STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Aqua Illinois, Inc.	**:**	
and	**:**	
Northern Illinois Investment Group, Inc.	**:**	
	:	
	:	**Docket No. 09-0369**
Petition for Approval of Proposed	**:**	
Reorganization and Approval of Asset	**:**	
Purchase Agreement; Petition for Issuance	**:**	
Of Certificate of Public Convenience and	**:**	
Necessity to Operate Water Production	**:**	
And Distributing System; and Approval of	**:**	
Rates and Accounting Entries	**:**	

INITIAL BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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February 5, 2010

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The Staff of the Illinois Commerce Commission ("Staff"), by and through its counsel, and pursuant to Section 200.830 of the Commission's Rules of Practice, 83 Ill. Adm. Code 200.830, respectfully submits its Initial Brief in the above-captioned matter.

I. Procedural History

On August 14, 2009, Aqua Illinois, Inc. ("Aqua") and Northern Illinois Investment Group, Inc. ("Northern Illinois")(collectively referred to as "Joint Applicants") filed a Verified Joint Petition for approval by the Illinois Commerce Commission ("Commission") pursuant to Sections 7-102, 7-204, 7-204A, 8-406, and 8-508 of the Public Utilities Act ("Act") of the following:

1.) A permanent transfer of an existing Certificate of Public Convenience and Necessity ("Certificate") for Northern Illinois to Aqua, thereby authorizing Aqua to construct, operate, and maintain a water production and distribution system, and in connection therewith, transact a public utility business in Cuba Township, Lake County, Illinois (the "Northern Illinois Area"), serving the Fairhaven Estates Subdivision;

2.) An asset purchase agreement entered into between Aqua and Northern Illinois and the acquisition of assets of Northern Illinois by Aqua;

3.) The rates currently in effect for Northern Illinois as applicable for Aqua;

4.) The accounting entries to record the net original cost of the water facilities used to provide service in the Northern Illinois Area taken from existing reports on file with the Commission;

5.) The filing of new tariff pages which transfer the application of the existing tariff to Aqua from Northern Illinois; and

6.) Northern Illinois' request to permanently abandon water service in the Northern Illinois Area.

Pet., at 1-2.

A status hearing was convened on September 3, 2009 at which a schedule for the proceeding was set. Tr. at 5. On October 14, 2009, the Village of Barrington ("Village") filed an objection to Joint Petitioner's petition, as well as a petition to intervene in the matter, to which Joint Applicants objected. *See*, generally, Village Motion to Intervene; Joint Applicants' Objection to Motion to Intervene. On November 10, 2009, the Administrative Law Judge ("ALJ") granted the Village's motion to intervene. Tr. at 19. Joint Applicants filed direct testimony on September 17, 2009, Staff filed direct testimony on November 3, 2009, and the Village filed direct testimony on November 13, 2009. Joint Applicants filed rebuttal testimony on December 1, 2009, and Staff filed rebuttal testimony on January 5, 2010. An evidentiary hearing was convened in the matter on January 12, 2010, and testimony taken and evidence otherwise adduced. This Initial Brief follows.

II. Argument

A. Need for Water Service

ICC Staff witness Jonathan M. Sperry testified that the Company has demonstrated that there is a need for water service. (ICC Staff Ex. 1.0 at 9) This is based on the testimony of Aqua witness Paul Anthony Wright that the Company has received a request from Northern Illinois Investment Group, Inc., to acquire its water system and provide retail water service to its existing customers. (Pet. Ex. 1.0 at 5) The Village has indicated that it is interested, willing and able to provide its municipal water service to the Fairhaven Estates Subdivision. (ICC Staff Ex. 5.0 at 2) The water rates proposed by Aqua and the Village are comparable. *Id*. at 3. However, customers would be assessed a water connection charge and a meter charge, totaling $1,775.00, if provided water service by the Village. *Id*. The only similar charge imposed by Aqua is a service connection charge of $6.00. *Id*. at 3-4. Based on this comparison, Mr. Sperry concluded that Aqua can provide water service on a least-cost basis. *Id*. at 5.

