

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
)	

**INITIAL BRIEF ON EXCEPTIONS OF
AQUA ILLINOIS, INC.**

Dated: October 13, 2005

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I. Introduction

The Proposed Order properly determines that Aqua Illinois' Oak Run ("OR"), Woodhaven Water ("WW") and Woodhaven Sewer ("WS") Division each have demonstrated the need for a rate increase. It, further, contains a number of proper conclusions based on the record presented. It correctly recognizes that Aqua is entitled to recover total bad debt expense in rates, including amounts caused by customers whose delinquencies Aqua cannot write-off, although, as discussed below, it errs by, nonetheless, not allowing Aqua to recover these amounts for the Woodhaven Divisions. It also concludes, appropriately, that the allocation of common costs via customer count, which equitably assigns an equal portion of common costs to all customers, is just and reasonable. These findings and some others should not be disturbed during the exceptions phase of this case.

The Proposed Order, nonetheless, does contain several conclusions that are contrary to the evidence and the law. Each such conclusion will be addressed herein, but some merit further discussion in this Introduction. Initially, regarding Rate Base for the Woodhaven Sewer Division, the Proposed Order overlooks undisputed evidence related to (a) the 1998 sewer main extension and lift station project, and (b) the installation of sewer service extensions for the Woodhaven Sewer Division. As a result, the Proposed Order recommends adjustments that are contrary to the evidentiary record.

Also, while recognizing Aqua's right to recover total bad debt expense, as noted, the Proposed Order errs by, nonetheless, for the two Woodhaven Divisions, denying Aqua's recovery of amounts caused by customers whose delinquencies Aqua cannot write-off. In this respect, the Proposed Order treats the Woodhaven Divisions differently than Oak Run, and does

so on the premise that Aqua and the Woodhaven Association (“WA”) may come to agreement on a “bulk billing” arrangement. Under such a scenario, Aqua would collect all charges from the WA. Because it is not known at this time whether Aqua and the WA will be able to agree on how to implement bulk billing, the possibility that they might is not grounds to disallow Aqua’s recovery of total bad debt expense. Rather, the possibility of the future arrangement would best be recognized by subjecting Aqua’s bad debt expense recovery to the condition that, should Aqua and the WA later agree to bulk billing, Aqua would return all savings in bad debt expense to the WA in the form of a collections fee.

The Proposed Order also errs in its treatment of Rate Case Expense. As set forth herein, Aqua presented the exact type of evidence upon which the Commission, as well as other State Commissions, has relied upon to support its original projections for each Division. *See Consumers Ill. Water Co.*, ICC Dkt. 03-0403, 2004 Ill. PUC Lexis 382, *47-*51 (2004). Those amounts should be allowed.

In sum, the Commission should amend portions of the Proposed Order to comport with the evidentiary record and the law. Aqua sets forth herein, with specificity, the Proposed Order’s conclusions that should be amended. Exception language follows the discussion of each issue. The appropriate Operating Income and Rate Base schedules are attached hereto as Appendix A (Woodhaven Water), Appendix B (Woodhaven Sewer) and Appendix C (Oak Run). It should be noted that only the schedules for Woodhaven Sewer have changed from those Aqua submitted with its Initial Brief in this proceeding. The changes in Aqua’s schedules for Woodhaven Sewer, as such, include a new column for “BOE Adjustments” and a final column entitled “Company BOE Pro Forma Proposed.”

II. **Discussion**

A. Rate Base

The Proposed Order adopts correct Rate Base levels for Oak Run and Woodhaven Water. For Oak Run, however, the Proposed Order errs in how it addresses Aqua's future recovery of preliminary costs incurred for the Reverse Osmosis ("RO") Plant. It incorrectly determines that, in the possible event the RO Plant is not built, Aqua should transfer the preliminary costs to a non-recoverable, non-utility account. This ruling is erroneous because those costs were incurred for a utility purpose and, thus, should be accounted for in a utility rather than non-utility account.

For Woodhaven Sewer, the Rate Base level adopted is incorrect. First, the Proposed Order does not recognize refunds Aqua paid to the WA for the 1998 sewer main extension and lift station project. Second, it does not accept that Aqua already has accounted for customer payments for new sewer service extensions as Contributions in Aid of Construction deducted from Rate Base and, thus, incorrectly requires Aqua to deduct the payments from Rate Base a second time. The Proposed Order's conclusions on these issues should be modified.

1. Reverse Osmosis Plant - Oak Run

The water in the Oak Run Division suffers from high levels of fluoride, total dissolved solids, sodium and chlorides. (Aqua Ex. 5.0 2A, pp. 3-4). At increased levels, these minerals have adverse health impacts (especially for individuals who are elderly and/or on sodium restricted diets), cause poor taste and decrease the useful life of at-home appliances, such as water heaters, plumbing, etc. (*Id.*) As such, the Federal Environmental Protection Agency

(“EPA”), the Illinois EPA and the health industry have established recommended¹ levels for these minerals. (*Id.*) The Federal EPA explained the need for the recommended levels as follows:

These levels represent reasonable goals for drinking water quality. The States may establish higher or lower levels which may be appropriate dependent upon local conditions such as unavailability of alternate source waters or other compelling factors, provided that public health and welfare are not adversely affected.

40 C.F.R. §143.3 (emphasis added). The water in Oak Run exceeds the recommended levels as follows:

Mineral	Recommended Level	Oak Run Level
Fluoride	1.2 mg/l	2.4 mg/l
Total Dissolved Solids	500 mg/l	1,300 mg/l
Sodium	20 mg/l	500 mg/l
Chlorides	250 mg/l ²	360 mg/l ³

(Aqua Ex. 5.0 2A, pp. 3-4).

Aqua has begun the process to lower the levels of these minerals in Oak Run to within the recommended standards. It has spent \$35,222 on a pilot study and \$32,958 on engineering plans for an RO Plant, which, as the Proposed Order recognizes, is the best technology for the removal of these minerals. (*See Proposed Order, p. 7*). The RO Plant would reduce the minerals to levels below those recommended by the Federal EPA, the Illinois EPA and the health industry, thus improving water quality.

¹ The Illinois EPA’s and the health industry’s standards for these minerals are not mandatory, but they are recommended.

² 40 C.F.R. §143.3; 35 Ill. Adm. Code §654.403.

³ Intervenor Ms. Sadler correctly notes that the chloride content in Oak Run water is 350 mg/l. (Sadler Intervention, Exhibit A).

During the pilot study, Aqua conducted a customer survey that showed customers overwhelmingly favored the heightened quality of the water produced through the RO Plant. (Tr., pp. 131-32). Clearly, consumers want the level of the mineral content in their water reduced, and the Federal EPA and Illinois EPA have both adopted the goal of reducing these minerals to promote the public health and welfare. Aqua believes it is appropriate to build the RO Plant to achieve this end.

Nonetheless, because the RO Plant will not be built by the end of 2005, which is the future test year being used, Aqua's preliminary costs for the RO Plant are not being included in Account 101, Utility Plant in Service.⁴ The Proposed Order properly recognizes that these costs should, instead, be recorded to Account 183, Preliminary Survey and Investigation at this time. (Proposed Order, p. 8). This is a utility account; but, because amounts in Account 183 are not included in Plant in Service, Aqua's preliminary costs for the RO Plant will not be reflected in the rates adopted in this case. Aqua is in agreement with this treatment.

The Proposed Order implicitly recognizes that Aqua's preliminary costs will later be transferred to utility plant account and recovered at the time the RO Plant is constructed. This is what Account 183, Preliminary Survey and Investigation, requires. 83 Ill. Adm. Code §605.10 (providing that "[i]f construction results, this account shall be credited and the appropriate utility plant account charged"). Aqua is also in agreement with this treatment.

However, the Proposed Order incorrectly requires Aqua to transfer the costs to Account 426, Miscellaneous Nonutility Expense, which is a non-recoverable non-utility account, should construction of the RO Plant be abandoned at some future time. It states that "[e]xclusion from

⁴ These costs were inadvertently included in Account 101 in the original filing; but, Aqua agreed in its rebuttal testimony that these costs should be removed from Plant in Service at this time. (Aqua Ex. 6.0 2A, p. 42).

rate base and below the line amortization of these costs in the event of abandonment would be appropriate because this project was initiated solely at the election of Aqua.” (*Id.*) This finding is erroneous. The Proposed Order should be amended to allow Aqua to transfer the costs to Account 675, Miscellaneous Expense, a utility account, in the event the project is abandoned.

The determination of whether costs are recorded in a utility or non-utility account is not based upon whether Aqua started a project on its own initiative. Utilities routinely take actions on their own initiatives in fulfilling their obligations to provide adequate service to customers. The Public Utilities Act, in fact, compels them to do so by imposing such an affirmative obligation. 220 ILCS 5/8-101, 8-401. As such, utilities are not required to wait for another party to request action appropriate to rendering quality service for the associated costs to receive proper accounting treatment as utility costs. Indeed, such a requirement would stagnate the system. Utilities would be virtually unable to act because they would be caught-up in applying and waiting for pre-approval. The slippery slope implications are endless. A utility must act on its own initiatives to fulfill its service obligations every day, and the associated costs are properly accounted for as utility costs.

Additionally, the determination of the appropriate accounting treatment is not dependent on the outcome of an event. The Proposed Order allows Aqua to properly account for the costs as utility costs if the RO Plant is constructed, but denies proper accounting treatment if the RO Plant is not constructed. (Proposed Order, p. 8). This is a double standard that would send mixed signals to all utilities. Utilities would be hesitant to take action, including to improve customers’ water quality as Aqua has done here, because of the possibility of improper and unfavorable accounting treatment. This would be poor regulatory and public policy.

Rather, the determination of whether the costs are recorded in an above-the-line utility account or a below-the-line, non-utility account is based solely on whether the costs were incurred for a utility or non-utility purpose. *See Commonwealth Edison Co.*, ICC Dkt. 96-0411, 1996 Ill. PUC Lexis 614 (1996). In Docket No. 96-0441, a witness for Commonwealth Edison Company (“ComEd”) testified that the purpose of non-utility accounts is to separate and remove the effect of non-utility related costs and revenues from the regulated utility field. *Id.* at *6-*7. It prevents the cross-subsidization of utility and non-utility services. *Id.* No party offered testimony in that case to rebut this assertion. Similarly, Aqua provides non-utility services, the costs and revenues of which are recorded in the below-the-line, non-utility accounts.⁵ In Docket No. 04-0442, Aqua witness Mr. Schreyer and Staff witness Ms. Everson agreed that these non-utility costs and revenues are the type that are appropriately recorded in the below-the-line, non-utility accounts because they are not, in any way, related to the provisioning of utility services. (*Id.*, p. 8; *accord* Staff Ex. 5.0, pp. 5, 7). As such, it is the utility/non-utility distinction that is the very reason for having both above-the-line utility and below-the-line non-utility accounts.

Here, the preliminary costs Aqua has incurred toward the RO Plant are directly related to utility service. The sole purpose of the RO Plant would be to improve the water quality provided to utility customers in Oak Run consistent with the public policy goals for water quality that the Federal EPA, the Illinois EPA and the health industry have all announced. This fact was never, nor could it logically be, contested. Because the purpose of the RO Plant’s costs is utility related, it is proper for Aqua to record them in an above-the-line, utility account.

