

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Aqua Illinois, Inc.	:	
	:	
Proposed general increase in water and sewer rates for the Woodhaven Water Division. (Tariffs filed on December 22, 2004).	:	05-0071
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Aqua Illinois, Inc.	:	
	:	
Proposed general increase in water rates for the Oak Run Division. (Tariffs filed on December 29, 2004).	:	05-0072
	:	(Consolidated)

**REPLY BRIEF OF THE STAFF  
OF THE ILLINOIS COMMERCE COMMISSION**

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TABLE OF CONTENTS

- I. BACKGROUND; PROCEDURAL HISTORY; NATURE OF OPERATIONS; TEST YEAR ..... 2
- II. RATE BASE ..... 3
  - A. Introduction..... 3
  - B. Summary of Uncontested Issues..... 3
  - C. Recommended Rate Bases..... 4
- III. OPERATING REVENUES AND EXPENSES ..... 4
  - A. Introduction..... 4
  - B. Summary of Uncontested Issues..... 4
  - C. Contested Issues..... 5
    - 1. Reverse Osmosis Plant Study Expense–Oak Run Division ..... 5
    - 2. Uncollectible Expenses ..... 6
      - a. Bulk Billing ..... 8
    - 3. Sewer Installation Costs–Woodhaven Sewer Division ..... 9
    - 4. Allocation of Management Expense..... 9
    - 5. Rate Case Expense ..... 11
      - a. Ahern Expense ..... 11
      - b. Rate Case Expense Recovery ..... 13
        - (1) Economies of Scale ..... 13
        - (2) Prior Commission Action..... 15
        - (3) Staff’s Balanced Approach..... 18
      - c. Staff Recommendations Regarding Future Rate Case Filings ..... 21

6. Amortization Period of Rate Case Expense.....	23
7. State and Federal Income Tax Calculation Errors .....	25
8. Alleged Staff Revenue Requirement Calculation Error .....	25
D. Recommended Operating Incomes/Revenue Requirements.....	26
IV. COST OF CAPITAL/RATE OF RETURN .....	26
V. COST OF SERVICE; RATE DESIGN; TARIFF TERMS AND CONDITIONS ....	26
VI. CONCLUSION.....	26

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Staff of the Illinois Commerce Commission (“Staff”), by and through its counsel, pursuant to Section 200.800 of the Illinois Commerce Commission’s (“Commission”) Rules of Practice (83 Ill. Adm. Code 200.800), respectfully submits its Reply Brief in the above-captioned proceeding.

In this proceeding, the Commission is investigating Aqua Illinois, Inc.’s (“Aqua” or the “Company”) December 22, 2004 requests for general increases in water and sewer rates for its Woodhaven Water and Sewer Divisions (“Woodhaven”, “Woodhaven Water” or “Woodhaven Sewer”), respectively, and its December 29, 2004 request for a general increase in water rates for its Oak Run Water Division (“Oak Run”), pursuant to Article IX of the Illinois Public Utilities Act (the “Act”), 220 ILCS 5/9. On August 24, 2005, Initial Briefs (“IB”) were filed in these consolidated matters by Staff, Aqua Illinois, Inc. (“Aqua”

or the “Company”), The Woodhaven Association, and Oak Run Property Owners Association. Staff hereby submits this Reply Brief in response to certain arguments and/or claims made by the parties in their Initial Briefs.<sup>1</sup>

Staff’s Initial Brief identified and responded to many, if not most, of the arguments raised in the Company’s Initial Brief. In this Reply Brief, Staff has incorporated many of those responses by reference or citation to Staff’s Initial Brief. However, in the interest of brevity, Staff has not raised and repeated every argument and response previously addressed in Staff’s Initial Brief. Thus, the omission of a response to an argument that Staff previously addressed simply means that Staff stands on the position taken in Staff’s Initial Brief because further or additional comment is neither needed nor warranted. As explained in detail below and in Staff’s Initial Brief, the arguments raised by Aqua lack merit and should be rejected.

**I. BACKGROUND; PROCEDURAL HISTORY; NATURE OF OPERATIONS; TEST YEAR**

Aqua misleads the Commission with respect to its dire need for a rate increase for its Woodhaven Water, Woodhaven Sewer and Oak Run Water Divisions. In support thereof, the Company laments:

Rate relief is necessary now because, at previously approved rates, each of these Divisions is significantly under-earning. In 2004, Aqua suffered losses in each of the Divisions as follows:

Oak Run	\$ (29,021)
Woodhaven Water	\$(100,428)
Woodhaven Wastewater	\$ (12,519)

(Aqua IB, p. 1.)

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<sup>1</sup> Pursuant to the August 12, 2005 Administrative Law Judge’s Notice, Staff’s Reply Brief follows the provided outline; however, only issues raised by the parties’ Initial Briefs that warrant discussion are discussed in Staff’s Reply Brief.

The support offered for this claim is Aqua witness Bunosky's rebuttal and surrebuttal testimonies, wherein he quotes the Company's response to Staff Data Request JF 1.05, which he represents to be the Income Statements for the three Divisions. (Id.) However, upon examination of the response to Staff Data Request JF 1.05, Aqua has provided the net income for the year, not the utility operating income. As Aqua should know, it is the utility operating income on which rates are based.

