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I. INTRODUCTION

For the reasons set forth herein, Illinois-American Water Company (“IAWC” or “Company”) seeks rehearing with respect to certain findings and conclusions stated in the order of the Illinois Commerce Commission (“Commission”), dated April 13, 2010, as amended by the Amendatory Order dated May 4, 2010 in Docket 09-0319 (together, the “Order”), with respect to the services that IAWC obtains from its affiliated service company, American Water Works Service Company, Inc. (“Service Company”). (The Service Company provides required services to IAWC at cost under a Commission-approved affiliated interest agreement. (IAWC Ex. 1.00 (Teasley Dir), p. 17).) In particular, the Order determined (Order, pp. 46-49), with no analysis or finding related to any specific service or the cost of any service, that IAWC’s detailed projection of the test year level of Service Company fees should be disregarded and the projected test year level of Service Company fees should instead be limited to an amount (the “Alternative Projection”) that is 5% above the amount allowed in IAWC’s prior rate case, Docket 07-0507. The Order also imposes a requirement that an audit (“Audit”) be performed of the fees charged to IAWC by the Service Company, “to compare the cost of each service obtained from the Service Company to the costs of such services had the services been obtained through competitive bidding on the open market.” (Order, pp. 47-48, as amended). IAWC seeks rehearing with respect to these two conclusions.

In support of the Order’s adjustment to Service Company fees and the Audit requirement, the Order relies on certain assertions offered in the Briefs of the Attorney General (“AG”), Municipalities and Bolingbrook, which are unsupported by the evidentiary record and, in certain cases, demonstrably incorrect. Most notably, the Order (p. 47) states that, in this proceeding, IAWC did not provide the information regarding the Service Company’s fees and services required by the order in IAWC’s prior rate case, Docket 07-0507 (the “Docket 07-0507 Order”),

including, *inter alia*, “a study comparing the cost of each service obtained from the Service Company to the cost of such services had they been obtained through competitive bidding on the open market.” In so doing, the Order references arguments of Interveners’ counsel, “that the Company’s Service Company cost study did not comply with the directive in the Order in Docket 07-0507.” (Order, p. 47.) The Order, however, does not indicate which arguments of counsel it is referring to or explain how such arguments relate to its conclusions. The Order (p. 47) then concludes, without explanation, that, “[w]ith no basis for comparison of the lower of cost or market for these services, the Commission cannot adequately determine whether the increases in Service Company fees proposed in this case by IAWC are just and reasonable.”

On this basis, the Order (p. 47) goes on to adopt the recommendation of AG/Joint Municipality (“AG/JM”) witness Mr. Smith to adopt the Alternative Projection. In this regard, the Order (p. 47) notes that, “AG/JM witness Mr. Smith recommended that the fees allowed be limited to 5% over the amount approved in Docket 07-0507. According to the AG, the 5% figure is consistent with the actual fluctuation in Service Company fees between rate cases.” As will be discussed, the “recommendation” referenced by the Order is baseless and insufficient to support the Order’s conclusion. In offering this recommendation, AG/JM witness Smith conducted no analysis whatsoever of any specific service expected to be provided to IAWC by the Service Company or the projected cost of any such service.

The Order (p. 48) also references an absence of cost/market comparisons in concluding that, “an independent audit is of benefit and necessary in evaluating whether the Service Company fees assessed to IAWC, are in fact provided on a lower of cost or market basis as we directed in the 07-0507 Order.” As will be discussed, IAWC’s evidence in this proceeding included detailed comparisons of the cost of services to be provided by the Service Company

during the test year with the projected market price of such services had they been obtained through competitive bidding on the open market. Thus, the Order's findings on this point are demonstrably incorrect and unsupported by the record. Moreover, this evidence demonstrated that the projected level of test year savings that would result from the procurement by IAWC of services through the Service Company as opposed to through non-affiliate providers at market rates determined by competitive bidding is approximately \$7.24 million. The Order ignores this unrefuted conclusion.

As noted above, after reciting language from the Docket 07-0507 Order with regard to cost/market comparisons and other information IAWC was directed to submit, the Order (p. 47) states that IAWC did not provide this information. With regard to this statement, the Order's intent may be to refer only to the cost/market comparisons referenced above. The statement, however, also could be read to suggest that IAWC failed to provide other information required by the Docket 07-0507 Order. In this regard, the Order's statement is unclear. As will be discussed, however, IAWC provided all of the information required by the Docket 07-0507 Order, and the statement in the Order is incorrect and unsupported by the record if it is intended to suggest otherwise.

For the reasons discussed herein, IAWC requests rehearing of the above-specified findings and conclusions of the Order and, on rehearing, modification of the Order to conclude:

- that IAWC has complied with the Docket 07-0507 Order's requirements that IAWC provide certain information regarding Service Company services and fees;
- that the evidence provided by IAWC provides a basis for comparison between Service Company and market cost for the services provided by the Service Company;
- that record evidence supports the test year level of Service Company fees (management fee expense) set forth in the Administrative Law Judge's Proposed Order and that that level of Service Company fees is just and reasonable;
- that the Alternative Projection is unsupported and should be rejected; and

- that an independent audit of Service Company fees is neither beneficial nor necessary to determine whether the Service Company's fees are provided on a lower of cost or market basis, and therefore should not be conducted.

II. ARGUMENT

A. The Order's Findings Regarding Service Company Fees Are Not Explained and Are Unsupported by Evidence of Record

1. Contrary to the Order's Finding, IAWC Submitted Extensive Evidence Comparing Projected Service Costs to Market Prices

The Order's conclusion that there is no demonstration of whether the projected test year Service Company fees are the lower of cost or market is incorrect and contradicted by the evidence, and therefore should be reversed. 220 ILCS 5/10-201(e)(iv). Contrary to the conclusions of the Order (pp. 46-49), three studies presented by IAWC provide cost/market comparisons for each service expected to be provided by the Service Company during the projected test year (and, in fact, for each Service Company job classification expected to be involved in providing test year services). These studies are: the Service Company Cost Study ("SCCS") (IAWC Ex. 11.01, sponsored by Mark Young and Bernard Uffelman), the Self-Provision Study (IAWC Exs. 1.04 & 1.01SUPP, sponsored by Karla Teasley) and the Belleville Lab Study (IAWC Ex. 5.04, sponsored by Edward Grubb). The studies compare Service Company cost and projected market price for each service that the Service Company is expected to provide. Moreover, the methodologies used in these studies and information provided were not contested by any witness in this case. Thus, the cost/market comparisons provided by IAWC were uncontested.

Service Company Cost Study

As the record shows, certain services can be obtained by IAWC from either an affiliated provider (i.e., the Service Company) or a non-affiliate provider. (IAWC Ex. 1.00, pp. 16-20.) The cost/market comparisons required by the Docket 07-0507 Order for those services are

provided by the SCCS. As IAWC witness Uffelman explained, the SCCS compared, “the cost of each service expected to be obtained from the Service Company that can be performed by a non-affiliate to the costs that would be incurred if such services were obtained through competitive bidding on the open market.” (IAWC Ex. 11.01, p. 2.) As stated in the SCCS, it provides a:

comparison of the forecasted cost of certain services expected to be obtained by IAWC from the Service Company during the forecast period to the expected cost or market price for the services in the future period if such services were obtained on the open market. The results of the analysis show either the cost savings expected to be realized (i.e., Service Company costs lower than market) or the excess costs expected to be incurred (i.e., Service Company costs higher than market) by IAWC from obtaining professional and managerial services through the Service Company when compared to the costs of acquiring such services in the open market from third-party service providers.

