STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Aqua Illinois, Inc.	:	
	:	
Proposed general increase in Water rates for the Kankakee Water Division. (Tariffs filed February 28, 2006).	:	Docket No. 06-0285

REDACTED

INITIAL BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

JAN VON QUALEN
Office of General Counsel
Illinois Commerce Commission
527 East Capitol Avenue
Springfield, IL 62701
Phone: (217) 785-3402
Fax: (217) 524-8928
jvonqual@icc.illinois.gov

MICHAEL LANNON
MATTHEW HARVEY
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Suite C-800
Chicago, IL 60601
Phone: (312) 814-2865
Fax: (312) 793-1556
mlannon@icc.illinois.gov
mharvey@icc.illinois.gov

Counsel for the Staff of the Illinois Commerce Commission

October 19, 2006

TABLE OF CONTENTS

I. INTRODUCTION 1

A. Procedural History 1

B. Nature of Operations 4

C. Test Year 4

D. Applicable Law 4

II. RATE BASE 4

A. Correction of AFUDC Rate Applied to WTP Plant 4

B. Part 287 Update 5

1. Disallowance of the Section 287 Update 5

a. Significant and Material Change 5

b. Required Schedules 6

2. The Scheduling of Updates 11

3. Updates to Be Scheduled at Prehearing Conference 11

4. Updates to Be Filed Prior to Company Rebuttal Testimony 12

5. Expedited Responses to Part 287 Data Requests 14

6. Support Required for a Part 287 Update 14

7. Accurate and Complete Information to Be Provided 17

8. Summary 22

C. Retired Utility Plant 23

D. Cash Working Capital 23

E. Contributions In Aid of Construction-Plant Facilities Charge 24

III. OPERATING REVENUES AND EXPENSES....24

A. Affiliated Interest Transactions....24

B. Industry Association Dues....25

C. Plant In Service Dates....25

D. Cancelled Utility Plant....26

E. Miscellaneous Other Expense....27

F. Original Cost Recommendation....27

G. Charitable Contributions....27

H. Contingencies in Utility Plant....29

I. Disallowed Obsolete Generator....30

J. Advertising....31

K. Written Scripts....34

L. Depreciation Rates....35

M. Rate Case Expense....35

1. AUS Consultants....35

2. London Witte....35

3. Guastella Associates....36

4. GPM Associates....36

5. Aqua Legal....36

6. Outside Legal....37

7. Aqua Rates Department....42

8. Other Expense/Miscellaneous....45

9. Staff Recommendations Regarding Future Rate Cases....46

10. Staff's Alternative Rate Case Expense Recommendation 50

N. Incentive Compensation Expense 51

O. Sludge Hauling Expense 54

P. Unaccounted For Water 55

IV. COST OF CAPITAL/RATE OF RETURN 58

A. Overview 58

B. Capital Structure, Debt Costs and Cost of Preferred Stock 58

C. Cost of Common Equity 59

1. Staff's Analysis 59

a. DCF Analysis 60

b. Risk Premium Analysis 60

c. Staff Cost of Equity Recommendation 61

2. Company's Analysis 62

a. DCF Analysis 62

b. Risk Premium Analysis 63

c. Company Cost of Equity Recommendation 63

3. Staff's Criticisms of the Company's Analysis 63

a. NAIC-2 Debt Rating 64

b. Aqua's Risk Premium Analysis. 68

c. Aqua's DCF analysis 69

4. Staff's Response to Aqua's Criticisms 70

a. Prior Commission Orders 70

b. Risk Premium. 72

c. Current U.S. Treasury Yields 76

D. Recommendation 78

V. COST OF SERVICE STUDY/RATE DESIGN 78

A. Cost of Service Study 78

B. Rate Design....79

C. Private Fire Protection Rates....80

D. Plant Facilities Charge....82

VIII. CONCLUSION 83

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Aqua Illinois, Inc.	:	
	:	
Proposed general increase in Water rates for the Kankakee Water Division. (Tariffs filed February 28, 2006).	:	Docket No. 06-0285

INITIAL BRIEF
OF THE
STAFF OF THE ILLINOIS COMMERCE COMMISSION

NOW COMES the Staff of the Illinois Commerce Commission ("Staff"), through its undersigned counsel, and files its initial brief in the above referenced docket.

I. INTRODUCTION

A. Procedural History

On February 28, 2006, Aqua Illinois, Inc. – Kankakee Water Division ("Aqua" or the "Company") filed revised tariff sheets ("Filed Rate Schedule Sheets") seeking an increase of approximately 24.48% in water rates, which increase was to become effective on April 14, 2006. Cover Letter to Chief Clerk for revised tariff sheets filing, dated February 28, 2006. On March 31, 2006, Aqua made a Part 285 Filing. 83 Ill Admin code Part 285. Included in its Part 285 filing were the direct testimonies of Mr. Thomas J. Bunosky, Aqua Ex. 1.0; Mr. Jack Schreyer, Aqua Ex. 2.0; Ms. Pauline Ahern, Aqua Ex. 3.0; Mr. Dave Monie, Aqua Ex. 4.0; and Mr. John Guastella, Aqua Ex. 5.0. On April 4, 2006, the Administrative Law Judge ("ALJ") issued a Deficiency Letter, under Part 285.145 (83 Ill. Adm. Code 285.145), to Aqua explaining the insufficiencies of

Aqua's Part 285 filing and also explaining how Aqua could correct these deficiencies to be in compliance with the requirements of Part 285.

On April 5, 2006, the Commission issued a Suspension Order which suspended the Aqua Filed Rate Schedule Sheets for the Commission to "enter upon a hearing concerning the propriety of the proposed general increase in water rates." Suspension Order at 1. On May 4, 2006, Aqua filed Supplemental Verified Responses to the ALJ's Deficiency Ruling. On May 16, 2006, the ALJ held a status hearing in which the following agreed to schedule was set: Staff/Intervenor Testimony due on June 29, 2006, Aqua Rebuttal Testimony due on July 31, 2006, Staff/Intervenor Rebuttal Testimony due on August 30, 2006, Aqua Surrebuttal Testimony due on September 11, 2006, Evidentiary Hearings to be held on September 20 and 21, 2006, Initial Briefs due on October 19, 2006, Reply Briefs due on October 31, 2006, Proposed Order by December 11, 2006, Brief on Exceptions due December 18, 2006, and Reply Brief on Exceptions due December 22, 2006,.

Pursuant to the above schedule, on June 29, 2006, Staff filed the direct testimony of Mary Everson, Staff Ex. 1.0; Mike Ostrander, Staff Ex. 2.0; Rochelle Phipps, Staff Ex. 3.0; Tom Smith Staff Ex. 4.0; William Johnson, Staff Ex. 5.0; and Mike Luth, Staff Ex. 6.0. On July 17, 2006, Aqua filed a Motion to file Updates to future Test Year Data Pursuant to 83 Ill Admin Code Section 287.30 ("Section 287 Update"). On July 31, Staff Responded to Aqua's Section 287 Update Motion. Also on or about July 31, 2006, Aqua filed the following rebuttal testimony: Thomas Bunosky, Aqua Rev. Ex. 10.0; Jack Schreyer, Rev. Aqua Ex. 7.0; Pauline Ahern, Aqua Ex. 8.0; and David Monie, Aqua Ex. 9.0. On August 7, 2006, Aqua filed its Reply to Staff's Response to its Section 287 Update

Motion. On August 25, 2006, the ALJ issued his ruling on Aqua's Section 287 Update Motion. The ALJ granted the company's Section 287 update Motion to the extent it could provide to Staff the "B" and "C" schedules related to the updated capital expenditure items within seven days. The ALJ also extended the Staff/Intervenor date for filing rebuttal testimony from August 30, 2006 to September 5, 2006, and Aqua's scheduled date for surrebuttal testimony from September 11, 2006, to September 12, 2006.

On August 30, 2006, Aqua filed its Compliance Update Filing Pursuant to Section 287.30. On September 5, 2006, Staff filed the following rebuttal testimony: Mary Everson, Staff Rev. Ex. 7.0R; Mike Ostrander, Staff Ex. 8.0; Rochelle Phipps, Staff Ex. 9.0; Thomas Smith, Staff Ex. 10.0; Mary Selvaggio, Staff Ex. 12.0; and Mike Luth, Staff Ex. 11.0. Also, on September 5, 2006, the County of Kankakee (the "County") filed the rebuttal testimony of Scott Rubin, County Ex. 1.0. On September 6 and September 8 the County and Staff respectively filed Motions to Compel. On September 12, 2006, Aqua filed its Response to Staff and the County's Motion to Compel. Also on September 12, 2006, Aqua filed the following surrebuttal testimony: Thomas Bunosky, Aqua Ex. 11.0; Jack Schreyer, Aqua Ex. 12.0; David Monie, Aqua Ex. 13.0; and Pauline Ahern, Aqua Ex. 14.0. On September 15, 2006, Staff and the County filed Replies to Aqua's Response to Motions to Compel. On September 15, 2006, the ALJ issued a Ruling which granted the Staff and County Motions to Compel. Evidentiary hearings, in which evidence was adduced and witnesses questioned, were held in Springfield on September 20 and 21, 2006, at the conclusion of which the record was marked "heard and taken." Tr. 459.

B. Nature of Operations

Aqua is engaged in the business of providing water and/or wastewater service to the public in Illinois.

C. Test Year

The Company proposes a future test year, the twelve months ending December 31, 2007.

D. Applicable Law

Section 9-101 of the Illinois Public Utilities Act (the "PUA") requires that "[a]ll rates or other charges made, demanded or received by any product or commodity furnished or to be furnished or for any service rendered or to be rendered shall be just and reasonable." 220 ILCS 5/9-101. Conversely, "[e]very unjust or unreasonable charge" or rate are "prohibited and declared unlawful." *Id*. Ratepayers are also not required to pay for costs unless those costs can be shown to "directly benefit them or the services" which the utility renders. *Illinois Bell Tel. Co. v. Illinois Commerce Comm.*, 55 Ill. 2d 461, 482 - 483 (1973). Moreover, the "burden of proof to establish the justness and reasonableness of the proposed rates or other charges . . . shall be on the utility." 220 ILCS 5/9-201(c).

II. RATE BASE

A. Correction of AFUDC Rate Applied to WTP Plant

Company Witness Schreyer in surrebuttal testimony stated that an incorrect Allowance of Funds Used during Construction (AFUDC) rate of 6.8% had been applied to the Water Treatment Plant (WTP) and that the AFUDC added to the WTP plant balance should have been $143,382 rather than $150,000 or a reduction of $6,618. Aqua Ex. 12.0, at 27, line 582 – 591.

Staff agrees that the plant-in-service balance should be reduced by $6,618 to reflect a correct application of the AFUDC rate for 2006 and 2007 to the WTP construction expenditures.

B. Part 287 Update

1. Disallowance of the Section 287 Update

Staff witness Selvaggio recommended that the Commission find that since the update did not comply with the requirements of 83 Ill. Adm. Code 287.30, Updates to Future Test Year Data, that the update should not be considered in the determination of the revenue requirement. Staff Ex. 12.0, at 19-20, lines 484-488. Staff's recommendation is based on the fact that a significant and material change affecting the revenue requirement had not occurred and that the required schedules supporting the update were not filed as required by Section 287.30.

a. Significant and Material Change

A significant and material change affecting the revenue requirement has not occurred. Section 287.30(a) provides for an update only when "evidence has been introduced that a significant and material change affecting the revenue requirement … has occurred." Moreover, it limits the number of updates that a utility can make in the re-suspension period to one. Aqua agrees that the update is not a significant and material change affecting the revenue requirement. In fact, in its Reply to Staff's Response to Motion to File Updates to Future Test Year Data, Aqua emphasized the insignificance and immaterial nature of the change, in stating:

> [T]he new evidence does *not drastically* alter the overall case.
>
> …
>
> The overall impact on the revenue requirement is *not large* either. The change in capital improvements, in total, produces

> a *mere* $181,109 change in the revenue requirement. The percentage impact on additional annual revenue is *only 1.33%.*
>
> To put the issue in context, the update is *minor* compared to the changes to Aqua's future test year that Staff has proposed via testimony. …As such, a drastic change to the case is not at issue here.

Reply of Aqua, at 7 (emphasis added).

b. Required Schedules

<u>The required schedules were not filed with the update.</u> Subpart J of 83 Ill. Adm. Code 285 ("Part 285") establishes the requirements and additional schedules that must be provided if the Company selects a future test year. Staff witness Selvaggio testified that Aqua did not provide all of the schedules that are required to be filed to support an update to a future test year. Staff Ex. 12.0, at 13, lines 324-345. Section 287.30(a) provides:

> When data are updated, the utility shall also provide updated information for any affected schedules and work papers originally submitted as a requirement of 83 Ill. Adm. Code 285.
>
> 83 Ill Admin Code Section 287.30(a).

Staff's position is that any schedule and workpaper submitted in the original Part 285 filing that is no longer representative (due to updated information) should be included with the updated filing. Moreover, Staff notes Aqua did not file all of the affected schedules and supporting workpapers that are required under Section 287.30(a). The schedules that were not provided are as follows:

A-1	Summary of Standard Information Requirements;
A-2	Overall Financial Summary;
A-4	Comparison to Prior Rate Order;
G-1	Comparison of Prior Forecasts to Actual Data – Prior Three Years;
G-2	Statement from the Independent Certified Public

Accountant;
G-3 Statement on Assumptions Used in the Forecast;
G-4 Statement on Accounting Treatment;
G-5 Assumptions Used in the Forecast;
G-7 Proration of Accumulated Deferred Income Taxes;
G-15 Income Statement;
G-16 Balance Sheet;
G-17 Statement of cash flows; and
G-18 Statement of retained earnings.

The most important schedules that were not provided by Aqua in support of its update are the following general schedules:

a) Schedule G-2 - A statement from an independent certified public accountant that the preparation and presentation of the applicable updated schedules comply with the Guide for Prospective Financial Information as of April 1, 1999 by the American Institute of Certified Public Accountants;

b) Schedule G-3 - A statement that the assumptions used in the updated forecast contains the same assumptions and methodologies used in forecasts prepared by management;

c) Schedule G-4 - A statement that the accounting treatment applied to anticipated events and transactions in the updated forecast is the same as the accounting treatment applied in recording the events once they have occurred and that there are no differences between the accounting treatment applied to anticipated events and transactions in the forecast forming the basis of the updated test year; and

d) Schedule G-5 - The revised assumptions used in preparing the updated projected financial information.

Staff Ex. 12.0, at 10-11, lines 261-285.

Any updated information introduced into the projected test year renders the original Schedules G-2 through G-5 obsolete. If the original test year assumptions and methodologies must be supported by specific requirements, updated information must be supported by the same requirements to undergo similar scrutiny. Otherwise, there is no assurance that the updated information is

more appropriate than the original information. The updated information is still a projection and may be no more certain than the original information. Staff Ex. 12.0, at 11, lines 288-296.

An update for a specific, targeted item without a consideration of all of the assumptions violates the integrity of the original projected information forming the basis of the test year. Rates are based upon the relationship between the investment in rate base and the operating income to provide utility service. When one item is selectively changed based on more recent information, the ratio may no longer be appropriate. For example, an increase to plant may result in reduced operating and maintenance expenses, an increase in customers and, thus, an increase in operating revenues. As time passes, factors and assumptions change. An update should be reflective of all key factors and assumptions known at the time of the update. Staff Ex. 12.0, at 12, lines 297-309.

Section 285.7010(a) requires a statement from an independent certified public accountant that the preparation and presentation of the applicable schedules comply with the Guide for Prospective Financial Information as of April 1, 1999 by the American Institute of Certified Public Accountants (Guide). The Guide provides that all key factors and assumptions should be analyzed in the preparation of a new financial forecast. Chapter 8.48 of the Guide addresses updates and states:

> *Updating*. **It is not usually expected that forecasts will be updated** and the responsible party may wish to consider stating in the presentation that it does not intend to update the forecast. Nevertheless, there may be situations in which updating would be appropriate, for example, if a material event occurs while an entity's debt or equity interests are currently being offered for sale. In deciding whether it would be appropriate to issue an updated

> financial forecast, the responsible party should consider whether users would expect prospective financial statements to be updated. **Updating requires the reanalysis of key factors and assumptions and preparation of a new financial forecast.** The reasons for updating should be described in a note to the updated presentation. (Emphasis added)

The Guide is clear that if there is an update, the updated forecast must also comply with the Guide and there would need to be a reanalysis of key factors and assumptions for the preparation of the new financial forecast. Staff Ex. 12.0, at 4, lines 76-100.

In addition, the Commission has also ruled on the issue of an update that specifically targets items within a future test year filing. In the Commission's Order in Docket No. 04-0779, a proceeding to increase the natural gas rates for Nicor Gas Company with a 2005 future test year, the Commission rejected the proposal by the Attorney General to update the 2005 construction forecast to incorporate the actual plant balance as of December 31, 2004. This proposal would have ignored the impacts on other items in the Company's forecast that may have changed since the date of the forecast. Thus, the Commission's stated rationale for rejecting the AG's proposal was that "…the AG's adjustment would reconstruct the entire forecast…" Docket 04-0779 Order, at 11. In other words, because the Commission recognized that the single change proposed impacted the Company's entire forecast, it was improper to update one forecasted item without making all known changes to the forecast. Staff Ex. 12.0, at 12-13, lines 312-323.

