

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

<b>ILLINOIS-AMERICAN WATER COMPANY</b>	<b>§</b>	
<b>Proposed general increase</b>	<b>§</b>	<b>Docket No. 09-0319</b>
<b>In water and sewer rates</b>	<b>§</b>	

**REPLY BRIEF ON BEHALF OF  
THE VILLAGE OF HOMER GLEN AND  
THE CITIES OF CHAMPAIGN AND URBANA AND  
THE VILLAGES OF ST. JOSEPH, SIDNEY, AND SAVOY**

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Illinois American Water Company (IAWC or Company) in its Brief notes that it “recognizes that the current economic climate has caused concern over rate levels,” Brief at 1, but continues to insist upon pursuing a massive rate increase and announcing it plans to file for even higher rates on a two-year cycle in the future. IAWC Brief at 45.

Numerous municipalities, many of which have never before participated in an IAWC proceeding, have intervened or otherwise participated in this docket. The public hearings have drawn scores of ratepayers who expressed dismay and displeasure over the proposed massive increase in their rates, and over 500 ratepayers have posted comments on the Illinois Commerce Commission’s (ICC or Commission) website. In filing for this increase, the Company’s president testified that it did not bother to perform any study to see what the impact would be on customers or the customers’ household budgets. Tr. at 81/18-82/8.

IAWC argues, in essence, that it is unable to lower its costs and, as an investor owned utility, must by definition have rates that are significantly higher than the rates charged to customers in surrounding communities whose water utilities are operated by municipalities. Nowhere in its brief does IAWC cite any instance where it has frozen staff levels, reduced

personnel levels, required vendors to roll back prices, or taken any real steps to hold the line on costs—all steps that other businesses and governmental entities have been forced to undertake in this “current economic climate” referenced by IAWC.

Instead, IAWC plays a shell game with its employees, moving them from the operating company to American Water Service Company, Inc. (Service Company) in one case (Docket 07-0507), then moving the employees (times two) back to the operating company in this case, while at the same time significantly increasing employee costs for both IAWC and the Service Company. IAWC ignores the direct mandate of the Commission in Docket No. 07-0507 to perform a competitive bidding study of the Service Company’s operations and instead devises its own study to obtain the results it desires.

In addition to the brief by the Village of Homer Glen and the Cities of Champaign and Urbana and the Villages of St. Joseph, Savoy, and Sidney, opposition briefs were filed by the Village of Bolingbrook, the People of the State of Illinois, and the Illinois Industrial Water Consumers. The common thread in all of the intervenors’ briefs is that the rates are too high and IAWC is not taking appropriate measures to control its costs.

This Reply Brief will not address all the issues raised in this case. Issues relating to rate of return and other adjustments are addressed by the Illinois Attorney General, the Citizens Utility Board, and the Illinois Industrial Water Consumers in their hearings briefs and will not be repeated in this Reply.

**I. IAWC's Argument that It Cannot Do Anything To Bring Its Rates in Line with Surrounding Communities Should Be Rejected.**

IAWC admits that its rates are higher than surrounding municipalities “but cannot address” the concerns raised by intervenors in this case. IAWC Brief at 6. The Company correctly states that the municipalities have “expressed concern related to the level of IAWC’s water and sewer rates when compared to the rates charged by certain municipally-owned water and sewer utilities.” IAWC Brief at 154.

IAWC argues that the fact that its rates cannot match the lower municipal rates was decided in the previous rate case and there is no reason to revisit the issue in this case. While IAWC’s rates are significantly higher than MOUs’ rates, the Company argues that “MOUs are presently increasing rates as well.” IAWC Brief at 165. What IAWC ignores, however, is the fact that in order for some MOU rates to approach the level charged by IAWC, the municipalities would have to increase their rates by 260 percent. Tr. at 358/4-13. With IAWC’s announced plan of increasing rates every two years, such as the requested 30 percent increase in this case, IAWC’s rates will continue to outpace any MOU increase.

