

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

ILLINOIS-AMERICAN WATER)
COMPANY)
) Docket No. 09-0319
Proposed general increase in water and)
sewer rates.)

**REPLY IN SUPPORT OF MOTION TO STRIKE
PORTIONS OF THE REBUTTAL TESTIMONY OF RALPH C. SMITH**

Illinois-American Water Company (“IAWC”) hereby replies to the People of the State of Illinois and the Joint Municipalities’ (“AG”) “Opposition To IAWC Motion To Strike Portions of Rebuttal Testimony of Ralph C. Smith” (the “Response”). As IAWC explained in its Motion to Strike (“Motion”), it seeks to strike the excerpts of the “Overland Report”¹ and related testimony and exhibits (the “California Materials”) sponsored by Mr. Smith.

I. INTRODUCTION

In rebuttal testimony filed on November 13, 2009, AG witness Ralph Smith stated the Overland Report had “recently come to my attention” (AG/JM Ex. 5.0, p. 52-53), although the Overland Report was prepared on September 11, 2008 and the California PUC order addressing its conclusions was issued July 10, 2009, prior to Mr. Smith’s direct testimony in this proceeding on October 2, 2009. Mr. Smith included selected excerpts of the Overland Report in his rebuttal testimony, to serve as a purported “reality check” on the Service Company Study proffered by IAWC. (Id. at 54.) His testimony, however, ignored the basic tenets of evidentiary admissibility: it laid no foundation to show his personal knowledge of the basis or accuracy of the report; it asserted as fact a series of out-of-court hearsay statements; and finally, it made no attempt to establish that the Overland Report was even relevant to this proceeding. Moreover,

¹ The Overland Report is a third-party report regarding certain California-American Water Company (“CAWC”) expenses, prepared by a third-party consultant on behalf of the California Division of Ratepayer Advocates (“DRA”) and submitted in a California Public Utilities Commission (“California PUC”) rate proceeding.

IAWC is denied its fundamental right to cross-examine the preparers of the report, since the preparers are not witnesses in this proceeding.

In response to IAWC's Motion to Strike Mr. Smith's references to this improper evidence, the AG tries to shore up Mr. Smith's testimony by providing *post hoc* foundation and relevance testimony *in its response brief*. The AG does not – and cannot – contest the fact that the Overland Report is hearsay. Instead, the AG tries to cast the Overland Report and its contents as a “public record” that is exempt from the hearsay rule (AG Resp. at 5), despite the fact that it was produced by a *private* consulting firm and not a “public office or agency.” Fed. R. Evid. 803(8). The Overland Report is an analysis performed by a private consulting firm, however, which contains conclusions and recommendations that IAWC cannot test through cross examination, and the Overland Report fails to meet the criteria of the “public record” exception.

The AG also asserts that the California Materials are appropriately admitted in this proceeding because they allegedly show how “another jurisdiction approached the issues raised by the rapid growth of affiliated company expenses.” (AG Resp. at. 7). Mr. Smith's testimony (and the AG's Response), however, fail to demonstrate any comparability between IAWC and CAWC that could support an argument that what happens in California has any relevance to Illinois. Additionally, since the preparers of the report are not available for cross-examination, IAWC is prevented from effectively demonstrating via cross-examination the precise reasons that the California Materials are irrelevant to the current proceeding.

Moreover, the AG has now taken contradictory positions on the admissibility of evidence related to IAWC's level of management fee expense: the AG has supported the Village of Bolingbrook's Motion to Strike IAWC's Service Fee Study (a study submitted by the utility, IAWC, in this proceeding in response to the directive of this Commission), but now argues that,

by contrast, a study by a third-party retained by the California DRA and submitted in a California proceeding should not be stricken in this proceeding.

It is not correct, as the AG suggests, that IAWC wants parties to be “prohibited from ever citing any PUC or Court Orders” (AG Resp. at 5). Consistent with Commission rules and Illinois law, IAWC seeks in its Motion only to exclude non-final orders and unreliable hearsay testimony and documents, the admission of which would violate IAWC’s fundamental right to cross-examine the preparers and preparation of the documents. By contrast, the AG appears to argue that a report from any regulatory proceeding in any jurisdiction should be admissible in Commission proceedings even if the preparers of the report are unavailable to cross examined and so the report cannot be properly tested. As explained below and in IAWC’s Motion, law, policy and logic dictate that all discussion of the Overland Report and the California Materials be stricken from the evidentiary record in this case.