Aqua could have, but did not, file an historical 2004 test year in support of its requested rate increases. Staff and the Intervenors have not reviewed the 2004 operating results of Aqua's operating divisions. Aqua should also know that there are many reasons that the financial operating results of a division might differ from a test year that is used to determine rates.

The basis for the Company's request is the 2005 future test year, not the historical 2004 net income. As such, Aqua's purported losses do not represent appropriate evidence that the three Divisions that are the subject of the instant proceeding are in dire need of a rate increase. The Commission should not be swayed by Aqua's melodramatics in the opening paragraph of its Initial Brief.

## **II. RATE BASE**

### **A. Introduction**

### **B. Summary of Uncontested Issues**

Staff does not take issue with any of Aqua's statements regarding uncontested rate base issues in its Initial Brief (Aqua IB, p. 3); however, Staff's Initial Brief offers a more complete discussion (Staff IB, pp. 6-14).

### **C. Recommended Rate Bases**

Aqua indicates that, “[t]here are no Rate Base issues between Aqua and Staff.” (Aqua IB, pp. 2, 5.) Staff does not disagree. Both Staff and Aqua recommend that the Commission adopt a rate base of \$1,589,806 for the Oak Run Water Division. (Staff IB, p. 14 and Appendix A (OR); Aqua IB, p. 5 and Appendix A, Schedule 8.1 (OR).) However, for the Woodhaven Water Division, Staff recommends a rate base of \$2,817,998, while Aqua recommends a rate base of \$2,831,454. (Staff IB, p. 14 and Appendix A (WW); Aqua IB, p. 5 and Appendix A, Schedule 8.1 (WW).) For the Woodhaven Sewer Division, Staff recommends a rate base of \$2,906,991, while Aqua recommends a rate base of \$2,918,721. (Staff IB, p. 14 and Appendix A (WS); Aqua IB, p. 5 and Appendix A, Schedule 8.1 (WS).) The differences in rate base amounts for the Woodhaven Divisions are attributed to the cash working capital adjustments reflected in Staff’s numbers.

## **III. OPERATING REVENUES AND EXPENSES**

### **A. Introduction**

### **B. Summary of Uncontested Issues**

Staff does not take issue with any of Aqua’s statements regarding uncontested Operating Revenues and Expenses issues in its Initial Brief (Aqua IB, p. 6); however, Staff’s Initial Brief offers a more complete discussion (Staff IB, pp. 15-17).

## C. Contested Issues

### 1. Reverse Osmosis Plant Study Expense—Oak Run Division

Aqua agrees with Staff's proposed adjustment to transfer capital expenditures incurred thus far for the Reverse Osmosis ("RO") Plant from Plant in Service to account 183, Preliminary Survey and Investigation. (Aqua IB, p. 7.) However, the Company errs in its argument that if the Commission disagrees that the RO Plant will likely be built, it is more appropriate to amortize the capital expenditures over a ten-year period to account 675, Miscellaneous Expense. (Id.)

Not only does the Uniform System of Accounts for Water Utilities specify that the aforementioned costs be recorded in account 183, Preliminary Survey and Investigation Charges, but it also specifies that the costs shall remain in account 183 until such time as construction results or the work is abandoned. (ICC Staff Exhibit 2.0, p. 7.) 83 Ill. Adm. Code 605.10 provides, in part:

This account shall be charged with all expenditures for preliminary surveys, plans, investigation, etc., made for the purpose of determining the feasibility of projects under contemplation. If construction results, this account shall be credited and the appropriate utility plant account charged. If the work is abandoned, the charge shall be to account 426 – Miscellaneous Nonutility Expenses, or to the appropriate operating expense account unless otherwise ordered by the Commission...

(Staff IB, pp. 17-18.)

Aqua's argument that pursuant to 83 Ill. Adm. Code 605.10, in the case of abandonment of a project, the expenses should be charged to an operating expense account (Aqua IB, p. 7), is misleading. The Company has neither indicated nor is it found anywhere in the record in the instant proceeding that the Commission's position on the likelihood that the RO Plant will be built would cause the Company to abandon

the project. As such, this is not an issue for which the Commission should make a determination.

Therefore, Staff recommends that the Commission: (1) accept its adjustment to remove from plant in service the cost of a pilot study and the projected cost for engineering plans related to the RO project under consideration by the Company for its Oak Run Water Division, and (2) disallow the Company to amortize the amount over a ten-year period to account 675, Miscellaneous Expenses. (Staff IB, p. 18.)

## **2. Uncollectible Expenses**

The Company claims that it is misleading for Staff to rely on Aqua's write-offs for the past five years to determine the proper level of Uncollectible Expense in the test year. Aqua maintains that it cannot write off the bad debts attributable to the majority of its delinquent customers at Oak Run or Woodhaven because service cannot be turned off or terminated, i.e., the Availability customers at Oak Run are not connected to the system and the water and sewer systems at Woodhaven were constructed without meters or shut-off valves. (Aqua IB, pp. 8-10.)

