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**STATE OF ILLINOIS**

**ILLINOIS COMMERCE COMMISSION**

**CONSUMERS ILLINOIS WATER COMPANY )**  
**Petition for (1) issuance of a Certificate of Public )**  
**Convenience and Necessity ("Certificate") to )**  
**operate a water supply and distribution system and ) Docket 00-0366**  
**sewage collection system in Lake County; )**  
**(2) approval of accounting entries related to )**  
**acquisition of facilities; (3) approval for application )**  
**of rates. )**

**BRIEF ON EXCEPTIONS OF CONSUMERS ILLINOIS WATER COMPANY**

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**BRIEF ON EXCEPTIONS OF CONSUMERS ILLINOIS WATER COMPANY**

Consumers Illinois Water Company ("CIWC" or the "Company") hereby submits this Brief on Exceptions with respect to the Hearing Examiner's Proposed Order ("Proposed Order") issued on March 20, 2001. The changes to the language of the Order, which are suggested herein, are set forth in Appendix "A."

**I. INTRODUCTION**

The Proposed Order (p. 3) concludes correctly that the Certificate of Public Convenience and Necessity ("Certificate") requested by CIWC should be granted. CIWC does not take issue with this conclusion. CIWC also does not dispute the Proposed Order's conclusion (p. 4) with regard to the application of rates of the Village of Mundelein. CIWC, however, does take exception to the proposed Order's conclusions (pp. 8-10; 13-14) with regard to appropriate accounting entries to reflect the original cost of the water and sewer facilities acquired.

**II. WATER SYSTEM ORIGINAL COST**

CIWC takes exception to the Section of the Proposed Order at pages 8 through 10 which is captioned "5. Commission Analysis." This Section should be deleted in its entirety, and replaced with the language set forth in Section I of Appendix "A."

**A. Summary of CIWC's Position**

The Proposed Order concludes (p. 9) that CIWC is correct in its belief that, under Accounting Instruction 18 of the USOA-Water, the "original cost" of the water system is equivalent to the "value" of the land which Thorngate exchanged for the water system.<sup>1</sup> The Proposed Order, however, goes on to make additional findings, each of which is incorrect and unsupported by the evidentiary record:

(1) The Proposed Order (p. 10) refers to, "... the value of whatever, if any, land can be deemed to have been exchanged for the water system." Both CIWC and Staff, however, agree that Thorngate exchanged land for the water system, cash and other infrastructure items. [Staff Ex. 3.0, p. 6, Tr. 35 (Sant); CIWC Ex. 1.0SR, p. 5 (Rakocy).] The fact that Thorngate exchanged land for the water system is not in dispute.

(2) The Proposed Order (p. 9) rejects undisputed evidence showing that the best measure of the value of the land exchanged for the water system is the estimated cost incurred by the Phase 2 developers to build the water system. The Proposed Order, however, does not explain why the land's value would differ from the then-current cost of the property exchanged for it. During the evidentiary portion of the proceeding, no one questioned or disputed CIWC's evidence regarding the value of the exchanged land. The record, therefore, does not support a finding that the undisputed valuation submitted by CIWC should be rejected.

(3) The Proposed Order (p. 9) incorrectly suggests that certain prior Commission Orders (Rollins Sewer and Water Company, Docket 83-0693 (Oct. 30, 1984) and Consumers Illinois Water Company, Docket 88-0045 (Oct. 12, 1988)) cited by CIWC in another context were cited in support of CIWC's position concerning the "value" of the exchanged land. These

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<sup>1</sup> Unless otherwise indicated, abbreviations used in this Brief on Exceptions are the same as those used in the Initial Brief and Reply Brief of CIWC.

Orders, however, were not cited by CIWC to indicate the land's value. In this regard, the Proposed Order's findings are incorrect and inappropriate. (The principle for which the Rollins and CIWC Orders were cited is discussed below.)

(4) The Proposed Order (p. 9) finds correctly that Thorngate's investment in the water system is equal to the "value" of its exchanged land. The Proposed Order (p. 10) then states inexplicably that "... under the circumstances of this case, Staff's estimated value of the original cost [the meaning of this phrase being unexplained], based in part on the actual financial records of Thorngate, is reasonable." There are several problems with these findings. First, Staff did not even purport to determine a "value" for the exchanged land. Staff maintained incorrectly that the "value" of the land was irrelevant. [Tr. 36.] What Staff attempted to determine was the cost of the exchanged land as reflected on Thorngate's books. [Staff Ex. 3.0, pp. 6-8.] Staff, however, does not suggest that this cost is the "value" of the land at the time of the exchange. Moreover, the Proposed Order's confusing reference (p. 10) to Staff's "estimated value of the original cost" being "based on actual financial records of Thorngate" should be deleted. This statement could be read to suggest that Staff somehow considered accounting records in determining the original cost of the water system. This, however, is not what Staff did. Staff agrees that there are no accounting records indicating the cost of the water system (Tr. 42.), and Staff's effort to calculate a cost to Thorngate for land later exchanged for the utility plant is wholly irrelevant. As noted above, the Proposed Order itself concludes (p. 9) that it is the land's value at the time of the exchange, and not its cost, that is the relevant figure.

