Docket No. 00-0340
ICC Staff Exhibit 4.0

DIRECT TESTIMONY

of

WILLIAM R. JOHNSON
Water Department
Financial Analysis Division
Illinois Commerce Commission

Illinois-American Water Company

Docket No. 00-0340

August 24, 2000

WITNESS IDENTIFICATION

Q. Please state your name and business address.

A. William R. Johnson, 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. What is your present position with the Illinois Commerce Commission?

A. I am currently employed as an Economic Analyst in the Water Department of the Financial Analysis Division. In that position, I review and analyze tariff filings by water utilities with regard to cost of service and rate design. I make recommendations to the Commission on such filings and participate in docketed proceedings as assigned.

Q. How long have you been employed by the Illinois Commerce Commission?

A. I have been employed by the Illinois Commerce Commission since September 1, 1994.

Q. Have you previously testified before the Illinois Commerce Commission?

A. Yes, in addition to my testimony in the instant proceeding, I have submitted cost-of-service ("COSS") testimony in Docket Nos. 94-0369 (Walk-Up Woods Water Company), 94-0497 (County Line Water Company), 95-0076 (Illinois American-Water Company), 96-0618 (United Cities Gas Company), 97-0254 (Northern Illinois Water Corporation), 98-0545 (Central Illinois Public Service Company), 99-0013 and 99-0121 (Central Illinois Public

Service Company and Union Electric Company). I have submitted rate design testimony in Docket Nos. 95-0219 (Northern Illinois Gas Company), 96-0618 (United Cities Gas Company), 97-0254 (Northern Illinois Water Corporation), 98-0545 (Central Illinois Public Service Company), 99-0013 and 99-0121 (Central Illinois Public Service Company and Union Electric Company).

Q. Please discuss your educational background.

A. I received a Bachelor of Arts degree in Economics from Sangamon State University (Now University of Illinois at Springfield) in May, 1990 and a Master of Arts degree in Economics, also from Sangamon State University, in December, 1993.

PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address Illinois-American Water Company's ("IAWC") or the ("Company") filing for a general increase in rates. I will be presenting testimony and exhibits concerning cost of service ("COS") and rate design issues for Illinois American's Pontiac District, Southern Division and Peoria District, and Streator District. Additionally, I will discuss the miscellaneous tariff charges (e.g. late payment charge, non-sufficient funds charge, and service reconnection charge) for the Pontiac District,

Southern Division and Peoria District, Streator District, Sterling District, and Champaign District.

Q. Are you making any recommendations concerning the appropriateness of the total annual revenue requirement for the Company in this proceeding?

A. No, I am not. My testimony is directed toward the review of the proposed tariffs (and underlying support) filed by the Company to recover the revenue requirement deemed appropriate in this proceeding.

Q. Please explain how your testimony is organized.

A. My testimony begins with a review of the Company's proposed test year usage. Next, I present the results of my embedded cost of service study ("COSS" or "cost study"). Then, I address single-tariff pricing, followed by more specific rate design issues, discussing the proposals of the Company and my recommendations. Finally, I discuss miscellaneous rate design issues.

TEST YEAR USAGE (Ccf)

Q. What test year is the Company proposing to use for cost of service purposes?

A. The Company is proposing to use year ending December 2001 as the test year for the Pontiac District, Southern Division and Peoria District, and Streator District. Gloriad, Exhibit No. 1.0, p. 14.

Q. Do you agree with the usage levels proposed by the Company for the Pontiac District ("PT"), Southern Division and Peoria District ("S&P"), and Streator ("STR") District?

A. I have examined the Company's usage levels and concur with the results for the Pontiac District, Southern Division and Peoria District, and Streator District.

EMBEDDED COST OF SERVICE STUDIES

Q. Briefly, please describe the importance of a cost study as the basis for determining rates for utility service.

A. A cost study is performed to allocate costs among all customer classes to determine each customer class' respective cost responsibility for the costs imposed on the utility by that specific customer class. A more detailed explanation of embedded cost studies and how costs are generally allocated is outlined in the attached Appendix A to this exhibit.

