STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

CEDAR BLUFF UTILITIES, INC.	)	Docket No. 03-0398
	)	
APPLE CANYON UTILITY COMPANY	)	Docket No. 03-0399
	)	
CHARMAR WATER COMPANY,	)	Docket No. 03-0400
	)	
CHERRY HILL WATER COMPANY	)	Docket No. 03-0401
	)	
NORTHERN HILLS WATER & SEWER COMPANY	)	Docket No. 03-0402
	)	
	)	
Proposed General Increase in Rates	)	*Consolidated*
	)	

INITIAL BRIEF OF UTILITIES, INC.

Utilities, Inc., by and through its attorneys and on behalf of its five subsidiaries Cedar Bluff Utilities, Inc., Apple Canyon Utility Company, Charmar Water Company**,** Cherry Hill Water Company, and Northern Hills Water & Sewer Company (together, "UI" or the "Company"), hereby submits this initial brief in support of its proposed rate increases.

I. INTRODUCTION

UI has filed rate schedules proposing a general rate increase for each of the five subsidiaries. The Company and Commission Staff have reached agreement on all issues except for the following three:

1) Continuing property records;

2) Insurance claim expense for Cedar Bluff Utilities, Inc. ("Cedar Bluffs");

3) Amortization of rate case expense.

This initial brief will discuss these three outstanding issues. Except for adjustments related to UI's proposed amortization of rate case expense and allowance of the Cedar Bluff's insurance claim, Staff's pre-filed rebuttal testimony reflects the current test year rate base and operating statements.

II. THE COMMISSION SHOULD NOT REQUIRE THAT THE COMPANY MAINTAIN CONTINUING PROPERTY RECORDS

A. The Company's Existing General Ledger Systems Meets the Continuing Property Records Requirement.

Instruction 28 of the Uniform System of Accounts for Water Utilities, as adopted by section 605 of the Commission's rules, requires that "each utility shall maintain records in which, for each plant account, the amounts of the annual additions and retirements are classified so as to show the number and cost of the various retirements units or other appropriate record units included therein." 83 IAC 605(a). These records are known as continuing property records ("CPRs").

UI's general ledger system, backed up by specific invoices, satisfies the requirements of section 605. The general ledger contains all additions and retirements to the original cost for the respective class of asset. The additions are recorded as a debit and also indicate the amount of the increase, the vendor who supplied or installed the asset and the time period in which it was incurred. The supporting invoices provide the amount of the increase, the name of the vendor who installed or sold the asset, the date installed and the location of the asset (if applicable), the cost per unit, a description of the unit, the quantity of physical units and other information. (UI Ex. 1.0-SR (Lubertozzi Surrebuttal) at 3). Furthermore, there is no additional information another form of CPR could provide that is required by the rule but is not already present in UI's existing ledger and invoice system. (*Id.* at p. 4)

Staff, however, believes that UI is not maintaining proper CPRs as required by section 605. (Tr. at 79). Staff believes that the Commission's Order in *Apple Canyon Utility Company, et. al.*, Docket No. 94–0157 (the "94-0157 Order"), requires UI to maintain CPRs using the "Will County Continuing Property Records" as a model. (Staff Ex. 6.0 (Pugh Rebuttal) at 10). However, the 94-0157 Order's Findings and Ordering Paragraphs No. 7 only states that "agreement has been reached by Staff and Petitioners on the various accounting, bookkeeping and other procedural issues [including continuing property records] . . . and the resolution of those issues . . . should be accepted by the Commission." Thus, although the Commission accepted the agreement to maintain CPRs, there is no Commission finding in the 94-0157 Order that the Company was required to maintain CPRs in a particular form or that a particular form would benefit the Company.

