain its competitiveness in its core European businesses is proving far more capital intensive than RWE could have predicted when it acquired American Water. (*Id.*) Consequently, RWE decided to sell the water operations of Thames Water in the U.K. and to return American Water to its status as a U.S. publicly-traded company. (*Id.*) The Proposed Transaction will allow RWE to focus on its core businesses in its home region, and more importantly for IAWC, will allow American Water to focus on its U.S. water and wastewater systems and customers. (*Id.*)

As a publicly-traded company, American Water will be able to access the capital markets directly and offer investors an involvement in a predominantly U.S.-regulated water utility, and so be better positioned to serve the future needs of its customers. (IAWC Ex. 2.0, p. 11.) On a going-forward basis, American Water will not have to compete for RWE's capital and the substantial capital requirements related to restructuring of the European energy markets. (*Id.*) As a result of the Proposed Transaction, American Water's access to the public U.S. debt and

equity markets should enhance its access to necessary capital to support the operations of its subsidiaries, including IAWC. (*Id.*)

In addition to other capital needs, American Water and its subsidiaries, including IAWC, are required to replace aging infrastructure and comply with ever more stringent water quality standards. American Water's status as a publicly-traded company will help assure that American Water and IAWC have ready, cost-effective access to capital to meet such needs. (IAWC Ex. 2.0, p. 12.)

Under an agreement last approved by the Commission in Docket 04-0582, IAWC is authorized to obtain short and long term debt capital from AWCC (subject to such further approval of long term debt issuances as the PUA requires). This allows IAWC to benefit from the economies of scale associated with system wide debt financing and decreased administrative costs. (IAWC Ex. 2.0, p. 12.) By "bundling" the financial needs of American Water's operating subsidiaries, AWCC provides cost-effective debt funding. (*Id.*) Combined borrowing power increases the efficiencies of borrowing operations and lowers the cost thereof (i.e. bank fees, legal fees, rating costs, SEC registration costs, and others.). (*Id.*) After the Proposed Transaction, AWCC will continue to be a subsidiary of American Water, and IAWC may still elect to obtain loans from AWCC as before.

Aside from the effects of merging the operations of TWAUSHI into American Water, there will be no material changes in American Water's revenues or expenses, the balance sheet will remain solid and there will be an ongoing emphasis on service and water quality. American Water's strong commitment to investing the capital required to properly maintain IAWC's operations will be continued. (IAWC Ex. 2.0, p. 13.)

American Water will take steps to ensure that, following the Proposed Transaction, its balance sheet remains solid and that its capital structure is such that the credit rating for AWCC's debt securities will remain at a solid investment grade. As the Commission recognized in Illinois-American Water Company et al., Docket 00-0476, Order, p. 43, (May 15, 2001),"[a] company with an investment grade BBB rating should be able to raise necessary capital on reasonable terms and maintain a reasonable capital structure." The cost rate of future debt issuances will, of course, depend on future market conditions. (IAWC Ex. 2.0, pp. 14-15.) American Water and AWCC, however, will have access to the Investment Grade Debt Markets and, in addition, American Water will have access to the markets for non-debt capital. (*Id.*) These markets provide sufficient depth to cover the financial requirements of IAWC. (*Id.*)

As shown on IAWC Exhibit 2.2R (Revised) (with regard to IAWC Exhibit 2.2R (Revised), note that only information discussed in public testimony is referenced herein), the expected common equity ratio for AW after the Proposed Transaction, as of December 31, 2007, is within the range of 45%-55%. (IAWC Ex. 2.0R, p. 3.) In addition, RWE has made a commitment that American Water's common equity ratio will be at least 45% at the time of the IPO. (*Id.*) RWE will infuse common equity capital as required to achieve a common equity target at or above this level at the time of the IPO, not including equity-like instruments. (*Id.*) To date, RWE has infused \$1.194 billion of common equity capital. If an additional equity infusion is needed to achieve a common equity ratio of at least 45% at the time of the IPO, the required infusion will be provided. (*Id.*)