Q. Did the Company present a cost of service study for each district in its filing?

A. No, they did not. The Company is proposing rates that are based upon across the board revisions to all rates for all Districts in accordance with revenue requirements applicable to each District. Stafford, Exhibit No. 3.0, p. 6.

Q. What methodology did you use in preparing your COSS for the Pontiac District, Southern Division and Peoria District, and Streator District?

A. I prepared a COSS for each division, which has been identified as ICC Staff Ex.4.0, Schedule 4.1, with a suffix added to the schedule number to identify the individual districts as follows:

Pontiac - PT

Southern & Peoria - S&P

Streator - STR

Each COSS uses the Base-Extra Capacity method of cost allocation to distribute costs to customer classes. The Base-Extra Capacity method is the same methodology employed and accepted by the Commission the last time the rates for each of these Districts or Divisions were set. Illinois-American Water Company's last rate case was Docket No. 97-0102 for S&P (Southern and Peoria), Northern Illinois Water Company's last rate case that included the STR (Streator) District was Docket No. 95-0220, and for the PT (Pontiac) District the last case was Docket no. 97-0254. Since these three rate cases the Companies have merged. (See Commission

Order Docket No. 99-0418). A further discussion on methodology is provided in the attached Appendix A to this exhibit.

Q. Please provide a brief explanation of your COSS, identified as ICC Staff Ex.4.0, Schedule 4.1.

A. The calculation and summary of total revenues at the Company's present and proposed rates, as well as my recommended rates for each customer class are set forth on Staff Exhibit 4.0, Schedule 4.1, pages 1 and 2.

The class relative cost-of-service figures, excluding Fire Protection, appear near the bottom of page 2 at the line, "Percent Cost of Service", for each customer class. For example, on Schedule 4.1-STR, these figures show that the Residential class will provide revenues equal to 99.9 percent of their calculated cost-of-service.

The Demand Factors for Maximum Day ("Max Day") and Maximum Hour ("Max Hour"), for customer classes and Fire Protection, and the million gallons per day ("MGD") pumpage and consumption numbers are listed on page 3 of the COSS. These factors represent the Max Day and Max Hour water usage relative to the average usage. The Demand Factors allocate costs to the customer classes and to Fire Protection. The allocation amounts are on pages 11 and 12. The water usage and pumpage amounts

in MGD are used to allocate plant in service and operation and maintenance ("O&M") expenses to the plant's Base, Max Day and Max Hour functions.

Page 4 contains a numerical listing, in percentages, of cost allocation codes for the COSS. For example, on Schedule 4.1-STR an account assigned an allocation Code 3 would be allocated 46.20 percent to Base Cost and 53.80 percent to Max Hour Cost.

Allocation of Net Plant in Service to the Base Cost, Max Day, Max Hour, Billing, Meters, Services, and Fire Protection categories is shown on pages 5 and 6. Page 6 also shows the percentage allocations for the Net Plant in Service categories. These percentages are then used to allocate Utility Operating Income, Other Taxes, and Income Taxes to the various plant functions on page 9.

The allocation of Total Revenue Requirement, i.e., total O&M, Depreciation, Other Taxes, Income Taxes and Utility Operating Income to the Base Cost, Extra Capacity, Customer Costs, and Fire Protection functions is shown on pages 7-10. The total revenue requirement is located at the bottom of page 9 on the line entitled "DIRECT CUSTOMER REVENUES". The "TOTAL REVENUES ALLOCATED TO SMALL MAINS", is on page 10. The Direct Customer Revenues and Total Revenues Allocated to Small Mains are used to calculate the Cost of Service at the bottom of page 2.