IAWC Ex. 11.01, p. 2.

The SCCS compares the projected level of Service Company costs that IAWC expects to incur in the 2010 test year to the projected market prices for such services in the test year. The SCCS developed this information for each of the five categories of services that IAWC is expected to receive from the Service Company during the test year:

- Accounting Services,
- Engineering Services,
- Information Technology Services,
- Legal Services, and
- Management Consulting Services.

(IAWC Ex. 11.01, p. 6.) The Service Company’s hourly cost for each service was based on a detailed analysis performed for each service and each Service Company job classification for employees that would provide the service. The SCCS determined projected market rates for the services based on: (i) market comparison survey data of hourly rates for the services involved; and (ii) actual hourly rates charged by non-affiliate vendors to IAWC or other American Water affiliates (“Supplemental Data”). As the SCCS describes (IAWC Ex. 11.01, pp. 10-13), the

market surveys were identified by Deloitte & Touche through research that, based on certain selection criteria, concluded the surveys each provided a reliable indication of a market price for services covered. (IAWC Ex. 11.01, p. 10.) The surveys contain 2008 information (the most recent annual information available at the time the SCCS was prepared) relating to the compensation, fee and billing practices for the five categories of professional services firms. As the SCCS further describes (IAWC Ex. 11.01, Schedules 1.2, 2.2, 3.3, 4.4 and 5.2), Supplemental Data, including market rates that are the result of request for proposal (“RFP”) responses and competitive bidding, was also available for the five categories of professional services.

As the SCCS explains, appropriate escalators were applied to the pricing information provided by the surveys and Supplemental Data to develop projected market pricing for 2010. (IAWC Ex. 11.01, p. 8.) As the SCCS further explains (IAWC Ex. 11.01, p. 7), to provide the comparison required by the Docket 07-0507 Order, it was necessary to adjust the hourly costs for Service Company personnel to provide an “apples-to apples” comparison with non-affiliate supplier hourly charges. For example, outside service providers, such as law firms, normally do not assess a separate hourly rate for clerical personnel, such as secretaries, who support professional personnel retained by a particular client. (*Id.*) Under the Services Agreement, however, the Service Company does apply an hourly charge for such personnel. Accordingly, to develop an apples-to-apples comparison, the SCCS adjusted the Service Company hourly charges to incorporate the cost for “support” personnel into the hourly charges of the personnel supported. (*Id.*, pp. 7-8.) Thus, the market survey and Supplemental Data arrive at expected 2010 hourly prices as would be obtained through competitive bidding. As with all other aspects of the SCCS, no witness challenged use in the SCCS of this approach, or suggested that, at the time of

the SCCS, some other approach was feasible. Further, no witness questioned the results or methodology of the SCCS.

Thus, for those services that: (i) IAWC obtains from the Service Company; and (ii) can be obtained from an affiliate or non-affiliate provider, the SCCS compared the cost expected to be incurred by the Service Company in the test year to the amount that IAWC would be required to pay a non-affiliate provider based on market hourly prices for services that would result from competitive bidding. (IAWC Ex. 1.00 (Teasley Dir.), p. 18.) Furthermore, as discussed above, the cost/market comparison data presented in the SCCS was uncontested by any witness in this case.

For each of the five service classifications, the applicable Schedule in the SCCS shows a comparison of Service Company cost to the expected market price. As an example, the SCCS's analysis for Engineering Services compared Service Company costs to market prices for 15 separate professional classifications, as set forth in Table 1 below. (IAWC Ex. 11.01, Schedule 2, p. 1.) For each classification, the SCCS projected a 2010 hourly market price, which was compared to the projected Service Company cost for that classification. For example, the 2010 market price for a "Senior Scientist" was projected to be \$134 per hour, which was compared to the projected cost of a Service Company Senior Scientist of \$85 per hour. Thus, as shown by the SCCS, IAWC's use of a Service Company employee in this job category results in a savings of \$49 per hour of required service. *Id.* The following Table 1 contains an excerpt from Schedule 2 of the SCCS that illustrates the comparison.

Table 1 – Cost/Market Comparison – Engineering Services

Source: IAWC Ex. 11.01, Sched. 2, p. 1.

<u>Comparison of Service Company Rates to Market Rates</u>							
Professional Classification [a]	Rate				AWWSC Rate Above/(Below) Market Rate [f]		
	Service Company [c]	Market [e]					
(A)	(B)	(C)	(C)	(D)			
17 Drafters	\$ 52	\$ 70	\$	(18)			
18 Designers	77	94		(17)			
19 CADD technicians	67	76		(9)			
20 Civil engineers	78	90		(12)			
21 Senior civil engineers	98	123		(24)			
22 Electrical engineers	70	94		(24)			
23 Planners	67	113		(46)			
24 Scientists	66	88		(22)			
25 Senior scientists	85	134		(50)			
26 Project managers	101	130		(29)			
27 Department heads	126	142		(16)			
28 Associate	158	131		27			
29 Mechanical Engineer	57	97		(41)			
30 Senior Mechanical Engineer	97	131		(34)			
31 Senior Electrical Engineer	90	129		(39)			

Likewise, Schedule 1 of the SCCS provides a comparison of projected Service Company hourly costs to market prices for Accounting services, setting forth the projected Service Company hourly rate, projected market hourly rate, and the amount the Service Company rate is above (or below) the market rate. (IAWC Ex. 11.01, Sched. 1). The following excerpt from Schedule 1 illustrates the cost/market comparison.

Table 2 – Cost/Market Comparison – Accounting Services

Source: IAWC Ex. 11.01, Sched. 1, p. 1

<u>Comparison of Service Company Rates to Market Rates</u>							
Professional Classification [a]	Rate				AWWSC Rate Above/(Below) Market Rate [f]		
	Service Company [c]	Market [e]					
(A)	(B)	(C)	(C)	(D)			
7 Partners	\$ 217	\$ 220	\$	(3)			
8 Directors	149	181		(32)			
9 Managers	100	145		(45)			
10 Senior Associates	74	115		(41)			
11 Associates	63	94		(31)			

Similarly, for the Legal, Information Technology and Management Consulting service classifications, Schedules 3 through 5 of the SCCS provide a “Comparison of Service Company Rates to Market Rates”. Excerpts from those schedules are provided below.