⁵ In Aqua’s last rate case for its Vermilion Division, Aqua witness Mr. Schreyer testified that Aqua provides non-utility billing services to the City of Danville Sanitation District, lab testing for Culligan Water, Realtors and School Districts, customer data services for the City of Danville, and collection services for Illinois Power. (*See* ICC Dkt. 04-0442, Aqua Ex. 2.0, p. 7).

Indeed, no party testified that it would be appropriate to record the preliminary costs of the RO Plant in a non-utility account. Staff did not propose non-utility accounting treatment either. Staff's position was that the Commission should require Aqua to record these costs in Account 183, Preliminary Survey and Investigation, now and that Aqua should not transfer the costs to a different account until such time that the project is either constructed or abandoned. (See Staff IB, p. 18, *citing* Staff Ex. 2.0, p. 7). But, Staff did not take a position on what account would be appropriate for the costs to be transferred into in the event of construction or abandonment. As such, there is no evidentiary basis for the Proposed Order's conclusion that, in the event of abandonment, Aqua's preliminary costs for the RO Plant should be transferred to a non-recoverable, non-utility account.

In fact, in the event of the future construction or abandonment of the project, Staff noted that Section 605.10 of the Commission's Regulations, which regards Account 183, Preliminary Survey and Investigation, sets forth the proper accounting treatment and reads:

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

(*Id. citing* 83 Ill. Adm. Code §605.10)(emphasis added). This language directs that costs should be transferred to a non-utility *or utility* account as "appropriate," *i.e.*, the account should be based upon the nature of the costs, which, in this case, were clearly incurred for a utility purpose.

Accordingly, if the RO Plant is later abandoned, which Aqua does not believe it will be, the costs should be transferred to the appropriate operating expense account. Aqua respectfully requests that the Commission make the following revisions to page 8 of the Proposed Order:

Because the reverse osmosis plant will not be constructed by the end of the 2005 test year, the Commission concurs with Staff that the \$68,180 representing the cost of the engineering plan and pilot study should be removed from Account 101 and recorded in Account 183. ~~As a result~~ Furthermore, these expenses will not be reflected in the rates adopted in this proceeding. If the possible construction of a reverse osmosis plant is abandoned, these expenses should be transferred to the appropriate utility operating expense account per 83 Ill. Adm. Code §605.10. ~~Account 426 and continue to be excluded from rate base. A ten year amortization of these costs through Account 675 is not appropriate. Exclusion from rate base and below the line amortization of these costs in the event of abandonment would be appropriate because this project was initiated solely at the election of Aqua. In other words, while seeking to improve water quality is laudable, Aqua is under no obligation to meet the IEPA's secondary standards. Additionally, given the nature of the Oak Run customer base, Aqua should not have assumed that recovery of preliminary expenses would be approved if the project was ultimately abandoned.~~

2. 1998 Sewer Main Extension and Lift Station Project - Woodhaven Sewer

In 1998, pursuant to a Sewer Main Extension Agreement, Aqua installed a new sewer main and lift station in the Woodhaven Sewer Division. (See Aqua Cross Ex. 1; WA Ex. 1.07 (the Agreement and Supplemental Memorandum and letters modifying the Agreement)). The project was funded, in part, with contributions from the WA. In relevant part, Aqua's Cross Exhibit 1, which constitutes its supplemental answer to Staff Data Request BAP 4.05 reads, as follows:

BCJ 4.05 Referring to Customer Advances on Schedule B-15 of the Woodhaven Sewer Division, provide the following information:

d) Work papers that support the test year balance of customer advances. For each advance, the work papers should identify (1) the date recorded, (2) the purpose or specific asset to which the advance applies and (3) the amount, the total of which should equal the balance of customer advances on Schedule B-15 at 12/31/05.

Answer d) The Company entered into a Customer Advance contract with the Woodhaven Lake Association on 5/22/97 to install 3,485' of PVC Sewer main, 17 manholes, 860 L. F. of 6" PVC Force Main, a Lift Station, road repair, grading and seeding in Sections 9 and 14 of Woodhaven Lakes. Support for the test year balance is as follows:

7/97	Receipt from Woodhaven Lakes Assoc.	\$ 12,100
10/98	“ “	\$184,277
1999	Two Refunds to Lake Association	\$(12,170)
12/31/05 Projected Balance		\$184,207

(Aqua Cross Ex. 1)(emphasis added). Aqua also acknowledged in its Reply Brief that the WA paid an additional \$21,623 upon the project's completion. (See Aqua RB, pp. 4-5). On a total basis, therefore, the WA paid \$218,000 (\$12,100 + \$184,277 + \$21,623) and *received refunds of \$12,170* for a net contribution of \$205,830 (\$218,000 - \$12,170) toward the project.

As set forth in Aqua Cross Ex. 1, Aqua accounted for \$184,207 of the WA's payments, net of refunds as Customer Advances and deducted that amount from Rate Base. (Aqua Ex. 5.0 2A, p. 28). This is confirmed by the fact that \$184,207 in Customers Advances is identified at Schedule B-15 (WS) and the identical amount in Customer Advances is deducted from Aqua's Rate Base in Schedule B-1 (WS). Aqua acknowledged in its Reply Brief that this amount should be \$205,830 to reflect the WA's additional payment of \$21,623. (See Aqua RB, pp. 4-5). As noted, this is an amount that the WA originally withheld from its contribution but later paid upon the project's completion. (WA Ex. 1.07). As such, Aqua does not oppose an adjustment to Rate

Base in the amount of \$21,623 to reflect the total contribution from the WA of \$205,830 (\$184,207 + \$21,623).

The WA did not present any evidence as to how much it actually paid toward the project. The WA claimed, however, *for the very first time in its Initial Brief* that it paid \$216,230 toward the project—\$10,400 more than the record, as discussed, establishes. (WA IB, pp. 6-7). The WA’s advancement of such a claim in its Initial Brief is highly prejudicial because Aqua had no opportunity to rebut the claim.

The WA’s claim, furthermore, is misleading. The WA only addresses what it *believes* it paid on a gross basis. But, it is the payment *net of refunds* that is appropriate to include as a Customer Advance and deduct from Rate Base. The WA does not address the \$12,170 in refunds Aqua paid.

Moreover, the amount that the WA now claims it paid is incorrect. The sum the WA identifies is actually the “original estimate” of the cost to complete the project. (*See* WA Ex. 1.07, Supplemental Memorandums) (setting forth \$216,230 as the “original estimate”). As can be seen from the language in the parties’ Agreement, identified as WA Ex. 1.07, the WA was not responsible for paying the original estimate. Rather, the WA was required to pay an adjusted amount equal to the original estimate *less* one and one half (1 ½) times the estimated annual revenues to be received from “Original Prospective Customers.” (WA Ex. 1.07, Sewer Main Extension Agreement §C). This adjusted amount was thereafter adjusted again, upon the completion of the first billing cycle, by an amount equal to one and one half (1 ½) times the difference between the annual revenue originally estimated and the actual revenue received. (*Id.*, Sewer Main Extension Agreement §E(2)). The WA also received refunds equal to all “tie in” fees. (*Id.*, Sewer Main Extension Agreement §E(4); Letter dated July 13, 1998).

Therefore, the WA was never contractually responsible for an amount equal to the \$216,230 original estimate. Its claim that it paid this amount is not supported by any evidence—it is simply a claim advanced for the first time in its Initial Brief. Moreover, it fails to recognize the \$12,170 in refunds Aqua paid to the WA

Accordingly, Aqua presented evidence, to which the WA did not even respond, that the WA paid a net total of \$205,830 toward the project. The evidence does not support any other conclusion. And the parties' agreement is in full accord with Aqua's evidence. Pursuant to the agreement, the WA's payment was adjusted for one and one half (1 ½) times revenues and the WA received refunds. (*See* Aqua Cross Ex. 1 (showing the actual amounts paid and received based on these adjustments and refunds)).

The Proposed Order, nonetheless, adopts the WA's unsupported and untimely claim that it paid a total of \$216,230 toward the project. (Proposed Order, p. 9). Because this finding is not supported by any evidence, Aqua respectfully requests that the Commission modify page 9 of the Proposed Order as follows:

In 1998, Aqua's predecessor, Consumers Illinois Water Company ("CIWC"), initiated in conjunction with WA a sewer main extension and lift station project. The total cost of the project was approximately \$244,851. Under their agreement, WA was to pay \$216,230 as adjusted by one and one half (1 ½) times actual revenues and refunds from Aqua for "tie in" fees, and CIWC would pay the remainder. WA now wants to be certain that none of its contribution is reflected in the rate base calculation for Woodhaven Sewer.

WA claimed, but not until its initial brief, that it paid \$216,230 toward the project. Aqua's Cross Ex. 1 shows a net payment, as properly offset by refunds paid to WA, of \$184,207 over the course of 1997 to 1999 related to the project. Aqua's Schedule B-15(WS) similarly reflects a customer advance in the amount of \$184,207. Aqua's Schedule B-1(WS) reflects a deduction from rate base in an equal amount. In its Reply Brief

(see p.4), Aqua agrees to an additional adjustment of \$21,623 to increase the amount of customer advances for this project to \$205,830. Aqua indicates that research conducted after reviewing WA's Initial Brief lead to its Reply Brief adjustment. Aqua maintains that the \$10,400 difference between what it and WA believe should be reflected as a deduction from rate base is accounted for by refunds paid to WA in 1999 and adjustments to WA's payments based on the revenues received. Aqua relies on Aqua Cross Exhibit 1 to support its contention.

~~Neither party's arguments definitively resolve this issue.~~ Aqua acknowledges that WA contributed \$205,830 to the project, which is \$10,400 less than what WA says it contributed. As noted, Aqua presented evidence of the actual payments received and refunds made related to the project. ~~While Aqua seems to believe that its Cross Exhibit 1 disposes of this issue, the Commission simply does not see how the calculation offered in the cross exhibit reconciles the discrepancy in the parties' numbers.~~ WA, on the other hand, did not claim that it had paid the full \$216,230 until its initial brief. Its claim is misleading because it does not account for the \$12,170 in refunds Aqua paid to WA. It is contradicted, as well, by offers several documents the WA offers in its Exhibit 1.07 concerning its agreement with CIWC. Although none of these documents are dispositive either, they support WA's contention that it contributed at least Those documents plainly set forth that WA was not required to pay, in net, the full original estimate of \$216,230. Rather, the WA's payment was to be adjusted by a portion of revenues and the WA was also to receive refunds. The WA did not present any evidence that the amounts Aqua shows the WA paid and received as refunds on Aqua Cross Ex. 1 are incorrect.