The cost-of-service allocation percentages for the customer classes and fire protection are summarized on page 11. The allocation percentages are derived from annual consumption, the demand factors listed on page 3, the number of monthly bills, and the number of monthly equivalent meters and services. For example, page 11 (Schedule 4.1-STR) calculates Residential usage of 1.227 MGD. That amount is 64.32 percent of total system usage. Therefore, 64.32 percent of total Base Cost is assigned to the Residential class. Multiplying the Residential Max Day factor of 1.90 MGD (from Schedule 4.1-STR, page 3 of 16) by the Average Day of 1.227 MGD (calculated by converting the annual residential usage, found on page 11, to million gallons per day) produces the Residential Max Day usage of 2.332 MGD. The difference between the Max Day and Average Day is the Excess of 1.105 MGD for the residential class. The Residential Excess of 1.105 MGD is 52.26 percent of the total Excess usage over Average Day usage, and is used to allocate the Residential share of total Max Day costs.

The percent allocation of costs to the primary customer classes and Fire Protection, the total cost-of-service, and the cost-of-service according to each customer class are on page 12. The calculation of Public Fire Protection and Private Fire Protection cost-of-service is on page 13. Public Fire Protection Rates are on page 14.

The number of equivalent meters and service lines and their capacity ratios are on page 15. Distribution of customer costs by equivalent meter and service ratios recognizes that meter and service costs vary, depending on considerations such as size of service pipe, materials used, locations of meters, and other local characteristics for various sized meters as compared to 5/8" meters and services. The number of equivalent meters and services (i.e. which is based on meter ratios) assists in allocating costs assigned for recovery in the customer charges. This is necessary to adjust the units of service for each customer class as indexed against the smallest meter size. Therefore, customers are allocated a charge that reflects the costs associated with their particular meter size. Equivalent Meters and Services ratios are taken from the AWWA Water Meters-Selection, Installation, Testing, and Maintenance Manual (M6), 1972 page 32-33.

The allocation of depreciation expense according to plant account is set forth on page 16 of the COSS.

A brief description of COSS allocation codes appears on page 17 of Schedule 4.1

Q. What demand factors and million gallons a day ("MGD") pumpage numbers are you proposing to use for the Pontiac District, Southern Division and Peoria District, and Streator District?

A. I have employed the same class demand factors that were approved by the Commission in the following Dockets:

Pontiac District - Docket No. 97-0254

Southern Division and Peoria District - Docket No. 97-0102

Streator District - Docket No. 95-0220

The MGD numbers that I have employed are from the peak year for the period, 1995-1999. In my opinion, my selection of the peak year is appropriate because it gives an indication as to how the system is used for periods of peak demand.

SINGLE-TARIFF PRICING

Q. Does IAWC currently have single-tariff pricing?

A. Yes they do. The Commission approved single-tariff pricing ("STP") for IAWC in Docket No. 92-0116 for all districts in the Southern Division. In Docket No. 95-0076, the Commission approved the movement of the Peoria District into the Southern Division's STP. The Peoria District's movement toward STP was continued in Docket No. 97-0102. The Peoria District has the same customer charges and first two usage block charges as the

Southern Division, however, the Peoria District's last two usage block charges are still different than the Southern Division.

Q. What is the Company proposing, with respect to single-tariff pricing, in this proceeding?

A. IAWC is proposing that the Peoria District's last two rate blocks be increased on the same basis as the other rates, that is they are based upon across the board revisions in accordance with the revenue requirement for the Southern Division and Peoria District. However, the Company is not proposing to merge the last two blocks of the Peoria District with the last two blocks of the Southern Division in this proceeding. Stafford, Exhibit 3.0, p. 7. Additionally, IAWC is proposing that the Streator District and Pontiac District be added to STP for the Southern Division and Peoria District. Stafford, Exhibit 3.0, p.7.

Q. Do you agree with the Company's proposal to incorporate the Streator and Pontiac Districts into the Southern Division and Peoria District's single-tariff pricing?