For the Oak Run Division, the Company's initial pro forma increase in the uncollectibles rate was not based on its experience with Oak Run customers, but on the uncollectibles experience of the Candlewick Availability customers. In response to Staff Data Request BAP 4.02(c), the Company stated:

Approximately 63% of the Company's requested rate increase is derived from Availability customer revenues. As noted on the fourth page of Aqua Exhibit 4.0, the Availability charge has been increased 81.92%. This, coupled with the high uncollectible expense experience of Candlewick Division Availability customers, led the Company to *conservatively* increase its Oak Run Uncollectible expense at some level higher than that

produced by the overall increase as reflected on Schedule C-2.3, line 35.  
(Emphasis added.)

In its rebuttal testimony, the Company amended bad debt expense to a lower amount, based on the allocation of accounts receivable over 91 days old over a three-year period. (Staff IB, pp. 18-19.)

Aqua states that it is entitled to recover its total Bad Debt Expense in rates. (Aqua IB, p. 9.) However, the Company presented no evidence to support its claim that Availability customer accounts over 91 days old will not be collected or that one third of that amount is reflective of actual bad debts. Staff believes that this method of estimating the annual bad debts expense is highly unorthodox and bears no apparent relationship to the experience of the Company in its ability to predict future write-offs. (Staff IB, p. 19.) Staff's analysis of the Company's actual write-offs for the past five years expressed as a percent of revenue indicates that the Company has experienced average write-offs of .3696% over the past five years, which is less than Staff's proposal to not increase the uncollectibles rate beyond the rate embodied in the pro forma present operating income of .4911%. The Company's amended pro forma adjustment increases the test year uncollectibles rate to 1.38%. (Id., pp. 18-19.) The Commission should approve Staff's proposed adjustment to disallow the Company's increase in the uncollectibles rate to 1.38% in order to maintain the uncollectibles rate of .4911% for the Oak Run Water Division.

With respect to the Woodhaven Divisions, Staff utilized the same methodology used for the Oak Run Water Division, i.e., the average of the last five years' actual write-offs to derive the combined uncollectibles rate. (Id., p. 20.) Aqua claims that

Staff's position is unreasonable because the Woodhaven Divisions' uncollectibles problem is worsening. (Aqua IB, p. 12.)

The reality is that Aqua's position is unreasonable. Aqua maintains that it would be too expensive to install shut-off valves for every Woodhaven customer, but not every customer needs a shut-off valve. According to Aqua, 552 accounts with a total amount of \$451,991 were delinquent at May 31, 2005. At \$400 per customer, it would cost Aqua \$220,800 (552 x \$400) to install shut-off valves that would enable it to discontinue service to customers it currently characterizes as delinquent. (Id., p. 10.) Rather than address the situation, Aqua asks the Commission to approve higher rates, which it will then bill to the same customers that it claims will not pay, so that by the next rate proceedings for these Divisions the Company's purported bad debt expense will be even higher.

There is no rational basis for allowing the Company to recover the level of uncollectibles expense that it seeks in its rebuttal position when doing so would reward the Company for poor management of its uncollectibles problem. Staff recommends that the Commission reject the Company's substantially higher requested Bad Debts Expense in favor of Staff's proposed adjustments to the uncollectibles rates.

**a. Bulk Billing**

The Woodhaven Association ("Association") has proposed that Aqua implement "bulk billing" for water and sewer, i.e., bill the Association directly rather than the individual customers. (Woodhaven Association IB, pp. 9-11.) Although Aqua believes a bulk billing option could be a good resolution to the Woodhaven Divisions' uncollectibles problem (Aqua IB, p. 13), it has not provided information requested by the Association

on the financial impact of bulk billing to the Association. (Staff IB, p. 20.) Although the record in this case does not address the impact that bulk billing would have on the revenue requirement for Woodhaven customers, it appears that it would be in the best interest of a continued relationship between Aqua and the Association to actively explore the possibility of bulk billing and the resulting impact on a test year revenue requirement. (Id.)

**3. Sewer Installation Costs–Woodhaven Sewer Division**

**4. Allocation of Management Expense**

The majority of Aqua’s arguments regarding the allocation of management expenses are based on statements made by Company witness Bunosky on the witness stand during re-direct. (Tr., pp. 115-133.) Not until the hearing does the Company begin to differentiate between direct and common costs and to designate management expenses as common costs. Because Staff did not have an opportunity to conduct a proper and thorough review of the allegations, Staff has no information with which to confirm or deny the Company’s claims that the avoidance of direct costs does not impact, in any way, whether Aqua incurs common costs, or that reduced allocations of common costs would double count savings of direct costs. (Aqua IB, pp. 17-18.)

There is no evidence in the record to support Aqua’s claim that Woodhaven customers “received unearned benefits” or “reaped a windfall” in the past when the rate base method was used to allocate management expense. (Id., pp. 23-24.) There is evidence that the change in allocation methodology from the rate base method to the customer count method effected a material increase in the amount of management expense allocated to the Woodhaven Divisions, i.e., a 305% increase for the

Woodhaven Water Division and a 249% increase for the Woodhaven Sewer Division. (Staff IB, p. 24.) The Oak Run Division would have experienced a 184% increase if the Company had not weighted Oak Run Availability customers at one-third for the purpose of calculating the customer count allocation factor in this proceeding. (ICC Staff Exhibit 7.0 C, p. 12.) The fact that Aqua weighted Oak Run's Availability customers belies its declaration that every single customer bears an equal amount of the costs. (Aqua IB, p. 15.)