AW's credit rating is currently A-. (IAWC Ex. 2.0R, p. 4; 2.4R.) Post-transaction, American Water's Debt to Equity structure will be similar to other water utilities which have Investment Grade ratings (Debt = 45-55%, Equity = 55-45%). A credit rating is dependent on a

multitude of factors, including a company's competitiveness and growth prospects, the caliber of its management, the industry's regulatory framework and how it applies to the company, and quantitative analysis metrics such as Funds from Operations to Total Debt, Pretax Coverage Ratios and Total Debt to Total Capital. (IAWC Ex. 2.0, p. 15.) Given American Water's plan for Debt to Equity levels at par with other water utilities (and RWE's commitment that American Water's common equity ratio will be at least 45% at the time of the IPO), and assuming timely rate relief and a rate of return similar to the average in the industry, Joint Applicants do not expect to see a change in American Water's credit rating from its current level of A-. (IAWC Exs. 2.0, pp. 15-16; 2.0R, pp. 7-8.)

IAWC's capital structure as of December 31, 2004, consisted of approximately 45% equity and 55% debt. (IAWC Ex. 2.0, p. 16.) IAWC's capital structure will not change as a result of the Proposed Transaction. (*Id.*) The Proposed Transaction will not impair the ability of IAWC to maintain a reasonable capital structure that is representative of other utilities in the water industry. (*Id.*) Following the Proposed Transaction, the capital structure of IAWC will be consistent with the provisions of Section 6-103 of the PUA. (*Id.*) Thus, Joint Applicants have shown that the Proposed Transaction meets the requirements of Section 7-204(b)(4).

2. Joint Applicants Have Addressed the Concerns of Staff Regarding the Financial Strength of American Water After the Proposed Transaction

- **Joint Applicant Testimony:** Ellen Wolf (IAWC Exs. 2.0R, pp. 1-9; 2.1R, 2.2R (Revised); 2.3R; 2.4R; 2.5R; 2.6R; 2.7R; 2.0R-REV, pp. 1-9; 2.0SR, p. 1.)

In her Direct Testimony, Ms. Kight-Garlich took the position that the finding required by Section 7-204(b)(4) should be made. In Supplemental Direct Testimony, however, Ms. Kight-Garlich changed her position and stated that, "until more information is available regarding the terms, maturity and credit rating of the new debt Applicants plan to issue to

refinance RWE debt, I am unable to determine whether the proposed reorganization will impair IAWC's ability to attract capital." Staff witness Kight-Garlich also indicated a need to review audited financial statements for TWAUSHI to complete the financial analysis. (IAWC Ex. 2.0R, pp. 1-2.) In Rebuttal Testimony (IAWC Ex. 2.0R, pp. 1-9), Joint Applicants responded in full to Staff concerns. In her Rebuttal Testimony, Ms. Kight-Garlich stated that the information in Ms. Wolf's Rebuttal Testimony "contained information and analysis that is sufficient to support the Applicants' assertion that the proposed reorganization will not significantly impair IAWC's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure." (ICC Staff Ex. 7.0, p. 2.) Ms. Kight-Garlich concluded that the proposed reorganization meets the requirements of Section 7-204(b)(4) of the PUA, subject to the following condition: "AWWC's common equity ratio shall be at least 45% at the time of the IPO. The calculation of the common equity ratio shall not include equity-like financial instruments." (*Id.*, pp. 2, 4.) Ms. Wolf accepted this condition in her Surrebuttal Testimony. (IAWC Ex. 2.0SR, p. 1.)

As noted above, AW's credit rating is presently A-. In addition, AWCC recently issued senior unsecured notes ("Notes") in the amount of \$900 million whose spreads are consistent with a corporate credit rating of A-. (IAWC Ex. 2.0R, pp. 3-4.) The Notes were issued in a private placement, and not in a public offering. Although AW and AWCC are rated by the ratings agencies, the Notes do not have a credit rating assigned by a credit rating agency. (*Id.*) However, based on spreads for fourteen public issuances of debt with assigned Standard & Poor's ("S&P") ratings at approximately the time that the terms of the Notes were finalized, the spreads and final coupon rates for the Notes are consistent with an "A-" corporate credit rating. (IAWC Ex. 2.0R, p. 4; 2.3R.) Because the Notes were issued with the buyers' knowledge that

American Water is no longer a core holding of RWE and that RWE intends to divest American Water through a public stock sale, the resulting interest rates are strong evidence of the favorable assessment by the capital markets of the post-IPO financial condition and creditworthiness of American Water. (IAWC Ex. 2.0R, p. 4.)

