



OFFICE OF THE CITY MANAGER

**Memorandum**

**To:** Mayor Jim Ardis  
Members of the City Council

**From:** Patrick Urich, City Manager

**Date:** May 5, 2017

**Re:** Background Information: Council Option to Purchase Peoria District of Illinois American Water Company

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In 1889, the City of Peoria entered into an agreement to sell its water utility to a private company, which is now Illinois American Water Company (IAWC). That agreement was amended in 1904. The Agreement provides an option that allows the City to repurchase the utility once every five years. This option will be before the City Council again in 2019; the deadline for final decision is May 3, 2019. Per the agreement, the City must give IAWC notice of its intent to consider purchasing the utility no later than six months prior to the anniversary of the agreement, or November 2, 2018.

According to the 1889 Agreement and subsequent amendments, the City when it desires to exercise its right to purchase, by resolution must determine to purchase the water works six months before the expiration of every 5 years (started with expiration of 10 years) from the date of passage, May 4, 1889. Hence the November 4th in the year preceding the expiration date. If the parties cannot agree upon a price to be paid the water company, then a commission is set up with an appraiser appointed by the City, second appraiser by Illinois American Water Company and a third appointed by the two already appointed appraisers. This commission determines what amount the City has to pay to the water company, the award.

The City then has the right to exercise the option of purchasing or refusing to purchase the water company for that set price. If the City elects to purchase, it must give notice to the water co. within 60 days from the notice of the award. If the City refuses to purchase the water company, then it must pay for all the necessary expenses incurred by three appraisers and their fees in making such award. If the City purchases the water co. and the purchase is completed, the City and the Water Co. equally divide and pay for the appraisers' expenses.

In 2002, the Appellate Court upheld the City's authority to purchase the water company. While stating that most provisions of the franchise agreement were no longer binding, the Court held that:

- (1) City had the authority to include the purchase option in the agreement;
- (2) Purchase option is not perpetual in duration but continues throughout the life of the city;
- (3) Option was not terminable at will;

- (4) Purchase option was not preempted and superceded by the Public Utilities Act;
- (5) Purchase option is not unenforceable due to the doctrines of commercial frustration or impossibility of performance; and
- (6) Water company did not have standing to contest the agreement between the city and PAAG.

## History

The Peoria Journal Star has reported on the water company and through its archives, a history of this issue can be developed. The following timeline reflects this history.

### Peoria Waterworks Water Buyout Timeline

- 1833 Stephen Stillman proposed conveying spring water from the head of Jackson Street to Courthouse Square using hollowed logs as conduit.
- 1845 Peoria Water Company chartered to improve springs.
- 1865 Voters rejected a bond referendum for a municipal water works.
- 1868 Voters passed a bond referendum for a municipal water works.
- 1889 Shaky public finances force City to sell water works to John Moffatt and Henry Hodgkins for agreeing to pay the remaining \$450,000 debt.
- 1894 New firm built a new pumping station and opened the water plant, but financial difficulties put it in receivership.
- 1898 Water company bought by another group of investor.
- 1909 Peoria Water Company merged with the Alton Water Company and the Illinois American Water Company.
- 1936 City opens up acquisition talks with NY based owners after rate complaints. Asking price: **\$7.3 million**, City counters with **\$5.5 million**.
- 1937 City threatened condemnation, Company countered with **\$6.45 million**. Talks broke off after City's investment firm went out of business.
- 1959 City pursues condemnation, also explores a buyout **\$13 million**, water works argues its worth **\$30-35 million**, arguments for included controlling growth and controlling rates.
- 1961 City drops condemnation effort, questioning whether it would remain profitable.
- 1977 Estimated purchase price **\$36 Million** through 35-year bonds, arguments for included controlling growth and controlling rates. Momentum fizzles after Illinois American changed management and improved service.
- 1989 City begins studying the water company question again. Commissioning a phased study that took 3 years to complete.
- 1993 Purchase estimated at **\$41 to \$215 Million**, County Board weighs in asking for a joint study of the issue. **\$76 million** was determined to be the break-even point.
- 1993 Illinois American submits petitions for an advisory referendum on the water buyout question in March 1994.
- 1993 Illinois American commissioned survey found 47 percent of respondents opposed the city buyout and 9 percent favored the buyout, with 7 percent holding mixed opinions and the remaining 38 percent answering "don't know."
- 1993 Hallock and Medina Townships water district referendum approved.

