

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

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

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

Dated: October 19, 2005

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I.
Introduction

Aqua Illinois, Inc. (“Aqua” or the “Company”) set forth the modifications that the Commission should make to the Proposed Order in its Brief on Exceptions, and hereby submits its response to the exceptions advanced by the Staff of the Commission (“Staff”), the Woodhaven Association (“WA”) and the Oak Run Property Owners Association (“ORPOA”) (WA and ORPOA collectively “Associations”). Aqua supports Staff’s exceptions regarding the introduction, depreciation rates and cost of service studies. Otherwise, Staff’s and the Intervenors’ arguments on exception have serious errors and provide no basis for the Commission to alter the Proposed Order in favor of their positions. For these reasons, with the noted exclusions, Aqua requests that the Commission not adopt Staff’s and the Intervenors’ exceptions but rather make the modifications to the Proposed Order that Aqua requested in its Brief on Exceptions. The Woodhaven Water Division, Woodhaven Sewer Division and Oak Run Division are sometimes abbreviated herein as (“WW”), (“WS”) and (“OR”), respectively.

II.
Discussion

A. Rate Base

1. Depreciation Rates - Woodhaven Sewer And Oak Run

Aqua does not object to Staff’s proposal for the Commission to include the depreciation rates approved in this proceeding for Woodhaven Sewer and Oak Run as Appendix D to the Final Order. The exception language Staff proposes for doing so is acceptable to Aqua.

B. Operating Expenses

1. Uncollectibles Expense - Oak Run

All parties agree that Aqua should recover, at a minimum, an amount equal to its five-year average of historical write-offs in bad debt expense. Aqua explained, however, that it cannot write-off delinquencies caused by availability customers. (Aqua Ex. 8.0, pp. 8-9). This is because availability customers only pay for the opportunity to take service and, thus, Aqua cannot shut-off their service. (*Id.*) As a result, delinquent availability customers remain customers, and it would constitute a forgiveness of debt to write-off their delinquencies. (*Id.*) Aqua's average historical write-offs, therefore, only account for uncollectibles caused by consumption customers whose delinquencies Aqua can write-off—they do not account for any bad debt expense caused by availability customers.

As such, Aqua must recover an amount in addition to historical write-offs to recover bad debt caused by availability customers. Aqua presented evidence that aged receivables greater than 91 days for availability customers in Oak Run is \$14,487. (Aqua Ex. 6.0R, p. 6; Aqua Ex. 8.0, p. 8). Aqua witness Mr. Schreyer testified that this is the amount Aqua is not likely to collect from availability customers. (Aqua Ex. 8.0, p. 9). He further testified that Aqua should recover the amount based upon a three year allocation, which equates to \$4,829 annually. (Aqua Ex. 6.0R, p. 6; Aqua Ex. 8.0, p. 9). Based on this evidence, he testified that Aqua seeks recovery of \$4,829 in addition to the amount of bad debt expense that is caused by consumption customers and evidenced by historical write-offs. (*Id.*)

No party attempted to rebut or even commented on this evidence. Staff witness Ms. Pearce acknowledged Aqua's evidence but then simply disregarded it in her analysis. (Staff Ex. 6.0, pp. 6-7). The ORPOA did not even analyze the issue on its own, but rather relied

entirely upon Staff. Thus, the evidence Aqua presented to support its recovery of \$4,829 for availability customers' bad debt expense was uncontested.

The Proposed Order correctly finds that “*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.” (Proposed Order, p. 14) (emphasis added). As Aqua’s evidence on this issue was not rebutted by any other party, this is the only reasonable conclusion for the Proposed Order to reach. It is the only conclusion that is supported by the evidence.

Nonetheless, in their Briefs on Exception, both Staff and the ORPOA argue for the Commission to change the Proposed Order’s finding on this issue. (Staff BOE, pp. 4-5; ORPOA BOE, pp. 1-4). While admitting that Aqua should recover bad debt expense that consumption customers cause, Staff and the ORPOA take exception to the Proposed Order’s finding that Aqua should also recover bad debt expense that availability customers cause. (*Id.*) They make a variety of arguments for their position; but, none are supported by the evidence and, therefore, none can be adopted. Assuming the Commission adopts the Proposed Order’s finding on this issue, as it should, Staff sets forth, in the alternative, a brand new proposal for how the expense should be recovered. But, Staff’s alternative recovery proposal also has no support in the record. (Staff BOE, pp. 4, 6-7). Because none of the arguments advanced by Staff and ORPOA are supported by the evidence, the Commission must not adopt them.

a. The Evidence Supports The Proposed Order’s Finding

The primary argument advanced by Staff and the ORPOA is that there is no evidentiary foundation for the Proposed Order’s finding that Aqua should recover \$4,829 annually in

availability customers' bad debt expense. (Staff BOE, pp. 4-5; ORPOA BOE, pp. 1-4). This argument lacks merit on its face because, as discussed *supra*, Aqua presented evidence that directly supports the Proposed Order's finding. Neither Staff nor the ORPOA rebutted or even commented upon the evidence.

More specifically, Staff claims that "the Company presented no evidence to support its claim that availability customer accounts over 91 days old will not be collected" (Staff BOE, p. 4). The ORPOA asserts that "[t]here is no evidence in the record that merely because an account is currently over 91 days that it is uncollectible." (ORPOA BOE, p. 2). It also states that "[u]nfortunately for Aqua, there is no evidence in the record as to how much of the \$14,487 represents amounts uncollectible from availability customers versus customers who take service," *i.e.*, consumption customers. (*Id.*) The record reveals, however, that these claims are simply wrong. Aqua witness Mr. Schreyer submitted availability customers' aged receivables greater than 91 days as evidence of availability customers' delinquencies that are not likely to be collected. (Aqua Ex. 6.0R, p. 6; Aqua Ex. 8.0, p. 9). He was clear that the aged receivables related solely to availability customers, not a combination of availability and consumption customers as the ORPOA suggests. (*See e.g.*, Aqua Ex. 8.0, p. 9) (testifying that "[t]he greater than 91 day *availability* customer receivables totaling \$14,487 are *not likely* to be collected") (emphasis added).

Despite this evidence, ORPOA argues that Aqua did not carry its burden of proof on the issue. (ORPOA BOE, pp. 1-4). This argument misapplies the law. Once Aqua presented evidence to support its request for recovery, the burden shifted to any party opposing Aqua's request to present evidence that rebuts Aqua's evidence. *City of Chicago v. People of Cook County*, 133 Ill. App. 3d 435, 442-43, 478 N.E.2d 1369, 1375 (1st Dist. 1985) ("Once a utility makes a showing of the costs necessary to provide service under its proposed rates, it has

established a prima facie case, and the burden then shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith.”). As noted, neither Staff nor the ORPOA did so. Thus, it is Staff and the ORPOA who failed to satisfy their burden of going forward by attempting to rebut Aqua’s clear evidence, and they cannot now complain that the Proposed Order relies upon the only evidence on the issue in the record.

The ORPOA further alleges that the Proposed Order’s notation of the “absence of any other alternative” is an insufficient basis for the Commission’s findings. (ORPOA BOE, p. 3). This argument clearly turns the law on its head. The Commission is required to make findings that are supported by the substantial weight of the evidence. 220 ILCS 5/10-201(e)(iv). Commission findings will only be overturned when a different conclusion is readily apparent from the evidence. *Cent. Ill. Pub. Serv. Co. v. Ill. Commerce Comm’n.*, 268 Ill. App. 3d 471, 479, 644 N.E.2d 817, 823 (4th Dist. 1994) (holding that under the “substantial evidence” standard of review, substantial evidence may support more than one conclusion; the evidence need only be such that a reasoning mind would accept the evidence as sufficient to support a particular conclusion). In this case, the only evidence on the issue was that presented by Aqua; therefore, no other conclusion could have possibly been “readily apparent.” As such, the Proposed Order’s finding is sound and in accord with the General Assembly’s instruction that the Commission reach findings based upon the evidence.