Unlike a historical test year, the data underlying a requested rate increase for a future test year is not based upon actual costs. Rather, it is based upon projected financial information, which, in turn, is based on assumptions and

methodologies that are the result of many factors both internal and external to a company. Thus, judgment must be used in the development of future test year information. These judgments subsequently may prove to be unrepresentative of future conditions. The Guide provides a basis for evaluating how judgment has been applied in developing the forecast that forms the basis for a future test year. The reliability of projected financial information can never be guaranteed. However, if the financial forecast is prepared under established and reasonable guidelines, the reliability of the forecasted information could meet a threshold level of credibility and reliability. Staff Ex. 12.0, at 6, lines 152-164.

When adopting a future test year as the basis for a company's request for a rate increase, it is essential to understand the inherent limitations that the company has accepted. When a company chooses a future test year, it accepts one of the risks of a future test year: the possibility that the forecast assumptions may change with the passage of time. Staff Ex. 12.0, at 6-7, lines 165- 169.

Accordingly, updates should not reasonably be expected to occur every time a company files a rate case. If an update to future test year forecasts were necessary in every rate case filed by a company, then that would suggest the Company's forecasting process is not reliable and would require further Commission guidelines regarding the filing of updates by that company. Staff Ex. 12.0, at 3-4, lines 53-73.

Staff, accordingly, finds that the revenue change of $2,888,192 (see Appendix A, Sch. 1, line 24 of col. I), which does not consider the Company's Part 287 filing in the determination of the revenue requirement, is supported by the evidence of record in this proceeding. The Company, moreover, accepted

Staff's position as evidenced in the Stipulation.

2. The Scheduling of Updates

Staff witness Selvaggio also recommended that the Commission put Aqua on notice that in its future rate proceedings using a future test year:

a) An update will only be allowed if the possibility for an update is provided for in the case schedule at the pre-hearing conference;

b) Updates must be scheduled to be filed prior to the filing of Company rebuttal testimony; and

c) The Company should commit to respond to data requests related to the updated filing in an expedited manner at the pre-hearing conference. Staff Ex. 12.0, at 19, lines 463-472.

The Company also accepted these Staff recommendations as evidenced in the Stipulation.

3. Updates to Be Scheduled at Prehearing Conference

Staff witness Selvaggio recommends that an update only be allowed if the possibility for an update is incorporated into the schedule at the pre-hearing conference. This recommendation allows for adequate notice to parties to the case to plan and prepare for the eventuality that additional work may be required well into the proceeding as a result of an update. An update by its nature interrupts and disrupts the analysis of the original data supporting the filing. There is a large amount of information to be analyzed in a rate case and by statute there are only 11 months to complete the analysis, provide a full and complete record, brief the issues, and allow for the entry of a Commission Order. An update renders the analysis conducted on the affected parts of the Company's original filing prior to the update moot. In addition, an update

provides new data that must be reviewed and analyzed. Updates provided pursuant to an established schedule would be less disruptive as the work could be planned on the contingency that an update would be provided on or before a date certain. Staff Ex. 12.0, at 7, lines 176-188.

Based upon this reasoning, Staff recommended and the Company has agreed that the Commission order in this proceeding include a finding that: in Aqua's future rate proceedings using a future test year, an update will only be allowed if the possibility for an update is provided for in the case schedule at the pre-hearing conference.

4. Updates to Be Filed Prior to Company Rebuttal Testimony

Staff witness Selvaggio recommends that updates must be scheduled to be filed prior to the filing of Company rebuttal testimony. This recommendation is to ensure that parties' rights to due process are not prejudiced. An update filed after the Company files its rebuttal testimony effectively means such update would be reflected in its surrebuttal testimony. Since this is the last round of testimony in a rate case, other parties would not have the opportunity to respond to such updates in written testimony. Moreover, updated information provided only <u>after</u> Company rebuttal testimony means other parties must respond to two sets of information in their own rebuttal testimony. This is an additional burden that is exacerbated by the fact that Staff and Intervenor rebuttal testimony is typically afforded no more than a month for preparation that includes a discovery process. Parties would likely need to issue additional data requests regarding the update, await data request responses from the company, possibly issue

follow-up data requests, and prepare rebuttal testimony all within a limited time frame.

It is also relevant to note the Commission's opinion on this very issue in a previous rate case. In the Commission's Order, in Docket No. 90-0127, a proceeding to increase the natural gas rates for Central Illinois Light Company ("CILCO") with a 1991 future test year, the Commission rejected CILCO's revision of its projected construction expenditures for 1990 and 1991 based upon the Second Quarter 1990 Update and based the test year construction expenditures on the Fourth Quarter 1989 Update. The Commission stated:

> **[T]he Commission does not believe that the ratemaking process is well served when updates prepared during the rebuttal stage of the hearings result in such substantial increases over prior forecasts of costs which have the effect of increasing the utility's revenue requirement.** Absent a showing that increases of this magnitude could not reasonably have been foreseen at an earlier time such as when the rate case filing or supporting forecasts were prepared, the Commission does not believe that a utility should be permitted to increase or rehabilitate its revenue requirement in this manner over objections by witnesses for another party. Accordingly, Ms. Gomez' adjustment excluding increases in projected construction expenditures over filed levels should be approved."
>
> Staff Ex. 12.0, at 8-9, lines 194-227; Tr. 159 (emphasis added).

Based upon this reasoning, Staff recommended and the Company has agreed that the Commission order in this proceeding include a finding that: in Aqua's future rate proceedings using a future test year, updates must be scheduled to be filed prior to the filing of Company rebuttal testimony. (See Stipulation)

5. Expedited Responses to Part 287 Data Requests

Staff witness Selvaggio recommended that the Company commit to respond to data requests related to an updated filing in an expedited manner at the pre-hearing conference. An update that could be provided as late as immediately prior to the Company's rebuttal testimony severely limits the time that parties to the case have available to review and analyze the effects of the update. As data requests are likely to be generated by the update and such discovery may include more than one round, it is essential that responses to data requests be provided on an expedited basis. In addition, Company representatives that are responsible for the preparation and approval of responses to data requests must be available to promptly address questions regarding their responses to the data requests. Staff Ex. 12.0, at 9, lines 228-241.

The Company accepted this Staff recommendation as evidenced in the Stipulation.

6. Support Required for a Part 287 Update

Staff witness Selvaggio recommended that the Commission put Aqua on notice of the following conditions regarding the support that is required for an update to a future test year:

a) All affected Part 285 schedules and workpapers must be submitted at the time of the filing of the update, inclusive of Schedules G-2 through G-5; and

b) The update, supporting schedules, and workpapers must be free from significant errors that would call into question the reliability of the updated information.

c) That failure to follow these guidelines will result in the disallowance of the update. Staff Ex. 12.0, at 19, lines 474-483.

This recommendation is necessary to allow a thorough review of the updated information. The time available to review updated information is less than that available to review the original filing. Thus, all affected schedules and supporting workpapers must be provided when the update is filed and be free from significant errors. Staff Ex. 12.0, at 10, lines 255-258. Errors inhibit the conduct of meaningful analysis and cause additional data requests and delay in obtaining the correct information. Staff Ex. 12.0, at 18, lines 449-451.

Company witness Bunosky testified that Staff witness Selvaggio's proposals "would be an unnecessary waste of time and expense, and it would not add to the substance of the filing." Aqua Exhibit 11.0, at 40, lines 912-913. He further testified that

> In an update, it will often be the case that new evidence pertaining to a single budgeted item will materialize that shows the original budget for that single item to be superseded. Certainly, accounting for such evidence by updating the budget for that item does not change the fact that the original budget was prepared in accordance with the GPFI.
>
> Aqua Ex. 11.0, at 40-41, lines 915-925.

Based on his testimony, it is clear that Company witness Bunosky does not understand the issue. No one is suggesting that the original budget was not prepared in accordance with the GPFI (Guide). He goes on to further testify that: "The budget does not need to be re-reviewed by a CPA to ensure that it still complies with the GPFI simply because a new piece of evidence has materialized that sheds more knowledge on an aspect of the future test year." Aqua Ex. 11.0, at 41, lines 927-930. The Guide, however, clearly states that "Updating requires the reanalysis of key factors and assumptions and the

preparation of a new financial forecast." Guide, Ch. 8.48.

If the Company had filed a historical 2005 test year, the Company would be able to propose adjustments for known and measurable changes to the 2005 data that can be properly and sufficiently reviewed by Staff and parties in the case prior to the record being marked heard and taken. However, the Company has filed a 2007 future test year and Staff and the parties have accepted the 2007 test year. Nothing is known with certainty about 2007. What will occur in the year 2007 is inherently speculative. To superimpose a change in one item for a guess than had been previously made does not improve the likelihood that the revised 2007 projection will be any more accurate than the original projected guess. There is no end to the changes that could be made to the originally filed 2007 future test year. That is why the Guide requires the reanalysis of key factors and assumptions and the preparation of a new financial forecast if there has been a significant change that requires the forecast to be updated.

Company witness Bunosky complains that the requirement for Schedule G-2 to be refiled to support an update would increase rate case expense by the cost to acquire the opinion letter of a Certified Public Accountant. Aqua Ex. 11.0, at 41, lines 930-935. However, the need for an update should not be a normal occurrence, it should rarely occur. The original forecast should be a sufficient representation of the test year. It should only be in the course of a significant and material change that a projection would need to be updated.

Company witness Bunosky also complains that Staff witness Selvaggio's proposals for future Part 287 updates are not necessary as "the rules would affect all utilities". Aqua Ex. 11.0, at 41, lines 937-944. However, as Staff

witness Selvaggio testified she is recommending that the Commission put Aqua on notice in its order for this proceeding as the Commission did in the prior rate order for a division of Aqua in Docket No. 05-0071 and 05-0072, wherein the Commission stated:

> As for its concern with the upward trend and level of Aqua's rate case expenses, the Commission urges Aqua to take the necessary steps to regain control of rate case expenditures and encourages Aqua to give thorough consideration to the Staff proposals. Aqua is on notice that in future rate case proceedings, the Commission intends to closely scrutinize rate case expenses and will only allow Aqua to pass on to ratepayers that level of expenses reasonably necessary to complete a rate case.
>
> The Commission also takes this opportunity to challenge Aqua to complete its next rate case proceeding without filing successive corrections and amendments to its testimony. In this proceeding, Aqua submitted testimony in which it simply indicated that its witness was not prepared to answer certain questions yet. Later, without seeking leave to submit amended testimony, Aqua filed its amended testimony. Obviously such efforts require additional resources. Had Aqua complied with the testimony filing date that it had agreed to, the expenditure of additional resources, and additional rate case expense, would not have been necessary.
>
> Tr. 170-171; *see also* Aqua Illinois, Inc.: Proposed general increase in water and sewer rates for the Woodhaven Water Division (Tariffs filed on December 22, 2004)/ Proposed general increase in water rates for the Oak Run Water Division (Tariffs filed on December 29, 2004), ICC Docket Nos. 05-0071/05-0072 (consol.) *Order*, 45-46 (November 8, 2005).

As demonstrated above, the record supports this Staff recommendation. The Company, moreover, accepted this Staff recommendation as evidenced in the Stipulation.

7. Accurate and Complete Information to Be Provided

Staff recommended that the Commission revise its previous challenge to Aqua to

complete its next rate case without filing successive corrections and amendments to its testimony and challenge Aqua to provide complete, accurate, and detailed information to data requests in timely fashion. In Aqua's previous rate case, the Commission noted an inordinate amount of errors and the need for corrections and amendments. The Commission put Aqua on notice that the Commission expects its future rate filings to not require corrections and amendments. Specifically, the Commission stated in its Woodhaven Rate Order:

> The Commission also takes this opportunity to challenge Aqua to complete its next rate case without filing successive corrections and amendments to its testimony....
>
> *See* Aqua Illinois, Inc.: Proposed general increase in water and sewer rates for the Woodhaven Water Division (Tariffs filed on December 22, 2004)/ Proposed general increase in water rates for the Oak Run Water Division (Tariffs filed on December 29, 2004), ICC Docket Nos. 05-0071/05-0072 (consol.) Order at 46-47 (November 8, 2005) ("Woodhaven Order").

The Illinois Commerce Commission is a regulatory agency; it has general supervisory authority over all public utilities operating within the State of Illinois. 220 ILCS 5/4-101. Public utilities are obligated to furnish the Commission with all information required by it to carry into effect the provisions of the Public Utilities Act ("Act"). 220 ILCS 5/5-101 ("Every public utility shall furnish to the Commission all information required by it to carry into effect the provisions of this Act, and shall make specific answers to all questions submitted by the Commission."). The Commission may only allow such changes in rates as are just and reasonable. 220 ILCS 5/9-101. Moreover, the burden of proof to establish the justness and reasonableness of the proposed rates or other charges . . . shall be on the utility." 220 ILCS 5/9-201(c).

Commission Staff exists to enable the Commission to carry out its duties and responsibilities under the Act. Staff sends out data requests to enable it to complete its analyses of the utilities' proposal. When a utility provides incomplete or inaccurate responses to Staff data requests, the result is an incomplete or inaccurate analysis from Staff. To the extent the incomplete or inaccurate information results in a failure by the utility to bear its burden of showing that it's proposed rates are just and reasonable, Staff recommends disallowances. It is in the utility's best interest to cooperate with Staff and provide ALL relevant information available to the utility. As stated in the Rules of Practice: "[i]t is the policy of the Commission to obtain full disclosure of all relevant and material facts to a proceeding ... ."

Staff recommends that the Commission challenge Aqua to provide complete, accurate, and detailed information to data requests in timely fashion in future rate filings. In addition, Aqua should be put on notice that Aqua will be held accountable for responses to data requests and provide an appropriate witness to respond to cross questions concerning its data request responses. If the data request response is not prepared by a witness and Staff counsel or another party's counsel asks Aqua counsel for the appropriate witness to direct questions in advance of the hearing, the named Aqua witness will be held accountable.

As was born out by the cross-examination in this docket, the Company failed to disclose all relevant and material facts to Staff even when Staff propounded data requests that directly requested the relevant information. The following lines of cross-examination and/or issues could have been eliminated

had information been provided as requested:

- Advertising
  Staff data request JMO 1.04 requested supporting detail regarding the actual 2004 and 2005 advertising costs. The Company did not provide an itemized list of costs for each advertisement for which the Company was seeking recovery. Thus, it was impossible for Staff to calculate an accurate adjustment for the costs to disallow. Tr. 50, 57.

- Sludge Hauling
  Staff data request MHE 6.01 requested the history of sludge hauling amounts. In the Company's response to Staff data request MHE 6.01, the Company could have indicated that the Company had determined that Aqua was going to apply for a permit with the IEPA to increase the tons of sludge to be removed. Without this information, Staff properly concluded that an adjustment was necessary to reduce the costs associated with sludge hauling. In rebuttal testimony, Aqua witness Bunosky testified that Aqua would be applying sometime in 2006 for an increase to the IEPA sludge hauling permit. Aqua Ex. 10.0, at 34, lines 769-772. During cross examination, Aqua witness Bunosky testified that the Company applied to the IEPA on the same day as the rebuttal testimony was filed. Tr. 80. Thus, the details of the application for revised permit were known at the time of rebuttal and these details could and should have been provided in rebuttal testimony.

- Plant in Service
  Staff data request JMO 9.01 requested information regarding the expected in-service date that supported the Company's rebuttal position. The Company response to Staff data request JMO 9.01 did not provide Staff with a sufficient explanation as to why the old generator had not been shown as a retirement to plant. Tr. 101-103. Staff attempted to obtain additional information regarding the 2007 expenditures for the generator and standpipe via an e-mail from Staff Counsel to Company Counsel dated 9/5/07. No response was ever received.

- Rate Case Expense – Outside Legal
  (1) Staff data request MHE 1.02 requested all supporting documents for the Company's forecast for rate case expense. The Company provided no information to support the forecast for outside legal costs. All the Company provided to support the projection for outside legal costs were actual invoices for legal services provided. The invoices were not provided until September 19th at the close of business, the day before the evidentiary hearing. Receipt of the invoices at this late date did not provide an opportunity for a thorough review by the parties and Staff.

  (2) Aqua witness Schreyer was the Company witness responsible for outside legal expenses. He sponsored the invoices in surrebuttal testimony as Aqua Ex. 12.3 and was unable to respond to questions about those invoices. Tr. 226-232. He was also unable to answer definitively

whether or not there were any documents, including a letter of engagement, to support the level of expense requested. Tr. 232. The witness testified on cross examination that a thorough and complete review had been performed by other Aqua employees on the outside legal invoices, but then admitted that certain items on the invoices concerned other proceedings and should not have been used to support rate case expense for Aqua's Kankakee division. Tr. 264, 286-291.

