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STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

IN THE MATTER OF:

The Petition Of The City Of Pekin, A Municipal Corporation, For Approval Pursuant To 735 ILCS 5/7-102 To Condemn A Certain Portion Of The Waterworks System Of Illinois-American Water Company.)
)
) Docket No. 02-0352
)
)

REPLY BRIEF OF ILLINOIS-AMERICAN WATER COMPANY

Illinois-American Water Company (“Illinois-American” or “IAWC”) submits this Reply Brief responding to the arguments raised in the Post-Hearing Brief of Petitioner City of Pekin (“Pekin” or “City”) and the Brief of the Staff of the Illinois Commerce Commission (“Staff”). In its Initial Brief, Illinois-American discusses the evidence presented in this matter that clearly demonstrates that the City failed to meet its burden to prove that City ownership of the Pekin District system would better serve the public interest as compared to continued ownership by Illinois-American. The City largely ignores this evidence in its brief, choosing instead to “cherry-pick” and address only carefully selected evidence favorable to the City’s case. For its part, Staff chooses to disregard entirely the import of the findings of its witnesses. The Commission, however, must base its decision on the “entire record of evidence.” (220 ILCS 5/10-201(iv)(A).) When the “entire record of evidence” is considered, the clear result is that the City has failed to meet its burden of proof. For the reasons set forth below, as well for the reasons set forth in Illinois-American’s Initial Brief, the City’s Petition must be denied.

I. The Staff's Brief Incorrectly States The Standard Of Review To Be Applied In This Case.

Both the City and Illinois-American agree that, to prevail in this proceeding, the City has the burden to prove that City ownership would better serve the public interest than continued ownership by Illinois-American. [IAWC Brief, pp. 8-14; City Brief, p. 13.] At page 2 of its brief, Staff disagrees with the standard of review accepted by both IAWC and the City. Tellingly, Staff makes no attempt to distinguish the numerous cases and Commission orders which clearly hold that entities petitioning for approval to condemn public utility property must prove that condemnation will better serve the public interest than the other viable alternatives. See Homer Township: Petition For Approval to Acquire the Chickasaw Division of Metro Utilities Co. by Eminent Domain, ICC Docket 92-0258, Order, p. 12 (1992) (holding that "in order for a governmental body to receive Commission approval to condemn, it must demonstrate that the condemnation would best serve the public, the public interest and utility users"); Fernway Sanitary District v. Citizens Utility Company of Illinois, ICC Docket 52024, Order, pp. 6-7 (1968) (adopting a "better public interest" standard of proof for condemnation petitions); Illinois Power Company, ICC Docket 81-0818, aff'd 111 Ill. 2d 505, 513 (1986) (holding that the Commission should approve a proposal only if it is in the better public interest); Klopf v. Commerce Comm'n, 54 Ill. App. 3d 491, 498-99, 369 N.E.2d 906, 911-12 (1977) (affirming Commission approval of condemnation petition filed by Conservation District to condemn land for nature trail after finding it would better serve the public interest than the proposed sale to adjoining landowners); see also Ambrose v. Thornton Township School Trustees, 274 Ill. App. 3d 676, 680, 654 N.E.2d 545, 548 (Ill. Ct. App. 1995) (the petitioner or party seeking affirmative relief bears both

the burden of producing evidence and the burden of persuading the trier of fact). The Staff argues unconvincingly and without citation to specific authority, that “better public interest” should not be the standard, yet Staff fails to describe with any particularity what it would substitute as the appropriate standard of review, other than to suggest, meaninglessly, that “the general criterion of public interest is applicable.” [Staff Brief, p. 2.]

The Staff’s disagreement with the “better public interest” standard clearly enunciated in several previous Commission orders and cases and accepted by both IAWC and the City appears to stem largely from the Staff’s vehement criticism of the admission of the testimony of former Commission Staff member and IAWC witness Tom Stack, who provided rebuttal evidence in response to Staff witness Johnson’s direct testimony describing the standard of review. Staff complains about the evidentiary ruling in its brief, and disparages the value of Mr. Stack’s opinions, but does not request reconsideration of the ruling. Staff’s gratuitous criticism of the evidentiary ruling, which Staff does not contest, is puzzling. The absurdity of the Staff’s position regarding the admissibility of Mr. Stack’s testimony is that Mr. Stack’s statements regarding the appropriate standard of review were made solely in rebuttal to the standard of review espoused by Staff witness Johnson. Evidently, Staff believes that only its own witness is free to testify regarding the appropriate standard of review, but that testimony on that subject from any other witness is inadmissible.

Staff’s dissatisfaction aside, the standard of review is exactly what the cases and Commission orders say it is, regardless of whether any witness testified regarding the standard at hearing. Based on the numerous precedents cited by IAWC, the standard

of review the Commission must apply to the City's Petition for condemnation is whether the City has proven that City ownership will better serve the public interest than continued ownership by Illinois-American. (See citations at page 2, supra.) Staff has failed to demonstrate otherwise.

In what is either a non sequitur or a patent attempt at misdirection, Staff implies in its brief that the better public interest standard should not apply because in Department of Conservation v. Chicago & North Western Transportation Company, 59 Ill. App. 3d 89, 91, 375 N.E.2d 168, 170 (1978), the Illinois Court of Appeals made the comment that the basic function of the Commission approval requirement in condemnation cases "is to ensure that property necessary for utility purposes is not taken." Staff fails to explain how that comment in a case involving condemnation of abandoned property could possibly apply to consideration of Pekin's Petition, given that all the property that Pekin seeks to condemn is needed for "utility purposes." If the comment referenced by Staff were indeed controlling in the context of this proceeding, the City's Petition would have to be denied on that basis alone. Of course, the comment referenced by Staff actually makes no sense in a case, such as this, in which condemnation of an operating utility system is proposed.