The ORPOA also argues that Aqua’s evidence is somehow insufficient because the Proposed Order questions certain aspects. (ORPOA BOE, p. 3). However, neither Staff nor the ORPOA raised any of these questions or presented any evidence to rebut Aqua’s evidence during the evidentiary phase of the case. It is legally improper to raise questions on the evidence *after the record has been marked heard and taken*—i.e., when Aqua no longer has an opportunity to respond to their “questions.” *Knox Motor Serv., Inc. v. Ill. Commerce Comm’n.*, 77 Ill. App. 3d

590, 596-97, 396 N.E.2d 280, 284-85 (4th Dist. 1979) (holding that the Commission cannot rely on facts introduced in a manner as to deprive all the parties the opportunity to be heard) quoting *Atchison, Topeka & Santa Fe Ry. Co. v. Commerce Comm'n.*, 335 Ill. 624, 638, 167 N.E. 831, 837 (1929) (“[t]he commissioners[’] . . . [f]indings must be based on evidence presented in the case, with an opportunity to all parties to know the evidence to be submitted or considered, to cross-examine witnesses, to inspect documents and to offer evidence in explanation or rebuttal, and nothing can be treated as evidence, which is not introduced as such.”).¹

Finally, the ORPOA asserts that the Proposed Order does not contain sufficient reasoning or analysis. (ORPOA BOE, pp. 1-3) (citing *Citizens Util. Bd. v. Ill. Commerce Comm'n.*, 291 Ill. App. 3d 300, 308, 683 N.E.2d 938 (1st Dist. 1997)). However, the Proposed Order correctly set forth all the evidence presented on the issue, notably from Aqua alone. No party rebutted Aqua’s evidence, and the Proposed Order correctly reaches a conclusion in accordance with the evidence. The law does not require anything more. *Citizens Util. Bd. v. Ill. Commerce Comm'n.*, 291 Ill. App. 3d at 304-05, 683 N.E.2d at 943 (recognizing that although the Commission must set forth more reasoning and analysis than would be acceptable from a circuit court, the Commission “is not required to make particular findings as to each evidentiary fact or claim.”); see also *City of Chicago v. Ill. Commerce Comm'n.*, 281 Ill. App. 3d 617, 623-24, 666 N.E.2d 1212, 1217 (1st Dist. 1996) (“[t]he Commission is not required to make a finding on each evidentiary fact or claim; rather, it is sufficient that its findings are specific enough to permit an intelligent review of its decision.”).

¹ For this reason, Aqua took exception to the Proposed Order raising such questions for the first time. (Aqua BOE, pp. 16-18) (explaining that there is no evidentiary foundation to support such “questions” and requesting that the Commission remove the language).

b. It Is Not Proper To Consider New Allegations Raised In Briefs

Staff takes another tactic. It improperly advances allegations in an effort to rebut Aqua's evidence now, in its Brief on Exceptions, even though its witnesses did not do so during the evidentiary phase of the proceeding. Staff alleges for the very first time that "it is premature to claim that an accounts receivable balance outstanding for 91 days will never be collected" and proposes that the Commission modify the Proposed Order to disallow the recovery of the availability customer accounts over 91 days old. (Staff BOE, pp. 4-6). In the alternative, if the Commission adopts the Proposed Order's finding, as it should, Staff alleges, again for the very first time, that it is better to amortize the amount over the period for rate case expense than the three years Aqua supported through Mr. Schreyer's testimony, and that it would be proper for the Commission to require Aqua to write-off the amount. (*Id.*, pp. 4, 6-8).

Neither of Staff's alternative proposals can be adopted because they both rest entirely upon new allegations that are not supported by any evidence. No witness testified that accounts receivable greater than 91 days do not represent amounts that Aqua is unlikely to collect, that it would be appropriate to amortize the amount over the period adopted for rate case expense, or that the balance should be written-off. The only evidence on the issue, rather, is Mr. Schreyer's testimony that aged receivables greater than 91 days are "not likely" to be collected, that they evidence bad debt expense Aqua cannot write-off, and that it is proper to recover the amount based on a three year annual allocation. (Aqua Ex. 8.0, p. 9). Staff's allegations, raised for the first time in its Brief on Exceptions, directly oppose the only evidence in the record in violation of the Commission's statutory duty to make findings consistent with the substantial weight of the evidence. 220 ILCS 5/10-201(e)(iv).

c. As a Matter of Policy, It is Appropriate For Aqua To Recover Its Entire Bad Debt Expense

Both Staff and the ORPOA argue, yet again *for the very first time* in their briefs on exception, that, as a matter of policy, Aqua should be denied recovery of bad debt expense caused by availability customers. (Staff BOE, p. 5; ORPOA BOE, pp. 2-3). The propositions they advance are unsound and not based on any credible evidence in the record. Nor do they provide a valid reason to treat Aqua's recovery of bad debt expense caused by availability customers any differently than that caused by consumption customers or all other utilities' recovery of bad debt expense.

First, Staff advances *for the very first time* the proposition that “[a]llowing the Company to recover the level of bad debt expense it requests only serves to penalize the customers who do pay their bills and to provide a disincentive for Aqua to find a meaningful solution to the problem.” (Staff BOE, p. 5). Staff's claim that recovering bad debt expense “only serves to penalize” paying customers runs contrary to the teachings of the Commission and the courts. While caused by the subset of customers who do not pay their bills, bad debt expense is a cost of providing utility service and properly recovered in rates. *See e.g., New Landing Util., Inc.*, ICC Dkt. 95-0610, 2005 Ill. PUC Lexis 640, *25 (2005) (taking into account bad debt as an operating expense in setting rates); *accord Illinois-American Water Co.*, ICC Dkt. 95-0076, 1995 Ill. PUC Lexis 884, *95 (1995); *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 116 Ill. 2d 111, 121 (1995) (holding the Commission “must allow the utility to recover costs prudently and reasonably incurred”); *Ill. Cent. R.R. Co. v. Ill. Commerce Comm'n*, 387 Ill. 256, 275 (1944) (holding utility constitutional rights are infringed on by the Commission fixing rates that are insufficient to pay operating expenses); *In re Commonwealth Edison Co.*, ICC Dkt. 87-0043, 84 PUR 4th 469, 1987 WL 257840 (1987) (“a utility is entitled to recover its reasonable expenses incurred in providing

service to its customers”). There is no valid basis to require Aqua to subsidize the cost of service by covering the cost of bad debt expense itself. There was no evidence that Aqua has failed to take appropriate steps to collect payment from availability customers. As such, the Proposed Order is right when it states that “[a]vailability 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.*” (Proposed Order, p. 14) (emphasis added).

Second, the ORPOA argues that Aqua should be denied recovery based on an *incomplete excerpt* of a statement made by the CFO of Aqua America during an investors conference call. (ORPOA BOE, pp. 2-3). The ORPOA implies that Aqua America’s CFO allegedly told investors that it is no longer charging for availability service in Illinois; however, the ORPOA removed critical information from the statement. (*Id.*, p. 2) (several ellipses noting the removal of language from the CFO’s statement at critical places when action in Illinois is being discussed). The statement does not lend itself to ORPOA’s interpretation, as the only thing that is clear from the statement is that Aqua is frustrated by the fact that many availability customers do not pay their bills despite Aqua’s efforts to collect payment.

ORPOA’s interpretation also conflicts, once again, with the record. Aqua is clearly charging for availability service in Oak Run, as the rate design recommended by Staff and accepted by Aqua contains charges for this service. (*See Proposed Order*, pp. 54-55). Thus ORPOA’s reading that Aqua is not charging for availability service is clearly contradicted by the record.

Accordingly, neither Staff’s nor the ORPOA’s “policy” arguments calling for denial of Aqua’s recovery of bad debt expense caused by availability customers are supported by the

record. It is well-established that bad debt expense represents a cost of providing utility service whether it is caused by consumption or availability customers. *See supra*. No party presented any evidence upon which the Commission could rely to deviate from this well-established holding by modifying the Proposed Order.

d. It Would Be Improper To Issue Rulings Regarding Aqua's Future Recovery Of Bad Debt Expense

Staff's request that the Commission issue rulings on Aqua's future recovery of bad debt expense are improper because they were never made as part of the record and because they are not supported by any evidence. (Staff BOE, pp. 6-8). It would be premature for the Commission to issue rulings or even discuss whether it would be proper for Aqua to recover bad debt expense caused by availability customers in future rate cases for Oak Run, as the record is devoid of any indication that this is currently true. *See Eissman v. Pace Suburban Bus Div. of the Reg'l. Trans. Auth.*, 315 Ill. App. 3d 574, 578, 734 N.E.2d 940, 943 (1st Dist. 2000) (recognizing that a "fundamental tenet" of American jurisprudence is that a tribunal does not have jurisdiction until an actual case or controversy arises).

Staff's proposals, furthermore, are troubling because they assign blame to Aqua for the uncollectibles caused by availability customers. In particular, Staff states that "the Company should be put on notice that the Commission is giving it the opportunity to resolve this issue between now and the next rate case for the Oak Run Division by allowing the Company full recovery of all collections over 91 days and that the Commission would not be impressed by the Company's inability to resolve this issue by its next rate case." (Staff BOE, pp. 6-8). However, as noted *supra*, no party presented any evidence or even advanced the claim that Aqua has not taken all appropriate steps to recover delinquencies from *availability customers*, and Aqua has been given no opportunity to rebut Staff's unfounded accusation.

e. Conclusion - Uncollectibles Expense - Oak Run

Mr. Schreyer's testimony is the only evidence in the record on the issue of how much bad debt expense availability customers cause and the manner in which the amount should be recovered. No party disputed or even discussed Mr. Schreyer's testimony on the issue. The Proposed Order properly relies upon it. Having lost the issue for their failure to even attempt to rebut Mr. Schreyer's testimony, Staff and the ORPOA now improperly attempt to introduce brand new allegations and proposals through their briefs on exception, thereby pre-empting all opportunity for Aqua to respond on the record. Staff goes so far as to seek premature rulings prohibiting Aqua's recovery of *availability customers'* bad debt expense in future cases despite Staff's failure to address the issue on the record in this case. Accordingly, Aqua respectfully requests that the Commission decline to adopt the exceptions of Staff and the ORPOA.