Table 3 – Cost/Market Comparison – Information Technology Services

Source: IAWC Es. 11.01, Sched. 3, p. 2

<u>Comparison of Service Company Rates to Market Rates</u>			
Professional Classification [a]	Rate		AWWSC Rate Above/(Below) Market Rate [i]
	Service Company [e]	Market [h]	
(A)	(B)	(C)	(D)
49 Director of Client Services	\$ 130	\$ 223	\$ (93)
50 Director of IT Operations	199	213	(14)
51 Director of Systems Development	164	215	(52)
52 Manager of Data Center Operations	105	153	(48)
53 Manager of Information Security	102	151	(49)
54 Manager of IT Finance	243	151	92
55 Manager of Systems Development	124	182	(58)
56 Manager of Technical Support	100	150	(50)
57 Manager of Telecommunications	107	162	(55)
58 Senior IT Trainer	77	131	(54)
59 Senior Project Manager	123	170	(47)
60 Application programmer II	98	112	(14)
61 Application programmer III	112	135	(23)
62 Business Systems Analyst II	83	106	(23)
63 Business Systems Analyst III	95	128	(33)
64 Quality Assurance Analyst II	62	94	(32)
65 Senior Data Warehouse Analyst	102	134	(32)
66 Senior Database Administrator	100	152	(51)
67 Senior Technical Architect	114	170	(56)
68 Senior Customer Relationship Manager	87	144	(57)
69 Web Application Developer III	131	141	(10)
70 Computer Operator I	41	57	(16)
71 Computer Operator III	52	79	(27)
72 Help Desk Representative I	51	67	(16)
73 Help Desk Representative II	66	79	(13)
74 Help Desk Representative III	57	95	(38)
75 Production Control Analyst II	128	98	30
76 Shift Supervisor, Data Center Operations	66	122	(56)
77 Technical Support Analyst I	55	87	(32)
78 Technical Support Analyst II	71	109	(38)
79 Technical Support Analyst III	80	122	(43)
80 Information Security Analyst II	98	120	(22)
81 Information Security Analyst III	109	144	(35)
82 Network Administrator III	98	123	(25)
83 Systems Administrator II	122	120	2
84 Systems Administrator III	104	145	(41)
85 Systems Programmer II	75	113	(37)
86 Telecommunications Support Analyst III	81	128	(46)
87 Test Engineer II	97	108	(11)
88 Unix System Administrator III	123	142	(19)
89 Webmaster	115	123	(9)
90 Director, IT Process and Change Mgmt [g]	127	206	(79)
91 Configuration Mgmt Analyst [g]	94	126	(32)
92 Project Manager [g]	102	155	(54)
93 Director Program Management [g]	142	192	(49)
94 Project Leader [g]	100	137	(37)
95 Release/Build Engineer [g]	37	114	(76)

Table 4 – Cost/Market Comparison – Legal Services

Source: IAWC Ex. 11.01, Sched. 4 p. 1

<u>Comparison of Service Company Rates to Market Rates</u>						
	Professional Classification [a]	Service Company [d]		Market [f]		AWWSC Rate Above/(Below) Market Rate [g]
	(A)	(B)	(C)	(C)	(D)	(D)
5	Partner	\$	226	\$	435	\$ (209)
6	Associate		140		264	(124)
7	Paralegal		84		143	(59)

Table 5 – Cost/Market Comparison – Management Consulting Services

Source: IAWC Ex. 11.01, Sched. 5 p. 1

<u>Comparison of Service Company Rates to Market Rates</u>						
	Professional Classification [a]	Rate		Market [e]		AWWSC Rate Above/(Below) Market Rate [f]
	(A)	(B)	(C)	(C)	(D)	(D)
7	Junior Partners	\$	222	\$	301	\$ (79)
8	Senior Management Consultants		126		246	(120)
9	Management Consultants		120		210	(90)
10	Entry Level Consultants		78		163	(85)
11	Research Associates		78		137	(59)

The cost/market comparisons provided for each service that the Service Company provides were not questioned, disputed or otherwise challenged by any witness in this proceeding. Thus, they represent uncontroverted evidence of a comparison of cost to market for Service Company fees that the Order, without explanation, disregards.

Overall, the SCCS demonstrates that Service Company services are obtained at the lower of cost or market. Schedule 8 of the SCCS, as updated in the Supplemental Testimony of Mr. Uffelman (IAWC Ex. 10.00SUPP, p. 2) and shown on Table 6 below, provided a summary comparison of the Service Company costs to market prices for each of the test year service categories.

Table 6 – Overall SCCS Cost/Market Comparison

Source: IAWC Ex. 10.01SUPP

Illinois-American Water Company						
Service Company/Outside Provider Market Cost Comparison						
IAWC 2010 Test Year						
Line No.	Service Category [a]	Service Company Rate [b]	Market Rate [a]	Hourly Rate Difference -- AWWSC Above/(Below) Market Rate [c]	Forecast of Service Hours [b]	Projected AWWSC Cost Above/(Below) Market [d]
	(A)	(B)	(C)	(D)	(E)	(F)
1	Accounting Services	\$ 90	\$ 126	\$ (36)	46,645	\$ (1,657,166)
2	Engineering Services	84	113	(29)	37,640	(1,080,110)
3	Information Technology Services	94	130	(36)	37,629	(1,371,310)
4	Legal Services	140	253	(113)	5,713	(646,588)
5	Management Consulting Services	110	188	(78)	32,299	(2,519,106)
6	Projected Cost Savings Realized by IAWC through AWWSC					<u>\$ (7,274,280)</u>

Source
[a] Schedules 1, 2, 3, 4 and 5
[b] Schedules 1.1, 2.1, 3.1, 4.1 and 5.1
[c] Column B - Column C
[d] Column D x Column E

As Table 6 demonstrates, and as IAWC witness Mr. Uffelman explained, for services that could be obtained from affiliate or non-affiliate sources, the projected level of test year savings that would result from the procurement by IAWC of services through the Service Company as opposed to non-affiliate providers at market rates determined by competitive bidding during the test year is approximately \$7.24 million. (IAWC Exs. 10.00SUPP, p. 2; 10.01SUPP.)

Self Provision Study

For all services obtained from the Service Company, including those that cannot properly be obtained from a non-affiliate source, IAWC provided a Self Provision Study, which compares the Service Company cost for the services to the cost that IAWC would incur to itself retain additional employees in the market to provide each service (i.e., to “self provide”). (IAWC Exs. 1.00 (Teasley Dir.), p. 18; 1.04.) The Self Provision Study concluded, as shown in Table 7 below, that to self-provide all services provided by the Service Company, IAWC would be required to retain 182.5 additional employees (on an FTE basis), and also incur one-time costs for (i) the hiring of new employees; (ii) training and orientation; and (iii) relocation cost. (IAWC Ex. 1.00 (Teasley Dir.), p. 19.) As IAWC witness Teasley explained, the increased cost

(including applicable overheads) for all services that IAWC would experience if it were to “self provide” test year services expected to be obtained from the Service Company would amount to approximately \$6.25 million. (IAWC Exs. 1.00SUPP (Rev.) (Teasley Supp.), p. 3; 1.01SUPP.) No witness challenged IAWC’s evidence in this regard.

Table 7 – Self Provision Cost/Market Comparison

Self Provision Cost Market Comparison	
Market (Self-provisioning Cost)	\$30,379,997
One-time Initiation	\$1,345,208
Total Market	\$31,725,205
Forecast Service Company Cost	\$25,472,187
Difference (Market – Cost)	\$6,253,018

Source: IAWC Ex. 1.01SUPP, Sched. 1 p. 1

As indicated by the testimony of Ms. Teasley, certain services cannot be feasibly outsourced to non-affiliate providers (a conclusion that was not challenged by any witness or party). (IAWC Ex. 1.00 (Teasley Dir.), p. 16.) These services include: (1) corporate governance, due to the need to ensure appropriate accountability and to protect the confidentiality of certain information in accordance with securities laws; (2) customer service functions, to assure proper management of customer communication and the billing process, as well as compliance with applicable regulatory requirements; and (3) the employee benefits service center, due to the complex and confidential nature of employee benefits and need to maintain an appropriate relationship between IAWC and its employees. The Self Provision Study also compared IAWC’s cost to obtain these services from the Service Company to the “market” cost of obtaining such services by hiring the necessary personnel to perform them. (IAWC Ex. 1.04, Sched. 3.) The results of this cost comparison are summarized in the table below.

