Docket Nos. 00-0337, 00-0338, 00-0339
Consolidated
ICC Staff Exhibit 9.00

REBUTTAL TESTIMONY

OF

STEVEN R. KNEPLER

ACCOUNTING DEPARTMENT

FINANCIAL ANALYSIS DIVISION

ILLINOIS COMMERCE COMMISSION

CONSUMERS ILLINOIS WATER COMPANY

DOCKET NOS. 00-0337, 00-0338, 00-0339
Consolidated

OCTOBER 26, 2000

Witness Identification

Q. Please state your name and business address.

A. My name is Steven R. Knepler. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. Have you previously filed testimony in this proceeding?

A. Yes. My direct testimony was filed on August 31, 2000 as ICC Staff Exhibit 2.00.

Purpose of Testimony

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to address several issues discussed in the rebuttal testimonies of Consumers Illinois Water Company (CIWC or Company) witnesses Bunosky (CIWC Exhibit No. 3.0R), Leppert (CIWC Exhibit No. 5.0R) and Simpson (CIWC Exhibit No. 6.0R).

Schedules

Q. Are you sponsoring any schedules as part of ICC Staff Exhibit 9.00?

A. Yes. I am sponsoring the following schedule as part of ICC Staff Exhibit 9.00:

Schedule 9.01(K)	Adjustment to Wages and Salaries for Omitted Employee

Q. Please explain the "(K)", "(V)" and "(W)" suffixes which appear in your schedule numbers.

A. Consumers Illinois Water Company has filed for rate increases for three operating divisions: Kankakee Water Division, Vermilion County (Water) Division, and Woodhaven Water Division. The "(K)" suffix identifies a schedule which pertains to the Kankakee Water Division. The "(V)" suffix identifies a schedule which pertains to the Vermilion County Division. The "(W)" suffix identifies a schedule which pertains to the Woodhaven Water Division.

Q. Messrs. Bunosky and Leppert address the Company's proposal to include the wages of an employee omitted from the original filing for the Kankakee Division. Do you agree with the proposal?

A. No, I do not agree with it for two reasons. First, Staff did not propose any wage and salary adjustments to the Company's filing. Therefore, the

recommendation to include the wages of the omitted employee is not rebuttal testimony (since there is no adjustment to rebut), but rather it is an update to the Company's filing. Second, the Company chose to file under the proposed filing requirements for a future test year which allows updates only in very limited circumstances. The proposed Section 287.110(b) addition to the Commission rules, Updates to Future Test Year Data, states that:

> A determination to require or allow the submission of an update shall include, but not be limited to, the consideration of:
> 1) Whether the changes significantly affect the revenue requirement;
> 2) Whether the changes could reasonably have been reflected in the initial tariff filing; and
> 3) Whether the Illinois Commerce Commission staff and other participants will have an adequate opportunity to review the updated information.

It is my opinion that the wage and salary update proposed by the Company is not in compliance with the update provisions. Of the three update tests identified above, it is questionable whether the Company passes the first test. The Company clearly fails the second test. The Company passes the third test. Therefore, under the proposed requirements above, the update would not be permitted. In fairness to the Company, Staff has reflected the omitted wage in its revenue requirement determination. Should the Commission find that the update for the omitted wage is inappropriate

because it violates the test year rules, then it would be necessary to remove that amount from the final revenue determination.

Q. What is the status of your Adjustment to Incentive Compensation Expense (ICC Staff Exhibit 2.00, Schedules 2.01(K), (V), and (W))?

A. Although the Company did not agree with the inclusion of 1997 in the computation of the average incentive compensation payout, it did agree to accept my adjustment for the purpose of this case. Therefore, there is no disagreement with respect to incentive compensation between the Company and Staff. As a result, my incentive compensation adjustment, shown on ICC Staff Exhibit 2.00, Schedule 2.01(K), (V), and (W), is properly reflected in the revenue requirement.