Following the 94-0157 Order, UI implemented the CPR system contemplated in its agreement with Staff. (Tr. at 36). However, Staff auditors who reviewed these CPRs reportedly told UI that they did not need to look at these types of records in their audits and that this CPR information was not necessary to trace invoices back to rate base. (Tr. at 36-37). As a result, UI concluded that its general ledger and invoice system was sufficient to meet the section 605 requirements for maintenance of CPRs. Beyond general references to section 605 and National Association of Regulatory Utility Commissioners ("NARUC") ratemaking principles, Staff has not specifically identified those areas where UI's general ledger and invoice system does not meet Commission requirements. (Tr. at 79–82; Staff Ex. 6.0 (Pugh Rebuttal) at 8-10).

B. The Costs to UI of Maintaining Separate Continuing Property Records Would Far Outweigh the Benefits.

The costs of developing the CPR system would be substantial, particularly for companies as small as the five companies in this proceeding, whose total combined rate base is only $1 million. (UI Ex. 1.0-SR (Lubertozzi Surrebuttal) at 5; UI Ex. 1.0-R (Lubertozzi Rebuttal in Docket 03-0398) at 7). Staff has admitted that it would be a "large project" to come into compliance with their view of the CPR requirements. (Tr. at 85). Since UI's existing employees are already working at capacity, the Company would have to hire two additional staff accountants at a total cost of $102,000 per year ($51,000 for each new staff member) to comply with Staff's recommended CPR program. (UI Ex. 1-SR (Lubertozzi Surrebuttal) at 5). These new staff members would have to segregate invoices for Illinois operating subsidiaries from all other UI invoices. They would also have to separate all capitalized expenditures from all expense invoices for Illinois only. After the invoices were successfully segregated these new employees would have to manually input the information that was already contained on the vendors invoice into an electronic database. (*Id.*) This process would be very time-consuming and burdensome.

The annual cost for this additional accounting staff would be allocated among the five UI companies in this proceeding as follows:

Apple Canyon Utility Company	$9,180
Cedar Bluff Utilities, Inc	$1,020
Charmar Water Company	$ 204
Cherry Hill Water Company	$1,836
Northern Hills Water & Sewer Company	$2,040

(*Id.* at 6).

This represents a significant additional burden for such small companies, a burden which the Commission has recognized in prior rulings. In Consolidated Docket Nos. 90-0475/92-0401, involving the Apple Canyon Utility Company, the Commission found that Apple Canyon's CPR system was adequate and concluded that "Staff's recommendation for a more complex and costly system is impractical for a utility the size of Apple Canyon." The Commission made a similar finding with regards to another UI subsidiary, Camelot Utilities, in Docket No. 92–0345, where the Commission did not accept Staff's recommendation on CPRs because the costs would outweigh the benefits.

As Staff acknowledged in this proceeding, it is the Commission's responsibility, not Staff's, to determine whether the benefits of a new CPR system for these five utilities exceed the costs. (Tr. at 91). In the case of UI and its subsidiaries, the Commission has determined in the past that instituting a complex new CPR system would be unduly burdensome. Staff cannot point to any changes in the regulatory environment since the Commission made those determinations which would require a different outcome now. Since Staff's proposed CPR system will require UI to expend significant resources, while producing information that will be little different from UI's existing system, the costs of maintaining CPRs clearly outweigh the benefits. For that reason, the Commission should reject Staff's recommendation on the CPRs.

III. THE COMMISSION SHOULD ALLOW CEDAR BLUFFS TO INCLUDE ITS ENTIRE INSURANCE CLAIM EXPENSE IN THE TEST YEAR

Cedar Bluffs incurred an insurance expense claim for the 2002 test year as a result of payments made to homeowners who suffered water damage to their homes. (Staff Ex. 2.0 (Hathhorn Direct in Docket 03–0398) at 7-8). Staff argues that this

insurance claim expense is "rather significant" when compared to other years and therefore should be amortized over a five year period. (*Id.*).

Staff's arguments abandon traditional test year methodology, which focuses on the overall actual revenues and costs incurred by a utility in a 12-month period of its choosing. 83 IAC 287.20. Instead, Staff's adjustment to insurance expense is a backward looking approach that allows the Staff to select certain individual expense categories and then reduce UI's test year expenses based on changes to that individual account alone.