(3) At the evidentiary hearing Aqua witness Schreyer made reference to having made the projection of the outside legal fees, but testified that only the Sonnenschein legal invoices had been provided as support for the outside legal expense projection in response to Staff Data Request MHE 1.02. Tr. 230.

- Rate Case Expense - Contingencies
  Staff data request MHE 1.04 requested information regarding the Other Expense/Miscellaneous component of rate case expense. The Company response to data request MHE 1.04 indicated that a projection for contingencies was included in the Other Expense/Miscellaneous component of rate case expense. Staff then issued Staff data request MHE 5.07 for the details of the contingencies. During cross examination, Aqua's witness indicated that the contingent amounts would be trued up at the close of the evidentiary record. Tr. 248. This true-up had not been entered into the record as of the close of the evidentiary record.

- Copies of the Bond Indentures - Aqua Response to Staff data request FD 4.07
  Staff data request FD 4.07 was served on the Company on August 5, 2006, but a response was not received by Staff until September 18th, 2 days before the evidentiary hearing. Aqua's response to Staff data request FC 2.07 was simply providing copies of the bond indentures. Aqua's failure to provide the documents in a timely manner deprived Staff of the opportunity to consider the documents when preparing its rebuttal testimony. This resulted in Staff requesting that the entire documents be included in the evidentiary record. Tr. 380-381.

- Aqua Response to Staff Data Requests FD 4.06, 4.07, and 4.14
  In advance of the evidentiary hearing, Staff Counsel inquired as to the appropriate Aqua witness to respond to data request responses that were prepared by Mr. Anzaldo. Counsel for Aqua indicated that Ms. Ahern would respond to that cross. However, at hearing when Staff attempted to lay a foundation for the documents to be entered into evidence, Ms. Ahern stated she had no familiarity with the Company's response to Staff data request FD 4.07 as prepared by Mr. Anzaldo. Tr. 309-311. Aqua should be held accountable for its data request responses and make a witness available at the evidentiary hearing to respond to cross questions about its data request responses, especially when Aqua counsel has been informed in advance of the evidentiary hearing that there will be cross questions on the subject matter.

- Purposes and Procedures Manual of the NAIC Securities Valuation Office. After initially denying Staff access to the document (indicating it must be viewed in New Jersey), the Company allowed Staff to review it for a one week time period. Having been denied the opportunity to fully review and analyze the document, Staff objected to the entry of the document into evidence at the evidentiary hearing. Tr. 404-405. Had the document been entered into evidence at the hearing, Staff would have been obligated to thoroughly review the document in the briefing stage after having been denied the ability to include such a review in the analysis provided in testimony.

Based upon the examples noted above, Staff recommends that the Commission challenge Aqua to provide complete, accurate, and detailed information to data requests in timely fashion in future rate filings. In addition, Aqua should be put on notice that Aqua will be held accountable for responses to data requests and provide an appropriate witness to respond to cross questions concerning its data request responses. If the data request response is not prepared by a witness and Staff counsel or another party's counsel asks Aqua counsel for the appropriate witness to direct questions in advance of the hearing, the named Aqua witness should be held accountable.

As demonstrated above, the record supports this Staff recommendation. The Company, moreover, accepted this Staff recommendation as evidenced in the Stipulation.

8. Summary

Staff recommends that the Commission take the following actions:

1) Put Aqua on notice that in its future rate proceedings using a future test year regarding the scheduling of an update:

   a) An update will only be allowed if the possibility for an update is provided for in the case schedule at the pre-hearing conference;

b) Updates must be scheduled to be filed prior to the filing of Company rebuttal testimony; and

c) The Company should commit to respond to data requests related to the updated filing in an expedited manner at the pre-hearing conference.

2) Put Aqua on notice of the following conditions regarding the support that is required for an update to a future test year:

a) All affected Part 285 schedules and workpapers must be submitted at the time of the filing of the update, inclusive of Schedules G-2 through G-5; and

b) The update, supporting schedules, and workpapers must be free from significant errors that would call into question the reliability of the updated information.

c) That failure to follow these guidelines will result in the disallowance of the update.

3) Challenge Aqua to provide complete, accurate, and detailed information to data requests in a timely fashion in future rate filings.

C. Retired Utility Plant

Staff witness Smith initially proposed an adjustment to disallow plant that should have been retired. Staff Ex. 4.0 at 4. In response to the Staff adjustment, Aqua witness Schreyer incorporated decreases to rate base for retirements in his rebuttal testimony. Aqua Ex. 7.0 R, at 33-34, lines 724-751. Staff witness Smith then withdrew his adjustment and accepted the adjustment proposed in Mr. Schreyer's rebuttal testimony. Staff Ex. 10.0 at 2.

D. Cash Working Capital

Staff witness Everson proposed an adjustment to cash working capital based on the operating expense adjustments proposed by Staff. Staff

Ex. 1.0, at 5, lines 94-98. The final amount of the adjustment will change based on the final amounts of operating expense ordered in this proceeding.

The Company agreed to this adjustment in the rebuttal testimony of Jack Schreyer. Aqua Ex. 7R, at 5, lines 81-85.

E. Contributions In Aid of Construction-Plant Facilities Charge

Staff witness Everson proposed an adjustment to Contributions in Aid of Construction ("CIAC") related to Staff witness Mike Luth's proposed disallowance of the Company's proposed Plant Facilities Charge ("PFC"). The Company had included an increase in CIAC in its direct testimony related to the PFC charge. Since Staff witness Luth opposed the PFC charge, it was necessary to remove the increase to CIAC reflected in Aqua's filing to be consistent with Mr. Luth's adjustment. Staff Ex. 7.0 4R, at 41, lines 889-901; Staff Ex. 6.0, at 14-16, lines 268-304; Staff Ex. 11.0 R, at 11-12, lines 220-259.

In Aqua witness Schreyer's surrebuttal revenue requirement, Aqua Ex. 12.7, Aqua reflected a reduction to Accumulated Depreciation related to the CIAC change of $427. On cross examination, Mr. Schreyer acknowledged that the amount of decrease to Accumulated Depreciation related to the PFC charge should be $214, not $427. Tr. 223. This correction is reflected in Staff's revenue requirement, attached as Appendix A.

III. OPERATING REVENUES AND EXPENSES

A. Affiliated Interest Transactions

Staff witness Ostrander initially proposed an adjustment to reduce operating expenses for the cost of services provided by the Company to Aqua Indiana, Inc. Staff Ex. 2.0, at 6-7, lines 114-134. Based on information provided in Mr. Schreyer's rebuttal testimony, Staff's adjustment was withdrawn.

Staff Exhibit 8.0, at 6, lines 112-117. The adjustment proposed in Mr. Schreyer's rebuttal testimony was accepted by Staff. Aqua Ex. 7.0R at 38.

B. Industry Association Dues

Staff witness Ostrander originally proposed a two-fold adjustment to reduce industry association dues. First, Staff's adjustment removed dues that are, in reality, community and economic development organizations' dues. Staff proposed this reduction because participation in community and economic development organizations is a promotional and goodwill practice which is not necessary in providing utility service. Second, the adjustment removed the portion of dues related to lobbying efforts. This proposal is consistent with PUA Section 9-224 ("The Commission shall not consider as an expense of any public utility company, for the purpose of determining any rate or charge, any amount expended for political activity or lobbying as defined in the "Lobbyist Registration Act."); *see also* Staff Ex. 2.0, at 8.

Staff withdrew the adjustment for removing lobbying expenses when the Company provided evidence that lobbying expenses were deducted before the allocation of dues to the Kankakee Water Division. Staff Ex. 8.0, at 7, lines 128-133. Although the Company believes that dues paid to local community and economic organizations do not constitute a burden to the ratepayers, the Company accepts Staff's adjustment to industry association dues. Aqua Ex. 11.0, at 28, lines 621-625.

C. Plant In Service Dates

Staff witness Ostrander originally proposed a two-fold adjustment to reduce industry association dues. First, Staff's adjustment removed dues that are, in reality, community and economic development organizations'

dues. Staff proposed this reduction because participation in community and economic development organizations is a promotional and goodwill practice which is not necessary in providing utility service. Second, the adjustment removed the portion of dues related to lobbying efforts. This proposal is consistent with PUA Section 9-224 ("The Commission shall not consider as an expense of any public utility company, for the purpose of determining any rate or charge, any amount expended for political activity or lobbying as defined in the "Lobbyist Registration Act."); *see also* Staff Ex. 2.0, at 8.

Staff withdrew the adjustment for removing lobbying expenses when the Company provided evidence that lobbying expenses were deducted before the allocation of dues to the Kankakee Water Division. Staff Ex. 8.0, at 7, lines 128-133. Although the Company believes that dues paid to local community and economic organizations do not constitute a burden to the ratepayers, the Company accepts Staff's adjustment to industry association dues. Aqua Ex. 11.0, at 28, lines 621-625.

D. Cancelled Utility Plant

Staff witness Ostrander proposed an adjustment to utility plant, accumulated deferred income tax, and depreciation expense for correction of utility plant that included the cost for a project that was cancelled. The Company's response to Staff data request JMO 7.01 indicated that the Bradley booster station upgrade, was cancelled. However, the construction work in progress balance for this project was erroneously included in the 12/31/06 utility plant balance. Staff Ex. 8.0, at 12. The Company accepted Staff's adjustment. Aqua Ex. 11.0, at 47.

E. Miscellaneous Other Expense

Staff witness Ostrander proposed an adjustment to reduce miscellaneous other expenses for preferred dividends and interest income. Non-operating expense items should not be included in the 2007 test year corporate overhead allocations to the Kankakee Water Division. Staff Ex. 8.0, at 12. The Company does not contest this adjustment. Aqua Ex. 12.0, at 24.

F. Original Cost Recommendation

Staff witness Ostrander recommended that the Commission make a finding in the Order in this proceeding that the Company's December 31, 2005 plant balances reflected in Aqua Sched. B-5, page 1 of 3, Column (C), are approved for purposes of an original cost determination, subject to any adjustments ordered by the Commission in this proceeding. Staff Ex. 2.0, at 9.

G. Charitable Contributions

Staff witness Ostrander proposes to reduce the Company's proposed revenue requirement by disallowing the community and economic development organization fees that have been included by the Company as charitable contributions. This proposal is identical in reasoning to Staff's proposal to reduce industry association dues by the amounts paid to community and economic development organizations rather than to industry associations. As stated in Mr. Ostrander's direct testimony,

> Contributing to community and economic development organizations is a promotional and goodwill practice. The Aqua contributions to community and development organizations are not for the public welfare or for charitable scientific, religious or educational purposes. While perhaps such contributions demonstrate good corporate citizenship, they are not necessary in providing utility service. Consequently, the ratepayers should not be burdened with the expense of the Company contributing to

these community and economic organizations.

Staff Ex. 2.0, at 3.

As further pointed out in Mr. Ostrander's direct testimony, the Commission has consistently adopted a similar position. *Id*. at 4; *citing Order* at 18, Consumers Illinois Water Company: Tariffs seeking general increase in water Rates for the Kankakee Water Division (Tariffs filed on May 21, 2003), ICC Docket 03-0403 (April 13, 2004)("2004 Kankakee Rate Order"); *Order*, Commonwealth Edison Company: Proposed General Increase In Electric Rates, ICC Docket No. 90-0169, 1991 Ill. PUC Lexis 99 (March 8, 1991);*Order*, Contel of Illinois, Inc.: Proposed general increase in rates, ICC Docket No. 90-0128, 1991 Ill. PUC Lexis 18; 119 P.U.R.4th 284 (January 16, 1991); *Order*, Commonwealth Edison Company: Proposed General Increase In Electric Rates, ICC Docket No. 94-0065, 1995 Ill. PUC Lexis 25; 158 P.U.R.4th 458 (January 9, 1995); *Order*, Central Illinois Public Service Company (AmerenCIPS) and Union Electric Company (AmerenUE): Request for approval of revisions to delivery services tariffs, and for approval of Delivery Services Implementation Plan for Residential Customers, ICC Docket No. 00-0802, 2001 Ill. PUC Lexis 1099; 214 P.U.R.4th 437 (December 11, 2001); *Order*, Central Illinois Public Service Company d/b/a AmerenCIPS and Union Electric Company d/b/a AmerenUE: Petition for approval of delivery services implementation plan and delivery service tariffs, ICC Docket No. 99-0121, 1999 Ill. PUC Lexis 646 (August 25, 1999). *See also* Illinois Bell Tel. Co. v. Illinois Commerce Comm'n, 55 Ill. 2d 461, 480-82 (1973).

The Company argues against Staff's proposal by insisting that there is no evidence that the $6,563 in contributions is burdensome to its

customers, and in fact, its involvement in the community benefits its customers and is, in fact, appreciated by its customers. Aqua Ex. 11.0, at 26-27.

The Company's argument fails to address Staff's argument that participation in community and economic development organizations is a promotional and goodwill practice that is not necessary in providing utility service. The Company also fails to give persuasive reasons why the Commission should depart from its consistent position of disallowing such expenses from the revenue requirement. Staff Ex. 8.0, at 3-4, lines 43-67. Staff, accordingly, recommends that the Commission accept Staff's adjustment to Charitable Contributions.

As demonstrated above, Staff's position is supported in the record. The Company, moreover, accepted Staff's position as evidenced in the Stipulation.

H. Contingencies in Utility Plant

Staff witness Ostrander proposes an adjustment to disallow amounts included in the Company's test year utility plant and depreciation expense for contingencies. The Company's response to Staff data request JMO 2.07 (Staff Cross Ex. 1) disclosed that the 2006 and 2007 revised capital budgets for the upgrade of the water treatment plant were inflated by a 5% contingencies factor for costs which cannot be determined. The Commission has previously evaluated budget items entitled "omissions and contingencies" included in budgets for capital projects in the rate proceeding of Illinois American Water Company in Docket No. 95-0076. The Order found that "Ratepayers should not be responsible for unknown costs that cannot be identified." Staff Exhibit 8.0, at 8, *citing* IWAC Order at 15; *see also Illinois Bell Tel. Co. v. Illinois Commerce Comm.*, 55 Ill. 2d 461, 482 - 483 (1973) (ratepayers are not required to

pay for costs unless those costs can be shown to "directly benefit them or the services" which the utility renders.).

In surrebuttal testimony, the Company purports that $90,000 of the contingencies factor has been spent with the remaining balance being only a small percentage of the total cost of the water treatment plant upgrade. The Company further asserts that contingencies are a part of any capital project's budget for unforeseen aspects of construction and are a standard practice in the construction industry. Aqua Ex. 11.0, at 42-43.

Notwithstanding the Company's claim of payment of certain contingencies, it is not known whether the 2006 and 2007 revised capital budgets will be completed as planned, or be over or under budget. .Tr. 86-87. The Staff adjustment would disallow the total contingencies factor due to the uncertainty of costs which cannot be ultimately determined. Although the use of contingencies in construction projects may be a standard industry practice, contingencies should not be allowed in rate base for ratemaking purposes as previously ordered by the Commission.

As demonstrated above, Staff's position is supported in the record. The Company, moreover, accepted Staff's position as evidenced in the Stipulation.

I. Disallowed Obsolete Generator

Staff witness Ostrander proposes an adjustment to utility plant, accumulated depreciation, and depreciation expense for the disallowance of utility plant that is not used and useful in the 2007 test year. As revealed in Company witness Bunosky's surrebuttal testimony, the 2007 expenditure of $116,696 to remove a replaced generator was included in rate base. Aqua Ex. 11.0, at 45, lines 1038-1046. Mr. Bunosky, during cross-examination,

stated that the old generator would be taken out of service after the new generator is functioning properly. Tr. 101. Mr. Bunosky continued to acknowledge that the old generator may be used elsewhere, such as at the Kankakee office or at one of the Company's well sites or even at the Bradley-Bourbonnais booster station, but could not commit to a specific location or timeframe. Tr. 102. The reduction to the 2007 average rate base of $57,306 is comprised of a decrease to utility plant of $57,348 offset by a decrease to accumulated depreciation of $1,042. The adjustment will reduce 2007 depreciation expense by $2,083.

Staff recommends that the Commission accept Staff's proposal to disallow not used and useful utility plant because the Company's disclosures confirm that the old generator will be taken out of service with no certain future plans for use in the Kankakee Water Division.

As demonstrated above, Staff's position is supported in the record. The Company, moreover, accepted Staff's position as evidenced in the Stipulation.

J. Advertising

Staff witness Ostrander proposes an adjustment to disallow a portion of advertising expense that is goodwill in nature or for which the appropriate documentation, as required by Section 9-226 of the Act, was not provided. It is not appropriate for utilities to recover in rates amounts for goodwill advertising. Staff Ex. 2.0, at 5. Staff had requested supporting detail regarding the actual 2004 and 2005 advertising costs in data request JMO 1.04. The Company did not provide an itemized list of costs for each advertisement for which the Company was seeking recovery. This resulted in Staff not being able to

calculate an accurate adjustment based upon the specific cost of each ad campaign that Staff determined were not recoverable. Staff's method of determining the amount of disallowed advertising expense involves using a ratio determined by the number of advertising scripts that were goodwill in nature plus the number of advertising scripts with no cost support to the total number of radio scripts provided by the Company. Staff Ex. 8.0, Sched. 8.03, at 3.