The Department of Conservation case cited by Staff dealt with two competing proposals for the sale of an abandoned railroad right-of-way. A group of adjoining landowners wanted to buy the right-of-way for development, and the Department of Conservation wanted to condemn it for a nature trail. Department of Conservation, 59 Ill. App. 3d at 90, 375 N.E.2d at 169 (referencing the more detailed recitation of facts in the previous proceedings reported in Klopf v. Illinois Commerce Comm'n, 54 Ill. App. 3d

491, 369 N.E.2d 906 (1977)). What Staff fails to grasp is that, in the very case it cites, the Commission approved the Department of Conservation's condemnation petition after applying the precise "better public interest" standard of review the Staff argues should not apply to this matter. Department of Conservation, 59 Ill. App. 3d at 90, 375 N.E.2d at 169 (referencing the previous proceedings in the case reported in Klopf v. Illinois Commerce Comm'n, 54 Ill. App. 3d 491, 369 N.E.2d 906 (1977) (affirming the Commission's finding that "the public interest [would] be better served if it approved the Department's petition" for condemnation)). Staff's reliance in its brief on the Department of Conservation case provides no support whatsoever to its disagreement with the better public interest standard of review, and in fact, is further authority that the better public interest standard is indeed correct.

Staff also argues, without any citation of authority, that the Commission should disregard the better public interest standard because such a standard "places the Commission in the dangerous position of platonic [sic] guardians second-guessing the determinations of Pekin's city council and electorate." [Staff Brief, p. 2.] It is not surprising that Staff cites no authority for this position, because the Commission has indicated repeatedly and unequivocally in previous orders that "second-guessing" local government determinations is precisely what the General Assembly has directed the Commission to do in reviewing petitions seeking permission to condemn under Section 7-102 of the Eminent Domain Act ("EDA").

The seminal case on this issue, which was completely ignored by Staff, is Fernway Sanitary District v. Citizens Utility Company of Illinois, ICC Docket 52024 (1968). In its order in Fernway, the Commission undertook a detailed examination of

the appropriate standard of review it should apply to petitions seeking permission to condemn utility property under Section 7-102 of the EDA, and specifically rejected the interpretation of Section 7-102 that is proposed by Staff. Staff argues that the Commission should refrain from second-guessing the City's determinations, and should, instead, accept the City's assertions of public interest at face value. In Fernway, the Commission disagreed, finding instead that Commission review was intended to "provide a forum to determine in such cases what action would best serve the public." Fernway, Order, p. 7. The Commission specifically stated that its review must not be limited to a "mere formal administrative duty" or rubber-stamp as Staff proposes, but should include a detailed inquiry into whether the proposed condemnation would better serve the public interest than continued ownership by the utility. Id. at p. 6.

The Commission rejected the argument made by Staff a second time in Homer Township, ICC Docket 92-0258 (1992). In that proceeding, Homer Township filed a petition under Section 7-102 of the EDA seeking permission to condemn a portion of Metro Utilities Company's water and sewage facilities, citing as its reasons the poor service, and the township's desire to control the utility in order to encourage economic development. Homer Township, ICC Docket 92-0258, Order, p. 1. The township argued, as Staff does in its brief, that the Commission was prohibited from second-guessing the township's legislative determinations that the condemnation would serve the public interest. Id. at p. 6. The Commission, citing Fernway, rejected the township's argument, finding that a lower standard would, contrary to the legislative intent of Section 7-102, limit the Commission's review in such proceedings to a "purely ministerial duty" or a "meaningless formality." Id. at pp. 10-11. Instead, the

Commission reaffirmed the standard announced in Fernway placing the burden on the petitioner to demonstrate that the condemnation would better serve the public interest than continued ownership by the utility. Id.

After applying that standard of review to the township's case, the Commission found that the township had not met its burden of proof, and granted the utility's motion for a directed finding without hearing any rebuttal evidence from the utility. Id. The Commission first concluded that the township's petition must be denied because the township did not have the statutory authority to condemn utility property outside its boundaries. As discussed in Illinois-American's Initial Brief (pages 86-90), the statute Pekin relies on for its authority to condemn, Division 130 of the Municipal Code, like the statute in Homer Township, also does not grant extra-territorial condemnation authority. The Commission should conclude in the present case, like it did in Homer Township, that the petitioner lacks the authority to condemn outside its boundaries.

In Homer Township, the Commission also found that the township failed to meet its burden of proof to demonstrate its proposal would better serve the public interest. In making this finding, the Commission cited, among other reasons, the fact that the township: had conducted little analysis pertaining to the costs of acquiring, operating or maintaining the utility facilities; had not sufficiently addressed the Commission's concerns regarding service to utility customers residing outside the township boundaries; and had not presented any analysis of the impact the condemnation would have on the remainder of the utility customers outside the district being condemned. Id. at p. 14. The Commission noted that "[a]bsent such information, it is impossible for the Commission to determine whether the condemnation would best serve the public, the

public interest and the balance of Metro's utility users," and therefore "the evidence demonstrates that Homer has not met the standard to receive Commission approval for condemnation." Id. pp. 13-14.

As noted above, not only does Staff fail to cite any authority which supports a standard other than the better public interest standard, Staff disregards the previous Commission orders which specifically reject the lower standard suggested by Staff, and instead reaffirm the better public interest standard applied by both the City and Illinois-American. In fact, all of the Staff's protestations are academic, because the Staff itself seems to later adopt the "better public interest standard." At page 6 of its brief, Staff notes that, in his rebuttal testimony, Staff witness Johnson, "no longer believes that the City's Pekin District acquisition best serves the public interest (Staff Exhibit 3.00, page 6)." Thus, there is no meaningful dispute on the proper standard for evaluation of the City's proposal; Illinois-American, the City and Staff (at least on page 6 of its brief) agree that, to prevail, the City must demonstrate that its proposal is in the "better" public interest (i.e., the "best" of the two alternatives presented).

There can be no question but that, as the City concedes, Pekin has the burden in this case to prove that its proposed condemnation would better serve the public interest than continued ownership by Illinois-American. When this correct standard of review is applied to the evidence presented in this case, it is obvious that Pekin has not met its burden and the Petition must be denied.