**A. Homer Glen's comparison to surrounding communities eliminated differences between IOUs and MOUs.**

The fact that there may be differences between IAWC and MOUs was eliminated by Homer Glen witness Mr. Fundich in his rate comparison analysis. His testimony demonstrated that the rate of increase by IAWC far outstrips any increase by MOUs. Mr. Fundich showed the following differences in rates charged by Mokena and New Lenox, villages near Homer Glen, and IAWC assuming IAWC obtains the increase it seeks:

	<b>WATER</b>	<b>SEWER</b>	<b>FIXED</b>	<b>TOTAL</b>	
<i>Town</i>	<i>\$/1000 gal</i>	<i>\$/1000 gal</i>	<i>water/sewer</i>	<i>@ 8,000 gal</i>	
<b>2-town average (MOU)</b>	\$4.98	\$3.68	\$6.415	<b>\$75.70</b>	<i>difference</i>
<b>Homer Glen (IAWC)</b>	\$9.74	\$5.0507	\$75.15	<b>\$193.47</b>	<i>\$117.77</i>

Fundich Rebuttal, HG Ex. 4.0R at 10/216-219.

As Mr. Fundich testified:

If the rate increase proposed by IAWC under this case is granted, the average user in Homer Glen would have seen its cost per month rise from \$117.09 to \$193.47, an increase of \$76.38, or 65.2%, in just four years. Over the same period, the same average user in the immediately adjacent MOUs experienced a monthly cost rise from \$57.15 to \$75.70, an increase of \$18.55, or 32.45%. Thus, an average Homer Glen resident who already has been burdened with an extra \$60/month MOU cost difference premium over the past several years, would now pay quadruple the net increase (\$76.38 vs. \$18.55) that neighboring MOUs have seen since 2005, and would now have a doubling of its 2005 MOU cost difference premium from \$59.94/month to \$117.77/month. I further note with amazement that **the proposed \$76.38 net increase since 2005 is greater than the 2009 average \$75.70 total service cost** for the immediately adjacent MOU's.

Fundich Rebuttal, HG Ex. 4.0R at 10/221-11/231.

IAWC attempts to discredit this conclusion by stating that he did not “demonstrate comparability of the respective systems, thus rendering his comparisons meaningless.” IAWC Brief at 168. To the contrary, the Company is the party that has failed to show why its rates are some \$117 per month higher than surrounding systems using Lake Michigan water and why the increases have been so staggering. IAWC’s Mr. Uffleman, who sponsored the Company’s MOU study, when asked whether he studied the operating costs for either the New Lenox or Mokena water utilities, replied, “I have not.” Tr. at 355/4-10. In fact, he did not even know what

percentage IAWC was proposing to increase rates in the Chicago Metro district. Tr. at 355/16-19.

**B. All water and wastewater utilities must comply with federal safety standards which means the cost requirements are common to both IOUs and MOUs.**

IAWC erroneously argues that its rates are higher than municipalities because it “has extensive regulatory responsibilities related to the drinking water standards (Safe Drinking Water Act (42 U.S.C. §300f et seq.)) and wastewater standards (Clean Water Act (33 U.S.C. §1251 et seq.))” IAWC Brief at 2. These are the same standards that must be met by municipally-owned utilities, as admitted at hearing by IAWC witness Teasley, “Yes, that is a federal statute that is applied to all water utilities.” Tr. at 80/7-10. Thus, these regulatory requirements are uniform for both IAWC and the surrounding MOUs. Compliance with federally mandated standards should not be more costly for IAWC because it is an IOU.

**C. There is no credible evidence that developers automatically “mark-up” home prices to include any contribution in aid of construction made to a MOU or, specifically, to the MOUs used in comparisons to IAWC’s rates.**

IAWC then argues that MOUs benefit from the ability to receive contributions in aid of construction from developers “who may include the contributions to the MOU in the price of a lot or a home and the purchaser of the lot or home ends up financing the plant contributed by the developer to the MOU as part of their mortgage.” IAWC Brief at 163. This is mere speculation by IAWC and not supported by the record. It assumes that developers sell homes with line items for each cost of the home such as lumber, concrete, labor, appliances, and the like. IAWC witness Mr. Uffleman, the consultant from Texas, who theorized on how developers price homes, testified:

Q. Am I correct in that testimony you state that a developer includes contributions that it may have made as part of construction to a municipally-owned utility, they include that in the price of a home?