Section 9-225(2) of the Act defines goodwill advertising, as advertising designed primarily to promote the image or name of the Company or promote industry wide issues, which should not be considered for the purpose of determining rates for gas or electric utilities. Although Section 9-225(2) and (3) specifically state that the statute applies to electric and gas utilities, it is equally important that water utilities do not recover rates for goodwill advertising. It is not appropriate for captive customers to pay for advertising that has the purpose which promotes the Company rather than providing information regarding service-related maters. The Commission has previously accepted an adjustment to disallow goodwill advertising expense in the orders entered in 2001 and 2004 for the Company's prior rate cases. Staff Ex. 2.0, at 5, *citing Order*, Consumers Illinois Water Company: Proposed general increase in water rates (Kankakee Water Division) (Tariffs filed April 14, 2000) / Proposed general increase in water rates (Woodhaven Division) (Tariffs filed April 14, 2000) / Proposed general increase in water rates (Vermilion County) (Tariffs filed April 14, 2000), ICC Docket Nos. 00-0337 / 0338 / 0339 (consol.) (January 31, 2001); *and* 2004 Kankakee Rate Order.

Company witness Bunosky mistakenly believes that the advertising expense reflected in the 2007 test year is prudent and reasonable since the

expense is for advertising allowed under Section 9-225(3). Aqua Ex. 6.0, at 30. Mr. Bunosky selected a limited number of vendors from the Company's detail of its 2005 advertising expense to substantiate that the 2007 test year advertising expense falls within the Commission guidelines.

According to Mr. Bunosky, radio scripts inform the customer, promote trust in the water supply, and educate the customer about conservation. Aqua Ex. 11.0, at 29. Staff's review of the provided scripts indicated the advertising on three of the four scripts to be goodwill in nature and this was confirmed by Mr. Bunosky during cross-examination. Tr. 41-43. In addition, the Company did not provide support for the radio advertising projected expense. Tr. 43-44.

In regard to advertising associated with the Village Profile (a chamber of commerce publication), the provided script (a map of Kankakee, IL) showing the general location of the Company was designed to bring the Company's name before the general public for goodwill purposes. Mr. Bunosky, during cross-examination, admitted that the provided script was only an excerpt of the map and that Staff would not be able to determine the location of the Company from the map. Tr 47.

Mr. Bunosky's surrebuttal testimony states that advertising in the Daily Journal newspaper informs customers of safety measures and service interruptions. Aqua Ex. 11.0, at 29. Staff's review concluded that two of the four scripts provided were promotional or goodwill in nature with no mention of safety measures. In addition, no expense support was provided for any of the four scripts. Mr. Bunosky used a hydrant flushing notice as an example of an allowable advertising expense. A script was provided, however, no expense support was provided for this advertisement. Tr. 47-52. Mr.

Bunosky opines in surrebuttal testimony that the ads published in the Daily Journal and Taylor Publishing are educational in nature. Aqua Ex. 11.0, at 30. On cross examination, Mr. Bunosky defined educating the public as creating trust in the water supply so customers would not purchase bottled water. Tr. 53. When asked what section of Section 9-225 he used to conclude that ads with educational information may be recovered from ratepayers, Mr. Bunosky was unable to cite a specific section. Tr. 55.

The Company's sponsorship of a program on the Chicago Bears contained a segment regarding summer safety tips, which Mr. Bunosky claimed are specifically allowed by Section 9-225(3). Aqua Ex. 11.0, at 30. On cross-examination, Mr. Bunosky was unable to explain how the summer safety tips relate to the Company providing water to its customers and agreed that safety tips should be water utility related to be recoverable in a rate case. Tr. 345-346. Besides the goodwill nature of the advertising, no expense support was provided.

As demonstrated above, Staff's position is supported in the record. The Company, moreover, accepted Staff's position as evidenced in the Stipulation.

K. Written Scripts

Staff witness Ostrander recommends that the Commission put Aqua on notice that written scripts of video or DVD programs should be provided to the Clerk's Office with an indication of the location of the relevant information contained therein when videos or DVDs are filed with the Commission. Staff proposed this recommendation in response to a sixty-minute DVD that Aqua filed in this proceeding as Exhibit 6.1 and subsequently as Exhibit 10.1 to support its sponsorship of a program on the Chicago Bears providing summer safety tips. The pertinent content on the DVD amounted to less than a minute of

promotional advertising that was buried at the end of the program. The effort to view the entire 60 minute program was an inefficient use of Staff and the other parties' scarce resources given the content and extent of supposedly relevant support for advertising expense contained within the DVD. Staff Ex. 8.0, at 13, lines 261-273.

As demonstrated above, Staff's position is supported in the record. The Company, moreover, accepted Staff's position as evidenced in the Stipulation.

L. Depreciation Rates

Aqua witness John Guastella performed a comparative analysis in order to establish average service lives and depreciation rates. Aqua Ex. 5.0. Aqua's proposed depreciation rates in this case are identical to those approved by the Commission in Consumers Illinois Water Company (Kankakee Division), Docket No. 00-0337/00-0338/00-0339 (cons.), *Order*, January 31, 2001. Staff witness William R. Johnson reviewed the depreciation rates and did not identify any necessary changes and therefore did not object to the Company continuing to use the same depreciation rates as proposed by Mr. Guastella. Staff Ex. 5.0.

M. Rate Case Expense

1. AUS Consultants

Staff witness Everson proposed an adjustment to limit Aqua's recovery of rate case expense related to AUS Consultants to 50% of the projection, which she later withdrew. Staff Ex. 7.0 4R, at 6-7, lines 119-124.

2. London Witte

Staff witness Everson proposed an adjustment to limit Aqua's recovery of rate case expense related to Aqua's external auditor, London Witte to the

actual amounts incurred for London Witte to complete the review of Aqua's forecasted financial statements. Staff Ex. 1.0, at 7, lines 124-138. Aqua accepted Ms. Everson's adjustment in its rebuttal testimony. Aqua Ex. 7 R, at 8, lines 144-147.

3. Guastella Associates

Staff witness Everson proposed an adjustment to limit Aqua's recovery of rate case expense related to Guastella Associates for preparation of a depreciation study to 88% of the projected amounts. Staff Ex. 1.0, at 7-8, lines 139-154. In rebuttal testimony, Staff witness Everson corrected the percentage reduction that had been applied to the projected cost in her direct testimony. Staff Ex. 7.0 4R, at 7-8, lines 133-143.

Company witness Schreyer accepted the adjustment in rebuttal testimony. Aqua Ex. 7.0 R, at 7-8, lines 134-147.

4. GPM Associates

Staff witness Everson proposed an adjustment to limit Aqua's recovery of rate case expense related to GPM Associates for rate design services. Staff Ex. 1.0, at 8, lines 155-172; Staff Ex. 7.0 4R, at 8, lines 145-188. Ms. Everson withdrew this adjustment at the hearing after Aqua provided invoices with its surrebuttal testimony that indicated that actual expenses were on track to meet Aqua's projection. The invoices, combined with an engagement letter indicated that Aqua had supported its projection for rate case expense for GPM Associates. Tr. 414-415.

5. Aqua Legal

Staff witness Everson proposed an adjustment to limit Aqua's recovery of rate case expense related to Aqua's in- house legal department. Staff Ex. 7.0

4R, at 16, lines 345-362. Ms. Everson withdrew this adjustment at the hearing after Aqua provided employee time records with its surrebuttal testimony that indicated that actual expenses were on track to meet Aqua's projection. Tr. 415.

6. Outside Legal

Staff witness Everson proposed an adjustment to Aqua's projected outside legal expense since the Company failed to provide supporting documentation for the projection. Staff Ex.1.0, at 9, lines 177-179. At the evidentiary hearing, Ms. Everson stated that she was revising her adjustment based on receiving unredacted invoices which indicated that Aqua was incurring outside legal expense. However, she also stated that the Company did not support its projection, had offered no evidence of any efforts to limit its rate case expense and therefore she was still recommending an adjustment of 1/3rd of Aqua's outside legal projection. Tr. 415-416.

Aqua disagreed with any downward adjustment to its outside legal expense, stating that the Company should recover all reasonable rate case expense that it incurs through the conclusion of the case. Aqua Ex. 7 R, at 25, lines 533-535.

Staff witness Everson requested information to support Aqua's projection of rate case expense in Staff data request MHE 1.02, which stated:

> Provide all of the supporting documentation for the rate case expense *projection* for each of the components of the rate case expense *projection* on Schedule C-10, Outside Consultant/Witness Detail. Supplement the documentation with a thorough explanation of the process which was used to develop each of the projected amounts. *Provide only the documentation that was used to develop each projected component*. (emphasis added)

Aqua offered no explanation for the process used to develop its rate case expense projection until a vague description in surrebuttal testimony and

offered only redacted invoices purporting to be support for the projected amounts. Aqua Ex. 12.0, at 7, lines 116-129. In fact, Aqua witness Schreyer agreed with Ms. Everson's contention that the projection was not supported when he stated: "The services performed in this case had not yet occurred at the time the projection was developed, so those services, as described in the service descriptions in the invoices, could not have been the basis for the projection and would not inform any reviewer as to the reasonableness of the projection." Aqua Ex. 12.0, at 6-7, lines 110-114. Since Aqua only provided invoices in response to a data request MHE 1.02, which asked for support for the projected expense, Aqua failed to support its projection. Aqua provided no engagement letter upon which it relied to determine its projected amount of outside legal expense of $262,000, thus there is no support for the projection. Staff Ex. 1.0, at 9, lines 177-179.

Aqua witness Schreyer only discussed actual costs Aqua was incurring during the case while mischaracterizing Ms. Everson's rationale for proposing disallowance of outside legal expense. Aqua Ex. 7 R, p.8, lines 149-166 and p.19, lines 400-401. Aqua provided only redacted invoices to support its outside legal expense projection until September 19, 2006. In direct testimony, Ms. Everson described various problems related to redacted invoices such as the potential for billing for the wrong case or billings for the wrong company. Staff Ex. 1.0, at 10, lines 202-210. These problems were demonstrated when Aqua was ordered to submit unredacted copies of the Sonnenschein invoices shortly before the hearing. On cross examination, Aqua witness Schreyer stated that although he was not the Aqua employee charged with the responsibility for reviewing the Sonnenschein invoices, he was confident that the invoices

were thoroughly reviewed and questionable entries were contested. Tr. 257, 259. * * * BEGIN CONFIDENTIAL

THIS SECTION LEFT BLANK INTENTIONALLY

THIS SECTION LEFT BLANK INTENTIONALLY

* * * END CONFIDENTIAL

Aqua also offered very little explanation of the process used to develop its' projected outside counsel expense and failed to provide an engagement letter or other similar evidence of an agreement between Aqua and its' outside legal counsel. The Company offered clarifying documents and revised data request responses on other components of rate case expense and

on other issues in its rebuttal testimony, but failed to provide a key document that would provide a starting point for Aqua's outside legal expense projection in this case. Staff Ex. 7.0 4R, at 12, lines 236-241. Only after the issuance of a ruling by the ALJ that ordered Aqua to provide copies of unredacted invoices, did Aqua comply. Nonetheless, some of the invoices reflected clearly erroneous entries. Aqua provided no clarifying explanation of the discrepancies or more importantly, offered no downward reduction in its projection due to the erroneous entries (Tr. 456-459). In fact, Aqua witness Schreyer described that the invoices demonstrate the accuracy and reasonableness of Aqua's estimate, because they prove that Aqua is actually incurring approximately the same amount in outside legal fees as it estimated. Aqua Ex. 12.0, p. 5, lines 77-82. It appears to Staff that at the time of writing this testimony, Mr. Schreyer had not himself seen the redacted service descriptions or he would not have been extolling the virtues of the invoices.

In the prior Aqua rate case, the Commission addressed the issue of whether invoices can provide meaningful support for a projection of rate case expense. *See e.g,.* Aqua Illinois, Inc., Proposed general increase in water rates [Woodhaven and Oak Run Divisions], ICC Docket Nos. 05-0071 & 05-0072, Order issued November 8, 2005 ("Woodhaven/Oak Run Order").

> In the Woodhaven/Oak Run Order, the Commission concluded that: *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. (Emphasis added.)

Thus, Aqua in only providing invoices from its outside legal counsel, failed to support its projection of rate case expense related to its outside counsel, which

resulted in Staff's adjustment to reduce Aqua's outside legal counsel projection by 33%. Aqua's outside legal expense projection was not supported with an engagement letter or any other evidence of a developed projection. Aqua has provided invoices that only support an assumption that an expense has been incurred for some purpose. The invoices that comprised Aqua's sole supporting documentation for its outside legal counsel expense contained numerous questionable entries which reduced the value of those invoices for that purpose.

Taking into consideration Aqua's failure to provide supporting documentation for the development of the projection and the outside legal counsel invoices that did demonstrate that Aqua was incurring costs to process the instant proceeding, Staff witness Everson stated at the hearing that she was revising her adjustment to disallow 33% of the rate case expense projection related to Aqua's outside counsel. This adjustment reflects the fact that Aqua incurred some amount of legal expenses for this proceeding but that it failed to support its projection. Aqua, moreover, failed to offer evidence or supporting documentation to indicate that it made *any* effort to minimize the amount of rate case expense, which fact alone renders its expenses for outside legal counsel unreasonable. Tr. 415-416.

Staff's proposed adjustment to rate case expense reflected on Staff Ex. 13.0 for amounts related to Aqua's outside legal counsel, as reflected in the Stipulation and is supported by record evidence and should be adopted by the Commission.

7. Aqua Rates Department

Staff witness Everson proposed no adjustment to the projected level of rate case expense for the Aqua rates department during this case. The Company

introduced an increased amount in its response to Staff data request MHE 5.07 that stated: "…the original estimate for contingencies was $55,000, which represented a ten percent contingency. Due to the typographical error in the original Schedule C-10, the Company reduced the contingency by $20,000 in order to rectify the error in rate department costs set forth in that schedule." Staff Ex. 1.0, at 11, lines 221-226.

In rebuttal testimony, Aqua witness Schreyer proposed that the contingent amount of $20,000 from the Other Expenses-Miscellaneous category should be considered as expenses of the Aqua rate department in an attempt to offset Ms. Everson's adjustment to the Other Expenses, Miscellaneous category of rate case expense. Mr. Schreyer mischaracterizes Ms. Everson's position by claiming that her position is that contingencies must be supported with an engagement letter. Aqua Ex. 7 R, p. 23, lines 494-503. It is not that Ms. Everson didn't understand what Aqua did by shifting contingent amounts to cover shortfalls in the original projection, but that she did not agree with Aqua's actions. ICC Staff Ex. 7.0 4R, p. 25, lines 520-524. Ms. Everson did not accept this shifting of contingent amounts to cover shortfalls in Aqua's original projection of costs for the Aqua rate department since the Company has included a contingent amount in rate case expense that is greater than Aqua's increased amount for its rate department. It is not appropriate for Aqua to move the contingent amount of $20,000 from the Other Expenses-Miscellaneous category into the Aqua rate department because an inaccurate projection was discovered. Aqua is using the $20,000 to cover a shortfall in the original projection when it believes that actual costs appear to be running higher than the projection. In sum, even if that were an appropriate shifting of the projected amounts, Aqua is therefore still requesting $35,000 more than it has estimated it will cost to process the rate proceeding. Staff Ex. 7.0 4R, at 25, lines 524-531.

As a general matter, the Company's request to update components of its estimated rate case expense is contrary to long-standing Commission

policy. In *Lincoln Water Company, Proposed general increase in water rates,* Docket No. 84-0011, Order, 1984 Ill. PUC LEXIS 7, pp. 16-17 (October 17, 1984) ("Lincoln") the Commission was presented with a similar water utility request to revise and increase its estimated rate case expense due to greater than anticipated discovery and other activity. The Commission limited the utility to initial estimates unless extraordinary or compelling circumstances dictated otherwise:

> The Commission agrees with the staff witness, however, the recovery of rate case expense should be limited to the utility's filed estimate based on the Commission's policy of restricting such expense to initial estimates unless extraordinary or compelling circumstances dictate otherwise.

Aqua's response to Staff data request MHE 5.07 does not indicate that the circumstances leading to its proposed increase to the Aqua rates department projection are either extraordinary or compelling as the Commission's long standing policy dictates. Aqua's proposed shifting of amounts included in its original filing for unknown contingency items is not that different from the circumstances demonstrated in Lincoln since contingent amounts should not be included in a rate case filing unless the Company has a reasonable expectation of a specific good or service to be obtained. In this case, Aqua could not demonstrate that the contingent amounts were related to specific goods or services, and thus should not have been included in its rate case expense projection. *Illinois Bell Tel. Co. v. Illinois Commerce Comm.*, 55 Ill. 2d 461, 482 - 483 (1973) (Ratepayers are not required to pay for costs unless those costs can be shown to "directly benefit them or the services" which the utility renders.). Without the contingent amounts included in the original filing, Aqua's proposed update to its projected Aqua rates department amounts would match the circumstances in the Lincoln order that the Commission declined to accept.