Table 8 –Cost/Market Comparison – Services Not Feasibly Outsourced to Non-affiliate

Cost Market Comparison for Services Not Feasibly Outsourced to Non-affiliate Provider				
	<i>Customer Call Center</i>	<i>Benefits Service Center</i>	<i>Governance</i>	
Market (Self-provision) Forecast Service Company	\$5,560,953	\$294,698	\$2,844,519	
Cost	\$4,780,168	\$187,296	\$2,035,743	Total
Difference (Market – Cost)	\$780,785	\$107,402	\$808,776	\$1,696,963

Source: IAWC Ex. 1.04, Sched. 3 p. 1

As the Table shows, IAWC projected savings of approximately \$1.7 million in the test year by obtaining these services from the Service Company rather than self-providing.

Belleville Lab Study

For water quality testing services, the SCCS was supplemented by the Belleville Lab Study performed by IAWC witness Mr. Grubb. (IAWC Ex. 5.04.) The SCCS demonstrated that, based on the expected per-hour market price for laboratory employee services, IAWC’s use of Service Company laboratory personnel is the lower cost approach. (IAWC Ex. 1.0, p. 18.) IAWC recognized, however, that laboratory services can be obtained in the market either by retaining outside laboratory personnel at a market-determined hourly rate or by obtaining laboratory tests from outside laboratories priced on a “per test” basis. (IAWC Ex. 5.00 (Rev.) (Grubb Dir.), p. 8.) Accordingly, IAWC supplemented the SCCS (which provided cost/market comparisons for retention of personnel at market determined hourly rates) with the Belleville Lab Study, which compared the Service Company’s projected “per test” laboratory cost to the expected market “per test” cost for the test year. (IAWC Exs. 5.00 (Rev.) (Grubb Dir.), pp. 8-12; 5.04.)

The Belleville Lab Study utilized per test price data based on competitive price information from three outside water quality testing labs for twenty-eight different water quality

tests currently being performed by the Belleville Lab. (IAWC Ex. 5.00 (Rev.) (Grubb Dir.), p. 9.)

The study demonstrates that, on a per-test basis (as opposed to the hourly rate basis examined in the SCCS), IAWC would realize test year savings of \$207,253 through projected test year use of the Service Company's Belleville Lab, rather than having an outside water quality testing lab perform the tests, as shown on Exhibit 5.04, page 1 of 3. (*Id.*) This savings amount is based on cost/market comparisons as follows:

Table 9 - Cost/Market Comparison – Belleville Lab

Source: IAWC Ex. 5.04, p.1.

Test Name (A)	Belleville Lab Cost (A)	Lowest Cost Vendor (B)	Overall Lowest Cost (C)	Vendor Lowest Cost (D)	AW Savings (E)
Carbamates	\$ 51,266	AW	\$ 51,266	\$ 60,447	\$ 9,181
Crypto/Giardia	79,720	AW	79,720	301,901	222,181
Cyanide	26,554	AW	26,554	28,704	2,150
Diquat	72,151	AW	72,151	76,357	4,206
EDB/DBCP	38,766	V2	30,046	30,046	(8,719)
Endothall	59,615	AW	59,615	59,664	49
Glyphosate	35,724	AW	35,724	43,716	7,992
HAA's	460,130	AW	460,130	817,762	357,631
Herbicides	191,898	V2	185,795	185,795	(6,103)
IC-DBP's	22,671	AW	22,671	133,014	110,344
IC-Minerals	108,407	AW	108,407	148,766	40,359
ICP	275,378	AW	275,378	512,076	236,698
ICPMS	285,524	AW	285,524	761,965	476,441
Lead & Copper	102,466	AW	102,466	110,360	7,894
Mercury	58,140	V1	38,085	38,085	(20,055)
Nitrate & Nitrite	68,510	AW	68,510	92,323	23,813
PCB's	50,842	V1	39,163	39,163	(11,679)
Perchlorates	21,021	AW	21,021	22,509	1,488
Radon	15,494	AW	15,494	31,658	16,164
Semi-Volatiles	151,922	AW	151,922	388,089	236,167
TOC	114,980	AW	114,980	144,483	29,504
TTHM's	213,509	AW	213,509	331,589	118,081
UV254	20,140	AW	20,140	26,715	6,575
Volatiles	174,670	AW	174,670	536,406	361,736
UCMR Degrad.*	98,799	V1	81,284	81,284	(17,516)
UCMR Explosive *	85,796	AW	85,796	103,115	17,319
UCMR Flame Ret *	74,454	AW	74,454	117,260	42,806
UCMR Nitro *	57,274	AW	57,274	97,940	40,666
Total	\$ 3,015,819		\$ 2,951,748	\$ 5,321,194	\$ 2,305,374

IL American's Portion of Savings \$ 207,253

No witness in this proceeding offered any evidence to contest the methodology or conclusions of any of the three studies discussed above (SCCS, Self Provision or Belleville Lab). No witness disputed the detailed forecast data presented in the SCCS, the Self Provision Study or the Belleville Lab Study.

Counsel for certain interveners offered as “argument” opinions and conclusions that were not based on the testimony of any witness. Thus, as the Order states, IAWC’s cost/market evidence was criticized, not by evidence of record, but via “arguments of counsel” alone. (Order, p. 47.) Strikingly, the Order did not identify a single specific evidentiary critique (or other comment) regarding any of the various cost/market comparisons provided by IAWC. Based on the record, the Order’s finding (p. 47) that, “there is no basis to compare cost to market” is inexplicable and contrary to the substantial record evidence discussed above. As a result, rehearing is needed to modify the Order’s findings and conclusions regarding Service Company fees to conclude that IAWC has complied with the Docket 07-0507 Order’s requirements that IAWC provide certain information regarding Service Company services and fees; that the evidence provided by IAWC provides a basis for comparison between Service Company and market cost for the services provided by the Service Company; and that record evidence supports the test year level of Service Company fees (management fee expense) set forth in the Administrative Law Judge’s Proposed Order (“ALJPO”)¹ and that that level of Service Company fees is just and reasonable.

¹ The ALJPO (p. 46) proposed to set the test year level of Service Company fees at the level projected by IAWC in its initial filing. IAWC did not take exception to this conclusion.

2. The Order’s Conclusion Regarding the Test Year Level of Service Company Fees Is Not Supported by Substantial Evidence, and Is Contrary to Law

As discussed above, based, at least in part, on the erroneous finding that IAWC did not provide cost/market comparisons, the Order adopted the Alternative Projection. As discussed above, the finding that there is no basis to compare cost to market is unexplained and unsupported. Thus, there is no basis for imposing the Alternative Projection.

In adopting the Alternative Projection, the Order (p. 47) states that, “the Commission agrees with the AG’s position on this issue and concludes that the Service Company fees should be capped at 5% over the amount approved in the 07-0507 Order.” Although this conclusion is not explained, it appears that Order is adopting the position of AG/JM witness Mr. Smith, who recommended the Alternative Projection in testimony. The Alternative Projection, however, is arbitrary and unsupported by the evidence. It is well established under Illinois law that, in setting rates, the Commission must determine that the rates allow the utility to recover its prudent and reasonable costs. *Citizens Utility Bd. v. Illinois Commerce Comm’n*, 166 Ill. 2d 111 (Ill. 1995); *see also Illinois Bell Telephone Co. v. Illinois Commerce Comm’n* (1953), 414 Ill. 275, 286 (rates fixed by the Commission must be adequate to recover reasonable operating expenses and for an adequate rate of return and operating expenses). 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. *Peoples Gas Light & Coke Co. v. Slattery*, 373 Ill. 31, 25 N.E.2d 482, 497 (1940).

