



Illinois-American Water Company

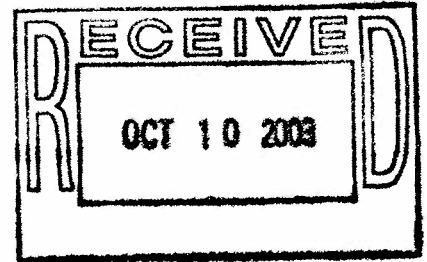
300 N. Water Works Dr. • P.O. Box 24040 • Belleville, IL 62223-9040 • (618) 236-1180 • FAX (618) 236-1186
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SUE A. SCHULTZ
General Counsel and Secretary
618-239-2225
e-mail: sschultz@illinoisamerican.com

October 8, 2003

VIA OVERNIGHT MAIL

Randall Ray
City of Peoria
419 Fulton, Room 207
Peoria, IL 61602-1270



Re: Rules of Order for the Commission

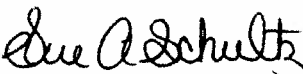
Dear Randy:

Enclosed, please find two fully executed Rules of Order, in the Peoria Franchise Option matter. Please note, the name of the Company's Commissioner is spelled incorrectly in the Rules. It should be John P. Kelly, P.E. Also, per discussions between Joe Conner and Joe Hempker, the effective date has been changed to the date fully executed, i.e. October 8, 2003.

If you have any questions, please let me know.

Very truly yours,

ILLINOIS-AMERICAN WATER COMPANY

By: 
Sue A. Schultz
General Counsel

SAS:lag
Enclosures

cc: Joe Conner, Esq. (w/encl.), Baker Donelson Bearman & Caldwell, 1800
Republic Centre, 633 Chestnut Street, Chattanooga, TN 37450-1800
John Kelly (w/encl.), 313 Boston Host Road, Ste. 210, Marlborough, MA 01752
J. Hempker (w/encl.), Michigan Building, Ste. 200, 100 Portage Street,
Kalamazoo, MI 49007-4802

RULES OF ORDER FOR THE COMMISSION

WHEREAS, pursuant to an ordinance enacted by the City of Peoria, Illinois ("City") adopted on May 4, 1889, and as amended thereafter (the "Ordinance"), the City has the option to purchase the waterworks of Illinois-American Water Company in Peoria, Illinois, as the successor to Peoria Water Company (the "Water Company"), the validity of which was confirmed in the case of *Illinois-American Water Co. v. City of Peoria*, 332 Ill. App. 3d 1098 (3d Dist. 2002).

WHEREAS, Section 17 of the Ordinance contains the terms and conditions for the exercise of the option ("Purchase Option") and provides for the appointment of a three member commission (the "Commission") to determine the fair market value of the property to be acquired.

WHEREAS, the Purchase Option valuation procedure and the extent of the property subject to the Purchase Option is unclear in certain respects and as a result the City and the Water Company have agreed to certain terms and conditions ("Rules of Order") which shall be followed in the execution of the valuation procedure set forth in Section 17 of the Ordinance.

Accordingly, the following Rules of Order for the Commission are hereby adopted:

1. Amendments or Additional Rules of Order.

Commissioners, by decision of a majority of the Commissioners, can propose amendments to these Rules of Order and/or provide for additional rules governing procedures, their meeting or organization, as they deem necessary. If the Commissioners propose amendments and/or additional rules, they shall deliver a copy of such proposed rules to the City and Water Company who must mutually consent to the amendments or additional rules in writing in order for such proposed amendments or rules to become effective.

2. Commissioners.

- (a) The City has appointed Kees W. Corssmitt, Ph.D. to serve as its designated Commissioner. The Water Company has designated John P. Kelley as its designated Commissioner.
- (b) The City and the Water Company Commissioners shall appoint the third Commissioner who shall not be a resident of the City of Peoria and who shall be disinterested and a competent business valuation expert. The third Commissioner shall have at least one of the following designations: (1) ASA (Accredited Senior Appraiser) designation by the American Society of Appraisers; (2) CFA (Chartered Financial Analysts) designation by the Association for Investment Management and Research; (3) ABV (Accredited & Business Valuation) designation by the American Institute of Certified Public Accountants; or (4) CBA (Certified Business Appraiser) designation by the Institute of Business

Appraisers; and a minimum of 5 years broad experience in conducting business valuations of operating companies, including experience in valuing utility companies.

