

**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)	
)	
Joint Application For Approval of Proposed)	Docket No. 06-0336
Reorganization and Change In Control of)	
Illinois-American Water Company)	
Pursuant To Section 7-204 of the Illinois)	
Public Utilities Act.)	

SUPPLEMENTAL REPLY BRIEF ON EXCEPTIONS OF JOINT APPLICANTS

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SUPPLEMENTAL REPLY BRIEF ON EXCEPTIONS OF JOINT APPLICANTS

I. INTRODUCTION

This Supplemental Reply Brief on Exceptions of Illinois-American Water Company ("IAWC"), American Water Works Company, Inc. ("American Water" or "AW"), Thames Water Aqua US Holdings, Inc. and Thames Water Aqua Holdings GmbH ("Thames GmbH") (collectively, "Joint Applicants") responds to the Village of Bolingbrook's ("Bolingbrook") Brief on Exceptions ("Bolingbrook BOE") with regard to the Administrative Law Judges' Proposed Order ("ALJPO") issued in this proceeding on May 25, 2007. Joint Applicants have filed a Reply to the Briefs on Exceptions of Staff of the Illinois Commerce Commission and the Village of Homer Glen ("Homer Glen"), City of Champaign ("Champaign") and City of Urbana ("Urbana") under separate cover.

As described in the accompanying Motion, the Bolingbrook BOE was not filed in accordance with the requirements stated in the Case Management Order issued by the Administrative Law Judge in this proceeding on May 24, 2006, and Joint Applicants have therefore moved to strike the Bolingbrook BOE. In the Motion to Strike, Joint Applicants request that, should the Motion be denied, they be granted leave *instanter* to file this Supplemental Reply Brief on Exceptions responding to the Bolingbrook BOE.

II. RESPONSE TO BOLINGBROOK

The Bolingbrook BOE fails to establish a connection between Bolinbrook's alleged concerns and the Proposed Transaction or otherwise demonstrate any flaw in the ALJPO. As a result, Bolingbrook's exceptions should be rejected.

A. Reply to Bolingbrook Exception I: Additional Facts Are Not Necessary for the Background Section

In its first exception, Bolingbrook argues that the ALJPO should include in its background section facts related to RWE's acquisition of AW in Docket 01-0832. (Bolingbrook BOE, p. 1.) The apparent purpose of Bolingbrook's proposed additional language is to set the stage for its conclusions in its Exceptions V and VI.A that the future operation of AW after the Proposed Transaction should be compared to circumstances under RWE's past ownership of AW. As Joint Applicants explained in their Initial Brief (pp. 14-20) and Reply Brief (pp. 1-6, 10, 11-13), RWE has revised its core business focus to be on the European power and energy markets, and consequently 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. This change in business focus is the principal reason for the Proposed Transaction. Accordingly, circumstances affecting AW's future operation should be compared not to the past (as Bolingbrook proposes), but to circumstances that would exist in the future if the Proposed Transaction were not approved and AW was required to operate as a non-core business of RWE. For this reason, additional language regarding the past circumstances of RWE's acquisition and ownership of AW is unnecessary.

B. Reply to Bolingbrook Exception II: Joint Applicants Have Met Their Burden of Proof

Bolingbrook's Exception II asserts that the ALJPO fails to set forth the burden of proof. (Bolingbrook BOE, p. 2.) Joint Applicants agree that they bear the burden of proof in this proceeding with respect to approval of the Proposed Transaction, and Joint Applicants have demonstrated, through extensive testimony and briefing, that they have satisfied the requirements of Section 7-204 of the Public Utilities Act ("Act") and have met that burden. (*See discussion at*

JA Init. Br. pp. 3-42; Reply Br., pp. 1-19). As a result, there is no issue as to the burden of proof, and Bolingbrook's Exception II is unnecessary.

Bolingbrook also proposes language under this exception suggesting that the Commission has no authority to "cure" an application by imposing conditions. For reasons discussed in Section G, below, this proposed language should be rejected.