(5) Turning original cost ratemaking on its head, the Proposed Order (p. 9) evaluates the reasonableness of Staff's proposed "\$0" rate base based, not on the return which CIWC would realize on an original cost rate base, but instead on "a reasonable rate of return

on . . . [CIWC's] \$200 total 'investment' for both systems." The Orders referenced above, in Rollins, Docket 83-0693 and CIWC, Docket 88-0045, were cited by CIWC, not with regard to the value of the exchanged land (as the Proposed Order suggests, p. 9), but instead as precedent for use of full original cost in setting rate base, even where the purchase price is below book value. The Proposed Order rejects the Commission's long-standing practice in this regard without making any finding that would support a change in approach.

**B. Determination of Water Original Cost**

Under an Amended and Restated Memorandum of Contract ("Amended Contract"), dated December 21, 1990, Thorngate agreed to provide water and sewer services for Ivanhoe Club in accordance with the Declaration of Covenants, Conditions and Restrictions For the Mutual Water and Sewer System of Ivanhoe Club ("Declaration"). [CIWC Ex. 1.0SR, p. 4.] The Declaration is also dated December 21, 1990. Under these documents and the original real estate agreement dated November 9, 1987, Thorngate conveyed 38 acres of land to Ivanhoe Club's Phase 2 developers and agreed to construct the sewer system (on its property and in the residential areas). Thorngate also agreed to provide water and sewer utility service, using its property and that owned by Mutual Services. [Id.] In return, Thorngate received from the Phase 2 developers \$3.5 million in cash, the water system and other infrastructure projects. [Id.] Thorngate also contracted to receive an Access Fee of \$12,000 from the purchasers of each lot in Phase 2. [Id.]

The Proposed Order (p. 9) correctly indicates that the determination of original cost for acquired water utility plant is made in accordance with Accounting Instruction 18 of the USOA.

[CIWC Cross-Exam. Ex. 1.] As Accounting Instruction 18(A) indicates, in pertinent part:

All amounts included in the accounts for utility plant acquired as an operating unit or system, shall be stated at the cost incurred by the person who first devoted the property to utility service.

[CIWC Cross-Exam Ex. 1, p. 1.] CIWC and Staff agree that, under the circumstances here, the entities which first devoted the water system to public service are Thorngate and Mutual Services. [Staff Ex. 3.0, p. 4.] Mr. Rakocy and Mr. Sant indicated that the collective investment of Thorngate and Mutual Services in the water system should be reflected as the system's original cost. [CIWC Ex. 1.0R, p. 4 (Rakocy); Staff Ex. 3.0, p. 4, Tr. 35 (Sant).] The record further shows, however, Mutual Services is an entity formed solely to hold title to certain portions of the water (and sewer) systems which are located in residential areas. Accordingly, as is undisputed and as the Proposed Order (p. 9) finds, the relevant investment is that of Thorngate. [CIWC Ex. 1.0SR, p. 4.]

As indicated above, Thorngate exchanged 38 acres of land in return for the water system (and cash and other infrastructure items). [Staff Ex. 3.0, p. 6 (Sant); CIWC Ex. 1.0SR, p. 5 (Rakocy).] The consideration provided by Thorngate for the system was therefore, "other than cash." In this circumstance, Accounting Instruction 18(B) of the USOA-Water states as follows:

When the consideration given for property is other than cash, the value of such consideration shall be determined on a cash basis (emphasis added).

[CIWC Cross-Exam. Ex. 1, p. 1.] This principle is confirmed by the last sentence of Accounting Instruction 18(A) which indicates that, as used in Section 18, the term "cost" has the meaning stated in Definition 9 of the USOA-Water. [CIWC Cross-Exam. Ex. 1, p. 1.] Definition 9 also indicates that the value of consideration "other than cash" constitutes the "cost" of acquired plant. [CIWC Cross-Exam. Ex. 1, p. 2.] Thus, as Mr. Rakocy indicated, the original cost of the water system is equivalent to the value of the portion of the 38 acres of land which Thorngate transferred to the Phase 2 developers in return for the water system. [CIWC Ex. 1.0SR, p. 6.]

Notwithstanding the Proposed Order's reference (p. 10) to "Staff's estimated value of the original cost" (a phrase which, as noted above, is unexplained), the record is clear that the only evidence regarding the value of the exchanged land is that presented by CIWC. The Proposed Order does not recognize at all Mr. Sant's clear testimony that he has no information at all about the land's value. [Tr. 36.] CIWC's valuation evidence was unquestioned at the hearing and not challenged at all in any Staff filing. The evidence is entirely undisputed.

The Proposed Order recognizes (p. 9) that it was necessary to develop a methodology to estimate the land's value. As Mr. Rakocy stated, the cost to the Phase 2 developers of constructing a water system of the type exchanged for the land is a reasonable estimate of the value which should be assigned to the applicable portion of the land. [CIWC Ex. 1.0SR, p. 8.] In other words, the cost which the developers agreed to incur is a reasonable estimate of the value the property received by the developers in exchange. [Id.]

