

Direct Testimony

of

Michael McNally

Finance Department

Financial Analysis Division

Illinois Commerce Commission

Aqua Illinois, Inc.

Petition for
Issuance of Certificate of Public Convenience and Necessity
to Operate Water Systems;
Approval of Asset Purchase Agreement;
Approval of Rates and Accounting Entries;
And Approval of Variance to the Standard Main Extension Rules.

Docket No. 07-0296

October 4, 2007

1 **Q1. Please state your name and business address.**

2 A1. My name is Michael McNally. My business address is 527 East Capitol Avenue,
3 Springfield, IL 62701.

4 **Q2. What is your current position with the Illinois Commerce Commission**
5 **(“Commission”)?**

6 A2. I am presently a Senior Financial Analyst in the Finance Department of the
7 Financial Analysis Division.

8 **Q3. Please describe your qualifications and background.**

9 A3. I received a Bachelor of Arts degree in Economics from the University of Illinois
10 at Urbana-Champaign in 1993. I received a Master of Business Administration
11 degree, with a concentration in Finance, from the University of Illinois at Urbana-
12 Champaign in 1999. I have been employed by the Commission since 1999.

13 **Q4. Please state the purpose of your testimony in this proceeding.**

14 A4. On August 31, 2007, Aqua Illinois, Inc. (“Aqua” or the “Company”) filed a second
15 amended petition for the issuance of temporary and permanent certificates of
16 public convenience and necessity to construct, operate, and maintain water
17 distribution systems in the Village of Sun River Terrace (the “Sun River
18 Expansion Area”), six square miles adjacent to the Kankakee Division,
19 Kankakee, Illinois (the “Southern Expansion Area”), and an additional adjacent
20 11 square mile area (“Additional Southern Area”) pursuant to Section 8-406 of
21 the Illinois Public Utilities Act (“Act”). The purpose of my testimony is to present
22 my evaluation of the financial implications of the proposed construction under
23 Section 8-406(b)(3) of the Act.

24 **Q5. What does Section 8-406(b)(3) of the Act require?**

25 A5. Section 8-406(b)(3) of the Act requires that before issuing the requested
26 certificate of public convenience and necessity the Commission find “that the
27 utility is capable of financing the proposed construction without significant
28 adverse financial consequences for the utility or its customers.”

29 **Q6. Please describe the proposed construction and estimated cost.**

30 A6. The Company proposes to operate and maintain the pre-existing water
31 distribution system in the Sun River Expansion Area, which it has agreed to
32 purchase from the Village of Sun River Terrace for \$95,000 plus transactions
33 costs of \$25,000.¹ The Company also proposes to construct, operate, and
34 maintain a water supply and distribution system in the Southern Expansion Area;
35 the cost to Aqua of the construction is estimated to be \$4,000,000 plus \$55,820
36 of administrative expenses.² The main extension in the Southern Expansion
37 Area will service Alternative Energy Sources, Inc.’s (“AES”) ethanol plant. The
38 main extension will be subject to a non-standard main extension agreement,
39 under which the developer of the land for AES will advance Aqua \$4,000,000,
40 which Aqua will repay when AES’s ethanol plant goes into full production.
41 Finally, the Company proposes to construct, operate, and maintain a water
42 supply and distribution system in the Additional Southern Area, which is directly
43 adjacent to the Kankakee service area, for which Aqua already is certificated to
44 provide service. It is my understanding that there are no immediate plans for the
45 development of the Additional Southern Area; however, the cost to Aqua of any
46 necessary construction for any future development requiring service will be 1 ½

¹ Second Amended Petition, p.3; Aqua Exhibit 2.1.

² Second Amended Petition, pp. 5-7; Aqua Exhibit 2.0, p. 4.

47 times annual revenues from the development, pursuant to standard main
48 extension rules.

