STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Aqua Illinois, Inc.	)	
	)	
Proposed General Increase for Water and Sewer Rates for the Woodhaven Division	)	Docket No. 05-0071
	)	
	)	
Proposed General Increase for Water Rates For the Oak Run Division	)	Docket No. 05-0072
	)	

REPLY BRIEF OF AQUA ILLINOIS, INC.

Dated: September 6, 2005

Attorneys for Aqua Illinois, Inc.:

John E. Rooney
Sarah N. Galioto
Sonnenschein, Nath & Rosenthal
233 S. Wacker Drive
Chicago, Illinois 60606
312-876-8000
jrooney@sonnenschein.com
sgalioto@sonnenschein.com

TABLE OF CONTENTS

Page

Introduction 1

Argument 4

I. Rate Base 4
   A. Reverse Osmosis ("RO") Plant Pilot Study – Oak Run 4
   B. Sewer Installation Costs – Woodhaven Sewer 4
      1. 1998 Sewer Main Extension And Lift Station Project 4
      2. Sewer Service Extensions 5

II. Operating Revenues And Expenses 5
   A. RO Plant – Oak Run 5
   B. Uncollectible Expense 8
      1. Response To Staff - All Three Divisions 8
         a. Staff's Arbitrary Limitation To Write-Offs Is Inappropriate 9
         b. Aged Receivables Support Bad Debt Expense 11
      2. Response to ORPA - Oak Run Division 12
      3. Response to WH Association - Woodhaven Divisions 13
         a. There Is No Evidence That Aqua Does Not Know What Collection Efforts To Take On Past Due Accounts 13
         b. A Bulk Billing Solution Cannot Be Required 15
   C. Allocation of Management Expense – Woodhaven Divisions 16
      1. Customer Count Is The Fairest Method 18
      2. Customer Count Is More Appropriate Even Though It Allocates More To The Woodhaven Divisions 20
      3. There Is No Basis To Grant Woodhaven Customers Preferential Treatment 21
      4. Woodhaven Customers Drive Greater Than Average Costs 23
      5. The WH Association Advances Red Herrings 25
         a. The WH Association Misleadingly Mixes Concepts Of Shared Direct And Common Costs 25
         b. It Is Not Proper To Track Common Costs 26
         c. The Association's Claim That Only Half The Customers Exist In The Woodhaven Divisions Is Meritless 28
      6. If The Commission Adopts Reduced Allocations, They Should Be Applied To 2005 Test Year Levels And Costs Should Be Reallocated To Other Divisions 29
      7. The WH Association's Claim To Reduce Transportation Expense Should Not Be Considered 30
   D. Rate Case Expense 31
      1. Expense for Aqua's ROE Witness Ms. Ahern 31
         a. There Is No Basis To Disallow Aqua's ROE Expense For Not Combining These Filings With Kankakee Or Vermilion 32
         b. Ms. Ahern Is A Highly Qualified Expert 33
      2. Aqua's Original Rate Case Expense Projections Are Fully Supported 36
         a. Staff Arguments Addressed On Interlocutory Review Should Be Rejected 39
         b. The Commission Must Take A Fair And Balanced Approach 39
         c. Response To Associations On Rate Case Expense 42

3. Staff Recommendations Regarding Future Rate Case Filings 43
E. Amortization Period Of Rate Case Expense 46
F. State and Federal Income Tax Calculation Errors 48
G. Staff Revenue Requirement Calculation Error 48
H. New Claim From WH Association That Should Be Stricken 50
I. Staff's Request For Admonishment 51

Conclusion 51

INTRODUCTION

Aqua demonstrated in its Initial Brief that its 2005 test year levels of Operating Expenses are both just and reasonable, and fully supported, especially with regard to the main issues of Bad Debt Expense, the allocation of Contractual Services - Management Expense, and Rate Case Expense. Aqua is legally entitled to recover its reasonable Operating Expenses in their entirety and to earn a fair return on its investment. *Commonwealth Edison Co. v. Department of Local Gov't. Affairs*, 85 Ill. 2d 495, 500 (1981); *Illinois Bell Tele. Co. v. ICC*, 414 Ill. 275, 286 (1953). The Commission should, therefore, grant Aqua revenue increases sufficient to do so based on Aqua's Surrebuttal Statements of Operating Income for each of the Divisions. (Aqua Ex. 8.0, Sch. 8.1 (OR), (WW) & (WS)).

Staff's Initial Brief does not present any compelling reason for the Commission to do otherwise. Rather, Staff proposes significant reductions to Aqua's Operating Expenses that disregard substantial evidence and are inconsistent with directives from the General Assembly and the Commission's prior decisions. In particular, on the issue of Bad Debt Expense, Staff improperly limits its analysis to average historical write-offs despite the fact that Aqua cannot write-off substantial amounts of uncollectibles in each of the Divisions. On the allocation of Contractual Services - Management Expense, Staff wrongly seeks to grant the Woodhaven Divisions preferential treatment although there is no relevant basis to them and the General Assembly has directed that the cost of providing service be borne by the cost causer. 220 ILCS 5/1-102(d)(iii). On Rate Case Expense, Staff proposes unilateral adjustments that disregard Aqua's actual expenses, which the Commission has relied on before, (s*ee e.g.*, Kankakee Order, Dkt. 03-0403, pp. 21-22), for reasons the Commission has already rejected. And it proposes amortization periods based solely on historical intervals rather than evidence as to when Aqua

will most likely file its next rate cases. Overall, therefore, Staff's positions are not reflective of the fair and balanced ratemaking that the Commission is required to perform. *See e.g., Bus. & Prof'l People for the Pub. Interest v. ICC*, 146 Ill. 2d 175, 208 (1991)("*BPPI*"). If adopted, Aqua would not recover its legitimate Operating Expense in full or earn a fair return on its investments.

Neither the Woodhaven Association ("WH Association") nor the Oak Run Property Owners Association ("ORPA") (collectively the "Associations") provide credible support for any adjustments. Both admit they relied on Staff rather than conducting any rate case analyses themselves. (WH IB, p. 6; ORPA IB, p. 2). As such, both advance baseless "concerns" that are founded on improperly drawn inferences, and reflect only their own biased interests. None of their positions should be adopted.

In fact, rather than present rate case analyses, both Associations attempt inappropriately to misdirect attention away from the relevant operating characteristics of the Divisions at issue and instead look to the profitability of Aqua's parent company. However, the operating utilities must recover their Operating Expenses and earn a fair return themselves—Aqua's parent company is not required to subsidize their cost of providing service. In fact, the ALJ has already recognized the irrelevancy of information related to the parent company by striking portions of Mr. Davison's testimony. (*See* Tr., pp. 273-75, 278).

Both Associations also seek to incorrectly portray the service areas as somehow "unique." The WH Association says the Woodhaven Divisions have primarily "campers" and the ORPA says Oak Run is "unusual" in the degree of "recreational" property owners. (WH IB, p. 4; ORPA IB, p. 1). Such characteristics, however, do not make these areas "unique" for purposes of ratemaking or in any way deserving of special treatment on Rates. With the

exception of any direct cost savings from decreased usage, which are passed on directly to the Divisions, the record demonstrates that it costs just as much to supply water and sewer service to these areas regardless of whether the end uses are recreational/property owners. (*See e.g.*, Tr., pp. 116-17 (Mr. Bunosky stating that Woodhaven customers "are just like every other customer that we have."), Tr., p. 124 (stating that all common costs are still incurred even if a customer does not use the service)). And, by virtue of the individuals owning campsites and "recreational" properties, it is clear they are largely able to afford second home, vacation-type properties. Individuals who can afford such a luxury should not be subsidized by Aqua or other ratepayers. Such a subsidization is contrary to the General Assembly's directive that all cost causers bear the cost of service, the Woodhaven and Oak Run Divisions included. 220 ILCS 5/1-102(d)(iii).

The ORPA also attempts to prejudice the Commission against granting Aqua proper rate increases by stating that it is "concerned" about the overall level of rates. However, the sole basis for its "concern" is a comparison to what are primarily public or municipal systems. (ORPA IB, p. 2). Such systems are subsidized and, thus, their rates are not representative of those charged by regulated utilities. (Aqua Ex. 7.0, p. 4). Of the few private systems included in its comparison, the rates the ORPA identifies are old. (*Id.*, pp. 4-5). Contrary to the ORPA's misrepresentative claim, rates in the Oak Run Division are and will continue to be very low following this case. (*Id.*, pp. 1-2).

Aqua witness Mr. Bunosky explained that each operating entity's rates must be set based on its own characteristics, *i.e.*, operating expenses, capital investments, etc. (*Id.*, p. 5). In these cases, each of the Divisions lost money in 2004. (Aqua Ex. 5.0A2, p. 14; Aqua Ex. 7.0R, p. 12). Despite the Associations' misdirected and foundationless attempts to assert otherwise, it is clear that rate increases are needed.

The WH Association, moreover, improperly raises new issues and factual allegations in its Initial Brief. Doing so is highly improper because Aqua had no opportunity to address them in the evidentiary record. All such newly alleged issues and facts should be stricken or, at a minimum, must not be considered or accorded any weight.

Accordingly, for these reasons as discussed more fully herein, Aqua respectfully requests that the Commission adopt revenue increases based on the Company's Surrebuttal Statements of Operating Income for each of the Divisions.

ARGUMENT

I. RATE BASE

A. Reverse Osmosis ("RO") Plant Pilot Study – Oak Run

All parties are in agreement that the expenses Aqua incurred in conducting the pilot study and preparing the engineering plans for the RO Plant should not be included in Plant in Service.[1] Aqua has, therefore, already removed these expenses from Plant in Service in its Schedules. The proper treatment of these costs as Operating Expenses is discussed below. (*See infra*, §II.B.1).

B. Sewer Installation Costs – Woodhaven Sewer

1. 1998 Sewer Main Extension And Lift Station Project

Aqua has included $184,207 paid by the WH Association for this project in Customer Advances that have been deducted from Rate Base. (*See* Aqua IB, p. 4). Aqua agrees to an additional adjustment of $21,623 to increase the current amount in Customer Advances for this project to $205,830 based on additional research which has revealed this $21,623 payment so

[1] Aqua agreed that these expenses should not be included in Plant in Service within the portion of Mr. Schreyer's Amended Rebuttal Testimony that Staff moved to strike and the ALJ granted. Aqua is still confused why Staff would move to strike amended testimony that brought the parties' into agreement on this issue. Irrespective, because Aqua is in agreement, it is not contesting that these expenses be removed from Plant in Service.

referenced in the WH Association's Initial Brief. The $216,230 suggested by the WH Association in its Initial Brief fails to account for refunds subsequently paid to the Association in 1999 per AQUA CROSS EXHIBIT 1, however. Woodhaven Sewer Customer Advances should be adjusted to $205,830.

2. Sewer Service Extensions

Consistent with Aqua's position, Staff explained in its Initial Brief that Aqua accounts for sewer service extensions correctly. (Staff IB, pp. 21-22). The WH Association does not address the issue in its Initial Brief. The Commission should decide this issue in Aqua's favor.

II. <u>OPERATING REVENUES AND EXPENSES</u>

A. RO Plant – Oak Run

As noted *supra*, Aqua has not included the capital investment incurred to date toward the RO Plant in Plant in Service. Further, Aqua and Staff agree that these expenses should be included in Account 183, Preliminary Survey and Investigation *if the Commission agrees that the likelihood the RO Plant will be built is reasonably certain*.[2] If the Commission disagrees that the RO Plant will be built, then it is appropriate to amortize the $68,180 over a ten year period to Account 675, Miscellaneous Expense. (Aqua Ex. 6.0R, p. 42). Staff witness Jones cites the Uniform System of Accounts for Water Utilities that "[i]f 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 Ex. 2.0, p. 7). The Company believes that any amortization resulting from a determination by the Commission that

[2] In such case, the Commission should also grant Aqua's proposed three year amortization period for Oak Run. (*See infra*, Sec. II.B.6).

the necessary and therefore prudent RO – related expenditures will never go into service should be to Account 675, Miscellaneous Expense.