A. The price of a home or the price of a lot, yes.

Q. Can you tell me which developers in Mokena that you talked to, to come up with this statement?

A. I did not discuss this with any developers.

\* \* \*

Q. I would like to go back to my original question. Which particular developers in the state of Illinois have you talked to concerning that they include contributions in the cost of the homes?

A. I have not talked to any developers.

Tr. at 354/2-355/3.

Thus, any statements he made concerning home builders “marking up” their home prices because of contributions to MOUs is without any factual basis and should be disregarded.

## **II. IAWC’s High Costs Demonstrate that Using Service Company Results In No Benefits to Ratepayers.**

The disparity between IAWC’s high rates and surrounding communities’ lower rates also discounts IAWC’s unsubstantiated claim that it is “able to engage in strategic supply sourcing through the use” of the Service Company “which achieves economies of scale that IAWC could not obtain on its own.” IAWC Brief at 2. However, IAWC still is unable to explain why its costs are substantially higher than rates charged in surrounding communities.

### **A. IAWC has no control over Service Company’s budget or charges.**

Part of the problem is that while IAWC states that it receives benefits from the Service Company, in fact, IAWC has no control over what it is charged by the Service Company. IAWC’s president Teasley testified that while the operating company “can review the budget” of

the Service Company, Tr. at 121/7, the final say on what the budget is rests with the Service Company alone. Tr. at 135/13-14. Thus, IAWC has no leverage in negotiating the costs it pays or in demanding that costs be reduced because IAWC is trapped by the charges imposed by its affiliated company and passes those charges onto ratepayers. IAWC then uses Service Company employees as witnesses in the case to justify their own billings.

**B. Prepayment to Service Company before services are performed and before Service Company pays the expenses billed does not benefit ratepayers, has no commercial basis, and is unreasonable.**

IAWC not only has to pay the high costs of the Service Company, but it also has to prepay for those services. IAWC argues in its Brief that paying the Service Company a month in advance before the work is performed is in the best interests of ratepayers since otherwise the Service Company would charge even more for providing services to IAWC. The Company boldly asserts that “there is no commercial basis to support the argument that the prepayment terms are unreasonable.” IAWC Brief at 24. To the contrary, prepayments to the Service Company are not consistent with payment terms for similar services from third party suppliers. Gorman Rebuttal, IAWC Ex. 3.0 at 38/850-39/853. Indeed, the Service Company itself does not prepay its employees’ monthly salaries. Tr. at 427/4-8. IAWC’s Mr. Kerckhove, a Service Company employee, himself, did not know of any vendors that the Service Company prepaid. Tr. at 427/20-22.

The Company argues that it must prepay its affiliated Service Company’s charges because the Service Company’s contract that was approved by this Commission mandates such prepayment. IAWC Brief at 23. This is not true. The provision referenced only addresses “overhead” for the Service Company, not the entire fee. Illinois American Water Company,

Docket No. 04-0595, Final Order at 2. In addition, what the Commission grants, the Commission can take away. Thus, if modification of the final order in Docket No. 04-0595 is required, the Commission can either reopen the docket or amend the order so that the enormous non-commercially-reasonable prepayment to the Service Company is eliminated. This would result in lowering the Company's cash working capital since it affects the lead-lag study as noted in the testimony of IWC witness Mr. Gorman and AG/Joint witness Mr. Smith.