II. The Testimony Of The Staff Witnesses Demonstrates That Pekin Has Not Met Its Burden To Show Condemnation Would Better Serve The Public Interest.

Although Staff did not articulate the point clearly in its brief, the testimony of all three staff witnesses demonstrates that the City has failed to meet its burden to prove that the public interest would be better served under City ownership. Illinois-American agrees with the only logical conclusion from the Staff's findings, which is that the Petition be denied.

A. Staff Witness Johnson's Findings.

Staff witness Johnson specifically found that condemnation of Illinois-American's Pekin District is not in the better public interest because the City failed to show that the significant population of non-City-resident customers would be adequately protected in the absence of Commission oversight. [Staff Ex. 3, pp. 5-6.] Staff requests that the Commission adopt Staff witness Johnson's finding. [Staff Brief, p. 6.] The City, in its brief, chooses to simply ignore Staff witness Johnson's finding.

In its brief, the City states, incorrectly, that it has a history of treating extraterritorial customers the same as customers residing inside the City limits, and fails to even acknowledge the undisputed evidence showing otherwise. [Pekin Brief, p. 37.] As demonstrated by the Brush Hill fire contract touted by the City as an example of non-discrimination, the City has a history of granting residents preference over non-residents in the provision of fire and rescue services. [Tr. 161-68.] The City also admits that its current practice is to condition sewer extensions to non-residents on annexation, and that it intends to continue that discriminatory practice with regard to water customers should the condemnation proceed. [Tr. 224-25; Pekin Ex. 1, p. 11.]

The City does not explain its failure to recognize and consider the higher rates charged non-residents in many of the municipally-owned systems cited by the City as examples of how City ownership can lower rates, (including Galesburg, a city held up by Pekin as a “model” for its proposal, which charges non-residents double for their water needs). [IAWC Ex. 2.0, p. 14.] The City does not acknowledge the fact that, as noted by Staff witness Johnson and conceded by the City’s own witnesses, commitments made by one administration are not binding on future administrations, and in fact, changing administrations have in the past resulted in changing policies. [ICC Staff Ex. 3.0, p.5; Tr. 783-86.] The City also fails to explain its failure to offer testimony of any elected official confirming the City’s alleged intent to treat residents and non-residents equally.

In its brief, the City misleadingly cites the recent resolution making the proposed five-year rate freeze applicable to residents and non-residents as evidence of its commitment to non-discrimination, completely ignoring the testimony by Staff witness Johnson which emphasized that the resolution does nothing to assuage his concerns regarding the protection of non-residents because its says nothing about rates for non-residents who are not current customers, nothing about the annexation requirement the City intends to implement, and provides no specifics about the changes the City states it intends to make to the ICC rules of service which currently assure equal treatment of non-residents and give non-residents equal rights to participate in service and rate-making issues. [Tr. 88-89; Pekin Ex. 15.1; IAWC Ex. 1.0R, p.12; IAWC Ex. 2.0, pp. 2-3.] As Staff witness Johnson explained, the resolution cited by the City makes a meaningless assurance that non-residents will have the “opportunity to be heard” on

future rate increases, but fails to give those non-residents any mechanism to protect themselves because the City Council members are not accountable to the non-residents, and the non-residents will have no vote on future rate increases. [Tr. 89-90.] The City is silent with respect to these arguments and findings by Staff witness Johnson.

B. Staff Witness Phipps' Findings.

The City has the burden to demonstrate that its condemnation proposal would better serve the public interest than continued ownership by Illinois-American. One way the City chose to attempt to meet that burden of proof was by demonstrating that the City has the financial resources to acquire and operate the Pekin District system and implement the necessary capital improvements while maintaining fair rates. [City Brief, pp. 20-34; Pekin Exs. 1.0, 5.0, 8.0, 17.0.] Of course, under the standard of review which must be applied, the Commission may not simply accept Pekin's assertions of financial feasibility as true, but must undertake an independent examination of those assertions. Staff witness Phipps performed an evaluation of the City's claims that it has the financial ability to acquire and operate the Pekin District system. [Staff Brief, p. 9; Staff Exs. 2.00, 4.00.]

Staff witness Phipps first noted that the City's ability to fund the acquisition and operation of the system was contingent upon the purchase price the City paid to acquire the system. [Staff Ex. 4.0, p. 5.] Staff witness Phipps concluded that the City has the financial ability to acquire and operate the Pekin District on one condition: that the acquisition price does not exceed \$26 million. [Staff Ex. 4.00, p. 9.] The City itself concedes that the acquisition would not be financially feasible if the purchase price

exceeds \$20 million. [Tr. 778.] However, Staff witness Phipps also recognized the possibility that the acquisition price could ultimately exceed \$26 million, and could quite possibly meet or exceed the \$60.3 million minimum value presented by IAWC witness Reilly. [Tr. 128.] Staff witness Phipps concluded that the acquisition is not financially feasible if the purchase price exceeds \$26 million, which she acknowledged is a possibility. [Tr. 133; Staff Ex. 4.0, p. 9.] Staff witness Phipps found that there was insufficient evidence to accept the City's estimate of purchase price over that offered by Illinois-American. [Tr. 126.] The unavoidable import of Staff witness Phipps' findings is that by failing to provide sufficient evidence showing that its valuation analysis should be accepted, and Illinois-American's valuation disregarded, Pekin failed to clear the hurdle it set up for itself by placing at issue its ability to finance the acquisition, which, as recognized by Staff witness Phipps, is necessarily dependent on the purchase price paid for the system. The City unsuccessfully attempted to demonstrate that its condemnation proposal will better serve the public interest by proving that it has the financial resources to acquire and operate the system. Staff witness Phipps was unpersuaded by the City's evidence on that issue. Illinois-American agrees.