The ORPA, nonetheless, requests that the pilot study expense[3] be removed from Aqua's revenue requirement entirely. (ORPA IB, pp. 3-5). Staff has not supported this position. Nor is the position supported by the evidence.

The sole basis for the ORPA's position is Mr. Davison's opinion that customers in the Division are not likely to vote in favor of building the RO Plant. However, Mr. Davison does not know in fact that they will not. And the reasons for his opinion are all flawed. First, he claims that availability customers will not want to pay for the RO Plant. (ORPA IB, p. 5). But, based on Staff's reduced rates for those customers in this case, they are more likely to vote in favor of the Plant, especially since they may decide to tap onto the system and the improved water quality would increase their property values. (Aqua Ex. 7.0, p. 15). Second, Mr. Davison claimed that approximately 50% of the 600 permanent Residents have installed private RO systems, although he provided no support for his claim. (ORPA IB, p.5). (Aqua Ex. 7.0, p. 17). Even if they have, however, the RO Plant would still provide those customers substantial benefits because it would treat the entirety of their water supply whereas private systems only treat a limited supply. (Tr., pp. 151-52). Further, the fact consumers install private RO systems indicates the high value they place on the improved water quality. (Aqua Ex. 7.0, p. 17). Third, Mr. Davison claims that customers will not vote for the RO Plant because of alleged "animosity" to Aqua. (ORPA IB, pp. 5-6). This claim is pure speculation. Mr. Davison cannot know how all the customers in the area feel on the issue. Irrespective, it would not be logical for customers to hurt themselves by voting against the RO Plant and its water quality benefits simply to spite

[3] The ORPA only contests Aqua's recovery of the $35,222 pilot study expenditures. It does not contest the recovery of the $32,958 in investment to prepare the engineering plans.

Aqua. (Aqua Ex. 7.0 pp. 17-18). Accordingly, the reasons Mr. Davison relies upon do not support his opinion that consumers will vote against installing the RO Plant. (*Id.*, pp. 1-5, 14-19).

Moreover, in Mr. Bunosky's opinion, consumers are likely to vote in favor of the RO Plant because of the substantial water quality benefits the plant would bring. (Aqua Ex. 5.0A2, pp. 2-5). An RO Plant would bring water quality into compliance with the IEPA's secondary and health industry standards for Fluoride, Total Dissolved Solids, Sodium and Chloride. (Aqua Ex. 5.0A2, pp. 3-4). Mr. Bunosky explained that these benefits far outweigh the incremental costs associated with the RO Plant. (*Id.*) Mr. Davison does not even consider the Plant's substantial water quality benefits as part of his analysis.

Most importantly, however, the larger majority of consumers have already expressed an overwhelming opinion in favor of the RO Plant. (Tr., pp. 131-32). This feedback was provided in response to a customer survey Aqua conducted during the pilot study. (*Id.).* It is the only true feedback across the entire customer base that is available. It supports Mr. Bunosky's opinion that the consumers will vote to install the RO Plant rather than Mr. Davison's opinion that they will not. Because it is direct feedback from the very consumers who will vote on the RO Plant, it is highly reliable and should be the basis for the Commission to conclude that the Plant will most likely be built in 2007.

Accordingly, the evidence supports that Aqua acted prudently in conducting the pilot study. Even if consumers ultimately do not vote in favor of the Plant, although all indications are that they will vote in favor, it is appropriate for Aqua to work toward water quality improvement. The Commission should allow Aqua's recovery of its pilot study expense.

B. Uncollectible Expense

Aqua cannot presently write-off substantial portions of uncollectibles in each of the Divisions. (*See* Aqua IB, pp. 7-12). Historical write-offs, therefore, cannot fully predict Aqua's future test year amounts of Bad Debt Expense. (*Id.*) In order for Aqua to fully recover this expense, as it is legally entitled, a method other than historical write-offs needs to be used *in addition* to account for the amount that Aqua cannot write-off. Aqua used its reserve against aged receivables greater than 91 days as the basis to predict the amounts of Bad Debt Expense it is unable to write-off. (*Id.*) No party disputed the validity of these amounts.[4] Accordingly, Aqua's proposed Bad Debt Expenses are fully supported by historical write-offs *plus* Aqua's reserve against aged receivables greater than 91 days for those amounts Aqua cannot write-off. For Oak Run, Aqua's pro forma proposed Bad Debt Expense is $7,385. For Woodhaven Water and Sewer, its test year amounts are $53,148 and $53,724 and its surrebuttal pro forma proposed amounts are $85,279 and $82,576, respectively. (*Id.*).

Indeed, for Woodhaven Water and Sewer, while the evidence shows Aqua would incur $103,394 and $112,174 annually in Bad Debt Expense at its originally proposed rates, it only included $53,148 and $53,724 in its test year for the Divisions. This is a windfall to Woodhaven customers because Aqua will bear the difference. The Commission should recognize this as a very significant compromise. (*Id*, pp. 9-12).

1. Response To Staff - All Three Divisions

Staff, nonetheless, proposes that the Commission substantially reduce Aqua's already compromised recovery. It proposes the Commission do so by arbitrarily limiting Bad Debt

[4] The WH Association claimed the number of delinquent customers in the Woodhaven Divisions was different but it *never* disputed the accuracy of the dollar amounts past due. (Aqua Ex. 7.0R, p. 23).

Expense recovery to amounts based on Aqua's historical write-offs. (Staff IB, pp. 19-20). Staff does not present any evidentiary or legal basis to support such a limitation on Aqua's recovery. Instead, it attempts unsuccessfully to discredit the use of aged receivables to predict Bad Debt Expense that cannot be written-off. For the first time in its Initial Brief, Staff asserts that the use of aged receivables is "highly unorthodox" and irrelevant. (*Id.*, p. 19). No Staff witness testified to this effect during the evidentiary phase. Staff cites no case law in support, either. Staff's position, therefore, lacks foundation and should not be adopted.

a. Staff's Arbitrary Limitation To Write-Offs Is Inappropriate

Sole reliance on historical write-offs is insufficient to predict Bad Debt Expense for these Divisions because, as noted, Aqua cannot write-off substantial portions of the uncollectibles in these Divisions. (*See*, Aqua IB, pp. 7-12). Historical write-offs do not account for *any* amount of Bad Debt Expense that Aqua cannot presently write-off. (*Id.*) As such, a method other than the review of historical write-offs is necessary to accurately predict Aqua's entire amount of Bad Debt Expense for the Divisions.

As will be discussed *infra*, Staff attempts unsuccessfully to discredit Aqua's use of aged receivables to predict the portion of Bad Debt Expense that cannot be written-off; however, Staff did not propose an alternative method for making such a prediction. Instead, Staff simply disregards the portion of Aqua's Bad Debt Expense that cannot be written-off—*i.e.*, it proposes that Aqua be required to forego recovery of a large portion of Bad Debt Expense simply because Aqua cannot write-off the amount. This is not a reasonable position.

The Commission must have a reasonable evidentiary basis to justify its decisions. *People ex re. O'Malley v. ICC*, 239 Ill. App. 3d 368,376 (1993) *citing Illinois Bell Tele. Co. v. ICC*, 203 Ill. App. 3d 424, 433 (1990). However, Staff did not introduce evidence or even attempt to

explain why it would be appropriate to limit Aqua's recovery of Bad Debt Expense to amounts that can be written-off. The record is *devoid* of any such evidence or explanation. As such, there is no foundation upon which the Commission could rely to limit Aqua's recovery to amounts that can be written-off.

Indeed, Staff's reasoning is entirely circular. Staff witness Ms. Pearce simply asserted that Aqua's Bad Debt Expense recovery should equate to average historical write-offs because that is what the write-offs are. (Staff IB, p. 19 (*citing* Staff Ex. 6.0, pp. 6-7)). However, write-offs do not equate to Bad Debt Expense. (*See* e.g., Staff Ex. 6.0, Sch. 6.10 (Staff calculating total Bad Debt Expense and Actual Write-Offs separately)). Ms. Pearce's testimony, therefore, does not explain why Aqua's recovery should be limited to write-offs.

Rather, it shows that Staff is improperly substituting write-offs for actual Bad Debt Expense. While Ms. Pearce calculated both total Bad Debt Expense and Actual Write-Offs, she proposes that Aqua recover an amount equivalent to the Actual Write-Offs rather than the total Bad Debt Expense she calculated. (*Id.*, Sch. 6.09). Such an apples for oranges substitution is improper.

Accordingly, because Aqua can presently write-off only limited uncollectibles, a method in addition to historical write-offs needs to be used to accurately predict Aqua's full Bad Debt Expense. There is not a rational basis for the Commission to adopt Staff's limitation to actual write-offs, which disregards the portion of Bad Debt Expense that Aqua presently cannot write-off. Like any other Operate Expense, Aqua is entitled to recover its total Bad Debt Expense, not only that portion that can be written-off. *Commonwealth Edison*, 85 Ill. 2d at 500; *Illinois Bell Tele. Co.*, 414 Ill. at 286. The Commission, therefore, should allow Aqua's full recovery.

b. Aged Receivables Support Bad Debt Expense

Staff attempts to discredit Aqua's use of aged receivables greater than 91 days by making a sweeping generalization that is entirely unsupportable and *nowhere in the record*. It claims without foundation that relying on *undisputed* evidence of aged receivables somehow "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). No witness, however, testified to this effect nor does Staff cite any case law for its proposition. The Commission cannot adopt Staff's broad assertion as a finding because it is not in the record.

Initially, Staff's assertion exhibits the fact it is mixing apples with oranges. Staff stated, again, that aged receivables "bear no relationship to the … ability to predict future write-offs." (Staff IB, p. 19). However, the amount that Staff should be predicting is future Bad Debt Expense, not future write-offs. The two are not the same, as noted above. Staff's statement that it is predicting future write-offs instead of Bad Debt Expense shows the fatal flaw in its analysis.

Further, despite Staff's assertion otherwise, the use of aged receivables to support Bad Debt Expense is appropriate. Aqua witness Mr. Schreyer testified that the *cause* of Bad Debt Expense is the actual account holders that do not pay, and that the amounts past due greater than 91 days are the amounts that "are not likely to be collected." (Aqua Ex. 6.0R, p. 8; Aqua Ex. 8.0, p. 9). He also explained that the identities of the actual account holders remain fairly constant over time. (Aqua Ex. 6.0R, p. 8). *No party disputed this evidence*. Thus, the evidence shows that aged receivables greater than 91 days do bear a direct relationship to Bad Debt Expense and, because the identity of account holders remains fairly constant, the use of aged receivables is a highly precise method for predicting future Bad Debt Expense.

In fact, because Aqua is using a 2005 test year, its current aged receivables will be an extremely accurate predictor of test year Bad Debt Expense. Aqua has submitted its actual 2005 aged receivables as they are being incurred. For Oak Run availability customers, Aqua's aged receivables totaled $14,487 as of June 15, 2005. (Aqua Ex. 6.0R, p. 6). For Woodhaven Water and Sewer customers, on a combined basis, aged receivables were $451,991 as of May 31, 2005, and an additional $192,480 were on the verge of becoming more than 91 days past due. (Aqua Ex. 8.0, pp. 10-11, Ex. C). It would be highly unlikely for this factual scenario to change in any material way between May and June 2005, and December 2005.