Accordingly, we do not find evidence to support the WA's claim that it paid a net total of \$216,230 toward the project. The payments and refunds Aqua shows, as adjusted by the additional \$21,623 Aqua acknowledged in its reply brief, are not contradicted. ~~What tips the scales in WA's favor on this issue is Aqua's apparent inability to fully account for WA's contributions at the outset. The Commission commends Aqua for being honest and disclosing its recent discovery of another \$21,623 contributed by WA. While it does not mean to punish Aqua for its honesty on this issue, and given the poor record on this issue, the Commission is inclined to believe that the remaining amount in dispute was paid by WA and not refunded by Aqua. The burden of proof lies with Aqua and, on this issue, Aqua's position is not persuasive. Accordingly, the rate base for Woodhaven Sewer should be~~

adjusted \$21,623 to reflect a deduction of \$205,830~~\$216,230~~ for WA's contribution to the sewer main extension and lift station project.

3. Sewer Service Installations - Woodhaven Sewer

The Proposed Order determines that Aqua should have invested \$7,112.88 for sewer service extensions in 2004 and allows that amount in Rate Base. (Proposed Order, p. 11). Aqua does not contest this conclusion. In deriving the appropriate adjustment to reflect an investment of \$7,112.88 in Rate Base, however, the Proposed Order does not account for Contributions in Aid of Construction ("CIAC") in the amount of \$16,355, (Sch. B-15, p. 3 of 4, ln. 5, col. (c)), representing customers' contributions that Aqua already has deducted from Rate Base.

In particular, the Proposed Order recommends a negative adjustment to Rate Base in the amount of \$17,988 to arrive at the \$7,112.88 of capital investment it recommends. (*Id.*, App. B, p. 5, ln. 1, col. (c)). While the derivation of this amount is not shown, it is presumably the result of subtracting the \$7,112.88 from the \$25,105 in capital investments for sewer service extensions shown at Aqua Sch. B-5, page 1 of 3, line 27, column (d).⁶ This calculation is incomplete because it does not reflect the \$16,355 in CIAC that reduces the amount of capital investment reflected in Rate Base. In other words, the \$25,105 is the gross cost of the new services recorded on Schedule B-5 but the Company's portion of the investment, reflected in Rate Base, is the net amount of \$25,105 less the CIAC of \$16,355, which is equal to \$8,750. As such, the Proposed Order should have calculated the adjustment from the \$8,750 that is the Company's portion of the investment included in Rate Base rather than the \$25,105 that is the gross investment. This proper calculation produces an adjustment of \$1,637.12.

⁶ This calculation equals \$17,992.12, which is within \$4 of the Proposed Order's adjustment of \$17,988.00.

Accordingly, Aqua requests that the Commission amend the rate schedules in Appendix B of the Proposed Order to reflect an adjustment of \$1,637.12 rather than \$17,988 in the rate schedules for Woodhaven Sewer. This change is reflected on the schedules for Woodhaven Sewer attached hereto. It is not necessary to amend any language in the Proposed Order.

4. Commission Conclusion on Rate Bases

To implement Aqua's proposed rate base changes as set forth herein, Aqua proposes the following changes at page 11 of the Proposed Order, which sets forth the final rate base amounts:

Giving affect to the adjustments to the rate bases approved above, the Commission concludes that the original cost rate bases for the 2005 test year for three operating entities are as follows:

Woodhaven Water	\$2,831,454	
Woodhaven Sewer	\$2,869,390	<u>\$2,895,502</u>
Oak Run	\$1,589,806	

The appendices attached hereto provide supporting calculations for the rate bases approved herein.

In addition, finding paragraph (6) on page 56 should be revised as follows:

- (6) for purposes of this proceeding, the net original cost rate base for Woodhaven Sewer operations for the test year ending December 31, 2005, as adjusted, is ~~\$2,869,390~~ \$2,895,502;

B. Operating Revenues and Expenses

The Proposed Order errs in how it addresses Aqua's recovery of (1) Uncollectibles Expense for the Woodhaven Divisions, and (2) Rate Case Expense, including the amortization periods. Also, while correctly allowing Aqua's recovery of Uncollectibles Expense for Oak Run, the Proposed Order characterizes the evidence in a way that is not supported. And, while

correcting Staff's Income Tax calculation errors, it improperly assigns faults for Staff's error to Aqua. As such, these latter two issues are addressed herein as well even though Aqua agrees with the Proposed Order's ultimate conclusions on these issues.

1. Uncollectible Expense - Oak Run

The Proposed Order correctly recognizes that Aqua cannot write-off uncollectibles expense caused by availability customers. (Proposed Order, p. 14). As Aqua explained, because availability customers are not connected to the system, Aqua cannot shut-off service to delinquent availability customers and, thus, such customers remain customers. It would constitute a forgiveness of debt to write-off those existing customers' delinquent accounts. (Aqua Ex. 8.0, pp. 8-9). As a result, it is necessary to utilize a method other than historical write-offs to project bad debt expense caused by delinquent availability customers. The Proposed Order reaches this proper conclusion as well. (Proposed Order, p. 14).

Aqua presented evidence of availability customers' aged receivables greater than 91 days to project availability customers' bad debt expense. Because aged receivables greater than 91 days are not likely to be collected, they are probative of the amount of uncollectibles availability customers are causing. (Aqua Ex. 8.0, pp. 8-9; Aqua Ex. 6.0R, p. 6). No party disputed this evidence or questioned Aqua's method of determining bad debt expense caused by customers whose delinquent accounts Aqua cannot write-off. In fact, Staff acknowledged this evidence but then simply disregarded it in its analysis. (Staff Ex. 6.0, pp. 6-7).

Then, for the first time in its Initial Brief, Staff calls the method "unorthodox." (Staff IB, p. 19). Staff does not cite anything for this proposition, nor could it because no witness testified to this effect. Staff's proposition, therefore, completely lacks an evidentiary foundation and should not be adopted.

It is, furthermore, incorrect. As discussed *supra*, the evidence is undisputed that aged receivables greater than 91 days are probative of bad debt expense. (Aqua Ex. 8.0, pp. 8-9; Aqua Ex. 6.0R, p. 6). It is not unorthodox to look to this evidence when the circumstances are such that uncollectibles from a significant number of customers cannot be written-off. In other words, historical write-offs are insufficient in this instance because they do not account for the amount of uncollectibles that cannot be written-off. It is entirely proper in such a circumstance to rely on evidence other than historical write-offs.

Nonetheless, the Proposed Order, while reaching the correct ultimate conclusion on the issue, recites Staff's untimely proposition that the use of aged receivables to evidence bad debt is "unorthodox" and questions aspects of the method that no party questioned during the case. (Proposed Order, p. 14). Because there is no foundation in the record either for the proposition or to question the method, such language should be removed from the Proposed Order. Aqua, therefore, recommends that the Commission modify the Proposed Order at page 14 as follows:

~~As Staff suggests, Aqua's revised method of calculating bad debt expense is unorthodox. The Commission, however, understands the position that Aqua finds itself in concerning Oak Run availability customers. Availability customers who do not pay their bills represent a cost to Aqua which only grows over time. Forgiveness of such irresponsible behavior of such customers is not appropriate under the circumstances. The Commission is concerned by the unorthodox calculation method employed by Aqua, the unexplained use of a three year denominator, and unexplained change in its calculation method in its rebuttal testimony, but~~ is mindful of the absence of any other alternative reflecting the impact of delinquent availability customers. Thus, given the record in this proceeding, the Commission believes that the most reasonable action is to adopt an uncollectibles rate of 0.3696%, the five year historical average of Aqua's actual write-offs, but also include an adjustment of \$4,829 to the test year reflecting bad debt expense caused by availability customers. In other words, Aqua's uncollectibles expense for Oak Run will reflect two components—the historical average of actual write offs and a separate factor reflecting bad debt caused by delinquent

availability customers. This conclusion recognizes the distinction between bad debt that Aqua writes off and bad debt that Aqua, for good reason under the circumstances, does not write off.

This conclusion ~~is by no means an endorsement of Aqua's methodology; rather,~~ it represents the selection of the least objectionable alternative. The Commission encourages the parties to explore means of resolving this collections problem, including the possibility of bulk billing [the Oak Run Property Owners Association ("ORPOA")]. Failure to develop a better alternative does not mean that the same or a similar methodology will be used in a future rate case. ORPOA must also understand that the rate increase approved in this proceeding is in part driven by those ORPOA members who have not paid their water bills.

2. Uncollectible Expense - Woodhaven Water and Sewer

Initially, Aqua clarifies its requested bad debt expense for the Woodhaven Divisions given the Proposed Order's comment that Aqua's discussion of the issue was confusing. (Proposed Order, p. 19). At *present rates*, *i.e.*, before any rate increase from this case, Aqua requested test year bad debt expense of \$53,148 and \$53,724 for Woodhaven Water and Sewer, respectively. (Aqua Sch. C-2.3 (WW), C-2.3 (WS)). These levels are reasonable because, in the last rate cases for the Divisions, the Commission allowed \$92,165 across both Divisions and the uncollectibles problem has worsened since then. (Aqua Ex. 8.0, pp. 11-12). At the increased rates Aqua originally proposed in this case, the *present rate* bad debt expenses of \$53,148 and \$53,724 equated to *pro forma* bad debt expense at *proposed rates* of \$86,456 and \$86,600, respectively. (Aqua Sch. C-2.3 (WW), C-2.3 (WS)). Because Aqua's proposed rate increases were adjusted during the case, the *pro forma* bad debt expense at *proposed rates* was similarly

adjusted such that the pro forma bad debt expense at *proposed (surrebuttal) rates* equals \$85,279 and \$82,576, respectively.⁷ (Aqua Sch. 8.1 (WW), 8.1 (WS)).

Aqua explained in its rebuttal filing that it actually anticipates bad debt expense to reach \$103,394 and \$112,174 at *originally proposed rates* for Woodhaven Water and Sewer even though, at the time of its filing, it only requested \$86,456 and \$86,600 at *originally proposed rates*, respectively. (Aqua Ex. 6.0R, p. 7; Aqua Ex. 8.0, p. 10, Ex. A and B (Aqua responses to Staff data requests BAP 5.04 and 6.04)). These calculations were based on 536 accounts across both Divisions that were delinquent more than 91 days as of April 22, 2005, when Aqua prepared its data request responses. (*Id.*) Aqua further explained in surrebuttal testimony that, as of May 31, 2005, delinquent accounts had increased to 552, with total delinquencies of \$451,991. (Aqua Ex. 8.0, p. 10, Ex. C). Also, an additional 250 accounts, with an estimated \$192,480 more in delinquencies,⁸ were on the verge of becoming more than 91 days past due. (*Id.*)

Aqua did not update the levels of its requested bad debt expense based on this evidence although the Proposed Order states that Aqua “updated” its bad debt expense projections in its rebuttal and surrebuttal filings.⁹ (Proposed Order, pp. 15-16). Rather, Aqua simply submitted evidence in its rebuttal and surrebuttal filings, discussed *supra*, to prove the reasonableness of its original requests. The evidence submitted demonstrates conclusively that Aqua’s originally requested levels of bad debt expense are extremely conservative.

⁷ Aqua’s bad debt expense projection at *present rates* never changed; but, pro forma bad debt expense at *proposed rates* is a dynamic cost of service component that unavoidably changes in conjunction with changes in proposed rates over the course of a rate proceeding.