2. Uncollectibles Expense- Woodhaven Divisions

Like Oak Run availability customers, the evidence establishes that Aqua cannot shut-off service to any customers of the Woodhaven Sewer Division because of environmental and health concerns, and that it would not be cost-effective for Aqua to incur the expense to shut-off service to many customers of the Woodhaven Water Division. (Aqua Ex. 5.0, pp. 16-17; Aqua Ex. 8.0R, p. 10; Tr., p. 133). For the delinquent customers that Aqua either cannot shut-off (all of the Woodhaven Sewer Division customers) or should not expend the cost to shut-off (many of the Woodhaven Water Division customers), the customers remain customers, and it would constitute a forgiveness of their debt to write-off their past-due amounts. (Aqua Ex. 8.0R, p. 10).

Based on this evidence, the Proposed Order properly recognizes that Aqua incurs bad debt expense in the Woodhaven Divisions that is not accounted for by Aqua's historical write-offs. (Proposed Order, pp. 19-20). Unlike Oak Run, however, the Proposed Order only allows

Aqua to recover the portion of bad debt expense commensurate with its historical write-off. (*Id.*, p. 20). It erroneously disallows Aqua's recovery of any amount Aqua cannot write-off based on the *possibility* that Aqua may be able to negotiate a bulk billing arrangement with the WA. (*Id.*) It is not proper to deny Aqua's legal right to recover an operating expense on the off chance that it may be successful in reaching a bulk billing arrangement with the WA. (Aqua BOE, p. 23). Rather, the potential for bulk billing could be recognized by requiring Aqua, in the event bulk billing is implemented, to return its savings in bad debt expense to the WA via a collections fee until such time as the Commission sets new rates that exclude the savings. (*Id.*)

a. Aqua Cannot Shut Off Service To All Woodhaven Customers

The WA claims that "Woodhaven customers can be disconnected;" therefore, the Proposed Order should be modified to disallow Aqua's recovery of bad debt expense in total. This contention is entirely at odds with the evidence. (WA BOE, p. 9). Aqua cannot shut-off service to any customers in the Woodhaven Sewer Division due to environmental and health concerns. (Tr., p. 133). Moreover, it would be imprudent for Aqua to incur \$400 to install a shut-off valve for Woodhaven Water Division customers whose past due amounts do not exceed \$400 or who are not likely to be induced to pay as a result of their service being shut-off.² (Aqua Ex. 5.0, p. 16). Shutting-off service is not likely to encourage payment from customers who do not pay their WA due or real estate taxes, or use their property regularly. (*Id.*) To explain, water customers who do not pay their WA dues or their real estate taxes would be prevented from using their property by the WA or the government, respectively. Water customers who do not use their property regularly, either because they are prevented from doing so by the WA or the government, or because they just choose not to, will not be motivated to pay their water bills by

² Indeed, it is worth noting that if Aqua incurred this expense even when the action is not likely to induce payment, as the WA appears to suggest, then rate base for the Woodhaven Water Division would increase commensurately.

service being shut-off because they are not at the property to take service anyway. It would be a needless expense for Aqua to install \$400 shut-off valves for such customers.

Accordingly, the WA's allegation that Aqua can shut-off service to all Woodhaven customers ignores the realities of the situation, namely that it would be wrong, from a health and environmental stand-point, to shut-off sewer service, and that Aqua should not incur expenses in efforts to collect payment when the cost of doing so will be greater than the amount Aqua is likely to collect in return.

b. Aqua's Efforts To Collect Payment Are Prudent

While the WA argues that Aqua's actions to collect payment from delinquent customers are inadequate, the record is replete with evidence of the significant actions Aqua takes to collect these payments from delinquent customers in the Woodhaven Divisions. (Aqua Ex. 5.0 2A, pp. 15-19, Att. A; Tr., pp. 80-84, 120). 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. (*Id.*) The actions are geared toward inducing payment by making it easier as well as the more traditional efforts geared toward collecting on already delinquent accounts. (*Id.*) Aqua employs its various collections options on an account-by-account basis and escalates from the lower cost options of sending collections letters and filing liens to the more cost-intensive efforts. (*Id.*) It only uses the latter if the information demonstrates that the amount likely to be collected outweighs the cost of the collection effort itself. (*See e.g.*, Aqua Ex. 5.0 2A, p. 16) (describing the factors considered before installing a shut-off valve).

Despite this evidence, the WA claims, once again in an untimely manner, that Aqua has acted imprudently by not installing shut-off valves for the two largest delinquent accounts in the Woodhaven Divisions. (WA BOE, p. 9). In particular, the WA infers that shutting off the two delinquent accounts would be the only prudent action. (*Id.*) However, as noted, Aqua cannot shut-off any sewer customers in light of the environmental and health concerns. (Tr., p. 133). Further, because payment is not likely to be collected by turning off service to water customers who do not use their properties regularly, installing a shut-off valve would not necessarily be cost-effective even for water customers. (Aqua Ex. 5.0, p. 16). Rather, payment would more likely be collected via foreclosure or pursuit of personal judgments if the account holders are not using their properties regularly.

The WA did not present any evidence that payment from the two largest delinquent customers would be more appropriately pursued by terminating service versus pursuing foreclosure or personal judgments. There is no evidence that these are water customers rather than sewer customers that cannot be turned off. There is no evidence that the two customers use their properties regularly. And there is no evidence that Aqua has not taken other appropriate steps to collect payment, such as pursuing foreclosure or personal judgments against the account holders. The Commission should not adopt the WA's inference that installing shut off valves is the only way, or even an appropriate way, for Aqua to collect payment from these customers.

The WA also argues that it has not impeded the prior implementation of a bulk billing arrangement, inferring that Aqua has acted unreasonably by not implementing bulk billing sooner. (WA BOE, p. 8). However, the evidence does not support the WA's argument. It was Aqua that first raised the possibility of bulk billing with the WA during a meeting in May, 2003. (Aqua Ex. 5.0 2A, p. 22; WA Ex. 1.01 (agenda from the meeting)). The WA did not indicate that it was willing to accept bulk billing, but rather simply stated that the option would be

presented to its Board of Directors. (Aqua Ex. 5.0 2A, pp. 21-22). As Aqua witness Mr. Bunosky described the WA's reaction to the option: "At best, the Association indicated the option was something it would 'consider' but has rejected numerous times in the past." (*Id.*, p. 22).

Subsequently, on March 8, 2004, Aqua witness Mr. Bunosky raised the option with the WA again. He did so in a letter to Ms. Becky Whelhel of the Association, in which he again asked the WA whether it would consider the bulk billing option. (*Id.*, p. 22; *see also*, WA Ex. 1.02, p. 1 (Bunosky letter of Mar. 8, 2004)). On April 15, 2004, Mr. Bunosky received a letter in return from Ms. Karen Roche on behalf of the WA stating:

Finally, you have asked if the Association would consider allowing Aqua Illinois, Inc., to bill all Woodhaven Accounts to the Association. The Board is carefully evaluating this request with Counsel. At this time we are not prepared to respond with a definite answer; further analysis is currently being conducted. Once we have concluded our study we will advise you of our position.

(Aqua Ex. 5.0 2A, p. 22; *see also* WA Ex. 1.02, pp. 2-3 (Roche letter of Apr. 15, 2004)). It was only after Aqua filed its rate applications for the two Woodhaven Divisions that the WA sought to advance the issue. (Aqua Ex. 5.0 2A, p. 23). While the WA witness Mr. Hickey alleges otherwise in his testimony, (*see e.g.*, WA Ex. 1.0, p. 8), the documentary evidence establishes unequivocally that Aqua was prepared to move forward with the bulk billing option before its rate filings, but the WA was not. (WA Ex. 1.01; WA Ex. 1.02, pp. 1-3).

Accordingly, the evidence demonstrates that Aqua has acted prudently in its efforts to collect payment. There is no evidence from which it could be reasonably inferred otherwise. The Commission, therefore, should reject the WA's claim raised now in its briefs, but not during the evidentiary phase, that Aqua has somehow acted imprudently.

c. Conclusion - Uncollectibles Expense - Woodhaven Divisions

The WA's proposal to disallow Aqua's recovery of bad debt expense *in total* is highly unreasonable and not supported by the evidence. The evidence shows that Aqua cannot shut-off service to a large number of customers, including all sewer customers, and, therefore, it does incur bad debt expense that is not accounted for by historical write-offs. Further, the evidence establishes that Aqua takes prudent steps to collect payment from all customers, including those it cannot shut-off, and timely sought to implement bulk billing well before making its rate filings for the Woodhaven Divisions; but, the WA declined to cooperate in those efforts. Therefore, the Commission should not adopt the exception language the WA proposes.