Mr. Sperry found errors in Aqua's legal description for the proposed certificated service area. (ICC Staff Ex. 1.0 at 13) Aqua responded in Rebuttal Testimony by correcting the legal description, as suggested by Mr. Sperry. (Pet. Ex. 3.0)

Mr. Sperry testified that the proposed reorganization satisfies Section 7-204(b) of the PUA in that it will not diminish the ability of Aqua to provide adequate, reliable, efficient, safe, and least-cost public utility service, (ICC Staff Ex. 1.0 at 6), that Aqua will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities, *Id*., that the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction, *Id*. at 7., and that the proposed reorganization is not likely to negatively impact rates. *Id*. at 8.

Mr. Sperry testified that the construction of the water system improvements as proposed by the Joint Applicants is necessary to provide adequate, reliable, and efficient water service to the customers in the Fairhaven Estates Subdivision. (ICC Staff Ex. 1.0 at 10) Mr. Sperry concluded that the Company is capable of efficiently managing and supervising the construction of the water system improvements. *Id*. at 11.

Mr. Sperry reviewed the proposed rules and regulations to govern the Company's water operations in the proposed certificated service area. Mr. Sperry testified that he agreed with these rules and regulations. (ICC Staff Ex. 1.0 at 14)

Mr. Sperry recommended that the Commission approve the proposed reorganization. (ICC Staff Ex. 1.0 at 15-16) Mr. Sperry further recommended that the Company be granted a Certificate and the rates currently applicable to Northern Illinois customers continue to be applicable after the water system is transferred to Aqua. *Id*. at 16. In addition, Mr. Sperry recommended that Northern Illinois be granted authority to abandon the Northern Illinois water system and cancel its Certificate. *Id*.

Mr. Sperry recommended that the Commission order Aqua to file a report with the Chief Clerk of the Commission, with a copy to the Manager of the Commission's Water Department, within seven days after the closing of the acquisition, indicating the date on which the closing on the transaction occurred. (ICC Staff Ex. 1.0 at 15-16) Mr. Sperry further recommended that the Rules, Regulations and Conditions of Service tariffs for water service applicable to Aqua shall be applicable to Northern Illinois customers. *Id*. Toward that end, Mr. Sperry recommended that Aqua file revised Rules, Regulations and Conditions of Service tariffs for water service to include the new area within fifteen days of the closing of the acquisition, with an effective date of not less than ten working days after the date of filing. *Id*. at 14, 17. Mr. Sperry also recommended that, with the same deadlines, Aqua file new Rate tariffs for water service that transfer the existing rate tariffs for water service for Northern Illinois to Aqua. *Id*. at 14-15, 17.

B. Financial Considerations

Under Section 7-204(b)(4) of the Act, the Commission must find that "the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure." (220 ILCS 5/7-204(b)(4)) Section 8-406(b)(3) of the Act requires that before issuing the requested certificate of public convenience and necessity the Commission find "that the utility is capable of financing the proposed construction without significant adverse financial consequences for the utility or its customers." (220 ILCS 5/8-406(b)(3)) Staff witness Janis Freetly evaluated the financial implications of the proposed acquisition of Northern Illinois by Aqua Illinois on Aqua Illinois' ability to access the capital markets on reasonable terms. She also presented her evaluation of the financial implications under Section 8-406(b)(3) of the Act. (ICC Staff Ex. 3.0)

The total cost to Aqua Illinois to purchase the wastewater collection and treatment system of Northern Illinois will be $191,000, which includes the $5,000 purchase price, $25,000 of transaction costs, and $161,000 of related costs through 2010 to upgrade the existing water treatment facilities. (Staff Ex. 3.0, at 3-4) The total cost of the proposed purchase would be minimal relative to the Company's total utility plant and operating revenue. *Id*. The Company's total utility plant had a net value of $224,750,179 as of December 31, 2008; its total utility operating revenues for the twelve months ended December 31, 2008, was $40,068,208. *Id*. The total cost represents 0.085% of the Company's net utility plant and 0.48% of the Company's total utility operating revenue. *Id*. Therefore, Ms. Freetly concluded that the Company is capable of financing the proposed purchase of Northern Illinois without significant adverse financial consequences for the Company or its customers.