⁸ This last estimate does not include the addition of late fees.

⁹ As noted *supra*, pro forma bad debt expense at *proposed rates* is a dynamic cost of service component because it changes in conjunction with changes to proposed rates over the course of the proceeding. This is distinct from and should not be confused with the Proposed Order’s suggestion that Aqua “updated” its requested levels of bad debt expense based on the evidence Aqua submitted in its rebuttal and surrebuttal filings.

Aqua explained that its bad debt expense for the two Woodhaven Divisions, like the Oak Run Division, cannot be based on historical write-offs alone because Aqua cannot write-off a substantial amount of uncollectibles in the Woodhaven Divisions. This is because it is not appropriate to shut-off service to a large number of customers. When service is not shut-off, the customers remain customers and it would constitute a forgiveness of debt to write-off the past due amounts. (Aqua Ex. 8.0R, p. 10).

In particular, Aqua cannot shut-off *any* sewer customers because of health and sanitation concerns. (Tr., p. 133 (Aqua witness Mr. Bunosky explaining that backups in the sewer system occur when service is shut-off, which, in turn create potential overflows and environmental hazards from the raw sewage)). Therefore, all sewer customers remain customers regardless of the level of delinquency. It would constitute a forgiveness of their debt to write-off their past due amounts.

Similarly, it would cost Aqua approximately \$400 per customer to install shut-off valves on the water system. (Aqua Ex. 5.0, p. 16). As such, Aqua only installs a valve on the water system when the cost-benefit analysis shows Aqua stands to recover more than the \$400 investment and the act of terminating service is likely to induce the customer to pay. (*Id.*) Such action is only likely to encourage payment from customers who pay their WA dues and real estate taxes,¹⁰ and use their property regularly.¹¹ (*Id.*) Aqua has installed shut-off valves for water customers who meet these requirements and whose past due amounts exceed the \$400 investment, and Aqua has shut-off service to customers who do not pay under these

¹⁰ Customers who do not pay their dues to the WA or their real estate taxes are prevented from using their property by the WA or the government, respectively. As such, customers who do not pay their dues or taxes and, thus, do not use their property would not be prompted to pay their water bill by Aqua shutting-off service.

¹¹ Similarly, shutting-off service to customers who do not use their property regularly would not give them an incentive to pay their water bill because they are not there to use service anyway.

circumstances. (*Id.*, pp. 16-17). No party introduced any evidence that these actions are either insufficient or not appropriate. As such, the Commission can only conclude, based on the evidence, that Aqua has taken the proper steps to induce customers' payments.¹² Irrespective, for those customers who are not appropriate to shut-off, they remain customers and it would constitute a forgiveness of debt to write-off their past due amounts.

Historical write-offs can only account for the portion of uncollectibles that Aqua writes-off; they can not account for the portion caused by individuals who remain customers despite their delinquencies. Aqua explained that, in this unique circumstance where it cannot write-off a substantial amount of uncollectibles, it is necessary to use a method in addition to historical write-offs to project future test year bad debt expense. (Aqua Ex. 8.0, p. 10). Aged receivables greater than 91 days are not likely to be collected and, therefore, demonstrate the amount of bad debt expense being caused by those customers whom Aqua either (a) cannot shut-off because they are sewer customers, or (b) should not shut-off because the expense of doing so would outweigh the likely recovery.¹³ (*Id.*, p. 9). In fact, because the identity of account holders who do not pay their bills remains fairly constant and Aqua presented evidence of delinquent accounts in this 2005 test year, the use of aged receivables to predict test year bad debt is highly accurate. (Aqua Ex. 6.0R, p. 8).

¹² In fact, for all water and sewer customers whom Aqua cannot shut-off, Aqua takes significant steps in other ways to induce payment. The evidence is replete with the examples, none of which were disputed. For instance, Aqua sends numerous collection notices, sends lien warning letters, files liens, submits notices in the WA's newsletter, sets up alternative means of payment to make paying the bill easier (i.e., automatic bank payments) and, when the circumstances show that the significant cost are worth it, Aqua files for foreclosures and personal judgments. (Aqua Ex. 5.0 2A, pp. 15-19, Att. A; Tr., pp. 80-84, 120).

¹³ Staff alleged for the first time in its Initial Brief that Aqua's use of aged receivables greater than 91 days is "unorthodox" and "bears no apparently relationship to the ... ability to predict future write-offs." (Staff IB, p. 9) (emphasis added). Aqua explained in its Reply Brief that Staff's allegation should not be considered because no witness testified to such a position and, thus, Aqua was not given the opportunity to present evidence to rebut the allegation. Aqua also explained that Staff's statement shows it is using the wrong standard—i.e., it is improperly seeking to predict future write-offs rather than future bad debt expense when write-offs can only account for the portion of bad debt expense or uncollectibles that can be written-off. (Aqua RB, p. 11; *see also*, Aqua IB, pp. 9, 11).

The Proposed Order correctly recognizes that aged receivables greater than 91 days is the best evidence available of the amount of bad debt expense that will be caused by delinquencies Aqua cannot write-off for the Oak Run Division and, thus, uses it to project the amount of bad debt expense that Aqua will not be able to write-off in that Division. (Proposed Order, pp. 14-15). Nonetheless, it declines to rely on this clear evidence in the same way for the Woodhaven Divisions. It provides one reason for not doing so: namely, because “Aqua and [the WA] agree in concept on a way to mitigate or perhaps even eliminate the uncollectibles problem—bulk billing.” (*Id.*, p. 20).

The term bulk billing is used to describe a concept whereby Aqua would bill the WA in total for all service to customers in the Woodhaven Divisions. The WA, in turn, would be responsible for the entire bill, and would bear the cost of any amounts it could not collect from the actual end users. Under such a scenario, Aqua’s uncollectibles expense for the Woodhaven Divisions should be reduced because the WA would bear responsibility for the total bill.¹⁴

Other than this general concept, however, the record does not contain evidence as to how a bulk billing arrangement would operate. (*See* Aqua IB, pp. 13-14; Staff IB, p. 21) (both stating that an evidentiary record on bulk billing and its impact on the Woodhaven Divisions’ revenue requirements was not developed). As such, the Proposed Order does not adopt bulk billing as a solution to eliminate the amount of uncollectibles the evidence shows Aqua will incur from delinquencies it cannot write-off. (Proposed Order, p. 20). Rather, it simply encourages Aqua and the WA to explore the option. (*Id.*) At the same time, however, it erroneously limits Aqua’s recovery to its historical write-offs for the Divisions. (*Id.*)

¹⁴ The evidence does not show that uncollectibles would be eliminated entirely, however. For example, there is always the risk that the WA would not pay the bulk bill. Aqua witness Mr. Bunosky also testified that there would continue to be aged receivables owed by customers that have not been collected prior to the implementation of the bulk billing arrangement. (Tr., p. 92).

The Proposed Order errs because it does not allow Aqua to recover the portion of its bad debt expense caused by delinquencies that are not written-off. While it recognizes bulk billing may be a way to reduce bad debt expense, the Proposed Order does not require the WA to implement the arrangement. As a result, Aqua is left with nothing—it is wholly denied recovery of a legitimate expense without any recourse. It has no means to force the WA to *fairly* implement a bulk billing arrangement, if at all.

In other words, there is no guarantee that Aqua could be successful in achieving an agreement with the WA to perform bulk billing on reasonable terms or at all. The Proposed Order's reliance on the chance that the parties may reach agreement, therefore, is not founded. The Commission should not rely on such voluntary action that may not materialize.

Irrespective, it is wholly improper for Aqua to be denied recovery of an operating expense on the off chance that it may be able to obtain an agreement from the WA. Bad debt expense is a legitimate operating expense that Aqua is legally entitled to recover in its entirety. *See e.g., New Landing Utility, Inc.*, ICC Dkt. 04-0610, 2005 Ill. PUC Lexis 640, *25 (2005) (taking into account the utility's bad debt as a line-item expenditure in setting water rates); *accord Illinois-American Water Co.*, ICC Dkt. 95-0076, 1995 Ill. PUC Lexis 884, *95 (1995). There is no legal basis for the Commission to except recovery in this situation.

As such, it would be in accordance with Aqua's legal right under the Public Utilities Act to recovery bad debt expense for the Commission to account for the possibility of bulk billing in an alternative way. Specifically, in the event the parties are able to implement a mutually compatible bulk billing arrangement, the Commission could require savings in bad debt expense to be returned to the WA in the form of a collections fee paid by Aqua. This collections fee would be paid until such time as new rates are set for the Divisions that exclude the savings.

Unless bulk billing comes to pass, however, Aqua should, consistent with the ruling for Oak Run, recover in rates the portion of bad debt expense that it cannot write-off.

Accordingly, Aqua respectfully requests that the Commission modify the language on pages 19-20 of the Proposed Order as follows:

~~Regardless of whatever amount Aqua seeks to recover for Woodhaven bad debt, however, the Commission is not inclined to adopt Aqua's position. As with Oak Run, the Commission understands Aqua's difficulties in collecting payment from Woodhaven Water and Sewer customers that it is unable to disconnect. Uncollectibles resulting in actual write-offs and uncollectibles resulting from delinquent customers that Aqua can not disconnect accumulate over time. But unlike Oak Run,~~

~~_____ While Aqua and WA agree in concept on a way to mitigate or perhaps even eliminate the uncollectibles problem—bulk billing -- there is no evidence how bulk billing would operate or what impact it would have on the revenue requirement, as Staff correctly points out. To ignore this alternative and include in rates a significant sum of money reflecting what a minority of delinquent customers owe is unreasonable. Doing so would not encourage the parties to come to any resolution of this issue and would most likely only exacerbate the problem and lead to Aqua seeking to include a larger amount of such bad debt expense in its next rate case.~~

~~_____ But the Commission will not order the implementation of the bulk billing alternative in this docket. As a practical matter, insufficient information exists in the record to establish such an arrangement and reflect its impact in Woodhaven Water and Sewer rates. Logically, Aqua would expend fewer resources if it did not have to deal with this uncollectibles problem, but the record simply does not contain adequate detail on this question. The Commission also recognizes the questions surrounding its authority to require bulk billing because the Public Utilities Act does not expressly grant authority to require a party other than the end user customers to pay for utility services or the ability to supervise the manner in which such party would collect payment, in turn, from the end user customers. As such, any bulk billing arrangement would need to be voluntarily agreed to by WA. Therefore, rRather than require bulk billing, the Commission strongly encourages Aqua and WA to negotiate in good faith means of implementing bulk billing, or any other mutually~~

acceptable alternative, to resolve this problem to their mutual satisfaction. How to address recovery of currently delinquent accounts may be discussed as well, but need not be reflected in any forward looking arrangement. Staff shall make itself available to help mediate such discussions if requested. In encouraging Aqua and WA to discuss bulk billing and/or other alternatives, the Commission does not mean to suggest that Aqua should not ~~feel free~~ continue to take other steps to encourage payment, such as installing shut off valves when appropriate, filing liens and a variety of other actions the record reflects Aqua has already been taking to induce payments.