3. Allocation Of Management Expense - Woodhaven Water And Sewer

Customer count is the fairest way to allocate Contractual Services - Management Expense. These are common costs incurred at the Illinois corporate and Aqua America, Inc. parent corporate levels in the overall operation of *all* Illinois divisions. (Tr., pp. 122-23). For example, a common cost that is accounted for as Contractual Services - Management Expense is the cost to prepare the overall state budget. (*Id.*) As such, these common costs are *caused equally* by all Illinois customers. (Tr., pp. 149-50). The customer count allocation method is the fairest because it assigns an equal share of these common costs, caused equally by all customers, to each customer.³ (Tr., p. 128). This result, furthermore, is consistent with the General Assembly's directive that all costs are to be borne by the causers of the costs:

It is further declared that the goals and objects of such regulation shall be to ensure ... Equity: the fair treatment of consumers and

³ Mr. Bunosky gave a hypothetical example. Assume Management Expenses of \$100 to be allocated over 100 total customers in Illinois using the customer count method. The \$100 is divided between divisions equal to the number of customers in each division, so that a division with 10 customers is allocated \$10 and one with 6 customers is allocated \$6. In turn, the division that is allocated \$10 divides that amount among each of its 10 customers so each customer is allocated \$1, and the division that is allocated \$6 divides that amount among its 6 customers so that, again, each customer is allocated \$1. (Tr., p. 130).

investors in order that ... *the cost of supplying public utility services is allocated to those who cause the costs to be incurred.*

220 ILCS 5/1-102(d)(iii)(emphasis added).

The Proposed Order appropriately approves Aqua's use of the customer count allocation method to distribute equal shares of these common costs to all customers. (Proposed Order, p. 26). In doing so, the Proposed Order correctly finds that the arguments advanced by Staff and the WA against customers in the Woodhaven Divisions bearing their fair shares of these costs are not compelling. (*Id.*) The Proposed Order's approval of allocations based on customer count is consistent with the Commission's prior approval of rates based on the method in Aqua's two most recent rate cases, which were for its Kankakee and Vermilion Divisions. (*See* Sch. A-5, WP-A5 in ICC Dkts. 03-0403 and 04-0442) (setting forth the use of the customer count method).

Nonetheless, both Staff and the WA argue that the Proposed Order is wrong in requiring customers in the Woodhaven Divisions to bear their fair shares of these common costs. (Staff BOE, pp. 9-11; WA BOE, pp. 1-8). In doing so, Staff does not propose that the customer count allocation method is inappropriate to allocate common costs.⁴ (Staff BOE, p. 9). Rather, Staff alleges that it is somehow unreasonable to require Woodhaven customers to bear their fair shares of these common costs, and proposes an arbitrary one half (1/2) discount to customers in the Divisions.⁵ (*Id.*, pp. 9-10). Such an arbitrary reduction is unreasonable, and the Proposed Order should not be modified to adopt it.

The arbitrariness of Staff's position is demonstrated by the fact that even the WA, whose customers would receive a windfall under Staff's proposal, *disagrees with it*. (WA IB, p. 12).

⁴ The fact that the Commission approved rates based on the method for Kankakee and Vermilion shows that the method is appropriate for allocating common costs.

⁵ Staff describes its position for the first time in its Brief on Exceptions as "phasing-in" the impact of Woodhaven customers bearing their full and equal shares of the costs. (Staff BOE, p. 9). This is misleading because Staff has not proposed to increase the allocation of common costs to customers in the Divisions to their fair, equal shares at any time in the future.

But, the WA's alternative proposal is just as unreasonable. It argues that allocations based on a rate base method, which would assign *unequal* shares of common costs to customers in different divisions,⁶ are somehow fairer. The WA's position, however, is not based on any evidence from which it possibly could be concluded that assigning customers in different divisions *unequal* shares of common costs is somehow fairer than assigning all customers *equal* shares. Rather, the crux of the WA's position throughout the case has been that rate base is fairer simply because it assigns smaller allocations of common costs to Woodhaven customers. (*Id.*) The Proposed Order should not be modified to adopt the WA's position either.

a. The Evidence Supports The Commission's Conclusion That Customer Count Is The Fairest And Most Appropriate Method

Staff and the WA both seek to change the Proposed Order's conclusion on this issue by arguing without basis that Aqua did not satisfy its burden of proof. (Staff BOE, p. 9; WA BOE, pp. 1-3). This clearly is not the case. The evidence, discussed *supra*, establishes unequivocally that the costs at issue are common to all customers and that the customer count allocation method is the most fair and equitable because it assigns an equal shares of these costs to all customers. (*See supra*). The persuasiveness of this evidence is demonstrated by the fact that the Florida Public Service Commission ("PSC") adopted this very rationale to hold unequivocally that "common costs *shall be* allocated" based on customer count. *In re Rentals and Util., Inc.*, 2001 WL 771089, at *8 (Fla. P.S.C. 2001) (emphasis added).⁷

⁶ Using the same hypothetical, if the division with 10 customers were allocated half its share, *i.e.*, only \$5 instead of \$10, then each customer in the division would only bear .50¢ rather than \$1 of the common costs. The remaining \$5 would be reallocated to the division with 6 customers, with the result being that the 6 customer division would be allocated \$11 in total and each customer in the division would bear \$1.83 of the common costs.

⁷ The Florida PSC stated: "We find it appropriate to allocate each system its common operating costs based on the average number of customers representing that system." *In re Rentals and Util., Inc.*, 2001 WL 771089, at *8 (Fla. P.S.C. 2001). Its rationale was that the customer count method "*most equitably* reflects the distribution of costs." (*Id.*)

Aqua witness Mr. Bunosky also testified to other reasons for using the customer count allocation method to assign common costs. He stated that “customer counts better reflect the fact that the more customers a water or sewer system has the more issues arise that require customer support, engineering, accounting, operations, maintenance, planning, forecasts, budgets, etc.” (Aqua Ex. 5.0 2A, pp. 27-28). He also explained that customer count is consistent with the manner in which Aqua’s parent company allocates common costs and, therefore, is the simplest for Aqua to administrate. (*Id.*, p. 28).

Accordingly, Aqua presented a compelling case for using the customer count method to assign equal portions of common costs to all customers. As such, the burden of proof shifted to any party opposing Aqua’s evidence. *See City of Chicago v. People of Cook County*, 133 Ill. App. 3d at 442-43, 478 N.E.2d at 1375 (“[o]nce a utility makes a showing of the costs necessary to provide service under its proposed rates, it has established a prima facie case, and the burden then shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith.”). However, neither Staff nor the WA disputed this evidence. Rather, they both proposed alternative allocations for entirely different reasons, none of which are meritorious, as the Proposed Order correctly finds. (*See* Staff IB, pp. 23-25; WA IB, pp. 11-13) (both arguing that alternative methods should be used simply because the allocations to Woodhaven customers are greater under a customer count than a rate base method). The Proposed Order, thus, correctly concludes that Aqua carried its burden of proof on this issue.

Although the evidence clearly shows that a customer count allocation is the fairest method, the WA erroneously asserts that this conclusion is somehow arbitrary and capricious, that the Proposed Order does not set forth sufficient analysis of the issue to allow an informed judicial review, and that it finds a rate reasonable without evidence. (WA BOE, pp. 1-5).

The Proposed Order clearly considered all parties' arguments, but it found that the alternatives raised by Staff and the WA allocated Woodhaven customers less than their fair and equal shares of common costs and therefore lacked merit. (Proposed Order, p. 26). The Order sets forth a full and correct analysis of the evidence, explaining why Staff's and the WA's arguments are in error. (*Id.*, pp. 20-26). Given that it is most equitable for all customers to bear equal shares of common costs that they equally cause, the Commission's conclusion is far from implausible but is instead well-reasoned and logical. *See, e.g., In re Rentals and Util., Inc.*, 2001 WL 771089, at *8 (Fla. P.S.C. 2001). Its conclusion, moreover, is in full accord with the General Assembly's directive that all customers bear the costs they cause, 220 ILCS 5/1-102(d)(iii), and with the Commission's adoption of rates based on customer count allocations of common costs in Aqua's most recent two rate cases, *i.e.*, Docket No. 03-0403 for Kankakee and Docket N. 04-0442 for Vermilion. Thus, the WA's assertions are clearly wrong given the evidence presented in the record.

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

As noted, the positions of Staff and the WA primarily rest on the fact that allocations to Woodhaven customers are greater under a customer count than a rate base method. (Staff BOE, p. 9; WA BOE, p. 2). They both assert that, to the extent Aqua may have previously allocated a portion of its common costs via rate base,⁸ it is somehow unfair to use the more equitable customer count method on a going-forward basis because the Woodhaven Divisions' allocations would increase. (*Id.*) This position is unfounded.