**C. IAWC has not demonstrated that the level of the fee paid to the Service Company is reasonable and necessary.**

Eliminating the prepayment to the Service Company only addresses part of the problem. The Commission also should reduce the amount of the requested payment for the Service Company. IAWC argues that its requested level of management fees "reflects the cost of the services IAWC is projected to receive from the Service Company in the test year" and therefore the full amount must be approved. IAWC Brief at 58. In other words, the Commission should not explore the reasonableness of the charge but merely approve it because that is what the non-regulated affiliate set in its budget to charge IAWC.

In the previous IAWC rate case, the Commission was concerned about the level of the Service Company charge. The ICC ordered the Company to perform a study comparing its costs to those charges if they were competitively bid and present it in the next rate case (this case). IAWC failed to perform such a study but instead did a study that is no more than a salary survey that must be rejected. A full discussion of the inappropriateness of the study is contained in the briefs of the Village of Bolingbrook and the Illinois Attorney General and will not be repeated here.

On the one hand, IAWC argues that the Service Company provides services that “save IAWC the need of replicating them in-house.” IAWC Brief at 66. On the other hand, IAWC wants to continue to increase its in-house employee count after telling the Commission in the last case that it was decreasing IAWC staffing by putting employees into the Service Company to save costs.

In this docket, IAWC has asked for \$21,167,057 for Service Company payments in 2010. This is 22.5 percent more than the \$17.251 million approved in Docket No. 07-0507 for the test year ended June 30, 2009. The \$17.251 million was an increase of 170 percent from the amount approved in Docket No. 02-0690, IAWC’s earlier rate case. To justify this increase, the Company argues that its request cannot be reduced because the Commission “may not simply disregard the level of a utility operating expense as shown by evidence in a rate proceeding in favor of an arbitrary lower amount.” IAWC Brief at 70. However, it is the utility that must justify its costs, not the intervenors.

As outlined in the hearings brief, at best the amount of Service Company charges that should be included in rates is the \$17.251 million. Since that amount was “questioned” by the Commission in Docket No. 07-0507, including this amount is the maximum that should be awarded.

**III. The Commission Should Reject IAWC’s Request to Increase Rate Case Expenses from the Previous Rate Case and in This Rate Case.**

As part of its request in this docket, the Company seeks to recover additional rate case expenses from its previous rate case Docket No. 07-0507 and has requested significantly higher rate case expenses in this docket. Both requests should be rejected.

**A. Including “additional” rate case costs from the previous case now would result in prohibited retroactive ratemaking.**

In the previous docket, the Commission approved recovery by the Company of \$1,482,020. AG Cross Ex. 19. IAWC has requested in this case to back charge to ratepayers an additional \$187,047 for costs incurred in the 2007 rate case. IAWC argues that it should receive these past incurred costs because the study has “continuing application.” IAWC Brief at 36. Both AG/Joint witness Smith and ICC Staff witness Wilcox oppose including this retroactive adjustment. As the AG argued in its hearings brief, imposing such a surcharge now would violate the rule against retroactive ratemaking and must be disallowed. AG Brief at 32-34. The Villages and Cities concur with the AG that this request would result in retroactive ratemaking. The adjustment should be disallowed.

**B. IAWC overstates rate case expenses in this docket by including excessive legal costs and imprudently incurred costs for a study that failed to comply with the Commission’s explicit order in Docket No. 07-057.**

In this docket, IAWC has requested \$2.34 million in rate case expenses. This includes both legal fees and the Service Company Fee Study.

The Company argues that reducing the cost of recoverable legal fees would be arbitrary. IAWC Brief at 40. The burden is upon the utility to prove the reasonableness of legal fees in a rate case. IAWAC states that its in-house counsel are “actively involved” in the rate case but then list only administrative or paralegal duties to support that argument (“coordinating discovery and planning for an [sic] attending public hearings.”)

In addition to legal fees, the Company seeks to recover the cost of the Service Company Fee Study. The Fee Study should be disallowed since it did not comply with the final order in the Company’s previous rate case. A full discussion of the inappropriate nature of the study

appears in the Hearings Briefs of the Village of Bolingbrook and the AG and will not be repeated here. Ratepayers should not be required to pay for this inappropriate and imprudent study.