Accordingly, Aqua's aged receivables greater than 91 days demonstrate unquestionably the amount of Bad Debt Expense Aqua is likely to incur in the 2005 test year. They demonstrate, moreover, that Aqua is incurring actual Bad Debt Expense in the Woodhaven Divisions that is substantially more than the test year amounts it seeks to recover. There is no basis in the record for the Commission to disregard this evidence. It should allow Aqua's full recovery of the pro forma proposed Bad Debt Expense amounts set forth in Aqua Sch. 8.01 (OR), (WW) & (WS).

2. Response to ORPA - Oak Run Division

The ORPA adopts Staff's position entirely so it should be rejected for the same reasons. (ORPA IB, pp. 6-7). The ORPA, however, makes two incorrect comments with regard to Aqua's position. First, it asserts that Aqua is seeking a 1,500 percent increase. Second, it claims that Aqua is supporting its requested increase on its experience in the Candlewick Division. (*Id.*) The ORPA's first assertion is yet another example of how percentages are misleading in that when the dollar amounts at issue are small even a small increase will represent as a large percentage. (Aqua Ex. 5.0A2, p. 5). Irrespective, these comments are incorrect because they address Aqua's original position. Aqua set forth an amended position in its Rebuttal case.

(Aqua Ex. 6.0R, p. 6; *see also*, Staff IB, p. 19 (noting that Aqua amended its position)). The ORPA's comments, therefore, are not relevant or material.

3. Response to WH Association - Woodhaven Divisions

The WH Association does not seek an adjustment of Aqua's Bad Debt Expense. Rather, it alleges that the Commission should implement a bulk billing option because Aqua allegedly does not know how to address the uncollectibles problem in the Divisions. (WH IB, pp. 7-9). This proposal lacks evidentiary and legal bases. As such Staff has not supported the Association's position. The Commission should not adopt the bulk billing option.

a. There Is No Evidence That Aqua Does Not Know What Collection Efforts To Take On Past Due Accounts

The WH Association advances this claim as the basis to establish an alleged need for the bulk billing option. But, because there is no evidentiary or legal basis for the Commission to implement the bulk billing option, it is not necessary for the Commission to reach the issue. The Commission should decline to render an advisory opinion on the issue. *See*, 83 Ill. Adm. Code §200.220 (Commission's Rules on declaratory orders are limited); *Harrisonville Tele. Co. v. ICC*, 176 Ill. App. 3d 389, 392 (1988)(Commission does not have general authority to render advisory opinions).

However, if the Commission does reach the issue, the record is replete with evidence of the significant efforts toward uncollectibles that Aqua has taken in the Divisions. (Aqua Ex. 5.0A2, pp. 15-19, Att. A; Tr., pp. 80-84, 120). The actions are geared toward inducing payment by making it easier as well as the more traditional efforts geared toward collecting on already delinquent accounts. (*Id.*) Aqua employs its various collections options on an account-by-account basis and escalates from the lower cost options of sending collections letters and

filing liens to the more cost-intensive efforts. (*Id.*) It only uses the latter if the information demonstrates that the amount likely to be collected outweighs the cost of the collection effort itself. (*See e.g.*, Aqua Ex. 5.0A2, p. 16 (describing the factors considered before installing a shut-off valve)).

The WH Association did not present any analysis from which it could be concluded that it would be cost-beneficial for Aqua to pursue any other type of action. Instead, it draws several, unsupported inferences. None would be a legitimate basis for the Commission to find that Aqua has not implemented appropriate collections efforts.

First, the WH Association asserts incorrectly that Aqua has admitted it "does not know how to deal" with collections in the Divisions. (WH IB, p. 8). The Association cites a statement from the CFO of Aqua's parent company expressing aggravation with the fact some availability customers do not pay their bills. The statement does not pertain to or even mention the problem with uncollectibles in the Woodhaven Divisions, which do not have any availability customers.

Second, the Association alleges that of the 536 delinquent water and sewer accounts as of May 31, 2005 (*see* Aqua Ex. 8.0, Ex. C), "*only* 60 have been turned off for non-payment." (WH IB, p. 8 (emphasis added)). Initially, this is a misrepresentation of the evidence. Mr. Bunosky testified that Aqua has turned off "*over* 60 customers for non-payment." (Aqua Ex. 5.0A2, p. 17). Further, the Association did not present any evidence that Aqua should have turned off *more* than the "over 60 customers" that Aqua has turned off. In fact, the evidence is clear that Aqua *cannot* turn off service to *any* sewer customers. (Tr., p. 133 (Mr. Bunosky explaining that it would create an environmental hazard if sewer service were turned off)).

Third, the WH Association alleges that Aqua does not know whether it installed shut-off valves on the two most delinquent accounts. (WH IB, p. 8). Once again, this misrepresents the

evidence. Mr. Bunosky was asked whether shut-off valves have been installed on these accounts while on the witness stand. Subject to check, he responded that he believed there had been. (Tr., p. 85). If the WH Association wanted an answer that was not "subject to check" with regard to the specific actions Aqua has taken on the 536 delinquent accounts, it should have submitted a data request so that Aqua could have referred to its records to respond.

In conclusion, therefore, Commission can decline to reach this issue. But, if it does, it should find that the WH Association did not present any credible evidence that Aqua has not taken appropriate action to deal with uncollectibles in the Divisions. It has not identified even a single action that Aqua should have taken but did not take. To the contrary, the record is clear that Aqua has implemented all appropriate collections efforts and, in fact, has worked with the WH Association on the collections efforts for years. (Aqua Ex. 5.0A2, pp. 15-21). Throughout the course of such efforts, the WH Association has never even suggested that Aqua should be taking any actions other than the ones it already has. (*Id.*, p. 19). To the extent it reaches the issues, the Commission should find accordingly.

b. A Bulk Billing Solution Cannot Be Required

Aqua believes bulk billing could be a good solution to the Divisions' uncollectibles problem. However, the Commission does not have the legal authority to implement the option and, even if it did, there is no evidentiary foundation from which it could do so. (Aqua IB, pp. 13-14). Staff agrees there is no evidentiary basis for the option. (Staff IB, p. 21).

The WH Association inappropriately tries to create a factual basis for the option *for the very first time* in its Initial Brief. It sets forth a whole group of Aqua's expenses that it alleges would somehow disappear under bulk billing and asks the Commission to disallow Aqua's recovery by implementing the option. (WH IB, pp. 10-11). None of these alleged expense

reductions are in the record. The WH Association even admits they "have not been specified." (*Id.*, p. 2). *These allegations should be stricken or, at a minimum, not considered*. Aqua respectfully requests this relief.

The WH Association failed to set forth in the record any basis for the Commission to implement a bulk billing option. It cannot do so now via its Initial Brief. Accordingly, there is no evidentiary basis or legal authority for the Commission to adopt the option.

C. Allocation of Management Expense – Woodhaven Divisions

Customer count is the fairest way to allocate Contractual Services - Management Expense. These are common costs incurred at the Illinois corporate and Aqua America, Inc. parent corporate levels in the overall operation of all divisions. (Tr., pp. 122-23). They are driven *equally* by all customers and benefit all customers. (Tr., pp. 149-50). The customer count method assigns an *equal* amount of the costs to each customer. (Tr., p. 128). This is the fairest way to allocate common costs that all customers cause equally.

It is, furthermore, the way the General Assembly intends costs to be allocated. The General Assembly is clear that it intends all costs to be borne by the cost causers. In relevant part, it expressly stated in Section 1-102 of the Public Utilities Act as follows:

> It is further declared that the goals and objects of such regulation shall be to ensure … Equity: the fair treatment on consumers and investors in order that … *the cost of supplying public utility services is allocated to those who cause the costs to be incurred*.

220 ILCS 5/1-102(d)(iii)(emphasis added). As such, the General Assembly has directed that it is "fair" for all customers to bear the cost of their own service. The General Assembly does not intend for customers in one division to subsidize the cost of providing service to customers in another. Because the customer count method assigns an equal share of common costs to all

customers who are equal causes of the costs, it fully accomplishes the General Assembly's intended result that cost causers bear the cost of the service.

Therefore, Aqua's equal allocations of Contractual Services - Management Expense to all customers,[5] including those in the Woodhaven Divisions, are just and reasonable. They are the fairest allocations by definition of the General Assembly's intent that all customers bear their own costs. Aqua's allocations to the Woodhaven Divisions should be approved.

Nonetheless, both Staff and the WH Association assert that Woodhaven customers should not pay equal shares of these common costs.[6] Their positions primarily rest on the fact that allocations to Woodhaven customers are more under a customer count than a rate base method. (Staff IB, pp. 23-25; WH IB, pp. 11-13). Staff does not dispute the merits of the customer count method, but rather asserts that the difference should be "mitigated" by maintaining the customer count method but only assigning Woodhaven customers half their shares. (Staff IB, p. 25). Staff argues that factors entirely irrelevant to how common costs are caused are allegedly "reasonable" bases for assigning Woodhaven customers only half of the common costs they cause. (*Id.*) This proposal to arbitrarily grant Woodhaven customers preferential treatment to the tune of half their shares of common costs should not be adopted.

Indeed, the arbitrariness of Staff's half allocations is demonstrated by the fact that the WH Association *disagrees* with it. (WH IB, p. 12). However, the WH Association's alternative position is just as unreasonable. It argues that rate base allocations, which would assign unequal

[5] The single exception is Aqua's 1/3 weighting to availability customers in Oak Run and Candlewick, which is appropriate because availability customers do not take any service but rather only pay for the option to take service in the future. (Aqua Ex. 5.0A2, p. 26)

[6] Staff's proposed adjustment is related solely to Contractual Services - Management Expense. The WH Association seeks to expand the adjustment in its Initial Brief to all Contractual Services accounts. (WH IB, p. 2). The Commission should not consider this expansion of the issue. If it does, however, it should find against any reduced allocations to the other Contractual Services accounts, all of which account for different categories common costs such as legal and accounting, for the same reasons that the Commission should find against a reduced allocation of Contractual Services - Management Expense.

shares of common costs to customers in different divisions, are somehow fairer and should be used simply because they would result in smaller allocations to Woodhaven customers. (*Id.*) It argues that Aqua has not demonstrated otherwise, and it raises several red herrings. (*Id.*, pp. 12-13). Its position should not be adopted either.

The positions of Staff and the WH Association are not reasonable. The common cost method is clearly the fairer way to allocate common costs. It should not be deviated from just because the rate base method would allocate less common costs to Woodhaven customers. Neither party has identified a credible reason to allocate Woodhaven customers less than their equal shares of common costs. Any such preferential treatment would set a very poor public policy precedent, and it would result in non-compliance with the General Assembly's stated intent that all costs be borne by the cost causers. The Commission should reject the positions of both Staff and the WH Association.

1. Customer Count Is The Fairest Method

As noted, Staff does not dispute the merits of the customer count method. In fact, the Commission approved Aqua's customer count allocations in the recent Kankakee and Vermilion rate cases.[7] Accordingly, the method is one that the Commission and Staff have endorsed.

The WH Association claims, however, that Aqua has not demonstrated customer count to be the more reasonable method. (WH IB, p. 11). Quite to the contrary, it is clear that customer count is the most equitable way to allocate the common costs in issue. It assigns all customers

[7] The WH Association asserts that Aqua has only used customer count in these two rate cases. (WH IB, p. 14) However, the Association has no foundation for its assertion. It relies upon Mr. Bunosky's testimony during the evidentiary hearing. But, while Mr. Bunosky stated that he did not recall the specifics of several cases, he testified that only the Illinois corporate portion of Account 634 was allocated via rate base prior to 2003. (Tr., pp. 63-64). The Aqua America, Inc. parent company portion has always been allocated by customer count.

an equal share of common costs that they equally cause. The General Assembly has stated that its intent is for all customers to bear the cost of their service.