Inexplicably, in its brief, Staff fails to acknowledge the logical result of Staff witness Phipps' findings, choosing instead to dismiss Staff witness Phipps' conclusion that the acquisition is not financially feasible if the purchase price exceeds \$26 million by speculating that "if the purchase price rises to a level causing adverse financial consequences," the City "will not proceed with the acquisition." [Staff Brief, p. 16.] Of course, Staff does not acknowledge that the City's ability to abandon the condemnation proceedings after the jury sets a purchase price is not absolute, and would result in the

City being liable for all Illinois-American's costs of defending the case up to that point, including attorneys fees and expert fees. Department of Public Works v. O'Brien, 402 Ill. 89, 91-92, 83 N.E.2d 280, 281 (Ill. 1948) (holding that the right of the condemnor to dismiss or abandon eminent domain proceedings is conditioned upon payment of costs, expenses, and reasonable attorneys fees incurred by the property owner.) That consideration aside, Staff has absolutely no basis to speculate what the Pekin City Council will or will not do or how it will decide to proceed should this case reach litigation. Staff's attempt to downplay Staff witness Phipps' findings by guessing what the City Council might do, and asking the Commission to assume its guess may be correct, is inappropriate and unconvincing. The Commission's role is to determine whether the City has proven that its proposal is in the better public interest, not, as Staff would have it, to guess and hope that things might somehow work out. As Staff witness Phipps' testimony demonstrates, the City failed to meet its burden to show that the acquisition of the Pekin District system is financially feasible.

C. Staff Witness Smith's Findings.

In addition to choosing to meet its burden of proof to show that condemnation will better serve the public interest by demonstrating that the City has the financial resources to acquire the Pekin District System, the City also asserts that it has the financial resources necessary to operate the system. [City Brief pp. 20-34; Pekin Exs. 1.0, 5.0, 8.0, 17.0.] Staff witness Smith evaluated the evidence presented by the City in support of its assertion that it is financially capable of operating the system. [Staff Brief, p. 16; Staff Ex. 5.00, pp. 2-4.] Staff witness Smith concluded that Pekin's revenue requirement forecast is based on pure speculation and therefore is totally unreliable.

[Staff Brief, p. 16; Staff Ex. 5.00, p. 4.] Staff witness Smith pointed out that he saw no plan or evidence supporting City witness Hals' assumption that a management firm will operate the utility upon acquisition, and that even if there was such a plan, Pekin does not know which management company it would hire, and therefore cannot know how much it will cost to operate the system. [Staff Ex. 5.00, p. 4.] Based on these conclusions, Staff witness Smith recommends that the Commission disregard Pekin's revenue requirement forecast entirely. [Staff Ex. 5.00, p. 5.] Clearly, Staff witness Smith's findings indicate that Pekin did not meet its burden to show that it has the financial ability to operate the Pekin District system. Illinois-American agrees.

Again, the arguments presented in the Staff's brief do not appear to acknowledge Staff witness Smith's findings. In its brief, Staff makes the statement that it is of the opinion that the City has the financial ability to operate the Pekin District system. [Staff Brief, p. 16.] How can Staff argue in its brief that the City has the financial ability to operate the system when Staff's own witness concludes that the City "cannot know how much the operations will cost?" Of course, a few paragraphs later, Staff contradicts itself and asks that the Commission accept the findings of Staff witness Smith and disregard the City's revenue requirement forecast altogether. [Staff Brief, p. 16.]

Staff's contradictory statements in its brief aside, the testimony of all three Staff witnesses demonstrate that Pekin has not met its burden to prove that its proposed condemnation of the Pekin District system will better serve the public interest than continued ownership by Illinois-American. In its brief, Staff asks the Commission to

adopt the findings of the Staff witnesses, which would result in denial of the City's Petition.

III. Pekin's Brief Ignored The Substantial Amount of Evidence Presented That Was Unfavorable To The City's Case.

In its brief, Pekin argues that its condemnation proposal will better serve the public interest for the following reasons: (1) the City will be able to better address fire service concerns; (2) the City has the financial ability to acquire and operate the system while reducing future rate increases; (3) the City can better coordinate water operations with other City departments and encourage development; and (4) the City's inadequate management and operation of its wastewater system is irrelevant. In discussing these reasons in its brief, the City presents its arguments and testimony as if no rebuttal evidence was filed and no cross-examination conducted. The City fails to acknowledge the substantial amount of evidence which demonstrated that the City's public interest assertions are unsupported, or in some instances, based entirely on faulty assumptions, exaggerations, and inaccurate characterizations of the facts. The City ignores the several instances in which its evidence was absolutely refuted by contrary proof. The City is essentially asking the Commission to view the case with blinders on, and only consider that evidence which is favorable to the City's case. The Commission, however, cannot properly function in this manner. The law is clear that the Commission must base its decision on the "entire record of evidence presented to or before the Commission for and against such...decision." 220 ILCS 5/10-201(iv)(A). As discussed more thoroughly below, when the Commission looks past the City's selective citation and considers the "entire record of evidence," it is clear that the City has failed to meet

its burden of proof on each of its asserted public interest reasons, and therefore the Petition must be denied.

A. The Evidence Clearly Demonstrates That Pekin's Criticisms of Illinois-American's Fire Protection Service Are Unfounded.

The first reason Pekin presents in support of its public interest argument is its claim that Illinois-American's fire protection service is inadequate, and its assumption that fire service will improve under City ownership. [Pekin Brief pp. 14-19.] As support for this argument, the City relies almost exclusively on the testimony of Fire Chief Janssen, perhaps the least credible of all the City's witnesses. The City makes no attempt to explain the numerous instances where Mr. Janssen's criticisms were shown to be contrary to undisputed facts. The City fails to acknowledge Mr. Janssen's admission that he had no basis for several of his criticisms beyond his own personal, and ultimately inaccurate speculation, and ignores the numerous times Mr. Janssen conceded his testimony was just plain incorrect. None of the City's criticisms of Illinois-American's fire protection service stand up to even the barest level of scrutiny.