The Proposed Order (p. 9) suggests that CIWC's position concerning the water system's cost is "unreasonable," but does not explain why. To determine the construction cost estimate, CIWC first surveyed the entire Ivanhoe system, and then estimated the present day cost of building a similar system. [CIWC Ex. 1.0R, p.2.] Using Handy-Whitman Indices, CIWC trended the estimated present day costs back to the approximate date of construction to determine an estimated original cost of the water facilities. [Id.] In this manner, CIWC estimated that the cost incurred by the Phase 2 developers to construct the water system was \$1,624,987, and that applicable depreciation is \$256,504. As shown in Exhibit H (Revised), the estimated net utility plant for the water system is \$1,368,483. [CIWC Ex. 1.0SR, p. 8.] Mr. Rakocy's uncontested and unquestioned testimony indicates that this amount, "is the best available evidence of the original cost of the water system at the time that it was first devoted to public service." [Id.]

This amount is also the best available evidence of the value of the land exchanged by Thorngate for construction of the water system. [CIWC Ex. 1.0SR, p. 8.]

**C. Original Cost Net of Contributed Plant**

As noted above, Thorngate receives Access Fees in the amount of \$12,000 for each lot in Phase 2 in return for its commitment to provide water and sewer service. Mr. Sant proposed that total Access Fees in the amount of \$1,080,000 be allocated between the water and sewer rate bases as the appropriate respective amounts of water and sewer contributed plant. [Staff Ex. 1.0, p.7.] As Mr. Rakocy indicated, CIWC accepts Mr. Sant's proposed levels of water and sewer contributed plant using the Access Fee approach (in lieu of the CIAC balance which CIWC had estimated). [CIWC Ex. 1.0SR, p. 10.] Accordingly, as shown in CIWC Ex. 1.3SR, the net original cost for the water system proposed by CIWC is as follows:

| <b>Description<br/>(A)</b>           | <b>Per<br/>Company</b> |
|--------------------------------------|------------------------|
| Utility Plant in Service             | \$1,624,987            |
| Less: Accumulated Depreciation       | <u>(264,504)</u>       |
| Net Utility Plant-in-Service         | 1,368,483              |
| Deduct:                              |                        |
| Contributions in Aid of Construction | <u>(483,840)</u>       |
| Net Original Cost Plant:             | <u>\$884,643</u>       |

**D. Staff's Position**

Although not explained in the "Commission Analysis" section of the Proposed Order (pp. 8-10), Mr. Sant took the position in his testimony that the original cost of the water system is not the value of the land at the time of the exchange (as required by Accounting Instruction 18(A) (Tr. 39)), but is instead limited to the cost of the land to Thorngate. [Staff

Ex. 3.0, p. 6-8.] Mr. Sant maintains that, because Thorngate realized a profit in selling its land (i.e., the cash proceeds exceeded Thorngate's book costs), Thorngate "has no . . . investment in the 38 acres of land nor the water system." [Staff Ex. 3.0, p. 9.] For this reason, Mr. Sant concludes that the net original cost of the water system is zero. [Staff Exs. 3.0, p. 9, Sch. 7 (Revised).]

As Mr. Rakocy indicated, however, Mr. Sant's position is not logical or correct. [CIWC Ex. 1.0SR, p. 7.] The cost of the land to Thorngate represents the amount of the original purchase price paid by Thorngate, plus capitalized improvements. [Staff Ex. 3.0, pp. 6-8; CIWC Ex. 1.0SR, p. 6.] At the time of the exchange for the water system, however, the value of the land had increased.<sup>2</sup> Thorngate paid for the water system, not with the "cost of its land exchanged" but with the value of its land exchanged. [Id.] In the transaction, the value of Thorngate's 38 acres of land was equivalent to the sum of: (i) the amount of cash received by Thorngate; and (ii) the value of the water system and other infrastructure which the Phase 2 developers agreed to construct. [Id., p. 7.] As Mr. Rakocy explained, Mr. Sant's suggestion that the value of the land should be reduced by the amount of cash received is illogical. There is no basis to subtract the amount of cash received in determining the value of Thorngate's payment to the Phase 2 developers. [Id.] Contrary to the position of Mr. Sant, the fact that the value of the land at the time of the exchange for the water system exceeded its cost does not suggest that Thorngate had no investment in the water system. [Id., p. 7.] Accordingly, Mr. Sant's position is baseless.

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<sup>2</sup> As Mr. Ackman explained, Thorngate's business is to convert rural, undeveloped, unincorporated properties to living environments with a golf course surrounding and setting. The effect of this transformation is to increase the value of land held by Thorngate. [Tr. 72-73.]

Ultimately, even Mr. Sant seemed to recognize the importance in this proceeding of the value of the land exchanged by Thorngate in return for the water system. On cross-examination, Mr. Sant testified initially that the value of the land exchanged was unimportant. At transcript page 36, the following exchange occurred:

Q. In your opinion, the value of the land exchanged for the water system is not the pertinent issue, is that correct?

A. That is correct.

[Tr. 36.] (emphasis added)

Three pages later, however, after Mr. Sant had an opportunity to review Accounting Instruction 18, Mr. Sant gave the following testimony:

Q. Would you please refer to Accounting Instruction 18B, does that instruction state: When the consideration given for property is other than cash, the value of such consideration shall be determined on a cash basis?

A. Yes, that's how it reads.

Q. Under the Uniform System of Accounts, when the consideration given for utility property is something other than cash, the value of that consideration is pertinent; is that correct?