IAWC’s proposed level of Service Company fees were based on a detailed projection of test year services and costs. (IAWC Exs. 5.00R2 (Rev.), pp. 4-5; 5.01R2.) As discussed above, evidence presented by IAWC regarding Service Company fees addressed in detail: the need for each service expected to be required in connection with IAWC’s operations (IAWC Ex. 12.00 (J.

Young Dir.), pp. 2-26); the number of service hours required for each job classification for each type of service; and the projected IAWC cost for each service to be acquired from the Service Company during the test year. (IAWC Exs. 5.00 (Rev.) (Grubb Dir.), pp. 4-11; 5.00R2 (Rev.) (Grubb Reb.), pp. 4-6.) IAWC also presented detailed evidence showing that, for each service expected to be acquired, the Service Company is the lower of cost or market provider. (IAWC Exs. 11.01; 1.04; 1.01SUPP; 5.04.)

In response to this evidence, Mr. Smith proposed that IAWC's detailed projection of test year Service Company costs be disregarded, and that, in its place, the Commission substitute the Alternative Projection. In offering this proposal, Mr. Smith did not contest the need for any service expected to be provided in the test year. Mr. Smith also did not contend that the projected cost of any required service was inaccurate, the number of service hours required for each job classification for each type of service was inaccurate, or that the Service Company is not the lower of cost or market source of the service. Thus, Mr. Smith's proposal is nothing more than substitution of an arbitrary amount for prudent and necessary projected cost levels supported by detailed evidence.

The adjustment offered by Mr. Smith is also contradicted by the evidence because the Alternative Projection is based on projected labor expense increases (from the Hewitt U.S. Salary Increase Survey), and so ignores the effect of increases in other non-labor expenses. (AG/JM Ex. 5.0, p. 50.) In fact, as Mr. Grubb explains, rising Service Company fees are not attributed only to increasing salaries, as Mr. Smith's testimony implies. (IAWC Ex. 5.00SR (Grubb Sur.), pp. 8-9.) Mr. Grubb provided detailed information explaining the factors that resulted in increased Service Company costs, including: increased pension and OPEB costs, increased depreciation expenses, caused by capital investments, increased maintenance costs for

information technology systems, and increases in labor and group insurance costs. (*Id.*, pp. 10-11.) Mr. Smith’s adjustment ignores these real cost increase factors in “computing” his arbitrary Alternative Projection. (IAWC Ex. 5.00R2 (Rev.) (Grubb Reb.), p. 4.)

The Order also references the position of the AG that, “the 5% figure is consistent with the actual fluctuation in Management Fees between rate cases.” The Order does not explain if or how this conclusion is supported by the record. The record does not contain any calculation or demonstration, by Mr. Smith or any other witness, of the level of Service Company fees between rate cases. In fact, this rationale for the Alternative Projection was not set forth in the testimony of any witness. Neither Mr. Smith, nor any other witness in these proceedings, testified that the Alternative Projection would be consistent with the fluctuation in management fees between rate cases. Rather, the assertion is based on claims of counsel that are unsupported by evidence of record: AG first presented this justification in AG’s Initial Brief, based on counsel’s submission of certain expense data. (AG Init. Br., pp. 22-24; *see also* AG Reply Br., p. 28). As a result, the Order must be modified to find that the Alternative Projection is unsupported and should be rejected, and instead, as explained above, the Service Company fee level set forth in the ALJPO should be approved.

3. The Docket 07-0507 Order Required the Company to Provide Certain Evidence Regarding Service Company Costs and Services, Which the Company Provided

The Order concludes (p. 47), without explanation, that IAWC failed to provide the information regarding Service Company fees and services required by the Commission’s mandate in Docket 07-0507. The Docket 07-0507 Order required the Company to perform three tasks:

- (1) “conduct a study comparing the cost of each service obtained from the Service Company to the costs of such services had they been obtained through competitive bidding in the open market;”

(2) provide an analysis of the services provided by the Service Company to all of IAWC’s affiliates,” with “details on the specific services provided to IAWC;” and

(3) “provide details on . . . how costs are allocated among affiliates of IAWC.”

Docket 07-0507 Order, pp. 30-31. As IAWC explained in its Initial Brief (pp. 57-69), Reply Brief (pp. 37-47) and Reply Brief on Exceptions (pp. 22-32) (hereby incorporated by reference), in response to the Docket 07-0507 Order, the Company submitted evidence (including the three studies discussed above) through five witnesses. The record, summarized in the chart below, shows that the Company fully satisfied each of these requirements, through extensive evidence provided by the five witnesses and through the preparation of the three separate comparative studies that provided cost/market comparisons. (See IAWC Init. Br., pp. 57-72, hereby incorporated by reference.)

DOCKET 07-0507 REQUIREMENT	RESPONSIVE IAWC EVIDENCE
1) Cost/market comparison study	Service Company Cost Study (IAWC Ex. 11.01) Self Provision Study (IAWC Ex. 1.04, 1.01SUPP) Belleville Lab Study (IAWC Ex. 5.04) Testimony of Ms. Teasley (IAWC Ex. 1.00 (Teasley Dir.), p. 15-21) Testimony of Mr. Uffelman (IAWC Ex. 10.00 (Uffelman Dir.), pp. 4-5) Testimony of Mr. Grubb (IAWC Ex. 5.00 (Rev.) (Grubb Dir.), p. 2-12)
2) Analysis of all services provided	Testimony of Ms. Teasley (IAWC Ex. 1.00 (Teasley Dir.), p. 15-26) Testimony of Mr. John Young (IAWC Ex. 12.00 (John Young Dir.), pp. 2-26)
3) Details on cost-allocation among affiliates	Testimony of Mr. Grubb (IAWC Ex. 5.00 (Rev.) (Grubb Dir.), pp. 4-11)

Collectively, IAWC’s detailed evidence in the chart above included, *inter alia*, evidence comparing the cost of each service obtained from the Service Company to the costs of such

services had they been obtained through competitive bidding in the open market (IAWC Exs. 11.01; 1.04; 5.04); extensive information on the nature and benefit of each service provided by the Service Company to IAWC (IAWC Ex. 12.00 (John Young Dir.), pp. 2-26); the job classification of all Service Company personnel expected to provide 2010 services, the number of projected hours of service required in the test year, and the related hourly cost for each functional service area and for each employee job classification (IAWC Ex. 11.01); a detailed budget for the services in the test year (IAWC Exs. 5.00R2 (Grubb Reb.), pp. 4-5; 5.01R2); and a detailed description of the process for allocating Service Company costs to IAWC and its regulated affiliates (IAWC Ex. 5.00 (Grubb Dir.), pp. 4-7.)

The Order does not explain the finding (p. 47) that IAWC's extensive evidence did not meet the requirements of the Docket 07-0507 Order. The Commission offers only the conclusory statement that, "the studies performed by IAWC do not represent a reasonable effort to comply with the directive of the Commission." (Order, p. 47.) In support of this statement, the Order also states that, "[the] Intervenors also assert, *through the arguments of counsel*, that the Company's Service Company cost study did not comply with the directive in the Order in Docket 07-0507." *Id.* (emphasis added). The Order, however, does not explain what arguments of counsel were relied on or how they were relied on. Moreover, the Order fails to recognize that, as the discussion above demonstrates, many of the claims made by counsel in Briefs filed by the AG, the Municipalities and Bolingbrook are unsupported by the evidence. Furthermore, unsupported assertions offered by counsel in briefing are not a proper basis for a conclusion. As explained below, the Order must base its decisions solely on the evidence of record. Failure to do so violates Illinois and constitutional law.

