STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

ILLINOIS-AMERICAN WATER COMPANY	)	
	)	
Petition for Authority to Incur $28,500,000 of Indebtedness and Approval of Affiliated Interest Transaction	)))	Docket No. 07-0371

DRAFT ORDER

I. BACKGROUND

On June 15, 2007, Illinois-American Water Company (the "Company" or "IAWC") filed with the Illinois Commerce Commission (the "Commission") a verified Petition for Authority to Incur $28,500,000 of Indebtedness ("Petition") under Sections 6-102, 7-101 and 7-102 of the Public Utilities Act ("Act") (220 ILCS 5/6-102, 5/7-101 and 5/7-102). IAWC seeks approval for a financing program for 2007 through 2009 (the "Financing Program"), which includes the issuance of up to $28,500,000 in long-term debt primarily to finance a portion of the capital costs of a new water treatment facility planned for Champaign County, Illinois, the Champaign County Water Treatment Facility ("Champaign Facility").

Pursuant to notice given in accordance with the law and the rules and regulations of the Commission, prehearing conferences were held in this matter on July 3, July 19 and November 13, 2007, before a duly authorized Administrative Law Judge of the Commission at its offices in Springfield, Illinois. Thereafter, this matter was called for hearing on December 5, 2007. At the conclusion of the hearing on December 5, 2007, the record was marked “Heard and Taken.”

The Company submitted the testimony of two witnesses. Mr. Michael Hoffman submitted Direct Testimony and attachments (IAWC Ex. MJH-1.0 (Corrected) and IAWC Exhibits MJH 1.1 to 1.6) and Rebuttal Testimony (IAWC Ex. MJH-2.0). Mr. Barry Suits submitted revised Direct Testimony and attachments (IAWC Ex. BLS-1.0 (Revised) and IAWC Exs. BLS 1.1 (Public and Proprietary), 1.2 (Public and Proprietary), 1.2A, and 1.3 to 1.9) and Rebuttal Testimony (IAWC Ex. BLS-2.0). Staff also submitted the testimony of two witnesses, Rochelle Phipps (ICC Staff Ex. 1.0) and William H. Atwood, Jr. (ICC Staff Ex. 2.0)

The Company filed a draft order on December 17, 2007.

The Company is a corporation organized and existing under and by virtue of the laws of the State of Illinois with its principal office in the City of Belleville, Illinois. IAWC currently owns, operates, and maintains potable water production, treatment, storage, transmission and distribution systems and wastewater collection, pumping, and/or treatment systems for the purpose of furnishing water and wastewater service for residential, commercial, industrial, and governmental users in its various districts. IAWC's districts include Alton, Cairo, Champaign, Chicago Metro, Interurban, Lincoln, Pekin, Peoria, Pontiac, South Beloit, Sterling, and Streator. Overall, IAWC serves approximately 302,000 customers in 129 communities in Illinois. IAWC is a wholly-owned subsidiary of American Water Works Company, Inc. ("AWW"), a holding company that owns the stock of water and sewer utility subsidiaries operating in 23 states.

II. COMPANY POSITION

A. The Financing Program

IAWC's witness, Mr. Hoffman, testified that IAWC seeks approval of the Commission under Sections 6-102, 7-101 and 7-102 of the Act to issue and sell or incur in one or more transactions indebtedness in the form of (i) promissory notes ("Notes") issued to its affiliate American Water Capital Corporation ("AWCC") pursuant to the approval for such transactions given by the Commission in the Order entered May 16, 2000 in Docket 00-0306 and reaffirmed in Docket 04-0582 and/or (ii) one or more series of General Mortgage Bonds ("Taxable Bonds") and/or (iii) loan obligations to one or more governmental bodies or political subdivisions of the State of Illinois ("Governmental Issuer") in connection with the issuance by the Governmental Issuer of one or more series of tax-exempt bonds ("Tax-Exempt Bonds") and/or (iv) one or more borrowings from the State of Illinois Public Water Supply Loan Program ("Revolving Fund Loans") created under the Illinois Environmental Protection Act (415 ILCS 5/19/1 et seq.) and pursuant to the rules and regulations thereunder (the "Revolving Fund Program"). The Revolving Fund Loans, together with the Notes, Taxable Bonds, and Tax-Exempt Bonds, are referred to collectively as the "New Indebtedness." Mr. Hoffman explained that the aggregate amount of New Indebtedness issued under the authority sought herein will not exceed $28,500,000 outstanding at any time and that immediately following each issuance approved herein, the Company's ratio of common equity to total capitalization shall be not less than 40%.

As further explained by Mr. Hoffman, IAWC is seeking authority to issue up to $28,500,000 in one or more issuances of New Indebtedness during the period 2007 through 2009. The purposes of the proposed issuances are (i) reimbursement to the Company for expenditures made for construction or improvements of or additions to the Champaign Facility, (ii) to refinance short-term debt incurred to temporarily fund construction expenditures expected to be incurred for the construction or improvements of or additions to its facilities needed to provide adequate and reliable water service, including the new Champaign Facility, and (iii) for other corporate purposes, including paying the debt issuance expenses associated with the proposed New Indebtedness. Mr. Hoffman noted that the primary driver of expenditures in the Champaign district is the Champaign Facility. As discussed below, this is a significant construction program that will require the investment of approximately $51,000,000. Mr. Hoffman testified that although short-term debt will be issued periodically to finance construction during this period, short-term debt is a temporary source of capital and must be refinanced. To permanently finance the Champaign Facility, including pre-construction costs and other purposes as described above, the Company plans to issue up to $28,500,000 of long-term debt and receive up to $22,500,000 in additional paid-in capital during the period 2007 through 2009. Mr. Hoffman also testified that to the extent internally generated funds are available to finance the capital costs associated with the Champaign Facility, IAWC will use those funds to offset the amount of New Indebtedness and additional paid-in capital that would otherwise have been required.