A. That appears to be correct.

[Tr. 39.] (emphasis added)

#### **E. Regulatory Incentives**

Because of Mr. Sant's view that the value of the land exchanged by Thorngate for the water system should be disregarded, he proposes a \$0 balance of Utility Plant-in-Service. [Staff Ex. 3.0, Sch. 7 (Rev.).] Mr. Sant also reflects as a contributed plant the portion of total Access Fees which is allocated to water operations (\$483,840). [Id.] Accordingly, Staff's calculation of

net original cost is a negative balance of (\$483,840). [Id.] In a footnote, however, Staff suggests that this balance should be increased to \$0 for rate base purposes. [Id., FN 2.]

The effect of Mr. Sant's calculation is to exclude from rate base the original cost of the water system in its entirety. [CIWC Ex. 1.0SR, p. 9.] As discussed above, the Net Utility Plant-in-Service consistent with the original cost of the water system at the time it was first devoted to public service is \$1,368,483, as compared to Mr. Sant's calculation of \$0. [Id.; Sch. 7 (Rev).] As Mr. Rakocy indicated, under these circumstances, CIWC would have no incentive to acquire or operate a small system, such as that of Ivanhoe. If there is little or no rate base assigned to a utility operation, there is no opportunity to earn a profit. [CIWC Ex. 1.0SR, p. 9.]

Although Mr. Rakocy's testimony was not disputed by Staff, the Proposed Order (p. 9, 13) offers an extra-record explanation of why a "significant operating profit" is possible based on the \$200 purchase price paid for the water and sewer system. No witness, however, presented this analysis. Furthermore, as discussed above, the Proposed Order's conclusion is directly inconsistent with the language of past Orders in which the Commission recognized that, when a small water system property is acquired for a purchase price below original cost, the full original cost of property at the time it was first devoted to public service (and not the purchase price) should be reflected in rate base. This is particularly true in circumstances where a failure to recognize the full original cost would result in a remaining rate base which is either low or a negative amount. The Commission has recognized that, in such circumstances, it is necessary to recognize the full original cost of property acquired in order to provide a proper incentive for acquisitions, such as the one in the present case, which are in the public interest. As the Commission recognized in Rollins, Docket 83-0693, a failure to recognize the original cost of property as first devoted to public service would raise "yet another disincentive or impediment"

to the acquisition of a small water system. The Commission also recognized this point in CIWC, Docket 88-0045.

An approach similar to that adopted by the Proposed Order (pp. 9, 13) was proposed by a water utility in Illinois-American Water Company, United Waterworks, Inc. and United Water Illinois, Inc., Docket 99-0457 (May 10, 2000). In that case, the utility proposed, inter alia, that the Commission should recognize in rates the purchase price paid for acquisition of another water utility (through inclusion in rate base of a positive acquisition adjustment or “merger premium.”) [Order, Docket 99-0457, p. 17.] The Commission Staff vigorously opposed the utility’s proposal, arguing, inter alia, that it would violate principles of original cost ratemaking. [Id., p. 21.] The Order summarizes Staff’s argument as follows:

“ . . . Staff states that IAWC’s proposed ratemaking treatment of the merger premium violates the principle of original cost ratemaking. Staff notes that in Illinois, a utility’s revenue requirement is based upon the expenses paid to provide service and a fair return on the net book value of the original cost of assets used to provide utility service. Staff indicates that the inclusion of an acquisition adjustment in rate base is tantamount to increasing the value of the utility’s assets from original cost to an amount approaching market value. (Id. at 25)

\* \* \*

Staff further states that the Commission’s Orders in Docket Nos. 83-0693, Rollins Water and Sewer Company and 88-0045, Consumers Illinois Water Company, cited by IAWC, support Staff’s position. Staff indicates that those orders concluded that the rate base should be based on original cost, rather than the price paid for the stock of the purchased utility. (Staff Reply Brief at 16-17)”

Id., pp. 21-22 (emphasis added).

Ultimately, in Docket 99-0457, the Commission approved a stipulation between the utility and Staff under which the acquisition adjustment (or merger premium) was excluded from rate base as Staff had proposed. [Order, Docket 99-0457, p. 24.] The Commission should be aware, however, that, as Staff argued in Docket 99-0457, adoption of the Proposed Order’s

approach in this case would violate “the principle of original cost ratemaking.” As noted above, use of such an approach in this case also is inappropriate because no witness proposed it. It is certainly inappropriate for the Commission to flip-flop back and forth, using an original cost approach for acquisitions, such as that in Docket 99-0457, where the purchase price is above book value and the approach suggested in the Proposed Order in a case, such as this one, where the purchase price is below book value. Yet, this is what the Proposed Order would have the Commission do.

The Proposed Order’s decision to reject the original cost approach used in past orders, without a finding which explains the reason for the change in approach also violates CIWC’s rights to due process and equal protection of the law. Atchison, T. & S. F. R.R. v. Wichita Bd. of Trade, 412 U.S. 800, 808 (1973) (agency has a “duty to explain its departure from prior norms”); Secretary of Agric. v. United States, 347 U.S. 645, 652-55 (1954); Business & Professional People for the Pub. Interest v. Illinois Commerce Comm’n, 136 Ill.2d 192, 228, 555 N.E.2d 693, 709 (1989) (limiting deference to Commission decision which depart from precedent); Commonwealth Edison Co. v. Illinois Commerce Comm’n, 180 Ill. App. 3d 899, 908-09, 536 N.E.2d 724, 730 (1st Dist. 1988) (“the Commission ‘may not depart, sub silentio, from its usual rules of decision to reach a different, unexplained result in a single case’”), appeal denied, 126 Ill.2d 557, 541 (N.E.2d 1105 (1989)). (Commission may approve a change approach, but must provide a reasoned explanation for doing so).