- 1994 City announces prior to election day that it would not pursue the water buyout. Voters in the 'no' votes in the advisory referendum won 15,237 to 2,449, or 86 percent to 14 percent.
- 1998 The Peoria City Council votes in favor of a \$1 million loan to begin the study of a possible public buyout of the waterworks.
- 1999 City consultant estimates that the City could collect \$62 million over 10 years with a purchase price of **\$68 million**. Alternative value of **\$90 million** presented, based on method.
- 2002 After a five-year legal battle, the 3rd District Appellate Court upholds the city's 1889 franchise agreement, forcing the water company to participate in the city's process of exploring a buyout.
- 2002 Route 150 Water District approved by referendum.
- 2004 The city estimates the utility to cost **\$96 million**; the water company tags it at **\$300 million**.
- 2005 A three-member appraisal panel tagged Peoria's privately owned division of the water company at **\$220 million**.
- 2005 Voters overwhelmingly oppose the buyout. In an advisory referendum, 81.8 percent said the city should not pursue it.
- 2005 By a 6-5 vote, council votes against pursuing the water company buyout, even if another public entity wanted to help with the purchase.
- 2006 Trivoli-Logan Water District approved by referendum.
- 2007 The water company offers the city **\$1.5 million** to purchase Peoria's option on the utility. City declines offer.
- 2008 By a 7-4 vote, council votes against continued pursuing the water company buyout.
- 2013 City granted a one month extension before deciding whether or not to buy out the water company.
- 2013 Poll conducted at the behest of Illinois-American Water found that by a 73 percent to 23 percent margin, voters opposed the City Council pursuing a buyout.
- 2013 By an 8-3 vote, the Peoria City Council did not exercise its option to purchase the water utility.
- 2014 A proposal to monetize the franchise agreement option was presented to the City Council that included an annual **\$2.5 million** franchise fee for 20 years.
- 2014 No deal to suspend the city's option to purchase the municipal waterworks jointly announced by City and Illinois American.
- 2016 In another survey by Illinois American, 69% of voters opposed, while 23% favor the buyout.
- 2017 Appellate Court determines City breached the 1998 agreement and owes PAAG \$1 million. The amount of accrued interest has been remanded back to the Circuit Court for determination.

*Source: Peoria Journal Star*

### **Policy Considerations**

There are a series of policy considerations for the City Council to consider. Some are large public policy questions and some are procedural questions. Fundamentally, the threshold policy question is, "Should the water supply, and its distribution system be owned by the public?" The procedural policy questions center on what information does the Council wish to obtain prior to starting the process outlined in the franchise agreement.

**Should the water supply, and its distribution system be controlled by the public?**

Approximately 85% of the American population is served by publicly-owned water utilities. In Illinois, only a relatively small number of communities are served by privately owned utilities such as Illinois American Water or Aqua Illinois. Locally, communities such as Peoria Heights and East Peoria manage their own water systems, as do larger peer cities such as Rockford, Decatur, Aurora, Springfield and Normal.

The City could purchase the water company and utilize a public-private partnership to manage the system, or the City could hire the staff and manage the operations directly. According to the National Association of Water Companies, a trade association of private water companies, there are ten publicly-traded water utility companies:

- American Water
- American States Water Company
- Aqua America
- Artesian Resources Corp.
- California Water Service Group
- Connecticut Water Service, Inc
- Middlesex Water Co.
- Pennichuck Corp.
- SJW Corp.
- York Water Co.