- (c) Within fifteen (15) days after the Effective Date (as that term is defined in Section 11 hereof), the City Commissioner and the Water Company Commissioner shall simultaneously exchange a list of three candidates for consideration in the selection of the third Commissioner. If there is one candidate who is on both lists, then that person will be appointed as the third Commissioner. If there is more than one candidate on both lists, then the City and the Water Company Commissioners will either agree on the same person or randomly appoint the person from those who appear on both lists. If no listed candidates are on both lists, each Commissioner will have full opportunity to review the credentials of each candidate and interview them over the phone if desired. If the City Commissioner and the Water Company Commissioner cannot agree on the appointment of the third Commissioner, then they will exchange another list of potential candidates until they can agree on one to serve as the third Commissioner. The City and Water Company Commissioner shall use their best efforts to appoint the third Commissioner within forty-five (45) days after the Effective Date. In the event that within ninety (90) days of the Effective Date, the City Commissioner and the Water Company Commissioner are unable to agree on the third Commissioner, the City and the Water Company shall use their best efforts to work directly together to reach agreement regarding the selection of the third Commissioner.
- (d) Pending appointment of, and acceptance thereof by, the third Commissioner, the City and the Water Company (and their respective representatives) shall be permitted to engage in *ex parte* contact with the Commissioner such party appointed. Neither the City nor the Water Company (or their respective representatives) shall engage in *ex parte* contact with the Commissioners after the third Commissioner has been appointed and has accepted the appointment.

3. Issue to be determined.

The Commissioners shall determine the existing fair market value ("Fair Market Value"), excluding any value associated with the unexpired term of the franchise, of the Waterworks based on evidence submitted by the parties. The City and Water Company agree that the term "Waterworks" includes all of the tangible and intangible property, both real and personal, that constitutes the "Peoria District" currently owned and operated by the Water Company which is located within and outside of the municipal boundaries of the City. The term Waterworks shall include the property described herein, but shall not include the assumption by the City of any prior indebtedness associated with such property. The parties' experts will use Water Company asset and financial information as of December 31, 2002 for purposes of preparing their initial reports and will update their reports as of December 31, 2003 (the "Valuation Date") to take into account any changes in the asset and financial information through the Valuation Date, which information will be furnished by the Water Company. Should the City elect to acquire the

Waterworks, the total amount to be paid by the City to the Water Company should it acquire Waterworks shall include the Fair Market Value determined by the Commissioners as adjusted to reflect changes in the assets since the Valuation Date which will also include all reasonable asset and/or property additions made to the Waterworks in the ordinary course of business, at cost, during the period from the Valuation Date to the closing date.

4. Meetings.

- (a) Commissioners shall meet as often as they deem necessary at such places and times and in such manner as they shall agree to make their determination of Fair Market Value of the Waterworks. Commissioners may meet via teleconference or similar electronic means. The Commissioners shall provide all parties prior notification of the date, time and location (or if telephone conference, call-in information) of all meetings by e-mail, facsimile or U.S. Mail.
- (b) Once all Commissioners are appointed, they shall conduct a scheduling conference with the parties to develop a schedule for discovery and the Evidentiary Hearing (within time limits described in Section 6, Section 7 and Section 9 hereof) at a neutral location in Peoria or another city with the agreement of the parties. The hearing schedule shall include deadlines for written discovery, physical inspections, depositions, filing of expert reports, legal briefs, hearing exhibits, witness lists and other matters necessary for the hearing.

5. Security.

The parties, their respective experts and the Commissioners will sign a confidentiality agreement which will protect the confidentiality of security-related information.

6. Evidentiary Hearing.

Commissioners shall conduct at least one Evidentiary Hearing in the City of Peoria at which they shall examine the expert reports submitted by the parties and take the testimony of experts and other witnesses presented by the City and the Water Company. Counsel for the City and the Water Company shall be permitted an opportunity to present direct evidence, to cross-examine the experts, make oral arguments, and submit legal memoranda to the Commissioners. The Evidentiary Hearing shall be scheduled at the convenience of all the parties and the Commissioners but in no event later than 9 months after the Effective Date. If the public is present at the Evidentiary Hearing, the Commissioners shall take appropriate precautions to prevent the release of confidential information.

7. Discovery.

- (a) Subject to the terms of the confidentiality agreement, the Water Company will provide the City and its representatives with reasonable access to the facilities, operations, books, records, contracts, business, commitments, and properties of the Water Company pertaining to the Waterworks (the "Facilities and Records") as the City shall deem necessary or advisable to familiarize itself with such

facilities, operations and other matters so as to enable the City to fully participate in the proceedings contemplated hereby, to determine the Fair Market Value of the Waterworks; and to determine thereafter whether to exercise the Purchase Option; provided that such investigation and access shall not unreasonably interfere with the normal operations of the Water Company.