Aqua Illinois balances its capital structure to achieve an equity ratio of 52% and a debt ratio of 48%. (Staff Ex. 3.0, at 4) Aqua Illinois intends to finance the capital costs through internally generated funds and debt financing. *Id*. In addition, the Company is a subsidiary of Aqua America, Inc. and is thus backed by the financial resources of a corporation that had revenues of approximately $626 million, assets of over $3.8 billion, and capital expenditures of over $267 million for the year ending December 31, 2008. *Id*. As of March 31, 2009, Aqua America had credit facilities that allow borrowings of up to $234 million. *Id*. Therefore, Ms. Freetly concluded that the proposed acquisition of and improvements to the water treatment facilities of Northern Illinois will not significantly impair Aqua Illinois' ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure. *Id*.

C. Accounting Considerations

<u>Section 7-204(b)(2) and (3)</u>

Ms. Dianna Hathhorn testified that she reviewed Aqua's testimony concerning the claims that the proposed reorganization:

- will not result in the unjustified subsidization of non-utility activities by the regulated utility or by Illinois customers [7-204(b)(2)]; and
- will provide for the fair and reasonable allocation of cost between the utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes [7-204(b)(3)].

(Staff Ex. 2.0 at 3)

Aqua witness Paul J. Hanley addresses the issue of no unjustified subsidization of non-utility activities by Aqua or its customers. (Aqua Ex. 2.0, at 4) Mr. Hanley explained that at present, neither Aqua nor Northern Illinois Investment Group engage in a significant level of such activity. *Id*. He further stated that to the extent Aqua engages in such activities in the future, it will continue to maintain its books and records in such a manner as to fairly and reasonably allocate utility and non-utility activities and allow the Commission to identify costs and facilities that are properly included for ratemaking purposes. *Id.,* at 5. Staff testified that the Company's testimony adequately addressed the requirements of Sections 7-204(b)(2) and 7-204(b)(3).

Section 7-204(c)

The Company did not offer direct testimony concerning Section 7-204(c) which states:

> The Commission shall not approve a reorganization without ruling on: (i) the allocation of any savings resulting from the proposed organization; and (ii) whether the companies should be allowed to recover any costs incurred in accomplishing the proposed reorganization and, if so, the amount of costs eligible for recovery and how the costs will be allocated.

(220 ILCS 5/7-204(c))

However, regarding any allocation of savings resulting from the proposed reorganization, the Company stated in discovery that there are no savings anticipated, as the projected capital expenditures and operating costs will exceed the current revenue generated by the system. (Staff Ex. 2.0, at 4) Concerning costs, the Company proposed to recover an estimated $25,000 in transaction costs as an increase to rate base, and to transfer $2,090 in NIIG's organizational costs as an increase to Aqua's rate base. There were no other costs of the proposed reorganization. *Id*. However, as discussed below, Staff disagreed with this accounting treatment, and in rebuttal testimony, Aqua did not object to Staff's recommendation to record the transaction costs of the acquisition as costs of the acquisition rather than as capitalized to rate base. (Aqua Ex. 3.0, at 2)

Transaction Analysis

Ms. Hathhorn reviewed the proposed journal entries in Aqua Exhibit 2.1. In Direct Testimony, Staff testified that the Uniform System of Accounts for Water Utilities, 83 Ill. Adm. Code 605 ("USOA") provides instructions regarding the transaction. The USOA's Instruction 21, Item A, states that the cost of the acquisition including incidental expenses thereto shall be charged to Account 104-Utility Plant Purchased or Sold. (Staff Ex. 2.0, at 5) Further, the USOA's Instructions to Account 104 state, among other things, that this account should be charged with the cost of utility plant acquired by purchase. Staff testified that the Company's Journal Entry #1 accurately reflects this guidance. *Id*.

However, in Journal Entry #2, the Company itemized its estimated costs of acquisition to include settlement costs including recording fees, title transfer costs, insurance, and legal fees, and proposed to record them in Account 301, Organization. (ICC Staff Ex. 2.0, at 5-6 and Attachment A) The proposed transaction costs also include costs for inspection and engineering. (Aqua Exhibit 2.0, at 37) Ms. Hatthorn testified that the Company's transaction costs should be accounted for as costs of the acquisition, since they are not consistent with the types of costs intended for organizational costs, as provided for in the following instruction to Account 301:

> This account shall include all fees paid to federal or state governments for the privilege of incorporation and expenditures

> incident to organizing the corporation, partnership or other enterprise and putting it into readiness to do business.