In its brief, the City argues that inadequate water flow due to small diameter mains at two fires - the Jim's Automotive Fire in March 2002 and the Anderson Upholstery Fire sometime in the 1980's - hampered the fire department's efforts to such a degree that the buildings were a total loss. [Pekin Brief pp. 14-15.] The only evidence the City offers in support of this argument is the testimony of Mr. Janssen, who admitted he had absolutely no evidence whatsoever to support his contention that the water flow at the two fires was inadequate. [Pekin Ex. 3.0, p. 4.] The City ignores the undisputed evidence presented by Illinois-American that absolutely refuted Mr. Janssen's personal opinion that small diameter mains (i.e., mains with a diameter of four inches or less)

resulted in inadequate water flow during the Jim's Automotive fire. The evidence presented by Illinois-American demonstrated that the two hydrants used to fight the Jim's Automotive fire were not served by small mains at all, but were in fact connected to six inch mains. [IAWC Ex. 4.0, pp. 27-28.] Illinois-American also produced a hydraulic analysis, which conclusively demonstrated that the water flows during the Jim's Automotive fire were between 1000 gallons per minute (g.p.m.) (with two wells disabled by a power outage) and 1600 g.p.m. (with the two wells in-service). [IAWC Ex. 4.0, pp. 28-29.] Mr. Janssen himself estimated that the hydrants produced at least 2900 g.p.m. during the fire. [Tr. 435.] Thus, there is no basis to contend that the available water flow available to fight the fire was inadequate. [IAWC Exs. 3.0, pp. 21-23; 4.0, p. 28.]

In its brief, the City also recites the direct testimony of Mr. Janssen accusing Illinois-American of ignoring, despite notice and complaint, a long-ongoing problem with gravel in the mains. [Pekin Brief pp. 17-18.] Of course, the City fails to mention that Mr. Janssen later admitted that he had no records or documentation whatsoever that the problem exists or that Illinois-American or the Commission had ever been notified of the problem. The City also ignores the fact that Mr. Janssen admitted he had made no effort whatsoever to complain to anyone about the alleged "problem." [Tr. 419-21.] The City also fails to acknowledge the evidence demonstrating that Illinois-American regularly conducts thorough inspections of all hydrants and well pumps in the Pekin District system, which would have revealed gravel in the mains, if the problem truly existed. [IAWC Ex. 4.0R, pp. 4-5.] Like Mr. Janssen's other criticisms, it is apparent

that the problem of gravel in the mains is one that exists solely for the purposes of this proceeding.

The City also recites Mr. Janssen's claims that the fire department has experienced delays in dealing with Illinois-American's centralized call center. [Pekin Brief pp. 18-19.] The City fails to address the fact that as Mr. Janssen admitted, the fire department had been provided with emergency contact numbers for several Illinois-American employees located in Pekin, but that in the incident he based his criticism on, he did not have those emergency numbers with him. [Tr. 422.]

The City also argues in its brief that the small diameter mains in the Pekin District system pose a safety hazard that Illinois-American has not adequately addressed. [Pekin Brief pp. 14-17.] The evidence presented by Illinois-American totally refutes this claim. The City has admittedly performed no analysis whatsoever of the impact the small mains have on the Pekin District system, and has no basis to conclude that the small mains provide "inadequate flow" or pose a "safety hazard." [Tr. 191-98; IAWC Ex. 1.0R, pp. 1-2, 9.] In contrast, in 2002, Illinois-American performed a comprehensive analysis, using a hydraulic model, of the entire Pekin distribution system which demonstrated that because the system is an integrated system, meaning there is no one area with a mass concentration of small diameter mains, there are no areas in which water pressure or rate of flow is inadequate, and no "safety hazard" is posed by the existence of small mains. [IAWC Ex. 3.0, pp. 16-17.]

The evidence presented by Illinois-American also completely debunks the City's claim that the Company has not adequately addressed the issue of small mains in the Pekin system. The City concedes in its brief that Illinois-American, with City input,

completed an ambitious small main prioritization project which catalogued all of the mains in the Pekin system with a diameter of four inches or less, analyzed the impact each small main segment has on the provision of water, and scheduled those mains for replacement based on need. [Pekin Brief, p. 15; IAWC Ex. 3.0, pp. 11-12.] As acknowledged by the City, under the resulting small main replacement plan, 100% of all water mains three inches in diameter or less in the Pekin system will be replaced within 30 years, which represents a replacement rate triple that of the last 20 years. [Pekin Brief, p. 15; IAWC Ex. 3.0, p. 12.] Pekin criticizes Illinois-American's plan because "only 80% of the inadequate, old water mains are scheduled to be replaced within that period." [Pekin Brief, p. 15.] The City's criticism is completely unfounded. The City has no basis whatsoever to determine which small mains are "inadequate" because it has performed no analysis at all. The City participated in Illinois-American's small main replacement program and approved the approach, and now claims it is insufficient based on their ad-hoc characterization of certain unspecified mains as "inadequate." [IAWC Ex. 4.0, p. 11.]

The City also criticizes Illinois-American's small main replacement plan because, as with any business decision, there is a remote possibility the plan could have to be altered sometime in the future due to an unforeseen change in financial conditions. [Pekin Brief pp. 15-16.] Of course, the City has no substitute main replacement plan to offer, other than to surmise that the City could forego other "less essential" capital improvements to funnel more money to small main replacement. The City's suggestion regarding foregoing "less essential" capital improvements is meaningless, however, because the City has not performed any analysis whatsoever, and has no basis to

conclude what improvements would be “less essential.” [Tr. 191-98, 206-09; IAWC Ex. 1.0R, pp. 1-2, 9.] The City pointedly claims Illinois-American’s small main replacement plan is subject to possible change, all the while hoping the Commission does not notice the City has no plan whatsoever.

With respect to all of the City’s claims regarding Illinois-American’s service and capital planning, it is important to note that (i) the City does not have any written documentation that the purported concerns exist (no memorandum, letter, note, report or other written material); and (ii) the City’s representatives who, for purposes of their testimony purport to have so many concerns, have never submitted even one complaint to the Commission regarding Illinois-American’s capital planning or service. [IAWC Ex. 2.0R, p.10.] What these officials have done is go on record in other forums recognizing Illinois-American’s consistent record of satisfactory service. [IAWC Exs. 5.0, pp. 3, 12-13; 5.1, 5.7, 5.8; Tr. 173-74, 199.]