A. Yes I do. Both the Streator and Pontiac Districts have similar surface water supply systems, with water coming from the Vermillion River. Gloriod, Exhibit 1.0, pp. 12-13. They all have common ownership and common senior management. Because of the common ownership many costs are similar and many services are purchased in large lots but delivered to individual

districts. Some services, such as billing and customer service are performed at a single location in Belleville. Financing and capital needs are supplied from a common source.

Due to the similar sources of supply, it is reasonable to assume that the costs in each district will move closer to one another over time as plant construction and various system wide projects are undertaken. The proposed rate merger will also provide benefits to customers in all districts concerning rate impact issues that would result from future construction and replacement projects. This also includes the Company's obligation to abide by future Environmental Protection Agency and Federal Safe Drinking Water Act requirements. Having a larger customer base over which to spread plant and operating expense costs over would mitigate the potential for large rate increases that would be prevalent on a district specific basis. A good example is the new water treatment plant being built for the Alton District. Spreading these costs over a large customer base will benefit customers in the Alton District now and some day the other districts will reap the benefits of a large customer base as well when large capital projects are needed in their districts.

As I described above, the Commission has supported STP for the Illinois American Water Company in Docket Nos. 92-0116 and 95-0076.

Additionally, the Commission approved the uniform rate concept for most of Citizens Utilities Company of Illinois, Docket 50181-50182.

Q. Do you recommend that the merger of rates between the Southern Division and Peoria District and Pontiac and Streator Districts completely take place in this proceeding?

A. No I do not. I recommend that the Pontiac and Streator Districts be considered part of the Southern Division and Peoria District STP group, but that a gradual movement of rates take place. There can be movement in that direction, but to totally merge the rates would result in substantial increases for some users in both the Pontiac and Streator Districts. It will be necessary to phase in the rates over several rate cases. A further discussion of the rates is described in the rate design section of my testimony.

RATE DESIGN

Q. What is the Company's rate design methodology?

A. The Company is proposing rates that are based upon across the board revisions to all rates for all Districts in accordance with revenue requirements applicable to each District (Stafford, Exhibit No. 3.0, p. 6), except for the Alton District where the Company is proposing a Source of Supply charge in addition to the regular customer and usage charges. Stafford, Exhibit No. 3.0, p. 9.

Q. Do you agree with the Company's rate proposal?

A. No I do not. The Company states that current rates for all Districts but one are based on cost of service studies performed only three years ago. (Stafford, Exhibit No. 3.0, p. 7). However, I believe that cost of service studies should be performed with the most recent data, if available, so that rates reflect current conditions especially in view of the construction of a major new facility such as the Alton treatment plant. The Company's methodology would be perfectly acceptable if current data was not available, or unforeseen circumstances arose which did not allow a cost of service study to be run, or because of unreliable data, or if there were no changes of significance in either operating expenses or plant investment. I believe the data received from IAWC is reliable, current, and there is a significant change in plant investment, therefore, I have incorporated Company provided data.

Q. Do the Southern Division and Peoria Districts have competitive rates with certain contractual lengths?

A. Yes they do. There is an industrial competitive rate and an other water utility competitive rate. Both rates have contracts that retain the current charges through the test year.

Q. Since these competitive rate customers will be paying the same charges and therefore providing the same revenues as before, how will you address the revenue shortfall (i.e., difference between what they are paying and what they should be paying for cost-of-service purposes) associated with these customers?

A. I have taken present rates (i.e., those charges the competitive customers would have paid if they would have stayed on regular rates) and multiplied them by present billing units to arrive at present revenues. I then compared those revenues to the competitive rate revenues. The difference would be the shortfall under present rates. I multiplied the shortfall under present rates by the proposed overall increase (i.e., Southern and Peoria, Pontiac, and Streator combined). The shortfall in revenues between what the competitive customers will be paying under proposed rates and what they should be paying will be spread to all classes on an equal percentage basis.