Although Aqua claims that all customers are equal causers of common costs (Id.), and that reducing allocations to the Woodhaven Divisions would cause inequalities (Id.) and be discriminatory (Id., p. 18), it has already set a precedent for deviating from its allocation methods by its treatment of Availability customers in other Associations. (Staff IB, p. 22.) Apparently, reducing the allocation of management expense constitutes preferential treatment (Aqua IB, p. 20) only when it affects the Woodhaven Divisions.

Staff did not propose that the Company change its allocation methodology for allocating management expenses, only that it modify the customer count allocation factors by weighting customers at each Woodhaven Division by one-half. (Staff IB, p. 25.) While other allocation factors were considered, the allocation factors selected by Staff are reasonable because: (1) Woodhaven is a campground and Woodhaven customers are permitted to use their properties only six months of the year, and (2) the Company has indicated that it would be willing to consider weighting Woodhaven customers in conjunction with a bulk billing agreement with The Woodhaven Association. (Id.)

Therefore, Staff's proposed adjustment is a reasonable way of mitigating the large adverse impact that the Company's change in allocation methodology had on the Woodhaven Divisions' revenue requirements and should be approved by the Commission.

## **5. Rate Case Expense**

### **a. Ahern Expense**

Aqua argues that all of the costs associated with its rate of return witness Pauline Ahern should be allowed because Ms. Ahern testified to her expert opinion in "good faith". (Aqua IB, pp. 29-31.) As stated in Staff's Initial Brief, Ms. Ahern's cost of equity analysis in this proceeding was simply an update of the same analysis she presented in Aqua's last two rate proceedings, Docket No. 03-0403 (Kankakee Division) and Docket No. 04-0442 (Vermilion Division). The Commission rejected her analysis in both of those dockets, yet Ms. Ahern did not address the specific concerns the Commission expressed regarding her analysis. In fact, the Commission rejected Ms. Ahern's cost of equity analysis in Docket No. 04-0442 because she did not present a convincing argument as to why the Commission's decision in Docket No. 03-0403 should not be followed. Ms. Ahern's continued reliance on methodology and arguments that the Commission has previously rejected was the basis for Ms. Freetly's proposal to disallow most of the rate case expense attributable to Ms. Ahern's cost of equity analysis. (Staff IB, pp. 27-30.)

Aqua also claims that because the Commission's decisions are not *res judicata*, the Company has the right to argue that the Commission should change its position on an issue, including return on investment. (Aqua IB, p. 30.) While Staff agrees that there

is nothing in the Act prohibiting Aqua from advancing a particular position no matter how unsound, Staff maintains that charging ratepayers for the continued advancement of a position that has been resoundingly and repeatedly rejected by the Commission is an affront to the Commission, its Staff, and the ratepayers.

Furthermore, Aqua misrepresents Staff's argument for disallowing most of Ms. Ahern's witness fees. (*Id.*, pp. 24-31.) Contrary to the Company's assertion, Staff did not argue that the Company should be prohibited from presenting and defending its own rate of return analysis. (Aqua IB, p. 24; Staff IB, pp. 28-30.) Also contrary to the Company's assertion, Staff did not suggest that Aqua should have relied on an old analysis that was put forward in a prior rate proceeding. (*Id.*) Contrary to the Company's assertion, Staff witness Freetly did not propose to disallow recovery of Ms. Ahern's fees because the cost of Ms. Ahern's analysis and testimony could have been avoided if Aqua had filed the rate increase requests for Oak Run and Woodhaven along with either of the larger Kankakee or Vermilion Divisions' recent rate proceedings. (Aqua IB, pp. 24-28; ICC Staff Exhibit 8.0, pp. 8-10.)

Rather, Ms. Freetly argued that ratepayers should not compensate a utility for the cost of expert testimony containing analyses that the Commission has consistently rejected as fundamentally unsound. In fact, Ms. Freetly's proposal would not foreclose the possibility of recovering witness fees for analyses the Commission has previously rejected if: (1) the specific concerns raised by the Commission in previous Orders are addressed, and (2) those arguments persuade the Commission to accept that witness' recommendations. (ICC Staff Exhibit 8.0, pp. 9-10.) Ms. Ahern's testimony did nothing to address the specific concerns the Commission expressed regarding her analysis.

Utilities have the right to present a cost of equity analysis using any methodology, including the use of previously-rejected techniques. However, all amounts that utilities wish to recover from ratepayers should be subject to tests of reasonableness, including consultants' fees. The adoption of Ms. Freetly's proposal would merely prohibit the utility from collecting from ratepayers costs incurred for the presentation of analyses that have been consistently and repeatedly rejected in past cases without some new, good-faith support for reliance on such analyses.

Therefore, Staff continues to recommend that the Commission disallow all but three percent of Ms. Ahern's fees attributable to her cost of equity analysis in the instant proceeding.