II. ARGUMENT

A. The AG Cannot Supply Missing Foundational Testimony Via Its Briefing.

Mr. Smith’s discussion of the California Materials on rebuttal fails to establish either a foundation for his testimony regarding the California Materials or any indicia of the California Materials’ reliability. As IAWC explained in its Motion, evidence that is not relevant is not admissible (IAWC Mot. at 7), and facts beyond Mr. Smith’s personal knowledge are equally inadmissible. (*Id.* at 4-5.) Perhaps recognizing the lack of foundation for the Overland Report, the AG attempts to provide the missing foundational information in its brief. The AG explains, for instance, that the Overland Report is ostensibly relevant as “an example of close scrutiny of . . . management fees,” (AG Resp. at 2); that the report is relevant to “the problem of escalating affiliated expenses” (AG Resp. at 6); what a “reasonable cost for an independent audit” of management fees is (Ag Resp. at 6); and that Mr. Smith did actually review the report

and California PUC's "Final Order", (AG Resp. at 7). Most strikingly, the AG provides – for the first time – half a page of non-record "facts" in support of the comparability of IAWC and CAWC. (AG Resp. at 8.) As Mr. Smith did not testify to these "facts", however, they cannot be used to provide a *post hoc* foundation or basis for Mr. Smith's testimony regarding the California Materials. See also 83 Ill. Admin. Code § 200.190(c). The only party with the personal knowledge to provide this requisite foundation is Overland Consulting, and they are conspicuously absent.

B. The California Materials Are Irrelevant to this Proceeding.

The AG claims (despite its extensive discussion of the comparability of IAWC and CAWC in its Response) that there is no requirement that comparability be shown between IAWC and CAWC. Indeed, Mr. Smith does not demonstrate in his testimony any comparability supporting application of the Overland Report's recommendations to IAWC. However, as IAWC has already explained in its Motion, if the AG does not show that the conditions of CAWC and IAWC's service are comparable, evidence from one utility's proceedings is held not to be probative to the reasonability of rates and charges for the other utility. (IAWC Mot. at 7.) And the Commission has frequently declined to consider comparative evidence without such a showing. (Id.)

The AG's testimony and briefing, however, clearly indicate that the AG *does* want the Commission to apply the facts and findings of the California PUC proceeding to the instant case. The Commission is asked to use the report as "an independent benchmark" of reasonableness of IAWC's costs. (AG Resp. at 3.) In fact, the AG wants the Commission to accept that the costs mentioned in the Overland Report represent "a reasonable cost for an independent audit of the affiliate Management Fee and related affiliate charges." (AG Resp. at 6.) For the AG to support these assertions, however, Mr. Smith must show there is comparability between IAWC and

CAWC, which he has not. In the absence of any testimony demonstrating the comparability of IAWC and CAWC, there is no basis to conclude that the California Materials are in any way applicable to IAWC's test year expenses.

The AG also accuses IAWC of “confus[ing] expert testimony with legal argument,” (AG Resp. at 7), because Mr. Smith is “not testifying on legal issues.” While IAWC agrees that Mr. Smith is not a legal expert, Mr. Smith's testimony must still meet the standards of admissibility. Mr. Smith's rebuttal testimony does not contain any basis for establishing that the Overland Report is relevant to this proceeding – and the AG acknowledges that “the California materials do not assess Illinois expenses.” (AG Resp. at 7.) There is no evidence in Mr. Smith's testimony of similarity of conditions of operations, of structure and process, or of other markers of comparability between IAWC and CAWC. Nor is there any way to independently judge the relevance of the report, since it is presented only in excerpted form. Mr. Smith's direct testimony must cross the threshold of relevance, which it has not done, thus rendering this testimony inadmissible. People v. Barbour, 106 Ill. App. 3d 993, 1000 (1st Dist. 1982).

