

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

<b>ILLINOIS-AMERICAN WATER COMPANY,</b>	)	
<b>CITIZENS UTILITIES COMPANY OF ILLINOIS</b>	)	
<b>and</b>	)	
<b>CITIZENS LAKE WATER COMPANY</b>	)	
	)	Docket No. 00-0476
<b>Petition For Approval Of Proposed Reorganization</b>	)	
<b>and Affiliated Interest Agreements, Issuance of</b>	)	
<b>Common Stock and Debt Securities and Assumption</b>	)	
<b>of Affiliated Interest Agreements.</b>	)	

**INITIAL BRIEF OF**  
**CITIZENS UTILITIES COMPANY OF ILLINOIS**

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## **INTRODUCTION AND POSITION OF CITIZENS UTILITIES COMPANY OF ILLINOIS**

The basic history, facts, and summary of issues presented by the Joint Application of Citizens Utilities Company of Illinois (“Citizens” or “CUCI”), Citizens Lake Water Company and Illinois-American Water Company (“Illinois-American” or “IAWC”) are set forth in the Initial Brief of Illinois-American and will not be repeated here. The purpose of this Brief is to explain how the testimony of Paul G. Townsley, Vice President, Citizens Water Resources, for Citizens Communications Company (“CUC”) supports the proposed acquisition of CUCI’s assets by Illinois-American and the necessary findings under Sections 7-204(b) and (c) of the Public Utilities Act (“PUA”),<sup>1</sup> 220 ILCS 5/7-204.

### **ARGUMENT**

**A. The Evidence Establishes That The Commission Should Approve Illinois-American’s Proposals Regarding The Allocation Of Costs And Savings Under Section 7-204(c).**

The water and wastewater industry is the most capital intensive of all regulated industries and forecasts for the future indicate that infrastructure replacement costs in these industries will approach \$1 trillion over the next 20 years. On a prospective basis, consumer and society demands for higher quality water and a clean environment are also leading to significantly more capital expense. What was acceptable ten or fifteen years ago is not acceptable today. Jt. App. Ex. 10 at lines 96-117.

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<sup>1</sup> Portions of the testimony of IAWC witnesses Kelleher and Gloriod also address similar issues, but that testimony will be addressed in IAWC’s Initial Brief.

The Safe Drinking Water Act and its subsequent amendments and interpretations have led to or will soon lead to new or more stringent standards in radon, arsenic, and disinfection by-products, among others. The U.S. EPA has recently promulgated a new standard requiring improved filtering operations, and the trend is for additional standards and requirements that can lead to the need for significantly more capital expense throughout the water industry. Similarly, the Clean Water Act impacts wastewater operations with new regulatory initiatives which may also require additional capital investments at significant levels. These include the implementation of new measurement techniques, more stringent effluent ammonia limits and a Total Maximum Daily Load (“TMDL”) process on an individual stream basis. Jt. App. Ex. 10 at lines 101-115.

Mr. Townsley explained that given these realities, it is becoming more difficult for medium-sized water/wastewater companies such as CUCI to keep up with the capital intensity of new regulations and requirements. Prospectively, there are demands for both greater expertise and greater capital infusion, which will make it more difficult for medium-sized companies to meet these demands without either causing rate shock because of the enormous amounts of capital needed and spread over a limited customer base or increased risk of regulatory non-compliance with the new standards. Jt. App. Ex. 10 at lines 126-135.

The need for ever greater amounts of capital and expertise dictate a fundamental change in the structure of the water/wastewater industry. The long-term providers of these services need to achieve optimum size to address the growing needs for capital and expertise, as well as to take advantage of all potential economies of scale. In other parts of the world, water utilities serve millions of customers, not just hundreds of thousands as proposed in this proceeding. Some consolidation has occurred in this country, as both the industry and regulators have recognized

that the increased environmental and health concerns can only be adequately addressed by larger entities. Unfortunately, however, the water/wastewater industry has lagged behind industries such as telecommunications and energy, where substantial economies of scale have been realized in combining the operations of multiple companies.<sup>2</sup> Jt. App. Ex. 10 at lines 80-92, 231-247.

It is with this background that CUC, the parent of CUCI, made the decision to focus all of its resources on expanding operations in the telecommunications industry and to exit other businesses, including water/wastewater operations. CUC faced the realities of today, where consolidation was occurring in all of the industries in which it operated, and realized that it would become increasingly more difficult to maintain expertise and competitiveness in four different industries in which it was a comparatively small player on a national scale. Jt. App. Ex. 10 at lines 138-143, 175-180. In this case, the Commission needs to recognize the same realities of increasing capital needs and cost pressures facing the water and wastewater industry, and approve a consolidation that will allow the creation of an Illinois-based company which is focused on the water and wastewater industry, and which also has adequate size, with sufficient resources, expertise, and access to capital to meet the challenges of the 21<sup>st</sup> century.

