

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

ILLINOIS COMMERCE COMMISSION,	)	
	)	
On Its Own Motion,	)	
	)	
v.	)	<b>ICC Doc. No. 00-0340</b>
	)	
ILLINOIS-AMERICAN WATER COMPANY,	)	
	)	
Proposed general increase in water rates.	)	

**O’FALLON’S REPLY TO THE OTHER  
BRIEFS ON EXCEPTIONS FILED BY OTHER PARTIES**

I. REPLY TO ILLINOIS-AMERICAN WATER COMPANY BRIEF ON EXCEPTIONS, PAGE 2.

The Illinois-American Water Company (the “Company” or “IAWC”) mistakenly believes that it matters who produced witnesses and direct testimony and who did not. The Company begins its brief on exceptions by remarking that only one of the intervenors, the Illinois Industrial Water Consumers (“IIWC”), has presented direct testimony related to the rate of return on common equity and the rate design, and that none presented direct testimony as to any other relevant matter. (IAWC Br. on Except., p. 2.) The correctness or erroneoususness of the hearing examiner’s proposed order (“HEPO”) is determined by the record no matter how made.

Intervenors are purely responsive parties. The burden of proof rests entirely on the rate applicant. 220 ILCS 5/9-201(e); *People ex rel. Hartigan v. Illinois Commerce Comm’n*, 117 Ill.2d 120, 510 N.E.2d 865, 871 (1987); *Central Ill. Pub. Serv. Co. v. Illinois Commerce Comm’n*, 5 Ill.2d 195, 125 N.E.2d 269, 277 (1955); *Citizens Utility Bd. v. O’Connor*, 121 Ill. App. 3d 533, 459 N.E.2d 682, 688 (1984). There is no need to introduce evidence in order to shine a light on the

weaknesses and holes in another party's case, and to point out the incompetency and/or irrelevance of another party's evidence.

Furthermore, evidence comes into the record not only through direct testimony, but also through cross-examination. For instance, material testimony was presented by O'Fallon's cross-examination of witnesses during the hearing (*e.g.*, Tr. 10/26/00, pp. 84-9, 103-11; 10/30/00, pp. 159-79; 274-84). And, as the conduct of the Company itself establishes, important evidence can also be introduced by intervenors and others through administrative notice (*e.g.*, IAWC Br. on Except., p. 20n.\*), and admissions made by the adverse party in argument (*e.g.*, IAWC Reply Br., p. 42).

II. REPLY TO ILLINOIS-AMERICAN WATER COMPANY BRIEF ON EXCEPTIONS, PAGES 10-15.

The Company's approach to its rate of return on common equity exception (IAWC Br. on Except., pp. 3, 7-15) treats a previous rate order as establishing a rule or projecting some kind of *res judicata* or collateral estoppel effect. As stated by the Company in summary:

The Commission, in its March, 2000 Order in the *Consumers Illinois* case, approved Staff's adjusted DCF calculation. In so doing the Commission adopted a rate making policy that DCF values below the yield on A-rated public utility bonds are not appropriate for calculating the DCF cost of equity for a company requesting rate relief.

(IAWC Br. on Except., p. 3.) This view is in error.

All the parties except the City of O'Fallon have fallen into this same error of exalting a prior factual determination as a rule. Indeed, in regard to single tariff pricing, the HEPO is founded on this error and consequently ignores the need for evidentiary proof establishing the fairness, reasonableness and non-discrimination of single tariff pricing within the confines of this present rate application and in the current circumstances of the Company, its divisions and its districts.

Every rate case is an individual proceeding and the Commission's Order in all its respects must be supported by substantial evidence in the record of that particular proceeding. *Central Ill. Pub. Serv. Co. v. Illinois Commerce Comm'n*, 5 Ill.2d 195, 125 N.E.2d 269, 275 (1955); *Citizens Utility Bd. v. Illinois Commerce Comm'n*, 276 Ill. App. 3d 730, 658 N.E.2d 1194, 1201 (1995). In each rate proceeding, there is a burden of proof on each element that is part of the applicant's case. *Central Ill. Pub. Serv. Co. v. Illinois Commerce Comm'n*, 5 Ill.2d 195, 125 N.E.2d 269, 277 (1955); *Citizens Utility Bd. v. O'Connor*, 121 Ill. App. 3d 533, 459 N.E.2d 682, 688 (1984).