Staff's recommendation to prohibit Aqua from increasing its projected Aqua rates department expense with contingent amounts when its rate filing

continues to contain additional contingent amounts that exceed the correction that Aqua is attempting to accomplish is supported by record evidence and should be adopted by the Commission.

8. Other Expense/Miscellaneous

Staff witness Ms. Everson proposed an adjustment to reduce the projection for Other Expense/Miscellaneous by the amount of the projection described as contingencies. Ms. Everson stated in direct testimony that the projected amount for contingencies has not been nor can it be supported with an engagement letter, invoices, employee time records or any other evidence that would support projected rate case amounts. Staff Ex. 1.0, at 11-12, lines 230-233. The projected amounts are unsupported because they do not represent actual services that Aqua expects to be performed. Unknown expense items that cannot be identified are not a reasonable item to be included in rate case expense Staff Ex. 7.0 4R, at 25, lines 534-539; *see also Illinois Bell Tel. Co. v. Illinois Commerce Comm.*, 55 Ill. 2d 461, 482 - 483 (1973) (Ratepayers are not required to pay for costs unless those costs can be shown to "directly benefit them or the services" which the utility renders.).. Aqua witness Schreyer acknowledged during cross examination that Aqua's contingencies expense was for unidentified expense items and not for a specific service. Tr. 242-243.

The Commission in Aqua's previous rate case, Woodhaven/Oak Run Order, stated:

> Aqua should not interpret this conclusion to mean that full recovery of outside legal expenses can be assured in the future simply by including in its initial filing an *inflated projection* for such expenses. To do so would ignore the requirement that the expenses must be reasonable in order to be recovered in rates. *(emphasis added)* (Woodhaven/Oak Run Order at 35)

Also in the Woodhaven/Oak Run Order, the Commission stated: "A utility has an

obligation to ensure that those costs it seeks to pass on to ratepayers are reasonable." Woodhaven/Oak Run Order at 34.

Aqua's response to Staff data request MHE 5.07 regarding the composition of the contingencies component of Other Expense-Miscellaneous stated that the contingencies were for: "…inevitable unforeseen costs, along with the possibility of underestimated components of rate case expense". Aqua's response indicated that the amounts labeled contingencies were not for actual services or for the purchase of goods, but rather those amounts are included to provide a safety-net to "make up" for any adjustments or errors that reduce the original projection. It is, in fact, an amount in excess of that which Aqua believes it will cost to process the rate case. Staff Ex. 7.0 4R, at 24, lines 511-516. Aqua is therefore requesting $35,000 more than it estimated to it would cost to process the rate proceeding. Staff Ex. 7.0 4R, at 25, lines 530-531.

Staff's proposed adjustment to rate case expense for Other Expense/Miscellaneous for the amounts related to contingencies as reflected in the Stipulation is supported by record evidence and should be adopted by the Commission.

9. Staff Recommendations Regarding Future Rate Cases

Staff witness Everson made several recommendations regarding future rate case filings for approval by the Commission. Ms. Everson based her recommendations on experience in processing Aqua rate filings over a period of several years, including trends that have become more pronounced in recent years.

Specifically, Ms. Everson made the following recommendations regarding future Aqua rate case filings:

1) Aqua should send out request for proposals for each of its outside rate case service providers;

2) Aqua should bring several of its divisions in at one time, rather than the piecemeal approach it has been using for the past several years; and

3) Aqua should be required by the Commission to provide engagement letters, signed contracts or other similar evidence to support rate case expense projections. Staff Ex. 1.0, at 16-17, lines 303-337.

Ms. Everson demonstrated that Aqua's per customer rate case expense is unreasonable. In the last Kankakee rate proceeding, Docket No. 03-0403, the Company's projected rate case expense per customer was $8.46, while in the instant proceeding Aqua's original projected rate case expense per customer was $24.52. Staff Ex. 1.0, at 12-13, lines 246-249. Aqua reduced its requested rate case expense to a level that would produce a rate case per customer of $23.28. Staff Ex. 7.0 4R, at 26, lines 560-562. The following table from ICC Staff Ex. 1.0, page 13 demonstrates the increasing projected cost per customer of Aqua's recent rate proceedings:

Division	Cost Per Customer	Total Proposed Rate Case Expense	Total Prior Rate Case Expense	% Increase from Last Rate Case
Docket No. 05-0071/05-0072				
Woodhaven Water	**$51.50**	**$160,950**	**$44,855**	**359%**
Woodhaven Sewer	**$58.85**	**$160,950**	**$62,491**	**258%**
Oak Run	**$149.28**	**$129,875**	**$24,096**	**539%**
Average		**$451,775**	**$131,442**	**343%**
Docket No. 03-0403 Kankakee	**$8.46**	**$195,000**	**$155,130**	**25%**
Docket No. 04-0442 Vermilion	**$13.19**	**$220,740**	**N/A**	**N/A**
Docket No. 06-0285 Kankakee	**$24.52**	**$597,000**	**$195,000**	**306.2%**

When compared to another similar large water company's last rate case, Aqua's rate case expense per customer is unreasonably high. In Illinois American Water Company's ("IAWC") most recent rate proceeding, the Company's total rate case projection was $320,475 for all 9 rate areas. The per customer cost of rate case expense included in IAWC's rates was $1.23. Staff Ex. 1.0, at 13, lines 257-260. When compared to the requested rate case expense for two more recent electric delivery service rate proceedings, Aqua's rate case expense per customer is much higher than the $2.50 and $2.00 per customer amounts requested in those cases. Staff Ex. 1.0, at 14, lines 265- 268.

IAWC brought in one rate proceeding that encompassed all of its divisions, thus achieving economies of scale; Aqua cannot achieve such economies by bringing in each division in separate rate filings. Staff Ex. 7.0 4R, at 27, lines 563-567.

Aqua mischaracterizes Ms. Everson's comparison of rate case expense per customer with other utilities' cost per customer to conduct a rate case by stating that Staff's position is that rate case expense is dependent on the number of customers. On cross examination, Aqua witness Schreyer could not identify a specific section in Staff witness Everson's testimony with that statement (Tr. 275). Aqua further attempted to argue in its cross examination of Ms. Everson that the expenses are due to the filing requirements which are the same whether Aqua files one division or all of its divisions. Ms. Everson explained that when the cost is spread over more customers, the cost per customer is reduced (Tr. 436-437). Aqua witness Schreyer argues that the requirements are no less for Aqua than Commonwealth Edison or Ameren. Aqua Ex. 12.0, p. 12, lines 229-231. What Mr. Schreyer fails to recognize is that both Commonwealth Edison and Ameren are proposing to spread that cost over each utility's entire system which is a much larger customer base, thus reducing the cost per customer (Tr. 436). Aqua wants the Commission to believe it has no choice but to bring in each division separately for rate cases due to division-specific issues. Aqua Ex. 12.0, p. 22, lines 468-473. However, other utilities bring in multiple divisions for rate proceedings despite having division specific issues, thus resulting in a much lower per customer cost (Tr. 238-240).

Since Aqua and Staff agree that the filing requirements are the same regardless of whether one or all divisions are prepared and that expense is included in the total rate case expense, the points raised regarding economies of scale raised by Ms. Everson are unrebutted. Tr. 238-240; ICC Staff Ex. 7.0 4R, p.

27, lines 562-566.

Mr. Schreyer stated in surrebuttal that Aqua is amenable to the recommendation regarding competitive bidding and states that Aqua does indeed undertake to do this, though not in all cases and then goes on to opine about obtaining the best product expeditiously and cost-effectively. Aqua Ex. 12.0. at 21, lines 438-446. However, Mr. Schreyer provided no evidence to demonstrate that Aqua sought competitive bids in this or any of its Illinois rate proceedings, nor has it presented any evidence that its current rate case providers provided services cost-effectively since Aqua's cost per customer is unreasonably high when compared to other utilities. Tr. 249-250.

Staff Staff witness Ms. Everson's proposal to reduce Aqua's rate case expense to the amount reflected on ICC Staff Exhibit 13.0 and in Staff's revenue requirement filed with this initial brief is supported by evidence of record. Staff, accordingly, recommends that the Commission order Aqua to in its future rate case filings:

1) Send out request for proposals for each of the outside rate case service providers;
2) Bring in several of the divisions in at one time rather than the piecemeal approach that has been used in the past several proceedings before the Commission, and
3) Provide engagement letters, signed contracts or other similar evidence as support for rate case expense projections.

10. Staff's Alternative Rate Case Expense Recommendation

Staff witness Everson also proposed an alternative which could be used in the

event the Commission chooses not to accept the settlement or her adjustment to rate case expense to reduce Aqua's total rate case expense to a level comparable with IAWC's in Docket No. 02-0690. ICC Staff Ex. 7.0 4R, p. 28, lines 573-592. If the Commission chooses to reject the settlement or the recommendation regarding rate case expense shown on ICC Staff Ex. 13.0, Staff's alternative recommendation of $1.40 per customer for its total rate case expense, which would result in a total rate case expense of $34,087 should be adopted.

N. Incentive Compensation Expense

Staff witness Everson proposed an adjustment to remove the amounts related to Aqua's incentive compensation plan for the following reasons:

1) The plan is dependent on a financial goal of the Company which benefits shareholders and not ratepayers;

2) The financial goal may not be met and thus no cost would be incurred by Aqua yet the ratepayers would have provided funding;

3) Aqua's recent history of payouts is below its budgeted amounts for incentive compensation; and

4) The disallowance of incentive compensation is consistent with prior Commission Orders.

In rebuttal testimony, Aqua witness Bunosky argued that: (1) setting an earnings threshold benefits the ratepayers; (2) the Commission has approved recovery of incentive compensation in two previous Aqua proceedings; and (3) the information provided to Staff is adequate to prove benefits to ratepayers. Aqua Exhibit 10.0, R, pp. 15-22. The Company's argument should be rejected.

The information provided by the Company demonstrates that payment of incentive awards is dependent on the financial goals of the Company. As Aqua witness Bunosky acknowledged during cross examination, Aqua America's,

Inc. and subsidiaries 2006 Annual Cash Incentive Compensation Plan ("AIP") states that: "Actual bonuses may range from zero dollars if the Company's financial results fall below the minimum threshold or the participant does not make sufficient progress towards achieving his or her objectives, to 187.5 percent if performance, both Company and individual, is rated at the maximum." Tr. 70.

Aqua's argument regarding the Commission's prior approval of its incentive plan assumes that once the Commission decides an issue in one proceeding that it should necessarily make the same decision in every other proceeding for that company. Aqua Ex. 6.0 R, p. 15, lines 326-348. Yet, in a later paragraph, Aqua witness Mr. Bunosky acknowledged that the Commission requires that incentive compensation expense must be supported on a case by case basis. Aqua Ex. 6.0 R, at 16, lines 350-354.

Ms. Everson demonstrated that the Commission has denied recovery of incentive compensation in many proceedings when the company's plans contain similar language limiting payouts of incentive compensation if financial goals are not met. Staff Ex. 1.0, at.22-23, lines 427-473; Staff Ex. 7.0 4R, at.32-33, lines 700-727. Furthermore, Ms. Everson demonstrated that Aqua's recent history of actual payouts to employees is consistently under the budgeted amounts. Staff Ex. 7.0 4R, at 32, lines 689-699. Thus, the Commission's expressed concern regarding the certainty of payouts versus the certainty of ratepayer funding of incentive compensation is complicated by Aqua's consistent history of budgeting more incentive compensation than it actually pays out. The Commission in the rate proceedings cited by Staff all expressed concern over the possibility

that ratepayers would be funding incentive compensation expense, but that the payout would not be made. Staff Ex. 1.0, at 22-23, lines 427-473) Thus, the demonstration of Aqua's consistently less than budgeted payout history should cause the Commission to be concerned not only in the event of no payout, but also in the event as Aqua's recent history has demonstrated that the payout is likely to be less than the amounts funded by ratepayers.

Moreover, Aqua has failed to demonstrate any detailed evidence of benefits flowing to Aqua's Kankakee ratepayers. The information provided by Aqua demonstrated that some of the goals and benefits claimed by Aqua cannot possibly save ratepayers money such as the goal of constructing and placing into service $4.9M in QIPS projects. First, the ratepayers pay for the QIPS projects as a separate charge on the monthly bills, which doesn't save them money. Secondly, the Company has a duty to provide a transmission system that is in good working order. The tangible benefit described was nothing more than the normal standard of care required in providing utility service. Similarly, other goals and related benefits claimed by the Company were nothing more than the normal ongoing duties that should be expected as a part of providing safe, reliable water service. Staff Ex. 7.0 4R, at 35, lines 777-783; 786-790. The only alleged benefit that was described with an associated dollar savings was the goal related to the Plant Facilities Charge ("PFC"). The flaw in that argument is that PFC is an outstanding issue in this proceeding, so the Company can't claim with certainty a specific dollar benefit that might be received as a result of the final order in this proceeding. Staff Ex. 7.0 4R, at 37, lines 810-818.

Staff's proposed adjustment to eliminate incentive compensation

expense from Aqua's operating expenses as shown on ICC Staff Ex. 7.0 4R, Schedule 7.09 is supported by record evidence and should be adopted by the Commission.

O. Sludge Hauling Expense

Staff witness Everson proposed an adjustment to limit Aqua's sludge hauling expense to its 4 year average amount. Staff Ex. 1.0, at 29, lines 600-613; Staff Ex. 7.0 4R, at 40, lines 872-875. Upon reviewing information provided with Aqua's surrebuttal and at the hearing, Ms. Everson stated that the sludge hauling expense should be capped for this proceeding at the maximum dry tons contemplated in Aqua's contract with SunAgro, 9,000 dry tons. Tr. (as corrected) 422.

Aqua witness Bunosky argued that the historical 4 year average was too low since the dry tons hauled in 2005 were higher than the previous 3 years, but provided no explanation for the dramatic increase in 2005. Aqua Ex. 6.0 R, at 33, lines 752-757. Aqua provided the historical amount of sludge removed during each of the previous 4 years. The 4 year historical average was 8,091 dry tons. The Company's projected amount of for 9,436 tons for sludge hauling at the contract price of $28/dry ton exceeds the 4 year average of 8091 dry tons of sludge removed. The tons of dry sludge removed between 2002 and 2005 were 7,441, 7,480, 7,530 and 9,912, respectively. The volumes for 2005 were in excess of the anticipated volumes in the contract which was based on 6,500 to 9,000 dry tons annually. Since the 2005 volumes were 32% higher than 2004 volumes and since the volumes between 2002 and 2004 remained within a 1% range, a 4 year average is a better representation of the volumes on which

to base sludge hauling expense. Staff Ex. 1.0, at 29, lines 604-613.

Aqua provided no specifics in its rebuttal testimony regarding the date that the Company was filing for a revised permit with the Illinois Environmental Protection Agency ("IEPA") when it was apparently readying its application to increase its allowed dry tonnage with the IEPA. Aqua Ex. 6.0 Revised, at 34, lines 765-772. Aqua witness Bunosky acknowledged during cross examination that Aqua actually filed its request for a revised permit with the IEPA on the same date that its rebuttal testimony was filed.

Aqua's contract with SunAgro Midwest ("SunAgro") contemplates between 6,500 and 9,000 dry tons to be hauled by SunAgro. Staff Ex. 1.0, at 29, lines 607-610.

With its surrebuttal testimony Aqua provided a copy of its higher permitted level from the IEPA. Even with a higher permitted level of dry tons, Aqua is still requesting a higher level of dry tons to be removed than is allowed in the contract with its sludge hauling provider. Therefore, Staff witness Ms. Everson's adjustment, which reflects the amount of dry tons allowed for in the contract with SunAgro as the maximum allowed, is supported by evidence of record and should be adopted by the Commission.

P. Unaccounted For Water

Staff witness Luth reduced Aqua's proposed level of Chemicals and Purchased Power Expense to reflect an Unaccounted-for Water percentage of 15 percent rather than the most recent 2005 level of 25.467 percent at the Kankakee Water Division (ICC Staff Exhibit 6.0, p. 16, lines 305-310). 15

percent Unaccounted-for Water is a general rule-of-thumb for a water utility such as Aqua (*Id.*, p. 17, lines 319-328). If a water utility has more than 15 percent Unaccounted-for Water, it must treat and pump more water than would ordinarily be expected to meet the requirements of its customers, which requires more power and chemicals than would ordinarily be expected to meet those requirements (*Id*. p. 17, lines 332-340). Aqua has not explained why it should not be held to the industry rule-of-thumb of 15 percent Unaccounted-for Water. In the absence of appropriate explanation and documentation of why the Kankakee Division should not be expected to meet the industry rule of thumb, Aqua customers should not be required to pay for Chemicals and Purchased Power to treat and pump quantities of water exceeding 15 percent Unaccounted-for water. The Commission should reduce the amount for Chemicals and Purchased Power expense because Aqua's percentage of Unaccounted-for Water is excessive.