Staff witness Kight-Garlich stated, in her Supplemental Direct Testimony, that the information Applicants provided, "does not clearly show that American Water will have sufficient cash flows to support an investment grade credit rating of at least 'A-'." (ICC Staff Ex. 5.0, p. 3.) However, as Ms. Wolf explained in Rebuttal Testimony (IAWC 2.0R, pp. 1-9), Joint Applicants anticipate that, after completion of the Proposed Transaction, American Water will maintain a solid investment grade credit rating. Under the "Standard & Poor's Corporate Credit Ratings Criteria" ("Ratings Criteria"), which explains the rating process, S&P considers certain numerical "credit statistics" and also non-numerical factors. (IAWC Ex. 2.2R (Revised).) Credit statistics for AW (including cash flow ratios) that would be considered by the credit agencies in updating the current AW investment grade rating were provided in IAWC Exhibit 2.2R (Revised). Also shown on IAWC Exhibit 2.2R (Revised) are ranges for certain credit statistics that correspond to specific rating levels as indicated in the Ratings Criteria. (IAWC Ex. 2.0R, pp. 5-7.) The AW credit statistics set out in the private placement memorandum distributed in connection with the issuance of the Notes (which, as indicated above, have an implied credit rating of "A-") are comparable to those shown in IAWC Exhibit 2.2R (Revised). (*Id.*) Based on historical credit statistics for American Water as of December 31, 2001, at and around the time of the 2001 ratios, AW's credit rating as determined by S&P was "A-", as it is today. (IAWC Ex. 2.6R.) The operating and financial data of AW as of December 31, 2005, are the data that were available to S&P when it issued the November 7, 2006 "A-" credit rating for AW that was

discussed above. As a comparison of the data shown on IAWC Exhibits 2.2R (Revised) and 2.6R demonstrates, AW's projected credit statistics are comparable and improving. Moreover, the 2007 Pro Forma capitalization as shown on IAWC Exhibit 2.2R (Revised) is comparable to that of water utilities that have strong investment grade credit ratings. (IAWC Ex. 2.0R, pp. 5-7.)

As the Ratings Criteria (IAWC Ex. 2.5R) indicate, along with the financial ratios, non-numerical factors also are considered during the ratings process. American Water enjoys a "2" (excellent) business risk profile from S&P (Utility business risk profiles are categorized from "1" (excellent) to "10" (vulnerable)). (IAWC Ex. 2.0R, pp. 7-8.) As discussed at page 10 of the Ratings Criteria, one of the important factors that S&P uses to arrive at a credit rating decision is the quality of management. American Water has proven management and has also added new and returning professionals as senior managers ahead of the IPO. (*Id.*) Based on this information, the data shown on IAWC Exhibit 2.2R (Revised), and assuming timely rate relief and a rate of return similar to the average in the industry, Ms. Wolf concluded that AW should maintain a credit rating of "A-" after the Proposed Transaction. (IAWC Ex. 2.0R, pp. 7-8.)

Joint Applicants do not believe that a rating as low as "BBB-" is realistic to expect. (IAWC Ex. 2.0R, p. 8.) However, if the credit rating were to move to "BBB+" (which is not expected), the expected increase in the cost of debt would be minimal. (*Id.*) As shown in IAWC Ex. 2.7R, during the 1996-2006 period, the interest rate spread for securities issued by "A-" utility issuers as compared to "BBB+" issuers for ten-year notes was, on average, seven basis points. (*Id.*)

3. The Concerns Raised by Urbana's Witness Mr. Gray Regarding Pension Funding Are Unwarranted and Unrelated to the Proposed Transaction

- **Joint Applicant Testimony:** Ellen Wolf (IAWC Ex. 2.0R, pp. 13-19; 2.0R-REV, pp. 9-11); Terry Gloriod (IAWC Ex. 1.0R, p. 29; 1.0R-REV, p. 23.)