Expert testimony should be rooted in the facts as they apply to the particular rate applicant's circumstances. Issues, like single tariff pricing, are fact influenced, and as the facts regarding the extent and circumstances of the Company's business and territory change, they must be adjudged anew. Rate applications are not clones of one another or there would be no need for application and company specific consideration at all.

Additionally, regardless of the procedural similarity of the hearing process to a judicial proceeding, the rate decision of the Commission is a legislative determination. *People Gas Light & Coke Co. v. Slattery*, 373 Ill. 31, 25 N.E.2d 482, 490, 491, 495 (1940). The doctrines of *res judicata* and collateral estoppel do not pertain to legislative decisions. *United Cities Gas Co. v. Illinois Commerce Comm'n*, 163 Ill.2d 1, 643 N.E.2d 719, 729 (1994). Legislative bodies are free to change their determinations, as well as their policies, from one proposal and proceeding to another. *Lakehead Pipeline Co. v. Illinois Commerce Comm'n*, 296 Ill. App. 3d 942, 696 N.E.2d 345, 354 (1998).

The Company cites cases that the Commission needs a good reason to change long established policy (*e.g.*, IAWC Br. on Except., pp. 11-12; *GTE North Inc.*, Doc. No. 94-0041 ("Staff argues that

it has been the long standing policy of the Commission . . .”); *see* several docket numbers referred to, all in the nature of procedural policies). These cases, however, give no aid to the Company. A single decision, rendered less than one year ago, is hardly a long established policy. Indeed, weighing opinion evidence in the context of one, specific contested proceeding, does not constitute policy or the promulgation of hearing procedure. It is fact and case specific.

There must be individual justification by case specific evidence on the issue of single tariff pricing in any event. Even a determination that might be characterized as policy in one proceeding can have no application to a case arising out of changed factual circumstances. Simply making reference to one or another earlier proceeding does not in and of itself satisfy the Company’s burden of proof or excuse the requirement that the Commission’s decision be supported by substantial evidence in the individual record of the particular rate application being decided by the Commission.

III. REPLY TO ILLINOIS-AMERICAN WATER COMPANY’S BRIEF ON EXCEPTIONS, PAGES 5-35, AND TO BRIEF ON EXCEPTIONS RATE OF RETURN PORTION OF ILLINOIS INDUSTRIAL WATER CONSUMERS INCONSISTENT WITH THIS REPLY.

The bulk of the Company’s Brief on Exceptions is consumed by its argument to boost the allowed rate of return on common equity. This part of the Company’s Brief on Exceptions restates yet again the Company’s criticism of the opinions and methods of the other witnesses testifying on the rate of return to be allowed on common equity. Transparent throughout the Company’s argument is its attempt to skew the analysis to the high end of those general data sources referred to by all the witnesses. But, it should be common sense that, to the extent that these general data sources are competent and relevant at all, they should be considered for the message they convey as an entirety, not as picked over, manipulated and skewed bits.

The underlying error that opens the proceeding to such partisan attempts to manipulate data, and the strong criticisms of each of the other party's witnesses testifying on this subject is the effort to substitute dissimilar equities (*e.g.*, publicly-traded securities) for like equities (*e.g.*, private, closely-held securities, particularly when the securities form only one holding, conglomerated with many other holdings by a parent corporation). The law is unequivocal. The evidence on which the Commission must base its determination is evidence of comparable securities of comparable companies in comparable circumstances. *Illinois Central R.R. Co. v. Illinois Commerce Comm'n*, 359 Ill. 563, 195 N.E. 32, 33 (1935); *Atchison T. & S.F. Ry. Co. v. Commerce Comm'n ex rel. Illinois Coal Traffic Bureau*, 335 Ill. 624, 167 N.E. 831, 835, 836 (1929). Not one witness on the issue of the proper rate of return on the Company's common equity used a comparable security (as admitted in the testimony (*e.g.*, IAWC., Ex. 7.0, p.3)) nor attempted to evidence the comparability of those companies whose stock was being referenced to the Company that is the subject of this proceeding.

