

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois-American Water Company)	
)	
Proposed General Increase)	Docket No. 02-0690
in Water and Sewer Rates.)	

REPLY IN SUPPORT OF
MOTION TO STRIKE

Illinois-American Water Company (“Company”), by its attorneys, hereby replies to the response of intervenor Village of Bolingbrook (“Bolingbrook”) to the motion of the Company to strike Section III, pp. 12-18, of the initial brief of Bolingbrook. In further support of its motion to strike, the Company respectfully states as follows:

1. Bolingbrook does not deny, and cannot, that it raised a new purported issue, for the first time in its initial brief, regarding “acquisition savings.” Bolingbrook presented no testimony as to its issue, did not raise its issue in its cross-examination of witnesses, and prior to its brief never objected to the calculation of acquisition savings. Accordingly, Bolingbrook has waived its new purported issue.

2. As the Company’s motion to strike points out, the purpose of rate case hearings is to identify and discuss in testimony all issues and assertions the parties perceive. As the Commission’s Rules of Practice state, “The principal goal of the hearing process is to assemble a complete factual record to serve as a basis for a correct and legally sustainable decision.” 83 Ill. Adm. Code Section 200.25(a). Only through this long-established hearing procedure can allegations be tested by due process cross examination and opportunity to respond. Bolingbrook now seeks to circumvent this procedure.

3. Bolingbrook relies on IAWC Ex. 12, which has been on file since September 20, 2002. Bolingbrook served data requests on the Company regarding Savings/Sharing on January

8, 2003. Bolingbrook could have presented direct and rebuttal evidence as to its perceived issue, but chose not to do so.

4. Bolingbrook had two attorneys as well as its witness present at the hearings herein, yet never raised this issue. The Company was unable to cross-examine Bolingbrook's witness as to this issue or to respond to cross-examination by Bolingbrook on this issue.

5. Bolingbrook's attempt to disguise its effort to testify in its brief by asserting "burden of proof" is disingenuous.

a. First, as Bolingbrook acknowledges, the Company presented evidence in support of its savings/sharing calculation. Staff also presented evidence on this subject. The burden of proof has shifted to Bolingbrook to present evidence in support of its perceived opposing position. "Once a utility makes a showing of the costs necessary to provide service under its proposed rates, it has established a *prima facie* case, and the burden then shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith." *City of Chicago v. Illinois Commerce Commission*, 133 Ill. App. 3d 435, 442-43 (1st Dist. 1985). Bolingbrook obviously has failed to meet its burden of proof.

b. Second, Bolingbrook cites, and purports to quote from, two prior Commission orders. Bolingbrook did not present these orders in evidence, nor did Bolingbrook request to include these orders in the record by asking the Commission to take administrative notice of them, as required by the Commission's Rules of Practice, 83 Ill. Adm. Code Section 200.640. These orders, therefore, are not of record in this case. The Commission may take cognizance of facts adduced at prior hearings only when they are introduced as evidence at a hearing where all parties have an opportunity to be heard. *Knox Motor Service, Inc. v. Illinois Commerce Commission*, 77 Ill. App. 3d 590 (4th Dist. 1979). The Illinois Supreme Court has held that, in a rate case, the Commission cannot consider an order entered in another case which was not introduced in evidence.

Atchison, T. & S.F. Ry. Co. v. Commerce Commission, 335 Ill. 624 (1929). Nothing can be treated as evidence which is not introduced as such. *Rockwell Line Co. v. Illinois Commerce Commission*, 373 Ill. 309 (1940). In *Rockwell*, the Court held that a prior order must be introduced in evidence at the hearing in order to be considered by the Commission, and that reference to an order in pleadings is not sufficient. *Id.* at 323.

c. Third, Bolingbrook's initial brief improperly makes assertions which purport to be factual but are not in the record. To illustrate this fact, Appendix A to this reply brief is a copy of Section III of Bolingbrook's initial brief. As examples, certain factual assertions not in the record are double-underlined to show how Bolingbrook is attempting to testify through its brief.

6. Unless the Company's motion to strike is granted, it will be prejudiced by the portions of the brief to which it objects. Therefore, the Company respectfully requests that the Commission grant the Company's motion to strike Section III, pp. 12-18, of Bolingbrook's initial brief.

Respectfully submitted,

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III.