To the extent the Order could be interpreted to refer to arguments of counsel regarding bidding requirements (*see* Bolingbrook Init. Br., pp. 4-7), however, IAWC understood the Docket 07-0507 Order as requiring a comparison of projected Service Company costs to the expected market price services, “had they been obtained through competitive bidding on the open market.” As discussed above, cost/market comparisons were provided for all services (including services that cannot feasibly be provided by non-affiliate providers) by the Self-Provision Study, the Belleville Lab Study and the SCCS. (*See also* IAWC Init. Br., pp. 63-64, hereby incorporated by reference.) As also discussed above, the market survey and Supplemental Data set forth in the SCCS arrive at expected 2010 hourly prices as would be obtained through competitive bidding. As with all other aspects of the SCCS, no witness challenged use in the SCCS of this approach, or suggested that, at the time of the SCCS, some other approach was feasible. Further, no witness questioned the results or methodology of the SCCS. (*See* IAWC Reply Br., p. 43-44, hereby incorporated by reference.) No witness testifying for any party suggested that any other procedure should or could be employed, or that such an approach would produce projected 2010 pricing information more accurate than that produced by the projection method that IAWC employed.

Rehearing must therefore be granted on the Order to conform the findings to the evidence of record, which, as explained above, demonstrates that IAWC did in fact comply with the Docket 07-0507 Order, a point which no witness in this proceeding has challenged.

4. The Order’s Requirement for the Audit Is Unsupported

As a consequence of the Order’s failure to consider IAWC’s cost to market comparisons, the Order’s conclusion that the Audit should be conducted must also be reversed to in light of the evidence of record. The Order states (p. 48) that the Audit is needed to determine, “whether Service Company fees assessed to IAWC are in fact provided on a lower of cost or market

basis.” However, as explained above, this determination can be made directly on the basis of record evidence uncontested by any witness, thus eliminating the need for an expensive audit² with doubtful incremental value. Because the Order erred in concluding (p. 48) that it lacked a basis for comparison of the lower of cost or market for the Service Companies services, and because the Company has already demonstrated that the Service Company provides services at a lower of cost or market basis, an audit would be superfluous and would impose an unnecessary additional burden on IAWC’s customers. *See* 220 ILCS 5/8-102 (stating that “[t]he cost of an independent audit shall be born initially by the utility, but shall be recovered as an expense through normal ratemaking procedures”).

IAWC has already provided extensive information on the services provided by the Service Company to IAWC and their costs, as discussed above. In accord with the Commission’s procedural rules, all parties in this proceeding had the opportunity to submit discovery requests directed to the evidence that IAWC submitted, and to respond as they deemed appropriate to the evidence with cross-examination and/or the presentation of responsive evidence presented through expert or other witnesses. *See, e.g.*, 83 Ill. Admin. Code §§ 200.340, 200.360, 200.610, and 200.660. Thus, all aspects of services provided by the Service Company to IAWC and the cost of those services were subject to review and comment to the extent that any party deemed appropriate.

Despite the comprehensive presentation and opportunities for review and challenge that this proceeding provided, no witness in this proceeding disputed any aspect of the evidence offered by IAWC’s five witnesses addressing this topic. As discussed herein, no witness challenged either the methodology or results of IAWC’s SCCS, the Self-Provision Study, or

² The Company notes that the projected cost of the SCCS was over \$420,000. (*See* Schedule C-10.)

Belleville Lab Study. No witness questioned the need for any service expected to be provided in the test year by the Service Company to IAWC. No witness identified even one Service Company service area or job classification for which the number of hours shown in the 2010 projection was purportedly high. No witness disputed the detailed forecast data presented in the SCCS, or suggested that the Service Company budget was inaccurate. IAWC provided information regarding its service procurement policies and practices, and these also were not criticized or challenged by any witness in any respect. In short, the parties had an opportunity to perform due diligence with respect to the Service Company fees and services and failed to do so. Finally, no witness recommended an independent audit, or suggested that one was necessary. (See IAWC Reply Br., pp. 46, 47, 54.) For this reason, rehearing should be granted to modify the Order to conclude that an independent audit of Service Company fees is neither beneficial nor necessary to determine whether the Service Company's fees are provided on a lower of cost to market basis, and therefore should not be conducted.

B. The Order's Findings Regarding IAWC's Service Company Fees Are Contrary to Law

As discussed above, the Order, arbitrarily and without explanation, ignores IAWC's extensive evidence regarding Service Company fees. As such, the Order in this regard is contrary to the manifest weight of the evidence. Moreover, the Order is based on extra-record considerations, including, as discussed below, unsworn extra-record comments. Under well-established Illinois law, findings of the Commission in rate-making and other proceedings must be based solely on record evidence. *Moline Consumers' Co. v. Illinois Commerce Commission*, 353 Ill. 119, 129 (Ill. 1933); 220 ILCS 5/10-103; 5 ILCS 100/10-35; see also 83 Ill. Adm. Code § 200.700; *Business & Prof. People for the Public Interest v. Illinois Commerce Commission*, 136 Ill. 2d 192, 227 (1989) ("*BPI I*") (after noting that Commission decisions must "be based

exclusively on the record,” finding reversible error where the record contained “evidence on which to determine [an issue], but the Commission chose to disregard this evidence”). Moreover, those findings must be supported by substantial evidence, and can be reversed if against the manifest weight of the evidence. 220 ILCS 5/10-201(e)(iv); *People ex rel. Hartigan v. Illinois Commerce Comm'n*, 117 Ill. 2d 120, 142 (1987). In addition, a decision of the Commission may be overturned if the decision is without the jurisdiction of the Commission; the decision is in violation of the State or federal constitution or laws; or the manner by which the Commission made its decision was in violation of the State or federal constitution or laws to the prejudice of the appellant or if the finding or order, or the manner in which it was made, are contrary to law. 220 ILCS 5/10-204(e)(iv); *BPI I*, 136 Ill. 2d at 204.

Moreover, the Commission is required to make findings which clearly describe the grounds on which it acted. *Island Lake Water Co. v. Illinois Commerce Comm'n*, 65 Ill. App. 3d 853, 855 (Ill. App. Ct. 1978); *Camelot Utilities Inc. v. Commerce Commission*, 51 Ill. App. 3d 5, 9 (Ill. 1977) (Commission must make specific findings as to the basic elements in a case). Such findings must be made with specificity and must be sufficient to allow “intelligent” review of the Commission’s decision by the Appellate Court. *Cerro Copper Products v. Illinois Commerce Commission*, 83 Ill. 2d 364, 370 (Ill. 1980); *Citizens Util. Bd. v. Illinois Commerce Comm'n*, 276 Ill. App. 3d 730, 741-43 (1st Dist. 1995) (where the Commission had not “articulated findings” which supported its order on certain expenses, court remanded these issues to the Commission for further consideration). With respect to Service Company fees, the Order’s conclusions have not been properly articulated, are contrary to the manifest weight of the evidence, and are contrary to law.

1. The Order Does Not Properly Articulate Findings in Support of Its Decision Regarding Service Company Fees

As discussed above, the Order does not articulate findings explaining the following conclusions regarding Service Company fees:

- The conclusion that IAWC did not provide the information in this proceeding that was required by the Docket 07-0507 Order in this rate filing (Order, p. 47);
- The conclusion that there is no basis for comparison of the lower of cost or market for Service Company services (Order, pp. 47-48);
- The conclusion that an independent audit is required under Section 8-102 of the Act (Order, pp. 48-49);

2. The Order's Decisions Regarding Service Company Fees Are Not Supported by Substantial Record Evidence

As discussed above, the Order's conclusions (p. 47) regarding the Alternative Projection on Service Company fees and the requirement for the Audit are not supported by (and are in fact contradicted by) substantial evidence of record. As such, these conclusions are contrary to Illinois law and a rehearing of them is appropriate.