49 **Q7. Would the Company be capable of financing the proposed purchase of the**
50 **water distribution system in the Sun River Expansion Area without**
51 **significant adverse financial consequences for the Company or its**
52 **customers?**

53 A7. Yes. The total cost to Aqua with respect to the Sun River Expansion Area will be
54 \$373,500, which includes the \$95,000 purchase price, \$25,000 of transactions
55 costs, and \$253,500 of related costs to upgrade the existing water facilities.³ The
56 Company states that it will be able to finance the proposed purchase with cash
57 on hand.⁴ In addition, the total cost of the proposed purchase would be minimal
58 relative to the Company's total utility plant and operating revenue. The
59 Company's utility plant had a net value of \$192,888,636 as of December 31,
60 2006; its total utility operating revenues for the twelve months ended December
61 31, 2006, was \$36,573,773.⁵ The \$373,500 total cost represents 0.19% of the
62 Company's net utility plant and 1.03% of the Company's total utility operating
63 revenue. Therefore, I conclude that the Company is capable of financing the
64 proposed purchase of the Sun River Expansion Area water system without
65 significant adverse financial consequences for the Company or its customers.

66 **Q8. Would the Company be capable of financing the proposed construction of**
67 **the main extension to service the Southern Expansion Area without**

³ Aqua Exhibit 1.0, p. 8; Company response to Staff data request FD 1.02.

⁴ Company response to Staff data request FD 1.01.

⁵ Aqua Illinois, Inc. Form 22 ILCC, December 31, 2005, pp. 4F and 7F.

68 **significant adverse financial consequences for the Company or its**
69 **customers?**

70 A8. Yes. As noted above, Aqua will not finance the construction of the main
71 extension to the Southern Expansion Area. Rather, Aqua will reimburse the
72 developers at the time the main extensions are put into service. Thus, Aqua's
73 investment in the proposed main extensions would immediately produce new
74 revenue. The Company forecasts that, after the completion of the proposed
75 transactions, it will produce a positive net income.⁶ Thus, the proposed
76 transactions would allow the Company to produce sufficient funds to cover its
77 operating expenses and debt expenses and still have funds available to pay
78 equity investors. Moreover, Aqua is capable of raising the investment funding
79 required for the proposed main extensions. Aqua intends to finance the capital
80 costs through internally generated funds and debt financing.⁷ The Company
81 notes that it has bank lines of credit totaling \$20 million available to finance
82 capital investment needs.⁸

83 In addition, the Company is a subsidiary of Aqua America, Inc. and, thus, is
84 backed by the financial resources of a corporation that had revenues of
85 approximately \$533 million, assets of over \$2.8 billion, and capital expenditures
86 of over \$270 million for the year ending December 31, 2006.⁹ Therefore, I
87 conclude that the Company is capable of financing the investment in the
88 proposed main extension without significant adverse financial consequences for
89 the utility or its customers.

⁶ Company response to Staff data request FD 1.11.

⁷ Company response to Staff data request FD 1.04.

⁸ Company response to Staff data request FD 1.09.

⁹ Company response to Staff data request FD 1.09.

90 **Q9. Would the Company be capable of financing the proposed construction of**
91 **the main extension to service the Additional Southern Area without**
92 **significant adverse financial consequences for the Company or its**
93 **customers?**

94 A9. Yes. As noted above, there are no immediate plans for the development of the
95 Additional Southern Area. Since the water system for the Additional Southern
96 Area will connect into Aqua's existing water system, the additional capital
97 requirements should be relatively small. Also, any water distribution system
98 needed in the Additional Southern Area will be built pursuant to standard main
99 extension rules. Thus, Aqua will not finance such construction, but rather will
100 reimburse the developers at the time the main extensions are put into service at
101 1 ½ times annual revenues from the development. At that time, Aqua's
102 investment in the new distribution system would immediately produce new
103 revenue to offset the reimbursement costs. Therefore, I conclude that the
104 Company would be capable of financing investment in the Additional Southern
105 Area without significant adverse financial consequences for the utility or its
106 customers.

107 **Q10. What is your recommendation?**

108 A10. In my judgment, Aqua has met the requirement of Section 8-406(b)(3) of the Act.
109 Therefore, I recommend the Commission find that the Company is capable of
110 financing the proposed main extensions without significant adverse financial
111 consequences for the utility or its customers.

112 **Q11. Does this conclude your prepared direct testimony?**

113 A11. Yes, it does.