Mr. Gray raises concerns (without providing supporting analysis) that AW's pension is underfunded. (Urbana Ex. 1.0, p. 7.) This is not the case. With regard to AW's pension funding policy, there are actuarially-determined minimum contribution amounts that a plan sponsor must make in order to comply with the Employee Retirement Income Security Act ("ERISA"). (IAWC Ex. 2.0R, pp. 14-15.) Prior to AW's acquisition by RWE, and during the entire time period of RWE ownership, it has been AW's policy to make the contributions required by ERISA. (*Id.*) At no time following its acquisition by RWE did AW contribute less than the amount actuarially determined under ERISA's requirements. (*Id.*) Thus, AW did not neglect its pension funding obligations under RWE ownership. (*Id.*) Because AW's pension funding was in strict accordance with applicable requirements, the funding status of the pension plan is unrelated to RWE's ownership of the AW or the Proposed Transaction.

The contribution rules under ERISA prescribe the methodology for determining the cash contributions that are required each year to a pension plan. (IAWC Ex. 2.0R, p. 15.) The rules establish a rational and systematic way for plan sponsors to contribute to the pension plan to ensure long-term benefit security for the plan participants, i.e., per the law, the plan is sufficiently funded and should be able to provide the promised benefits at retirement. (*Id.*) At the most basic level, the rules currently in place view pension plans as very long term obligations of the sponsor and require that the plan is funded based on this notion (known as the "accrued liability"). (*Id.*) However, as an added layer of protection for plan participants, the minimum funding rules also require that the plan maintain minimum solvency levels (known as the "current liability"), otherwise, accelerated contributions are required. (*Id.*) Based on ERISA criteria, AW's plan is, and has been, financially sound. (*Id.*, pp. 15-16.)

After the Proposed Transaction, AW will continue to fund its pension plan in accordance with applicable requirements. The new funding rules under the Pension Protection Act ("PPA") are effective in 2008, and generally require that companies contribute the amount of benefit that will be earned during the year plus a seven-year amortization of the underfunded obligation. (IAWC Ex. 2.0R, p. 18.) The underlying theoretical intent of the new law is to achieve full funding, based on assets and obligations defined under PPA, in seven years. (*Id.*) As a result, there is no concern with pension funding levels.

C. The Proposed Transaction Meets the Requirements of Section 7-204(b)(7)

1. Joint Applicants Have Demonstrated That No Adverse Rate Impacts Will Result from the Proposed Transaction

- **Joint Applicant Testimony:** Terry Gloriod (IAWC Exs. 1.0, p. 9; 1.0R, pp. 19-21, 24-25, 28-29; 1.0R-REV, pp. 14-16, 19, 23; 1.0SR, pp. 5, 14-15; 1.3SR.)

The Proposed Transaction will not adversely impact IAWC's rates. (IAWC Ex. 1.0, p. 9.) Mr. Gloriod testified that Joint Applicants will not seek recovery in rates of costs of the Proposed Transaction, which are comprised of the SEC registration fee, the NASD filing fee, the stock exchange listing fee, legal fees and expenses of the Proposed Transaction, accounting fees and expenses of the Proposed Transaction, printing and engraving fees and expenses for the registration statement, Blue Sky fees and expenses, transfer agent fees and expenses, and legal fees for the state regulatory approval process. (*Id.*, pp. 9-10.) IAWC will continue to operate under its existing tariffs and rate structures (until such time as such tariffs and rate structures are revised in accordance with Illinois law) and to honor all its customer and regulatory obligations. (*Id.*, p. 9.) The testimony of Ms. Wolf, however, discusses the potential for enhanced ability to attract capital which could result in future cost savings that would be passed on to ratepayers. The amount of any such savings cannot be quantified. (IAWC Ex. 1.0R, pp. 20-21.)