This case presents the Commission with the unique opportunity to approve under Section 7-204(c) exactly the kind of consolidation that will lead to the economies of scale and cost savings necessary to support the continued provision of quality water and wastewater service at

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<sup>2</sup> Staff witness King's testimony about consolidation of very small utilities (under 100 customers each) or even acquisitions involving water companies in the 1000 customer range (Staff Ex. 12.00 at pp. 3-6) simply does not address the relevant issue. If Illinois is to have a long-term, stable investor-owned water/wastewater utility community, whatever benefits and economies of scale may be achieved by the consolidation of much smaller entities pales in comparison to the true needs facing the industry for capital and expertise on a forward-looking basis. It is only transactions such as that proposed in this proceeding which can create entities with adequate efficiencies and economies of scale to meet those challenges.

reasonable prices to customers. Citizens respectfully submits that these considerations strongly support the adoption of cost and savings allocations methods which allow an opportunity to recover the costs associated with a reorganization which can produce significant cost savings. Illinois-American is the only party which has presented such a proposal, and it should be approved under Section 7-204(c).

Approving the Joint Applicants' proposals before the Commission in this case will also have two added benefits. First, it will create an entity with sufficient size, expertise and resources to regularly assist the Commission in resolving the problems which occur when small water or wastewater utilities are not able to provide quality service at reasonable prices.<sup>3</sup> Second, the proposed acquisition will provide CUCI's customers with numerous near term and long term service enhancements which are not presently available to them. Mr. Townsley's testimony that, without a doubt, American Water Works Company, Inc. ("AWW") is the finest quality water provider in the country and that Citizens customers can only be well served by approval of the sale to Illinois-American, stands uncontroverted. Jt. App. Ex. 10 at lines 36-39, 42-62, 235-237, 248-250. See e.g., IAWC Ex. 1.0 at pp. 9-12 (Gloriod); IAWC Ex. 5.0 at pp. 8-10 (Kelleher); IAWC Ex. 5.0R at pp. 3-11 (Kelleher).

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<sup>3</sup> Staff's apparent theory that the mere existence of statutes and rules requiring utilities to provide adequate, reliable, efficient, safe and least-cost public utility service is enough to meet the current and prospective needs of the water/wastewater industry (Staff Ex. 12.00 at p. 8; Staff Ex. 7.0 at pp. 20-21) is belied by Staff witness King's own admission that there have been many instances in which utilities have not met those standards. Tr. 725-730. Therefore, the existence of a large, financially stable entity which is willing to help the Commission solve these types of problems in the water/wastewater industry is a substantial benefit to the Commission and the residents of the State of Illinois.

**B. Mr. Townsley’s Testimony Supports the Required Findings Under Sections 7-204(b)(1) and 7-204(b)(7) of the PUA.**

In addition to addressing the ultimate conclusions which the Commission should reach under Section 7-204(c), Mr. Townsley’s testimony is directly relevant to the findings which the Commission should make under Sections 7-204(b)(1) and 7-204(b)(7). As explained above, Mr. Townsley’s testimony establishes a clear need for and trend towards consolidation in the water/wastewater industry, as well as the need for larger, industry-focused entities to address the capital and other operating needs facing the water/wastewater industry today and in the future. Specifically, adding CUCI’s operations and customers to the existing operations and customer base of Illinois-American will **enhance** and clearly “will not diminish” the combined operation’s “ability to provide adequate, reliable, efficient, safe and least-cost public utility service.” The ability of the larger entity to attract capital and operating expertise, as well as the ability to spread costs over a much larger customer base and to achieve significant economies of scale, would clearly contribute to enhancing the overall ability of Illinois-American to provide not just “adequate, reliable, efficient, safe and least-cost” service, but to provide better service than either CUCI or IAWC could provide on a stand-alone basis if both entities continued to operate independently of each other.

With regard to Section 7-204(b)(7), Mr. Townsley’s testimony also supports the conclusion that “the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.” In fact, the evidence in this case establishes that medium-sized companies like CUCI are facing higher capital and operating costs which they will be forced to spread over a limited customer base, if consolidations, such as proposed in this proceeding, are not approved by the Commission. In short, approving the proposed reorganization will help to **minimize** any

adverse rate impacts to retail customers flowing from the investments in plant and operations which will be required in the water/wastewater industry in Illinois on a going forward, long-term basis.

### **CONCLUSION**

For each of the foregoing reasons, Citizens respectfully requests the Commission to enter an Order at the earliest possible date which approves the proposed reorganization and grants the related approvals requested in the Amended Verified Application and explained in the testimony and exhibits of the Joint Applicants.

Respectfully Submitted,

**CITIZENS UTILITIES COMPANY OF ILLINOIS**

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