For the reasons discussed, the Proposed Order’s references to a rate of return on the purchase price of the acquired property (rather than its original cost) should be deleted, and the full original cost of the water system as proposed by CIWC should be recognized. Appropriate language for this purpose is set forth in Appendix “A,” Section I.

### III. SEWER SYSTEM ORIGINAL COST

CIWC takes exception to the Section of the Proposed Order on page 13, which is captioned, "6. Commission Analysis." The Section should be deleted and replaced in its entirety with the language set forth in Appendix "A," Section II.

#### A. Summary of CIWC's Position

As stated in the Proposed Order (p. 9), the USOA indicates that the original cost of an acquired system should be determined from the accounting records of the predecessor company, if the original cost of acquired plant can be "known" from a review of those records.

[USOA-Accounting Instruction 17(C); Staff Ex. 1.0, p. 6; CIWC Ex. 1.0R, p. 3.] CIWC and Staff agree that, where the original cost cannot be "known" from a review of the accounting records, the USOA requires use of an estimate of original cost. [CIWC Ex. 1.0R, p. 3 (Rakocy); Tr. 39. (Sant).]

The Proposed Order (p. 13) states that, "[i]t seems clear from the record that Thorngate's accounting records are adequate to provide an indication of the original cost of the system." This statement, however, disregards the evidence. Staff witness Sant agreed that there is nothing in Thorngate's accounting records which indicates the content of the two accounts which the Proposed Order relies on for its findings with regard to the sewer system's original cost.

[Tr. 42.] Furthermore, it is undisputed that Thorngate recorded costs associated with the sewer system in accounts other than those used by Mr. Sant, and adopted by the Proposed Order to determine an original cost. [Tr. 66-67, 73-75.] Thus, there is no basis for the Proposed Order's statement (p. 13) quoted above.

As in the case of the water original cost determination, the Proposed Order rejects the Commission's past policy and practice by evaluating rate of return based, not on the net original

cost, but instead on the purchase price of acquired assets. No witness in this case proposed such an approach, and the Proposed Order's language should be modified.

For the reasons given below, the net original cost of sewer plant proposed by CIWC should be adopted. Appropriate replacement language for the Proposed Order is set forth in Appendix "A," Section II.

**B. Determination of Sewer Original Cost**

Contrary to the statement in the Proposed Order (p. 13), CIWC did not propose in this proceeding "to disregard predecessor records for original cost determinations whenever a utility purchases a system from an unregulated entity . . . ." The Proposed Order's suggestion (p. 13) that CIWC made such a proposal is incorrect, unfair and inappropriate.

Thorngate's relevant "records" are one sheet of paper which was submitted as Staff Ex. 1.0, Sch. 3. A copy of Schedule 3 is attached to this Brief on Exceptions as "Attachment 1." The sheet of paper shows two accounts, labeled "Land-Waste Water" and "Land Improvements-WWTS," respectively. As the record shows, CIWC's proposal to use an engineering estimate as the basis to determine original cost is based on the nature of the "accounting records" (i.e., Attachment "1"). CIWC maintains that, based on the available evidence, the Commission should conclude that the two accounts shown on Attachment "1," and relied on by Mr. Sant, do not show the original cost of the entire sewer system. Thorngate's General Manager and Chief Operating Officer testified expressly that sewer system costs also were recorded in other accounts, such as the account for the Country Club's "grounds and greens." [Tr. 66-67, 73-75.] Contrary to the language of the Proposed Order, CIWC has never suggested that an unregulated predecessor's records should always be disregarded. CIWC has pointed out only that, under the circumstances of this case, it is not possible to determine the sewer system's cost by reviewing the accounting records.

From the entries shown on Attachment "1," Mr. Sant derived the amounts shown on Staff Ex. 1.0, Schedule 6, for Land and Land Rights (Acct. 353) and Structures and Improvements (Acct. 354), which when added together total \$2,277,925. [CIWC Ex. 1.0AS, p. 3.] This is the amount set forth on Mr. Sant's Exhibit 3.0, Sch. 7 (Rev.) as sewer Plant-in-Service. Thorngate's accounting records, however, do not indicate what is included in the Plant-in-Service balance reflected by Mr. Sant. [CIWC Ex. 1.0AS, p. 3.] As Mr. Sant acknowledged, aside from Staff Exhibit 1.0, Sch. 3 (Attachment "1"), there are no accounting records, studies, workpapers, analyses or any other document indicating the content of the two accounts shown on the Schedule. [Tr. 42.]

As Mr. Sant indicated, the sewer system at Ivanhoe Club includes such items as force mains, gravity mains and services, pumping equipment, treatment and disposal equipment and receiving wells. [Tr. 46-47.] Mr. Sant further indicated that the Uniform System of Accounts for Sewer Utilities (83 Ill. Admin. Code 650) ("USOA-Sewer") requires that the original cost of sewer plant be recorded in the appropriate account shown on Staff Exhibit 1.0, Sch. 1, p. 2 (e.g., Force Mains-Account 361, Services-Account 363, Pumping Equipment-Account 371, Treatment and Disposal Equipment-Account 380 and Receiving Wells-Account 370). Although Mr. Sant agreed that facilities in all of these categories are present in the Ivanhoe system (Tr. 46-47), there is no available accounting data for any of the relevant USOA accounts. [Tr. 47-48.] As Mr. Sant acknowledged, Thorngate's accounting records contain data only for Accounts 353 and 354. [Tr. 48.]