The rate base method does not accomplish this result and, therefore, is less equitable. It is inherent in the rate base method that customers are allocated unequal shares of common costs even though they cause them equally. Such a result violates the General Assembly's intent.

Take the Woodhaven Sewer and Willowbrook Sewer Divisions as an example. Those two Divisions have close to the same percentage of rate base at 2.41% and 2.82%, respectively; but, the Woodhaven Sewer Division is significantly larger with 5,046 customers versus 1,083 in Willowbrook Sewer. As a result, the rate base method would allocate customers in Woodhaven Sewer only $13.12 each of the common costs at issue (*i.e.*, Account 634); but, it would allocate the customers in the significantly smaller Willowbrook Sewer Division $76.75 each—*a substantial $63.63 more*![8] (Staff Ex. 7.0, Att. A). There is no reason why customers in Willowbrook Sewer should pay almost five times more in common costs than customers in Woodhaven Sewer.

The customer count method, moreover, has several other advantages. It benefits from administrative ease because it is the same method used by Aqua's parent company. (Aqua Ex. 5.0A2, p. 28). Aqua witness Mr. Bunosky also testified that the "utilization of a customer count methodology is viewed as *more appropriate* for these common costs" (*i.e.*, management), because it better reflects the fact that the more customers a water or sewer system has the more issues arise that require oversight, such as customer support, engineering, accounting, operations, maintenance, planning, forecasts, budgets, etc. (Aqua Ex. 5.0A2, pp. 27-28 (emphasis added)).

[8] Under the rate base method, Woodhaven Sewer would receive 2.41% of the Account 634 common costs for a total of $70,928 that, divided by the 5,406 customers in Woodhaven Sewer, equals $13.12. The significantly smaller Willowbrook Sewer Division, on the other hand, would receive 2.82% of the Account 634 common costs for a total of $83,125 that, divided by the 1,083 customers in the Division, equals $76.75.

In fact, given the superiority of the customer count method in allocating common costs, the Florida Public Service Commission had held unequivocally that "common costs *shall be* allocated" based on customer count. It stated: "we find it appropriate to allocate each system its *common operating costs* based on the average number of customers representing that system." The Florida PSC's rationale was that the customer count allocation "*most equitably* reflects the distribution of costs." *In re Rentals and Utilities, Inc.*, 2001 WL 771089, at *8 (Fla. P.S.C. May 22, 2001)(emphasis added). This decision is sound and should be followed.

Accordingly, customer count is superior to rate base for allocating common costs and is consistent with the General Assembly's directive that all customers bear their own cost of service. The WH Association did not present any evidence to the contrary. Accordingly, the Commission should approve the Woodhaven Divisions' allocations of Contractual Services - Management Expense based on customer counts as it did in the Kankakee and Vermilion rate cases.

2. Customer Count Is More Appropriate Even Though It Allocates More To The Woodhaven Divisions

As noted, the positions of Staff and the WH Association primarily rest on the fact that allocations to Woodhaven customers are more under a customer count than a rate base method. (Staff IB, pp. 23-25; WH IB, pp. 11-13). However, this does not in any way mean that customer count allocations are improper. To the contrary, it means that the rate base method would allocate too little to the Woodhaven Division. In particular, it would allocate those customers less than their equal shares and customers in other divisions would make up the difference—*i.e.*, they would be required to *subsidize* Woodhaven customers. (*See* Aqua IB, pp. 15-16). Customer count allocations are proper because they prevent such subsidization from occurring.

3. There Is No Basis To Grant Woodhaven Customers Preferential Treatment

Staff says it is trying to "mitigate" the impact of the difference in the allocation methods.[9] However, Contractual Services - Management Expense is a single expense that is factored into overall rates. The Woodhaven Divisions' rates are and will remain low following these cases. At Aqua's original proposed rate increases, the increase would raise the average water bill only 19¢ per day from 31¢ to 50¢ per day, and the average sewer bill only 22¢ per day from 35¢ to 57¢ per day. (Aqua Ex. 1.4 (WW), (WS)). That is very reasonable. Accordingly, there is no need to "mitigate" the rate impact on customers in the Woodhaven Divisions of each customer bearing an equal share of common costs.

The WH Association does not even attempt to identify a reason why Woodhaven customers should be "mitigated" from the impact of bearing their equal shares of common costs. Staff, however, asserts it would be reasonable to do so for two reasons. First, Staff notes that the area is a campground that is not used all year. Second, its points out that Aqua said it would consider a reduced weighting as part of a bulk billing option. (Staff IB, p. 25). Neither of these factors has merit or is even relevant.

First, the expenses at issue are common costs incurred at the Aqua Illinois corporate and Aqua America, Inc. parent company levels to operate all divisions. (Tr., pp. 64, 122-23). The use of the property in the area as a campground, however, can only impact direct costs. (*See* Aqua IB, pp. 16-17). Any direct cost savings from the factors Staff identifies are directly passed through. (*Id.*, pp. 17-18). If the allocations of common costs to Woodhaven customers were reduced because of direct cost savings that they already receive, then the savings would be

[9] As noted, Aqua witness Mr. Bunosky testified that before 2003 Aqua allocated the Illinois corporate portion of the common costs accounted for as Contractual Services - Management Expense via rate base (Tr., pp. 63-64); but, as of 2003, Aqua allocated all of these common costs via customer count. (*See*, Dkt. 03-0403, Sch. A-5, WP-A5 (Kankakee rate case showing all costs were allocated via customer count during 2003)).

double counted. (*Id.*) Thus, Staff's direct cost factors are not relevant or material to how common costs should be allocated.

Second, Aqua only said it would consider a reduced weighting in conjunction with a bulk billing option and, even then, only in a manner that is fair to all customers. (Aqua Ex. 5.0A2, pp. 24, 26-27). Because the Commission cannot adopt a bulk billing option in these cases, (s*ee supra*, §II.B.3.b), Aqua's statement has no relevancy. Further, the manner in which Staff proposes to reduce the Woodhaven divisions' allocations would not be fair to other customers. It would impose on other customers more than their equal shares of common costs simply for a reason that bears no relation to how common costs are caused. Indeed, Staff does not set forth any quantitative analysis showing that the campsite characteristics of the Divisions allegedly only drive half of the common costs.

The arbitrariness of Staff's proposal is demonstrated by the fact that the WH Association does not even agree with it. (WH IB, p. 12). When discussing Staff's proposal, the WH Association stated unequivocally: "The Association does not agree." (*Id.*) The Commission should not find that Staff's position reasonably is tied to any evidence showing that a half versus any other weighting is appropriate when the WH Association does not even agree with it.

The arbitrariness of Staff's position is further demonstrated by its deviation from the Commission's rulings in the Kankakee and Vermilion rate cases. The Commission approved Aqua's use of customer count allocations in those cases without any objection from Staff. Staff attempts unsuccessfully to distinguish those cases by asserting that there "the impact of the change was not as overt" because the difference between a rate base or customer count allocation for Vermilion is a "reasonable" 24%. (Staff IB, p. 25). This argument is another example that percentages are misrepresentative. The *dollar* difference between a rate base and customer count

allocation is *substantially larger* in Vermilion than it is in the Woodhaven Divisions. The difference is $248,199 in Vermilion versus $179,748 and $148,557 in Woodhaven Water and Sewer, respectively. (Staff Ex. 7.0, Att. A). The differences in the Woodhaven Divisions only represent as larger percentages because the underlying dollar amounts for those Divisions are so much smaller. Staff's claim that the impact of the change was not as "overt" in Vermilion is simply wrong - on a dollar-for-dollar basis the impact of the change was significantly greater in Vermilion than it is for either of the Woodhaven Divisions.

Accordingly, neither Staff nor the WH Association has set forth any reasonable basis for granting Woodhaven customers reduced allocations of common costs. Instead, under Staff's theory, Woodhaven customers would be allowed to pay substantially *less than their equal share* while other division customers would be required to *subsidize* the Woodhaven customers' shares of the costs. (*See* Aqua IB, pp. 15-16, n. 14 (explaining this outcome)). This is not reasonable.

4. Woodhaven Customers Drive Greater Than Average Costs

Staff states incorrectly that Aqua witness Mr. Schreyer attempted to tie the allocation levels to the uncollectibles problem. (Staff IB, p. 25). Then, Staff tries unsuccessfully to discredit Mr. Schreyer by noting that Aqua witness Mr. Bunosky testified Management Expense would not decrease if the problem with uncollectibles was resolved. (*Id.*, p. 26). This is not impeaching because the position Staff ascribes to Mr. Schreyer is incorrect.

The Management Expense allocations to the Woodhaven Divisions are solely a function of customer count. The Woodhaven Water Division has 9.6% of the Company's Illinois customers and is allocated 9.6% of Management Expense whereas Woodhaven Sewer has 8.41% of the customers and is allocated 8.41% of Management Expense. (*See* Staff Ex. 7.0, Att. A). It

is clear, therefore, that Aqua has not increased the Woodhaven Divisions' allocations above their customer counts due to any increased management time to address the uncollectibles problem.

As such, Mr. Schreyer recognized that the allocations of Management Expense to the Divisions had not been increased above customer count. He stated that "***if*** management expense allocation was a function of management resources necessary to collect past due amounts, Woodhaven customers ***would*** receive a weighting greater than proposed in the Company's methodology." (Aqua Ex. 8.0, p. 19)(emphasis added). The terms "if" and "would" establish that Mr. Schreyer was describing a hypothetical scenario.

Mr. Bunosky's testimony during the evidentiary hearings was consistent. While the Woodhaven Divisions have seen a higher degree of management oversight due to uncollectibles, Mr. Bunosky explained that the Company does not assign the *common costs* accounted for as Contractual Services - Management Expense to the Divisions based on that factor. (Tr., p. 154). Rather, the common costs included in Contractual Services - Management Expense are allocated based solely on customer count. (*Id.* (stating "[i]t is based upon the number of customers")). The WH Association, in fact, acknowledges that the allocations have not been increased above customer count due to the uncollectibles problem. (WH IB, p. 14).

Because the allocations have not been increased, they would not be decreased if the uncollectibles problem were resolved. (*Id.*) Indeed, any reduction based on such a scenario would unjustly reward the Divisions simply for starting to drive an average rather than a heightened degree of management oversight. As such, Mr. Bunosky's testimony that Management Expense would not decrease if the uncollectibles problem were to be resolved also is consistent.

Ultimately, the reason underlying Mr. Schreyer's and Mr. Bunosky's testimonies in this regard may be subtle, but it is important. To the extent that the Divisions demand increased management oversight, they still are allocated only an equal share of Management Expense. (Aqua Ex. 8.0, pp. 19-20; Tr., p. 153). This is very favorable to the Divisions. If anything, they should receive increased allocations to account for the additional management oversight the uncollectibles problem necessitates.