⁸ As noted, there are two types of common costs included in Contractual Services - Management Expense, namely the common costs incurred at the (i) Illinois corporate, and (ii) Aqua America, Inc. parent levels to operate all Illinois divisions. Previously, Aqua allocated the Illinois corporate but not the Aqua America, Inc. portion via rate base. (Tr., pp. 63-64). Both Staff and the WA misrepresent the record by asserting incorrectly that Aqua previously allocated all these costs via rate base. (Staff BOE, p. 9; WA BOE, p. 2).

Initially, the position is not based on any claim that customer count allocations are improper. (See Staff BOE, p. 9) (recognizing that customer count is a proper method to allocate common costs). To the contrary, it shows that the rate base method allocates *too little* to customers in the Woodhaven Divisions because it assigns those customers less than their equal shares of common costs. This is doubly problematic because allocations methodologies are intended to distribute 100% of common costs, which cannot be directly assigned, across all customers.⁹ (Tr., pp. 127-28; see also Staff Ex. 7.0R, Sch. 7.02, p. 2 (showing how 100% allocations would be achieved under either the customer count or rate base method)). As such, if customers in any one division are assigned less than their equal shares of common costs, the allocations to customers in other divisions necessarily increase such that 100% of the costs are still allocated in total.¹⁰ (Tr., pp. 127-28).

As an example, compare the Woodhaven Sewer Division to the Willowbrook Sewer Divisions. Those two Divisions have close to the same percentage of rate base at 2.41% and 2.82%, respectively; but, Woodhaven Sewer is significantly larger with 5,046 customers versus 1,083 in Willowbrook Sewer. As a result, the rate base method would allocate customers in Woodhaven Sewer only \$13.12 each of the common costs at issue (*i.e.*, Account 734); but, it would allocate the customers in the significantly smaller Willowbrook Sewer Division \$76.75 each—a *substantial \$63.63 more!*¹¹ (Staff Ex. 7.0, Att. A). There is no reason why customers in

⁹ 100% allocation is necessary because Aqua is entitled to recover its operating expenses, including its common costs, in rates. *Commonwealth Edison Co. v. Dept. of Local Gov't. Affairs*, 85 Ill. 2d 495, 500, 426 N.E.2d 817, 819 (1981); *Ill. Bell Tel. Co. v. Ill. Commerce Comm'n*, 414 Ill. 275, 286, 111 N.E.2d 329, 335 (1953).

¹⁰ For this reason, Aqua has explained that if customers in the Woodhaven Divisions receive reduced allocations, which they should not as a matter of fairness, then the Commission should recognize the offset to customers in Aqua's other Illinois divisions, including to customers in Oak Run within the context of this case.

¹¹ Under the rate base method, Woodhaven Sewer would receive 2.41% of the Account 734 common costs for a total of \$70,928 that, divided by the 5,406 customers in Woodhaven Sewer, equals \$13.12. The significantly smaller Willowbrook Sewer Division, on the other hand, would receive 2.82% of the Account 734 common costs for a total of \$83,125 that, divided by the 1,083 customers in the Division, equals \$76.75.

Willowbrook Sewer should pay almost five times more in common costs than customers in Woodhaven Sewer.

In fact, allocating less than equal shares to Woodhaven customers would cause increased allocations to customers in mostly smaller divisions. The two Woodhaven Divisions are the third and fourth largest in customer size.¹²

Kankakee	23,093	Candlewick Water	1,908
Willowbrook Water	1,038	Candlewick Sewer	1,907
Willowbrook Sewer	1,083	Oak Run	1,266
University Park Water	2,044	Ivanhoe Water	280
University Park Sewer	1,968	Ivanhoe Sewer	237
Woodhaven Water	6,169	Vermilion	17,255
Woodhaven Sewer	5,406		

(Staff Ex. 7.0R, Att. A). Customers in these other divisions should not bear more than their equal shares of common costs just so Woodhaven customers can bear less.¹³

Accordingly, to the extent rate base previously was used, it assigned too little to customers in the Woodhaven Divisions. Customers in other divisions made up the difference - *i.e.*, they *subsidized the* Woodhaven customers' shares of common costs. (See Aqua IB, pp. 15-16). Customer count allocations are proper because they prevent such subsidization from occurring and, therefore, are more appropriate even though the allocations may be greater for Woodhaven Divisions customers than under the rate base method.

¹² Again, Hawthorn Woods Water and Sewer are included within Ivanhoe Water and Sewer in Staff Ex. 7.0R, Att. A.

¹³ While Kankakee and Vermilion are larger, the customer count method allocates a proportionately larger share of common costs to those Divisions. In particular, Kankakee and Vermilion customers bear \$984,474 out of a total of \$1,568,014 in Illinois corporate and \$864,347 out of a total of \$1,376,683 in Aqua America, Inc. parent costs allocated via account 634. (Staff Ex. 7.0R, Att. A).

Staff and the WA attempt to circumvent the logic of the customer count allocation by arguing that the impact of allocating Woodhaven customers their fair shares of common costs is allegedly too great. (Staff BOE, p. 9; WA BOE, p. 2). The percentages they recite as the basis for their positions, however, are highly misleading. As Aqua witness Mr. Bunosky explained, when the dollar amounts at issue are small, even a small increase shows up as a large percentage. (Aqua Ex. 5.0 2A, p. 5) (explaining that a dollar increase of a dollar is 100% increase even though a dollar increase is extremely small). Here, Contractual Services - Management Expense is a single expense that is factored into overall rates. The Woodhaven Divisions' rates are and will remain low following this case. At Aqua's original proposed rate increases, the increase would raise the average water bill only 19¢ per day from 31¢ to 50¢, and the average sewer bill only 22¢ per day from 35¢ to 57¢. (Aqua Ex. 1.4 (WW), (WS)). There is no need to "mitigate" this rate impact by assigning customers in the Woodhaven Divisions less than their equal shares of common costs and requiring customers in Aqua's other Illinois divisions to subsidize the difference. Any prior windfall to customers in the Woodhaven Divisions should not dictate the use of a less equitable allocation method going forward.

c. The WA's Red Herring Arguments Should Not Be Considered

The WA offers three additional arguments in an effort to change the Proposed Order's well-reasoned conclusion that is supported by the weight of the evidence. Each of the arguments is a red herring designed to mislead the Commission's analysis, and none should be adopted.

First, the WA asserts that there is no evidence as to which customers are actually causing the common costs at issue because Aqua did not present studies tracking the costs. (WA BOE, p. 3). However, common costs cannot be tracked to individual customers because they are incurred to provide service to all customers. (Tr., p. 125). For example, the cost to prepare an overall state budget cannot be tracked to an individual customer or even an individual division

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because it is incurred to provide service to all customers. (Tr., pp. 122-23, 125). The very fact that common costs cannot be tracked is the reason that allocation methodologies are used to allocate them across all customers in all divisions. (Tr., p. 125). The Proposed Order properly reflects that the costs at issue are “common costs and as such are not allocated to specific divisions.” (Proposed Order, p. 26).

Second, the WA argues that its percentage share of *common* costs should be lower because its percentage share of certain *direct* costs are lower. (WA BOE, pp. 3-4). This claim mixes apples with oranges. The direct costs to operate the Woodhaven Division is not at issue. Moreover, direct costs have no bearing whatsoever on the common costs incurred. In fact, if the Woodhaven Divisions’ shares of common costs were reduced just because certain direct costs were less, then the Woodhaven Divisions would receive unjustified reductions in their shares of the common costs. The Commission should not be misled by the WA mixing the concepts of common and direct costs.

Third, the WA makes numerous factual allegations for the very first time in its Brief on Exceptions. (WA BOE, pp. 5-6). The WA’s allegations are intended to support its position that the Commission should adopt a rate base method, which, as discussed, would result in unequal common cost allocations to the benefit of the Woodhaven Divisions but to the cost of most other divisions. The WA did not make any of these allegations during the evidentiary phase of the case and, by raising them only now after the record has been marked heard and taken” prejudices Aqua who has no opportunity to present contrary evidence. These brand new allegations should not be considered.

d. Conclusion - Allocation of Management Expense - Woodhaven Water And Sewer

The Public Utilities Act requires the Commission to make findings that are supported by the substantial weight of the evidence. 220 ILCS 5/13-201(e)(iv). The Proposed Order clearly does so in this instance as the evidence establishes that allocating each customer an equal share of common costs that are driven equally by all customers is the fairest result. Therefore, its finding, which is fully supported by the evidence and inherently reasonable, should not be modified.