## **b. Rate Case Expense Recovery<sup>2</sup>**

### **(1) Economies of Scale**

Aqua has the audacity to argue that it would have cost ratepayers *more* if Aqua had filed the instant requests with its Kankakee or Vermilion Division requests. (Aqua IB, pp. 25-28.) In addition, the Company presents various and sundry numbers in an effort to convince the Commission that the customers of Oak Run and Woodhaven are better off with the instant rate request filings not being combined with that of a larger division.

In reality, there is no way to quantify a net benefit or net detriment of actions that did not occur. Aqua only considered the cost savings associated with its rate of return witness expense. Other cost savings should also have been considered in the analysis,

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<sup>2</sup> This section contains a discussion of outside counsel, GPM Associates, Aqua Rate Department, and miscellaneous rate case expenses, as indicated in the Administrative Law Judge's outline, in an effort to respond to Aqua's IB, which alters the provided outline.

such as the legal expense associated with the rate case. (Tr., p. 334.) However, Aqua claims that this is not correct as none of the issues in the instant proceedings are the same as those in either the Vermilion or Kankakee proceedings, and would thus have required incremental legal expense. (Aqua IB, p. 27.) However, one cannot say what issues would or would not have been raised if these cases had been filed with the Vermilion or Kankakee cases since the assigned Staff would not have been the same. Aqua's refusal to admit that there would be cost savings for the smaller divisions if rate requests were filed simultaneously with a larger division to obtain economies of scale defies logic and common sense.

Aqua further improperly maintains that "[t]he evidence demonstrates that Aqua lost money in each of these three Divisions during 2004." (*Id.*, p. 29.) As pointed out *supra*, 2004 was not the basis for the rate increase requests filed in these proceedings, is not relevant in this case, and does not represent utility operating income on which a revenue requirement is based.

Aqua misrepresents the rebuttal testimony of Jeffrey S. Hickey by stating that, "The WH Association asserts Aqua could have avoided its ROE witness expense if it had postponed these cases from December, 2004 until early 2006 when it intends to file its next rate case for Kankakee." (*Id.*, p. 28.) Mr. Hickey actually states that,

Prior to the Association intervening in this rate case, Aqua was planning to file a rate case for its largest division, Kankakee in 2005 and Woodhaven's rate cases could have been included as a part of that filing.

(Exhibit WA 2.0, p. 12.)

Aqua also misrepresents Staff, when it goes so far as to state that, “Staff has not even supported the position.” (Aqua IB, p. 29.) This is misleading. Staff witness Pearce testified that,

In response to Data Request BAP 1.04(a) (ICC Staff Exhibit 1.0, Attachment H), the Company indicated that the prior case benefited from greater economies of having been filed with the larger Kankakee and Vermilion Divisions, specifically:

Costs associated with cost of equity, rate of return, development of total company schedules, common expense and accounting issues, etc. applicable to all divisions consolidated under Docket 97-0351 resulted in the economies noted.

Because the instant proceeding was filed apart from the recent Kankakee filing and even more recent Vermilion filing, the customers of Oak Run Water, Woodhaven Water and Woodhaven Sewer Divisions will not benefit from economies of being included with a larger division. Thus, the requested level of rate case expense is unreasonably high.

(ICC Staff Exhibit 1.0, p. 23.)

Therefore, Staff urges the Commission to give considerable weight in its determination of the appropriate rate case expense for the instant proceeding to the economies of scale that could have been achieved had Aqua filed the instant rate requests with the request for one of its larger divisions.

## **(2) Prior Commission Action**

Aqua proclaims knowledge of what the Commission allows for rate case expense in future test years based on one Commission finding to be “a function of actual costs incurred plus a reasonable estimate of the costs that will be incurred through the conclusion of the case. *Consumers III. Water Co.*, Dkt. 99-0288, 2000 WL 34446603, slip op. at 16 (2000).” (Aqua IB, p. 31.) However, the Commission found otherwise in

Docket No. 93-0183, a rate case approving gas rates for Illinois Power Company based on the future test year 1984. In that rate case, the Commission stated:

The Commission has no reason to doubt IP's claim that rate case expense in excess of \$847,000 will be incurred. The Commission, however, agrees with Mr. Kerckhove that IP has not provided adequate support for the additional \$149,000 of rate case expense. While IP provided a breakdown of the \$996,000 total amount of projected rate case expense IP has not provided any itemization of the remaining \$149,000. The Commission concludes that Mr. Kerckhove's adjustment is reasonable and should be approved. (Docket No. 93-0183, Order, p. 39, entered April 6, 1984.)

As such, the Commission finding in Docket No. 93-0183 allowed recovery of actual costs incurred but did not provide recovery of costs that could not be itemized.

As support for its ever-increasing costs for outside legal expenses, Aqua improperly bases the remaining outside legal expense on the prior Vermilion case since "Vermilion is a reasonable case from which to estimate additional outside legal expense because it was Aqua's most recent rate case. It is the most reflective of the degree of work necessary to process a rate case before the Commission's current Staff, which as discussed *infra*, is conducting more extensive reviews...In fact, the number of issues raised has been relatively equal." (Aqua IB, p. 32.)