If Aqua and WA agree to a bulk billing arrangement, savings in bad debt expense should be returned to the WA via a collections fee paid by Aqua until such time as the Commission may set new rates for the Divisions that reflect the bad debt expense savings. ~~Until the next rate case for Woodhaven Water and Sewer, however,~~ Until such time as bulk billing or any alternative arrangement is implemented, however, Aqua's rates should recover ~~include some level of~~ uncollectibles expense reflecting both its actual write offs and the amount Aqua cannot write-off. Bad debt is a legitimate operating expense that Aqua is entitled to recover in its entirety. See e.g., New Landing Utility, Inc., ICC Dkt. No. 04-0610, 2005 Ill. PUC Lexis 640, *25 (2005)(taking into account the water company's bad debt as a line-item expenditure in setting water rates); accord Illinois-American Water Co., Docket No. 95-0076, 1995 Ill. PUC Lexis 884, *95 (1995). While Staff identifies 4.2298% as the five year average combined ~~uncollectibles~~ rate of historical write-offs for Woodhaven Water and Sewer, this does not reflect any amount for the portion of uncollectibles Aqua cannot write-off. Consistent with the Commission's ruling for Oak Run, an additional amount should be allowed for the portion Aqua cannot write-off. Aged receivables greater than 91 days for the Divisions is the best evidence as to uncollectibles in total, and shows that Aqua is on track to incur greater uncollectibles in the test year than it is requesting recovery of in this proceeding. Accordingly, Aqua should be allowed recovery at test year proposed rates of \$85,279 and \$82,576 for Woodhaven Water and Sewer This percent of the revenue received by Woodhaven Water and Sewer shall be reflected in their respective rates as uncollectibles expense.

~~Having come to this conclusion, WA, as the party requesting bulk billing, is strongly advised not to "lose interest" in bulk billing since Aqua's new rates will not reflect the delinquent accounts that Aqua does not write off. While the current threat of~~

~~higher rates from such delinquent accounts has subsided, the Commission will not look favorably upon similar WA objections in the next rate case if it comes to light that WA failed to make the best of this opportunity.~~

3. Rate Case Expense

The Proposed Order erroneously disallows recovery of two components of Aqua's Rate Case Expense. These findings are erroneous because they are contrary to the evidence. In part, the findings also are inconsistent with the Commission's prior rulings in similar proceedings and are based on incorrect legal standards. The Commission should amend the Proposed Order to allow Aqua to recover its overall Rate Case Expense projections of \$129,875, \$160,950 and \$160,950 to process the Oak Run, Woodhaven Water and Woodhaven Sewer cases, respectively.

a. Aqua's Position Regarding Rate Case Expense

As an initial matter, the Proposed Order suggests that Aqua has in some fashion changed its position regarding the recovery of its rate case expenses during the course of this proceeding. (Proposed Order, p. 27.) On the contrary, Aqua's position in this proceeding is, and always has been, that the Commission should grant Aqua's full recovery of its original rate case expense projections. Moreover, Aqua has supported those projections with competent evidence throughout this proceeding.

In particular, Aqua seeks recovery of its original projections in the amount of \$129,875, \$160,950 and \$160,950, as amortized annually, to process the Oak Run, Woodhaven Water and Sewer cases. (*See* Aqua's Schedules C-2.2). In part, Aqua submitted Mr. Jack Schreyer's surrebuttal testimony to support its request for rate case expense, attached to which were copies of the actual invoices of expenses Aqua had incurred to that date to process these cases. The actual invoices proffered established how Aqua's actual expenses compared to its original

projections. Mr. Schreyer testified that the invoices support Aqua's full recovery of its *original projections* and expressly stated that *Aqua's position on rate case expense is the same now as when it first filed these cases*:

[I]t is my opinion that the amounts Aqua has incurred to date and reasonably anticipates to incur support Aqua's original projection of overall rate case expenses of \$129,875, \$160,950 and \$160,950 for Oak Run, Woodhaven Water and Sewer, respectively. Accordingly, Aqua requests full recovery of its original projection.

(Aqua Ex. 8.0, p. 14, ln. 332-36). It is very clear from this testimony that Aqua only has requested full recovery of its original rate case expense projections and that it is not seeking *any* increase over its original projections for rate case expense.

Finally, and perhaps most importantly, the Commission already has rejected arguments raised by Staff on the Petition for Interlocutory Review, including the argument that Aqua "updated" its original rate case expense projections in its surrebuttal filing. Instead, in reversing the underlying ruling to strike Mr. Schreyer's surrebuttal testimony on the issue, including Aqua's invoices, the Commission clearly concluded that Aqua is only seeking recovery of its original projections.

In order to correct the Proposed Order's mischaracterization of Aqua's position, Aqua requests that the Commission make the following changes to page 27 of the Proposed Order:

Aqua is entitled to recover reasonable rate case expenses. Aqua's rate case expenses include costs for outside legal counsel, outside consultants, support from its own rate department, and other miscellaneous items and activities. Aqua's December 2004 filing estimated total rate case expenses of \$160,950, \$160,950, and \$129,875 for Woodhaven Water, Woodhaven Sewer, and Oak Run, respectively.⁸ [Fn. 8: The rate case expenses for Woodhaven Water, Woodhaven Sewer, and Oak Run's prior rate cases amounted to \$44,855, \$62,491, and \$24,096, respectively. (See Schedules C-10.1(WW), C-10.1(WS), and C-10.1(OR))]. (See

Schedules C-10(WW), C-10(WS), and C-10(OR)) ~~Prior to filing its surrebuttal testimony, Aqua attempted to justify each individual component of its overall rate case expense for each division. As the evidentiary hearings approached, actual expenditures for some components were less than initially projected while actual expenditures for other components exceeded initial projections. Aqua's position is that its original projections are supported in total.~~ Staff recommends several adjustments to rate case expenses, including limiting recovery to actual expenses where actual expenses for the underlying components of rate case expense do not exceed the initial projection. Where the actual expenses for a component exceed the initial projection, Staff recommends capping recovery at the level of the initial projection.

~~In its surrebuttal testimony, Aqua began arguing that its overall rate case expense projections should be considered rather than the individual components.~~ Because rate case expense is incurred over the course of rate proceedings, Aqua points out that the final amounts are not known until case completion. Aqua also claims that the Commission allows recovery of actual costs incurred plus a reasonable estimate of the costs that will be incurred through the conclusion of the case. Aqua adds that the Commission has accepted actual costs to complete similar cases as a reasonable basis to estimate costs through case completion. Aqua contends that the most recent rate case for its Vermillion Division, Docket No. 04-0442, is a similar case and as such can be used to justify Aqua's projected overall rate case expenses through the conclusion of this proceeding.

In addition, because Aqua has taken the consistent position in this proceeding that it should be granted its full recovery of original rate case expense projections, Aqua submits that the language in the Proposed Order commenting on Aqua's alleged surrebuttal proposal is surplusage that should be stricken. Accordingly, Aqua respectfully requests that the Proposed Order be amended at page 28 by striking the last full paragraph found on that page.¹⁵

¹⁵ The reference in the last paragraph on page 28 to the timing of Aqua's "surrebuttal proposal" is addressed in the next sub-section of this Brief.

b. Timeliness of Aqua's Evidentiary Submissions

The Proposed Order erroneously finds that Aqua's surrebuttal represents an untimely attempt to update certain rate case expense components. Specifically, the Proposed Order states that "[t]he relative lateness of Aqua's proposal is troubling in that it limits the Commission's ability to review the reasonableness of expenses within the individual rate case expense components." However, this finding is unsupported by the evidence, which demonstrates conclusively that Aqua did *not* provide these invoices to Staff for the first time via surrebuttal testimony. Instead, in response to data requests ("DRs") served by Staff witness Ms. Bonita Pearce, Aqua began providing copies of its invoices to Staff and the intervening parties on March 15, 2005, over four months before the evidentiary hearings. (Aqua Cross Ex. 2; Tr., pp. 340-50; 365-67). Aqua continually supplemented its response to these data requests each month as it received additional rate case expense invoices. (*Id.*)

Aqua also provided Staff with summaries of its rate case expenses based on its invoices in response to the DRs served by Ms. Pearce. The summaries were prepared by invoice and identified the service provider and the associated expense. Aqua also provided a total of the expenses. Aqua, thus, provided Staff with a running tab of its rate case expenses. (Tr., p. 372 (Ms. Pearce admitting Aqua provided these summaries)).

Staff had all of these invoices, along with Aqua's summaries, in more than sufficient time to perform its review. Indeed, Ms. Pearce testified that the review she performed was very minimal, describing it as follows:

I reviewed them on the face of it. They appeared to be copies of actual invoices from Aqua, Sonnenschein. And I also reviewed the summaries that were provided by the Company that included the descriptions and amounts, and I compared those to the amounts that were on the invoices.

(Tr., pp. 372-73). Accordingly, Ms. Pearce would have had time to perform this review with respect to all of the invoices provided before the start of the evidentiary hearings on July 27, 2005.

In fact, Ms. Pearce testified under examination that she reviewed all the invoices within a reasonable time of receipt. (Tr., p. 350). Aqua had provided Ms. Pearce with 182 pages of the 279 total pages of invoices before her July 7, 2005, rebuttal testimony. It only provided 97 pages of invoices to Staff on or subsequent to July 7, 2005. Of these 97 pages, Aqua provided 33 on July 7, 2005, 25 on July 8, 2005, 21 on July 19, 2005 and 18 on July 20, 2005. As such, Staff had more than sufficient time prior to the evidentiary hearings on July 27, 2005 to review all of these invoices.

The Proposed Order compounds the erroneous finding by applying the wrong standard for analyzing the issue. While the Proposed Order states that the timing of Aqua's submission of evidence limited Staff's ability to review it, the question of how much time Staff may have had to review the information is irrelevant to the analysis. The timeliness of disclosure is a procedural issue that may go to the admissibility of evidence. *See Bachman v. General Motors Corp.*, 332 Ill. App. 3d 760, 791-92 (4th Dist. 2002). However, it is not a factor that goes to the merits of the evidence nor is it a legal basis to disregard evidence once it has been admitted. Aqua's legal invoices were admitted into evidence after Aqua's successful Petition for Interlocutory Review. The invoices support Aqua's rate case expense projections and should be given all appropriate evidentiary weight.

Given Aqua's timely submission of evidence supporting recovery of its rate case expense projections, Aqua respectfully requests that the Commission modify page 29 of the Proposed

Order by striking the first full paragraph in its entirety.¹⁶ This modification is further supported by the fact that this paragraph contains dicta regarding alleged dangers of “Aqua’s approach” that is prejudicial to Aqua and has no bearing on the Proposed Order’s conclusions regarding Aqua’s rate case expense recovery. Moreover, as discussed *infra*, this language is contrary to prior Commission Orders. *See Consumers Ill. Water Co.*, Dkt. 03-0403, 2004 Ill. PUC Lexis 382, *47-*51 (Commission allowing Aqua to submit revised estimates of actual rate case expense, based on actual invoices incurred and projections of costs to complete the case, in rebuttal testimony, again in surrebuttal testimony and again at the evidentiary hearings).

c. Substance of Aqua’s Evidentiary Submissions

The Proposed Order erroneously concludes that certain of Aqua’s rate case expense components should be capped at the original projection amounts filed by Aqua while other components should be reduced from the original projection amounts.¹⁷ Specifically, the Proposed Order concludes that “the level of outside legal expenses that Aqua is allowed to recover in rates for each division is limited to its original projection contained in its December 2004 filing for each division” and that “Aqua’s recovery in rates for each division of GPM’s fees is limited to its original projection contained in its December 2004 filing for each division.” (Proposed Order, pp. 34, 37.)