CIWC concluded that, although the limited accounting entries shown on Schedule 3 are available from Thorngate's records, it is not possible to determine what the entries represent or whether the entries cover all of the installed sewer facilities. [CIWC Exs. 1.0R, p. 4; 1.0AS,

p. 3.] Indeed, Mr. Ackman testified expressly that the costs for capital projects completed for sewer operations (installation of equipment to transfer water flow from the sewer system to sprayer irrigation fields; replacement of up to seven grinder pumps and other projects) are not reflected in the two accounts shown on Attachment "1" and considered by Mr. Sant. [Tr. 73-75.] As Mr. Ackman explained, Thorngate does not maintain separate books for its water or sewer system (Tr. 75), and the costs for the sewer system have been capitalized in Thorngate's golf course accounts other than those used by Mr. Sant, such as the account for the "grounds and greens" department. [Tr. 66-67.]

Based on the condition of Thorngate's records (Attachment "1"), CIWC performed a survey of the Ivanhoe system and developed an estimate of the present-day cost of the system. [CIWC ex. 1.0R, p. 2.] As discussed above, CIWC trended the estimated present-day costs back to the approximate date of construction to determine an estimated original cost, net of depreciation. [Id.] As Mr. Rakocy indicated, CIWC also estimated a level of customer contributed plant. [Id., p. 3.]

The Proposed Order (p. 13) suggests that CIWC's determination of original cost is "unreasonable." CIWC's cost determination, however, was not questioned or otherwise disputed in the record. Accordingly, there is no evidence at all which would support the Proposed Order's unexplained statement (p. 13), suggesting that the determination is "not reasonable."

As shown on CIWC Exhibit "H (Revised)," page 2, the level of sewer utility Plant-in-Service estimated by CIWC is \$2,795,805, and applicable depreciation is \$649,329. Thus, the original cost of Utility Plant-in-Service, net of depreciation is \$2,146,477. [CIWC Ex. H (Rev.), p. 2.] As in the case of the water system, CIWC accepted Staff's proposal to adopt as the appropriate level of CIAC an allocation of the total balance of Access Fees which

Thorngate will ultimately receive (in lieu of the balance of CIAC which CIWC had estimated). [CIWC Ex. 1.0SR, p. 12, 1.0AS, p. 4.] As shown on Mr. Sant's Schedule 7 (Revised) and CIWC Exhibit 1.3SR, the agreed level of CIAC for sewer operations is \$596,160. Thus, net original cost for sewer operations based on the estimated original cost developed by CIWC (using Staff's proposed level of CIAC) is as follows:

**Sewer Net Original Cost**

|  |                    |
|--|--------------------|
| Utility Plant-in-Service                 | \$2,795,805        |
| Less: Accumulated Depreciation           | (649,328)          |
| Net Utility Plant-in-Service             | 2,146,477          |
| Deduct:                                  |                    |
| Contributed Plant in Aid of Construction | <u>(596,160)</u>   |
| Net Original Cost Plant                  | <u>\$1,550,317</u> |

[CIWC Ex. H (Rev.), p. 2, adjusted to reflect Staff's proposed level of CIAC Staff Ex. 3.0, Sch. 7 (Rev.)]

**C. CIWC's Alternative Position**

The Proposed Order (p. 13) makes no findings at all with regard to CIWC's alternative sewer original cost proposal or Staff's failure to reflect the cost of contributed plant as part of its plant-in-sewer balance. As the record shows, in his Direct Testimony and Exhibits, Staff witness Sant included as an element of Plant-in-Service Staff's calculation of the cost of contributed plant. [Staff Ex. 1.0, Sch. 4; CIWC Ex. 1.0AS, p. 2.] This approach is appropriate because, under the USOA and in rate cases, the balance of contributed plant is included in Plant-in-Service and then deducted from rate base as a separate line item. [CIWC Ex. 1.0AS, p. 2.] Mr. Rakocy noted that this approach has been consistently used in past rate proceedings of CIWC, including, but not limited to, Dockets 99-0288 and 97-0351. [Id.]

The record also shows that, at the time of his Direct Testimony, Mr. Sant believed that the two accounts shown on Schedule 3 (Attachment "1") contained cost data for both water and sewer operations. [Tr. 42.] As shown on Schedules 2 and 4 which accompany Mr. Sant's Direct Testimony (Staff Ex. 1.0), Mr. Sant's determination of the original cost of water utility Plant-in-Service, \$1,256,017 (Schedule 2), is the sum of: (i) the two balances allocated by Mr. Sant from the accounts on Schedule 3, \$669,301 and \$102,876; and (ii) Mr. Sant's allocated balance of contributed plant in the amount of \$483,840. [Staff Ex. 1.0, Schs. 2-4; Tr. 40-41.] Similarly, for sewer operations, Mr. Sant added together to determine his Utility Plant-in-Service balance: \$2,101,908, the sum of the two allocated sewer plant amounts from Schedule 3 (\$1,305,140 and \$200,608, respectively); and (ii) contributed plant in the amount of \$596,160. [Staff Ex. 1.0, Schs. 2-4; Tr. 42-43.] Thus, as Mr. Rakocy indicated, Mr. Sant initially included contributed plant in determining the Plant-in-Service balances. [CIWC Ex. 1.0AS, p. 2.]