(Staff Ex. 2.0, at 6)

The costs the Company has or expects to incur are more accurately defined as costs incurred to purchase the system, not to reorganize the corporation of Aqua, and thus should be treated as an added cost to purchase the NIIG system. (Staff Ex. 2.0, at 6) In rebuttal testimony, Aqua did not object to Staff's recommendation to record the transaction costs of the acquisition as costs of the acquisition rather than as capitalized to rate base. (Acqua ex. 3.0, at 2)

Staff further testified in direct testimony that $2,090 in NIIG's organizational costs should not be transferred to Account 301 of Aqua, as proposed by the Company. (Staff Ex. 2.0, at 7) However, in rebuttal testimony, Staff testified that Aqua explained that in Docket No. 94-0440, NIIG was authorized to purchase Tri County Utilities assets, including the $2,090 of organizational costs at issue here. (ICC Staff Ex. 6.0, at 2) NIIG has been depreciating the organizational costs at a rate of 2% per year, and the estimated net book value at 12/31/2008 is $1,061. *Id*. Therefore, due to the small dollar amount involved, and the Commission's previous action on this matter, Staff accepted the Company's rationale and withdrew objection to transferring NIIG's organizational costs to Aqua as a part of this reorganization. *Id.*

The final result of the Company's revised journal entries is to increase the purchase price of the acquisition and reduce the negative acquisition adjustment as follows:

1	Purchase Price	$ 5,000
2	Transaction Costs	25,000
3	Total Purchase Price	$ 30,000
4	Original Cost:	

5	Net Plant	$	84,332
6	NIIG Organizational Costs		2,090
7	Total Original Cost	$	86,422
8	Acquisition Adjustment (line 3 - line 7)	$	(56,422)

(Summary of Aqua Revised Ex. 2.1)

A negative acquisition adjustment means the Company paid less for the assets than the original cost of the assets, in this case, by $56,422. Thus, Aqua will earn a rate of return on the original cost of the assets ($86,422) rather than the amount Aqua paid for the assets ($30,000). (Staff Ex. 2.0, at 9, Aqua Revised Ex. 2.1) Staff did not object to the Company's proposal to record the negative acquisition adjustment below-the-line in Account 421 at the time of the final order. Staff recommended the Commission approve the Company's revised journal entries as reflected in Aqua Revised Exhibit 2.1.

Finally, Staff recommend Aqua file with the Commission the final accounting entries for the transaction, showing the actual dollar values of all involved accounts, as a filing on the Commission's e-Docket system with a copy to the Commission's Accounting Department Manager and to the Office of the Chief Clerk of the Commission within sixty (60) days of the transaction date. (Staff Ex. 2.0, at 10-11) If the transaction has not occurred within six months of the Final Order in this proceeding, Staff recommended the Company submit a status report in the same manner described above. *Id*. Aqua agreed to Staff's recommendation. (Aqua Ex. 3.0, at 4-5)

D. Depreciation

Aqua has proposed to use the same water depreciation rates that are currently in effect for Northern Illinois. The current water depreciation rate is 2% for all depreciable water utility plant. Aqua stated that it will address the water depreciation rates of the water system during its next rate case filing. (Aqua Ex. 1.0, at 3) Staff witness William R. Johnson stated that he had no objection to Aqua utilizing the existing Northern Illinois water depreciation rates until Aqua's next rate case filing for the Northern Illinois service area. (Staff Exhibit 4.0)

III. Conclusion

Staff recommends that the Commission approve Joint Applicants' Petition for approval of their proposed reorganization and asset purchase agreement and find that:

1.) the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service;

2.) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;

3.) costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes;

4.) the proposed reorganization will not significantly impair the utility's ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;

5.) the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;

6.) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction; and

7) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.

Staff also recommends that Aqua be issued a certificate of public convenience and necessity, and that their rates and accounting entries as discussed above be approved.

WHEREFORE, the Staff of the Illinois Commerce Commission respectfully requests that its recommendations be adopted in their entirety consistent with the arguments set forth herein.

Respectfully submitted,

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