<u>Advertising Expense</u>

Q. **Beginning on page 9 of his rebuttal, Mr. Bunosky states that he does not agree with the calculation of your adjustment to remove promotional advertising expense from the test year. Mr. Bunosky agrees with the methodology in general, however he believes that expenses related to the distribution of bottled water are not promotional. Do agree you with his conclusion?**

A. No, I do not agree. Mr. Bunosky states that the bottles are filled with water produced at the Kankakee water treatment plant and distributed free of charge at community events held throughout the year. According to Mr. Bunosky, the Company estimates that 60% or $4,800 of the $8,000 spent for mugs and bottles relates to the distribution of bottled water. Mr. Bunosky believes that the distribution of bottled water is a community service, and is thus not specifically promotional in nature (CIWC Exhibit NO. 3.0R, p. 10, lines 23 and 7). Mr. Bunosky also claims that the distribution of bottled water should be allowed because it educates the public that tap water "tastes as good and is as safe to drink as bottled water…." (Id., p. 11, lines 4-5).

I believe that expenses related to the distribution of bottled water are goodwill advertising and are not permissible for the following reasons:

1. The expenses are not specifically identified as allowable expenses under Section 9-225 of the Act.

2. CIWC is a utility and is allowed to recover expense necessary to provide water service within its certificated area. The distribution of bottled water at community events is not a necessary function of a water utility and any related expenses should not be recoverable.

3. Furthermore, if the Company is attempting to demonstrate that tap water tastes as good as bottled water, then a side-by-side taste comparison must be made. Since the comparison was not made,

the only alternative is to conclude (once again) that this expenditure is made for goodwill purposes.

4. On the other hand, if the Company is attempting to develop a bottled water product which would compete with bottled water and other beverages currently available, then this is a (competitive) non-utility activity, and any related expense is not recoverable and it should be accounted for below-the-line.

Section 9-225(1)(d) defines Goodwill or institutional advertising as "any advertising either on a local or national basis designed to bring the utility's name before the general public in such a way as to improve the image of the utility or to promote controversial issues for the utility or the industry. For the reasons stated above, I believe the distribution of bottled water enhances the goodwill of the Company and the related expense should not be recovered from ratepayers. Therefore, I am maintaining my Adjustment to Demonstration Selling, Advertising, and Miscellaneous Sales Expense on Schedules 2.05(K), (V) and (W).

<u>Amortization of Rate Case Expense- Kankakee Division</u>

Q. In his rebuttal testimony, CIWC witness Simpson agrees with your proposal to amortize rate case expense for the Woodhaven Division over 4-years. However the Company indicates that the appropriate amortization period for the Kankakee Division should be revised from its proposal in direct testimony of 1.5 years or 18 months to 2.5-years

or 30 months. (CIWC Ex. 6.0R, p. 9). Do you believe that a 2.5-year amortization period for the Kankakee Division is appropriate?

A. No. Although the average time between CIWC's two most recent rate cases is approximately 2.5 years, I believe that the determination of a rate case amortization period should not be limited to an exact mathematical average of the time between rate cases. CIWC's most recent rate filings[1] have used a future test year and one of the benefits of such a test year is the need for fewer less frequent rate case filings. Furthermore, a 3-year amortization period would moderate the Company's 19.12% (or $1,625,808) requested rate increase for the Kankakee Division because the rate case expense is amortized over a longer period. For these reasons, I am maintaining my adjustment to amortize rate case expense for the Kankakee Division over a 3-year period. The details of this adjustment are shown on ICC Staff Exhibit 2.00, Schedule 2.03(K).

Q. If the Commission were to accept Staff's proposed 3-year amortization period, and if the Company were to file a rate case for its Kankakee Division before costs were fully recovered, would the Company be harmed?

[1] Docket No. 99-0288 for the Candlewick Water Division filed on April 30, 1999 and Dockets 00-0337, 00-0338 and 00-0339 (Consolidated) filed on April 14, 2000.

A. No. The Company would be permitted to fully recover the unrecovered portion of rate case expense in a future rate proceeding. This is precisely the same recovery methodology that the Company is proposing in this proceeding for its Kankakee and Vermilion Divisions. At the time the new rates go into effect the Company will have approximately $34,164 in unamortized rate case expense for its Kankakee Division from Dockets 95-0342 and 97-0351; and $13,088 for its Vermilion Division from Docket No. 97-0351. As noted in my direct testimony, Staff does not oppose the Company's proposal to recover the remaining balance of rate case expenses associated with prior dockets (ICC Staff Exhibit 2.00, p. 6). The recent Commission practice is to allow the utilities to fully recover rate case expense.