IAWC Has Failed to Meet its Burden of Proving Acquisition Savings

A second rate base-related issue concerns the methodology used in IAWC's Acquisition Savings proposal. In Docket No. 00-0476, the Commission approved the acquisition by IAWC of the water and wastewater assets of CUCI and certain business assets of a CUCI affiliate. In the course of that proceeding, IAWC argued that its acquisition of CUCI's assets would result in cost savings, which could then be shared by ratepayers and IAWC shareholders. Staff witness, Thomas Q. Smith, and other members of the Staff, had serious reservations about the ability of IAWC to demonstrate that savings were solely related to the acquisition of CUCI's assets. As Staff argued:

Staff states that savings cannot be shared if they cannot be identified. Staff indicates that Illinois-American identifies savings as the difference between the cost of operating Citizens as a part of the Illinois-American and the cost of operating Citizens as though it had not been acquired by Illinois-American. Therefore, Staff concludes that it would be necessary to develop a hypothetical cost of service for Citizens on a stand-alone basis in order to determine Acquisition savings. Staff states that it is Illinois-American's burden to develop the resources that will enable the Commission to identify this hypothetical cost of service. Staff indicates that Illinois-American has not met its burden with conjecture that savings can be identified in year 1 and then adjusted as time progresses or by its promise to provide a detailed plan for identification of savings within five years. (Staff Initial Brief at 11)

* * *

Staff asserts that there is no way to verify hypothetical cost estimates for a stand-alone Citizens that will no longer exist. Staff states that engaging in such a fruitless endeavor could result in rates that are based on ad hoc cost estimates developed by Illinois-American to justify the recovery of the Acquisition revenue requirement. (Id. at 14)

Order in Docket No. 00-0476 at p. 25.

Nonetheless, the Commission determined that IAWC should be given the opportunity to prove that there were demonstrable Acquisition Savings.

The Order concluded that, in rate proceedings filed within three years of the date of the Order, savings resulting solely from the Acquisition should be shared between shareholders and

customers on a 50/50 basis. The Order required that IAWC file, within 90 days of the date of the Order, a petition for approval of a specific methodology for quantifying the amount of Acquisition Savings. In accordance with the Order, on August 14, 2001, Illinois-American filed a petition in Docket No. 01-0556, seeking approval of a specific methodology for the purpose of quantifying the amount of Acquisition Savings.

The proposed methodology for quantification consisted of two components: (1) cost of Capital Savings and (2) Savings not related to Cost of Capital (the “two-part” methodology). Thomas Q. Smith reiterated his disagreement with including savings as a component of revenue requirement, but further recognized that the Commission had ordered that a Savings sharing program should be adopted. Order in Docket No. 01-0556 at p. 5. Mr. Smith agreed that the “two-part” methodology was reasonable, with the following qualification:

Mr. Smith recognized that, at this time, it is not possible to develop a template for calculating Savings based on specific inputs. According to Mr. Smith, a template cannot be developed until specific inputs are available at the time of a rate case. Mr. Smith indicated, however, that approval of the methodology would help limit the contested issues in a rate case. Mr. Smith stated his expectation that, at the time of the next rate case, Illinois-American will present all information that it believes necessary for the Commission to determine appropriate rate levels. Mr. Smith stated that, at that time, relevant information can be reviewed the evaluated, and an analysis can be provided for the Commission’s consideration.

Order in Docket No. 01-0556 at p. 5.

The Commission approved the use of the “two-part” methodology. Pursuant to the Order, the amount of any Acquisition Savings would be allocated 50% to ratepayers and 50% to IAWC. Both IAWC and Staff have utilized a “two-part” methodology in this rate case. While Bolingbrook concurs with the Staff’s application of the “two-part” methodology in most

respects, Bolingbrook submits that the portion of the Acquisition Savings template related to labor cost savings is seriously flawed.³

In IAWC Exhibit 12.0 Schedule C-2.4 p. 1 of 1, IAWC presents its computation of the Acquisition Savings. The IAWC calculation identifies five categories of costs: (1) labor and labor-related expense; (2) management fees; (3) rate case expense; (4) non-Citizens rate area long term debt; and (5) Citizens rate area long term debt. IAWC's witness, Ronald D. Stafford describes IAWC's calculation methodology in IAWC Exhibit 4.0 pp. 24-28. Bolingbrook does not dispute that these categories are generally appropriate in order to quantify Acquisition Savings.

What Bolingbrook does dispute, however, is the manner in which the template was employed to quantify "labor and labor-related savings." IAWC claims "labor and labor-related savings" of \$821,136 with respect to the Chicago Metro Division.⁴ IAWC closed on the CUCI asset acquisition and took control of the Chicago Metro Division in January 2002. IAWC Exhibit 2.0 p. 5.