4. Rate Case Expense

a. Rate Department Expense And Miscellaneous Rate Case Expense

As Aqua noted in its Brief on Exceptions, it is a fundamental principle of ratemaking that the process is to be fair and balanced. *See, e.g., Bus. & Prof'l. People for the Pub. Interest v. ICC*, 146 Ill. 2d 175, 208, 585 N.E.2d 1032, 1045 (1991); *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 276 Ill. App. 3d 730, 737, 658 N.E.2d 1194, 1200 (1st Dist. 1995). Throughout this proceeding, including in the submission of its Brief on Exceptions, Aqua has explained in detail why the Commission should allow its recovery of its original rate case expense projections in their entirety. Aqua has shown that recovery of those projections is appropriate because it has supported them with competent evidence. In particular, Aqua submitted the sworn testimony of Mr. Jack Schreyer in support of its original projections, which demonstrated that Aqua's original projections were good-faith estimates of the expenses it will incur through case completion, as shown by Aqua's actual billings in this proceeding and Aqua's rate case expenses in a similar rate case. (Aqua Ex. 8.0, pp. 12-18, Ex. D). The most fair and balanced approach is to allow recovery of Aqua's original projections in total, as set forth more fully in Aqua's Brief on Exceptions, because the evidence fully supports those projections.

Because rate case expense is incurred during the case, it is never possible to project with certainty the degree to which each component will need to be relied upon. (Aqua Ex. 8.0, p. 16). Actual events will drive more costs for some components and less for others, so the original projections for some components will be exceeded and others will not. (*Id.*) That was exactly the case here, since actual events drove costs away from in-house Rate Department and Miscellaneous to Outside Legal Counsel and Witness Expense. Indeed, these events continue to drive Aqua's rate case expense higher, as evidenced by the late intervention of Monica J. Sadler after the Proposed Order was issued, her filing of a Brief on Exceptions and the potential for at least one interested party to appeal the Commission's Final Order.

Staff takes exception to the Proposed Order's conclusions that Aqua should be allowed to include in rates "75% of the originally projected Rate Department expense for each division" and "50% of the originally projected miscellaneous expense for each division." (Proposed Order, pp. 38-39). Staff argues that the Commission should only allow Aqua to recover 50% and 25% of its projections for Rate Department expense and Miscellaneous expense, respectively, because the evidence was insufficient to show that Aqua will incur any more than those amounts. (Staff BOE, pp. 11-14). In particular, Staff states that Aqua provided no support for recovery of 75% and 50% of its original projections for Rate Department expense and Miscellaneous expense, respectively, "other than its statement in surrebuttal testimony that it anticipated that it would incur" those amounts. (*Id.*, pp. 11, 13).¹⁴

¹⁴ In its Brief on Exceptions, Staff also claims as to both Rate Department expense and Miscellaneous expense that "no party had the opportunity to conduct a proper and thorough review of the Company's claim or to provide a proper response." (Staff BOE, pp. 11-13). Staff's argument is presumably based on the notion that Aqua somehow prejudiced Staff by submitting an amended request for recovery of Rate Department expense and Miscellaneous expense with its surrebuttal testimony. Aqua fully addressed the timeliness of its evidentiary submissions in its Brief on Exceptions (*see* Aqua BOE, pp. 29-30), so it respectfully refers the Commission to that discussion in response to Staff's argument on this point.

Staff's argument ignores the competent evidence submitted by Aqua in this proceeding, which fully supports the findings of the Proposed Order as to Rate Department expense and Miscellaneous expense. In particular, the Proposed Order relies 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. (Proposed Order, pp. 38-39). The manner in which the Proposed Order does so is exactly right. Taking Aqua's rate department expense for example, the Proposed Order looked at the actual costs incurred during the first four months of the case, which were commensurate with the first four months of the year, and then identifies a reasonable estimate through case completion. (*See Id.*, p. 38) (stating that "[b]ecause approximately one quarter of the projected expenses were incurred during the first four months of 2005, the 75% estimate for the calendar year [*i.e.*, until case completion] seems reasonable").

The soundness of the Proposed Order's conclusion is demonstrated by the case activities undertaken during the different periods of the case. In particular, during the first four months, the only activities were Aqua's preparation of its rate filings and discovery, during which time the Proposed Order notes the rate department incurred 25% of its total original projection. Most of the work in the case occurred subsequent to that time. It was not until after the first four months that Staff and the WA filed direct testimony, thereby identifying the issues in the case. Aqua subsequently had to analyze the direct filings of Staff and the WA, respond to a significant amount of further discovery of the issues raised by Staff and the WA, prepare rebuttal testimony, analyze the rebuttal filings of Staff, the WA and the ORPOA, continue to respond to discovery, prepare surrebuttal testimony, prepare for evidentiary hearings, have its witnesses participate in the hearings, assist in the preparation of briefs, analyze the briefs of Staff, the WA and the ORPOA, analyze the Proposed Order, analyze Ms. Sadler's intervention, assist in the preparation

of exceptions briefs, and analyze the exceptions briefs of Staff, the WA, the ORPOA and Ms. Sadler. Finally, following the Commission's issuance of a Final Order, Aqua's rate department will need to analyze the Final Order and take all steps toward compliance. It will also need to assist in any possible appeal that may follow the Commission's Final Order. As such, the large majority of expense would be incurred subsequent to the initial four month period. It is more than reasonable to conclude, as the Proposed Order does, that Aqua will incur 50% of its original projection for its rate department to complete these activities during the seven months remaining to case completion when it incurred 25% during the first four months.

Staff also proposes for the very first time in its Brief on Exceptions that Aqua should be cautioned to "provide support for its rate case projections in the workpapers that support its initial rate case filing" and to make such support "available for review when [it] files its rate case." (Staff BOE, pp. 12, 14). Such a request must be rejected because Part 285 of the Commission's Regulations sets forth the requirements for rate filings. 83 Ill. Adm. Code Part 285. The proper process for promulgating changes to those regulations is a rulemaking, the result of which would apply equally to all utilities. 5 ILCS 100/5-5; *Riverboat Dev. Corp. v. Ill. Gaming Bd.*, 268 Ill. App. 3d 257, 259, 644 N.E.2d 10, 11 (1st Dist. 1994). It would not be appropriate for the Commission to develop a new rule during a rate proceeding that would apply to Aqua alone. Doing so would be a clear example of discriminatory rulemaking.

Further, Staff provides no support for its proposition, and Aqua respectfully submits that such a proposition would be unworkable. Rate case expense is a unique expense in a rate case proceeding because it is entirely dependent on the course of the proceeding. Accordingly, the Commission should not require Aqua, or any other utility, to provide full evidentiary support for its rate case expense at the time of its initial filing. Instead, the Commission should, as it has

done in the past, allow 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.

The Proposed Order found that Aqua's recovery of 75% of its originally projected Rate Department expense and 50% of its originally projected Miscellaneous expense should be allowed. (Proposed Order, pp. 37-39). This finding is fully supported by the evidence. (*See* Aqua Ex. 8.0 and Ex. D thereto). Therefore, the Commission should not reverse the Proposed Order's holding that Aqua is allowed to recover these amounts.

b. AUS Consultants' Expense

As an initial matter, Staff has apparently abandoned its primary argument that Aqua's recovery of its expense for the testimony of its Return on Equity ("ROE") witness, Ms. Ahern, should be disallowed. Specifically, Staff asserts that its proposed disallowance for this expense "is not based on the argument that this case should have been consolidated with one of the prior rate cases since the same cost of equity analysis was utilized." (Staff BOE, p. 15). As a result, Staff suggests that the Proposed Order be revised to strike the following language from the first full paragraph on page 43: "Staff and WA suggest that the fees could have been spread over a larger customer base had Aqua combined its rate request with other larger divisions. This proposal fails to consider the impact on customers of an earlier rate increase and the impact on Aqua of a delayed rate increase." (*Id.*, p. 19).

Even if Staff's proposed disallowance is no longer based on this argument, Staff directly advanced the argument in its filings in this proceeding, up to and including its Initial Brief.¹⁵ (Staff Ex. 1.0, pp. 12-13; Staff Ex. 6.0, pp. 8-11; Staff IB, p. 27). Therefore, the Proposed Order

¹⁵ Staff first begins to disassociate itself from the argument in its Reply Brief, where it unjustly accuses Aqua of misrepresenting Staff as having advanced the argument. (Staff RB, p. 12). It states that Staff witness Ms. Freetly never made the argument. (*Id.*) It was Staff witness Ms. Pearce, however, who repeatedly advanced the argument. (Staff Ex. 1.0, pp. 12-13; Staff Ex. 6.0, pp. 8-11). Certainly, Staff should have known this.

properly addresses it. By seeking to strike the Proposed Order's well-considered conclusion that this argument is problematic, Staff is attempting to remove a valid conclusion only after it has learned that the conclusion is not in its favor. A party should not be permitted to nullify an adverse Commission conclusion simply by withdrawing its argument after-the-fact. Should the Commission allow parties to do so, it would eliminate valuable precedent obtained after a full hearing on the merits for no appropriate reason. Therefore, the Commission should reject Staff's proposed revision set forth above.