Southern Division and Peoria District

Q. Are you proposing to completely merge the Peoria District's last two rate blocks with the Southern Division's?

A. No I am not. My COSS shows that customers who use the third and fourth blocks would have a considerable increase in those blocks in order to meet their COS on a STP basis. In order not to unduly impact these customers I have kept the same difference between the third and fourth blocks for this

case. It will take several additional rate cases to eliminate that difference without causing too great an increase in any one case.

Q. How did you determine rates for the Southern Division and Peoria District?

A. I initially set rates at full cost of service. I then, incorporated the shortfall in revenues between what the competitive customers would be paying under proposed rates and full cost of service. This amount was spread to all classes on an equal percentage basis. It was apparent that the impact on industrial and resale customers would have been extremely large, (i.e., 16% for resale customers) so I limited the impact by spreading costs to other classes. While my rates may not be set at full cost-of-service, they do make progress towards that end without too large an impact on any one class.

Q. What are you proposing for the Large User Water Service?

A. I am proposing that the Large User Water Service customers pay full cost-of-service rates. This means they will pay customer charges by size of meter (ICC Staff Ex. 4.0, Schedule 4.1-S&P, Page 1 of 17) plus an additional $50 per meter per month (for each demand meter). The remaining revenues will be collected in the usage rate, as set forth on ICC Staff Ex. 4.0, Schedule 4.1-S&P, Page 1 of 17. However, I am proposing that the Company divide the usage charge between usage and demand components in the rebuttal stage of the proceeding since they have the Customer specific information needed to make this calculation.

Q. What rates are you recommending for the Southern Division and Peoria District?

A. I recommend that the rates on Staff Exhibit 4.0, Schedule 4.1-S&P be adopted for the Southern and Peoria District.

Q. If the Commission adopts a revenue requirement which differs from Staff's proposed revenue requirement, what do you propose?

A. I propose that if the change in revenue requirement is relatively minor, 5% or less, that the usage rates be changed by a uniform percentage to generate the desired revenue. If the change is larger, I recommend that the customer charges and usage charges be adjusted to reflect cost of service.

Q. Did you prepare a Schedule showing the bill impact on a residential customer from both the Company's proposed rates and Staff's proposed rates?

A. Yes, I did. ICC Staff Exhibit 4.0, Schedule 4.2-S&P shows several comparisons involving Staff's proposed rates. Specifically, this schedule depicts the percentage change (i.e., increase or decrease) between the Company's present and proposed monthly revenues and between Staff's proposed monthly revenues.

Pontiac and Streator District

Q. Since you are proposing that the Pontiac and Streator Districts become part of the Southern Division and Peoria District STP tariffs, what are you proposing for the Pontiac and Streator Districts in order to move towards STP?

A. I am proposing that the rates for the Pontiac and Streator districts generate revenues equal to the proposed percentage increase for all four districts (i.e., Southern and Peoria, Pontiac, and Streator) combined. For example, if the Commission determines that the Southern and Peoria District, Pontiac District, and Streator District combined should have a 5% increase in revenues, then the Pontiac and Streator District's rates, separately, would generate a 5% increase in revenues. I determined the rates for the Pontiac and Streator Districts by first setting rates according to COS to meet Staff's Schedule 1.1 revenue requirement. I then adjusted all rates on an equal percentage basis to generate revenues equal to the percentage increase for all districts combined. Since I am proposing that the Pontiac and Streator Districts generate revenues equal to the proposed percentage increase for all four districts combined, my revenue requirement for the Pontiac and Streator Districts separately will not match Staff's proposed Schedule 1 revenue requirement for these districts. However, the total revenue requirement (i.e., Southern and Peoria District, Pontiac District, and Streator District combined) will equal the combined revenue requirement of all districts.