Q. Would the ratepayers be disadvantaged if the Commission was to select the Company's proposed rate case amortization period and if the Company was to file for rate relief subsequent to the (Company proposed) 2.5-year amortization period?

A. Unlike the Commission policy of guaranteeing full recovery of rate case expense, there is no reciprocal agreement or Company tariff to reduce rates once rate case expense has been fully recovered. Therefore, in

order to prevent the overrecovery of rate case expense, the Commission should select an appropriate amortization period.

Deferred Rate Case Expense

Q. Beginning on page 9 of his rebuttal testimony, Company witness Simpson states that recovery of rate case expense deferred from Docket 99-0288 (Candlewick Water Division) and allocated to the Kankakee, Vermilion and Woodhaven Water Division is appropriate for recovery in this proceeding. He further states that this deferred expense was used to develop a new computer model used in rate proceedings. Please respond to Mr. Simpson's comments regarding the necessity for a new computer model and its alleged benefits.

A. Mr. Simpson's arguments are less convincing if one is aware of the facts surrounding the deferral issue. I will not reiterate these items in my rebuttal testimony as they are cited beginning on page 8, line 182 through page 10, line 232 of my direct testimony (ICC Staff Exhibit 2.00).

Company witness Simpson indicates that the computer model "was necessary for the Company to develop an *entirely new* set of filing schedules…". (Id., p.10, Lines 3-4, *Emphasis Added*). Presumably the

prior rate case model could have been modified to accommodate a future test year. Although there are differences in the current filing requirements and the proposed requirements, the similarities outweigh these differences.

Mr. Simpson also states that "the Company was required to develop entirely new computer software models to generate the filing requirement schedules." (Id., Lines 8-9). There is no requirement in the proposed filing requirements which requires a utility to develop entirely new computer software models and, again, it seems that it should have been possible for the Company to modify the prior model used for historical test years.

Other alleged benefits of the new model made by Mr. Simpson are that the "model containing the new filing requirements was two to three times as large as the model for the previous single division filing under the old filing requirements." (Id., Lines 10-12). I submit that this is not a benefit per se, but rather an inherent difference between the Company's old model and new model. The Company's old model was limited to financial information and included separate components used to track plant balances and to calculate depreciation expense. Under the new model, the company is attempting develop an integrated model.

Q. Mr. Simpson also cites new filing requirements as a reason for additional rate case expense in Docket No. 99-0288. Does he correctly characterize the filing requirements and, if so, are they significant enough to create additional rate case expense?

A. Staff has never claimed that there are not any new filing requirements as these difference clearly are identified in Appendix A to Staff's Initial Brief in Docket No. 93-0351. As noted correctly by Company witness Simpson, the H Schedules are part of those additional requirements. However, the point is, are these new requirements significant enough to require the Company to incur $430,612 for a rate case of one division consisting of 2,500 customers or are there other reasons for which the shareholders rather than the ratepayers should be held responsible? Staff has testified that much of the additional information required by the proposed filing requirements was typically provided by the utilities in response to Staff's generic data requests. In other words, sooner with the filing of testimony (using proposed filing requirements) or later in response to generic data requests (under the current filing requirements) - the Company would provide this additional information to Staff.

With respect to the information required by the H Schedules, a good portion of it should be readily available in conjunction with the Company's

normal budget and business plan. Thus, it should not be a Herculean effort to supply the required H Schedules. Staff nonetheless notes that the Company has demonstrated difficulty in performing basic record keeping and rate case tasks such as maintaining its required continuing property records (Kankakee and Vermilion Divisions), losing count of the fire hydrants in the Kankakee Division, and failing to file revenue requirement schedules with its rebuttal testimony in this proceeding.

Q. Mr. Simpson refers to "Conversion Activities" which presumably the outside consultants performed with respect to the most recent Candlewick Water Division rate case, Docket No. 99-0288. Has the Company further identified these activities?