2. Staff's Concerns About Rate Impacts Have Been Addressed

- **Joint Applicant Testimony:** Ellen Wolf (IAWC Ex. 2.0R, p. 9; 2.0R-REV, p. 9.)

Staff witness Pearce originally found that the Proposed Transaction met the requirements of Section 7-024(b)(7). (ICC Staff Ex. 2.0, p. 5.) However, in Supplemental Direct Testimony, Staff witness Pearce stated that "if IAWC's ability to raise capital is negatively impacted by the reorganization, there could possibly be an adverse impact on rates charged to retail customers" and she could not conclude that there would be no adverse rate impacts pursuant to Section 7-204(b)(7). (ICC Staff Ex. 4.0, p. 3.) Staff witness Pearce's recommendation was based solely on Staff witness Kight-Garlich's testimony regarding IAWC's ability to attract capital on reasonable terms. (IAWC Ex. 2.0R, p. 9.) As a result, in her Rebuttal Testimony, Staff witness Pearce stated that her "previous concern related to potential adverse rate impacts has been alleviated" and that Proposed Transaction meets the requirements of Section 7-204(b)(7) of the PUA. (ICC Staff Ex. 6.0, p. 3.)

3. Ms. Niemiec's Concerns About Rate Impacts Are Baseless

- **Joint Applicant Testimony:** Terry Gloriod (IAWC Exs. 1.0, p. 9; 1.0R, pp. 20-21; 1.0R-REV. pp.14-16; 1.0SR, p. 5.)

Ms. Niemiec recommends that IAWC be required to file a plan with the Commission and Homer Glen setting a schedule and milestones for IAWC to reduce its rates so that the rates are within the mid-range of water rates for privately-owned utilities, not the highest in the state. (HG Exs. 1.0, p.9; 2.0, p. 4.) There is no basis for the Commission to conclude based on the record in this proceeding that IAWC's rates are inappropriate. (IAWC Ex. 1.0R, pp. 20-21.) The rates that Ms. Niemiec complains of were approved in Docket 02-0690, a rate proceeding in which all of the procedures and ratemaking principles established by Illinois law were applied. Under Illinois law, rates set by the Commission must produce revenues sufficient to cover the

utility's operating expenses and provide a reasonable return on the utility's investment in property devoted to the provision of utility service. Illinois Cent. R.R. Co. v. Illinois Commerce Comm'n, 387 Ill. 256, 281 (1944); Illinois Bell Tel. Co. v. Illinois Commerce Comm'n, 414 Ill. 275, 286 (1953); Business & Prof. People for the Pub. Interest v. Illinois Commerce Comm'n, 146 Ill. 2d 175, 195-96 (1991). Ms. Niemiec's proposal disregards this requirement. (*Id.*) Ms. Niemiec provides no evidence with regard to IAWC's operating expenses, rate base, rate of return, or any component of IAWC's revenue requirement, and, therefore, does not demonstrate that IAWC's rates for water or sewer service are excessive, unjust, or unreasonable. Therefore, Ms. Niemiec's suggestion that rates be adjusted without regard to IAWC's cost of service is inappropriate, and contrary to long-established ratemaking principles applied by the Commission. (*Id.*)

Ms. Niemiec also suggests that Homer Glen be given an option to buy that portion of IAWC's system that serves it. (HG Ex. 1.0, pp. 9-10.) However, IAWC has no interest in selling a portion of its system to Homer Glen. (IAWC Ex. 1.0R, p. 21.) Furthermore, an option to purchase is a valuable property right, and it would be wholly inappropriate for the Commission to "give" Homer Glen an option to purchase without proper compensation to IAWC for granting such an option (even if IAWC were willing to make such a grant (which it is not)). (*Id.*) For the reasons discussed above, there is no basis for Ms. Niemiec's suggestion that IAWC should reduce its water rates, and this suggestion in no way relates to the Proposed Transaction in this proceeding. Also, Ms. Niemiec's unexplained suggestion that UFW be reduced to a level of 5% is wholly unsupported. (*Id.*) The matter of UFW is fully addressed in Dockets No. 05-0681 and 06-0196, and issues related to UFW should be resolved in Docket 06-0196. (*Id.*)