Mr. Hoffman explained that the Company is seeking approval for the New Indebtedness planned for the years 2007 through 2009 to obtain the flexibility to respond to favorable capital market conditions when they arise, and to finance the capital expenditures for the Champaign Facility in an efficient and cost-effective manner. Under the Company's initial proposal, none of the New Indebtedness proposed in this proceeding was to be issued after December 31, 2009. Mr. Hoffman noted that the precise timing of the issuances will depend on capital market conditions, as well as the timing of the capital expenditures during the construction of the Champaign Facility. The Company will have the flexibility to obtain the additional equity as needed through receipt of additional paid-in capital from AWW. The Company will not issue any new shares of IAWC common stock ("Common Stock"). Mr. Hoffman noted that IAWC will file with the Commission a written report on the terms of each issue of New Indebtedness within thirty days after it occurs and thereafter as specified in 83 Ill. Adm. Code 240 ("Part 240").

Mr. Hoffman testified that the Company is seeking Commission approval to issue Notes, Taxable Bonds, Tax-Exempt Bonds, and/or enter into Revolving Fund Loans and the Company will seek to match its financing needs with the types of financing that are available at the time and that will produce the lowest overall cost of debt available to IAWC.

Mr. Hoffman stated that the Notes will be sold to AWCC pursuant to the Financial Services Agreement ("FSA") between IAWC and AWCC that has been reviewed and approved by the Commission. To give the Company flexibility to complete its Financing Program, it is seeking authority to issue Notes, as long as the interest rate, determined at the time of sale, does not exceed a rate equal to the then-current yield on 30-year U.S. Treasury Bonds ("U.S. Treasuries"), as published in *The Wall Street Journal*, plus 200 basis points. Mr. Hoffman explained that U.S. Treasury Bond yields are widely followed as a benchmark for many interest rate calculations and are most often used by the market to price utility bond offerings. Mr. Hoffman testified that the 200 basis point spread is sufficient to give the Company the needed flexibility to obtain financing and accommodate the spread on the return investors require for an unsecured note over that of a natural AAA offering. The Commission authorized a maximum rate for IAWC as 275 basis points over U.S. Treasuries in ICC Docket Nos. 06-0650 / 06-0651 (consolidated).

Mr. Hoffman further testified that AWCC will fund the Notes to IAWC through long-term senior unsecured debt instruments ("AWCC Securities") issued in a public offering or private placement by AWCC. The AWCC Securities will not be issued to or guaranteed by any person that constitutes an "affiliated interest" of AWCC or IAWC. Mr. Hoffman explained that IAWC does not have as ready access to capital markets as does AWCC and the AWCC Securities will be issued in a transaction of a sufficient size to ensure that AWCC is able to obtain the most favorable market rate possible given the circumstances. Mr. Hoffman explained that IAWC expects that the interest rate or rates it will pay in connection with the Notes issued to AWCC, which are in turn funded by AWCC through the AWCC Securities, will be no greater, and may be lower, than it could obtain if it issued its own securities. Further, IAWC expects that the total transaction costs incurred by IAWC in a transaction through AWCC will be lower than the total transaction costs incurred by IAWC in a transaction where IAWC issued its own securities. Mr. Hoffman stated that IAWC will not issue Notes to AWCC unless it can determine that, based on market conditions applicable at the time, such issuance will result in the lowest overall cost available to IAWC for the securities of comparable type, maturity, and terms.

With regard to Taxable Bonds, Mr. Hoffman explained that the interest rate will be set at the time of issuance through negotiation with one or more underwriting firms (each an "Underwriter") and consistent with then-current market conditions. The interest rate on fixed-rate Taxable Bonds, determined at the time of sale, will not exceed a rate equal to the then-current yield on U.S. Treasuries, as published in *The Wall Street Journal*, plus 200 basis points. Mr. Hoffman also testified that if IAWC can obtain a bond insurance policy (a "Policy") at a cost that will result in an all-in cost of debt on a series of bonds being less (taking into account the insurance premium) than the all-in cost of debt of such bonds without a Policy, then the Company will purchase such a Policy. The bond insurer may require the Company to enter into an Insurance Agreement providing for reimbursement to the insurer if the insurer pays on a claim under the Policy.

Mr. Hoffman stated that the Tax-Exempt Bonds would most likely be sold in a public offering pursuant to a contract of purchase among the Governmental Issuer, if applicable, one or more Underwriters, and IAWC. The Tax-Exempt Bonds will be secured through a Loan Agreement between IAWC and the Governmental Issuer and may also be secured by General Mortgage Bonds issued under IAWC's Indenture of Mortgage (the "Indenture"). Mr. Hoffman explained that the interest rate will be a fixed rate negotiated with the Underwriter, or floating rate determined in accordance with market conditions at the time of issuance. To give IAWC flexibility to implement its Financing Program, Mr. Hoffman added that IAWC is seeking authority to issue Tax-Exempt Bonds provided that the fixed interest rate, determined at the time of sale, does not exceed a rate equal to the most currently available Municipal Market Data ("MMD") Index, plus 100 basis points. Mr. Hoffman noted that the MMD Index is a widely followed and generally recognized generic index used as a benchmark for rates on long-term tax-exempt bonds similar to the Tax-Exempt Bonds for which IAWC is seeking approval to issue in this proceeding. It is reflective of interest rates for AAA-rated municipal general obligation bonds, which are the highest quality debt a state can issue.

Mr. Hoffman testified that, similar to the use of U.S. Treasuries as a basis for the interest rate for the Notes and Taxable Bonds, the MMD index is based on AAA credit quality and thus the rate that IAWC could obtain would in all cases be higher than the index. This 100 basis point spread will give IAWC flexibility to price its obligations to offer the spread on the return investors require for an insured tax-exempt bond over that of a natural AAA offering, and giving consideration to the alternative minimum tax imposed on corporate-backed tax-exempt bonds.

Mr. Hoffman further testified that, if IAWC can obtain a Policy at a cost that will result in an all-in cost of debt on a series of bonds being less (taking into account the insurance premium) than the all-in cost of debt of such bonds without a Policy, then the Company will purchase such a Policy. The bond insurer may require the Company to enter into an Insurance Agreement providing for reimbursement to the insurer if the insurer pays on a claim under the Policy. Mr. Hoffman added that he did not anticipate that Tax-Exempt Bonds will be available for a substantial portion of the New Indebtedness. The amount of available Tax-Exempt Bonds is limited by federal tax law. The Champaign Facility is a project that would be eligible to use tax-exempt financing, but only a limited amount of bonds can be issued in the State for this and similar projects.