In addition to the publicly-traded companies, there are other companies such as United Water, and Utilities, Inc. and CH2MHill that will operate municipal water systems. A fact sheet from NAWC ([http://www.nawc.org/uploads/documents-and-publications/documents/document\\_ecf5b3ac-c222-4b6c-b99f-a0128ae1e9aa.pdf](http://www.nawc.org/uploads/documents-and-publications/documents/document_ecf5b3ac-c222-4b6c-b99f-a0128ae1e9aa.pdf)) is attached.

Secondary policy questions concern economics and control. Questions concerning water rates paid to Illinois American; the concern over funds leaving Peoria in the form of dividends and returns on equity; and whether a city-owned water company could establish an additional revenue stream are all economic considerations. The issue of whether the City should own the water company to control growth either inside or outside of its boundaries is a matter concerning control. These questions can be explored during the pre-due diligence phase should the Council decide to proceed.

**Should the City perform some due diligence up front prior to notifying the water company of the intent to purchase?**

The procedural policy questions are timely at this stage as well. The City nearly 2 years away from the anniversary date of the franchise agreement and 18 months from the deadline to determine if we want to purchase the water company. The remaining valid provision from the 1889 franchise agreement outlines a process where the a price is agreed to either by consent or by a valuation process, and then the City is allowed to perform the due diligence on whether or not to purchase the water company at that price.

This far out from the deadline, the City Council may want additional information to make the most informed decision. The City may wish to ascertain, to the best of its abilities the legal, financial, and engineering considerations of a purchase of this magnitude. The City may wish to retain experts in law, asset valuation, economics, and engineering to gather as much information as possible in order to make the most informed decision. The questions of economics and control outlined above may be explored.

Discussing these issues now gives the Council ample time to compile and document all questions that they wish to explore and gives staff time to research the answers.

Currently, the City does not have funds budgeted to perform this due diligence. The City would have to pull funds out of fund balance to pay for the study, or the City would have to curtail certain budgeted expenditures to reallocate funds. The City could also look to interested parties that might wish to fund the due diligence prior to officially starting the process with the water company.

**What is the status of the PAAG lawsuit?**

In 1998, the City was loaned \$1 million from the Peoria Area Advancement Group, LLC to be used to explore the feasibility of purchasing the water company. The City entered into a second agreement with PAAG in 2005. In 2005, the City Council declined to proceed with the purchase of the water company and in 2006 PAAG filed a demand for arbitration claiming that the City breached the 1998 agreement by failing to conduct due diligence or act in good faith by failing to determine the affordability of the purchase of the water works at \$220 million. In 2006, the Circuit Court concluded the 1998 agreement was terminated. In 2009, PAAG filed another suit stating that the 2005 agreement was breached and the City was required to pay back the loaned funds plus interest. The Circuit Court determined that the City breached the 2005 agreement by failing to perform due diligence tasks even though the Council had voted not to proceed with the purchase. In 2016, the Appellate Court took up the matter and determined that the City did breach the 2005 agreement and that the amount of interest would need to be arbitrated. Both parties filed appeals of this decision, and the Appellate Court upheld their previous decision and ruled this week that the interest determination be remanded back to the Circuit Court. City staff is currently reviewing this decision and the City's legal options including, but not limited to, appealing this decision to the Illinois Supreme Court.

The attached filing from the State of Illinois shows the Registered Agent of Peoria Area Advancement Group, LLC. The membership has changed throughout the years but the currently listed roster is also attached.

**How does the Council want to include the public in these discussions?**

In 2013, at the request of the Mayor, former Councilman Robert Manning convened a small working group of the Mayor's Sustainability Commission to review information for the City Council. In the fall of 2016, the CEO Council presented a study to the City Council about the water company purchase. Discussions have been occurring at various community groups and neighborhood associations this year. The water company has periodically surveyed the residents about their satisfaction and their support of a purchase of the water company.

As the City progresses towards the franchise agreement deadlines, the Council may want to engage the public in a series of meetings about this issue. The Council may also want to establish a formalized committee of residents to explore this issue. Staff seeks guidance from the Council on the methods of public engagement.