Evidence that is not limited to comparable securities of comparable companies is neither competent nor relevant. *Atchison T. & S.F. Ry. Co. v. Commerce Comm'n ex rel. Illinois Coal Traffic Bureau*, 335 Ill. 624, 167 N.E. 831, 838 (1929); *Alton & So. R.R. Co. v. Illinois Commerce Comm'n ex rel. Perry Coal Co.*, 316 Ill. 625, 147 N.E. 417, 419 (1925). Because the Company bears the burden of proof in this proceeding (*supra*, p. 1), its failure to introduce competent and relevant evidence on the appropriate rate of return on the Company's particular common equity should result in the cancellation of the new, increased rate and the dismissal of the Company's rate application. The result of this proceeding should be to leave the Company where it was before the pending rate application. Should the Commission, however, insist on going forward despite the lack of competent,

relevant evidence, it should at least recognize that the disagreements on fundamental issues (such as which utility industries or companies should have their stocks included and averaged) (*e.g.*, IAWC, Ex. 7.0, pp. 3, 23; ICC Ex. 3.0, p. 10; IIWC, Ex. 1.0, p. 14) is a result of the witnesses breaking loose from the discipline and limits imposed by actual comparability. Each witness disagrees from the others on how to distill a comparable result from non-comparable sources. The simple answer, demonstrated by their differences, is that an actual or reliable comparability cannot be achieved by reference to non-comparable, publicly-traded stocks and companies. One cannot learn the life requirements of moths by studying butterflies. One cannot learn the dynamics of tribal based societies in New Guinea or the Amazon by studying western nation-based societies. And, there has been no proof that one can know the requirements of a private, closely-held common equity (particularly one held by a parent that holds the common equities of many other like companies as well) from individual companies that are publicly traded.

The height of the absurdity that subjectivity reaches in the attempt to manufacture comparability is the Company's contention that it, as a water company, should be allowed a rate of return that can be justified only "if Staff's comparable sample were adjusted, *and its water utility sample eliminated*" (IAWC, p. 32 (emphasis added)).

Only water companies are comparable to water companies. And, even then there is not comparability unless the company's territory, customers, sources, competitive pressures, *etc.*, are shown to be closely similar and its common equity is private and closely-held. Even publicly-traded water companies do not have a high rate of return on equity (*e.g.*, 6.96%, 7.22%, 7.69% (IAWC Br. on Except., p. 3) and the return to be gained from the acquisition of E-town was found to be attractive even after paying a 36% premium over its immediately prior stock price (IAWC Br. on

Except., p. 28)). The HEPO, by allowing the Company a 10.20% cost of common equity, has exceeded whatever publicly traded water companies actually need by a very wide margin. Not only is a rate of return of 10.20% not supported by the actual experience of publicly-traded water companies, but also it greatly exceeds the actual experience of the Company in particular. The Company has conclusively admitted in these proceedings that despite its allowed rate of return on common equity of 9.05% for its previous test year, in its Southern Division (the largest water service territory in the entire state save that of the City of Chicago) and in its Pontiac District, it could not realize this high a return. It could obtain only a rate of return of 7.05%. (IAWC Reply Br., p. 42.) Not only does a regulatory agency make itself look ridiculous when it provides a rate of return far above that which the company is limited to by the marketplace, (and has even continued to thrive and expand on), but it also acts contrary to the intention of the law. *State Pub. Utilities Comm'n v. Springfield Gas & Elec. Co.*, 291 Ill.209, 125 N.E. 891, 896 (1920) (“The real test of the justice and reasonableness of any rate seems to be that it *should be as low as possible*, and yet sufficient to induce the investment of capital in the business and its continuance therein” (emphasis added)). In the current proceeding, there is absolutely no call for this Commission to set an allowable rate of return above that which the Company has actually been able to obtain in the marketplace.