Mr. Hoffman then explained that the Revolving Loan Program provides low interest loans to units of local government for the construction of community water supply facilities. This loan program is capitalized at an annual amount of $30 - $40 million with federal and state funds. The amount that is available to the Company under the Revolving Fund Program is limited and likely will not be sufficient for all our financing needs for the Champaign Facility and other projects. Mr. Hoffman stated that the interest rate on the Revolving Fund Loans will be below market rates for securities of similar risk, rendering a cap unnecessary.

Mr. Hoffman testified that, in his opinion, the maximum rates compare favorably with the rates for the new issues of the securities of the quality comparable to that of IAWC's debt while giving the Company the flexibility to respond to changing market conditions.

Mr. Hoffman explained that the Tax-Exempt Bonds and Taxable Bonds may be redeemable in whole or in part at the option of IAWC, with a pre-payment premium, if any, determined in accordance with market conditions at the time of issuance. Further, these bonds may be subject to mandatory sinking fund requirements. The Notes will be prepayable as provided in the FSA. The Revolving Fund Loans will be prepayable as allowed or required by the Revolving Fund Program.

Mr. Hoffman estimated the cost the Company expects to incur in connection with the Financing Program to be $161,266, noting that the amount of the statutory issuance fee of $68,400 associated with the New Indebtedness was calculated pursuant to Sections 6-108 and 6-108(2) of the Act, on the maximum amount of the New Indebtedness ($28,500,000) to be issued pursuant to the Financing Program. No fee is due under Section 6-108 with respect to the $22,500,000 of additional paid-in capital. The Company proposes to treat the expenses related to the issuance of the New Indebtedness as a deferred charge and amortize that deferred charge over the life of the New Indebtedness.

The Company proposes to issue the Taxable Bonds and, if they are to be secured by the mortgage, the Tax-Exempt Bonds under the Indenture. IAWC must be in compliance with the terms of the Indenture and any Supplemental Indentures and receive authorization from the Board of Directors of IAWC and this Commission in order to issue additional bonds under the Indenture. Mr. Hoffman explained that under the terms of the Indenture, IAWC may issue additional bonds as long as all outstanding "Long Term Debt", including the bonds to be issued, does not exceed 65 percent of the "Total Capitalization" of IAWC, as those terms are therein defined (the "Total Capitalization Test"). Under the terms of certain Supplemental Indentures, IAWC may issue additional bonds as long as the before-tax income of IAWC covers aggregate annual interest charges on all Long Term Debt to be afterwards outstanding at least one and one-half times, as defined in the applicable prior Supplemental Indentures (the "Required Net Income for Debt Test").

Mr. Hoffman testified that the Company's goal is to minimize the overall cost of capital. He also testified that it is necessary, however, to maintain financial ratios that allow the Company to attract new capital on reasonable terms, and that provide the flexibility to enable the Company to issue various types of securities (e.g., tax-exempt debt, long-term taxable debt, preferred or common equity) under varying market conditions. Pursuant to a Stipulation entered into by the Company in Docket 06-0336, the Company has committed, for three years following the date of the final order in that case, to maintain its equity-to-capital ratio between 40% and 50%. The Company's present objective is to maintain its common equity ratio within a target range of approximately 43% to 48%. As outlined above, the major construction program of the Champaign Facility will be financed with a mix of New Indebtedness and additional paid-in capital obtained from AWW.

In this proceeding, the Company proposes to issue Tax-Exempt Debt and/or Revolving Fund Loans to the extent possible. However, given the limits on availability of those sources as discussed by Mr. Hoffman, the remaining funds, which may be up to 100% of the New Indebtedness, will be Taxable Bonds or Notes. As Mr. Hoffman noted, IAWC's pro forma capitalization, assuming issuance of $28,500,000 of New Indebtedness and receipt of $22,500,000 of additional paid-in capital, will consist of 43.6% common equity and 56.4% long-term debt. Mr. Hoffman testified that this capital structure is reasonable for the Company, and, in addition, the pro forma equity ratio of 43.6% is consistent with the Company's long-term target equity range of 43% to 48%. Finally, the equity ratio may increase over the term of the Financing Program, assuming increases in retained earnings.

Mr. Hoffman also explained that IAWC is not seeking approval in this proceeding to issue any additional shares of its Common Stock. IAWC will periodically receive additional paid-in capital from AWW necessary to maintain its equity ratio within the desired range. This process does not require the issuance of any additional shares of Common Stock or other securities by IAWC. If the Company were to determine that the appropriate form of equity investment is through the sale of additional shares of Common Stock, the Company would seek to obtain approval from the Commission at that time for such issuance.

Mr. Hoffman described the alternatives that the Company considered in developing the Financing Program presented in this docket. The Company will use internally generated funds to the extent available rather than obtaining financing. In conjunction with all financings, the Company considers the appropriate mix of debt, preferred stock and common equity. In this instance, Mr. Hoffman explained the Company concluded that the resulting debt and equity ratios would be at the target ranges if the financing was made up of the New Indebtedness and receipt, as needed, of approximately $22,500,000 of additional paid-in capital. Thus, no preferred stock, which is more costly than debt due to higher risk exposure, was included in the proposed Financing Program. The Company is seeking flexibility in this docket regarding the exact type and mix of New Indebtedness to issue to give it the ability to take advantage of any available tax-exempt financing and of future market conditions to obtain favorable financing terms.

B. The Champaign Facility

IAWC's witness, Mr. Barry Suits, testified regarding the primary facility addition that the Company intends to finance, the new Champaign Facility. Mr. Suits explained that growth in the City of Champaign ("Champaign") area has caused peak maximum day water demand to approach the rated capacity of the existing Champaign water treatment facilities, the East Water Treatment Facility ("East WTF") and the West Water Treatment Facility ("West WTF"). As a result, after conducting studies and analysis, IAWC has determined that it will be necessary to build new capacity.