The evidence presented in this case demonstrates that the City’s criticisms of Illinois-American’s fire service protection and small main replacement program are unfounded and baseless political rhetoric. As such, the City has not met its burden to prove that its condemnation proposal would better serve the public interest than continued ownership by Illinois-American and the City’s Petition must be denied.

B. Pekin Has Not Met Its Burden To Show That Acquisition Is Financially Feasible Or That The City Will Be Able To Reduce Future Rate Increases.

The second reason the City cites in its brief in support of its public interest argument is its claim that the acquisition of the water system is financially feasible and the City will be able to operate the system while reducing rates. The City admits that its

ability to finance both the acquisition and operation of the system, as well as its ability to reduce rates, are all wholly dependent on one thing: the price the City pays for the system. [Tr. 791.] The City itself chose to make the value of the Pekin District system an issue in this case, and because Pekin has the burden to prove each of its public interest assertions, “valuation” is one of the issues on which Pekin has the burden of proof. As Administrative Law Judge Woods acknowledged at hearing, the amount of indebtedness that the City would undertake to fund the acquisition is an issue in this case. [Tr. 845.] Thus, by structuring its case in the manner it did, Pekin has necessarily assumed the burden of proving that it can pay to purchase and operate the system and still reduce rates, which in turn requires Pekin to prove, at the very least, that its financial feasibility and rate analysis are based on a reasonable assumption of value. Pekin has failed to meet this burden of proof.

Pekin admits that it cannot afford to purchase and operate the system if the purchase price exceeds \$20 million. [Tr. 778; IAWC Ex. 7.1.] Despite this admission that the purchase price is the key underlying assumption on which all of its financial feasibility and rate analyses depend, the City concedes that the valuation analysis it offers in support of its claims was performed by a consultant who is not a certified appraiser in the state of Illinois or any other state, who holds no appraisal designations from any appraisal certifying association, and who made no attempt whatsoever to follow generally accepted appraisal standards in performing her analysis. [Tr. 441-47.] Not surprisingly, the City’s consultant selected a methodology that improperly equates the water system’s value and net original cost, a methodology which she admits has not

been accepted as valid in Illinois or anywhere else over the past ten years. [IAWC Exs. 2.0, p. 8; 10.0, pp. 19-20; 26; Tr. 514.]

In contrast to the obviously unqualified and unsupported opinions of the City's consultant, Illinois-American presented the testimony of Robert Reilly, a state-certified general appraiser in Illinois who has qualified as an expert witness on valuation on numerous occasions and who has significant experience in all forms of business valuation. Mr. Reilly's analysis, which began with a detailed engineering analysis of the observed depreciation of all tangible assets in the system, included a comprehensive consideration of all three approaches to valuation consistent with generally accepted appraisal standards. Mr. Reilly concluded that the value of the Pekin District system would be no less than \$60.3 million. In contrast to the detailed analysis performed by Mr. Reilly, the City's valuation consultant admitted both that she did not perform a market-approach analysis, and that she disregarded the RCNLD method of calculating value under the cost approach because it was simply "too complex." [IAWC Ex. 10, p. 21; Tr. 482-83.]

There are numerous additional fatal errors in both the City's valuation analysis and the financial feasibility and rate analyses based on that valuation, all of which are discussed in detail in Illinois-American's Initial Brief. [IAWC Brief, pp. 51-74.] However, the deficiencies outlined above, all of which the City has readily admitted, demonstrate beyond doubt that the City has failed to meet its burden of proof on the fundamental valuation assumption on which all of its financial feasibility and rate analyses are based. When that speculative assumption is removed, the house of cards collapses.

In its brief (pages 7-8), the City points to certain costs, such as income taxes, which, as it notes, would not be incurred if the City were to acquire ownership. The City's cost discussion, however, is one of the many examples of its selective consideration of the evidence. Not only did the City admit that all the cost savings were contingent upon the acquisition price, the City completely ignores in its brief the advantages of the mass-purchasing programs and economies of scale provided by the American system which would disappear under City ownership. [IAWC Ex. 2.0R, p. 18; 2.3R.] The City's Finance Director candidly admitted that, even without the water system acquisition, the City's capital plan is "ambitious." [Tr. 783-86.] He also likened the water system to a "cash cow" and "goose that laid the golden egg." [Tr. 778-79.] Obviously, the City has an interest in obtaining revenues from the water system. What the City failed to demonstrate is that it has the financial ability to purchase and operate the system at all, much less to do so while reducing rates, and maintaining service levels. The City fails to present any definite plan with regard to how it will meet the service and capital needs of the resident and non-resident customers. Accordingly, the City has failed to prove what it set out to prove - that the acquisition will better serve the public interest. Therefore, the City's Petition must be denied.

C. Pekin Has Not Met Its Burden To Show That The Public Interest Will Be Better Served Through City Control And Management Of The Water System.

The third reason Pekin presents in its brief in support of its public interest argument is its claim that the public interest would be better served through City control and ownership of the water system. The City's reasoning for this claim is twofold. First, the City claims that City ownership would improve the coordination of capital

improvements and maintenance work by the City and the water system. Second, the City asserts that it will be better able to manage development if it owned the water system.