Additionally, I am moving the rates themselves towards the Southern Division and Peoria District rates. As I discussed above in the Single Tariff Pricing section of my testimony, there should be a gradual movement of rates towards STP for the Pontiac and Streator Districts.

Q. What rates are you recommending for the Pontiac and Streator Districts?

A. I recommend that the rates on Staff Exhibit 4.0, Schedule 4.1-Pt be adopted for the Pontiac District and Staff Exhibit 4.0, Schedule 4.1-STR be adopted for the Streator District.

Q. If the Commission adopts a revenue requirement which differs from Staff's proposed revenue requirement, what do you propose?

A. I propose that if the change in revenue requirement is relatively minor, 5% or less, I recommend that the usage rates be changed by a uniform percentage to generate the desired revenue. If the change is larger, I recommend that the customer charges and usage charges be adjusted to reflect cost of service.

Q. Did you prepare a Schedule showing the bill impact on a residential customer from both the Company's proposed rates and Staff's proposed rates?

A. Yes, I did. ICC Staff Exhibit 4.0, Schedule 4.2-PT (Pontiac District) and ICC Staff Exhibit 4.0, Schedule 4.2-STR (Streator District) show several comparisons involving Staff's proposed rates. Specifically, these schedules depict the percentage change (i.e., increase or decrease) between the Company's present and proposed monthly revenues and between Staff's proposed STP monthly revenues, as well as Staff's revenues without STP.

Alton Surcharge

Q. Has IAWC proposed a Source of Supply Charge applicable to the Alton District in addition to the regular customer charge and usage charge?

A. Yes they have. The Company believes that since the Alton District is building a new water treatment plant at an approximate cost of $38.8 million, the revenue requirements arising from the new treatment facility should be equitably assigned to the Alton District. Stafford, Exhibit 3.0, p. 9.

Q. How does the Company calculate the source of supply rates for the Alton District?

A. The Company is proposing a monthly Source of Supply Charge applicable to the Alton District that is calculated based upon monthly rates equal to the General water service usage rates multiplied by a factor of 0.25. Stafford, Exhibit 3.0, p. 9. The Company states that:

> "The Source of Supply charge will produce revenue to support the approximate revenue requirement for the additional investment per customer resulting from the addition of the new treatment facility in the Alton District when compared with the average investment per customer in the balance of the single-tariff pricing group". Stafford, Exhibit 3.0, p. 9.

Q. Do you agree with the Company's proposed Source of Supply Charge for the Alton District?

A. No I do not. One of the main benefits of STP is the ability to spread large capital costs over a large customer base. While I would agree that the Alton treatment plant is a huge capital investment, the whole movement towards STP has been with the end view of spreading those costs among all members of the STP group. When another district has similar large plant and operating expense investments, then all districts will help with the recovery of those costs. STP should either be used or not used. There should not be some hybrid to suit the situation. I believe the Commission has agreed with the Company's position that there is STP for Illinois American's Southern and Peoria Districts. Therefore, I do not believe it is appropriate to surcharge the Alton District for the construction of the new plant.

Standby Service Rates

Q. In the Company's last rate proceeding, Docket Nos. 97-0102/97-0081 (Cons.), the Commission requested that the Company address the reasonableness of the 300 ccf per day threshold for application of the

standby tariff to customers who have not contracted for standby service. Did the Company respond to the Commission's request?

A. Yes they did.

Q. Do you agree with the Company's proposed 300 ccf threshold for standby service?

A. Yes, I do. Imposing standby service on customers whose usage is below 300 ccf a day could place excessive costs on small use customers. Customers taking service under the standby rate are required to pay a demand charge of $17.07 per ccf of contractual demand, usage charges of $0.170 per ccf for all water used up to a daily average use equal to 2/3 of the contractual demand and then the regularly tariffed usage rates for usage above that level. In addition, the customer would be required to pay a customer charge based on the size of meter installed plus an additional amount of $276.94 per month. There may be a customer who has a well in their backyard that may never be used. If the 300 ccf threshold is removed then technically that customer would have to be considered a standby customer. Also, such small customers do not impact capacity planning by the Company. If such small customers were forced to pay standby charges, they would, in effect, be forced to abandon either their wells or service from the Company.