IAWC serves a population of approximately 124,000 in the Champaign area, based on the 2000 census data. Approximately 92 percent of the Champaign customer base is residential, 6 percent is commercial, and the remainder consists of fire services, industrial users and "other" public authorities including the University of Illinois. The Champaign County District of IAWC (“Champaign District”) provided an average of 22.1 million gallons per day (MGD) to approximately 50,300 customers in the Champaign District in 2005. As Mr. Suits discussed, Champaign and Urbana lie in a region where major surface waters are scarce. As a result, Mr. Suits explained, the community's water supply depends on high-capacity wells that extract water primarily from the Mahomet Aquifer, a deep sand-and-gravel aquifer that is the major source of water for many communities, farmers, and industries in central Illinois. Currently, IAWC operates two well fields, one located within and just outside Champaign, finished in the Mahomet Aquifer, and the other in Urbana, finished in the Glasford Sands.

Mr. Suits testified that the current water treatment capacity of the Champaign system is 40 MGD. This consists of 30 MGD at the West WTF and 10 MGD at the East WTF. However, the West WTF's capacity will be adjusted to 13.75 MGD in 2009 and 20.5 MGD in 2010, and the East WTF's capacity will be adjusted to 11 MGD in 2009, because of the Illinois Environmental Protection Agency's ("Illinois EPA") current criteria and planned modifications to the facilities.

Mr. Suits explained that the Champaign District has experienced moderate, steady population growth over the past three decades that has led to a projection that maximum day water use demands could exceed the current 40 MGD combined rated capacity of the District's existing two (2) facilities (East WTF and West WTF) after 2008. In order to meet the projected maximum day demands, Mr. Suits stated the Champaign District needs to construct additional water supply and treatment facilities to add to the existing capacity of the system. In addition, the Illinois EPA has indicated that the rated capacity of the West WTF should be reduced in order to meet the required disinfectant contact time. Mr. Suits added that the project will also include the construction of an additional source of supply, raw water transmission mains and finished water transmission mains in order to meet expected maximum day demands. Construction of the new facility began in 2007. Mr. Suits stated that the Champaign Facility will be placed in service in December, 2008 and be finally completed (completion of minor items that do not affect the Champaign Facility's in service status) during 2009.

Mr. Suits testified that upon completion of the Champaign Facility, and in conjunction with improvements to the East WTF and its source of supply system that will increase its capacity to 11 MGD in 2009 and improvements to the West WTF that will increase its capacity to 20.5 MGD in 2010, the rated capacity of all facilities in the Champaign District combined will be increased to 46.5 MGD in 2010. A detailed analysis supporting the need for additional capacity was performed as a part of the 1998 Master Plan Study ("1998 Study") and subsequent 2003 Demand and Source of Supply Analysis ("2003 Study"). In addition, the Company has recently prepared an engineering analysis which refines the projection of demand and available capacity for the Champaign system through 2031. Mr. Suits explained that the 1998 Study was undertaken by IAWC's predecessor, Northern Illinois Water Company, to assess future demand in the Champaign District. The 1998 Study found that recent growth in the Champaign District is due to residential customer increases (while commercial growth was stable), the acquisition of several new resale accounts, and increased demand by the University of Illinois. The 1998 Report concluded that maximum daily demand could be as high as 45 MGD by 2020. The 2003 Study concluded that maximum day demands could exceed the current rated capacity of the Champaign District's treatment facilities by about 2008 and grow to 44.6 MGD by 2016.

Mr. Suits also testified about an additional reason why increased capacity is needed in the Champaign District. The Illinois EPA conducted an engineering evaluation of the Champaign District facilities during several days in May 2004. Following the evaluation, the Champaign District was notified that the District had certain deficiencies, which the Illinois EPA outlined in July 27, 2004 correspondence summarizing the engineering evaluation and an October 13, 2004 Notice of Violation. In the course of the engineering evaluation, the Illinois EPA reexamined the capacity of the Champaign District treatment facilities and recommended the addition of treatment capacity and other improvements to address issues of filter capacity and the shortfall in chlorine contact time at the existing West WTF. If these deficiencies were not addressed, it was Illinois EPA's opinion that the overall rated capacity of the West WTF would be limited to 13.75 MGD (down from 30 MGD).

Mr. Suits stated that through discussions and correspondence with the Illinois EPA, it was determined that the Company could resolve Illinois EPA's concerns if new water treatment facilities were constructed and then changes were made to the existing West WTF to address disinfectant contact time and to limit existing capacity. Because of difficulties in adding new facilities to the West WTF site, the Company proposed to satisfy the Illinois EPA's concerns by making improvements to and reducing the capacity at the West WTF and by building the new Champaign Facility.

Mr. Suits further stated that under the proposed solution, some original treatment facilities will likely be taken out of service at the West WTF to comply with the Illinois EPA requirements for disinfectant contact time. Mr. Suits indicated that the resulting removal of these facilities and additional work to meet the requirements of the Illinois EPA are expected to reduce the current rated capacity of 30 MGD for the West WTF to 13.75 MGD in 2009. This capacity would increase, with certain improvements, to 20.5 MGD in 2010. Mr. Suits explained that this would effectively reduce the existing treatment capacity for the entire Champaign District (without the new plant) to 24.75 MGD in 2009 and to 31.5 MGD in 2010. Because the 95% confidence level maximum demand is projected at 40.5 MGD in 2009, the new Champaign Facility must be constructed prior to the removal of the West WTF facilities from service, with sufficient capacity (as discussed below), to make up for this reduced rating.

Mr. Suits testified that the Company determined that an increase in overall treatment capacity to 48.7 MGD would allow the Champaign District to meet the projected 95% confidence level of maximum day demands to 2023, or approximately 15 years following the in service date of the facility. Mr. Suits indicated that a span of 10 to 20 years is considered to be a reasonable period for planning a water supply system, including the capacity of the water treatment facility. However, a span of 15 years is generally agreed upon as an acceptable planning period for an immediate system design and construction. Mr. Suits explained that construction of the new 15 MGD facility to be in-service in December, 2008 (and the later completion of modifications to the West WTF to be in-service in 2010) is the most cost-effective options for meeting future maximum day demands through 2023 plus recover the capacity loss that the existing West WTF would experience in order to meet the requirements by the Illinois EPA. According to Mr. Suits, with the construction of a new 15 MGD treatment facility, the net increase of treatment capacity for the system in 2010 will be 5.5 MGD (15 MGD initial facility capacity minus the 9.5 MGD reduction at the existing West WTF). System capacity will be further increased to 48.7 MGD following additional improvements at the West WTF in 2019. Mr. Suits also stated that the plant is designed to accommodate expansion to 20 MGD, which expansion is expected to occur in 2023 under current Company projections.