3. The Order's Consideration of Extra-record and Ex Parte Material is Contrary to Law

The Commission has long conducted forums at which members of the public are provided with an opportunity to comment with regard to rate case and other matters. *See, e.g., Illinois Power Co.*, Docket 82-0152, 1983 Ill. PUC LEXIS 39; 51 P.U.R.4th 39 (Jan. 12, 1983). More recently, the Public Utilities Act ("Act") has required that, "members of the public shall be afforded time, subject to reasonable constraints, to make comments to or to ask questions of the Commission," and that the Commission provide a web site and a toll-free telephone number to accept comments from Illinois residents regarding matters before the Commission. 220 ILCS 5/2-107. For water utilities, a provision added to the Act in 2006 establishes specific requirements for public forums and states that, "reports and comments made during or as a result

of each public forum must be made available to the hearing officials and reviewed when drafting a recommended or tentative decision, finding or order pursuant.” 220 ILCS 5/8-306(n).

IAWC does not dispute that unsworn comments offered by members of the public can serve an important purpose. Specifically, these comments can provide guidance to the Commission and Staff as to issues in a proceeding that require review. Based on such comments, the Commission may assign its Staff to review a utility’s costs, as it did in this case by assigning seven Staff witnesses to review IAWC’s proposed rate increase and develop evidence addressing that review. Public comments may also guide the Commission to review evidence regarding areas of concern, pursuant to the requirement in Section 8-306(n).

IAWC also values comments and input from its customers, as the record evidence in this case shows. IAWC’s witness Ms. Teasley identified a number of customer concerns raised in this proceeding. (IAWC Ex. 1.00R (Teasley Reb.), pp. 1-2.) As Ms. Teasley explained, IAWC is able to respond to the concerns raised through measures to minimize increases in its costs and rates, and by providing high quality service to customers as required by the Act. (IAWC Exs. 1.00 (Teasley Dir.), pp. 21-26; 1.00R (Teasley Reb.), pp. 5-8; 1.00SR (Teasley Sur.), pp. 2-5); 2.00 (Norton Dir.); 3.00 (Kaiser Dir); 12.00 (J. Young Dir.), pp. 2-26.)

As discussed above, however, under well-established Illinois law, findings of the Commission in rate-making and other proceedings must be based solely on record evidence. As explained in IAWC’s Reply Brief on Exceptions (pp. 2-10, hereby incorporated by reference) unsworn statements, given at forums or otherwise, such as on a website, are out of court statements – in short, hearsay. *Albertina v. Owens*, 3 Ill. App. 3d 703, 704 (Ill. App. Ct. 1971). Hearsay is not evidence. *U.S. v. International Harvester Co.*, 274 U.S. 693, 703 (1927); *People v. Williams*, 85 Ill. App. 3d 850, 855 (Ill. App. Ct. 1980). The prohibition on the use of hearsay

in judicial and administrative proceedings is strongly connected with the prohibition on the use of *ex parte* communications, discussed below, as both are, in part, considered unreliable because they are not subject to cross-examination. *Waste Management of Illinois, Inc. v. Pollution Control Board*, 175 Ill. App. 3d 1023, 1046 (2nd Dist. 1988). Thus, Section 2-107 makes clear: “Notwithstanding any other provision of this Section, the Commission's established procedures for accepting testimony from Illinois residents on matters pending before the Commission *shall be consistent with the Commission's rules regarding ex parte communications and due process.*” 220 ILCS 5/2-107 (Emphasis added).

Moreover, the Illinois Supreme Court has held, “that the commissioners are not allowed to act on their own information but must base their findings on evidence present in the case.” *Island Lake Water Co.*, 65 Ill. App. 3d 859. In other words, “findings must be based on evidence presented in the case, with an opportunity to all parties to know of the evidence to be submitted or considered, to cross-examine witnesses, to inspect documents, and to offer evidence in explanation or rebuttal, and nothing can be treated as evidence which is not introduced as such.” *Chicago & E.I. Ry. Co. v. Illinois Commerce Commission*, 341 Ill. 277, 285 (Ill. 1930). The Commission has itself recognized that unsworn, extra-record statements made at a forum are not reviewable as evidence in the record. *Commonwealth Edison*, Docket 96-0410, 1998 Ill. PUC LEXIS 341, at *17, 46 (Ill. PUC 1998) (Commission rejected arguments based on forum comments, not made under oath or subject to cross-examination, as arguments were premised on testimony and articles which were not admitted into the record). As a result, it is clear that unsworn statements at public hearings are not evidence. *See, e.g., O'Brien v. Retirement Board of Firemen's Annuity & Ben. Fund*, 343 Ill. App. 630, 637 (Ill. App. Ct. 1951) (unsworn statements and reports cannot be considered by the Retirement Board in a hearing for benefits).

In addition, due process rights apply to parties to administrative hearings under both the Fourteenth Amendment to the United States Constitution and Article I, Section 2 of the Illinois Constitution. U.S. Const. amend. XIV; Ill. Const. Art I, Sec. 2; *In re Abandonment of Wells Located in Illinois*, 343 Ill. App. 3d 303, 306 (5th Dist. 2003). The due process requirements of administrative proceedings include, “the opportunity to be heard, the right to cross-examine adverse witnesses, and impartial rulings on the evidence.” *Gigger v. Board of Fire and Police Com'rs of City of East St. Louis*, 23 Ill. App. 2d 433, 439 (4th Dist 1960); *see Abrahamson v. Illinois Dep't of Professional Regulation*, 153 Ill. 2d 76, 95 (Ill. 1992). In particular, constitutional due process rights, “require[] that parties have an opportunity to cross-examine witnesses.” *Waste Management of Illinois, Inc.*, 175 Ill. App. 3d at 1036; *see also Balmoral Racing Club, Inc. v. Illinois Racing Board*, 151 Ill. 2d 367, 400-401 (Ill. 1992) (finding it would be a violation of basic due process protections to allow documents not subject to adversarial testing or cross examination to be included in record as “cross-examination is required in order to ensure that due process requirements are met”). Reliance on unsworn, extra-record statements that are not subject to cross-examination is therefore a due process violation.

For these reasons, the orders of the Commission generally do not recite public comments as grounds for decision. The Order, however adopts a different approach. The Order states (p. 206):

The Commission also wishes to emphasize that it appreciates the many comments provided in the public forums and on the e-Docket system, as well as the time and effort expended by those who prepared and provided them. These comments have been considered by the Commission in reaching its decisions in this Order, to the extent permitted by law. The Commission notes that many of the adjustments proposed by Staff, the AG and other Intervenors have been adopted in this Order, thereby reducing the revenue increase proposed by IAWC.

This conclusion follows extensive recitation in the prefatory portions of the Order of the nature and extent of public comments. *See Order*, pp. 2-3, 197-203. Thus, it is clear that the

Commission considered public comments in reaching its decision in this proceeding. What is not clear, however, is what public comments were considered, and how the Commission's decision relied on them. Also unexplained is how public comments could be considered, "to the extent permitted by law." Certain unsworn extra-record comments were expressly directed to the level of IAWC's Service Company fees and the need for an audit. (*See, e.g.*, March 24 Bench Session, Tr. 5-6.) Whether these comments factored into this decision, however, is not explained. This statement also suggests that (although, as discussed above, the meaning of this discussion is unclear), the Commission has adopted adjustments (including the adoption of the Alternative Projection) in response to public comments.