Staff correctly states that a test year "should reflect a company's normal expected, recurring level of expenditures for the period in which rates will be in effect." (Staff Ex. 7.0 (Hathhorn Rebuttal) at 7). However, Staff fails to consider operating and maintenance ("0 & M") expenses as a whole over the five year period from 1998 through 2002 (the period examined by Staff). The 2002 test year 0 & M expenses for Cedar Bluffs, $36,571, are comparable to the five-year average of 0 & M expenses, $36,261. (UI Ex. 2-SR (Weeks Surrebuttal) at KEW Ex. 1). Thus the total 0 & M expense for the test year is consistent with past years.

It is not unusual to have variances in individual expense accounts from year to year, with an increase to one expense account offsetting a decrease to another. These individual account variances tend to balance each other out. The proposed five-year amortization of the insurance claim distorts the test year, however, by making a downward adjustment to one account, insurance claim expense, without examining other accounts to see how they have changed. Should Staff's proposed five-year

amortization be allowed, it will mean that test year O & M expenses will be below average, and UI will experience an underrecovery in its rates.

Staff concedes that it did not apply this historical averaging methodology consistently to other individual expense accounts. (Tr. at 59). For example, UI's test year expense for account 401.1Y, maintenance for sewer plant, showed a substantial decrease of $2,309 from the previous year. However, Staff did not make any positive adjustment to rate base for this decrease in an individual account. (Tr. at 62-64). As a result, its appears that Staff was picking and choosing among individual accounts when determining when to adjust test year expenses for the insurance claim alone.

Because the overall O & M expenses for Cedar Bluffs are in line with past averages for O & M expenses, there is no reason to amortize the single insurance expense account just because it varies from prior years. Instead, the Commission should allow the entire insurance claim expense in the test year. Alternatively, Staff should test all the individual O & M expense accounts against the average of the past five years to obtain a consistent result.

IV. THE COMMISSION SHOULD ALLOW A THREE-YEAR AMORTIZATION PERIOD FOR RATE CASE EXPENSE

The Commission has amortized rate case expense over three years for other recent UI rate makings. For example, the Commission approved three-year amortization of rate case expense for UI subsidiaries Lake Wildwood Utilities, Docket No. 01-0663, and Del Mar Water Company, Docket No. 02-0592. However, Staff seeks to amortize rate case expense for these five UI subsidiaries over five years due to the fact that Staff believes the time elapsed since these companies last applied for a rate increase is generally "significant." (Staff Ex. 7.0 (Hathhorn Rebuttal) at 5).

Staff's proposal is not consistent with these other recent Commission rulings for UI subsidiaries. Moreover, Staff's proposal does not reflect the rapid recent increase in certain expenses, such as health insurance expense, which may lead to UI filing for a rate increase prior to the completion of a five-year amortization period.

In addition, if the Commission accepts Staff's recommendation for a drastic change in UI's continuing property record system, UI will be forced to incur compliance costs, including the addition of two new staff members. (UI Ex. 1–SR (Lubertozzi Surrebuttal) at 5). This increase in costs will also lead to UI's filing of a rate case before the five year amortization period is complete.

UI fully expects to file rate cases for all of its operating subsidiaries within a three to four year cycle. Therefore, the Commission should follow its typical practice and amortize rate case expense over a three year period.

V. CONCLUSION

There are only three contested areas remaining in this matter:

1) Because the costs of changing UI's CPR system would greatly outweigh any benefit, the Commission should not accept Staff's recommendation that it maintain CPRs separate and apart from its general ledger and supporting invoices.

2) Because Cedar Bluff's overall O & M expenses for the 2002 test year are in line with the five-year average for Cedar Bluff's O & M expenses, there is no need to amortize Cedar Bluff's insurance claim expense over five years.

3) A rapid increase in expenses will require UI to file another rate case before a five year amortization period is over. Therefore, the Commission should approve a three-year amortization period for rate case expense as it has for other recent UI rate cases.

Respectfully submitted,

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