C. Joint Applicants Take No Position on Bolingbrook Exception III

Joint Applicants take no position with regard to Bolingbrook's Exception III (Bolingbrook BOE, p. 3), except to note that the Initial and Reply Briefs of Homer Glen, Champaign and Urbana did not specifically attribute their arguments to subsections of Section 7-204. To the extent Exception III references assertions made by Bolingbrook in its Initial Brief, Joint Applicants have refuted those arguments in their Reply Brief (pp. 1-11).

D. Reply to Bolingbrook Exception IV: Joint Applicants Have Met Their Burden of Proof with regard to Section 7-204(b)(1)

Bolingbrook's Exception IV seeks to strike the sentence of the ALJPO (p. 6) which states that "Joint Applicants have established a *prima facie* case that they meet the requirements of Section 7-204(b)(1)." Bolingbrook argues that Joint Applicants have to not only establish a *prima facie* case, but also meet their ultimate burden of proof. (Bolingbrook BOE, p. 4.) As discussed above, however, Joint Applicants have met their burden of proof with regard to all the criteria of Section 7-204, including Section 7-204(b)(1). Thus, it is also appropriate for the ALJPO to conclude that Joint Applicants have established a *prima facie* case. Further, as the ALJPO indicates, where Bolingbrook, Homer Glen, Champaign or Urbana alleged that Joint Applicants did not meet the requirements of Section 7-204, Joint Applicants demonstrated that such allegations should be rejected. (ALJPO, pp. 6-7.) Thus the ALJPO (p. 23) properly

concludes that Joint Applicants have met their burden of proof and Bolingbrook's Exception IV should be rejected.

E. Reply to Bolingbrook Exception V: Bolingbrook Does Not Establish That Joint Applicants Have Not Met the Requirements of Section 7-204(b)(4)

Bolingbrook's Exception V argues that the Joint Applicants have failed to meet their burden of proof with respect to Section 7-204(b)(4). As Joint Applicants explained in their Reply Brief (pp. 6-10), Joint Applicants submitted extensive evidence showing that the Proposed Transaction will not significantly impair IAWC's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure as required by Section 7-204(b)(4). (*See also discussion at JA Init. Br.*, pp. 14-22.) Joint Applicants pointed out that Staff agreed that the Proposed Transaction met the requirements of Section 7-204(b)(4). (ICC Staff Ex. 7.0, p. 2.) Joint Applicants also pointed out that Champaign and Urbana witnesses' concerns about IAWC's ability to raise necessary capital on reasonable terms and maintain a reasonable capital structure were based on the testimony of an Attorney General witness that has since been withdrawn. (JA Reply Br., p. 7.) No other witness suggested that the Proposed Transaction did not meet the requirements of Section 7-204(b)(4). Therefore, the Joint Applicants have met their burden of proof on this issue. In particular, Bolingbrook's assertion that Joint Applicants offered nothing more than an "agglomeration of speculation and conjecture" mischaracterizes the record. Joint Applicants presented detailed evidence demonstrating that the Proposed Transaction met the requirements of Section 7-204(b)(4), and that evidence was not refuted. (*See IAWC Exs. 2.0, pp. 8-17; 2.0R-REV, pp. 1-9.*)

Bolingbrook now acknowledges that RWE is no longer providing capital to AW, that RWE's water subsidiaries are no longer core holdings and that the market has already "factored in RWE's removal of support from AW" in determining that AW's credit rating is currently "A-."

(Bolingbrook BOE, pp. 5, 7.) These acknowledgments confirm Joint Applicants' position that RWE is not expected to be a future source of capital for AW and that RWE's credit rating would not be relevant to AW's future cost of capital. (See JA Init. Br., pp. 14-20; JA Reply Br., pp. 1-6, 11-13.) The acknowledgments further confirm that RWE's changed circumstances could have a negative impact on AW and IAWC under continued RWE ownership. Moreover, no evidence has been offered in this proceeding that AW's credit rating would become "A" if the Proposed Transaction were not approved. To the extent that Bolingbrook continues to argue that the proper comparison is between AW's circumstances after the Proposed Transaction and past circumstances under RWE's ownership, Joint Applicants have refuted that argument in their Reply Brief. (See *discussion at* JA Reply Br., pp. 1-6.)