A. No. Staff has requested a copy of the contract to develop the software, but was informed that none exists. Without a contract it is impossible to identify the "Conversion Activities" or responsibilities to be performed. Given that no contract exist and that the "development of software" was first disclosed during the rebuttal stage in the Company's Docket No. 99-0288, the "Conversion Activities" appear more illusionary that real. The Company may believe that it is an appropriate business practice to finance the development of software with a blank check. If that is the case, then

the stockholders, not the ratepayers, should be responsible for covering the blank check.

Q. On page 11 of his rebuttal, Mr. Simpson cites certain rate case cost savings which he suggests are attributable to the Company's rate case model. Do you have any comments?

A. Yes. The difference in rate case expense, is not necessarily attributable to the Company's new model. There may be other factors involved, such as the decision to use in-house legal service as opposed to outside legal service, or accounting service from the parent organization as opposed to outside consultants. The $339,876 cited by Mr. Simpson is the Company's original estimate of current rate case for the Kankakee, Vermilion and Woodhaven Divisions in this proceeding. In the recent Candlewick proceeding, where CIWC's original cost estimate was $300,000, the Company reported that it spent a total of $430,612 for a rate case involving one division of 2,500 customers.

The real issue is how much was budgeted and how much was incurred for rate case expense in Docket No. 99-0288; as well as how much of this expense should be the responsibility of ratepayers and how much should be the responsibility of the stockholders. In the Candlewick Water

proceeding the Company exceeded its rate case expense budget of $300,000 by $130,612 for a total rate expense of $430,612. Being over-budget, presumably the Company realized that it could only charge the Candlewick ratepayers an amount that approximated the original budget. In its rebuttal in that proceeding the Company disclosed that much of the amount over-budget was for the development of software. The end result was that the Candlewick ratepayers were charged $314,246 and $116,366 was deferred.

Q. Is it reasonable to conclude that the amount the Company stated that it incurred for the development of software was actually for assistance in filing testimony and related schedules?

In addition to not having a contract and the Company's disclosure in rebuttal that a portion of its costs were for the software development, there are other facts. In response to Staff Data Request DH-110, regarding the number of hours Danny E. Allen (an employee of the parent company) spent developing or modifying the revenue requirement rate model used in this proceeding, CIWC indicated:

> Mr. Allen charged 343 hours to the Consumers Illinois Water Company rate filing from October 1999 through the filing date of April 14, 2000. It is estimated approximately 90% of these hours

> were directly attributable to developing / improving the existing rate filing template and modifying it specifically to produce the revenue requirement rate models used in this proceeding.

Thus, it appears that the Company paid for a computer model that was not fully functional. Furthermore, the fact that of the $116,366 of deferred rate case expense, 57% is attributable to legal fees instead of software program development expenses is a further indication that the Company's "deferral theory" lacks credibility.

Q. Please summarize the status of your adjustment to eliminate deferred rate cases expense.

A. Until the Company can provide a contract for the development of its computer model and responds to the 9 conditions surrounding the presentation of Docket No. 99-0288 identified on pages 8-10 of my direct testimony, I am maintaining my adjustment. The details of the adjustment are shown on Schedules 2.03(K), (V), and (W) attached to my direct testimony.

<u>Conclusion</u>

Q. Please summarize the status of your adjustments.

A. The status of my adjustments are as follows:

- My incentive compensation adjustment was accepted by the Company (Schedules 2.01(K), (V) and (W)).

- My adjustment to political and lobbying expense was accepted by the Company (Schedules 2.02(K), (V) and (W)).

- The Company accepted my adjustment to amortize the Woodhaven rate case expense over 4 years (Schedule 2.03(W)). I am maintaining my adjustment to amortize the Kankakee Division rate case over 3 years (Schedule 2.03(K)).

- As stated previously, I am maintaining my adjustment to eliminate rate case expense deferred from Docket 99-0288 (Schedules 2.03(K), (V), and (W)).

- The Company has accepted my adjustment to social and service club membership dues (Schedules 2.04(K) and (V)).

- The Company accepted my adjustment to demonstration selling, advertising, and miscellaneous expense, with the exception of those expenses related to the distribution of bottled water. I am maintaining my adjustment in its entirety (Schedules 2.05(K), (V), and (W)).

- The wages of an employee omitted from the Company's direct case have been reflected in Staff rebuttal revenue requirement.

Q. Does this conclude your prepared rebuttal testimony?

A. Yes, it does.