Aqua witness Bunosky objected to Staff's witness Luth's Unaccounted-for Water adjustment (Aqua Exhibit 6.0, pp. 2-14, lines 30-310; and Aqua Exhibit No. 11.0, pp. 3-18, lines 41-402). Mr. Bunosky's objections are centered around two general themes: one, that the potential reasons for Unaccounted-for Water are numerous, making it difficult to identify and correct an Unaccounted-for Water problem, and two, that the Company is not required to file with the Commission tariffs specifying " . . . the maximum percentage of unaccounted-for water that would be considered in the determination of any rate or surcharges." (Aqua Exhibit 6.0, pp. 4-10, lines 83-192.)

Given the size and complexity of water distribution systems, and the fact that much of water distribution system is installed underground, it is not surprising that it might be difficult to identify and correct unaccounted-for

water. If unaccounted-for water was an easy problem to identify and correct, however, it is likely that the industry rule-of-thumb for unaccounted-for water would approach zero because a problem easy to identify and correct should not exist for very long. An industry rule-of-thumb likely takes into consideration the size, complexity, and the fact that a water distribution system is installed underground in determining that 15 percent or less Unaccounted-for Water is to be expected. Mr. Bunosky's testimony provides some introductory detail into the complexity and difficulty of correcting an Unaccounted-for Water problem, but does not support the notion that the Kankakee Division should not be expected to meet the industry rule-of-thumb (ICC Staff Exhibit 11.0R, p. 7, lines 127-140; and p. 8, lines 154-171).

Aqua does not get a free pass with respect to Unaccounted-for Water in this docket even though Aqua is not required to file tariffs with the Commission until December 31st, 2006 specifying the maximum percentage of Unaccounted-for Water it will seek to have considered in the determination of any rates or surcharges. Mr. Bunosky is incorrect with his claim that it is premature to reduce expenses associated with an excessive Unaccounted-for percentage in this docket. The amendment to the Public Utilities Act referenced by Mr. Bunosky (Aqua Exhibit No. 11.0, pp. 4-5, lines 65-88) does not preclude an evaluation of a water utility's unaccounted-for water in determining expenses recoverable through rates. Rather than usurping the legislative process in evaluating unaccounted-for water in this docket, as suggested by Mr. Bunosky, the Commission would complement the legislative process by reviewing a problem that the Legislature found necessitated an amendment to the Public Utilities Act. Since Aqua has not adequately explained and documented why it is

reasonable for the Kankakee Division to have an excessive percentage of Unaccounted-for Water, the Commission should reduce Aqua's proposed Chemicals and Purchased Power expense.

The Company accepted Staff's position as evidenced in the Stipulation.

IV. COST OF CAPITAL/RATE OF RETURN

A. Overview

Aqua requests a 9.02% cost of capital. Staff estimates the cost of capital for Aqua is 8.78%. Staff Exhibit 3.0R, Schedule 3.01. Three witnesses presented testimony regarding Aqua's cost of capital. Company witness Pauline M. Ahern presented testimony regarding the cost common equity. Aqua Exhibits 3.0 R, 3.1 through 3.9, 8.0 R, 8.1 through 8.12, 14.0 and 14.1. Company witness Jack Schreyer presented testimony regarding capital structure and the costs of debt and preferred stock. Aqua Exhibits 2.0 through 2.2. Staff witness Rochelle Phipps presented testimony regarding Aqua's overall cost of capital, including capital structure and the costs of preferred stock, debt and common equity. Staff Exhibits 3.0R and 9.0

B. Capital Structure, Debt Costs and Cost of Preferred Stock

Aqua's proposed average 2007 capital structure, debt costs and cost of preferred equity are very similar to those proposed by Staff, as shown in ICC Staff Exhibit 3.0R, Schedule 3.01. Aqua did not object to Staff's proposed capital structure comprising 52.35% common equity, 41.04% long-term debt, 0.27% preferred stock and 6.33% short-term debt; 7.12% cost of long-term debt; 5.86% cost of short-term debt (equal to the current LIBOR rate, plus sixty-five (65) basis points); and 5.48% cost of preferred equity. ICC Staff Exhibit 3.0R, Schedule 3.01.

C. Cost of Common Equity

Staff estimates the investor-required rate of return of common equity for Aqua is 10.45%. Aqua estimates an 11.00% rate of return on common equity. ICC Staff Exhibit 3.0R, Schedule 3.01.

1. Staff's Analysis

Staff witness Rochelle Phipps estimated the investor-required rate of return on equity for Aqua using discounted cash flow ("DCF") and risk premium models, which cannot be applied directly to Aqua because its common stock is not market-traded. Thus, she applied both models to a water utility sample and a public utility sample. The water sample comprises eight market-traded water utilities within the *Standard & Poor's Utility Compustat* database for which Zacks Investment Research ("Zacks") growth forecasts were available. The utility sample consists of nine public utilities selected from the *Standard & Poor's Utility Compustat* database based on principal components analysis of Aqua using nine financial and operating ratios for the 2003-2005 measurement period and three stability ratios for the 2001-2005 measurement period. From the principal components analysis, Ms. Phipps retained four components for risk analysis, which were used to rank-order the utilities in the database in terms of least relative distance from Aqua. Additionally, the companies comprising Staff's utility sample met the following criteria: were not in the process of being acquired by another company; had not reduced dividends since at least 2003 and for which Zacks growth forecasts were available. ICC Staff Exhibit 3.0R, pp. 12-15.

a. DCF Analysis

DCF analysis assumes that the market value of common stock equals the present value of the expected stream of future dividend payments. Ms. Phipps applied a constant-growth DCF model that accounts for the quarterly payment of dividends by the companies comprising her samples. ICC Staff Exhibit 3.0R, pp. 15-16.

DCF analysis requires a growth rate that reflects the expectations of investors. Staff witness Phipps measured the market-consensus expected growth rates with projections published by Zacks. The growth rate estimates were combined with the closing stock prices and dividend data as of June 8, 2006. ICC Staff Exhibit 3.0R, pp. 17-18. Staff's DCF-derived cost of equity estimate is 10.43% for the water sample and 10.57% for the utility sample. ICC Staff Exhibit 3.0R, p. 20, and Schedule 3.10.

b. Risk Premium Analysis

According to financial theory, the required rate of return for a risky security equals the risk-free rate of return plus a risk premium associated with that security. The risk premium methodology is consistent with investors' risk-aversion. Staff used a one-factor risk premium model, the Capital Asset Pricing Model ("CAPM"), to estimate the cost of common equity. In the CAPM, the risk factor is market risk, which cannot be eliminated through portfolio diversification. ICC Staff Exhibit 3.0R, pp. 20-21.

The CAPM requires the estimation of three parameters: beta, the risk-free rate, and the required rate of return on the market. First, using Value Line

beta estimates and regression analysis, Ms. Phipps estimated forward-looking betas of 0.60 for the water sample and 0.73 for the utility sample. ICC Staff Exhibit 3.0R, p. 30. Second, Ms. Phipps considered two current estimates of the risk-free rate of return as of June 8, 2006: the 4.89% yield on U.S. Treasury bills and the 5.12% year on long-term U.S. Treasury bonds. ICC Staff Exhibit 3.0R, p. 24. Forecasts of long-term inflation and the real risk-free rate suggest that the long-term risk-free rate is between 4.9% and 5.8%. Thus, Ms. Phipps averaged the yields on U.S. Treasury bills and U.S. Treasury bonds to estimate the risk-free rate of return because currently both closely approximate the long-term risk-free rate. ICC Staff Exhibit 3.0R, p. 25. Finally, to measure the expected rate of return on the market, Ms. Phipps conducted a DCF analysis on the firms composing the Standard & Poor's 500 Index. That analysis estimates that the expected rate of return on the market equals 13.42%. ICC Staff Exhibit 3.0R, pp. 26-27. Using those three parameters in her risk premium model, Staff estimates the cost of common equity is 10.06% for the water sample and 11.15% for the utility sample. ICC Staff Exhibit 3.0R, p. 30, and Schedule 3.11.

c. Staff Cost of Equity Recommendation

Ms. Phipps testified that a thorough cost of common equity analysis requires both the application of financial models and the analyst's informed judgment. A cost of common equity recommendation based solely upon judgment is inappropriate. However, because cost of common equity measurement techniques necessarily employ proxies for investor expectations, judgment is necessary to evaluate the results of such analyses. Along with DCF and CAPM analyses, Staff considered the observable 6.15% rate of return the

market currently requires on A-rated utility long-term debt. ICC Staff Exhibit 3.0R, p. 31.

To assess the similarity of the water and utility samples to Aqua in terms of risk, Staff witness Phipps compared the average factor scores for the water and utility samples with those of Aqua. The average factor scores for Staff witness Phipps' samples vis-à-vis Aqua revealed that Aqua's risk is more similar to the water sample while Aqua is less risky than the utility sample. Thus, Staff witness Phipps assigned two-thirds weight to the water sample estimates and one-third weight to the utility sample estimates to derive her 10.45% cost of equity recommendation for Aqua. ICC Staff Exhibit 3.0R, pp. 33-35.

2. Company's Analysis

Company witness Ahern also estimated Aqua's cost of common equity using the DCF model and the CAPM, which she applied to a sample of seven water utilities ("water sample") and a sample of eight utilities based on least relative distance ("utility sample").[1] Ms. Ahern added thirty-two (32) basis points to her cost of equity estimate for Aqua to reflect the Company's NAIC-2 debt rating. Aqua Exhibit 3.0R, pp. 5-6.

a. DCF Analysis

Ms. Ahern's DCF analysis used January 12, 2006, stock prices and concurrent Zacks' growth rate estimates. Ms. Ahern's cost of equity estimates of 10.45% for her water sample and 10.43% for her utility sample excluded company-specific estimates that did not exceed a forecasted 6.41% yield on long-term A-

[1] In rebuttal testimony, Ms. Ahern agreed with Staff witness Phipps that the Company's utility sample should exclude Constellation New Energy because it announced a merger during December 2005. The results of Ms. Ahern's DCF and risk premium analyses, as described herein, reflect this uncontested adjustment.

rated utility bonds by at least 200 basis points. Aqua Exhibit 3.0R, pp. 23-27; Aqua Exhibit 8.0R, pp. 23-24.

b. Risk Premium Analysis

Ms. Ahern's CAPM, or risk premium, analysis used a projected 5.22% U.S. Treasury bond yield as a proxy for the risk-free rate of return along with an 8.24% market risk premium and Value Line betas. Ms. Ahern's CAPM analysis estimated a 10.05% cost of common equity for her water sample and 11.18% for her utility sample. Aqua Exhibit 3.0R, pp. 27-33 and Aqua Exhibit 8.0R, p. 24.

c. Company Cost of Equity Recommendation

Ms. Ahern recommends an 11.00% cost of equity for Aqua, which is between her 10.57% cost of equity estimate for the water sample (*i.e.*, 10.25%, plus 32 basis points) and her 11.13% estimate for the utility sample (*i.e.*, 10.81%, plus 32 basis points). Aqua Exhibit 8.0R, p. 24.

3. Staff's Criticisms of the Company's Analysis

Staff witness Phipps testified that Ms. Ahern's analysis contained the following critical errors, which led her to overestimate Aqua's cost of common equity. First, Ms. Ahern improperly added an investment risk premium to her cost of equity estimates to reflect Aqua's NAIC-2 debt rating, which she alleges reflects a higher degree of risk than the samples used to estimate the Company's cost of equity. In her risk premium analysis, Ms. Ahern incorrectly used a projected U.S. Treasury bond yield to estimate the risk-free rate. Finally, Ms. Ahern also improperly eliminated DCF-derived cost of equity estimates for her water sample based on an arbitrary minimum threshold criterion. ICC Staff Exhibit 3.0R, p. 36.

a. NAIC-2 Debt Rating

Aqua's NAIC-2 debt rating does not warrant adding an investment resk premium to the cost of equity. Aqua has certain debt issues that have been assigned an NAIC-2 rating by the National Association of Insurance Commissioners ("NAIC"), which Ms. Ahern alleged reflects a higher degree of credit risk for Aqua than exists for either of her proxy groups. On this basis, she added thirty-two (32) basis points to her cost of equity estimate for Aqua. Aqua Exhibit 3.0R, pp. 6 and 16-17.

Ms. Ahern's claim that Aqua's NAIC-2 debt rating denotes Aqua is riskier than her samples is based on the false premise that NAIC debt ratings are equivalent to credit ratings issued by Nationally Recognized Statistical Rating Organization (NRSROs), such as Standard & Poor's ("S&P"). Aqua Exhibit 3.0R, p. 17. Ms. Ahern could not confirm her claim with any documentation from any NRSRO that stated its credit ratings are equivalent to NAIC debt ratings. ICC Staff Exhibit 3.0R, pp. 45-46. Further, the NAIC website (Aqua Exhibit 8.9) and The Purposes and Procedures Manual of the NAIC Securities Valuation Office (the "NAIC Manual") explicitly warn NAIC ratings are not equivalent to NRSRO ratings and should not be used by anyone other than NAIC members, *i.e.* insurance company regulators. ICC Staff Exhibit 9.0, p. 12. In summary, Ms. Ahern failed to provide a sound basis for her opinion that investors rely on Aqua's NAIC-2 debt rating and, thus, Staff recommends that it not be given any weight in this proceeding.

Staff witness Ms. Phipps averred that the only connection

between NAIC debt ratings and NRSRO ratings is that the NAIC uses NRSRO ratings, whenever possible, as a starting point for its analysis. The NAIC also explicitly reserves the right to assign lower (but not higher) designations than the NRSRO ratings would suggest due to security-specific factors. Ms. Phipps testified that Aqua's NAIC-2-rated bonds might include terms that merit a lower NAIC designation than the general level of investment risk for Aqua because the NAIC debt ratings reflect security-specific factors that may not reflect the level of investment risk inherent in the Company's operations. ICC Staff Exhibit 3.0R, p. 46; ICC Staff Exhibit 9.0, pp. 12-13; Aqua Schedule R-3.9, p. 6.

Company witness Ahern also claimed that investors are aware of the comprehensive analysis completed by the NAIC's Securities Valuation Office ("SVO") even though the NAIC Manual does not specify any details regarding its risk analysis. ICC Staff Exhibit 9.0, pp. 14-15; Aqua Exhibit 8.10, p. 4. Ms. Phipps testified that because the details regarding the NAIC risk analysis are unknown, no basis exists for comparing the NAIC's rating methodology to the methodology used by NRSROs such as S&P. Ms. Phipps testified that, in contrast to the NAIC, S&P publishes the following information regarding its rating process and methodology: (1) definitions of ratios used in credit analysis; (2) benchmarks for those ratios that vary according to business profile score; (3) ratings reports that provide the rationale behind assigned credit ratings; (4) periodic and ad hoc updates regarding rating changes; and (5) ratings affirmations as necessary. She asserted that the details S&P provides regarding its rating process and methodology allow investors to not only understand the S&P rating process but to also make educated inferences regarding a company's

level of risk in comparison to other companies rated by S&P. ICC Staff Exhibit 9.0, pp. 14-15. In contrast, the NAIC does not provide any of that information and does not actively monitor securities it rates. The last rating reviews that the NAIC conducted occurred during 2003 and 2004. ICC Staff Cross Exhibit 3. Moreover, even Aqua does not know the rationale behind its NAIC debt rating and does not have any details regarding the factors considered by the NAIC in assigning its ratings. ICC Staff Exhibit 9.0, p. 15. Thus, the substitutability of NAIC designations for NRSRO ratings remains doubtful at best due to lack of publicly available information, not to mention record evidence, regarding the NAIC rating methodology and review process. ICC Staff Exhibit 9.0, pp. 14-15.

Despite the evidence showing NAIC designations are not equivalent to NRSRO ratings, Ms. Ahern alleged the average A S&P bond rating of her samples means they would have an NAIC-1 debt rating. Aqua Exhibit 8.0R, p. 19. Yet, Ms. Ahern admitted that she does not know whether the companies comprising her samples have been assigned NAIC debt ratings. Aqua Exhibit 8.0R, p. 19. Staff witness Ms. Phipps noted that companies comprising her sample groups, or their operating subsidiaries, might have been assigned NAIC-2 debt ratings. ICC Staff Exhibit 3.0R, p. 45. Thus, the Commission should not assume that utilities with “A” credit ratings have no debt with NAIC-2 designations or that Aqua would not merit an “A” credit rating from S&P and Moody’s despite having debt with NAIC-2 designations.