However, in reviewing the final Commission Order for Aqua's Vermilion Division, Docket No. 04-0442 entered April 20, 2005, the number of issues remaining to be litigated during the hearing and briefing stages of that proceeding far exceeded the number of issues remaining in the instant proceeding. The issues that had to be litigated in Docket No. 04-0442 consisted of the following:

- Overbudgeting of Payroll Expense
- Incentive Compensation
- Advertising Expense
- Charitable Contributions
- Management Fees/Collection Revenues

- Rate Case Expense
- Return on Equity
- Rate Design of the Customer Charge
- Rate Design of the Meter Rates (Teepak)

On the other hand, the only contested issues remaining in the instant proceeding are the following:

- Uncollectible Expense
- Allocation of Management Expense
- Rate Case Expense
- Amortization Period of Rate Case Expense
- Reverse Osmosis Plant–Oak Run Division

There are no contested issues regarding the Return on Equity or Rate Design in the instant proceeding. Therefore, one cannot draw the conclusion that the same level of outside legal cost would be appropriate for the two proceedings.

In addition, Aqua has innocently proclaimed that Staff “is conducting more extensive reviews”. (Aqua IB, p. 32.) This is incorrect. Aqua also states: “In fact, the number of issues has been relatively equal.” (Id.) However, the following is a comparison of the number of issues that were raised in the current case (for three divisions) and the prior case, Docket No. 04-0442 (for one division):

	<u>Current Case</u>	<u>04-0442</u>
Rate Base Issues	7	8
Operating Statement Issues	<u>8</u>	<u>17</u>
	15	25

The numbers do not deceive. The current case for three divisions has 15 contested issues, while the prior case for one division had 25 contested issues. The instant proceeding is not reflective of a more extensive review by Staff.

Therefore, Staff requests that the Commission deny Aqua's request to increase its original estimate for outside legal expenses and reject Aqua's proposal to trade off various components of rate case expense.

### **(3) Staff's Balanced Approach**

Aqua claims that Staff has proposed a one-sided approach by not considering rate case expense incurred in total rather than considering each of the components of projected rate case expense separately and setting a cap on recovery of each category to the original estimate. Aqua proposes that the incremental outside legal costs should be absorbed by the in-house Rate Department and miscellaneous expenses that were less than the original estimate. (Aqua IB, p. 34.) Staff maintains that each component should be considered separately as there should be some limit to what is prudently incurred as rate case expense. In fact, Staff withdrew its adjustment for outside legal expense in rebuttal testimony. (ICC Staff Exhibit 6.0, p. 14; Tr., p. 351.) As such, Aqua should not be allowed to make this a contested issue at such a late stage in the proceeding.

Aqua did not develop documentation to support its initial estimate of rate case expense. All that Aqua has provided are copies of actual invoices and now, in its Initial Brief, a poorly supported estimate for increased outside legal cost based on costs incurred in the Vermilion case. (Aqua IB, p. 32.) Without documentation to support the Company's original estimate for rate case expense, there is no basis to determine a reasonable level. Since the Company never provided documentation to show how Aqua developed its estimate of rate case expense, Staff did not have a basis upon which to evaluate the reasonableness of its estimate. By the time actual invoices supporting the

Company's original estimate were provided, there was insufficient time to review the documentation and formulate a position.

If the Commission were to allow Aqua to recover all outside legal costs through case completion, it would be as if the Commission were giving Aqua a credit card with the bill being charged to the ratepayers. There would be no incentive for the Company to be conservative in applying the minimum cost to achieve the result. Aqua would be rewarded for using outside legal counsel to perform tasks that could have been performed by Aqua's in-house Rate Department. For example, Aqua stated in its Initial Brief: "Aqua also used its outside legal counsel for miscellaneous-type activities, such as copying, postage, transcript fees and filings rather than handling those activities in-house." (Id., p. 34.) The cost for these services would have been far less if the services had been performed by Aqua's in-house Rate Department.

Aqua asserts that "[b]ecause Rate Case Expense is incurred during the case, it is never possible to project with certainty the degree to which each component will need to be relied upon." (Id.) Aqua conveniently forgets that it filed the instant rate requests with a 2005 future test year, in which none of the cost or revenue components are known with certainty. Everything contributing toward the revenue requirement is a projection. To true-up only one component to the actual cost incurred is without justification. If this rationale were applied to other components of the revenue requirement, it would not take long to find original estimates for other revenue and cost items that are overstated in the proposed revenue requirement based on more current information.

In addition, the Company alleges that it “had to rely on its outside witness Mr. David Monie to a greater degree than anticipated to respond to very time consuming rate design data requests and handle issues raised by Staff’s Schedule 9.01.” (Id.) However, Staff witness Harden only asked two questions regarding Oak Run rates (CLH 2.01-2.02) and four questions regarding Woodhaven rates (CLH 1.01-1.04). To state that Mr. Monie had to respond to very time consuming rate design data requests is sheer misrepresentation. In addition, Ms. Harden’s rebuttal Schedule 9.01 was not significantly different from her direct Schedule 4.01, to which Mr. Monie could have responded had he decided to file rebuttal testimony. Instead, he waited until surrebuttal testimony to advance an alternative method regarding billing determinants,<sup>3</sup> which caused Ms. Harden to be called to the stand three times during the evidentiary hearings in order to adequately address.