The AG also asserts (Resp. at 9) that the California Materials are evidence that is “of a type commonly relied upon by reasonable prudent persons.” 83 Ill. Admin. Code § 200.610(c). As IAWC explained (IAWC Mot. at 8-10), this is not the case – the California Materials lack any indicia of reliability such that reasonably prudent persons would rely on them as Mr. Smith seeks to do. For example, Mr. Smith proffers the California PUC Order of July, 2009 as a final order. (AG/JM Ex. 5.0 at 53-54.) As explained in IAWC's Motion (pages 8-10, and as also explained in IAWC Exhibit 12.00SR), however, the California PUC proceeding is still pending (a fact which the AG's Response does not address). The California PUC's July order specifically granted CAWC the right to file a petition for modification of the disallowance for these charges.

Moreover, once CAWC filed this petition, DRA itself indicated that it would not challenge the near-25% adjustment to DRA's recommendations that CAWC was seeking. Thus, Mr. Smith's claim that the California PUC adopted the DRA's recommendation is incorrect.

In addition, making Mr. Smith available for cross-examination does not cure any of the deficiencies that render the Overland Report inadmissible. Although AG attempts to introduce foundational support for the California Materials via its Response, the evidentiary record does not contain any evidence that Mr. Smith reviewed and independently assessed the Overland Report. Mr. Smith has not, as IAWC pointed out in its motion, offered testimony that he discussed the report with the preparers, analyzed its underlying data, or tested its assumptions. Moreover, the actual preparers of the Overland Report are not available to be examined in this proceeding, thus denying IAWC an opportunity to expose the Overland Report's deficiencies, factual inappositeness or contrary findings. Admission of any part of the Overland Report therefore denies IAWC the fundamental protection for which the hearsay rule was enacted – to guard against use of unreliable evidence. As the Commission will not be able to judge the credibility of the report and its preparers, the Overland Report must therefore not be admitted.

C. Mr. Smith's Objectionable Testimony Does Not Meet the "Public Records" Exception to the Hearsay Rule.

The AG does not dispute IAWC's position that Mr. Smith's testimony regarding the California PUC proceeding and the Overland Report is hearsay. Rather, the AG asserts that the Overland Report falls within an exception to the hearsay rule for "public records", apparently believing that the fact that the Overland Report was filed in a public proceeding makes it a public record. This is clearly not the case, otherwise any report introduced in any regulatory proceeding could simply be borrowed as evidence in a different jurisdiction. The AG argues incorrectly that

the Overland Report is nonetheless admissible as hearsay, because it falls into the “public records” exception stated in Fed. R. Evid. 803(8). (AG Resp. at 4-5.)

The Overland Report cannot be admitted under the “public records” exception because it is not a record created or maintained by a public official. The report was not compiled or prepared by the California PUC, or by the DRA – instead, it was prepared by third-party private consultants (Overland Consulting). (AG/JM Ex. 5.3 at 1.) Those consultants, who prepared the Overland Report, are not public officials, and, more importantly, are not here. Under the exception, public records are allowed in, despite hearsay, as “a substitute for the personal appearance of the official charged with [the document’s] preparation.” Lombard Park Dist. v. Chicago Title & Trust Co., 105 Ill. App. 2d 371, 379 (2d Dist. 1969). As AG’s own brief notes, “the exception is based on the assumption that *public officers* will perform their duties”, and that *public* officials “lack motive to falsify” the public record. (AG. Resp. at 5, citing People v. Leach, 391 Ill. App. 3d 161, 170 (1st Dist. 2009) (emphasis added).) This assumption does not stretch to private third-party actors such as Overland Consulting. And there is *no evidence on the record* that any public official helped draft this report (AG/JM Ex. 5.3.) Moreover, as indicated previously, the public agency that sponsored the report, the DRA, has itself now agreed not to oppose CAWC’s position on significant portions of the Overland Report.t

Independently, the Overland Report cannot be admitted under the “public records” exception because it contains analysis, conclusions, and recommendations. Under long-standing Illinois law, “[r]ecords which concern causes and effects, involving the exercise of judgment and discretion, expressions of opinion, or the drawing of conclusions, are not admissible” under the exception. Lombard, 105 Ill. App. 2d at 378-79; see also Bloomgern v. Fire Insurance Exchange, 162 Ill. App. 3d 594, 599 (3d Dist. 1987) (excluding an official report because it

contained an opinion); Barker v. Eagle Food Centers, Inc., 261 Ill. App. 3d 1068, 1074 (2d Dist. 1994). The Overland Report presents the judgment and opinions of Overland Consulting regarding CAWC's 2009 test-year data, and contains all of Overland's conclusions and recommendations regarding CAWC's expenses and its revenue requirement. (See IAWC Ex. 5.3.) Thus, it cannot be excepted from inadmissibility under Rule 803(8).