5. The WH Association Advances Red Herrings

As noted, the WH Association does not attempt to explain why Woodhaven customers should be allowed to pay less than their equal shares of common costs. Instead, it advances red herrings in a misleading attempt to claim that Aqua is applying the customer count method to common costs improperly when, in fact, Aqua is not. These arguments should be rejected.

a. The WH Association Misleadingly Mixes Concepts Of Shared Direct And Common Costs

The WH Association unsuccessfully attempts to challenge Aqua's allocations of common costs included in Account 634 - Management Expense by arguing that Aqua does not allocate its direct costs appropriately. (WH IB, pp. 13-14). During the hearings, Mr. Bunosky explained that "shared" direct costs, *i.e.*, those direct costs that are incurred for the benefit of two divisions like Woodhaven Water and Sewer, are shared or allocated between the two divisions. Aqua accomplishes this by assigning a shared cost to one division the first time it is incurred and to the second division the next. As such, both divisions are assigned only half of the shared costs over time. (Tr., p. 108-10). *This method of assigning shared direct costs is not an issue in these cases*. The WH Association did not raise it as an issue during the evidentiary phase of the cases,

it is not on the WH Association's Issues List, and it is not on the ALJ's Outline of Issues for use in the Initial and Reply Briefs.

The manner in which Aqua assigns shared direct costs, moreover, has no bearing on its methodology for allocating common costs. The issue in this case is the allocation of common costs that are accounted for in Account 634, Contractual Services - Management Expense. Those costs are incurred at the Illinois corporate and Aqua America, Inc. parent levels to operate all divisions. (Tr., p. 64, 122-23). They are allocated via customer count because they are common costs incurred to operate all divisions and, thus, are equally caused by all customers.

The shared direct costs that the WH Association discusses are assigned via a different allocation method for different reasons. They are costs that are incurred only to support two divisions, and they are assigned directly between the two divisions such that each division over time bears half the shared costs. This is an entirely different method that is used for an entirely different reason.

Accordingly, the WH Association mixes the concepts of common and shared direct costs. Its discussion as to the appropriateness of how Aqua assigns shared direct costs is not relevant to whether Aqua's common cost allocation method is the most equitable, which, as discussed *supra*, it is. The Commission should not be misled by the WH Association's confusion of the two different type of costs and allocation methods.

b. It Is Not Proper To Track Common Costs

The WH Association asserts that Aqua's common cost allocation method is unjustified because it is not supported by tracked costs. (WH IB, pp. 14-15). Further, because common costs are not tracked, it asserts that they somehow do not benefit customers. (*Id.*) It incorrectly

compares common costs to a license fee that the Illinois Supreme Court disallowed because the fee was not cost-based. (*Id.*, p. 15). The fact that common costs are not tracked is not a basis to disallow Aqua's customer count methodology.

Common costs do not lend themselves to tracking. They are costs incurred to manage and operate all divisions, such as the costs to prepare an overall state budget, and the salaries of the Company's President and Chief Financial Officer. (Tr., pp. 122-23). Because of the nature of the costs, it would be very time consuming and difficult to track them specifically. (*Id.*, p. 125). Mr. Bunosky explained:

> [T]rying to track all time associated with any individual rate area … would become very time consuming as well as certain items that are just physically difficult to track by rate area. If you are looking at an overall budget for the state, for instance, you are looking at the overall state budget and working on that versus any one particular entity.

(*Id.*)

Because of the inherent difficulty and time that would be involved to track common costs, an allocation method is used to assign the costs across all customers in a fair manner. (*Id.*) Mr. Bunosky explained that this is the "purpose" of using an allocation methodology. (*Id.*) As such, the Commission's Part 285 Rules recognize that "allocation factors" and an "allocation methodology" will be used to "allocate the test year costs of the total company to each of the utility's applicable services." 83 Ill. Adm. Code § 285.1025. In other words, it is commonly recognized that allocation methods are used to assign common costs to all customers because of the administrative ease. *See e.g., In re Rentals and Utilities, Inc.*, 2001 WL 771089, at *8 (Fla. P.S.C. May 22, 2001)(Fla. P.S.C. mandating all common costs be allocated based on customer count).

The case cited by the WH Association, *Illinois Bell Tele. Co. v. ICC*, 303 N.E.2d 364, 375 (1973), is distinguishable. In that case, the specific license fee expense was contested as being unsupported, and the Court disallowed recovery of the expense because its incursion was not shown to benefit ratepayers. In these cases, however, no party has contested Aqua's recovery of any expense included within Account 634, Contractual Services - Management Expense on the alleged basis that it is unsupported. Nor has there been any claim or evidence that Aqua's common costs do not benefit ratepayers in all divisions. The issue, rather, simply is whether customer count is the appropriate method to allocate Aqua's common costs across all customers. This issue was not addressed by the Court in *Illinois Bell*.

Indeed, the WH Association makes misrepresentations when attempting to argue that Aqua should track its common costs. It states that "no in house labor tracks actual hours." (WH IB, p. 14 (citing Tr., p. 137)). Actually, however, Mr. Bunosky only testified that in-house labor does not track time spent on the collections issue—to the Woodhaven customers' benefit. (Tr., p. 137). All other direct costs are tracked and directly assigned. (Tr., p. 115-16, 123).

Accordingly, the WH Association's implication that common costs need to be tracked in order to support an allocation method is flatly wrong. Allocation methods are used because of the difficulty inherent in tracking common costs. The WH Association's attempt to discredit the adequacy of Aqua's "tracking" of common costs is a red herring. It should be rejected.

c. The Association's Claim That Only Half The Customers Exist In The Woodhaven Divisions Is Meritless

Aqua has 11,575 customers across both Woodhaven Divisions (6,169 in Woodhaven Water and 5,406 in Woodhaven Sewer). (*See*, Staff Ex. 7.0, Att. A). The WH Association claims that only half of these customers should be counted. (WH IB, pp. 16-17). Its claim is

based on the fact that Aqua issues a single bill to individuals who are both water and sewer customers, and the fact that there are some shared direct costs between the two Divisions. (*Id.*)

Aqua explained in its Initial Brief that these facts do not distinguish the Woodhaven Divisions from the rest of Aqua's divisions. Aqua provides both water and sewer service in the majority of its service areas. In each of those areas, Aqua issues a combined water and sewer bill bi-monthly, and Aqua assigns shared direct costs between both divisions. (*See* Aqua IB, pp. 18-20). The customers in Aqua's other service areas where both water and service are provided are counted in total. Customers in the Woodhaven Divisions should be as well.

6. If The Commission Adopts Reduced Allocations, They Should Be Applied To 2005 Test Year Levels And Costs Should Be Reallocated To Other Divisions

Staff asserts that Aqua accepted the use of 2004 actual Management Expenses for the Woodhaven Divisions and, thus, Aqua's 2004 actual rather than 2005 test year should be the basis from which Staff's half allocation is calculated. (Staff IB, pp. 25-26). However, Aqua only accepted the use of 2004 actual in its Rebuttal filing based on Staff's Direct case wherein Staff approved *full allocations* for the Woodhaven Divisions. (Aqua Ex. 8.0, p. 21). Staff did not propose half allocations until its Rebuttal filing—which was an *extreme* change in Staff's position. Aqua's Rebuttal Testimony based on Staff's position in its Direct case simply does not stand when Staff engages in such a radical shift in position.

If a reduced customer allocation is adopted for the Woodhaven Divisions, it would not be appropriate to rely on 2004 actual Management Expense levels as the basis for the allocations. The data on which Staff draws its rate base versus customer count disparity is 2005, not 2004. It would not be appropriate to adjust 2004 levels based on 2005 data. Rather, any adjustment should be made to 2005 levels as well. (Aqua Ex. 8.0, p. 21).

Further, because a common cost allocation methodology is intended to distribute 100% of common costs across all customers, if the allocations to the Woodhaven Divisions are reduced it would be necessary to increase the allocations to other divisions.[10] (Tr., pp. 127-28). Any such reallocations should be based upon the most recent, forward looking information available, which is the 2005 test year. This is especially so because, with the exception of Oak Run, the other Divisions to whose customers the costs would be transferred will not be brought in for rate relief until some later time. The disparity between the years utilized should be diminished to the extent possible, not increased. (*Id.*)

Accordingly, should the Commission, for some reason, adopt reduced allocations, which it should not, then it should base the reduction on a 2005 test year and hold that the offset will be recognized by increased allocations to Aqua's other divisions, including Oak Run herein. (Aqua Ex. 8.0, p. 20). It should expressly make this holding herein. Mr. Schreyer's Rebuttal Testimony based on Staff's substantially different position in its Direct case was not a concession otherwise.

7. The WH Association's Claim To Reduce Transportation Expense Should Not Be Considered

The WH Association raised for the first time the issue of Transportation Expense. It states:

> [T]he increase in Transportation Expense] is largely due to vehicle lease costs. These vehicles serve both Woodhaven and Sublette and are allocated on a customer count basis that would be changed if the current methodology is retained.

[10] Staff has asserted that a decrease in the Woodhaven Divisions' allocations should not impact Aqua's ability to recovery its legitimate expense. (Staff IB, p. 26). This is not correct. Because allocation methods distribute 100% of the costs, if allocations to two Divisions are reduced and offsetting increases are not made to the allocations of other divisions, then 100% of the costs would no longer be allocated and Aqua would not recover its entire expense.

(WH IB, p. 17). There is no basis in the record for the WH Association's claim that Transportation Expense should be modified. *It should be stricken and not considered*.

D. Rate Case Expense

Neither the WH Association nor that ORPA conducted any analysis or presented any evidence on Rate Case Expense. The ORPA admits it relies totally on Staff's position. (ORPA IB, p. 7). The WH Association generally does as well; yet, it again makes assertions that are not in the record and should be disregarded. (WH IB, pp. 17-18).

Aqua has established that all of Staff's Rate Case Expense proposals are improper and should not be implemented. (Aqua IB, pp. 24-39). Staff's Initial Brief does not advance any compelling reason why they should. Instead, Staff's Initial Brief demonstrates its positions to be contrary to past Commission decisions, one-sided, discriminatory and to constitute poor public policy. None of them should be adopted by the Commission.

1. Expense for Aqua's ROE Witness Ms. Ahern

Staff advances two, vitally flawed arguments in support of its proposal to disallow Ms. Ahern's expense. First, Staff asserts that Aqua could have avoided the expense if it had filed these cases with either the Kankakee case in May 2003 or the Vermilion case in May 2004. (Staff IB, p. 27). The Commission has already rejected this argument as having "no legal basis." Consumers Ill. Water Co., Dkt. 99-0288, 2000 WL 34446603, slip op. at 14 (2000). Second, Staff claims erroneously that a Commission's decision against a party on a position somehow equates to a legal finding that the party's position is "fundamentally unsound." (Id., pp. 27-28). That is clearly not the case, and it disregards the fact that Commission decisions are not *res judicata*. Staff's proposal should be rejected again like it was in *Consumers Ill. Water Co*.

a. There Is No Basis To Disallow Aqua's ROE Expense For Not Combining These Filings With Kankakee Or Vermilion

The Commission has unequivocally held that "there is no legal basis on which to penalize [Aqua] and disallow a portion of the proposed rate case expense, as Staff suggests, for not combining this rate filing with rate filings for other divisions." *Consumers Ill. Water Co.*, Dkt. 99-0288, 2000 WL 34446603, slip op. at 14 (2000). As such, the Commission has already *rejected* Staff's position without qualification. It should not be considered further.

Indeed, Staff failed to provide any sort of convincing argument for the modification or reversal of the Commission's earlier decision on this issue. Staff alleges incorrectly and without any sound evidentiary foundation that expenses would have been saved if Aqua had filed these cases with Kankakee or Vermilion. (*See* Aqua IB, pp. 26-28). Yet, Staff's position relies fully upon the testimony of Staff witness Ms. Pearce who, when asked about the alleged savings, responded with "I can't say," It might," and an unqualified admission that she did not conduct any sort of quantitative analysis. (Tr., pp. 332, 335). And the questioning was objected to on the ground that Ms. Pearce is not "in a position to know." (Tr., p. 331). Clearly, Ms. Pearce did not present a good faith argument for the Commission to modify or reverse its decision.