While IAWC claims that there have been significant labor-related savings as a result of the CUCI asset acquisition, labor expenses attributable to the Chicago Metro Division have ballooned by 34% since IAWC took over from CUCI in January 2002. According to IAWC Exhibit 12.0 Schedule C-2 pp. 7 and 8, the following is a summary of the changes in labor costs since the CUCI closing:

³Bolingbrook accepts the Staff's quantification of Cost of Capital Savings and of Savings Not Related to Cost of Capital, with one exception: labor and labor-related expenses. However, Bolingbrook further submits that any labor and labor-related expense increases should be used to offset other Savings as discussed below.

⁴The Chicago Metro Division is comprised of Chicago Metro Water and Chicago Metro Sewer Districts.

Chicago Metro Division

December 31, 2001 (Historical)	December 31, 2003 (Pro forma)
\$ 1,556,358 (water)	\$ 2,666,642 (water)
\$ <u>1,191,934</u> (sewer)	\$ <u>1,025,842</u> (sewer)
\$ 2,748,292	\$ 3,692,484

See IAWC Exhibit 12.0 Schedule C-2 pp. 7 and 8.

IAWC has failed to adequately explain on this record how an increase in labor expenses of \$944,000 (or 34%) since IAWC assumed control over the Chicago Metro Division in January 2002 can somehow be categorized as labor expense “savings” of \$821,000.

Presumably, CUCI had adequate personnel immediately prior to the closing to provide safe and reliable public utility service. Indeed, in Docket No. 00-0476, the Commission specifically found: “There has been no showing that Citizens has been unable to provide safe and reliable service or to raise necessary capital.” Order in Docket No. 00-0476, Section E., p. 39. If CUCI’s personnel were able to provide safe and reliable service to the Chicago Metro Division on December 31, 2001, IAWC’s proposed increase in labor-related expenses by \$944,000 from historical year 2001 to pro forma 2003 hardly seems to result in labor-related Acquisition Savings of \$821,000. In fact, it appears that instead of producing labor cost savings, IAWC’s acquisition of CUCI’s assets has actually caused these costs to jump by 34%, according to IAWC’s own testimony. Moreover, if the \$944,000 increase in labor-related expenses (IAWC Exhibit 12.0 Schedule C-2 pp. 7 and 8) is used to offset the reported savings in the categories of management fees, rate case expense and Citizens Rate Area long term debt (see, IAWC Exhibit 12.0 Schedule C-2.4 p. 1 of 1 at lines 2, 3 and 5), then the total amount of Acquisition Savings is actually a negative number.

In Docket No. 01-0556, the Commission approved the “two-part” Acquisition Savings methodology. However, the actual template for applying the methodology and its inputs were

reserved for further review in the context of this rate proceeding. Bolingbrook submits that there is an obvious flaw in the labor cost portion of the template and its inputs if a labor cost increase of \$944,000 since IAWC assumed control can be somehow characterized as labor cost savings of \$821,000.

The burden of fully justifying that Acquisition Savings have in fact resulted from IAWC's acquisition of CUCI's assets lies with IAWC. As IAWC itself conceded in Docket No. 00-0476:

Illinois-American states that savings that result from a technological change will not be included in Acquisition savings and would not be used as a basis to allocate the Acquisition Revenue Requirement under the SSP. Illinois-American emphasizes that it has the burden in future rate cases to demonstrate that the savings under consideration initially result from, and continue to result from, the Acquisition. [Emphasis supplied.]

Order in Docket No. 00-0476, Section III.B.5 p. 23.

IAWC has failed to meet that burden in this case with respect to the labor cost component of the Acquisition Savings calculation. Far from demonstrating an overall decrease in labor costs since the CUCI asset acquisition, IAWC's testimony demonstrates precisely the opposite.

The Commission has proceeded in an extremely cautious manner in both Docket Nos. 00-0476 and 01-0556 in order to assure ratepayers that IAWC's shareholders will benefit only from Acquisition Savings that have, in fact, occurred and are solely attributable to the CUCI asset acquisition. The Commission has shown great concern that the ratepayers not be penalized by purported, but unjustified, Acquisition Savings. The labor cost component input clearly is flawed. CUCI provided safe and reliable service until December 31, 2001 at a total labor expense of \$2,748,292, yet safe and reliable service in pro forma 2003 would require IAWC to expend \$3,692,484. The record in this case simply does not support that any net Acquisition Savings have, in fact, been realized.

Bolingbrook, therefore, submits that IAWC has failed to meet its burden of demonstrating actual Acquisition Savings in this proceeding and that IAWC's request for Acquisition Savings with respect to the CUCI asset acquisition should be denied.