Another shortcoming in Ms. Ahern’s argument that an investment risk premium is necessary due to her A-rated samples is her estimate of the samples’ credit rating was incorrectly based on the credit ratings for all of the rated

operating subsidiaries of her sample companies when it should have been based on the credit ratings of the holding companies. Staff witness Ms. Phipps testified that the ratings of those operating subsidiaries are not pertinent to Ms. Ahern's cost of equity analysis because she used stock price data for the holding companies to estimate Aqua's cost of equity. There is no stock price data for the operating subsidiaries because, like Aqua, they do not have publicly traded stock. Thus, the holding companies' issuer ratings are the appropriate measure of the samples' risk because the issuer ratings reflect the level of financial risk and business risk inherent in each sample company's stock price, including risks arising from the holding companies' non-operating subsidiary businesses. ICC Staff Exhibit 9.0, p. 10.

Nevertheless, assuming for the sake of argument that the Company's NAIC-2 debt rating denotes a level of risk commensurate with the BBB credit rating category, which it does not, Aqua is no riskier than Staff's utility sample. ICC Staff Exhibit 9.0, p. 11. Thus, adding an investment risk premium to Staff's cost of equity estimate for the utility sample is unwarranted.

All of the Company's privately placed debt is rated NAIC-2. ICC Staff Cross Exhibit 3. That is, Aqua may incur liquidity costs (*e.g.*, transaction or information costs) due to a more limited market for privately placed indebtedness than exists for publicly issued debt. ICC Staff Ex. 3.0, p. 41. Consequently, Aqua's NAIC-2 rating may reflect a liquidity premium due to the fact that Aqua's NAIC-2-rated bonds are privately placed rather than a higher level of investment risk for the Company. To the extent that Aqua's NAIC-2 debt rating reflects higher liquidity costs because those bonds are privately placed, the higher

debt cost is already reflected in the Company's embedded cost of long-term debt, which is a component of the Company's authorized cost of capital; and, thus, already recovered from ratepayers. Adding an investment risk premium to Aqua's cost of equity would effectively double-charge Illinois ratepayers. On this basis, Aqua's proposed investment risk premium should be rejected.

The Company indicated that privately placed bonds issued by Aqua New Jersey, Aqua Maine and Aqua Ohio are also rated NAIC-2. ICC Staff Cross Exhibit 3. Company witness Ahern provided rate of return testimony for Aqua New Jersey and Aqua Maine, both of which have NAIC-2-rated bonds. Yet, Aqua Illinois is the only company for which Ms. Ahern has proposed adding an investment risk premium to the cost of equity due to its NAIC-2 rating. ICC Staff Cross Exhibit 3. This invites the question of why Ms. Ahern has determined that the NAIC-2 designation is sufficient for adding an investment risk premium to the cost of common equity of Aqua but not its affiliates in Maine and New Jersey. Because Ms. Ahern has not answered this question satisfactorily, the Commission should not award Aqua an investment risk premium based solely on NAIC designations.

b. Aqua's Risk Premium Analysis.

Ms. Ahern used a projected U.S. Treasury bond yield to estimate the risk-free rate in her CAPM analysis. However, as Staff demonstrated, accurately forecasting interest rates is problematic. ICC Staff Exhibit 3.0R, p. 53 and ICC Staff Exhibit 9.0, Schedule 9.01. Staff witness Ms. Phipps also testified that absent convincing evidence that Ms. Ahern's forecasted interest rates are accurate, the Commission should continue to rely on current, observable, market

interest rates. Moreover, the Commission rejected using forecasted yields in CAPM analyses in prior rate cases. ICC Staff Exhibit 3.0R, pp. 53-54, *citing* ICC Docket No. 02-0837, Central Illinois Light gas rate increase; ICC Docket Nos. 02-0798/03-0008/03-0009 Consolidated, Central Illinois Public Service Co. and Union Electric Co. rate increase. .

Ms. Ahern's espousal of estimating the risk-free rate with interest rate projections is based upon her assertion that the Efficient Market Hypothesis ("EMH") requires that investors evaluate all information available to them. Aqua Exhibit 8.0R, p. 21. According to Ms. Ahern, since interest rate forecasts are publicly available, investors (allegedly) rely on them, and since investors (allegedly) rely on those forecasts, cost of equity analysis must use them as well. Aqua Exhibit 8.0R, p. 3.

Ms. Ahern cited three source documents as support for her assertion that the EMH requires investors to evaluate all available information. However, not one of those publications state that the EMH requires investors to evaluate all available information. Staff Cross Exhibit 3. Ms. Phipps testified that the EMH is concerned only with whether security prices fully reflect all relevant, available information and whether investors can reap "excess" returns from a given information set. The EMH does not identify which information is relevant and says nothing concerning the importance that investors impart to various sources and types of information. ICC Staff Exhibit 9.0, p. 4.

c. Aqua's DCF analysis

Company witness Ahern testified that she eliminated DCF-derived cost of equity estimates that were equal to or below 8.41% (*i.e.* Blue Chip Financial

Forecast ("BCFF") projected 6.41% A-rated bond yield, plus 200 basis points) but did not assess whether any of those DCF estimates were too high. Ms. Ahern's arbitrary elimination criterion inflated her DCF-derived cost of equity estimate for Aqua as including the "low" estimates results in a 10.0% DCF-derived cost of equity estimate for the water sample versus her 10.45% estimate she presents in testimony. ICC Staff Exhibit 3.0R, pp. 50-52.

4. Staff's Response to Aqua's Criticisms

a. Prior Commission Orders

Company witness Ahern argues that Staff witness Phipps' recommendation against adding an investment risk premium to Aqua's cost of equity is "a complete departure from prior Commission rulings". Aqua Exhibit 8.0R, p. 9. Aqua initially requested, and was authorized, a rate of return that includes an investment risk premium in Docket No. 03-0403, the Kankakee division's last rate case. In that case, the Commission accepted Staff's methodology and 9.86% rate of return on common equity and added thirty (30) basis points to reflect an "additional risk factor not already explained". Order, Docket No. 03-0403, April 13, 2004, p. 28. In Aqua's next rate case, Docket No. 04-0442 (Vermilion Division rate increase), the Commission's Order clarified that Aqua's NAIC-2 rating is not an automatic upward adjustment to cost of equity. Notably, the Commission's Order states:

> The manner in which Aqua cites the text of 03-0403 suggests that it attempts to expand the context to the entire cost of equity analysis. The proper scope, however, is limited to a determination of whether an additional adjustment is warranted to account for business risk not incorporated already within the cost of equity models, and not to "common equity analysis." Such an adjustment therefore is foreclosed if the cost of equity analysis properly

> accounts for all relevant risk. The Commission finds that this limitation is necessary to remove any incentive to view a weaker credit rating as an asset within the ratemaking process.
>
> Order, Docket No. 04-0442, April 20, 2005, pp. 44-45.

Thus, the Docket No. 04-0442 Order contradicts Aqua's suggestion that two Commission Orders establish a precedent that removes Staff's ability to assess the necessity of adding an investment risk premium to Aqua's cost of equity.

Moreover, the Commission's Order in Aqua's most recent rate case, Docket Nos. 05-0071/0072 Consolidated (rate increases for Aqua's Woodhaven and Oak Run divisions), states the following:

> [T]he Commission finds it significant that Staff testifies that such an investment risk premium is unnecessary and may not be recommended by Staff in future Aqua rate proceedings. (cite omitted) Thus, in Aqua's next rate proceeding, the Commission expects to consider the propriety of an incremental investment risk premium on the cost of common equity.
>
> Order, Docket Nos. 05-0071/0072 Consolidated, November 8, 2005, pp. 53-54.

That is, the Commission's Docket No. 05-0071/0072 Consolidated Order confirms that the propriety of an incremental investment risk premium to Aqua's cost of equity will be determined on a case-by-case basis and is not an automatic cost of equity adjustment for the Company.

In this case, Staff used a quantitative risk analysis to assess the risk of Aqua vis-à-vis Staff's water and utility samples. Specifically, Staff witness Phipps' principal components analysis, which was based on twelve financial and

operating ratios, revealed that in terms of risk, Aqua is more similar to the water sample and less risky than the utility sample. Staff Exhibit 3.0R, pp. 33-34. Thus, the samples are not less risky than Aqua and, as such; there is no "unaccounted for risk factor" that warrants adding an investment risk premium to Aqua's cost of equity. Thus, Staff witness Phipps' recommendation against adding an incremental risk premium to Aqua's cost of equity should be adopted.

b. Risk Premium.

Ms. Ahern claimed that Ms. Phipps's cost of common equity cost provides an insufficient risk premium. Aqua Exhibit R-3.0, lines 337-351. Ms. Phipps's cost of common equity is 10.45% and the concurrent yield on A-rated utility long-term debt was 6.15%. Thus, Ms. Phipps' cost of equity recommendation produces a risk premium of 4.30%. Staff Exhibit 9.0, pp. 16-17.

Ms. Ahern's claim rests on an invalid comparison of Ms. Phipps's cost of equity estimate to Aqua's embedded cost of debt, which reflects interest rates that Aqua locked in as early as 1988, rather than the interest rate Aqua would pay on new debt capital. Since the interest rates on Aqua's debt issues have fallen since 1988 (*see* ICC Staff Exhibit 3.0R, Schedule 3.03), a risk premium measured in reference to Aqua's embedded cost of debt would be lower than a risk premium measured in reference to Aqua's current cost of debt.

Further, Ms. Ahern compounded her error by comparing Ms. Phipps' recommended cost of common equity and Aqua's embedded cost of debt to a risk premium calculated in relation to Aaa-rated corporate bond yields. That

comparison is invalid for two reasons. First, the Aqua risk premium is calculated from an embedded cost of debt (*i.e.*, debt costs incurred over almost 20 years) while the benchmark risk premium is calculated from concurrent debt and equity costs. Second, the Aqua risk premium is calculated from its embedded debt cost, which should be commensurate with no better than A-rated utility debt (if not BBB-rated utility debt if the NAIC-2 designation is interpreted in the manner Ms. Ahern espoused) while the benchmark risk premium is calculated using the cost of Aaa and Aa-rated debt. Ms. Ahern's invalid comparisons, consequently, utterly fail to undermine Ms. Phipps' cost of common equity analysis. Staff Exhibit 9.0, pp. 16-17.

In another attempt to show Staff's 10.45% cost of equity estimate for Aqua is inadequate, Ms. Ahern sponsored Aqua Exhibit 8.4, which purports to present authorized rates of return for various Aqua America, Inc. subsidiaries. Ms. Ahern testified that Staff's recommended rate of return on equity could affect Aqua America, Inc.'s investment decisions. Aqua Exhibit 8.0R, p. 15. Even if the information contained in Aqua Exhibit 8.4 were not severely flawed, Ms. Ahern admitted that she does not know how Aqua America, Inc. prioritizes its investment decisions. Tr., p. 325. Despite Ms. Ahern's contention that Aqua America, Inc. could determine a 10.45% cost of equity for Aqua is too low to continue to invest in its Illinois assets, Staff notes that Aqua currently has three docketed certification proceedings before the Commission (*see* Docket Nos. 06-0043 (filed 1/18/2006), 06-0203 (filed 3/17/2006) and 06-0655 (filed 10/6/2006)), which request authority pursuant to Section 8-406 of the Act to expand its service territory and increase the amount of investment in Illinois

assets. Consequently, Ms. Ahern's testimony is pure speculation, which would appear to be belied by Aqua's own regulatory actions, and should not be given any weight in this proceeding.

Further, the information in Aqua Exhibit 8.4 contains several deficiencies. First, of the fifteen jurisdictional rates of return on equity presented on Aqua Exhibit 8.4, only four orders specify the authorized rate of return on equity. (*See* Order, Pennsylvania Public Utility Commission, Docket R-00038805, August 5, 2004, p. 30; Order, Illinois Commerce Commission, Docket Nos. 05-0071/0072 Consolidated, November 8, 2005, p. 53; Order, New Jersey Board of Public Utilities, June 10, 2004, p. 2; and Order, North Carolina Utilities Commission, Docket No. W-274, SUB 478, April 18, 2005, p. 6, all of which are cited in Aqua's response to ICC Staff data request response 4.03, provided in Staff Cross Exhibit 2.) Second, the Ohio orders reference only an authorized rate of return on rate base. (*See* Orders, Public Utilities Commission of Ohio, Case No. 03-2290-WW-AIR, October 20, 2004, p. 5 and Case No. 00-713-WW-AIR, March 22, 2001, p. 8 (*i.e.*, the Lake and Masury Orders, respectively, referenced in Staff Cross Exhibit 2)). Third, orders for Texas, Indiana and Maine specify neither a return on equity nor a rate of return on rate base (*See* Order, Texas Natural Resource Conservation Commission, SOAH Docket No. 582-01-0416 TNRCC 2000-1074-UCR and 2000 1075-UCR, September 17, 2002; Order, Indiana Utility Regulatory Commission, Cause No. 41968, December 10, 2003; and Order, Maine Public Utilities Commission, Docket No. 2003-784, Consumers Maine Water – Kezar Falls Division proposed rate increase, December 31, 2003.) Fourth, orders that support the 11% rate of return that Aqua claims was

authorized in Virginia for the four water companies listed in Aqua Exhibit 8.4 do not exist; that is, Aqua Virginia's proposed tariff sheets, which do not mention a rate of return, were automatically approved by Virginia's State Corporation Commission. Fifth, Aqua Exhibit 8.4 excludes some Aqua America, Inc. subsidiaries. For example, Aqua Exhibit 8.4 does not include Aqua America, Inc.'s Florida jurisdiction. Tr., p. 325. Sixth, Aqua Exhibit 8.4 is out of date. During cross-examination, Ms. Ahern admitted that there are more recent rate decisions and rate cases pending in at least three of the jurisdictions provided in Aqua Exhibit 8.4 (*e.g.* Pennsylvania, Texas and Virginia). Tr., pp. 332, 335 and 338. Seventh, Aqua Exhibit 8.4 is missing a critical component that provides context to authorized rates of return on equity – the level of financial risk inherent in each company's capital structure as measured by the equity ratio. Financial risk directly impacts the investor-required rate of return as higher equity ratios require lower returns on equity, all else being equal (Tr., p. 336). Yet, Aqua Exhibit 8.4 does not provide the capital structure for any of the Aqua jurisdictions listed on that exhibit. Eighth, Ms. Ahern admitted that the risks for the companies listed on Aqua Exhibit 8.4 are different. Tr., p. 342. Yet, Aqua Exhibit 8.4 fails to address how those risks differ. Finally, the authorized rates of return in Texas, Virginia and Indiana are simply not comparable to Illinois; given that Texas allows water companies a 12% rate of return automatically (Tr., p. 335), Virginia approved Aqua's proposed tariff sheets for the four jurisdictions listed on Aqua Exhibit 8.4 without investigation, and the Indiana rate case authorizing an 11.50% return on equity was filed before the water company was acquired by Aqua America, Inc. Order, Indiana Utility Regulatory Commission, Cause No. 41968, December 10, 2003, p. 8. Consequently, Aqua Exhibit 8.4 fails to

support Ms. Ahern's 11% rate of return on equity recommendation and Staff asserts that due to the errors, omissions and lack of support with respect to Aqua Exhibit 8.4, it should be rejected in its entirety.

c. Current U.S. Treasury Yields

Company witness Ahern alleged that Staff witness Phipps' risk premium analysis is understated because it is based upon current U.S. Treasury security yields (including U.S. Treasury bill yields). Aqua Exhibit 8.0R, p. 2. Ms. Phipps testified that current, observable U.S. Treasury yields are the best available proxy for the true, unobservable risk-free rate because current interest rates reflect investor expectations about future interest rates. Consequently, estimating Aqua's cost of equity with projections of the risk-free rate would effectively double-count investor expectations regarding future interest rates. Moreover, since both Ms. Ahern and Ms. Phipps are estimating Aqua's current cost of equity, using interest rate projections in risk premium analysis also mismatches measurement periods. Ms. Phipps averred that the problems inherent in using interest rate projections to estimate the risk-free rate reduces the accuracy of Ms. Ahern's cost of equity estimate for Aqua. Staff Exhibit 9.0, p. 5.

Ms. Ahern argued that interest rate projections should be used in cost of equity analysis because they are available to investors. Aqua Exhibit 8.0R, p. 3. In response, Ms. Phipps showed that accurately forecasting interest rates is problematic. Staff Exhibit 3.0R, p. 53; ICC Staff Exhibit 9.0, Schedule 9.01. Specifically, ICC Staff Exhibit 9.0, Schedule 9.01, which compares actual U.S. Treasury bond yields and BCFF projections, shows that BCFF interest

rate projections have been consistently higher than actual interest rates and the accuracy of forecasted yields diminishes as the forecast period lengthens. Moreover, Ms. Phipps testified that the current U.S. Treasury yields she used to estimate the risk-free rate reflect all relevant, available information, including investor expectations regarding future interest rates and investor appraisals of the value of BCFF forecasts. That is, using current market interest rates in a risk premium analysis renders speculation of whether investor expectations of future interest rates equals BCFF projections unnecessary in cost of equity analysis. Staff Exhibit 9.0, pp. 6-7. Thus, the Commission should adopt Staff's risk premium analysis, which relies upon current, observable market interest rates, and reject the Company's faulty risk premium analysis, which improperly relies upon interest rate projections.