4. Mr. Berg and Mr. Gray's Concerns About Rate Impacts Are Baseless

- **Joint Applicant Testimony:** Terry Gloriod (IAWC Exs. 1.0, p. 9; 1.0R, pp. 24-25, 28-29; 1.0R-REV. pp. 19, 23; 1.0SR, pp. 14-15; 1.3SR.)

Both Mr. Berg and Mr. Gray allege that the Proposed Transaction will have adverse impacts on IAWC's customers. (Champaign Exs. 1.0, p. 7; 2.0, p. 6; Urbana Ex. 1.0, pp. 8-9.) There is no direct correlation between the Proposed Transaction and IAWC's rates. (IAWC Ex. 1.0R, pp. 24-25.) No costs of the Proposed Transaction will be passed to ratepayers, and if any savings result they will accrue to the benefit of the ratepayer. (*Id.*) Moreover, Mr. Berg's assertion (Champaign Ex. 1.0, p. 7) that because there are no savings from the Proposed Transaction the Proposed Transaction will have an adverse impact on rates is utterly unsupported by evidence or logic. (IAWC Ex. 1.0SR, pp. 14-15.)

With regard to lost water, neither Champaign nor Urbana has presented any evidence that levels of UFW in the Champaign District are excessive or that the Proposed Transaction would affect levels of UFW. Moreover, discussed above, AW and IAWC are taking steps to address UFW, and these steps will apply equally to Champaign and Urbana. In addition, the level of UFW recoverable in rates was addressed through the tariff filing made in accordance with Section 8-306 of the PUA, capping UFW for IAWC's service areas. (IAWC Ex. 1.0R, pp. 24-25.) Finally, the Champaign Franchise Agreement requires that UFW "shall not exceed 15%". (IAWC Ex. 1.0R, pp. 24-25.) Therefore, there is no basis to assert that UFW will have any adverse impacts on rates.

As discussed above, with regard to pension funding, there is no justified concern about pension under-funding, and the issue has no connection to the Proposed Transaction. (IAWC Ex. 1.0R, pp. 28-29.) IAWC's recovery of pension funding costs in rates is also not related to the Proposed Transaction. (*Id.*) With regard to the new water plant which Urbana says will impact rates (Urbana Ex. 1.0, p. 9), any rate impacts of a new water treatment plant or other capital

improvements are not related to the Proposed Transaction, and would be subjected to the scrutiny of the Commission in a rate proceeding. (IAWC Ex. 1.0R, pp. 28-29.)

D. Relief Sought if Commission Adopts Joint Applicants' Position on Contested Issues

If the Commission adopts Joint Applicants' position regarding the contested issues discussed above, the Commission should find that the Proposed Transaction meets the requirements of Section 7-204 of the PUA, including the requirements of Sections 7-204(b)(1), (b)(4) and (b)(7), and should be approved.

WHEREFORE, Joint Applicants respectfully request:

A. That the Commission enter an Order pursuant to Section 7-204 of the PUA approving the Proposed Transaction, granting approval for (i) the sale of 100% of the shares of common stock of American Water in one or more public offerings to the public and (ii) prior to the closing of the IPO, the merger of TWAUSHI with and into American Water;

B. That the Commission confirm in its Order in this proceeding that Conditions 2 and 3, as stated in the Order issued by the Commission in Docket 01-0832, are no longer applicable, and that Condition 4 should be modified as set forth by Staff witness Kight-Garlich; and

C. That the Commission grant such other and further relief as the Commission may deem appropriate or necessary to effectuate the terms of the Proposed Transaction.

February 27 ,2007

Respectfully submitted,

ILLINOIS-AMERICAN WATER
COMPANY, AMERICAN WATER
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WATER AQUA US HOLDINGS, INC.,
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