The basis for the City's argument that coordination of projects will improve is its criticism that there have been "historical problems with the coordination of utility work." [Pekin Brief, p. 35.] In making this criticism, the City presented no tangible evidence of such alleged problems, and completely ignores undisputed evidence that current cooperation between Illinois-American and the City is excellent. [IAWC Exs. 4.0, pp. 9-11; 4.11, 5.2, 5.3.] The City's characterization of Illinois-American is based largely on the testimony of City Manager Hierstein, whose credibility was made suspect by his own previous admissions that he was "satisfied" with the level of communication and coordination received from Illinois-American; that the City "greatly appreciated" the cooperation the City received from Illinois-American; and that coordination between the City and the Company had "greatly improved over the past years." [IAWC Exs. 4.11, 5.1, 5.2, 5.3.] The City also ignores the numerous unrefuted examples of cooperation presented by Illinois-American, including, for example, the Company's participation in monthly utility coordination meetings conducted by the City; daily e-mails of the Company's work schedule to the City engineer; sharing and receiving input from the City in the preparation of the Company's annual capital improvement plan; and coordination of projects with the City's five-year street plan. [IAWC Ex. 4.00, pp. 9-11.] The City's criticisms of the level of cooperation between Illinois-American and the City are unfounded.

The City's assertion that it would be able to better manage development if it owns the water system is actually a reference both to the City's desire to be able to force existing water system customers to subsidize new developments through higher rates, and its stated intention to condition access and extensions to new customers upon annexation. [Tr. 105-06; Hierstein Aff. to Pet., ¶ 19.] The City accuses Illinois-American of causing "delay" with regard to the Hanna Steel development. In that situation, at the City's request, Illinois-American obtained, on an expedited basis, a variance from Commission rules to accommodate the City's desire to maintain ownership of main extension constructed to serve Hanna Steel. [IAWC Ex. 4.0, pp. 12-13; IAWC Ex. 11.0R, p. 10.] The "delay" the City refers to was the time necessary to obtain the variance. The purpose of the Commission rules requiring developers to bear the cost of main extensions is to ensure that existing customers are not required to unfairly subsidize a main extension for a new developer through higher rates. [IAWC Ex. 11.0R, p. 10.] Of course, the customers will lose the protection of the Commission rules under City ownership. The City claims development advantages will be available under City ownership. The development advantages the City is referring to are the ability to require annexation and to "attract" developers of its own choosing by forcing existing customers to subsidize the main extensions needed to serve the new development. [Pekin Brief pp. 35-36.] Such practices are contrary to Commission rules, and not in the public interest. See, e.g., Illinois-American Water Company, ICC Docket No. 96-0007, pp. 10-11 (June 26 1996) (authorizing IAWC to provide water service to a new subdivision over the objection of a neighboring city that wanted to

condition water service on annexation in accordance with its alleged right to “govern the city’s growth”).

The evidence in this case demonstrates that current coordination between Illinois-American and the City is excellent, and that the City’s claim that it will be able to better manage development under City ownership is unfounded. As such, Pekin has not met its burden to prove that the public interest would be better served through City control and ownership of the water system. Therefore, the City’s Petition must be denied.

D. Pekin Cannot Avoid The Devastating Effect Of The Evidence Regarding The Inadequate Operation And Management Of Its Wastewater System By Simply Asking The Commission To Ignore That Portion Of The Case.

Throughout its brief, Pekin ignores any evidence presented through rebuttal testimony or cross-examination that is harmful to its case. In the final section of its brief discussing the evidence presented regarding Pekin’s wastewater system, Pekin goes a step further, and actually has the audacity to request that the Commission ignore evidence the City itself presented. The sole reason the City urges the Commission to disregard that entire portion of the case is that, as it turned out, the proof did not show what the City claimed it would. The City’s argument that the Commission should ignore the wastewater evidence is a desperate attempt by the City to avoid the disastrous impact of its decision to argue that its “outstanding” operation of the wastewater system provided a “solid basis” for the acquisition of the water system. The evidence on the City’s wastewater operations not only raises significant doubt about the City’s ability to properly operate the water system, it reveals the liberties the City is willing to take with the truth in its attempt to gain approval of its Petition, destroying the City’s credibility in

the process. The fact that the City, instead of responding to the evidence in its brief, ignores the testimony of its own specially-retained wastewater expert and simply tells the Commission “never-mind” is further proof that the wastewater evidence is so devastating to the City’s case it simply has no arguments to make. There is no basis whatsoever for the Commission to disregard the substantial evidence regarding the City’s wastewater operations. Indeed, the basic tenets of the Public Utilities Act mandate the opposite -- that the Commission carefully consider the wastewater evidence in analyzing whether the City has met its burden of demonstrating that City ownership of the water system will better serve the public interest than continued ownership by Illinois-American.

In support of its argument that the Commission should ignore the wastewater evidence, the City hangs its hat on a single case, Commonwealth Edison Company v. Illinois Commerce Commission, 181 Ill. App. 3d 1002, 538 N.E.2d 213 (Ill. Ct. App. 1989). The City claims that all of the evidence presented regarding the City’s wastewater operations can be characterized as “environmental concerns,” and incorrectly argues that the Commonwealth Edison case holds that the Commission is prohibited from considering “environmental concerns” when evaluating condemnation proposals. The City’s argument fails on both points: the City’s characterization of the evidence regarding its wastewater operations as merely “environmental concerns” is inaccurate, and even if it were correct, the City’s interpretation of the Commonwealth Edison case is simply wrong. In addition, the blatant hypocrisy of the City’s argument should not be overlooked. The City in its brief accuses Illinois-American of trying to “camouflage the real issues in this proceeding by highlighting environmental issues

related to the wastewater facility.” [Pekin Brief, p. 39.] What the City fails to acknowledge is Illinois-American did not place the wastewater system at issue: the City did. The City chose to meet its burden to prove its condemnation proposal is in the better public interest, in large part, by claiming that it had successfully “solved any problem areas of the [wastewater] system [Hierstein Aff. to Pet., ¶ 12]; that the City’s operations of the wastewater system as a whole, as well as the City’s compliance with applicable environmental regulations is “outstanding” [Kief Aff. to Pet., ¶ 8; Pekin Ex. 2.0, p. 10]; and that “the City’s track record in dealing with the Wastewater Treatment System is a solid basis” for acquisition of the water system [Pekin Ex. 2.0, p. 12]. The City did not merely rely on its own witnesses to support this claim - it retained an expert whose sole purpose was to investigate the City’s management of the wastewater system “to determine whether the City of Pekin has demonstrated an ability to properly manage and run the drinking water system.” [Pekin Ex. 12.0, p. 9.]