As a result, the request for legal fees for this docket should be reduced as outlined by AG/Joint witness Smith. All costs associated with the imprudent Service Company Fee Study should be excluded.

#### **IV. IAWC's Requested Reduction in Short-Term Debt Is Unreasonable And Is Detrimental to Ratepayers.**

IAWC seeks to reduce the amount of short-term debt in its capital structure, thereby inappropriately increasing the costs to ratepayers. The Company's proposal should be rejected.

IAWC proposes to decrease the amount of its short-term debt for its capital structure to .015 percent from the 3.26 percent approved by the Commission in IAWC's previous rate case, Docket No. 07-0507, Final Order at 55. The Company argues that this low amount is justified because "the vast majority of IAWC's investments are long-term in nature." IAWC Brief at 78. Rather than using short-term debt with a cost of 1.97 percent, IAWC wants to instead use common equity with a cost of 10.90 percent. IAWC Brief at 73.

This request is curious in the current rate environment where the cost of short term debt is below one-half of 1 percent. IAWC's most recent actual cost for short-term debt was .04634 percent. Smith Rebuttal, AG/JM Ex. 5.0 at 12/243-244. It is not prudent to use high-cost equity when the costs for short-term debt are at historic lows.

IAWC's proposal inflates the cost of capital by \$2.2 million at CUB witness Thomas's 7.4 percent cost of equity and \$3 million using ICC Staff's 1 percent cost of short-term debt and a 10.38 percent cost of equity. AG/Joint Ex. 5.0 at 13-15.

Since IAWC's parent is the only shareholder, this proposal provides a windfall to the parent to the detriment of the ratepayers. The Commission should reject IAWC's proposal to reduce its short-term debt as part of its cost of capital.

**V. An Independent Study Should Be Ordered by the Commission to Determine How to Replace IAWC as the Provider of Wastewater Services.**

IAWC argues that the AG's recommendation for an investigation into the municipalization of the Company's wastewater treatment facilities should be rejected because the AG does not identify any "municipalities that are willing to, or are able to, take over IAWC's wastewater treatment plant." IAWC Brief at 178. This argument has no merit and should be rejected.

It is undisputed that IAWC's wastewater collection and treatment rates are out of line and excessively high and will continue to climb even higher. IAWC's proposal is to increase the base sewer collection and treatment rate for Homer Glen residents to \$42 from \$26, a 61 percent increase. In addition, for all amounts over 1.33 ccf, there is an additional charge of \$3.778 per ccf, a 33 percent increase over the current \$2.84 per ccf. In other words, the effective rate per 1,000 gallons for a typical user of 8,000 gallons is \$8.08, which is over 200 to 500 per cent higher than surrounding communities. Niemiec Direct, HG Ex. 2.0 at 5/76-85.

The inability of IAWC to provide reasonably-priced wastewater collection and treatment service warrants an independent investigation to determine the best mechanism to remove IAWC from providing this service. IAWC seeks to prejudge who should replace it and then uses that straw man to argue that the study should not be done in the first place.

AG witness Rubin is correct that an independent study must be undertaken and that the Commission should limit the increase for wastewater to no more than 50 percent. As Homer

Glen witness Niemiec testified, “all reasonable economic alternatives to providing economic sewer service to Homer Glen’s residents should be explored.” Niemiec Direct, HG Ex. 2.0 at 6/102-106.

The Commission should follow Mr. Rubin’s recommendation for the study and restricting the sewer rate increase.

## **VI. Overrecovery of Fire Protection Charge Endangers Lives and Property.**

IAWC seeks to recover more than the cost of service for private fire service, which is the monthly fee the Company charges individuals and businesses to have fire sprinkler systems in their homes or businesses. The Company wants the Commission to “reject” Homer Township Fire Protection District Chief’s Schofield’s “concerns in this matter.” IAWC Brief at 152.