Ultimately, what rate is reasonable for the Company must be decided on the Company’s own individual facts. *State Pub. Utilities Comm'n v. Springfield Gas & Elec. Co.*, 291 Ill. 209, 125 N.E. 891, 901 (1920) (“There is no particular rate of compensation which must in all cases and in all parts of the country be regarded as sufficient for capital invested in business enterprises. Such compensation must depend greatly upon circumstances and locality”). The need to set a rate of return different from that set by the market only arises when the Company through abuse of

monopoly power would otherwise exceed a reasonable rate of return. *State Pub. Utilities Comm'n v. Springfield Gas & Elec. Co.*, 291 Ill. 209, 125 N.E. 891, 896 (1920) (“The necessity of public regulation of rates arises out of the monopoly of the public service company”). The Commission should not be setting a higher rate than the Company can obtain as the result of market forces.

The Company has competition. The actual rate this competition results in should be the rate allowed. *State Pub. Utilities Comm'n v. Springfield Gas & Elec. Co.*, 291 Ill. 209, 125 N.E. 891, 896 (1920) (“Fixing rates by public authority may. . . result in such a rate as might properly be supposed to result from free competition if free competition were possible”).

No customer should be required to pay more than the reasonable value of the service provided. *State Pub. Utilities Comm'n v. Springfield Gas & Elec. Co.*, 291 Ill. 209, 125 N.E. 891, 894 (1920). To allow a rate of return on common equity above that actually available under real world, competitive conditions would be to provide for a water rate above the value of the service provided, and in excess of that which is proper. The real rate of return on common equity actually obtained by the Company of 7.05% is above its actual embedded cost of debt of 6.96%. The rate paid on Treasury Bills at the time the testimony was determined to be 6.40% and on Treasury Bonds 5.81% (IAWC Br. on Except., p. 19). And, since that testimony was formulated, the economy has begun to head into a recession and the Fed has been dropping interest rates. *People Gas Light & Coke Co. v. Slattery*, 373 Ill. 31, 25 N.E.2d 482, 501 (1940) (“ . . . in view of present economic conditions, of which we take judicial notice”); *Island Lake Water Co. v. Illinois Commerce Comm'n*, 65 Ill. App. 3d 853, 382 N.E.2d 835, 839 (1978) (“[T]his court may take judicial notice of economic conditions”). In short, there is neither confiscation nor unreasonableness in allowing the Company to earn as a rate of return exactly what it has actually been earning as a rate of return.

IV. REPLY IN SUPPORT OF THE ILLINOIS-AMERICAN WATER COMPANY AND THE ILLINOIS INDUSTRIAL WATER CONSUMERS BRIEFS ON EXCEPTIONS IN THEIR ATTACK ON THE HEPO'S FAILURE TO ADOPT AN ACROSS-THE-BOARD RATE DESIGN.

O'Fallon has supported the Company's across-the-board rate design approach as against the Staff's design approach. O'Fallon continues to urge that the across-the-board approach be modified to reduce its real dollar impact on rate blocks 3 and 4. Nevertheless, the across-the-board approach by the Company does mitigate impacts on large volume customers more than the alternative proposed by Staff, which the preliminary HEPO has unwisely adopted.

The Company has the greatest interest and highest motivation to maintain its system and avoid defections, and the greatest familiarity with the competitive pressures to which it is subject. The Company has stated its concern regarding additional, future defections of customers. (IAWC Br. on Except., p. 3.)

The Illinois Industrial Water Consumers concur with the across-the-board approach in the Southern Division/Peoria District. (IIWC Br. on Except., pp. 4-5.) The City of O'Fallon (including the Village of Caseyville), as wholesale-for-resale customers also concur with the across-the-board approach (although preferably with some reduction in rate blocks 3 and 4). These users know the attraction of lower cost competing water sources.

Only the Staff, who stands grandly aloof from the business pressures of operating the Company's system, disagrees with the across-the-board approach.<sup>1</sup> The Staff keeps the larger water

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<sup>1</sup> The City of O'Fallon, however, welcomes the Staff's recommendation in its Brief on Exceptions to move more of the rate into customer charges and out of volumetric blocks. This is a move in the right direction, though hardly enough.

user blocks at a higher level increase.<sup>2</sup> While Staff risks no adverse business affects to itself, it dares the larger water users to leave the Company's system. The Staff thus gambles the interests of the smaller water users whose system costs are now contributed to by the larger water users.