The Commonwealth Edison case provides no support for the City’s argument that the Commission is prohibited from considering the wastewater evidence presented in this case. In Commonwealth Edison, the Commission denied a petition for approval of the sale of utility property solely because of the adverse environmental impact the residential development proposed by the purchasers would have on a wetlands area located on the property. Commonwealth Edison, 538 N.E.2d at 216. The court recognized that the Commission’s duty is to regulate public utility service, and held that the environmental impact of a residential development on the ecology of a wetlands area is beyond the particular expertise of the Commission. Id. The court was careful to emphasize, however, that the Commission was free to examine all aspects of the

proposed sale “in the public utility context.” Id. The court noted that the proper scope of the Commission’s review would include such factors as “costs to customers, simplification of utility service, operating costs, facility planning, and proximity of service territories.” Id. The court held that “[h]ad the Commission correctly determined that the sale would somehow adversely affect utility service, then we would defer to the Commission’s expertise.” Id. Thus, the sole reason the court reversed the Commission’s decision in Commonwealth Edison was because the environmental concerns that formed the basis of the Commission’s decision had absolutely no impact on public utility service, and therefore were beyond the jurisdiction of the Commission as defined by the Public Utilities Act. Id.

In this case, the wastewater evidence was presented “in a public utility context,” and, as stated repeatedly by the City’s own witnesses, does have an impact on public utility service. The express language of the Public Utilities Act gives the Commission the specific responsibility of ensuring that a utility operates in an “environmentally safe” manner. 220 ILCS 5.9-401; see also ICC v. Utilities Unlimited, Inc., ICC Docket 98-0846, Order, p. 11 (2000) (revoking utility’s certificate of public convenience and necessity for utility’s failure to comply with environmental statutes, regulations, and conditions of its NPDES permit). Illinois-American did not make the connection between the wastewater evidence and the City’s ability to operate the water system in an environmentally safe manner -- the City itself made that claim repeatedly, even going so far as to hire an expert whose sole purpose was to opine that “the City of Pekin is doing an excellent job of managing the Pekin POTW [wastewater system] and has demonstrated the ability to successfully and properly manage and operate the drinking

water system.” [Pekin Ex. 12.0, p. 9.] As it turned out, the wastewater evidence demonstrated conclusively that City ownership of the water system would adversely affect utility service, which is precisely the type of analysis the Commonwealth Edison case holds the Commission should undertake. Contrary to the City’s characterization of the wastewater proof as only encompassing “environmental concerns,” the wastewater evidence presented demonstrated that not only does the City’s wastewater system have a chronic and ongoing inability to comply with IEPA regulations, the system suffers from operational breakdowns and management inefficiencies within the City’s wastewater treatment plant; suspected squandering of funds by the premature shut down of treatment plant 2; inadequate facilities planning by the City; and a continued inability or unwillingness to locate a long-suspected sanitary sewer overflow that could potentially be causing a significant public safety hazard by dumping thousands of gallons of raw sewage directly into the river. [IAWC Ex. 8.0, pp. 15-23.] All of these issues have a direct and adverse impact on the provision of wastewater utility service. All of these inadequacies hinder the ability of the wastewater system to adequately collect and treat wastewater. All of these inadequacies can impact operating costs, costs to customers, and facilities planning, all of which are factors the Commonwealth Edison court specifically held were within the Commission’s purview. And, as the City originally argued, all of its wastewater experience has a direct impact on its ability to run the water system.

Not only does the wastewater evidence have an adverse impact on the provision of utility service, it also has a significant impact on public safety. The City itself concedes that public safety is “an important determination in ascertaining the ‘public

interest' in granting or denying a petition" for approval of a condemnation. [Pekin Brief, p. 14.] Yet the City ignores the obvious public safety implications of the wastewater evidence presented in this case. For example, the evidence presented demonstrated that despite repeated prompting and warnings by the IEPA, the City has failed to adequately address a long-suspected sanitary sewer overflow that could potentially be dumping thousands of gallons of raw sewage directly into the river. [IAWC Ex. 8.0R, p. 6.] The City is arguing that the Commission is prohibited from considering this evidence. The evidence also demonstrated that the City maintains very low standards and does not even strive for full compliance with regulatory standards, much less proactively plan for regulatory changes. [Tr. 293-94; 307.] As IAWC President Terry Gloriod testified, such low standards are entirely insufficient when it comes to providing safe drinking water. [Tr. 731.] Again, the City urges the Commission to ignore this evidence. Apparently, the City believes the Commission should take public safety into account in all situations except those related to its inadequate wastewater operations.

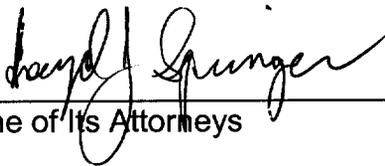
There is absolutely no basis for the Commission to disregard the substantial amount of evidence presented in this case regarding the City's inadequate management and operation of its wastewater system. Before it filed its brief, the City urged the Commission to examine its track record with the wastewater system as proof of how it would perform should it acquire the water system. That is exactly what the Commission should do. An examination of the wastewater evidence can lead to only one conclusion: that the City's attempt to meet its burden of proof to show that condemnation will better serve the public interest has failed miserably.

IV. Conclusion

The evidence in this case clearly demonstrates that the City has utterly failed to meet its burden to prove that City ownership of the Pekin District system would better serve the public interest than continued ownership by Illinois-American. The testimony of all three Staff witnesses confirms this conclusion. In briefs, both the Staff and the City attempt to evade the unavoidable result dictated by the evidence. The Staff attempts to evade the result by asking the Commission to disregard the standard of review accepted by Illinois-American and the City: the City, by asking the Commission to disregard evidence unfavorable to its case. Both the Staff's and the City's arguments must fail. A proper application of the standard of review to the evidence presented in this case leads to only one logical result: the City's Petition must be denied.

Respectfully submitted,

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