While Staff simply advanced a previously *rejected* argument, Aqua presented undisputed evidence that demonstrates overwhelming the Commission's prior decision should be followed. It would have cost ratepayers $1,839,528 or $677,721 more in advanced revenue recovery if Aqua had filed these cases with either Kankakee or Vermilion. (Aqua Ex. 6.0R, pp. 12-14). No amount of savings could have been realized from advancing these cases that would be more than these costs -- Aqua is not incurring that much to process the cases now. It would not have been prudent for Aqua to advance these filings simply to save ROE expense.

Nor could the Commission have legally required Aqua to hold the cases until some time in the future, as the WH Association suggested. A similar amount of costs would be imposed on Aqua in the form of foregone revenue recovery by a delay. Aqua is entitled to a fair return on its investment. *Candlewick Lake Util. Co. v. ICC*, 122 Ill. App. 3d 219, 222 (1983); *Cerro Copper Prod. v. ICC*, 83 Ill. 2d 364, 369 (1980); *Union Elec. Co. v. ICC*, 77 Ill. 2d 364, 379 (1979); *Illinois Cent. R. Co. v. ICC*, 387 Ill. 256, 275 (1944). Under-earning cannot be imposed legally for any period of time as a condition to the recovery of legitimate Rate Case Expense.

Accordingly, the Commission has decided that there is "no legal basis" to disallow the recovery of Rate Case Expense on the ground that filings were not combined. Staff did not present a valid or compelling reason for the Commission's decision to be modified or reversed. Rather, the evidence overwhelmingly establishes the unsoundness of Staff's argument. It should be rejected and Ms. Ahern's expense allowed.

b. Ms. Ahern Is A Highly Qualified Expert

Ms. Ahern is a highly qualified expert in her field. Her qualifications are impeccable. (Aqua Ex. 3.0, pp. 1-2, App. A (OR), (WW), (WS)). They are attached hereto as Appendix A. There is no basis to question the validity of her expertise or opinion.

The Commission's decisions in the Kankakee and Vermilion rate cases, Docket Nos. 03-0403 and 04-0442, did not do so, either. In those cases, the Commission adopted Staff's analysis as adjusted by Mr. Ahern's opinion that 30 basis points ("bps") are appropriately added to account for the degree of risk reflected by Aqua's NAIC-2 rating. (Kankakee Order, Dkt. 03-0403, p. 43). Nowhere within either decision does the Commission hold Ms. Ahern's expert opinion to be a "fundamentally unsound," invalid, non-credible or un-useful as Staff

claims. Rather, with the exception of the 30 bps adjustment, the Commission simply did not adopt it.

The Commission's decisions are not *res judicata*. Parties always have the opportunity to present opposing positions to the Commission, and to seek modifications or reversals of earlier decisions. *Citizens Util. Bd. v. ICC*, 225 Ill. Dec. 435, 440 (1997); *Peoples Gas, Light & Coke Co. v. ICC*, 175 Ill. App. 3d 39, 51 (1988). There is no prohibition either in the Public Utilities Act or the Commission's regulations concerning the raising of arguments in succeeding rate cases. A position is not "invalid" simply because it may not be the one the Commission adopted in an earlier decision.

Ms. Ahern's distinguished expert opinion, moreover, would be a reasonable basis for the Commission to modify or reverse its previous adoption of Staff's ROE analysis. In both the Kankakee and Vermilion cases, Ms. Ahern explained at length why Staff's ROE analysis does not comport with sound financial analysis and should not be adopted. (*See* Ms. Ahern's discussion in her Rebuttal Testimony in Docket No. 04-0442 on pages 7 through 40). She explained why the Commission should depart from Staff's analysis. The soundness of her expert opinion is not dependent on whether she was successful in persuading the Commission to do so.

Indeed, in these cases, the issue of ROE did not even get to a point where Ms. Ahern had the opportunity to explain to the Commission why Staff's ROE analysis should not be adopted. In order to avoid litigation on the issue, Aqua accepted Staff's proposed ROE. The issue is not being presented to the Commission for resolution. Accordingly, there is no basis for Staff's presumption that the Commission would not have been persuaded by Ms. Ahern's expert opinion in these cases.

Moreover, Staff cannot have it both ways. It argues that Ms. Ahern's position is not valid because the Commission did not adopt it previously; yet, Staff advances positions herein that the Commission has unequivocally rejected. Staff argues that Aqua's recovery of ROE expense should be denied because Aqua did not consolidate these cases with other filings when the Commission has held, unconditionally, that Staff's argument is legally baseless. *Consumers Ill. Water Co.*, Dkt. 99-0288, 2000 WL 34446603, slip op. at 14 (2000). Staff argued against the 30 bps adjustment in Docket No. 04-0442 even though the Commission rejected Staff's position in Docket No. 03-0403. When asked if Staff would argue against the Commission's decision to add 30 bps again, Staff witness Ms. Freetly said she could not guarantee Staff would not. (Tr., p. 388).

In fact, Staff advances arguments that the Commission rejected as recently as the Petition for Interlocutory Review. The Commission disagreed with Staff's arguments raised on Review. Yet, in the face of the Commission having rejected Staff's arguments as recently as August 18, 2005, Staff sets for *the exact same arguments, in total*, in its Initial Brief. (Staff IB, pp. 31-36). While Staff repeatedly advances positions the Commission has unequivocally rejected, it clearly advances a different and unjustified standard for other parties.

Ms. Ahern's expertise is beyond question. Her opinion does not become unsound or invalid simply because the Commission does not adopt it. Staff's argument runs counter to the law in that Commission decisions are not *res judicata* and it is, moreover, inconsistent with Staff's own actions. There is no basis to find Ms. Ahern's expert opinion invalid. Therefore, Commission should reject Staff's argument and allow Aqua's recovery of Ms. Ahern's expense.

2. Aqua's Original Rate Case Expense Projections Are Fully Supported

Aqua has incurred more than $89,156, $85,133 and $80,665, respectively, process the Oak Run, Woodhaven Water and Sewer cases through the time of its Surrebuttal Filing.[11] (Aqua Ex. 8.0, p. 14). From the week before hearings through case completion in the Vermilion rate case, Aqua incurred $97,819.36 in outside legal expense.[12] (*Id.*, p. 15). Assuming each Division in these cases drives approximately 1/3 of the costs, this supports an additional $32,606.45 per Division in outside legal expense through case completion. (*Id.*) In addition, further outside witness, rate department and miscellaneous expense will be incurred through case completion, and it is appropriate to include a margin of error to account for unanticipated events that may arise.[13] (*Id.*, p. 16). As such, Aqua's *original* projections of $129,875, $160,950 and $160,950 to process these cases, respectively, are supported. (Aqua Ex. 8.0, p. 16). This equates to $43,292, $40,238 and $40,238 as amortized annually based on Aqua's proposed amortization periods.

The Commission allows recovery as a function of actual costs incurred plus a reasonable estimate of the costs that will be incurred through the conclusion of the case. *Consumers Ill. Water Co.*, Dkt. 99-0288, 2000 WL 34446603, slip op. at 16 (2000). The Commission has accepted actual costs to complete similar cases as a reasonable basis to estimate costs through case completion. *Id.* at 12, 16 (the Commission accepted Aqua's Rate Case Expense where the

---

[11] These are not the total amounts Aqua had incurred because they do not include July time for Aqua's counsel Mr. Rooney, witness Mr. Schreyer or any other individual in the rate department of Aqua's parent company. (*Id.*)

[12] Vermilion is a reasonable case from which to estimate additional outside legal expense because, as Aqua's most recent rate case, it is the most reflective of the degree of work necessary to process a case and the three Divisions at issue in these cases, in total, should drive a similar amount of work. Indeed, Vermilion will be a conservative estimate because there are two active intervenors in these cases (Aqua has to respond to 3 sets of briefs) whereas in Vermilion there were none, and Staff's review has been heightened as demonstrated by the fact that it issued almost 700 data requests in these cases. (*Id.*; Aqua Ex. 6.0R, pp. 29-30).

[13] Indeed, the need for a margin of error has been demonstrated in these cases. Unanticipated events during the evidentiary hearings necessitated an expedited Petition for Interlocutory Review.

costs through case completion was based on Aqua's actual costs in a similar rate case). Aqua's original projections, therefore, are supported and should be approved.

Indeed, the evidence provided in support of Aqua's original projections is exactly the type of evidence routinely relied upon in determining reasonable rate case expenses. The Commission conducted this exact type of analysis in Aqua's last rate case for Kankakee, Dkt. 03-0403. In that case, Aqua submitted its actual costs incurred through October, 2003, when the parties filed Rebuttal testimony. It then submitted updates to its actual costs through November, 2003, just before the evidentiary hearings and the Company's surrebuttal testimony that was filed on December 1, 2003. Aqua witness Mr. Schreyer testified under oath to his opinion that Aqua would incur the remainder of its original projection to complete the case, *i.e.*, to conduct the evidentiary hearings and prepare briefs. Kankakee Order, Dkt. 03-0403, pp. 21-22.

The Commission rejected Staff's proposal to adjust Aqua's Rate Case Expense below the amount based on Aqua's actual invoices and reasonable projection for case completion. The Commission stated that "the determination of rate case expense involves estimation." *Id.*, p. 22. It also found that Aqua's estimate "was more likely to be observed than the estimate offered by Staff." *Id.* As such, the Commission determined the actual costs Aqua was likely to incur. It relied upon Aqua's evidence of its actual costs, as supported by invoices, through a period before the evidentiary hearings plus the sworn testimony of Aqua witness Mr. Schreyer as to the amount Aqua estimated it would incur through rate completion. *Id.* This is the exact type of evidence that supports Aqua's Rate Case Expenses in these proceedings.

It is also the exact type of evidence other State Commissions rely upon. *See e.g., Wash. Util. & Transp. Comm'n v. Am. Water Res., Inc.*, Dkt. UW-031284, 2004 WL 2640362, slip

op. at 16-17 (Wash. U.T.C. Nov. 1, 2004) (relying upon the record and sworn witness declarations to determine reasonableness of rate case expenses); *In Re Lake Placid Util.*, Dkt. 951027-WS, 1996 WL 422594, slip op. at 6 (Fla. P.S.C. July 15, 1996) ("We have reviewed the actual invoices and the revised estimate to complete and we find that the amounts submitted are reasonable.")

In *American Water Resources*, the Staff of the Washington Utilities and Transportation Commission argued that the utility's estimates for future rate case expenses should be rejected as unreliable. Dkt. UW-031284, 2004 WL 2640362, slip op. at 16. In response, the utility submitted with its post-hearing reply brief, supplemental witness declarations that showed actual billings, work in process and estimates through case completion, including expense estimates for completion of the utility's reply brief, review of the Staff's reply brief, and review of the Commission's order. *Id*. at 17. Addressing the Staff's concerns about the reliability of its estimates, the utility argued that the witness declarations "submitted under oath, represent good-faith estimates of the amounts it would take to finish the case." *Id*. Based upon its review of the record and the sworn witness declarations, the Commission allowed the utility's proposed adjustment for rate case expenses because it found those expenses "to be reasonable and justified for a case with this degree of complexity." *Id*.