Q. What did the Company propose for standby charges?

A. The Company is proposing to increase the standby charges for the Champaign, Pontiac and Sterling Districts using the same method used for all other rates, which is across the board revisions to all rates for all Districts in accordance with revenue requirements applicable to each District. Stafford, Exhibit No. 3.0, p. 6. The Company is not proposing to adjust standby rates for the Southern Division and Peoria District in this case.

Q. What is your proposal for Standby rate charges?

A. I propose to leave the Standby charges the same for the Pontiac District. The Company has proposed not to increase the Standby rates for the Southern Division and I believe the same should be done for the Pontiac District. Standby Rates, for Districts with Standby service, can be determined the next time the Company files a general rate case involving those Districts. The Company should be directed to provide all necessary information in order to determine Standby rates in their next case.

MISCELLANEOUS ISSUES

Infrastructure Maintenance Charge

Q. Did IAWC propose an Infrastructure Maintenance Charge ("IMC")?

A. The Company has not filed an actual IMC tariff but initially provided an exhibit which showed their IMC proposal. Stafford, Exhibit 3.3. They have

subsequently filed a letter withdrawing that exhibit and accompanying testimony, so I am not addressing that issue.

Streator District Public Fire Protection Rates

Q. What changes have you made with respect to the calculation for monthly public fire protection rates in the Streator District?

A. I am calculating the public fire protection rates for the Streator District using the same methodology as was used in the Company's previous rate case for the Streator District, Docket No. 95-0220.

In that proceeding, it was discovered that some of the Streator District customers lived outside the City of Streator and received no public fire protection services. However, those customers are still responsible for non-hydrant costs associated with their service. An adjustment was made to remove a portion of non-hydrant costs from the cost of service for public fire protection. The adjustment was based on the ratio of the number of monthly bills outside the City of Streator to the number of monthly bills for the District.

As shown on ICC Staff Ex. 4.0, Schedule 4.1-STR, page 14, approximately $35,000 is attributed to customers living outside the City of Streator who do not receive fire protection services.

Q. How are you proposing to recover the $35,000 adjustment for public fire protection in the Streator District?

A. I am proposing that the shortfall of approximately $35,000 be recovered through the usage charges that apply to all customers.

Miscellaneous Tariff Charges

Q. Is the Company proposing any changes to certain miscellaneous tariff charges for the Eastern Division, formerly Northern Illinois Water Company?

A. Yes they are. The Company is proposing to make applicable to the Eastern Division its tariff provisions for a late payment charge, a non-sufficient funds "(NSF)" charge, and service reconnection charges. Rumer, Exhibit 4.0, p. 5. The Company is proposing to change the NSF charge from $10 to $15. ILL.C.C.No. 5, Original Sheet No. 1.2, 20th Revised Sheet No. 11, 12th Revised Sheet No. 14, and 18th Revised Sheet No. 19.

Currently, the Reconnection Charge is $25 if made during normal business hours, $60 if made outside normal business hours, and $75 if made on a Sunday or holiday. The Company is proposing a $32 reconnection charge if made during normal business hours and any service turned on at the request of a customer after regular business hours or on Saturdays, Sundays or holidays will be charged the actual cost incurred by the Company. Exhibit No. 14.0, Schedule E-2, Page 3 of 34, Page 16 of 34, Page 18 of 34, and Page 23 of 34.

The Company does not currently have a late payment charge applicable in the Eastern Division. They are proposing to implement a late payment charge that will equal one and one-half (1-1/2) percent per month of the past due amount, including amounts previously past due. Exhibit No. 14.0, Schedule E-2, Page 3 of 34, Page 16 of 34, Page 18 of 34, and Page 25 of 34.