The Fire Chief’s concern in this matter is that the charge, which the Company admits is overpriced, will discourage ratepayers from installing life-saving fire sprinklers—hardly a concern that this Commission should ignore as IAWC requests.

The private fire protection charge is recovering 138 percent of its cost of service, yet neither the Company nor the ICC staff believes it should be reduced to cost. This is a problem for several reasons.

First, by leaving the charge above the cost of service, it is distorting the cost/benefit analysis of installing life-saving fire sprinklers in homes and businesses. There is a potential cost savings when fire sprinklers are installed since it may result in a reduction in property damage insurance. However, this cost savings can be eliminated by the higher-than-appropriate fire protection charge. “While many insurance companies offer discounts to customers for having a

sprinkler system the discounts quickly can be wiped out by this type of monthly fee.” Schofield Direct, HG Ex. 3.0 at lines 38-39.

Second, not only is there a problem with the non-cost justified fee distorting the cost/benefit analysis, the high fee discourages communities to pass ordinances requiring fire sprinkler systems that could save lives and reduce property damage. “IAWC’s assessment of this monthly fee places progressive communities at a disadvantage and may put pressure on them to amend the ordinances that currently require sprinkler systems to no longer make them mandatory, thereby eliminating a significant safety system.” *Id.* at 41-44.

Third, Chief Schofield is concerned that by labeling the charge as “Fire Protection” on the bill, residents mistakenly believe that the money is going to help support the Homer Township Fire Protection District, when it is not. “This designation is confusing to IAWC customers who think the fee is being used to fund our Fire Protection District.” Schofield Direct, HG Ex. 3.0 at lines 23-24. In fact, IAWC charges the Fire Protection district \$69 a month for connecting its own fire sprinkler system in its fire station to IAWC. *Id.* at 36.

IAWC’s casual dismissal of Chief’s Schofield’s concerns should be rejected and the Fire Protection fee lowered so that it only recovers the cost of service.

## **VII. Homer Glen Issues Are Not Resolved.**

Homer Glen’s witnesses raised several issues concerning IAWC’s performance. Those issues include IAWC not repairing leaks on a timely basis, IAWC not timely metering usage, IAWC’s failure to comply with Homer Glen ordinances, IAWC failing to properly and timely restore rights of way after construction or repairs, and IAWC not properly maintaining fire hydrants.

To each of these concerns, IAWC states in its brief that it is taking steps to overcome the problems. IAWC Brief at 173-175. This is not sufficient. The problems have been ongoing and long-standing. In each case before the Commission, IAWC vows to correct the problems, but it is more words than action.

In the vital area of fire protection, the Company states that the Fire Chief's testimony should be disregarded because the Company's records indicate there is no problem. IAWC Brief at 175. However, the unrebutted testimony of the Fire Chief is that the "Fire District has constantly found issues with hydrants and has (at a cost to local taxpayers) found itself doing periodic inspection of hydrant." Schofield Direct at lines 50-51. This is a company that has been cited before for not properly maintaining fire hydrants, Docket Nos. 05-0681, 06-0094 and 06-0095, (where the Commission found that as to the periodic inspection and maintenance of fire hydrants "the record evidence is that three of the four communities that Staff investigated were found not to be in compliance with either record keeping or maintenance requirements." Order at 20).

The question then is who the Commission is to believe—the Company and its records, or the Fire Chief whose duty it is to protect the public in the case of fires who did on the ground inspections and found the hydrant repairs lacking?

### **VIII. Conclusion.**

The Commission should adopt the recommendations set out in this Reply and the Hearings Brief as well as the recommendations of the various intervenors to exclude from rates the inappropriate charges and adjustments proposed by the Company, reduce its requested return,

order an investigation into IAWC's advertising practices, and investigate whether IAWC should continue to operate any wastewater facilities.

Village of Homer Glen

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**CERTIFICATE OF SERVICE**

I, Richard C. Balough, hereby certify that a copy of the foregoing Reply Brief was served upon all parties on the ICC eDocket Service List by electronic means on this 21st day of January 2010.

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