Here, Aqua submitted the sworn testimony of Jack Schreyer in support of its original projections. (Aqua Ex. 8.0). That testimony demonstrates that Aqua's original projections were good-faith estimates of the expenses it will incur through case completion, as demonstrated by Aqua's actual billings in this proceeding and Aqua's rate case expenses in a similar rate case. (Aqua Ex. 8.0, pp. 12-18, Ex. D). As in *American Water Resources*, the Commission should rely

upon the competent evidence submitted by Aqua in support of its original projections and approve those projections for recovery.

a. Staff Arguments Addressed On Interlocutory Review Should Be Rejected

In a complete recitation of its various argument on the Petition for Interlocutory Review, Staff asserts that the Commission should disregard Aqua's evidence of the actual expenses that have been incurred to processes these cases. (Staff IB, pp. 31- 36). The Commission has already rejected Staff's arguments. It has held, moreover, that Aqua has not "updated" its original rate case expense projections, but rather is seeking recovery of its original projections. Aqua's invoices are relevant evidence that support its original projections. As such, the Commission should again reject Staff's arguments as they are advanced in opposition to Aqua's recovery.

b. The Commission Must Take A Fair And Balanced Approach

Rate Case Expense is a function of the case itself and, thus, cannot be predicted with certainty. In these cases, actual events drove costs away from in-house Rate Department and Miscellaneous expense to Outside Legal and Witness expense. (Aqua Ex. 8.0, pp. 14-18; *see also*, Aqua IB, pp. 34-36). Yet, Staff proposes adjustments only to those two components, namely "In-house Rate Department" and "Miscellaneous," where Aqua's actual expenses are not meeting its original projections. It leaves untouched the two components, Outside Legal and Witness, where Aqua's actual expenses are clearly exceeding its original projections. (Staff IB, pp. 31-39). As explained in Aqua's Initial Brief, this approach is unreasonable because it is entirely one-sided.

It is a fundamental principle of ratemaking that the process is to be fair and balanced. *See, e.g., Bus. & Prof'l People for the Pub. Interest v. ICC*, 146 Ill. 2d at 208, 585 N.E.2d at

1045 ("The Commission is charged by the legislature with setting rates which are '*just and reasonable*' not only to the ratepayers but to the utility and its stockholders.") (emphasis in original) (quoting 220 ILCS 5/9-201(c)); *Citizens Util. Bd. v. ICC*, 276 Ill. App. 3d 730, 658 N.E.2d 1194 (1st Dist. 1995) ("The Commission has the responsibility of balancing the right of the utility's investors to a fair rate of return against the right of the public that it pay no more than the reasonable value of the utility's services.") (internal quotation marks omitted). *See also Appeal of Conservation Law Found.*, 127 N.H. 606, 636 (1986) (recognizing that the object of the rate making process is "to strike a fair balance between recognizing the interests of the customer and those of the investor").

The most fair and balanced approach is to allow recovery of Aqua's original projections in total, as discussed *supra*. The evidence fully supports Aqua's original projections. And, the Commission has approved recovery based on similar evidence in other cases. *Consumers Ill. Water Co.*, Dkt. 99-0288, 2000 WL 34446603, slip op. at 16 (2000).

However, if the Commission engages in a component-by-component analysis, it must do so in a balanced fashion. Actual costs deviate from the original projections for the components in *both* directions. Adjustments are only balanced, therefore, if they are made in *both* directions.

Staff notes that Aqua is likely to incur 50% of in-house Rate Department and 25% of Miscellaneous Expense. (Staff IB, pp. 37-39). However, the evidence establishes that Aqua is also likely to incur the following amounts above its original projections for Outside Legal and Witness Expense:

> Outside Legal: As of Aqua's Surrebuttal, it had already incurred $46,760, $45,069 and $44,427 for Oak Run, Woodhaven Water and Sewer, respectively. Based on the amount Aqua incurred in Vermilion between the week before evidentiary hearings through

> case completion, Aqua is likely to incur an additional $32,606.45[14] more for each Division. This far exceeds Aqua's original projection for this component of $50,400 per Division.
>
> Outside Witness (GPM Associates Fee - Mr. David Monie): Aqua originally projected fees for Mr. Monie of $5,000 for Oak Run and $2,500 for each Woodhaven Division. As of Aqua's Surrebuttal, however, it had already incurred $8,751, $7,378 and $7,506, respectively; and Aqua estimated it would incur an additional $1,500 per Division. This exceeds Aqua's original projections by $5,251, $6,378 and $6,506, respectively.

(Aqua Ex. 8.0, p. 15).

Staff's proposal to only adjust Rate Department and Miscellaneous Expense, therefore, violates the fundamental principle that ratemaking is to be balanced. The Commission cannot only adjust those components downward. If the Commission does adjust those components, it must also adjust Outside Legal and Witness Expenses upward.

Staff accuses Aqua of proposing a "cavalier trade-off" rather than supporting its Rate Case Expense. (Staff IB, pp. 31, 35). Such a claim could not be farther from the truth. Aqua has fully supported its Rate Case Expense. It is simply responding to Staff's attempt to use Aqua's actual invoices to make unilateral downward adjustments while disregarding the fact that Aqua's actual invoices establish upward adjustments should be made to other components.

In fact, this is another example of Staff attempting to apply a different standard to Aqua than Staff applies to itself. Staff makes downward adjustments to rate case expense components based on actual invoices. But, it then objects when Aqua uses actual invoices to show that other components should be adjusted upward.

---

[14] At the time of Aqua's Surrebuttal Filing, it estimated an additional $15,000 per Division; but, as the need for Aqua to file a Petition for Interlocutory Review demonstrates, it is proper to add a margin of error to this amount. The Vermilion case evidences that costs could reasonably reach an additional $32,606.45 per Division.

Accordingly, this is not an instance of Aqua not being satisfied with Staff's acceptance of its original projections. (Staff IB, p. 31). Staff has not accepted Aqua's original projections. Instead, in a move that defies the reality of the situation being that rate case expense is a function of the case, Staff penalizes Aqua for being unable to predict to which rate case components the parties actions are going to drive the case expense. As such, if Staff's downward adjustments to Rate Department and Miscellaneous Expense are adopted, the Commission must balance them by making upward adjustments to Outside Legal and Witness Expense.

c. Response To Associations On Rate Case Expense

Neither Association presented any analysis on Rate Case Expense. Yet, they assert without basis that they are "concerned" because of the Divisions' sizes. (ORPA IB, p. 7; WH IB, pp. 17-18). The size of the Divisions, however, does not affect the amount of work required to process these rate cases. Per Part 285 of the Commission's Regulations, it is necessary for Aqua to conduct full rate cases for each of these Divisions. With close to 700 data requests and two active intervenors, the amount of work has been substantial. The number and significance of issues has been just as great as in the Kankakee and Vermilion cases. Accordingly, there is no merit to the Association's implications, that are unsupported by any evidence, that Rate Case Expense should be less just because the Divisions are not Aqua's largest.

The WH Association also makes several factual allegations that are entirely unsupported. It asserts, once again for the first time in its Initial Brief, that the professional fees are not the "norm." (WH IB, pp. 17-18). But, there is no evidence from which the Commission could draw such a conclusion. The WH Association also says incorrectly that Rate Case Expense would have been less if Aqua had consolidated these three cases with another division. (*Id.*) However, the evidence shows clearly that costs would have been substantially more if Aqua had done so.

(*See supra*, §II.D.1.a). Accordingly, the Associations do not advance any valid positions on this issue.

3. Staff Recommendations Regarding Future Rate Case Filings

Aqua set forth numerous reasons in its Initial Brief why the Commission can not legally, and should not as a matter of policy, adopt Staff's proposed rules on Aqua's future rate case filings. (Aqua IB, pp. 36-39). Staff does not set forth any compelling reason within its Initial Brief why the Commission should. Instead, it makes numerous generalizations that are not supported by the evidence or the law.

First, Staff states that Aqua should be able to file different divisions together. (Staff IB, pp. 40-41). However, Staff witness Ms. Pearce admitted that different factors drive the need to file rate cases in different divisions. (Tr., pp. 326-27). The factors will not necessarily coincide across different divisions. (Aqua Ex. 6.0R, p. 33). As such, Ms. Pearce also admitted that it is *impossible* to know today whether Aqua should file different divisions at the same time. (Tr., p. 323). It is not appropriate to impose strict rules requiring different divisions to be filed together when it cannot even be determined whether the relevant factors will indicate the cases should be filed together.

In fact, Ms. Pearce even recommends that Aqua file its next rate cases for Woodhaven Water and Sewer *at different times*. Ms. Pearce stated that her proposed amortization periods are based upon the periods of time that she believes are reasonable for the Divisions' rates to be in effect. (Tr., p. 321). Presumably, given her future rate case filing recommendation, she would believe that the rates for Woodhaven Water and Sewer, at a minimum, would be in effect for the same time. However, she proposes a 5-year amortization period for Woodhaven Water and a

7-year period for Sewer. (Staff Ex. 1.0, p. 19). Accordingly, Ms. Pearce does not even believe that Aqua should file its next Woodhaven Water and Sewer Divisions at the same time.

Second, Staff asserts that the rules will promote lower rate case expense. (Staff IB, pp. 41-42). However, the evidence is clear that to the extent the divisional-specific factors do not show that it is appropriate to file divisions together, significant costs will be incurred if Aqua is nonetheless required to do so. (Aqua Ex. 6.0R, p. 33). If a hasty, accelerated filing is made, ratepayers will face costs in the form of advanced revenue increases. (*Id.*) There would also be the risk that the best information would not be available and a second, follow-up filing would be necessary. (*Id.*, pp. 11-12, 34). If Aqua is required to illegally delay a filing, it will incur costs in the form of forgone revenue recovery. (*Id.*, p. 34). Neither outcome is appropriate.

Nor does the evidence support Staff's theory that savings will, even possibly, outweigh these costs. Staff did not conduct a quantitative analysis. (Tr., p. 335). It further admits that consolidated cases only have the "potential" to reduce costs via "outside witnesses, outside legal services, and the cost of responding to data requests." (Staff IB, pp. 42-43).

The evidence establishes that there really is not even the "potential" to reduce costs when cases are accelerated or delayed for filing. ROE witness expense is very small in comparison to the significant costs that would result from accelerated or delayed filings. (Aqua Ex. 6.0R, pp. 12-15; Aqua Ex. 8.0, p. 23). The same will hold true for any other witness expense.

As for legal expense, Staff witness Ms. Pearce was unqualified to support her position that legal expense would somehow be reduced. (Tr., pp. 331-32, 335). She presumes without any knowledge of the issue that legal work would be reduced by a simple consolidation of the cases. But, as Staff admits, "each case is unique with its own set of facts and circumstances."

(Staff IB, p. 42). As such, the unique issues related to each case would still need to be addressed in a consolidated filing. While a single brief would be filed, the brief would simply be longer.

The same holds true for data requests. Staff states that if Aqua had filed these cases with Vermilion, then Staff would not have had to ask for so much information.[15] (Staff IB, pp. 41-42). However, the issues in these cases were not issues in the Vermilion case, so Staff should still have had to ask for information on issues in these cases even if they had been consolidated with Vermilion. To the extent there was any overlap, Staff should have already asked for the information in the Vermilion case. It should not have needed to ask for information again in these cases.

The only other expense Staff claims would be saved is the cost of preparing two separate total company test years. (Staff IB, p. 41). While Staff is correct that these savings would be realized in consolidated filings, they are also realized when cases are not filed together. Aqua, in fact, is recognizing them in these cases because it used the total company portion of the rate template from Vermilion. (Aqua Ex. 6.0R, p. 35). Accordingly, this is not a savings that would only be incrementally realized with consolidated filings.