Q. Do you agree with the Company's proposed miscellaneous tariff charges?

A. Yes I do. In response to ICC Staff Data Request WRJ-1.14, the Company provided the methodology and data used to determine these rates which I reviewed and such changes appear reasonable. Additionally, the late payment charge is authorized by 83 ILL. Adm. Code 280.90.

Q. Does this conclude your direct testimony?

A. Yes, it does.

APPENDIX A

Narrative Description of COSS Methodology

SUMMARY

In general, the objectives of a COSS are to functionalize a utility's revenue requirement into basic categories and allocate those costs across rate classes to determine each classes cost of service. Rates can then be designed to recover the cost to serve each customer class. In the water industry, embedded cost studies are utilized as the main guide to designing rates which are unique to each utility.

The development of water rates, in general, involves the following procedures, described in the American Water Works Association ("AWWA") Manual M1, "Water Rates," p. vii (Fourth Edition):

- Determination of the total annual revenue requirements for the period for which the rates are to be effective.
- Allocation of the total annual revenue requirements to the basic functional cost components.
- Distribution of the component costs to the various customer classes in accordance with their requirements for service.
- Design of water rates that will, recover from each class of customer, within practical limits, the cost to serve that class of customer.

The following report describes the procedures employed in performing the embedded cost of service study for the Company.

COSS METHODOLOGY

Staff's COSS uses the Base-Extra Capacity method described in detail in AWWA's *Water Rates*, Manual M1, (Fourth Edition) pages 11-16, 1991. This procedure is a generally accepted and often used method of determining the cost to serve water customers and thus provides the basis of designing rates for a water utility.

The basic breakdown of cost is the functionalization into operational components. For a water utility the three basic types of costs are 1) operation and maintenance ("O&M") expense 2) depreciation expense and 3) return on capital investment. This information is normally readily available from the utility's accounting records.

After the costs are functionalized, they are allocated to four main components 1) base costs 2) extra capacity costs 3) customer costs and 4) direct fire protection costs.

- **Base costs** are those costs that tend to vary with the total quantity of water used. These costs also include O&M expenses and capital costs associated with serving customers under average load conditions.

- **Extra capacity costs**, and their associated O&M and capital costs, are costs correlated with meeting usage in excess of average usage. These costs can be further subdivided into costs associated with maximum-day extra usage and maximum-hour extra usage.

- **Customer costs** encompass those expenditures related to serving a customer regardless of that customers water usage or rate of usage. These contain costs associated with meters, services and other customer related costs.

- **Direct fire protection costs** are directly applicable to the fire protection function.

After costs are properly allocated between cost components, the cost of service for each meter size is determined. The fixed customer cost of service per meter has three basic components:

- **Equivalent meter costs** include those customer costs associated with meters.

- **Equivalent service costs** include those customer costs associated with services.

- **Other customer costs** are those costs attributed directly to customers, divided by the number of bills to obtain a customer charge per bill. Other customer costs are non-meter size sensitive with each meter size being allocated the same per unit charge, regardless of class (i.e. residential, commercial, industrial etc.).

Equivalent meters and services is a method of assigning costs based on the size of the meter. Distribution of customer costs by equivalent meter and service ratios recognizes that meter and service costs vary, depending on considerations such as size of service pipe, materials used, locations of meters, and other local characteristics for various sized meters as compared to 5/8" meters and services. The number of equivalent meters and services (i.e. which is based on meter ratios) assists in allocating costs assigned for recovery in the customer charges. This is necessary to adjust the units of service for each customer class as indexed against the smallest meter size. Therefore, customers are allocated a charge that reflects the costs associated with their particular meter size. Actual cost differentials are taken from the AWWA Water Meters-Selection, Installation, Testing, and Maintenance Manual (M6), 1972 page 32-33.