Bolingbrook now argues, without the benefit of evidence, that RWE ownership provides an "enhancement" to AW's credit rating and that undefined "negative implications" of the Proposed Transaction would adversely affect any post-transaction credit rating. (Bolingbrook BOE, pp. 5-6.) No witness in this proceeding, however, testified that RWE's ownership would enhance AW's credit rating if the Proposed Transaction did not take place, nor did any witness testify that AW's credit rating would decline after the Proposed Transaction. In fact, the evidence in this proceeding shows that 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.) Joint Applicants also demonstrated that AW should maintain a credit rating of "A-" after the Proposed Transaction. (IAWC Ex. 2.0R-REV, pp. 1-9.) No witness testified that IAWC's cost of capital would increase following the Proposed Transaction. Instead, public investor ownership of AW following the Proposed Transaction will provide access to the public U.S. debt

and equity markets, and should enhance AW's access to necessary capital to support the operations of its subsidiaries, including IAWC, and assure that AW and IAWC have ready, cost-effective access to capital to meet ongoing infrastructure investment needs. (IAWC Ex. 2.0., pp. 11-12.)

Bolingbrook also argues that Joint Applicants have not shown that IAWC will "maintain" a reasonable capital structure. (Bolingbrook BOE, p. 6.) This is not the case. As Joint Applicants explained in their Initial Brief (pp. 14-20) and Reply Brief (pp. 6-10), IAWC's capital structure will not change as a result of the Proposed Transaction. (IAWC Ex. 2.0, p. 16.) 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.*) To the extent Bolingbrook continues to argue that AW has a "historic inability" to maintain a reasonable capital structure, Joint Applicants refuted that argument in their Reply Brief (pp. 6-8) by demonstrating that Bolingbrook had no basis to assert that AW's common equity ratio was unreasonably low. Therefore, Bolingbrook's Exception V should be rejected.

F. Reply Bolingbrook Exception VI: Bolingbrook Does Not Demonstrate That the Proposed Transaction Will Result in an Adverse Rate Impact

In its Exception VI, Bolingbrook asserts, again without evidence, that IAWC ratepayers "will lose the benefit that RWE's ownership reflects upon Illinois-American." (Bolingbrook BOE, p. 8.) This argument ignores the fact, as discussed above and in Joint Applicants' Reply Brief (pp. 1-6, 10-11), that RWE's changed circumstances could have a negative impact on AW and IAWC under continued RWE ownership. Bolingbrook acknowledges that AW and its subsidiaries are no longer core holdings of RWE (Bolingbrook BOE, p. 7), but nevertheless asserts that RWE's continued ownership of AW would provide some "benefit." This argument is

at best inconsistent, and no witness testified that continued RWE ownership of IAWC as a non-core holding would provide any "benefit" for IAWC.

Bolingbrook also argues that "Joint Applicants had the burden of proving to the Commission that approval of the Proposed Transaction would not result in any further deterioration of AWCC's A-minus credit rating." (Bolingbrook BOE, p. 8.) Joint Applicants have met that burden. Ms. Wolf demonstrated, with a detailed analysis, that AW should maintain a credit rating of "A-" after the Proposed Transaction (IAWC Ex. 2.0R-REV, pp. 1-9), and no witness testified otherwise. (*See discussion at JA Init. Br.*, pp. 17-20.)

Bolingbrook further states that it agrees with the ALJPO's conclusions regarding unfunded pension liabilities. (Bolingbrook BOE, p. 9.) For the reasons discussed in Joint Applicants' Brief on Exceptions (pp. 1-14), the ALJPO's conclusions regarding the impact on rates of pension plan funding are incorrect.