Aqua also claims that “[i]t estimates that it will incur an additional \$1,500 per Division for Mr. Monie’s testimony during the hearings and assistance on the briefs.” (Id., p. 35.) Mr. Monie attended the evidentiary hearings by telephone and was asked neither cross nor clarifying questions. The Company’s Initial Brief addressed no rate design issues since Aqua accepted Staff’s rate design proposal during the evidentiary hearings. (Id., p. 43.) As such, Aqua’s gross misrepresentations with respect to costs regarding its rate design witness should not be allowed to increase rate case expense.

Therefore, Staff recommends that the Commission adopt Staff’s balanced approach to rate case expense and not allow Aqua to trade off various components of rate case expense.

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<sup>3</sup> See Staff’s objection at the evidentiary hearings to the introduction of new substantive proposals in Mr. Monie’s surrebuttal testimony. (Tr., pp. 170-171.)

**c. Staff Recommendations Regarding Future Rate Case Filings**

Aqua proclaims that Staff's recommendations regarding future rate case filings should not be adopted because "Staff has not presented any basis to justify promulgating rules via a rate proceeding or applying the rules to Aqua alone. Its proposal is a clear example of discriminatory rulemaking." (Aqua IB, p. 36.) However, no Illinois utility besides Aqua employs the practice of having a rate case for one of its divisions before the Commission at any given time.

In Illinois-American Water Company's ("IAWC") most recent rate case filing, Docket No. 02-0690, IAWC simultaneously filed for an increase for nine of its ten divisions; and in the rate case prior to that, Docket No. 00-0340, IAWC filed a simultaneous rate increase for five of its divisions. Currently, IAWC is the only other utility under the jurisdiction of the Commission that has multiple divisions with separate rate structures. If IAWC is able to file simultaneous rate cases for multiple divisions, Aqua should be able to do the same.

The Commission has previously addressed the consolidation issue. In a rate proceeding filed by Northern Illinois Water Company, the Commission ordered:

IT is further ordered that Respondent shall consider consolidating future rate filings for its four operating divisions into a single filing, and in future filings shall include a study detailing the advantages and disadvantages of joint versus separate filings. (Docket No. 83-0397, Order, p. 11.)

(ICC Staff Exhibit 1.0, pp. 25-26.)

Staff witness Pearce proposed recommendations for Aqua regarding future rate case filings in an attempt to curb the rising rate case expenses for the Company's small divisions. The total requested rate case expense for the three divisions in the instant

proceeding increased 243%, or \$320,333, from \$131,442 to \$451,775, as summarized below:

	Rate Case Expense Per Customer	Current Rate Case Expense	Last Rate Case Expense	% Increase
Woodhaven Water	\$26.01	\$160,950	\$ 44,855	359%
Woodhaven Sewer	\$30.37	\$160,950	\$ 62,491	258%
Oak Run Water	\$49.95	<u>\$129,875</u>	<u>\$ 24,096</u>	<u>539%</u>
		<u>\$451,775</u>	<u>\$131,442</u>	243%

(Id., Attachment A.)

The Company's proposed rate case expense per ratepayer is unreasonably high. (Id., p. 21.) A comparison of the estimated rate case expense for the instant proceeding to the rate case expense for the most recent rate filings for the Kankakee and Vermilion Divisions shows that the costs of rate case expense per customer for each of the divisions in the current proceeding is more than double the cost of rate case expense for both the Kankakee and Vermilion Divisions. (Id., p. 22.) The cost per customer in the Vermilion Water Division in Docket No. 04-0442 was \$12.79, for a total rate case expense of \$220,740. The cost per customer in the Kankakee Division was \$8.44, for a total rate case expense of \$195,000. (Id., Attachment A, pp. 2, 3.)

When the Company was asked to explain the substantial increase in rate case expense, the Company responded that the increase was partially due to the fact that the prior cases benefited from greater economies of being filed with other divisions, including the Company's two larger divisions. (Id., pp. 22-23; Attachments C, D, and F.)

Staff recommended that the Commission put the Company on notice that it must be attentive to the cost for outside legal services in future rate filings. The higher cost of

having outside counsel with knowledge and experience in Commission proceedings should be weighed against any corresponding benefits, ideally producing efficiencies that offset the higher costs of such counsel and result in no overall increase in the cost to ratepayers. (Id., p. 15.)

Staff witness Pearce proposed three recommendations in an attempt to reduce rate case expense. The Company offered no solution to the rising costs except to say that Aqua did not need artificial incentives in the form of more regulations to maintain Rate Case Expense and that Staff's proposed rules simply are not needed. (Aqua IB, p. 38.) Clearly, Aqua must take action with respect to future rate filings to mitigate the rate case expense.

Therefore, Staff recommends that the Commission adopt Staff's recommendations regarding future Aqua rate case filings.

