

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. : 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. :

**REPLY BRIEF ON EXCEPTIONS OF THE STAFF  
OF THE ILLINOIS COMMERCE COMMISSION**

**I. INTRODUCTION**

Pursuant to Section 200.830 of the Illinois Commerce Commission's ("Commission") Rules of Practice (83 Ill. Adm. Code 200.830), Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned counsel, respectfully submits its Reply Brief on Exceptions to the Cities of Champaign and Urbana's and the Village of Homer Glen's (collectively, the "Municipalities") and the Village of Bolingbrook's ("Bolingbrook") Briefs on Exceptions to the Proposed Order ("BOE") filed in response to the Administrative Law Judge's Proposed Order issued on May 25, 2007 ("Proposed Order"). Staff offers no reply to the Brief on Exceptions of Joint Applicants.

**II. ARGUMENT**

The Municipalities and Bolingbrook argue that Joint Applicants have failed to meet one or more of the requirements of Section 7-204 of the Public Utilities Act (the

“Act”). Accordingly, they request that the Commission deny Joint Applicants’ request for approval of their proposed reorganization (the “Proposed Transaction”).

The Municipalities and Bolingbrook argue that the requirements set forth in Section 7-204(b)(1), 7-204(b)(4) and 7-204(b)(7) of the Act have not been met. Specifically, they claim that the Proposed Order errs in finding that: (1) Illinois-American Water Company (“IAWC” or the “Company”) currently provides, and will in the future provide, adequate service to its customers; (2) the Proposed Transaction will not significantly impair IAWC’s ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure; and (3) the Proposed Transaction will not likely result in any adverse rate impacts on retail customers. Bolingbrook also claims that the Commission may not impose conditions, as reflected in the Proposed Order, to cure a defective application.

Staff has extensively addressed the requirements of Section 7-204 of the Act both in testimony and briefs. Staff herein addresses the criteria of Section 7-204 of the Act that the Municipalities and Bolingbrook have so egregiously misinterpreted and so erroneously applied.

**A. The Proposed Transaction Will Not Diminish IAWC’s Ability to Provide Adequate, Reliable, Efficient, Safe and Least-cost Public Utility Service (Section 7-204(b)(1) of the Act)**

The Municipalities and Bolingbrook argue that Joint Applicants have failed to demonstrate that the Proposed Transaction will not diminish IAWC’s ability to provide adequate, reliable, efficient, safe, and least-cost public utility service. (Municipalities BOE, pp. 1, 2-6, 9, 11-12, 18, 19, 20; Bolingbrook BOE, pp. 3, 4.) The Proposed Order already considered and properly rejected that argument. (Proposed Order, pp. 4, 6-7, 22, 23, 24, 25, 26.) Staff agrees with the Proposed Order.

The Municipalities argue that the Proposed Order should impose conditions on the Proposed Transaction to protect the public safety and health. (Municipalities BOE, pp. 9, 18, 19.) The Proposed Order already considered and properly rejected that argument. (Proposed Order, pp. 22, 23.) Staff agrees with the Proposed Order.

Therefore, Staff recommends that the exceptions and suggested replacement language offered by both the Municipalities and Bolingbrook be rejected and the Proposed Order language remain intact.

**B. The Proposed Transaction Will Not Significantly Impair IAWC's Ability to Raise Necessary Capital on Reasonable Terms or to Maintain a Reasonable Capital Structure (Section 7-204(b)(4) of the Act)**

Bolingbrook and the Municipalities argue that the starting point for assessing impairment on IAWC's ability to raise capital on reasonable terms should be an "A" credit rating. (Bolingbrook, BOE p. 5; Municipalities BOE, p. 6.) The Proposed Order already considered and properly rejected that argument. Even if one accepts the foregoing argument, a drop in the Company's credit rating from "A" to "A-", does not constitute a significant impairment in its ability to raise capital on reasonable terms.

Bolingbrook further claims that AWW will not be able to maintain a reasonable capital structure. (Bolingbrook, BOE p. 6.) The Proposed Order already considered and properly rejected that argument. The Proposed Order imposed conditions on AWW and IAWC to maintain certain capital structures to ensure that Joint Applicants maintain a reasonable capital structure. (Proposed Order, pp. 25-26.)