In preparing his Rebuttal Testimony, Mr. Sant discovered that CIWC was correct in pointing out that the accounts on Schedule 3 (Attachment "1") do not contain water system costs. [Tr. 42.] In Schedule 7 which accompanied Mr. Sant's Rebuttal Testimony (Staff Ex. 3.0), however, Mr. Sant continued to reflect for water operations the balance of contributed plant as Plant-in-Service. [Staff Ex. 3.0, Sch. 7; Tr. 45.] For sewer net original cost, however, Mr. Sant's Schedule 7 omitted (without explanation) the CIAC component of Utility Plant-in-Service, and included only balances of the two accounts shown on Schedule 3. [Staff Ex. 3.0, Sch. 7; Tr. 43-44.] By means of this omission, Mr. Sant reduced the balance of sewer Plant-in-Service by \$596,160 from \$2,874,085 to \$2,277,925. [Tr. 43-44; CIWC Ex. 1.0SR, p. 11.]

As Mr. Rakocy's Surrebuttal Testimony indicates, CIWC believed that Mr. Sant's unexplained omission of the cost of contributed plant in calculating the original cost of sewer (but not water) Plant-in-Service was an inadvertent error. [CIWC Ex. 1.0SR, p. 11.] As discussed above, Mr. Rakocy further indicated that, if the apparent error were corrected, CIWC would accept Staff's calculation of sewer Utility Plant-in-Service. [Id., p. 12.]

When adjusted to include contributed plant in the amount of \$596,160, the level of Plant-in-Service determined from Thorngate's accounting records is \$2,874,085, which compares favorably to CIWC's estimated Plant-in-Service balance of \$2,795,805. [CIWC Ex. 1.0AS, p. 4.] For this reason, as Mr. Rakocy indicated, CIWC would accept the adjusted Staff result based on Thorngate's records, detailed as follows on CIWC Exhibit 1.3SR:

| <b>Description<br/>(A)</b>           | <b>Per<br/>Company</b> |
|--------------------------------------|------------------------|
| Utility Plant-in-Service             | \$2,874,085            |
| Less: Accumulated Depreciation       | <u>(1,179,310)</u>     |
| Net Utility Plant-in-Service         | 1,694,775              |
| Deduct:                              |                        |
| Contributions in Aid of Construction | <u>(596,160)</u>       |
| Net Original Cost Plant:             | <u>\$1,098,615</u>     |

After CIWC accepted the alternative position, Mr. Sant submitted a data response (marked as CIWC Exhibit 1.1ASR) in which he indicated (without explanation) his belief that CIAC "should be excluded from Utility Plant-in-Service." [CIWC Exs. 1.0AS, p. 2; 1.1ASR.] Later, Mr. Sant submitted Supplemental Rebuttal Testimony (Staff Ex. 5.0) which purported (for the first time) to explain his approach. [Staff Ex. 5.0, pp. 3-4.] With the Supplemental Rebuttal filing, Mr. Sant also included a revised version of Schedule 7 in which the cost of contributed

plant was for the first time excluded from both water and sewer Plant-in-Service. [Staff Ex. 5.0, Sch. 7 (Rev.); Tr. 44-45.] In the Supplemental Rebuttal, Mr. Sant abandoned the position he took in the data response (that CIAC should be excluded from Plant-in-Service) and maintained that, after the filing of Direct and Rebuttal evidence by both CIWC and Staff, he “realized that the Plant-in-Service totals already included contributed plant.” [Staff Ex. 5.0, p. 4.]

As indicated in Mr. Sant’s Supplemental Rebuttal evidence (Staff Ex. 5.0, pp. 4-5) and in Staff’s Brief (p. 11), the sole basis for Mr. Sant’s proposal to exclude the cost of contributed plant from plant-in-service is a belief that all sewer system construction costs are reflected in the two accounts shown on Schedule 3 (Attachment “1”). [Staff Ex. 5.0, pp. 4-5.] As discussed above, however, the record demonstrates that this is not the case.

In this regard, CIWC and Staff agree that all of the available information from Thorngate’s accounting records is set forth on Mr. Sant’s Schedule 3 (Attachment “1”). [CIWC Ex. 1.0AS, p. 3 (Rakocy); Tr. 42 (Sant).] As explained above, however, CIWC and Staff also agree that there is no information with regard to the content of the two accounts shown on the Schedule. [CIWC Ex. 1.0AS, p. 3 (Rakocy); Tr. 42 (Sant).] As Mr. Rakocy indicated, if the cost of contributed plant is excluded from Mr. Sant’s calculation of Plant-in-Service, there is a significant discrepancy between Mr. Sant’s sewer Plant-in-Service result based on Schedule 3, \$2,277,925 (Schedule 7, Revised)), and the estimated original cost of the entire sewer plant as surveyed by CIWC, \$2,874,085. [CIWC Ex. 1.0AS, p. 2.] Staff offers nothing in its evidence or its Brief to explain why Thorngate’s cost records should vary to this extent from the results of the survey and estimate. Also, the Proposed Order contains no findings which would explain the difference.