In addition, some of the comments received under Section 2-107 were from witnesses and representative of parties in the case, who were provided with opportunities to make extra-record statements to the Commission as "members of the public," but to whom IAWC had no opportunity to respond. In particular, certain "members of the public"³ ("Ex Parte Speakers") who addressed the Commission pursuant to Section 2-107, at its regular open meeting on March 16, 2010 and its bench session of April 7, 2010, were witnesses for parties to this proceeding. The Ex Parte Speakers made unsworn, extra-record statements ("Ex Parte Statements") regarding IAWC's level of expenses, as well as the need to examine IAWC's business practices.

As noted above, Section 2-107 requires that the Commission's procedures for accepting testimony on matters before the Commission, "*shall be consistent with the Commission's rules regarding ex parte communications and due process.*" 220 ILCS 5/2-107 (emphasis added). It was a violation of the Commission's *ex parte* rules and of due process for these Ex Parte

³ The speakers were: Robert Boros, witness for the AG, Avis Gibbons, witness for the AG and Mary Niemiec, witness for Homer Glen.

Speakers to address the Commission outside of the hearing context and without notice or an opportunity for IAWC to respond.

The Commission's Rules of Practice provide, in pertinent part: "...once notice of hearing has been given in a contested case or licensing proceeding, Commissioners, Commission employees and Hearing Examiners shall not communicate directly or indirectly with: (1) Any party to the proceeding on any issue in the proceeding; or (2) A party's representative on any issue in the proceeding; or (3) Any other person concerning an issue of fact in the proceeding; without notice and opportunity for all parties to participate." 83 Ill. Adm. Code § 200.710(a). The Ex Parte Speakers were witnesses for parties in this case who directly addressed the Commission at its meetings. IAWC, however, did not receive notice that the Ex Parte Speakers would be making statements, and did not have an opportunity to participate or otherwise respond.

As witnesses, the Ex Parte Speakers presented record testimony in this proceeding. Their testimony was subject to discovery and IAWC had an opportunity to respond in testimony in accord with the established schedule. These witnesses were also subject to cross-examination as deemed required at the evidentiary hearing. Their appearance before the Commission at its bench sessions and open meetings, long after the evidentiary record had been closed, was an attempt by these witnesses, on behalf of the AG and Homer Glen, to supplement their testimony without an opportunity for IAWC to respond. For parties and witnesses in this proceeding, the Commission established a schedule for the filing of testimony and presentation of evidence. The purpose of such a schedule was to allow the orderly presentation of, and response to, testimony. By presenting themselves to the Commission as "members of the public," witnesses subverted

the schedule in this proceeding with a “second bite at the apple” in contravention of 83 Ill. Adm. Code Section 200.710(a).

In addition, under Section 10-103 of the Act, the requirements regarding *ex parte* communications in Section 10-60 of the Illinois Administrative Procedure Act (“IAPA”), “shall apply in full to Commission proceedings, including ratemaking cases.” 220 ILCS 5/10-103. Section 10-60 states that, “agency heads, agency employees, and administrative law judges shall not, after notice of hearing in a contested case . . . communicate, directly or indirectly, in connection with any issue of fact, with any person or party, or in connection with any other issue with any party or the representative of any party, except upon notice and opportunity for all parties to participate.” 5 ILCS 100/10-60(a). Under Section 10-60, therefore, *ex parte* communications are prohibited unless there is notice and an opportunity to participate. Moreover, Section 10-60 recognizes that communications by a party or a party representative require different treatment than those by non-party members of the public. Like 83 Ill. Adm. Code § 200.710(a), Section 10-60 places heightened restrictions *ex parte* statements by a party or the representative of a party in a contested case. Section 10-60 prohibits communications with “any person or party” in connection with any issue of “fact”. 5 ILCS 100/10-60(a) For a party or the representative of a party, however, Section 10-60 is much broader, and prohibits communications in connection with *any* issue in a contested case, without notice and an opportunity to participate.

Section 10-60(d) requires that *ex parte* communications under that Section be made part of the record of the proceeding. 5 ILCS 100/10-60(d). In the case of the Ex Parte Speakers, however, placing their comments on the record (for example by posting the transcript of their statements on e-docket) does not “cure” the prejudice to the Company of allowing witnesses and

party representatives to address the Commission through unsworn, extra-record statements, because the Ex Parte Speakers' extra-record statements also violate IAWC's due process rights. As discussed above, due process requires that a party have the opportunity to be heard and have the right to cross examine adverse witnesses. IAWC did not receive notice that the Ex Parte Speakers would be making statements, nor did the Commission give IAWC an opportunity to cross-examine the Ex Parte Speakers after they spoke or otherwise respond to their unsworn, extra-record statements. Therefore, the Ex Parte Speakers' extra record presentations violated IAWC's due process rights.

The Order acknowledges that unsworn and extra record statements were considered, at least to some extent, in reaching its decisions. (Order, p. 206.) IAWC, however, had no opportunity to conduct cross examination or discovery on these statements, or otherwise respond. Under Illinois law, these statements do not constitute proper evidence on which the Commission may base a decision. Moreover, certain of the comments were received in violation of the Commission's *ex parte* rules and due process requirements. To the extent these statements are a basis for the Order's findings on Service Company fees (which is not explained), for the reasons discussed above, the Order's findings and conclusions in this regard violate provisions of the Act, IAPA and Commission rules, 220 ILCS 5/10-103; 5 ILCS 100/10-35; 220 ILCS 5/2-107; 83 Ill. Adm. Code § 200.710, longstanding Illinois law, *BPI I*, 136 Ill. 2d 192, 227 (1989); *Island Lake Water Co.*, 65 Ill. App. 3d at 855, and IAWC's constitutional and statutory due process rights. U.S. Const. amend. XIV; Ill. Const. Art I, Sec. 2; 220 ILCS 5/2-107; 5 ILCS 100/10-60; *Waste Management of Illinois, Inc.*, 175 Ill. App. 3d at 1036.

III. CONCLUSION

As discussed above, the Order does not explain its findings regarding Service Company fees, the Order's findings and conclusions on Service Company fees disregard substantial evidence provided by the Company and so are contrary to the manifest weight of the evidence, and the Order based its decision on extra-record statements in a manner that is not explained but which violates *ex parte* rules, due process and Illinois law. As a result, with respect to Service Company fees, the Order is not supported by substantial evidence and is contrary to law.

Rehearing of the above-specified findings and conclusions of the Order is therefore appropriate to modify the Order to conclude: (1) that IAWC has complied with the Docket 07-0507 Order's requirements that IAWC provide certain information regarding Service Company services and fees; (2) that the evidence provided by IAWC provides a basis for comparison between Service Company and market cost for the services provided by the Service Company; (3) that record evidence supports the test year level of Service Company fees (management fee expense) set forth in the Administrative Law Judge's Proposed Order and that that level of Service Company fees is just and reasonable; (4) that the Alternative Projection is unsupported and should be rejected; and (5) that an independent audit of Service Company fees is neither beneficial nor necessary to determine whether the Service Company's fees are provided on a lower of cost to market basis, and therefore should not be conducted.

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Respectfully submitted,

ILLINOIS-AMERICAN WATER
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