Therefore, Staff recommends that the exceptions and suggested replacement language offered by both the Municipalities and Bolingbrook be rejected and the Proposed Order language remain intact.

**C. The Proposed Transaction Will Not Likely Result in Any Adverse Rate Impacts on Retail Customers (Section 7-204(b)(7) of the Act)**

The Municipalities assert that the capital costs to IAWC have already increased as a result of the proposed transaction since the imputed credit rating for the Company has changed from A to A-. As a result, they claim the hypothetical increased cost of capital will be passed on to ratepayers by IAWC in its next rate case, planned for later this year. (Municipalities BOE, p. 8.) The impact of the Proposed Transaction on capital costs was extensively addressed by Staff both in testimony and briefs. As such, Staff's conclusion and the reasons therefore, that the Proposed Transaction will not significantly impair IAWC's ability to raise capital or to maintain a reasonable capital structure, need not be repeated herein.

The Municipalities also claim that the Proposed Order lacks a requirement that IAWC keep track of any savings that may result from the Proposed Transaction, asserting that this contradicts the requirements of Section 7-204(c) of the Act because the Commission cannot rule on the allocation of any savings resulting from the Proposed Transaction without the requirement that savings be tracked. (*Id.*) Hence, the Municipalities assert that the Commission cannot rule on the allocation of savings until after the Commission has tracked those savings to know what they are.

The replacement language offered by the Municipalities states:

Moreover, neither Applicants nor the ICC Staff have any plans or mechanisms in place to monitor or to track any savings resulting from the proposed transaction. Without such mechanisms, there is no way that the Commission can know what savings may result from the proposed transaction and the Commission therefore cannot allocate the savings as required under the statute. (*Id.*, pp. 15-16.)

Thus, the Municipalities would have the Commission find that it cannot make a finding about the allocation of savings until those savings have been tracked. This

would effectively preclude the Commission from making any findings about the allocation of savings when the Commission approves a reorganization pursuant to Section 7-204 of the Act because those savings would not yet have occurred in order to be tracked.

Staff believes this circular reasoning egregiously misinterprets the requirements of Section 7-204(b)(7) and Section 7-204(c)(i) of the Act. As Staff has stated repeatedly in testimony and briefs, there is no requirement that the Proposed Transaction must generate any savings. Rather, Section 7-204(c)(1) of the Act states that the Commission must rule on the allocation of any savings. Joint Applicants have stated in their application, testimony and briefs, that they do not expect any savings to result from the Proposed Transaction. Accordingly, they propose that any savings that may result be fully allocated to ratepayers. Staff supported this treatment and the Proposed Order accepted it.

There is no need to require a tracking of savings. As Staff stated in cross-examination, any savings that may result will flow automatically to the ratepayers by virtue of lower costs that will be reflected in the rate model during the course of a rate proceeding. In fact, the only way for ratepayers to reap any savings is through a cost-based rate proceeding. The Commission is not legally required to order the utility to “track savings” before it can approve the Proposed Transaction.

The Municipalities also misinterpret the requirement in Section 7-204(b)(7) of the Act that the Proposed Transaction will not adversely impact rates to mean that rates may not subsequently increase. As Staff has stated in testimony and briefs, IAWC may seek a rate increase after the Proposed Transaction, just as it could absent the

Proposed Transaction. The mere fact that a rate increase is supported by higher costs, does not equate to adverse rate impact *as a result of the Proposed Transaction*.

Accordingly, Staff recommends that the Commission approve the Proposed Transaction with the Conditions noted in the Proposed Order, with the exception of Condition 22, as noted in Staff's BOE, pp. 2 - 10.

### III. CONCLUSION

For the foregoing reasons, Staff of the Illinois Commerce Commission respectfully requests that its recommendations be adopted in this proceeding and that the Proposed Order be modified as set forth in this Reply Brief on Exceptions and Staff's Brief on Exceptions.

Respectfully submitted,



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