In so concluding, the Proposed Order penalizes Aqua for not being able to accurately predict the distribution of rate case expense across the various sub-components of that expense.

Penalizing Aqua for the inherently imperfect task of predicting expenses is inappropriate,

¹⁶ As noted above, Aqua respectfully submits that the last full paragraph on page 28 should be stricken from the Proposed Order, including its finding that “Aqua’s attempt to update certain rate case expense components comes relatively late in the proceeding.”

¹⁷ Except for Aqua’s position that the Commission should approve its overall rate case expense projections in total, Aqua does not contest, and therefore files no exception to, the Proposed Order’s conclusions regarding its Rate Department expense, its Miscellaneous expense and its AUS Consultants expense. (*See* Proposed Order, pp. 37-43).

especially where, as here, Aqua's requested recovery amount does not exceed the total of its original projections for rate case expense. While the Proposed Order recognizes that "accurately projecting expenses is very difficult," the Proposed Order does not acknowledge, as it should, that rate case expense is a unique expense in a rate case proceeding because it is entirely dependent on the course of the proceeding.

As Aqua demonstrated in its post-hearing briefs, actual events in these cases 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). These events include the active role of two intervenors and the heightened review of Staff as evidenced by the almost 700 DRs issued. (Aqua Ex. 6.0R, p. 30). Moreover, Aqua submits that it is appropriate to include a margin of error to account for unanticipated events that may arise, which occurred here with an expedited Petition for Interlocutory Review during the evidentiary hearings as well as Aqua's need to correct Income Tax and revenue increase calculation errors.

Moreover, the conclusion of the Proposed Order to cap certain of Aqua's rate case expense components and adjust other components downward ignores the 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 175, 208 (1991) ("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) (citing 220 ILCS 5/9-201(c)); *Citizens Util. Bd. v. ICC*, 276 Ill. App. 3d 730 (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 *infra*, because the evidence fully supports Aqua’s original projections.

In the event the Commission determines it should engage in a component-by-component analysis, it must do so in a balanced fashion. As the Proposed Order recognizes, actual costs deviate from Aqua’s original projections for the rate case expense components in *both* directions. Adjustments are only balanced, therefore, if they are made in *both* directions. As noted in footnote 15, Aqua supports the finding of the Proposed Order with respect to its Rate Department expense and its Miscellaneous expense. However, an equitable ruling would adjust Aqua’s Outside Legal and Witness expenses upward to balance the downward adjustments to these other components. Accordingly, Aqua submits that if the Commission engages in a component-by-component analysis, the Commission should balance the downward adjustments to Rate Department Expense and Miscellaneous expense by making upward adjustments to Outside Legal and Witness expense.

The Proposed Order compounds the error by basing its conclusion to limit Aqua’s recovery of Outside Legal and Witness expense entirely upon matters that were not raised at the evidentiary hearings or in any submissions of the parties to these rate cases. In particular, the Proposed Order states:

The Commission notes that there is minimal discussion in the record of exactly what services were rendered in return for outside legal expenses. While it is obvious that counsel for Aqua attended hearings and assisted with and prepared certain filings, it is not clear whether all of the time and resources devoted by outside counsel were reasonable

(Proposed Order, p. 32.) However, the reasonableness of the services performed that formed the basis of Aqua's expenses was not an issue to be resolved by the Proposed Order, as it was not an issue raised by any party to this proceeding. No party ever challenged the reasonableness of the legal services being performed by Aqua's outside counsel or the consulting services being performed by Aqua's witness Mr. Monie. Instead, the only issue ever raised in the proceeding was whether Aqua provided sufficient evidence to demonstrate that it would actually incur its initial Rate Case Expense projections.

The Illinois statutory scheme which governs this proceeding limits the Commission's consideration to matters raised at the evidentiary hearings. Of particular relevance here is the following statutory provision: "In any hearing, proceeding, investigation or rulemaking conducted by the Commission, the Commission, commissioner or hearing examiner presiding, shall, after the close of evidentiary hearings, prepare a recommended or tentative decision, finding or order including a statement of findings and conclusions and the reasons or basis therefore, *on all the material issues of fact, law or discretion presented on the record.*" 220 ILCS 5/10-111 (emphasis added). Here, the only issue regarding Aqua's Rate Case Expense that was presented on the record at the evidentiary hearings was the sufficiency of Aqua's evidentiary submissions. It would be manifestly inequitable to sustain the conclusion of the Proposed Order as to the "reasonableness" of the services performed by Aqua's outside legal counsel and witness Mr. Monie where Aqua was given no opportunity to address that issue within the context of the evidentiary hearings.

Even if the Proposed Order had properly addressed the reasonableness of the services performed, the Proposed Order erred in several respects in concluding that not all the amounts incurred by Aqua for outside legal services and witness fees were reasonable.

First, the Proposed Order errs by according “little weight” to the invoices for outside legal services as support for the reasonableness of these costs. The Proposed Order states that the invoices submitted by Aqua “tell the Commission nothing about the service provided or the reasonableness of the expense incurred,” because the “narrative” column on each invoice is blank. (Proposed Order, p. 32). Because the narrative portion of the invoices of Aqua’s outside counsel describes the attorney work performed, that information is privileged and was properly redacted from each invoice submitted into evidence. *See Stricklin v. Becan*, 293 Ill. App. 3d 886, 891 (4th Dist. 1997) (holding that letter could be privileged from discovery but to the extent it contained non-privileged material “that portion of the document is to be ordered produced to plaintiff after redacting any privileged material”). Indeed, even though Aqua submitted redacted invoices to Staff in the same form as those submitted into evidence here as part of the discovery process, *Staff never objected to the redactions made by Aqua*. Moreover, Staff never questioned the reasonableness of the services being performed. As Aqua’s redactions of its invoices were entirely proper and unobjectionable to Staff, Aqua respectfully requests that the Commission modify the Proposed Order by striking the last paragraph on page 32.¹⁸

Second, the Proposed Order errs by finding “evidence of the unreasonableness of Aqua’s outside counsel expenses” in the fact that Aqua “used its outside counsel for miscellaneous activities, such as copying, postage, transcript fees, and filings, rather than handling the activities in-house.” (Proposed Order, p. 33). The Proposed Order fails to consider, however, that most of these miscellaneous costs are fixed amounts that have nothing to do with the manner in which they were incurred. Aqua would incur the exact same cost for requesting a transcript or making

¹⁸ This portion of the Proposed Order should also be stricken because, like the rest of the Proposed Order’s discussion on the reasonableness of the services performed by outside counsel, no party raised Aqua’s redactions of its invoices as an issue in the case. As noted, Staff, who was the recipient of this discovery, did not object to Aqua’s redactions. As such, the Proposed Order, by discrediting Aqua’s invoices because they contain redactions, addresses an issue not raised by the parties and, thereby, again exceeds the authority granted by 220 ILCS 5/10-111.

a filing regardless of whether Aqua paid the amount up front or reimbursed its outside counsel for their payment of the amount. The only reason that Aqua is seeking recovery of these costs under the component of Outside Legal expense as opposed to Miscellaneous expense is because Aqua's outside counsel paid the costs in the first instance. Accordingly, there is no merit to this finding in the Proposed Order and Aqua respectfully requests that the Commission modify the Proposed Order by striking the first paragraph on page 33.

Third, the Proposed Order errs by concluding that the volume of discovery conducted in this proceeding has no bearing on the amount of outside legal costs incurred by Aqua. Specifically, the Proposed Order concludes "the Commission can not say with any certainty whether Staff conducted a more thorough review in this proceeding than it has in prior rate proceedings." (Proposed Order, pp. 33-34.) This conclusion is simply not supported by the facts. As noted above, Staff issued nearly 700 data requests during the course of discovery. Although Staff claimed that the number is, in part, the result of it issuing duplicate data requests for each of the three Divisions, only 76 requests actually called for the same answers. Each non-duplicative request demanded individualized consideration and response from Aqua and its outside counsel. Because the Proposed Order's conclusion regarding Staff's review in this proceeding is wholly unsupported by the record, Aqua respectfully requests that the Commission modify the Proposed Order by striking the last two paragraphs on page 33.

Fourth, the Proposed Order errs by questioning the assumptions used by Aqua in projecting its witness expenses and implying that Aqua has acted unreasonably in some fashion in incurring these expenses. However, Aqua's ability to accurately project its witness expenses has no bearing on whether the expenses incurred were reasonable, which is purportedly the review being conducted in the Proposed Order. Accordingly, Aqua respectfully requests that the

Commission modify the Proposed Order by striking the last paragraph on page 36 and the first two lines on page 37.

Fifth, the Proposed Order errs by relying upon amounts incurred by Aqua in prior rate cases to determine the reasonableness of Aqua's witness expenses in this proceeding. That reliance is misplaced because, as demonstrated above, the level of review imposed by Staff here has exceeded that imposed in prior rate cases and has necessitated Aqua's increased reliance upon its outside witness Mr. David Monie. Moreover, Aqua also has had to respond to the claims of active intervenors in this case. Because the events in this proceeding do not mirror those in prior rate cases, Aqua respectfully requests that the Commission modify the Proposed Order by striking the first paragraph on page 37.

When properly limited to the issues raised before the ALJ, the Proposed Order should be revised to conclude that Aqua has sufficiently supported its request for rate case expense recovery in these cases.

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 III. Water Co.*, ICC 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 costs through case completion was based on Aqua's actual costs in a similar rate case). Aqua's original projections are supported by the competent evidence of its actual costs, as demonstrated by its invoices, and the testimony of Mr. Schreyer and, therefore, 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, Docket No. 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. *Consumers Ill. Water Co.*, ICC Dkt. 03-0403, 2004 Ill. PUC Lexis 382, *49.

In that case, 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.* at *50. It also found that Aqua's estimate "was more likely to be observed than the estimate offered by Staff." *Id.* at *51. 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.* at *50-*51. 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 sworn witness declarations **submitted with the utility's post-hearing reply brief** that showed actual billings, work in process and estimates through case completion); *In Re Lake Placid Util.*, Dkt. 951027-WS, 1996 WL 422594, slip op. at 6 (Fla. P.S.C. July 15, 1996) (relying upon **actual invoices and a second**

revised estimate to complete submitted at the request of the Commission while considering final approval of rate increases to find that the amounts were reasonable).