The AG also claims that the Commission may take administrative notice of the California Materials. (AG Resp., p. 9.) While it is correct that the Commission may take administrative notice of “[r]ules, regulations, administrative rulings and orders, and written policies of governmental bodies other than the Commission,” 83 Ill. Adm. Code § 200.640(a)(1), the Overland Report is not a rule, regulation, administrative ruling or order, or written policy of a governmental bodies other than the Commission. The Overland Report is a document prepared by a private consultant and submitted by a party as an exhibit in an adversarial proceeding before the California PUC. Thus, it is not properly subject to administrative notice.

Illinois law is clear: “The fundamental purpose of the hearsay rule was and is to test the real value of testimony by exposing the source of the assertion to cross-examination by the party against whom it is offered.” People v. Singletary, 273 Ill. App. 3d 1076, 1081 (1st Dist 1995). IAWC has the right to conduct this scrutiny, but the absence of the preparers of the Overland Report means it cannot exercise this right, and so the Commission cannot accept the Overland Report into evidence just on the say-so of Mr. Smith.

D. Excerpted Portions of a Document Are Properly Excluded From Commission Consideration.

The AG also misunderstands the impact of Mr. Smith's failure to include the entirety of the documents he selects excerpts from – that such excerpting results in inadmissible evidence. As IAWC explained in its Motion, where the entirety of a document is not part of the record, an

adjudicator, by law, cannot rule on the basis of excerpts, because “there is no way [a court] can examine [a party’s] statements in the context in which they were made.” Ainsworth Corp. v. Cenco Inc., 158 Ill. App. 3d 639, 649 (1st Dist 1987). The AG tries to suggest that IAWC is “free to attach other portions of the Final Order” in order to complete the evidentiary record. (AG Resp. at 4.) Whether or not IAWC can do so, however, is immaterial. Instead, since the AG wishes the Commission to rely on this report, it is the AG’s burden to avoid this restriction of Illinois law by entering the complete document at issue.

Nor is it sufficient to assert, as the AG has done, that Mr. Smith has “attach[ed] the relevant portions” of the California proceeding’s record. (AG Resp. at 3.) No one party can unilaterally determine the relevance or irrelevance of a document or other piece of evidence – relevance is a matter for the fact-finder to decide. This is the precise danger being warned of by the court in Ainsworth: that an out-of-context excerpt’s relevance cannot be properly determined by an adjudicator, just as the AG is expecting the Commission to do here. Moreover, as IAWC has explained in the Motion (p. 9), and above, the AG has not included all the relevant portions of the California proceeding record. For example, Mr. Smith did not include the section of the California PUC order that invited CAWC to file a petition to modify, the petition to modify, or the DRA’s response accepting CAWCs position in its petition to modify, a position contrary to the position taken in the Overland Report.

WHEREFORE, for all the reasons set forth above and in the Motion, Illinois-American Water Company reaffirms its request that the Commission strike AG/JM Exhibit 5.0, pages 50-52, lines 1080-1124; AG/JM Exhibit 5.3; and AG/JM Exhibit 5.4.

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Respectfully submitted,

ILLINOIS-AMERICAN WATER
COMPANY

By: /s/ Niloy Ray

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CERTIFICATE OF SERVICE

I, Niloy Ray, an attorney, certify that on December 7, 2009, I served a copy of the foregoing **Reply In Support of Motion to Strike Portions of the Rebuttal Testimony of Ralph C. Smith** by electronic mail to the individuals on the Commission's Service List for Docket 09-0319, with the exception of the parties listed below, who were served via U.S. Mail, first class postage prepaid, from 77 W. Wacker, Chicago, Illinois 60601.

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