Mr. Suits further testified that the Champaign Facility will also require a new source of supply. The existing two treatment facilities in the Champaign District are supplied by groundwater wells predominately within the Mahomet Aquifer, which is the primary source of supply for much of this part of Central Illinois. The overall capacity of the existing 21 wells is 38.5 MGD, with a reliable capacity of 35.0 MGD. Thus, new supply would be needed to provide sufficient water to supply the Champaign District at a 46.5 MGD capacity following the 2010 improvements. The Company concluded that it should develop a new well field west of Champaign to meet expected increase in demand.

Mr. Suits explained that the Company evaluated the possible locations and impacts of a new well field. Wittman Hydro Planning Associates of Bloomington, Indiana ("Wittman Hydro") conducted a Source of Supply Investigation ("Supply Investigation") dated November 27, 2006 at the request of the Company to assist with the planning of the new treatment facility. The Supply Investigation evaluated the sustainable yield of the Mahomet Aquifer and considered the long-term impacts of a new well field located several miles west of Champaign, and concluded that the proposed new well field could provide a sustainable supply at IAWC's planned future pumping rate. The Supply Investigation also concluded that a redistribution of current pumping withdrawals in the Champaign area would benefit the Mahomet Aquifer.

The Company also considered alternatives for a new source of supply. However, Mr. Suits explained that it was determined that a new well field represented the best option for a new source of supply. Champaign County is situated on the divide between the Ohio and Mississippi Rivers and is at the head of four (4) major river watersheds that contribute to the Ohio and Mississippi Rivers. As a result, surface waters are scarce. In the Wittman Hydro Supply Investigation, several well field locations were reviewed with the input of the Illinois State Water Survey. The Company determined that an area north of Bondville and Seymour would provide additional capacity with the least impact on existing pumping. The Supply Investigation also reviewed seven possible well field configurations and provided a suggested well field development strategy to lessen the impact on the Mahomet Aquifer.

Mr. Suits described the Champaign Facility and new well field as consisting of the following facilities:

New Wells: Seven (7) wells will provide groundwater to the new water treatment plant. These include six (6) new wells to be constructed and an existing well that will be redrilled.

Raw Water Transmission Piping: Approximately 24,000 feet of raw water transmission mains generally sized between 16 and 24 inch diameter will be installed to connect the new well discharges to the proposed treatment facility.

New Lime Softening Treatment Facility: The new 15 MGD treatment facility is proposed to be constructed on a 40-acre site in Scott Township between the City of Champaign and Village of Bondville. The site is currently owned by the Company. Raw water will be treated using the split treatment excess lime softening process, which is the process currently used at the two existing treatment facilities in the Champaign District. This process is exceptionally suited for treating groundwater of the quality found locally in the Mahomet aquifer, which contains high amounts of calcium and magnesium hardness. High service pumping units will deliver treated water to the distribution system. The facilities will be laid out such that expansion of the process to 20 MGD in the future is easily accommodated without the construction of an additional facility. The facility will include backup power capabilities and will have modern electronic instrumentation and controls systems installed to allow IAWC staff to monitor the facility from any of the other facilities in the Champaign District.

Finished water transmission piping: Approximately 2 miles of at least 30-inch diameter finished water transmission piping will be installed along public right-of-way to connect the new treatment facility to the existing distribution system.

Residuals Handling: Treatment residuals from the primary and secondary treatment units will be directed to on-site lagoons; backwash waste from the filters will be directed to a backwash holding tank. Lagoon decant and backwash waste will be recycled to the head of the facility. Treatment residuals will be removed periodically from the lagoons and will be land-applied similarly to the residuals produced at Champaign District's other treatment facilities.

Mr. Suits explained that the proposed new well field would have to be located a sufficient distance away from the existing well field to avoid interference between the two sources of supply. In addition, the Champaign District is situated on the edge of the buried bedrock valley that forms the southern boundary of the Mahomet Aquifer, and the thickness of the Mahomet Aquifer declines to the north and east of the West Well Field. Therefore, Mr. Suits stated the proposed well field has been located to the west/southwest of the West Well Field to access a deeper and thicker portion of the aquifer.

Mr. Suits testified that IAWC selected the site for the Champaign Facility based on hydrogeological aspects of the area and the Company's desire for the Champaign Facility to be located in close proximity to the well field source of supply. As discussed above, the Wittman Hydro Supply Investigation determined the best location of a new well site that would limit impact on existing landowners and communities and ensure that the well field would be viable into the future. The determination of an area that would support additional wells for the community was used to establish a search area in which to site the new treatment facility. The Company wanted to be in close proximity of the well field to increase operational efficiencies of the facility and increase the reliability of the raw water transmission mains. In addition, the close proximity of the treatment facilities to the wells offers the ability to monitor the well sites more effectively and to respond to the sites if security/operational issues arise. Mr. Suits also discussed additional considerations that were used to determine the siting of the facility, such as proximity of natural drainage way to allow for storm water management and redundant discharge from lagoons, hydraulic fit with the existing treatment facilities and ability to support the future growth areas, safety and limited impact from neighboring industrial activities to reduce the potential contamination of raw water and finished water, availability of future expansion, and availability of a parcel of land.