Because Aqua submitted sufficient evidence to support recovery of its original rate case expense projections, Aqua respectfully requests that the Commission modify pages 32 through 34 in section 4(a) of the Proposed Order as follows:

Aqua proposes in its surrebuttal testimony that it be allowed to recover all of its legal fees so long as the total recovered rate case expense does not exceed its original total rate case expense projection. Aqua believes it is appropriate to recover more for outside legal fees because Aqua has actually incurred fees in excess of its original projection for this component of the Rate Case Expense. Further, Aqua submits that recovery of its actual expenses in outside legal fees should not raise an issue where, as here, actual expenses for other rate case expense components have been less than projected. Aqua maintains that it should be allowed to recover these amounts because this proceeding has involved two active interveners and Staff has, in its opinion, conducted a more thorough review than it did in Aqua's most recent rate case for its Vermillion Division (Docket No. 04-0442). Aqua also states that it used its outside counsel for miscellaneous activities, such as copying, postage, transcript fees, and filings, rather than handling the activities in-house. Overall, Aqua indicates that it simply relied on outside counsel to a much greater extent than anticipated. Aqua ~~states seems to suggest~~ that the invoices attached to its surrebuttal testimony ~~support justify~~ recovery of the legal fees.

* * *

~~Aqua is entitled to recover in rates the expenses incurred to support its rate filing, but only those expenses that are reasonable. The notion underlying Aqua's position on the recovery of its outside legal expenses seems to be that because Aqua paid the invoices for the outside legal services, the expenses must be reasonable. The Commission notes that there is minimal discussion in the record of exactly what services were rendered in return for outside legal expenses. While it is obvious that counsel for Aqua attended hearings and assisted with and prepared certain filings, it is not clear whether all of the time and resources devoted by outside counsel were reasonable.~~

~~Aqua argues that invoices for outside legal services contained in Exhibit D attached to its Exhibit 8.0 support its calculation of total outside legal expenses. Actual invoices are generally good evidence of an expense having been incurred, but the offered invoices tell the Commission nothing about the service provided or the reasonableness of the expense incurred. The Commission observes that none of the many invoices from Aqua's outside counsel contain any narrative of the activities engaged in. In fact, the "narrative" column on each invoice is blank. If the narrative column was blank when Aqua received the invoices, the Commission questions the wisdom and reasonableness of paying such bills without an explanation of services rendered. If the narrative column was redacted for purposes of this proceeding, the Commission questions the appropriateness of offering an incomplete document into the record without any clear statement that information has been removed. While it is possible that Aqua and its counsel feared that narratives of some of the activities might have revealed privileged information, such a concern does not explain why no narratives were provided. Accordingly, the invoices for outside legal services contained in Exhibit D are accorded little weight as support for the reasonableness of such costs.~~

[As set forth above, Aqua proposes that the next four full paragraphs from pages 33-34 be stricken from the Proposed Order in their entirety.]

Aqua clearly incurred legal expenses in this proceeding that are clearly supported by the evidence provided, including the invoices submitted and the sworn testimony of Aqua witness Mr. Schreyer as to the amount Aqua estimated it would incur through rate completion, but absent a sufficient showing or explanation of the work behind the invoices for outside legal services, the Commission is unable to conclude that all of the billed amounts are reasonable and should be recovered from customers. Accordingly, in light of the foregoing, and in the absence of any extenuating circumstances, the level of outside legal expenses that Aqua is allowed to recover in rates for each division is limited to its original projections contained in its December 2004 filing for each division. The Commission notes further that had it accepted Aqua's proposal to limit review to overall rate case expense, Aqua would have avoided scrutiny of expenses found unsupported by the Commission. Specifically, Aqua is allowed to recover its overall Rate Case Expense projections of \$129,875, \$160,950 and \$160,950, including its actual costs incurred in outside legal expenses and witness fees, to

process the Oak Run, Woodhaven Water and Woodhaven Sewer cases, respectively.

Further, Aqua respectfully requests that the Commission modify pages 36 through 37 in section 4(b) of the Proposed Order as follows:

As with outside legal expenses, Aqua is entitled to recover ~~reasonable~~ expenses for consultants and expert witnesses hired to support Aqua's rate request. Aqua hired GPM to assist with issues concerning rate design, including responding to rate design data requests. The Commission must now determine whether Aqua should be allowed to recover amounts billed by GPM above what Aqua originally estimated GPM's services would cost. Given the level of GPM's involvement in the case, Staff challenges Aqua's effort to pass on to ratepayers the full amount invoiced by GPM. Aqua suggests that Staff fails to appreciate just how much GPM did in this proceeding.

~~At the outset, the Commission notes that by the time of the evidentiary hearing, disagreements concerning rate design issues had been resolved. In fact, the full extent of Mr. Monie's involvement in the hearing is reflected on roughly five pages of the transcript (Tr. 168-172) when he identified and affirmed his previously submitted written testimony. As Staff points out, Mr. Monie appeared at the hearing by telephone and was asked no cross or clarifying questions. From the transcript, it appears that he also "hung up" after the admission of his testimony. These facts draw into question just how much Mr. Monie could have contributed to the hearing and to briefs which do not address any contested rate design issues.~~

[As set forth above, Aqua proposes that the next two paragraphs from pages 36-37 be stricken from the Proposed Order in their entirety.]

Accordingly, in light of the foregoing and based upon the evidence submitted by Aqua regarding its witness expenses in the absence of any extenuating circumstances, Aqua's recovery in rates for each division of GPM's fees is not limited to its original projection contained in its December 2004 filing for each division, and, Aqua is allowed to recover its overall Rate Case Expense projections of \$129,875, \$160,950 and \$160,950, including its actual costs incurred in outside legal expenses and witness fees, to process the Oak Run, Woodhaven Water and Woodhaven Sewer cases, respectively. Aqua must realize that simply paying an

~~invoice does not mean that the expense is reasonable and recoverable from customers.~~

4. Amortization Period of Rate Case Expense

It is uncontested that Rate Case Expense “should be recovered over the period of time that the subject tariffs are reasonably anticipated to be in effect.” (Staff Ex. 6.0, p. 24). Aqua intends to file its next rate cases for the two Woodhaven Divisions within four years to capture the effects of inflation and capital investments that are routinely incurred and, thereby, avoid any degree of rate shock that would result from longer intervals. (Aqua Ex. 6.0R, p. 39). It intends to file its next rate case for Oak Run within three years to capture the capital investment to install the RO Plant in 2007. (Aqua Ex. 6.0R, p. 39). The evidence supports a finding that Aqua is likely to build the RO Plant in 2007. (Aqua Ex. 5.0 2A, pp. 1-5). If, for some reason, however, Aqua does not build the RO Plant for Oak Run, it would similarly intend to file a rate case for Oak Run within four years to capture the effects of inflation and routine capital investments. (Aqua Ex. 6.0R, p. 39). As such, Aqua’s Rate Case Expense should be amortized over four years for the Woodhaven Divisions and over three years for the Oak Run Division, but at a maximum over four years for the Oak Run Division should the Commission, for some reason, decide that the RO Plant is not likely to be built.

The Proposed Order instead relies on Staff’s historical analysis of rate case intervals for the three Divisions to adopt an amortization period of five years for each. (Proposed Order, p. 48). Use of a historical analysis conflicts with the uncontested premise that Rate Case Expense should be amortized over the period the rates are likely to be in effect. Here, it is clear that Aqua intends to file its next rate cases for the Divisions within four years and, with respect to Oak Run, most probably within three years.

Further, the Proposed Order errs in determining that Aqua is not likely to build the RO Plant for the Oak Run Division in 2007. (Proposed Order, p. 48). While the ORPOA asserts that consumers will not vote to install the RO Plant, it does not know that they will not and all of the reasons the ORPOA advances in support of its speculation are flawed. (See Aqua IB, pp. 6-7) (explaining the flaws underlying each of the reasons advanced by the ORPOA's for its position). The evidence supports Aqua's opinion that consumers will vote in favor of the RO Plant, particularly given the significant water quality benefits the RO Plant would bring to the Division. (See *Id.*, p. 7) (citing Aqua Ex. 5.0 2A, pp. 2-5). These are benefits that the Federal EPA, Illinois EPA and health industry have set goals to achieve. See 40 C.F.R. §143.3; 35 Ill. Adm. Code §654.403. Indeed, the majority of customers have already formally stated their opinion in favor of the water quality produced by the RO Plant. (Tr., pp. 131-32). Accordingly, it is highly likely customers will vote in favor of Aqua installing the RO Plant.

Aqua requests, therefore, that page 48 of the Proposed Order be modified to reflect an amortization period of four years for the Woodhaven Divisions and three years for the Oak Run Division as follows:

The Commission generally concurs with the premise that rate case expense should be recovered over the period in which rates are anticipated to be in effect. Staff's approach to determining appropriate rate case expense amortization periods. As Staff suggests, examining a company's historical pattern of submitting rate increases may give some indication of what this period will be; but, because it looks to history rather than facts relating to the future period in which rates will be in effect, a pure historical analysis falls short is objective. Good reasons may exist and situations may arise that warrant deviating from a historical pattern, and evidence of factors that will come into play during the future rate period warrant consideration but absent such, Staff's analysis of historical patterns is the generally preferred approach.

We find Aqua's intention to file its next rate cases for these Divisions within four years to capture the effect of inflation and

routine capital investments reasonable. Given that this is clear evidence of the future period rates will likely be in effect, we adopt a four year amortization period for the Woodhaven Divisions. For the Oak Run Division, we further note the evidence as to Aqua's intent to build the RO Plant in 2007, and its testimony that it will need to file a rate case in 2008, or within three years, to capture the impact of that significant investment. We find that Aqua is likely to build the RO Plant in 2007 despite the ORPOA's testimony that consumers may not vote in favor of the RO Plant. The evidence shows, to the contrary, that consumers most likely will vote to install the RO Plant given the significant benefits to water quality the RO Plant would bring, and the fact that consumers have already expressed a clear preference for the water quality improvements from the RO Plant. Therefore, the Commission will adopt a three year amortization period for the Oak Run Division. The historical pattern of rate filings for Woodhaven Water leads to the adoption of a five year amortization period of rate case expense. The Commission can not perceive any reason why adherence to the historical pattern is not warranted for Woodhaven Water. Staff's proposed seven year amortization period for Woodhaven Sewer, however, is not adopted even though it is based on a historical analysis of rate filings. The Commission rejects Staff's seven year period because it contradicts another of Staff's recommendations that Aqua combine rate filings to save on rate case expense. Combining Woodhaven Water and Sewer rate filings seems logical and consistent with Staff's proposals to minimize rate case expense, but Staff's amortization period proposal runs afoul of this effort. Accordingly, the Commission concludes that the greater good is served by adopting a five year amortization period for Woodhaven Sewer as well, thereby encouraging Aqua to file its next rate cases for Woodhaven Water and Sewer together.

— With regard to Oak Run, the Commission is not convinced that the reverse osmosis plant will be built when Aqua expects, if at all.⁴⁴ [Fn 11. In making this statement, the Commission is expressing no opinion on the merits of a reverse osmosis plant for Oak Run.] Therefore, Oak Run's rate case expense will not be amortized over a three year period. Nor, however, will it be amortized over a seven year period either. In order to further encourage Aqua to combine rate case filings to lessen rate case expense, the Commission will adopt a five year rate case expense amortization period for Oak Run as well.