## **6. Amortization Period of Rate Case Expense**

Aqua continues to support a three year amortization of rate case expense for the Oak Run Water Division, based in large part on the fact it anticipates building a Reverse Osmosis Plant there in 2007. (Aqua IB, p. 39.) The Company will ask consumers to vote on whether to install the RO Plant, and it claims that there is a reasonable likelihood they will vote in favor of doing so. (Id.) According to Company witness Bunosky, the RO Plant would produce substantial water quality benefits that outweigh the additional rate increase that would be necessary to pay for the Plant. (Id.)

Aqua's view runs counter to the Oak Run Property Owners Association ("ORPOA") position that it is highly unlikely that ORPOA members will vote to approve the RO Plant because: (1) Most owners purchase lots solely for use of lake and other

facilities and are not permanent residents, (2) Half of permanent residents have already installed private reverse osmosis systems in their homes, and (3) Aqua has very poor customer relations in the community, which is hardly conducive to obtaining a positive vote for building the Plant. (ORPOA IB, pp. 4-5.) Additionally, given the 64% increase in rates proposed by the Company in this proceeding, it is doubtful the Oak Run ratepayers would be supportive of increasing those rates again within the next three years. (Staff IB, p. 45.) Due to the uncertainty about when, or ever if, the RO Plant will be installed, Staff recommends that the Commission reject three years as a reasonable period over which to amortize rate case expense for the Oak Run Water Division.

Aqua's additional rationale for proposing a three year amortization period for Oak Run and a four year amortization period for each Woodhaven Division, to capture the effects of inflation and capital projections that are routinely incurred so as to avoid any degree of rate shock that would result from longer intervals, is vague and unpersuasive. (Aqua IB, p. 39.)

Rate case expenditures are infrequent in occurrence and should be recovered over the period of time that the subject tariffs are reasonably anticipated to be in effect. (Staff IB, p. 48.) The prior rate case history of a utility is an objective method of determining the period of time the rates in the instant proceeding are likely to remain in effect in the absence of supportable evidence to the contrary. (*Id.*, p. 44.) Based on the average of time between the last two rate cases filed for each Division and the instant proceeding, Staff proposed a rate case expense amortization period of seven years for the Oak Run Water and Woodhaven Sewer Divisions (Docket No. 97-0351 and Docket

No. 91-0317) and an amortization period of five years for the Woodhaven Water Division (Docket No. 00-0338 and Docket No. 95-0641). (*Id.*, pp. 44-46.)

Therefore, Staff recommends that the Commission accept Staff's proposed rate case expense amortization periods as reasonable alternatives to the Company's proposals.

#### **7. State and Federal Income Tax Calculation Errors**

Staff addressed the Company's concerns regarding state and federal income tax calculation errors in its Initial Brief. (Staff IB, pp. 49-50.) The remaining differences between the Company's calculations of income taxes as described in Aqua's Initial Brief at page 40 and the income taxes reflected in Appendix B (WW), (WS), and (OR) attached to Staff's Initial Brief are due to the fact that the Company did not use the correct state income tax rate of 7.30% in its rate case filing.

#### **8. Alleged Staff Revenue Requirement Calculation Error**

Aqua is correct in stating that there are no revenue requirement adjustments *per se* associated with this issue. (Aqua IB, p. 41.) The Company is simply unhappy with the revenue change and percent of revenue change, which are for informational purposes only, presented on lines 26 and 27 of Appendix B (WW), (WS), and (OR) attached to Staff's Initial Brief. Whether the Total Operating Revenue on Staff's proposed revenue requirement schedule for each Division is compared to the Company's Direct Pro Forma position or to the Company's Rebuttal Pro Forma position is a matter of preference. Because neither presentation affects the dollar amount of Staff's proposed revenue requirement, Staff does not oppose a change should the

Commission's preference for calculating the revenue change and percent of revenue change align with the Company's.

**D. Recommended Operating Incomes/Revenue Requirements**

For the reasons discussed above, Staff recommends that the Commission reject Aqua's proposed operating revenues and expenses (Aqua IB, Appendix A, Schedules 8.01 (OR), (WW), and (WS)). Instead, for purposes of developing rates in this proceeding, Staff recommends that the Commission adopt a revenue requirement of \$1,110,407 for Woodhaven Water Division, \$991,006 for Woodhaven Sewer Division, and \$486,994 for Oak Run Water Division, as set forth in Appendix B attached to Staff's Initial Brief.

**IV. COST OF CAPITAL/RATE OF RETURN**

Aqua has accepted all of Staff's proposals regarding cost of capital/rate of return for purposes of this proceeding. (Aqua IB, p. 43.) Staff does not disagree.

**V. COST OF SERVICE; RATE DESIGN; TARIFF TERMS AND CONDITIONS**

Aqua has accepted all of Staff's rate design proposals in this proceeding. (Aqua IB, p. 43.) Staff does not disagree.

**VI. CONCLUSION**

WHEREFORE, for all the reasons set forth in its Initial Brief and this Reply Brief, Staff respectfully requests that the Commission's Final Order in this proceeding reflect Staff's recommendations and proposed rates for and modifications to the Company's

proposed general increase in water and sewer rates for its Woodhaven Water, Woodhaven Sewer, and Oak Run Water Divisions.

Respectfully submitted,



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