Finally, Bolingbrook asserts that because the "Proposed Transaction would result in the ratepayers having to pay an added expense related to Sarbanes-Oxley compliance costs, the Proposed Transaction will have an adverse impact on ratepayers." (Bolingbrook BOE, p. 9.) This is not the case. Joint Applicants proposed that the Commission should rule in this case that "Joint Applicants do not seek recovery in rates of the costs associated with the Proposed Transaction; accordingly, the costs of the Proposed Transaction are not recoverable in rates." (JA Init. Br., p. 12.) The ALJPO accordingly finds that "costs of the Proposed Transaction as detailed above are not recoverable in rates." (ALJPO, p. 24.) Conditions 7 and 8 of the ALJPO also prohibit IAWC from recovering through rates, *inter alia*, any costs of the Proposed Transaction. (ALJPO, pp. 25-26.) As the ALJPO correctly notes (p. 13), whether Sarbanes-Oxley costs are recovered at all is a matter for a future rate case, and to the extent that IAWC

seeks to recover costs unrelated to the Proposed Transaction in a future rate case, such recovery will be subject to Commission approval and IAWC will be required to support cost recovery under established ratemaking principles. (JA Reply Br., pp. 10-11.)

Bolingbrook also incorrectly asserts that "Joint Applicants have not put on any evidence with respect to this matter." (Bolingbrook BOE, p. 9 (emphasis in original).) In fact, Joint Applicants have discussed Sarbanes-Oxley compliance in the context of the Proposed Transaction (IAWC Ex. 2.0, pp. 7-8) and have made clear that no costs of the Proposed Transaction will be passed to ratepayers. (IAWC Exs. 1.0, pp. 9-10; 1.0R-REV, pp. 19, 23; *see also* Stipulation Ex. B, p. 4, ¶¶ 13.E, 13.F.) As a result, there is no basis for Bolingbrook's Condition VI.

G. Reply to Bolingbrook Exception VII: There Is No Basis in Illinois Law for Bolingbrook's Contention That Conditions Cannot "Cure a Defective Application" or Represent an Improper Settlement

In Exception VII, Bolingbrook takes the position that Section 7-204 of the Act does not permit the Commission to impose conditions on the Proposed Transaction "in order to cure a defective application." (Bolingbrook BOE, pp. 9-10.) Bolingbrook cites no authority that supports this position, which defies logic and Illinois law. Bolingbrook argues that, until the criteria of Section 7-204(b) are met and a reorganization is approved, the Commission cannot impose conditions on a proposed reorganization. (Bolingbrook BOE, pp. 10-11.) This misreads Section 7-204. The plain language of Section 7-204(f) (which Bolingbrook seeks to mischaracterize) allows imposition of "such terms, conditions or requirements as, in [the Commission's] judgment, are necessary to protect the interests of the public utility and its customers." 220 ILCS 5/7-204(f). As explained in Joint Applicants' Brief on Exceptions (p. 11), the Commission has authority to impose appropriate conditions on the reorganization pursuant to

Section 7-204(f), provided that such conditions are not unconstitutional, contrary to law, or otherwise beyond the Commission's authority. (As discussed in Joint Applicants' Brief on Exceptions, Condition 22 of the ALJPO, relating to use for IPO proceeds to fund pension plans, exceeds the Commission's authority and should be rejected).

Bolingbrook's reading of Section 7-204 would make Section 7-204(f) a nullity, because any need to "protect the interests of the public utility and its customers" for which a condition might be imposed under Section 7-204(f) would render a proposed reorganization "defective" under Bolingbrook's interpretation of Section 7-204. Bolingbrook appears to suggest, moreover, that Section 7-204 establishes a two-step procedure under which the Commission would first review and approve a reorganization under Section 7-204(b), with conditions being adopted thereafter. Section 7-204 does not suggest a two-step process, but makes clear the Commission may impose appropriate conditions during its review of a reorganization. In particular, Joint Applicants point out that Section 7-204(f) begins: "In approving any proposed reorganization pursuant to this Section . . .". 220 ILCS 5/7-204(f) (emphasis added). This language makes clear that imposition of conditions may occur in conjunction with the Commission review of a reorganization under Section 7-204 as a whole.