- (b) The City and the Water Company also agree to simultaneously exchange expert reports ninety (90) days prior to the Evidentiary Hearing and will complete taking the depositions of the respective experts thirty (30) days prior to the Evidentiary Hearing pursuant to the procedures regarding experts provided by Rule 26 of the Federal Rules of Civil Procedure.

8. Expenses.

- (a) The statements for services rendered and expenses of each of the party designated Commissioners shall be paid by the party designating that Commissioner.
- (b) Pending the City's final determination of whether to exercise the Purchase Option and complete the purchase, the fees and expenses of the third Commissioner chosen by the other two Commissioners will be divided one-half each and paid by the City and the Water Company as those fees and expenses are incurred.
- (c) After approval by the Commissioners of all other fees and expenses incurred by the Commission, including but not limited to, court reporter fees, photocopy expenses, etc., the approved invoices will be divided one-half each and paid by the City and the Water Company pending final determination by the City as to whether it will exercise the Purchase Option.
- (d) According to the Purchase Option, if the sale is completed, the expenses set forth in Section 8(b) and Section 8(c) shall be divided one-half each and paid by the City and the Water Company. If the City fails to complete the purchase, it shall reimburse the Water Company for the portion of the expenses it paid as set forth in Sections 8(a),(b) and (c), within thirty (30) days after the City advises the Water Company that it will not complete the purchase.
- (e) The City and the Water Company are responsible for the payment of their own costs of investigation, expenses, expert witnesses, and attorneys' fees.

9. The Award.

- (a) Within 45 days of the conclusion of the Evidentiary Hearing, the Commissioners shall submit to the parties a written award containing the Fair Market Value of the Waterworks and explaining the basis of the reasoning for said finding, with detailed description of the real and personal property that would be conveyed by the Water Company upon payment of the award by the City pursuant to the Purchase Option. In the event the Commissioners are unable to unanimously agree on the Fair Market Value of the Waterworks, the decision of a majority of

the Commissioners shall govern and any such decision shall be conclusive and binding on the City and the Water Company.

- (b) The award shall be delivered by hand or next day delivery service to the City Clerk, Peoria City Hall, Peoria, Illinois 61602, and to the Illinois-American Water Company, attention Sue A. Schultz, Esq., 300 North Water Drive, Belleville, Illinois 62223. Copies of the award shall also be delivered to: Joe A. Conner, Esq., Baker Donelson Bearman & Caldwell, P.C., 1800 Republic Centre, 633 Chestnut Street, Chattanooga, Tennessee 37450; and to: Theodore L. Eissfeldt, Esq., Howard & Howard Attorneys, P.C., One Technology Plaza, Suite 600, 211 Fulton Street, Peoria, Illinois 61602-1350.
- (c) Subject to Section 10 hereof, the City shall notify the Water Company of its decision to accept or reject the award not later than sixty (60) days after the delivery thereof to the City as aforesaid. Such notice to the Water Company shall be in the manner and to the address described in Section 9(b).

10. Post Award Procedures.

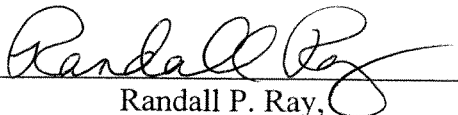
- (a) Should the City accept the award, the Water Company will provide the City and its representatives with reasonable access to the Facilities and Records for 180 days following the City's acceptance of the award to conduct standard due diligence to determine if the City wishes to complete the purchase or decline to exercise the Purchase Option.
- (b) If the City shall not then elect to complete the purchase, Section 8(d) hereof will govern. If the City shall elect to complete the purchase, the parties shall execute instruments of conveyance consistent with the award and with transactions of this type. Closing of the transaction will proceed as expeditiously as possible consistent with reasonable business practices and customer needs, but in no event later than eighteen (18) months after delivery of the award to the City.

11. Agreement.

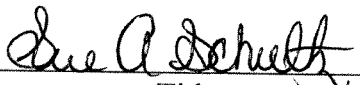
The terms hereof are made effective the ~~30th~~^{8th} day of ~~September~~^{October}, 2003 (the "Effective Date"). The terms and conditions of this agreement are governed by Illinois law. The undersigned acknowledge their agreement to these Rules of Order by their signatures.

SFB

City of Peoria, Illinois:

By: 
Randall P. Ray,
Its: Corporation Counsel

Illinois-American Water Company:

By: 
Title Corporate Counsel