IAWC's existing certificate for Champaign, issued by the Commission in Docket 99-0418 states: "IT IS HEREBY CERTIFIED that the public convenience and necessity require the construction, operation and maintenance by Illinois-American Water Company of a public water supply and distribution system in or about the municipalities of Champaign, Urbana, Savoy, Bondville, Philo and Tolono, and the transaction of a public utility business in connection therewith." The Commission has determined that a water utility need not obtain a separate construction Certificate to build facilities, including water treatment plants, within an area for which the utility already has a Certificate authorizing it to provide service. Because IAWC is authorized to provide service "in and about" Champaign, Urbana, Savoy, Bondville, Philo and Tolono, Mr. Suits stated that a separate construction Certificate is not required for the new facilities.

As an alternative to building a new treatment facility, IAWC considered expanding the treatment capacity at the two existing facilities. This alternative was not pursued due to the inability of the existing facilities' sites to accommodate the amount of required treatment expansion. Further, initial analysis indicated the necessary expansion would have required extensive improvements to both source of supply transmission mains and finished water transmission mains that are located in highly developed and congested areas as discussed in the 1998 Study. Each of the two existing facilities are surrounded by developed areas owned by others and do not have any significant amount of vacant land owned by the Company, reducing the ability to expand either of the existing treatment facilities and residuals handling facilities at those sites. Existing site conditions at each facility reduce the amount of expandable space available and anticipated improvements at the existing West WTF to address Illinois EPA concerns for the lack of sufficient disinfectant contact time will further reduce the ability to add additional capacity.

Moreover, Mr. Suits explained that the source of supply for each existing facility would have to be increased to support additional treatment capacity. Each location would have required the supply of additional wells and raw water transmission piping due to the at-capacity status of the current transmission piping. In addition, hydrological analysis (in the Wittman Hydro Supply Investigation) of the existing West Well Field recommended that a redistribution of the current rates of pumping in that area of the Mahomet Aquifer would allow the water levels during pumping drawdown to be reduced and improve the sustainability of the existing wells and reduce the overall impact to the aquifer. Based on this recommendation, a new well field would be required to be developed further away from the existing facilities, requiring extended lengths of raw water transmission mains that would have required construction in established residential areas.

Mr. Suits further explained that analysis of expanding the capacity at the existing facilities indicated that additional finished water transmission mains would have been required due to the head conditions in the existing transmission mains. As would be the case for the raw water transmission mains, these finished water transmission mains would have to be installed in established residential areas, reducing the available alignments for construction and adding to costs. Based on the these difficulties, the Company determined that a new facility, closer to the proposed new well field and with access to the rapidly developing areas to the west of Champaign was the most viable solution to meet the increasing demands of the system.

III. POSITION OF STAFF

Staff witness Ms. Rochelle Phipps testified that she did not object to IAWC's proposal to incur up to $28,500,000 of new indebtedness, provided IAWC will issue new indebtedness only to the extent such indebtedness does not reduce IAWC's equity ratio to less than 40% of its total capitalization.

Ms. Phipps testified that the Company indicated a portion of the proceeds from the New Indebtedness would be used for “other corporate purposes,” which the Company defined as the temporary investment of borrowed funds pending use for purposes stated previously; repayment of principal, interest and debt expense on indebtedness; and costs and expenses related to the design, study, planning, engineering, architect, legal, insurance and surety, materials and supplies, permit and other fees in connection with the Champaign Facility.

Ms. Phipps testified that IAWC currently has access to the capital markets on reasonable terms. She also testified that, in her judgment, IAWC's proposed financing program will not limit its ability to access the capital markets on reasonable terms because under the Company's proposed financing program, AWW will provide IAWC equity infusions as the Company's debt balance increases.,That would allow IAWC to maintain an equity-to-capital ratio of between 40% and 50%, as required by the Commission's Order in Docket No. 06-0336.

Ms. Phipps testified that using the Company's June 30, 2007, financial statements, she calculated IAWC's current financial metrics and compared those to pro forma metrics that assume IAWC issues debt and equity totaling $51 million and utilizes the remaining $94 million of refinancing authority granted by a prior Commission Order. She compared the Company's current and pro forma financial metrics to target ranges that S&P uses in its analysis of investor-owned utilities. The target ratios measure financial risk and vary according to business profile score. From this comparison, Ms. Phipps concluded that the proposed financing program would not materially weaken IAWC's financial metrics. Thus, she did not object to IAWC's proposal to incur up to $28,500,000, of new indebtedness, provided that immediately following each debt issuance, equity infusions from IAWC's parent company will be sufficient to maintain an equity ratio of at least 40%.

Furthermore, Ms. Phipps did not object to IAWC's proposal to issue long-term indebtedness through its affiliate AWCC, provided such issuance will result in a lower overall cost to IAWC than would an independent debt issuance by IAWC for securities of comparable type, maturity and terms.

Ms. Phipps recommended that, should the Commission authorize the proposed New Indebtedness, IAWC should be required to file with the Commission's Chief Clerk quarterly reports in accordance with Part 240, which should specify that they are filed in connection with Docket No. 07-0371.

Ms. Phipps recommended further that (1) IAWC should also be required to report the actual interest rates for any new indebtedness authorized in the instant docket; and (2) in the event that IAWC elects to issue indebtedness through AWCC, the Company should provide a comparison of the costs to issue indebtedness through AWCC (including interest) and the costs the Company estimated it would have incurred to issue indebtedness directly to investors in either the reports it will file pursuant to Part 240 or in a separate filing.

Ms. Phipps also recommended the Commission limit IAWC's authority to issue new indebtedness to a date two years from the date the Commission issues its Order in the instant proceeding. Ms. Phipps testified that a two year window in which to issue new indebtedness is appropriate because it mirrors the United States Securities and Exchange Commission requirements that certain registered securities must be issued no later than two years from the registration date. Moreover, she stated that two years would still provide IAWC sufficient flexibility to respond to favorable capital market conditions when they arise and to finance the Champaign Facility capital expenditures in an efficient and cost-effective manner.

Ms. Phipps agreed with the Company's calculation of a $68,400 financing fee for the New Indebtedness pursuant to Section 6-108 of the Act.

With regard to the Champaign Facility, Staff witness Mr. Bill Atwood summarized IAWC's plans with respect to expanding its source of raw water supply and its water treatment capacity in Champaign and IAWC position that the current 40 MGD rated capacity of its existing water treatment plants will soon be insufficient to meet the increased demand that will arise due to future growth in the Champaign District.