As indicated above, Staff and the "Commission Analysis" section of the Proposed Order completely fail to note Mr. Ackman's testimony that capitalized sewer system costs are recorded in accounts other than those shown on Schedule 3, such as the country club account for grounds and greens. (emphasis added) [Tr. 66-67, 73-75.] Mr. Ackman's undisputed testimony establishes that the reason for at least part of the discrepancy between the cost data shown on Mr. Sant's Schedule 3 (Attachment "1") and the cost estimate developed by CIWC is that the Schedule 3 (Attachment "1") data doesn't reflect the cost of the entire sewer plant. As Mr. Ackman expressly indicated, sewer plant costs are recorded by Thorngate not only in the two accounts shown on Schedule 3 (Attachment "1"), but also in other country club accounts. [Tr. 66-67, 73-75.] Thus, Staff's position that the two Schedule 3 accounts reflect all capitalized sewer costs is wholly unsupported by the record and the Proposed Order's decision to adopt Staff's position is inexplicable.

Under the circumstances of this case, CIWC submits that the original cost of the acquired sewer utility plant cannot be "known" on the basis of Thorngate's records. For this reason, Accounting Instruction 17(c) of the USOA-Sewer requires that an estimate of original cost be developed. [CIWC Ex. 1. OR, p. 3 (Rakocy); Tr. 39 (Sant).] The Proposed Order (p. 13) should be modified to adopt as the appropriate level of sewer original cost either the cost data from CIWC Exhibit H (Revised) as set forth at pages 16 above or CIWC's alternative proposal based on an adjustment of Mr. Sant's data as set forth at page 18 above which CIWC has indicated that it will accept. Appropriate replacement language for the Proposed Order is set forth in Appendix "A," Section II.

The Proposed Order (p. 13) includes an unexplained suggestion that, "... under CIWC's proposal, CIWC would receive an unfair benefit at the expense of Ivanhoe Club's homeowners."

Presumably, this statement relates to the following sentence which makes reference to the argument developed by the Proposed Order (p. 13) “that all or part of the \$3.5 million received by Thorngate was intended as CIAC to finance the Sewer System.” These statements, however, should be deleted. It is wholly inappropriate for the Commission in an Order to develop argument on behalf of a party which the party “did not make.” Furthermore, there is no evidence at all in the record which suggests that all or part of the \$3.5 million received by Thorngate was intended to “finance the sewer system.”

The record shows that, in return for the payment of \$3.5 million and the developer’s commitment to build the water system and other infrastructure items, Thorngate transferred land to the developers. [CIWC Ex. 1.0SR, p. 4.] Thorngate also agreed to construct the sewer system. [Id.] In return for its agreement to provide water and sewer service, Thorngate recovered Access Fees in the amount of \$12,000 from the purchasers of each lot in Phase 2 of the development. [Id.] Thus, the record makes clear that, what Thorngate received in return for its commitment to provide water and sewer service with the sewer system constructed by Thorngate and the water system constructed by developers was the ultimate right to access fees in the amount of \$1,080,000 (which both CIWC and Staff proposed to deduct from net plant as contributions). [CIWC Ex. 1.0R, p. 7.] No witness suggested that any portion of the \$3.5 million conveyed to Thorngate for its land had any relationship to the sewer system. The Proposed Order’s suggested “argument” in this regard is extra-record and inappropriate.

**D. Regulatory Incentives**

As in the case of the water original cost determination, the Proposed Order finds that the return realized by CIWC on the purchase price of the system, not its original cost, is a “reasonable rate of return.” As in the case of the “water” analysis, this finding ignores the Commission’s past policy and practice. As discussed above, well-established Commission

policy is that, when utility plant is acquired at a price below book value, the full original cost of the plant is recognized in rates. No witness suggested, that, under the circumstances here, use of a "purchase price" approach of the type referenced in the Proposed Order (p. 13) is appropriate for evaluating the rate of return. For these reasons, the Proposed Order's extra-record finding should be deleted.

**IV. ADJUSTMENT TO FINDINGS AND ORDERING PARAGRAPHS**

Finding 11 of the Proposed Order at page 15 is consistent with adoption of CIWC's position with regard to water original cost and alternative position regarding sewer original cost. (The Finding, however, is inconsistent with earlier discussion in the Proposed Order.) If the Commission elects to adopt CIWC's principal position regarding sewer original cost rather than the alternative position, Finding 11 should be modified in the manner shown in Section III(A) of Appendix "A." The second to last Ordering Paragraph on page 16 should be deleted in its entirety and replaced with the language shown in Section III(B) of Appendix "A."

**V. CONCLUSION**

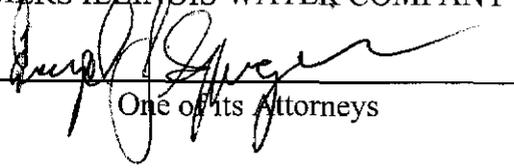
For reasons discussed herein, the Proposed Order's conclusions regarding the original cost of the water and sewer systems should be modified to reflect the language set forth in Appendix "A."

Dated: April 2, 2001

Respectfully submitted,

CONSUMERS ILLINOIS WATER COMPANY

By: \_\_\_\_\_



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