The Commission routinely imposes appropriate conditions on reorganizations pursuant to Section 7-204(f). *See, e.g. Illinois Power Co. & Ameren Corp.*, Docket 04-0294 (Jan. 23, 2003); *Illinois-American Water Co. & Thames Water Aqua Holdings, GmbH*, Docket 01-0832 (Nov. 20, 2002); *Illinois-American Water Co., Citizens Util. Co. of Ill. and Citizens Lake Water Co.*, Docket 00-0476 (May 15, 2001); *see also* 220 ILCS 5/7-101(3) (Commission has similar authority, when approving affiliated interest agreements, to "condition such approval in such manner as it may deem necessary to safeguard the public interest"). Bolingbrook cites no

authority, of the Commission or otherwise, that the conditions imposed in those cases were inappropriate. Rather, these conditions reflect the Commission's proper exercise of its authority under Section 7-204(f). Contrary to Bolingbrook's assertions (Bolingbrook BOE, p. 10), such decisions of the Commission, as "judgments of a tribunal appointed by law and informed by experience," are entitled to substantial deference. *Archer-Daniels-Midland Co. v. Illinois Commerce Comm'n*, 184 Ill.2d 391, 397 (Ill. 1998); *Village of Apple River v. Illinois Commerce Comm'n*, 18 Ill.2d. 518, 523 (Ill. 1960). These decisions are entitled to deference because they are the judgments of an administrative body which possesses expertise in the field of public utilities and which is qualified to interpret specialized and highly technical evidence. *United Cities Gas Co. v. Illinois Commerce Comm'n*, 163 Ill.2d 1, 12 (Ill. 1994).

Bolingbrook also argues that the imposition of conditions in this proceeding represents an improper settlement offer by the Commission. Again, this argument would render Section 7-204(f) a nullity because, under Bolingbrook's argument, a condition imposed under that Section would constitute an offer of settlement, and so conditions could never be imposed.

Bolingbrook's reliance on *Business & Professional People for the Public Interest v. Illinois Commerce Commission*, 136 Ill. 2d 192, 201 (1990) ("*BPI*") is misplaced. In that case, the Commission offered a settlement to the utility that contained "certain provisions which the Commission could not legally implement unilaterally." *Id.* at 201. The court ruled that such a settlement was improper because it did not have unanimous consent of all the parties, *id.* at 217, and because it was not supported by the evidentiary record. *Id.* at 212. The instant proceeding is distinguishable from *BPI* in that: (i) the Commission did not offer the terms of the conditions in the ALJPO as a settlement (in fact, all of the conditions in the ALJPO, except for Condition 22, which is inappropriate for the reasons discussed in Joint Applicants' Brief on Exceptions, were

proposed by Joint Applicants and various parties or Staff); (ii) the record in this proceeding fully supports the imposition of all the conditions, except Condition 22; (iii) the conditions proposed in this proceeding are within the Commission's authority to implement (except for Condition 22, as discussed in Joint Applicants' Brief on Exceptions).

H. Bolingbrook Exception VIII Should Be Rejected

Bolingbrook Exception VIII (Bolingbrook BOE, p. 12.) recommends certain changes to the ALJPO's Finding and Ordering Paragraphs, based on the arguments in the rest of the Bolingbrook BOE. As discussed above, the arguments in the Bolingbrook BOE and Bolingbrook's proposed exceptions should be rejected. For those same reasons, the changes proposed in Bolingbrook Exception VIII should also be rejected.

III. CONCLUSION

For all the reasons stated herein, and in the Brief on Exceptions of Joint Applicants and Reply Brief on Exceptions of Joint Applicants, the Commission should reject the changes to the ALJPO proposed by Bolingbrook, and adopt the changes regarding the ALJPO set forth in Appendix A of the Brief on Exceptions of Joint Applicants.

Dated: June 14, 2007

Respectfully submitted,

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