5. State and Federal Income Tax Calculations

During its review of Staff's rebuttal schedules, Aqua discovered that Staff's income tax calculations were misstated. The error revealed itself to Aqua for investigation following Staff's rebuttal filing. Based on Staff's adjustments to Aqua's rate request in Staff's rebuttal filing, income taxes should have increased as compared to Staff's direct case filing; but, Staff's rebuttal schedules showed income taxes as having decreased. (Aqua Ex. 8.0, p. 6). Aqua investigated this anomaly by running *Staff's numbers* through what is the well-established calculation for identifying Taxable Income: pro forma proposed revenue requirement less operating expenses before income taxes less synchronized interest. (*Id.*, p. 4). Aqua then multiplied this amount by *the State tax rate of 7.30%* to produce the State Income Tax that Staff should have identified in its rebuttal schedules. (*Id.*, pp. 4-5). That Aqua was correct in suspecting that the anomaly in Staff's income tax amounts between its direct and rebuttal filings reflected an underlying error in Staff's calculation was thus confirmed. Each Division's Taxable Income (as calculated using Staff's numbers) multiplied by the State tax rate of 7.30% produces State Income Tax amounts different than those shown by Staff in column (i) of its Schedules 6.01 (OR), (WW) and (WS). (*Id.*) In turn, Aqua confirmed that Staff's Federal Income Tax amounts were also in error because using either the correct or the Staff erroneous State Income Tax as the State deduction for Federal purposes results in Federal Income Tax amounts that are different than those Staff identified in its Schedules 6.01. (*Id.*, p. 5).

While conceding an error in its calculations, Staff asserted that part of the difference is caused by Aqua's alleged usage of (i) 7.18% rather than 7.30% as the State income tax rate, and (ii) a different amount of interest expense than that used by Staff. (Staff IB, p. 50). However, as noted above, Aqua used 7.30% as the State income tax rate as well as Staff's rebuttal numbers,

including interest expense, to run the correct calculations for Staff's rebuttal schedules. Staff's allegations that Aqua ran its corrective calculations using a rate of 7.18% or something other than Staff's numbers do not have any merit.

The Proposed Order correctly recognizes that Staff's schedules do contain erroneous levels of income tax expense. (Proposed Order, p. 49). However, it incorrectly blames Aqua for Staff's error. It states that the problem "appears to stem from Aqua's original filing which incorporated an incorrect State income tax rate and produced an incorrect State income tax expense for each operating division." (*Id.*) It then goes on to state its disappointment in Aqua for not discovering Staff's error sooner, implying that Aqua somehow placed the Commission "in the difficult situation" of having to develop the proper income tax expenses. (*Id.*)

First, the Proposed Order is wrong that Staff's error stems from Aqua's use of a 7.18% State Income Tax rate in its original filing. Aqua utilized 7.30% as the State Income Tax rate in all of its schedules filed later in the case. Irrespective, however, the rate Aqua used is irrelevant to whether Staff used the correct rate in its schedules. Staff has complete control over the development of its schedules and the determination of the Income Tax rate to use therein. The Proposed Order improperly holds Aqua responsible for Staff's possible use of an incorrect rate.¹⁹

Second, Aqua does not have the resources to double-check all of Staff's calculations set forth in its rate case schedules. Rather, Aqua generally has to trust that Staff has performed the calculations correctly. Here, it was only because of the anomaly between the Income Tax calculations in Staff's direct and rebuttal schedules that Aqua became aware of a potential error and had noticed that corrective calculations may need to be performed. The Proposed Order is

¹⁹ It is unclear whether Staff was arriving at incorrect Income Tax amounts because it used the wrong tax rate or because of an error in the formula Staff used to derive the amounts.

incorrect in faulting Aqua for not discovering earlier Staff calculation error that was not apparent on the face of Staff's direct schedules.

Accordingly, Aqua requests that the Commission modify page 49 of the Proposed Order as follows:

The Commission has reviewed the Schedules attached to Staff's Initial Brief and there are, in fact, erroneous levels of income tax expense stated therein. ~~This problem appears to stem from Aqua's original filing which incorporated an incorrect State income tax rate and produced an incorrect State income tax expense for each operating division.~~ This problem has been corrected in the Appendix attached to this Order. The Commission has added column (e) on page 2 of each operating division's Statement of Operating Income With Adjustments. This column removes the effect of the incorrect State income tax rate incorporated in Aqua's original and rebuttal filings. Column (h) on that page, which carries forward to column (b) on page 1 of each operating division's Statement of Operating Income With Adjustments comport to what Aqua characterizes as the "well established calculation" used to identify taxable income and associated State income tax.

~~While it is appropriate to allow Aqua, or any utility, the opportunity to recover its income tax expenses, the Commission is somewhat disappointed that this issue was identified for the first time in Aqua's surrebuttal testimony. Had this problem, which clearly existed earlier in the case, been identified and addressed in a more timely manner, it could have been resolved and the Commission would not be placed in the difficult situation of attempting to develop the proper method for calculating Aqua's State income tax expense in this Order.~~

6. Commission Conclusion on Operating Income/Revenue Requirements

To implement Aqua's proposed operating expense changes as set forth herein, Aqua proposes that the Commission make the following changes at page 50 of the Proposed Order setting forth its conclusions on final operating income and revenue requirements:

Giving effect to the adjustments approved above and the rates of return on rate base authorized hereafter in this Order, the

Commission concludes that the net operating income for Woodhaven Water, Woodhaven Sewer, and Oak Run are \$250,300, ~~\$253,654~~\$255,962, and \$140,539, respectively. The net operating income for Woodhaven Water reflects a revenue increase of ~~\$433,984~~ \$482,598 or ~~54.37%~~ 60.46%, which is authorized by this Order. The operating income for Woodhaven Sewer reflects a revenue increase of ~~\$345,271~~ \$399,984 or ~~46.00%~~ 53.29%, which is authorized by this Order. The net operating income for Oak Run reflects a revenue increase of ~~\$169,861~~ \$190,701 or ~~51.49%~~ 57.81%, which is authorized by this Order. The appendices attached hereto provide supporting calculations for the conclusions contained herein.

In addition, finding paragraphs (15), (16) and (17) should be amended for two reasons. First, to reflect Aqua's proposed operating expense changes as set forth herein. Second, to correct an error in the Proposed Order's calculation of the base rate revenue increases. The Proposed Order inappropriately compares the "Total Operating Revenue" increase with the "Operating Revenue" component rather than the "Total Operating Revenue" component. (*See* Proposed Order, App. A - C, Col. (a), ln. 1, 4). As a result, the dollar and percentage increase the Proposed Order sets forth for "annual base rate revenues" is not correct. To correctly calculate increases in "annual base rate revenues," the Proposed Order should not have taken into account the "Other Revenues" component of "Total Operating Revenue" that are produced by rates for which rate increases have not been proposed, *e.g.*, rates for turn-on fees. Accordingly, Aqua proposes that finding paragraphs (15), (16) and (17) be modified as follows:

(15) Woodhaven Water should be authorized to place into effect tariff sheets designed to produce annual base rate revenues of ~~\$1,167,657~~ \$1,217,065, which represent an increase of ~~\$433,984~~ \$460,934 or ~~54.37%~~ 60.96%; and that are designed to produce annual total revenues of \$1,280,868, which represent an increase of \$482,598 or 60.46%; such revenues will provide Woodhaven Water with an opportunity to earn the rate of return set forth in Finding (8) above; based on the record in this proceeding, this return is fair and reasonable for Woodhaven Water;

(16) Woodhaven Sewer should be authorized to place into effect tariff sheets designed to produce annual base rate revenues of ~~\$1,049,321~~ \$1,106,316, which represent an increase of ~~\$345,274~~ \$384,600 or ~~46.00%~~ 53.29%; and that are designed to produce annual total revenues of \$1,150,569, which represent an increase of \$399,984 or 53.29%; such revenues will provide Woodhaven Sewer with an opportunity to earn the rate of return set forth in Finding (8) above; based on the record in this proceeding, this return is fair and reasonable for Woodhaven Sewer;

(17) Oak Run should be authorized to place into effect tariff sheets designed to produce annual base rate revenues of ~~\$494,149~~ \$515,110, which represent an increase of ~~\$169,861~~ \$188,999 or ~~51.49%~~ 57.96%; and that are designed to produce annual total revenues of \$520,591, which represent an increase of \$190,701 or 57.81%; such revenues will provide Oak Run with an opportunity to earn the rate of return set forth in Finding (8) above; based on the record in this proceeding, this return is fair and reasonable for Oak Run;

C. Cost of Capital/Rate of Return

The Proposed Order recognizes that Aqua did not contest Staff's proposed capital structure and cost of capital, including cost of common equity. (Proposed Order, pp. 50-53). It, further, notes that Staff's cost of common equity includes a 30 basis point "investment risk premium," even though Staff questions the need for the premium, because the Commission adopted the premium in Aqua's most recent two rate cases—*i.e.*, for its Kankakee Division in Docket 03-0403 and for its Vermilion Division in Docket 04-0442. (*Id.*, pp. 52-53). It states that, "in Aqua's next rate proceeding, the Commission expects to reconsider the propriety of an incremental investment risk premium on the cost of common equity." (*Id.*)

The Proposed Order's remarks as to what issues will be considered in Aqua's next rate case are premature and should be stricken. Whether the Commission should reconsider the investment risk premium for Aqua at some future time was not at issue in this case. As such, the Proposed Order's comments have no bearing on the issues the Commission needs to decide in

this case. Section 10-111, as noted *supra*, limits the Commission's consideration to issues presented on the record in the case. 220 ILCS 5/10-111.

The Proposed Order's comments are, furthermore, prejudicial to Aqua. The Commission has twice adopted the investment risk premium, over Staff's objections, after extensive litigation on the issue between the parties. *Aqua Illinois, Inc.*, Dkt. 04-0442, slip op. p. 45; *Consumers Ill. Water Co.*, Dkt. 03-0403, 2004 Ill. PUC Lexis 382, *101. The Commission's orders are not *res judicata*; and, as such, the Commission is free to revisit its prior decisions. But, the Proposed Order's premature statement will ensure that the issue is litigated yet again, and related rate case expense incurred, in Aqua's next rate case. Such repeated litigation of the exact same issue should not be encouraged.

Accordingly, Aqua respectfully requests that the Proposed Order be amended by deleting in its entirety the first full paragraph beginning with the word "Finally" on page 53.

III.
Conclusion

WHEREFORE, for each of the forgoing reasons, Aqua Illinois, Inc. respectfully requests that the Commission adopt the exception language to the Proposed Order set forth herein, and grant any and all other appropriate relief.

Dated: October 13, 2005

Respectfully submitted,
AQUA ILLINOIS, INC.

By: _____
One of its attorneys

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CERTIFICATE OF SERVICE

I, Sarah N. Galioto, hereby certify that I caused to a copy of the Brief on Exceptions of Aqua Illinois, Inc to be served upon the service list in consolidated Docket Nos. 05-0071 and 05-0072 by electronic mail on October 13, 2005.

Sarah N. Galioto