The City of O'Fallon agrees with the points made by the IWC in its Brief on Exceptions addressing the across-the-board rate design aspect of the HEPO. (IWC Br. on Except., pp. 5-7.) Rather than repeat what is stated therein, the City of O'Fallon adopts and supports those points. The City of O'Fallon also agrees with the points made in regard to this aspect of the HEPO made by the Company, and consequently also adopts and supports the points made on pages 35-37 of the Company's Brief on Exceptions in regard to the across-the-board rate design. The across-the-board approach of the Company, whether modified as advocated by the City of O'Fallon or not, should be adopted as against the proposed rate design of Staff.

V. REPLY TO ILLINOIS INDUSTRIAL WATER CONSUMERS' BRIEF ON EXCEPTIONS REGARDING THE ALTON SOURCE OF SUPPLY CHARGE.

Although the City of O'Fallon does not waive the failure of substantial evidence in the record of this proceeding to support single tariff pricing in the Southern Division/Pontiac District, this issue is distinct from the Company's proposed Alton Source of Supply Charge. The Alton Source of Supply Charge although not dependent on single tariff pricing, is consistent with it. The record made in this proceeding clearly establishes that the theory of single tariff pricing is justified against charges of unfairness, unreasonableness and discrimination by its underlying concept of approximately equal reciprocity. And, as the Company's Brief on Exceptions makes clear, it is the Company's desire to

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<sup>2</sup> The Staff does this on the claim of cost of service. But, its stale allocation figures, drawn from an earlier, three-year old rate proceeding can neither be accepted as accurate nor appropriate. *United Cities Gas Co. v. Illinois Commerce Comm'n*, 163 Ill.2d 1, 643 N.E.2d 719, 731, 733 (1994).

stay within this justifying concept that has inspired, and animates, the Alton Source of Supply Charge.

As the Company states in its Brief on Exceptions:

The Company supports single-tariff pricing . . . .

However, as a result of the new treatment facility, the Company's net investment per customer in the Alton District exceeds its net investment per customer in the balance of the Southern Division/Peoria single-tariff pricing area by approximately \$1,800 (Company Exhibit SR-1, p. 3). As Mr. Stafford stated, "this differential supports the Company's concept of a 25 percent Alton Source of Supply Charge based upon the approximate additional revenue requirements arising from the differential in net investment per customer." (Company Exhibit SR-1, pp. 3-4).

\* \* \*

The proposed charge in no way mitigates against the single-tariff pricing concept, as Staff asserts.... Rather, it is consistent with single-tariff pricing.

The charge is premised upon comparative investment per customer within the single-tariff pricing group. It is an acknowledgment that the huge \$38 million investment in the Alton treatment facility would distort comparative investment in the absence of the proposed charge.

(IAWC Br. on Except., pp. 37-8.)

The Company makes the valid point that the Illinois Industrial Water Consumer's objection to the proposed Alton Source of Supply Charge, cited by Staff, makes absolutely no sense (IAWC Br. on Except., p. 38). Adoption of the charge would not adversely affect the Illinois Industrial Water Consumers. It would actually benefit them. Many, if not all, of the members of the Illinois Industrial Water Consumers are outside the Alton district (yet still within the single-tariff pricing territory).

It is also hard to fathom the objection of the Staff to the Alton Source of Supply Charge. If Staff actually believes in a cost-of-service approach to rate design to be consistent (which single-tariff pricing can only be justified on a reciprocity basis), then Staff should actually favor the Alton Source

of Supply Charge. To the extent that the cost of the Alton water treatment facility exceeds what experience shows can reasonably be expected to be repaid by reciprocity, the cost should be borne by those whose service has occasioned it. Adoption of the Alton Source of Supply Charge is actually consistent with the other contentions of the Staff, in spite of Staff's litigation position in opposition to it. The Company's Alton Source of Supply Charge proposal should be adopted in the final HEPO.

Respectfully submitted,

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