Staff claims in its Brief on Exceptions that the only reason the Commission should adopt its proposed disallowance is that Ms. Ahern employed an ROE analysis that the Commission has not adopted previously. (Staff BOE, pp. 15-17). Staff argues that the Commission should employ what Staff describes as a "straightforward" test but which, in reality, is entirely arbitrary and would infringe on parties' legal rights to advance arguments in good faith. In particular, Staff asserts that a party could only collect a witness' expense if the party wins but not if it loses. (*Id.*, p. 16). Such a test may be "straightforward" but it has no basis under the law. Indeed, Staff cites no legal basis pursuant to which the Commission could disallow a witness' expense on the mere fact that the party lost an issue. As described in detail below, Staff's argument is unsupported and should be rejected by the Commission.

Aqua is entitled to seek what it believes is a reasonable ROE, and it bears the burden of presenting evidence in support of its ROE recovery. Aqua could not rely upon the Commission's prior ROE findings for other rate divisions because capital costs change over time. (Aqua Ex. 6.0R, p. 18). It had to support its position in these cases or it would have had no recourse if it found Staff's position unacceptable. Aqua's ROE witness expense, therefore, is a legitimate expense that needs to be recovered.

First and foremost, the Commission's decisions are not *res judicata*. *Citizens Util. Bd. v. ICC*, 291 Ill. App. 3d at 304, 683 N.E.2d at 943; *Peoples Gas, Light & Coke Co. v. Ill. Commerce Comm'n*, 175 Ill. App. 3d 39, 51, 529 N.E.2d 671, 679 (1st Dist. 1988). Parties always have the opportunity to argue for the Commission to change its position on an issue, including ROE. There is no prohibition in the Public Utilities Act or the Commission's rules on what positions parties may advance. The Commission can change its position on any issue provided it has a reasonable basis for doing so. *Citizens Util. Bd. v. ICC*, 166 Ill. 2d 111, 132, 651 N.E.2d 1089, 1100 (1995). A position is not "invalid" simply because it may not be the one the Commission adopted in an earlier decision. Indeed, Staff does not provide any legal support for its proposal.

Moreover, as demonstrated in Aqua's filings in this proceeding, Ms. Ahern's expert opinion would be a reasonable basis for the Commission to adopt a new position on ROE. Ms. Ahern is a highly qualified expert in her field. (*See* Aqua Ex. 3.0, pp. 1-2, App. A (OR), (WW), (WS)). There is no basis to question the validity of her expertise or opinion in this proceeding, and the Commission has not previously done so, even where it did not adopt her opinion. (*See* ICC Dkts. 03-0403 and 04-0442).

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

Staff's proposal here, furthermore, is contrary to its own actions. It argues that Aqua should not be permitted to recover its expense for its ROE witness because she "[chose] to present an analysis that has been rejected by the Commission" (Staff BOE, p. 15); however, Staff testifies to positions that are contrary to Commission decisions all the time. In fact, Staff is doing so in these pending cases,¹⁶ it did so in the 2004 Vermilion rate case, Dkt. 04-0442, and Staff witness Ms. Freetly testified there is no guarantee it will not do so again. Staff should not be permitted to advance its own positions that are contrary to prior Commission orders while also seeking a ruling from the Commission that other parties may not do so. Such a position is unreasonable and discriminatory, and should not be adopted by the Commission here.

Finally, Staff proposes that if the Commission allows recovery of the rate case expense attributed to AUS Consultants, it should only do so in an amount equal to the actual costs incurred by Aqua. (Staff BOE, p. 18). This proposal is problematic because it is yet another new argument advanced by Staff for the first time in this proceeding in its Brief on Exceptions. Another problem with Staff's proposal is that it asks the Commission to again take an unbalanced approach in this proceeding. In particular, Staff asks the Commission to look at the actual costs incurred for AUS Consultants (via the invoices Aqua submitted in this proceeding) because Staff argues that these costs are less than Aqua's original projection for this expense. However, Staff has taken the exact contrary position in this proceeding by arguing that the Commission should not consider Aqua's actual costs as evidenced by invoices for outside legal expense and witness expense—two rate case expenses that have increased from Aqua's original

¹⁶ For example, Staff argued in these cases to disallow Ms. Ahern's fee on the ground that Aqua did not file these consolidated cases with either its Kankakee filing in 2003 or its Vermilion filing in 2004. (See *supra*). Staff advanced the same argument in *Consumers Ill. Water Co.*, ICC Dkt. 99-0288, 2000 WL 34446603, slip op. at 14). In that case, Commission held unequivocally that "there is no legal basis on which to penalize [Aqua] and disallow a portion of the proposed rate case expense, as Staff suggests, for not combining this [single division] rate filing with rate filings for other divisions." *Id.*, slip op. at 16. Nonetheless, Staff advanced the exact same argument here.

projections. Staff should not be allowed to have it both ways. The Commission should reject Staff's renewed invitation to adopt a one-sided approach to rate case expense.

In sum, Ms. Ahern's expertise is beyond question, and her opinion does not become invalid simply because the Commission does not adopt it. Aqua's submission of her opinion here was not, as Staff suggests, a fruitless effort for which the expense should be disallowed. Instead, as shown above, Aqua's submission of its ROE analysis in this proceeding was entirely reasonable and consistent with the Commission's rules and practices. Staff's argument runs counter to the law in that Commission decisions are not *res judicata* and it is, moreover, inconsistent with Staff's own actions. Therefore, the Commission should reject Staff's argument and proposal to strike in its entirety the first full paragraph on page 43 of the Proposed Order. Instead, the Commission should maintain that paragraph as written and allow Aqua's recovery of Ms. Ahern's expense.

c. Staff's Proposals Regarding Future Rate Case Filings

Staff argues that the Commission should recommend "that Aqua consider Staff's proposals regarding [its] future rate case filings in an attempt to minimize rate case expense." (Staff BOE, p. 21). Aqua set forth numerous reasons, however, as to why the Commission can not legally, and should not as a matter of policy, adopt Staff's proposed rules on Aqua's future rate case filings. (*See*, Aqua IB, pp. 36-39; Aqua RB, pp. 43-46). Neither past Commission decisions nor the evidence presented in this proceeding demonstrate that it would be proper for the Commission to impose the rules Staff proposes for Aqua's future rate case filings. Rather, the evidence establishes that the rules would amount to poor public policy and would result in significant costs rather than savings. They would, moreover, be both discriminatory and promulgated in non-compliance with the proper procedure for administrative regulations.

Accordingly, Staff's proposals are wholly unsupported by the evidence or the law. Its request that the Commission, nonetheless, "recommend" Aqua comply with the proposals is an improper attempt to side-step the Proposed Order's sound conclusion that the proposals should not be adopted. While couched in the phrase "recommend" rather than "require," the end effect would be the same—*i.e.*, Staff would expect Aqua's "compliance" with the "recommendations." That this is the intent is clear from the exception language Staff proposes: "If the Company is unable to *comply* with Staff's proposals, the Company should provide rationale for not being able to *comply* in its testimony in future rate case filings." (Staff BOE, p. 21) (emphasis added). In other words, Staff proposes that the burden be placed on Aqua to justify noncompliance with proposals the Proposed Order rightly finds to be unsound. The Commission should reject Staff's attempt to impose through the back door proposals that it rightly has not been allowed to impose through the front door. The Commission should reject Staff's proposed revisions to the last paragraph on page 44 and first paragraph on page 45 of the Proposed Order.

d. Amortization Period Of Rate Case Expense

The evidence establishes that Aqua intends to file its next rate cases for all divisions within, at the most, four years. (Aqua Ex. 6.0R, p. 39). By filing its next cases within this period, Aqua intends 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. (*Id.*) No party disputed the reasonableness of this goal. Aqua also presented evidence that it is most likely to build a Reverse Osmosis ("RO") Plant in the Oak Run Division in 2007, and that the capital investment for the RO Plant will require a rate filing. Thus, the next filing for Oak Run will most likely be made well in advance of four years. (Aqua Ex. 5.0 2A, pp. 1-5; Aqua Ex. 6.0R, p. 39).

The Proposed Order adopts a uniform five year amortization period for all three Divisions. (Proposed Order, p. 48). It does so in recognition of a serious flaw in amortization periods that Staff's proposes—namely, that Staff recommended disparate amortization periods for the three Divisions, which provides an inherent disincentive for Aqua to file its next rate cases for these Divisions at the same time, while, at the same time, arguing that Aqua should file its next rate cases for these Divisions at the same time. (*Id.*) Aqua agrees with the Proposed Order's intent to remove obstacles to simultaneous filings for these Divisions; but, Aqua believes the five year amortization period the Proposed Order adopts is too long given Aqua's intent to file for all three Divisions within, at the most, a four year period. (Aqua Ex. 6.0R, p. 39).