Mr. Atwood testified that, based upon his review of the evidence contained in the Company's testimony and associated exhibits that document the conditions and capacities of the Company's existing water facilities, as well as that supporting the forecasted future growth of water demand, IAWC is reasonably required to expand its water supply source and water treatment plant capacity. Mr. Atwood indicated that the extent to which the new water facilities are to be included in rate base will be addressed by Staff in IAWC's recently filed rate case, Docket No. 07-0507 and that his conclusions are therefore only intended to be applied in the instant proceeding.

Mr. Atwood testified that the Company is not seeking a Certificate of Public Convenience and Necessity for construction of the proposed Champaign water facilities. Mr. Atwood agreed that a Certificate is not required for the construction of the proposed water plant facilities (the water supply wells, raw water mains and water treatment plant) because their purpose is to provide water to the previously certificated service area of its Champaign District. He stated that this is consistent with his understanding of the approach the Water Department has taken in previous cases involving water public utilities. Mr. Atwood noted, however, that the Company also intends to serve customers that are adjacent to the finished water main, thereby creating a new service area, which he stated is outside its Champaign District certificated service area as depicted on maps currently held by the Commission. Mr. Atwood noted that the Water Department's policy has been to require water utilities to file for a Certificate when it desires to serve customers outside the currently defined certificated service area.

Mr. Atwood testified that the Commission should require the Company to file for a Certificate on this, or on any other occasion when it intends to provide service to customers outside of areas which are clearly defined in Certificates it already holds, and proposed that the Commission require IAWC to file for a Certificate before it can provide service along the proposed new, two-mile finished water main.

IV. COMPANY RESPONSE

In response to Ms. Phipps testimony, Mr. Hoffman testified that the Company is committed to maintaining an equity ratio within the range of 40% to 50%. He noted that, in Docket No. 06-0336, the Company agreed to a stipulation which states that for three years following the date of the final order in that case, it will maintain its equity-to-capital ratio between 40% and 50%. The Company has no intention of violating that commitment.

Mr. Hoffman explained that an additional factor will help IAWC maintain an equity-to-capital ratio of between 40% and 50%. The planned equity infusions totaling $22,500,000 (in the form of additional paid-in-capital), when combined with the Company's planned indebtedness, will result in "negligible changes" to the Company's equity ratio. He noted that while $22,500,000 is the amount of paid-in-capital expected to finance the Champaign Facility, the Company's business plan currently includes a total paid-in-capital addition of $30,000,000 in December 2007. The actual timing of this infusion could vary slightly. Mr. Hoffman emphasized that since paid-in-capital equity infusions from AWW do not require Commission approval, this additional $7,500,000 could be added to IAWC's capitalization if needed to keep the equity ratio above 40%. In any event, the proposed Financing Program, along with any additional paid-in-capital infusions, will be managed in a manner consistent with the Company's present objective of maintaining its common equity ratio within a target range of approximately 43% to 48%.

The Company agreed with Ms. Phipps' recommendation that the Commission limit the Company's authorization to issue the new indebtedness addressed in this case to a date two years from the date the Order is entered. Mr. Hoffman also agreed that the Company accepts its obligation to file quarterly financing reports pursuant to Part 240.

For the purpose of resolution of this particular case, the Company accepted Ms. Phipps' recommendation that "in the event that IAWC elects to issue indebtedness through AWCC, the Company should provide a comparison of the costs to issue indebtedness through AWCC (including interest) and the costs the Company estimated it would incur to issue indebtedness directly to investors." In the event that the Company issues debt through AWCC, the Company stated it would provide to the Commission an analysis that compares all the issuance costs and interest rates for the new indebtedness issued through AWCC with estimates of the issuance costs and interest rates that the Company might have incurred had IAWC issued unsecured indebtedness directly to investors. Mr. Hoffman noted that if the Commission orders the Company to provide the cost comparison recommended by Ms. Phipps, the Company will include this comparison with its Part 240 report.

Mr. Hoffman also testified that the Company typically provides the interest rate associated with new security issuances in its Part 240 reports to the Commission and agreed to do so for the new indebtedness authorized by Commission Order in this docket.

With regard to the Champaign Facility, Mr. Suits testified that he agreed with Staff witness Atwood's conclusion that IAWC is reasonably required to expand its source of water supply and water treatment plant capacity in Champaign.

Mr. Suits also stated that he agreed with Mr. Atwood's conclusion that "a Certificate is not required for the construction of the proposed water plant facilities (the water supply wells, raw water mains and water treatment plant)" in the Champaign District. Mr. Suits indicated, however, that he did not agree with his conclusion that IAWC is required to seek an additional Certificate to serve customers in areas not shown on the maps presently submitted to the Commission. Mr. Suits stated that it is IAWC's opinion that its present Certificate covers certain areas not now shown on the submitted maps. Mr. Suits pointed out that, as explained in his Direct Testimony, IAWC is authorized to construct, operate and maintain "a public water supply and distribution system in or about the municipalities of Champaign, Urbana, Savoy, Bondville, Philo and Tolono", pursuant to an existing Commission Order in Docket No. 99-0418. For purposes of resolving the issue, however, Mr. Suits testified that IAWC would accept Mr. Atwood's proposal that IAWC seek a new Certificate when it proposes to serve customers outside of the areas shown on maps presently submitted to the Commission, including customers along the route of the proposed new finished water main.

To implement Mr. Atwood's recommendation regarding the filing for a Certificate to provide water service to customers outside of areas shown on the presently submitted maps, Mr. Suits testified that the Company proposes that it be required, within six months of a final Order in this proceeding, to file for an additional Certificate that will reflect proposed water service along the finished water transmission line, as well as reflect areas where projects are planned or underway outside the boundaries of IAWC's service areas as identified on the map of the Champaign District service area provided to the Commission in March 2007. The requested additional Certificate will define the areas involved with a legal description and will be shown on a revised map submitted to the Commission under Section 600.140(d). Mr. Suits added that the Company will also file for additional Certificates in the future when the service area expands beyond the areas delineated on the present maps. The additional service areas covered by those Certificates also would be shown on revised maps submitted to the Commission under Section 600.140(d).