The two cases Staff cites do not support the adoption of its proposed rules, either. (Staff IB, p. 42). Initially, in Docket No. 83-0397, the Commission only told the utility to "consider" filing its divisions together. (*See* Staff Ex. 1.0, pp. 25-26 (quoting the Commission's order)). The Commission did not "order" the utility to do so, as Staff requests the Commission do against

[15] As Aqua noted in its Initial Brief, Staff propounded almost 700 data requests in these cases. While Staff attempts to argue that Aqua's rate case expense has been driven by the fact that Staff issued a separate request for each of the three Divisions to the extent it asked the same question of each Division; but, that is not the relevant factor. It costs Aqua just as much to respond to the questions whether they are issued on 1 piece of paper or 3. Even when Staff's questions are the same, the answers generally are not because the operating factors for each Division are different. Only 76 of Staff's close to 700 questions called for the same answers.

Aqua. Further, Docket No. 02-0690, wherein a utility filed several divisions simultaneously is no different than Aqua's decision to file these three pending cases simultaneously.

Indeed, the Commission's decision to only instruct the utility in Docket No. 83-0397 to "consider" filing divisions together equates to a decision not to *require* the utility to do so with all the improper attendant consequences. It is also consistent with the Commission decision in *Consumers Ill. Water Co.* not to disallow the recovery of rate case expense simply because the division was not consolidated with other rate filings. These rulings support Aqua's position that it would be improper to require consolidated filings, not Staff's position to the contrary.

Accordingly, neither past Commission decisions nor the evidence demonstrate that it would be proper for the Commission to impose the rules Staff proposes for Aqua's future rate case filings. Rather, the evidence establish that the rules would amount to poor public policy and would drive significant costs rather than savings. They would, moreover, be both discriminatory and promulgated in non-compliance with the proper procedure for administrative regulations. They should not be adopted.

E. Amortization Period Of Rate Case Expense

Aqua's three year amortization period for Oak Run and four year periods for the Woodhaven Divisions are reasonable projections of when Aqua is likely to file its next rate cases. (Aqua IB, pp. 39-40). Staff agrees that rate case expenditures "should be recovered over the period of time that the subject tariffs are reasonably anticipated to be in effect." (Staff IB, p. 48). This is a prospective, *future* analysis. However, Staff disregards the evidence as to when Aqua is likely to file its next cases for each Division and, instead, looks solely to the *historical* intervals. (*Id.*, pp. 48-49). As a result, Staff's analysis is not reasonably targeted to projecting the actual periods of time that the Divisions' rates will be in effect.

Staff's position, moreover, improperly penalizes Aqua simply for staying out as long as it has been able to for these Divisions. (Aqua Ex. 6.0R, p. 38). Staff erroneously claims that Aqua over-recovered because it stayed out longer than the amortization periods the Commission ordered in its last cases. (Staff IB, pp. 48-49). The WH Association echoes this flawed claim. (WH IB, pp. 18-19). However, the evidence is clear that Aqua has been *losing* money in these Divisions. (Aqua Ex. 5.0A2, p. 14; Aqua Ex. 7.0R, p. 12). No division that loses money during the extra interval it stays out of the rate arena "over-recovers" rate case expense.

Further, the deferred balance on rate case expense is un-earning even though it is capital the Company has already expended. (Aqua Ex. 6.0R, pp. 38-39). If the amortization period is too long, *i.e.*, beyond the time in which the evidence establishes Aqua is likely to file its next cases, then Aqua will not be able to achieve its allowed return. As discussed *supra*, it is a fundamental principle of ratemaking that the Commission should set balanced rates so that the Company is kept whole. It would be inconsistent with this principle for the Commission to set amortization periods that are longer than when the evidence establishes Aqua is likely to file its next cases for these Divisions. The Commission should set Aqua's amortization periods consistent with when the evidence establishes Aqua is likely to file its next cases.

The evidence shows that Aqua will likely file its next case for Oak Run in three years, and for the two Woodhaven Divisions within four years. Aqua witness Mr. Schreyer testified that Aqua intends to file cases for all three Divisions within four years to capture the effects of inflation and capital projects that are routinely incurred. This is reasonable because it would avoid any degree of rate shock. (Aqua Ex. 6.0R, p. 39). At a minimum, the Commission should allow Aqua to recover its Rate Case Expense for all Divisions over four years.

In addition, however, the evidence establishes that Aqua is likely to build the RO Plant for Oak Run in 2007. (Aqua Ex. 5.0A2, pp. 2-5). While the ORPA asserts consumers will not vote to install the RO Plant, (ORPA IB, pp. 4-5), it does not know that they will not and the evidence supports the Commission finding otherwise. (*See supra*, §II.A). Most particularly, the majority of consumers have already expressed their opinions in favor of the RO Plant -- this is direct evidence as to how customers truly feel. (Tr., pp. 131-32). The RO Plant will necessitate a filing for Oak Run. (Aqua Ex. 6.0R, p. 39). Accordingly, the Commission should allow Aqua's recovery of Rate Case Expense for its Oak Run Division over a three year period.

F. State and Federal Income Tax Calculation Errors

Staff revised its columns (f) in its Initial Brief, but asserts any other discrepancy is allegedly because Aqua is using the incorrect State Income Tax Rate. (Staff IB, p. 50). That is not the case. Aqua did use the correct rate of 7.30% when it ran the calculations. Even after Staff's correction, the Tax amounts it includes in its Schedules still do not follow the well-established calculations. (*See* Aqua IB, p. 40 (setting forth the calculations)). To the extent Staff's Schedules are utilized, therefore, the Income Tax amounts should be modified to comport with the established calculations.

G. Staff Revenue Requirement Calculation Error

Staff continues to assert that its Revenue Change and Percentage Revenue Change calculations for each of the Divisions are not overstated. (Staff IB, pp. 50-51). It states that the Schedules it proposes in these cases is "the same model that has been utilized in cases pending before the Commission for over 15 years." (*Id.*) But, it is clear from a simple comparison of Staff's Schedules in these cases to the Schedules the Commission approved as recently as last

year in Aqua's Kankakee and Vermilion rate case orders that Staff is proposing new Revenue Change and Percentage Revenue Change calculations here.

In particular, in these cases, Staff's Schedules calculate the Revenue Change as Staff Pro Forma Proposed Revenues (Col. (i), Line 4) minus Staff Adjusted Company Rebuttal (Col. (d), Line 4). (Staff IB, App. B, p. 1 of 3, ln. 26 (OR), (WW), (WS)). The latter number incorporates Staff's adjustments to Aqua's Pro Forma Present Revenues by adjustments to Aqua's Pro Forma Proposed Revenues. This is incorrect because Aqua's Pro Forma Present Revenues have not changed. The adjustments should apply to Aqua's Pro Forma Proposed Revenues that will be adopted in these cases.

However, in the Vermilion and Kankakee cases, the Commission correctly calculated the Revenue Change from Aqua's Pro Forma Present Revenues unadjusted by changes in Proposed Revenues. In particular, in Dkt. 04-0442, it calculated the Revenue Change as the Pro Forma Proposed Revenues in the Operating Statement Per Order (Col. (h) Line 3) minus ***Company Direct Pro Forma Present*** (***Page 2, Col. (b)*** Line 3). (Aqua IB, App. B, p. 1, ln. 25 (constituting a copy of the Appendix from the Commission's Order in Docket N. 04-0442)). And, in Docket No. 03-0403, the Commission calculated the Revenue Change as the Pro Forma Proposed Revenues in the Operating Statement Per Order (Col. (i), Line 4) minus ***Pro Forma Present*** (Col. (d), Line 4). (Aqua IB, App. B, p. 3, ln. 29 (constituting the Appendix from the Commission's Order in Docket No. 03-0403)). As such, Staff's current Schedules do deviate from the method the Commission used to calculate Revenue Changes previously.

Similarly, in these cases, Staff's Schedules calculate the Percentage Revenue Change as the Revenue Change (Col. (i), Line 26) divided by the same Staff Adjusted Company Rebuttal, which is the number that improperly incorporates adjustment to Proposed Revenues to Aqua's

Present Revenues. (Col. (d), Line 4). (Staff IB, App. B, p. 1 of 3, ln. 27 (OR), (WW), (WS)). Again, however, in the Vermilion and Kankakee cases, the Commission calculated the Percentage Revenue Change from Aqua's Pro Forma Present Revenues unadjusted by changes in Proposed Revenues. Specifically, it calculated the Change as the Pro Forma Proposed Revenues in the Operating Statement Per Order (Col. (h), Line 3) divided by ***Company Direct Pro Forma Present*** (***Page 2, Col. (b)*** Line 3). (Aqua IB, App. B, p. 1, ln. 26). And in Docket No. 03-0403, the Commission calculated the Percentage Revenue Change as Pro Forma Proposed Revenues in the Operating Statement Per Order (Col. (i), Line 4) divided by ***Pro Forma Present*** (Col. (d), Line 4). (Aqua IB, App. B, p. 3, ln. 30). Thus, again, Staff's current Schedules incorrectly deviate from the Commission's past practice.

That Staff's current Schedules should be modified also is apparent from the Oak Run percentage increase the Schedules indicate. Staff is proposing significant reductions to Oak Run's requested increase. Yet, because of the overstatements included within its calculations, Staff's Schedules improperly indicate that it is proposing Oak Run receive virtually all of its requested increase.

Aqua requests that the Commission modify the calculations to the extent it uses Staff's schedules to comport with the manner in which the Commission calculated the Revenue Changes in Docket Nos. 03-0403 and 04-0442. Aqua believes such a change is appropriate to accurately portray the revenue increases the Commission authorizes in these cases.

H. New Claim From WH Association That Should Be Stricken

The WH Association raises yet another brand new issue in its Initial Brief. It claims that Aqua's radium removal costs should be decreased allegedly because the material could be removed on a greater than an annual basis. (WH IB, p. 19). This issue was not raised during the

evidentiary phase, nor did the WH Association identify it on its Issues List. The allegations, moreover, is not supported. Aqua witness Mr. Bunosky testified that how often the material is removed depends on how concentrated it becomes, and that Aqua currently estimates it needs to be removed every year. (Tr., pp. 101-02). There is no other testimony on the issue in the entire record. Accordingly, this claim should be stricken or, at a minimum, not considered; but, if for some reason it is considered, then it should be denied.

I. Staff's Request For Admonishment

Staff asks for Aqua to be admonished for alleged non-compliance with Commission procedural practice. (Staff IB, p. 65). Its basis is a reiteration of its arguments that the Commission rejected on Interlocutory Review. Staff, moreover, misrepresents the comments of the Commission on Interlocutory Review. Because the Commission has already rejected Staff's claims, its request for admonishment should not be granted either.

CONCLUSION

WHEREFORE, for each of the reasons set forth herein, Aqua Illinois, Inc. respectfully requests that the Commission approve proposed rates based on its test year Surrebuttal Statements of Operating Income for each of the three Divisions, Aqua Schedule 8.1 (OR), (WW)

and (WS), respectively, strike and not consider the new allegations and claims raised by the WH Association, and grant any and all other appropriate relief.

Dated: September 6, 2005

Respectfully submitted,

AQUA ILLINOIS, INC.

By: _____
One of its attorneys

John E. Rooney
Sarah N. Galioto
Sonnenschein, Nath & Rosenthal
233 S. Wacker Drive
Chicago, Illinois 60606
312-876-8000
jrooney@sonnenschein.com
sgalioto@sonnenschein.com

CERTIFICATE OF SERVICE

I, Sarah N. Galioto, hereby certify that I served a copy of the Reply Brief of Aqua Illinois, Inc upon the service list in consolidated Docket Nos. 05-0071 and 05-0072 by electronic mail on September 6, 2005.

_____

Sarah N. Galioto