Staff now asks that the Proposed Order be modified to adopt a seven year period for all three Divisions rather than the five year period that the Proposed Order finds to be reasonable. (Staff BOE, pp. 22-23). Staff does so based upon a completely new argument that the period for amortization should be set to reflect a reasonable level of rate case expense in rates each year. (*Id.*) Because this argument is *raised for the very first time in its Brief on Exception*, it would not be appropriate, once again, for the Commission to consider a new argument. *Knox Motor Serv., Inc. v. Ill. Commerce Comm'n.*, 77 Ill. App. 3d at 596-97, 396 N.E.2d at 284-85 (holding that the Commission cannot rely on facts introduced in a manner as to deprive all the parties the opportunity to be heard) *quoting Atchison, Topeka & Santa Fe Ry. Co. v. Commerce Comm'n.*, 335 Ill. at 638, 167 N.E. at 837 (“[t]he commissioners['] . . . [f]indings must be based on evidence presented in the case, with an opportunity to all parties to know the evidence to be submitted or considered, to cross-examine witnesses, to inspect documents and to offer evidence in explanation or rebuttal, and nothing can be treated as evidence, which is not introduced as such.”).

Staff's new argument, further, contradicts the testimony of its own witness Ms. Pearce as to what factors are determinative in setting a proper amortization period. Ms. Pearce testified, with the agreement of all parties, 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). As such, during the evidentiary phase of the proceeding, the parties sought to determine the period of time that the subject tariffs are reasonably anticipated to be in effect. It is highly inappropriate for Staff to now, during the exceptions phase, attempt to change the standard from that which the parties have submitted evidence to satisfy.

The five year amortization period the Proposed Order adopts is already too long for the three Divisions. The deferred balance on rate case expense is un-earning even though it is capital the Company has already expended. (Aqua Ex. 6.0R, pp. 38-39). If the amortization period is too long, *i.e.*, beyond the time in which the evidence establishes Aqua is likely to file its next rate cases for the Divisions, then the extent to which the unamortized balance represents unearning capital would unreasonably and unfairly increase. (*Id.*) It is a fundamental principle of rate-making that the Commission should set balanced rates so that the Company is kept whole. *See, e.g., Bus. & Prof'l. People for the Pub. Interest v. Ill. Commerce Comm'n*, 146 Ill. 2d at 208, 585 N.E.2d at 1045 ("[t]he Commission is charged by the legislature with setting rates which are '*just and reasonable*' not only to the ratepayers but to the utility and its stockholders") (emphasis in original) (*quoting* 220 ILCS 5/9-201(c)); *Citizens Util. Bd. v. Ill. Commerce Comm'n*, 276 Ill. App. 3d at 737, 658 N.E.2d at 1200 ("[t]he 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”). Staff’s proposal, in its Brief on Exceptions, to extend the amortization period for all three Divisions to seven years, well beyond the time the evidence shows Aqua intends to file its next rate cases for these Divisions, fails this fundamental principle. The Commission should not adopt it.

C. Cost Of Service And Rate Design

1. Cost Of Service Study

Aqua concurs with Staff’s proposal to delete the first paragraph under D. Other on page 55 of the Proposed Order concerning the need for Aqua and Staff to prepare cost of service studies in future rate cases. Staff is correct that cost of service studies were not necessary in these cases. (Staff BOE, pp. 24-27). As such, preparing the studies would have unnecessarily increased rate case expense, and requiring the studies in future rate cases would do so as well. (See Proposed Order, p. 55) (acknowledging that “cost of service studies [are] not cost free”). Such a directive, therefore, would contrast with Aqua’s efforts to minimize rate case expense in future proceedings.

2. Woodhaven Sewer Rate Design

In an effort to minimize rate case expense, Aqua did not contest Staff’s rate design proposal for the Woodhaven Sewer Division. However, that is not to say that Aqua believed Staff’s proposal would send the correct signals. Rather, Aqua believed that Staff’s proposal failed to account for one of the Division’s primary operating characteristics—namely, the high level of uncollectibles caused by a portion of the residential customers.

Commercial customers in the Woodhaven Sewer Division do not drive the uncollectibles problem—rather, the problem is primarily caused by a portion of the residential customers. Under Staff’s proposal, the charges to the commercial customers would be reduced by a

significant amount. (Proposed Order, p. 54) (calculating the reduction at 87%). Particularly, at previous rates, commercial customers were charged a sewer rate equal to 130% of the commercial water rate in the Woodhaven Water Division. At that rate, the commercial customers would produce revenues of \$66,042. (Tr., p. 156). In comparison, under Staff's new and significantly reduced rate, commercial customers would only produce revenues of \$5,000. (Tr., p. 158). This is a drop of over 92% in the amount commercial customers will contribute to the revenue requirement. This is problematic because the burden to cover the revenue drop from commercial customers is shifted to the residential customers, including the portion of whom that are causing the uncollectibles problem. The Proposed Order is correct to recognize this inherent flaw in Staff's rate design proposal. (Proposed Order, p. 54).

The Proposed Order's solution to maintain the commercial sewer rate at its previous level is also appropriate. Staff's argument that all customers drive the same costs in the absence of a cost of service study is not supported. (Staff BOE, p. 27). The Proposed Order is correct to recognize that under the prior rate structure, "the monthly sewer charge is a function of the customer's water bill for the same month, which is a function in part of the customer's water usage for that month." (Proposed Order, p. 54). The Commission certainly determined a sewer charge for commercial customers of 130% of the commercial water rate to be just and reasonable in prior rate cases.

The WA's opposition to the change is puzzling as it is supposed to represent the interest of the end user customers in the Woodhaven area who would see the direct hit of the revenue shift. (WA BOE, pp. 13-14). The WA's comments on the issue, moreover, are new factual allegations that are not set forth in the record evidence. Indeed, the extent to which the WA passes on its own costs to Woodhaven residents is not an issue for the Commission to consider.

Accordingly, neither Staff nor the WA set forth legitimate reasons for making a significant revenue shift from commercial to residential customers in the Woodhaven Sewer Division. The Proposed Order is correct to forestall such a revenue shift, especially in light of the level of uncollectibles in the Division. The Commission should not adopt Staff's or the WA's exceptions to the Proposed Order's conclusion on rate design for the Woodhaven Sewer Division.

D. Miscellaneous

1. The Proposed Order's Introduction

Staff proposes some minor revisions to the introductory portion of the Proposed Order. In addition to those proposed by Staff, one further clarification should be made. In particular, the very first sentence states that Aqua's filed revised water and sewer rates for its "Woodhaven Water Division." (Proposed Order, p. 1). However, Aqua filed revised water rates for its Woodhaven Water Division and revised sewer rates for its Woodhaven Sewer Division. The first sentence on page 1 of the Proposed Order should be revised to reflect this distinction as follows:

On December 22, 2004, Aqua Illinois, Inc. ("Aqua") filed with the Illinois Commerce Commission ("Commission") revised tariff sheets proposing general increase in water and sewer rates for its Woodhaven Water Division (~~"Woodhaven"~~), and Woodhaven Sewer Division, respectively. (Woodhaven Water Division and Woodhaven Sewer Division collectively "Woodhaven").

2. Ms. Sadler's Brief On Exceptions

None of the exceptions proposed by Ms. Sadler have merit or should be adopted. With regard to her first exception, the Administrative Law Judge granted Aqua permission to file its evidence of compliance with publication on September 26, 2005. All of Ms. Sadler's remaining exceptions rely upon information that has not been admitted into the evidentiary record.

Pursuant to Section 200.200(e) of the Commission's Rules of Practice, except for good cause shown, Ms. Sadler is required to accept the record as it existed at the time of her intervention. 83 Ill. Adm. Code §200.200(e). Here, all Oak Run customers, including Ms. Sadler, were given proper notice of Aqua's rate filing pursuant to the Commission's regulations. (*See* Aqua Ex. 1.4R (OR)). The ORPOA has actively represented Oak Run customers in the case. Ms. Sadler did not to intervene until well after the evidentiary record had been marked "heard and taken." (Tr., p. 423). Now, with only forty-five (45) days until the Commission is required to issue a final decision on Aqua's rate filing,¹⁷ Ms. Sadler has filed a Brief on Exceptions that advances new allegations as the sole basis for her exceptions. She has not presented good cause for failing to make her allegations in a timely manner during the evidentiary phase of the case. Accordingly, the Commission should deny Ms. Sadler's exceptions because they are based upon new allegations that are not in the record.

III. Conclusion

WHEREFORE, for each of the reasons set forth herein, Aqua Illinois, Inc. respectfully requests that the Commission grant Staff's proposed exceptions regarding the introduction, depreciation rates and cost of service studies; deny all other exceptions proposed by Staff, the

¹⁷ The Commission is required to act on Aqua's filing by November 27, 2005, pursuant to Section 9-201 of the Public Utilities Act, 220 ILCS 5/9-201.

Oak Run Property Owners Association, the Woodhaven Association and Ms. Sadler; grant the modifications to the Proposed Order set forth in Aqua's Brief on Exceptions, and grant any and all other appropriate relief.

Dated: October 19, 2005

Respectfully submitted,

Aqua Illinois, Inc.

By: _____
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CERTIFICATE OF SERVICE

I, Sarah N. Galioto, hereby certify that I served a copy of the Reply Brief on Exceptions of Aqua Illinois, Inc upon the service list in Docket Nos. 05-0071 and 05-0072 by electronic mail on October 19, 2005.

Sarah N. Galioto