V. Commission Conclusion

Based on the evidence, the Commission finds that the financing proposal set forth in IAWC's Petition, to incur indebtedness in an amount not to exceed $28,500,000 of New Indebtedness, is reasonable and should be approved. The conclusion that this additional indebtedness is reasonable is based, in part, on the representation by the Company that it can maintain a minimum equity ratio of 40% by obtaining additional equity capital from time to time through additional paid-in-capital contributions by its parent (without the need to issue additional shares of its Common Stock), and that such paid-in-capital contributions do not require prior Commission approval. The Company has agreed that the Commission limit the Company's authorization to issue the New Indebtedness to a date two years from the date the Order is entered and that it will file quarterly financing reports pursuant to 83 Ill. Adm. Code 240. In the event that the Company issues debt through AWCC, the Company stated it would provide to the Commission, with its Part 240 report, an analysis that compares all the issuance costs and interest rates for the new indebtedness issued through AWCC with estimates of the issuance costs and interest rates that the Company might have incurred had IAWC issued unsecured indebtedness directly to investors. The Commission finds this reasonable.

The Commission also finds that IAWC is reasonably required to expand its water supply source and water treatment plant capacity and that it is appropriate to apply the proceeds of the New Indebtedness for this purpose. The Commission notes that the extent to which the new water facilities are to be included in rate base will be addressed in IAWC's recently filed rate case, Docket No. 07-0507. The Commission further finds that, as IAWC and Staff agree, a Certificate is not required for the construction of the proposed water plant facilities (the water supply wells, raw water mains and water treatment plant) in the Champaign District. IAWC has, however, accepted Staff's proposal that IAWC seek a new Certificate when it proposes to serve customers outside of the areas shown on maps presently submitted to the Commission, including customers along the route of the proposed new finished water main. The Commission finds that the Company's proposal that it be required, within six months of a final Order in this proceeding, to file for an additional Certificate that will reflect proposed water service along the finished water transmission line, as well as reflect areas where customers are being served or projects are planned or underway outside the boundaries of IAWC's service areas as identified on the map of the Champaign District service area provided to the Commission in March 2007, is reasonable and should be approved.

VI. Finding and Ordering Paragraphs

The Commission, having considered the entire record and being fully advised in the premises, is of the opinion and finds that:

(1) Illinois-American Water Company is a corporation that furnishes water and/or sewer utility service to the public in Illinois and, as such, is a public utility within the meaning of the Act;

(2) the Commission has jurisdiction over the Company and the subject matter of this proceeding;

(3) the recitals of fact set forth in the prefatory portion of this Order and conclusions reached in the Commission Conclusion section (Section V) are supported by the record and are hereby adopted as findings of fact;

(4) IAWC's proposal to incur New Indebtedness through the issuance, sale and delivery by the Company on or prior to the date which is two years following the date of this Order of Notes, Taxable Bonds, Tax-Exempt Bonds or Revolving Fund Loans not to exceed $28,500,000 in aggregate principal amount is reasonable and should be approved;

(5) the execution, delivery and performance by the Company of one or more of the following instruments, (i) Notes; (ii) Taxable Bonds and Supplemental Indentures; (iii) obligations in respect of Tax-Exempt Bonds; (iv) Revolving Fund Documents and any required security documents; (v) Insurance Agreements; and (vi) such other documents as may be necessary for the incurrence of the New Indebtedness, should be authorized;

(6) IAWC is reasonably required to expand its water supply source and water treatment plant capacity in the Champaign District and application of the net proceeds from the indebtedness to the purposes set forth herein, including construction of the Champaign Facility, is reasonable and should be approved;

(7) the Company should file quarterly financing reports pursuant to 83 Ill. Adm. Code 240, and its Part 240 reporting shall include (i) the actual interest rates for any debt issued as a result of authorization granted in this proceeding; and (ii) a comparison of the issuance costs and interest rates for the New Indebtedness issued through AWCC with estimates of the issuance costs and interest rates that the Company might have incurred had IAWC issued unsecured indebtedness directly to investors;

(8) the Company should, within six months of a final Order in this proceeding, file for an additional Certificate that will reflect proposed water service along the finished water transmission line, as well as reflect areas where customers are being served or projects are planned or underway outside the boundaries of IAWC's service areas as identified on the map of the Champaign District service area provided to the Commission in March 2007;

(9) in accordance with Section 6-101 of the Act, the Company should, before issuance and sale of any of the New Indebtedness described herein, cause the following to be placed on the face of such securities:

(A) For the Notes: Ill. C.C. No. ____;

(B) For the Taxable Bonds: Ill. C.C. No. ____;

(C) For the Tax-Exempt Bonds: Ill. C.C. No. ____;

(D) For the Revolving Fund Loans: Ill. C.C. No. ____.

(10) the Company should pay a fee in the amount of $68,400 in accordance with Section 6-108 of the Act, and this fee should be paid no later than 30 days after service of the Commission Order;

IT IS THEREFORE ORDERED that Illinois-American Water Company's proposal to incur indebtedness, in an amount not to exceed $28,500,000, for the purposes outlined herein, through the issuance, sale and delivery by the Company on or prior to the date which is two years following the date of this Order of Notes, Taxable Bonds, Tax-Exempt Bonds and/or Revolving Fund is approved.

IT IS FURTHER ORDERED that the execution, delivery and performance by the Company of one or more of the following instruments, (i) Notes; (ii) Taxable Bonds and Supplemental Indentures; (iii) obligations in respect of Tax-Exempt Bonds; (iv) Revolving Fund Documents and any required security documents; (v) Insurance Agreements; and (vi) such other documents as may be necessary for the incurrence of the New Indebtedness is approved;

IT IS FURTHER ORDERED that the pledge of or granting of a security interest in any property of the Company in connection with the issuances is approved;

IT IS FURTHER ORDERED that the payment and amortization by the Company of certain expenses in connection with the indebtedness set forth herein is approved;

IT IS FURTHER ORDERED that Illinois-American Water Company shall comply with findings (7) through (10) of this Order; and

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By order of the Commission this __th day of December, 2007