Company witness Ahern also criticized Staff's risk premium analysis for including U.S. Treasury bill yields in its estimate of the risk-free rate. However, U.S. Treasury bills can be appropriate proxies for the risk-free rate of return, as described in Staff witness Phipps' direct testimony, which describes the relative merits of using long- and short-term U.S. Treasury yields as proxies for the risk-free rate. Staff Exhibit 9.0, p. 8; Staff Exhibit 3.0R, pp. 22-24.

Moreover, Ms. Ahern exaggerated the way in which Ms. Phipps' inclusion of U.S. Treasury bill yields allegedly "understates" Aqua's cost of equity. On June 8, 2006, U.S. Treasury bill yields were 4.89% in comparison to the 5.12% yield on U.S. Treasury bonds – a difference of only twenty-three (23) basis points. Staff Exhibit 3.0R, Schedule 3.11. Towards that end, Ms. Ahern admitted that the current 30-year U.S. Treasury bond yield is 4.86% (Tr., p. 308), which

is below the U.S. Treasury bill yield that she objects to in rebuttal testimony. The evidentiary record shows that Ms. Phipps' inclusion of the U.S. Treasury bill yield in Ms. Phipps' risk-free rate estimate does not understate the results of her risk premium analysis. Thus, the Commission should reject Ms. Ahern's arguments against using U.S. Treasury bill yields to estimate Aqua's cost of equity.

D. Recommendation

Aqua's DCF and risk premium analyses are flawed for the reasons described previously and should be rejected. Aqua's proposal to add thirty-two (32) basis points to its rate of return on equity should also be rejected because Staff showed that NAIC ratings improper substitutes for NRSRO credit ratings. Moreover, Staff's quantitative risk analysis of Aqua in comparison to Staff's samples revealed that both of Staff's samples are very similar in risk to Aqua, even though Aqua is less risky than Staff's utility sample. Thus, even if NAIC ratings were equivalent to NRSRO ratings, which they are not, adding an investment risk premium to Aqua's cost of equity is unwarranted. In contrast, Staff's 10.45% cost of equity estimate for Aqua is based on a sound analysis and judgment, is supported by the record and should be adopted.

V. COST OF SERVICE STUDY/RATE DESIGN

A. Cost of Service Study

Aqua does not contest the allocation of costs among residential, commercial, and industrial customers, private fire protection, and public fire protection that result from Staff's cost of service study ("COSS") (Aqua Ex. 9.0, p. 2, lines 34-36). One change that both Staff and the Company agree upon and should be implemented in the COSS is the elimination of the City of Kankakee municipal utility tax ("Kankakee tax") from non-metered variable revenues

and from revenue requirement to be recovered under rates established in this docket because the Kankakee tax is recovered under an add-on charge to the amounts that customers are charged for water service (ICC Staff Exhibit 11.0R, pp. 13-15, lines 260-305, Aqua Ex. 13.0, p. 2, lines 21-24). Given the agreement between the Company and Staff, Staff's COSS (ICC Staff Exhibit 11.1), adjusted to eliminate the revenue and revenue requirement effects of the Kankakee tax, should be used as the starting point for determining rates based upon the revenue requirement that the Commission finds appropriate in this docket.

B. Rate Design

Aqua disagrees with Staff's cost-based rates that would apply to the customer charge, usage block charges, and fire protection charges. Aqua agrees with Staff's design of public fire protection charges, adjusted for differences in revenue requirement (Aqua Ex. 13.0, p. 2, lines 38-43), but does not agree with Staff's proposed private fire protection charges (Aqua Ex. 13.0, p. 3, lines 44-58). The County of Kankakee also disagrees with Staff's cost-based rates and favors Aqua's approach to rates, which is essentially an across-the-board increase to customer charges and usage charges, with increases in revenues from public fire protection charges used to reduce the increase in customer charges (County Exhibit 1.0, pp. 6-7, lines 120-138). However, neither the Company nor the County claims that Staff's rates are not cost-based.

Nonetheless, in the interest of compromise and in order to preserve scarce Commission resources and efficiently address issues in this proceeding, Staff has compromised and, thus, agrees that customer charges can increase by the currently effective QIPS of 5 percent, as discussed in Aqua Ex. 13.0, p. 4, l. 67-69 and County Exhibit 1.0, p. 5, l. 93-95. Any overcollection of customer-

related costs should be credited to usage charge revenues. Given the five percent increase in present customer charges, Aqua has agreed to rates based upon Staff's recommendations, with adjustment to reflect the difference in revenue requirement. In Staff's view, this agreement and stipulation concerning the increase in customer charges is reasonable, but is only for the purpose of settling this docket and is not precedential for future proceedings.

C. Private Fire Protection Rates

Staff witness Luth recommended private fire protection rates that are different from the private fire protection rates proposed by Aqua (ICC Staff Exhibit 11.0R, p. 4, lines 62-84). Aqua witness Monie recommended a percentage-based across-the-board increase (Aqua Ex. 13.0, p. 3, lines 51-58). Mr. Monie offered two reasons in opposing Mr. Luth's recommended private fire protection rates. First, a number of factors can affect the capacity of fire protection lines. Second, the QIPS increases current rates by 5 percent (*Id*., lines 44-55). The Commission should reject Mr. Monie's objection to Staff witness Luth's rates because Mr. Monie has not shown how his approach to private fire protection rates improves upon Mr. Luth's approach based upon the relative capacities of different sized private fire protection lines.

Aqua agreed with Staff that the QIPS is not an input or component in a COSS. Instead, the QIPS is a mechanism that allows the Company to recover, on an interim basis, costs associated with plant in service replacements between rate cases (Tr., pp. 203-206). As an interim mechanism to allow the company to increase rates for cost increases between general rate dockets that is not an input or component in a COSS, the QIPS should not affect the design of rates

based upon a COSS in the current docket which considers costs currently recovered through the QIPS.

In comparing two pipes of different diameter, the capacity of each pipe is not measured by the cross-sectional areas of the pipes. Instead, the capacity of each pipe is measured by the Hazen-Williams formula, in which the carrying capacity increases at a faster rate for larger diameter pipes than by comparitive measures of cross-sectional areas (ICC Staff Exhibit 11.0R, p. 4, lines 71-84). The Hazen-Williams formula measures flow capacity of pipe by increasing the multiplication factor of the radius by a power of 2.63, rather than squaring (multiplying the measurement of the radius by the value of the measurement) the radius as is done in measuring cross-sectional area. If the measured size of a radius is raised to the 2.63 power, the measurement of flow capacity increases at faster rate than squaring the size of the radius.[2] As a result, it is appropriate that rates based upon the flow capacity of pipes serving the private fire protection connection are higher for a larger-sized pipe than a comparison to the cross-sectional area of a smaller-sized pipe suggests.

The Company has not shown why factors other than flow capacity should be considered in determining private fire service protection rates because the effects of those factors have not been measured, or their existence demonstrated, at the various private fire connections in the Kankakee Division. The Commission should base private fire protection rates based upon Staff's

---

[2] For example, squaring a 1-inch radius of a pipe results in a cross-sectional area of $3.14 = \Pi \times 1^2$. Squaring a 2-inch radius of another pipe results in a cross-sectional area of $12.56 = \Pi \times 2^2$. The ratio of the cross-sectional area of the 2-inch radius pipe to the 1-inch radius pipe is therefore 4.

The Hazen-Williams measure of the flow capacity of the 1-inch radius pipe remains $3.14 = \Pi \times 1^{2.63}$. The Hazen-Williams measure of the flow capacity of the 2-inch radius pipe, however, is $15.8256 = \Pi \times 2^{2.63}$, or $3.14 \times 2 \times 2 \times 1.26$ ($2 \times .63$). The ratio of the Hazen-Williams measure of the 2-inch radius pipe to the 1-inch radius pipe is therefore 5.04.

recommended ratios which use the Hazen-Williams formula to measure relative capacities of various sized connections.

The Company accepted Staff's position as evidenced in the Stipulation.

D. Plant Facilities Charge

Aqua proposes a new charge, applicable to new customers only, the Plant Facilities Charge ("PFC") (Aqua Exhibit 4.0, p. 11). The PFC ostensibly charges new customers for existing facilities already in place so that existing customers will not pay more in rates as a result of the Company adding customers. The Commission should reject the PFC because it is unfair to new customers, violates 83 Ill. Adm. Code 600.370, and is essentially retroactive ratemaking because the PFC would charge new customers for costs not specifically incurred to allow new customers to begin utility service.

The PFC is unfair to new customers because the PFC would require new customers to fully pay for their weighted share of existing facilities prior to their use of those facilities, but new customers would also be subject to the same rates that existing customers pay. Rates are based, in part, upon the return paid on the net depreciated cost of existing facilities as well as annual depreciation on those facilities, as shown in Staff's COSS (ICC Staff Exhibit 11.1, pp. 5-6, 9, and 16). If existing facilities are replaced before those facilities are fully depreciated, new customers will not receive full value for their PFC payment because they, along with existing customers, will pay a return and depreciation on the replacement plant in service (ICC Staff Exhibit 11.0R, pp. 11-12, lines 236-243). Existing customers, however, not having paid the PFC, will not be penalized by having fully paid for plant no longer in service. The PFC's disparate treatment of

new customers compared to existing customers makes the PFC discriminatory against new customers.

The PFC violates 83 Ill. Adm. Code 600.370(a), which requires that "[t]he utility [will] provide all supply plant (backbone plant) at its cost and expense without requiring contributions or tap-on-fees from customers, developers or promoters, except in those unusual cases where extensive plant additions are required before customers can be attached." The PFC, as proposed by Aqua, would apply generally to all new customers and would therefore not be limited to the unusual cases requiring extensive plant additions described in 83 Ill. Adm. Code 600.370(a). The Commission should reject the PFC, which in addition to being a discriminatory rate against new customers, violates 83 Ill. Adm. Code 600.370(a).

The Company accepted Staff's position as evidenced in the Stipulation.

VIII. CONCLUSION

WHEREFORE, for all the reasons set forth above, the Staff of the Illinois Commerce Commission urges that its recommendations and proposals be adopted in their entirety consistent with the arguments set forth herein.

Respectfully submitted,

_____

JANIS E. VON QUALEN
MICHAEL LANNON
MATTHEW HARVEY
Staff Attorney

Counsel for the Staff of the Illinois
Commerce Commission

MICHAEL LANNON
MATTHEW HARVEY
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle St., Suite C-800
Chicago, IL 60601-3104
Phone: (312)814-4368
(312)793-3243
Fax: (312)793-1556

JANIS E. VON QUALEN
Office of General Counsel
Illinois Commerce Commission
527 East Capitol Avenue
Springfield, IL 62701
Phone: (217)785-3402
Fax: (217)524-8928

Aqua Illinois, Inc. - Kankakee Division

Statement of Operating Income with Adjustments

For the Test Year Ending December 31, 2007

Line No.	Description	Company Rebuttal ProForma Proposed (ICC Staff IB Appendix, Sch. 1, p2)	Staff Adjustments (ICC Staff IB Appendix, Sch. 2, p3)	Staff ProForma Present (Cols. b+c)	Company Proposed Increase (Co. Sch. C-1)	Staff Gross Revenue Conversion Factor	Proposed Rates With Staff Adjustments (Cols. d+e+f)	Adjustment To Proposed Increase	Staff Pro Forma Proposed (Cols. g+h)
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
1	Operating Revenues	13,702,817	$ (233,540)	$ 13,469,277	$ 3,389,991	$ 23,014	$ 16,882,282	$ (524,813)	$ 16,357,469
2		-	-	-	-	-	-	-	-
3	Total Operating Revenue	13,702,817	(233,540)	13,469,277	3,389,991	23,014	16,882,282	(524,813)	16,357,469
4	Uncollectible Expense	126,858	(2,162)	124,696	31,385	213	156,294	(4,859)	151,435
5	Wages & Salaries	1,425,890	(71,876)	1,354,014	-	-	1,354,014	-	1,354,014
6	Employee Benefits	561,039	-	561,039	-	-	561,039	-	561,039
7	Contractual Services	1,707,481	(12,195)	1,695,286	-	-	1,695,286	-	1,695,286
8	Operation & Maintenence Expense	2,008,358	(120,534)	1,887,824	-	-	1,887,824	-	1,887,824
9	Depreciation & Amortization Expense	2,351,825	(43,975)	2,307,850	-	-	2,307,850	-	2,307,850
10	Regulatory Expense	141,730	(33,976)	107,754	-	-	107,754	-	107,754
11	Taxes Other than Income	763,507	(54,004)	709,503	-	-	709,503	-	709,503
12	Miscellaneous Expense	901,969	(43,406)	858,563	-	-	858,563	-	858,563
13		-	-	-	-	-	-	-	-
14		-	-	-	-	-	-	-	-
15	Total Operating Expense								
16	Before Income Taxes	9,988,657	(382,128)	9,606,529	31,385	213	9,638,127	(4,859)	9,633,268
							-		
17	State Income Tax	140,926	16,757	157,683	242,655	4,187	404,525	(37,957)	366,568
18	Federal Income Tax	626,349	74,485	700,834	1,078,483	18,614	1,797,931	(168,699)	1,629,232
19	Deferred Taxes and ITCs Net	(19,104)	-	(19,104)	-	-	(19,104)	-	(19,104)
20	Total Operating Expenses	10,736,828	(290,886)	10,445,942	1,352,523	23,014	11,821,479	(211,515)	11,609,964
21	NET OPERATING INCOME	$ 2,965,989	$ 57,346	$ 3,023,335	$ 2,037,468	$ -	$ 5,060,803	$ (313,298)	$ 4,747,505
22	Staff Rate Base (ICC Staff IB Appendix, Sch. 3, col. d)								$ 54,071,798
23	Staff Overall Rate of Return (ICC Staff Exhibit 9.0, Schedule 9.01)								8.78%
24	Revenue Change								$ 2,888,192
25	Percentage Revenue Change								21.44%

Aqua Illinois, Inc. - Kankakee Division

Statement of Operating Income with Adjustments

For the Test Year Ending December 31, 2007

Line No.	Description	Company Direct Pro Forma Proposed (Co. Sch. C-1)	287 Update: Part 287 Filing Change (Attachment D-2)	287 Update: Company Part 287 Update Pro Forma Proposed (Co. Ex. R-2.1)	Modified Adjustments: Additional Retirements (Response to MHE 9.03 2nd revised)	Modified Adjustments: Affiliated Interests (Aqua Ex. 7.0)	Modified Adjustments: Rate Case Expense (Response to MHE 9.03 2nd revised)	New Adjustments: Call Center Expense (Aqua Ex. 7.0)	New Adjustments: Kankakee Franchise Tax (Aqua Ex. 7.0)	Revenues: Revenues	Interest Synchronization	Company Rebuttal Pro Forma Proposed (sum d thru k)	Difference (Rounding)	Company Rebuttal Pro Forma Proposed (Co. Ex. 7.14)	Remove Company Proposed Increase (Co. Ex. 7.14)	Company Rebuttal Pro Forma Present (o-p)
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(m)	(n)	(o)	(p)	
										-	-		-			
1	Operating Revenues	$ 17,057,913	$ 181,109	17,239,022	$ -	$ -	$ -	$ -	$ -	$ (146,214)	$ -	$ 17,092,808	$ -	$ 17,092,808	$ 3,389,991	$ 13,702,817
2		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
3	Total Operating Revenue	17,057,913	181,109	17,239,022	-	-	-	-	-	(146,214)	-	17,092,808	-	17,092,808	3,389,991	13,702,817
4	Uncollectible Expense	157,920	1,677	159,597	-	-	-	-	-	(1,354)	-	158,243	-	158,243	31,385	126,858
5	Wages & Salaries	1,425,890	-	1,425,890	-	-	-	-	-	-	-	1,425,890	-	1,425,890	-	1,425,890
6	Employee Benefits	561,039	-	561,039	-	-	-	-	-	-	-	561,039	-	561,039	-	561,039
7	Contractual Services	1,813,119	-	1,813,119	-	-	-	(105,638)	-	-	-	1,707,481	-	1,707,481	-	1,707,481
8	Operation & Maintenence Expense	2,008,358	-	2,008,358	-	-	-	-	-	-	-	2,008,358	-	2,008,358	-	2,008,358
9	Depreciation & Amortization Expense	2,317,706	34,954	2,352,660	(834)	-	-	-	-	-	-	2,351,826	(1)	2,351,825	-	2,351,825
10	Regulatory Expense	149,250	-	149,250	-	-	(7,520)	-	-	-	-	141,730	-	141,730	-	141,730
11	Taxes Other than Income	748,882	-	748,882	-	-	-	-	14,625	-	-	763,507	-	763,507	-	763,507
12	Miscellaneous Expense	946,336	-	946,336	-	(44,367)	-	-	-	-	-	901,969	-	901,969	-	901,969
13		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
14		-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
15	Total Operating Expense															
16	Before Income Taxes	10,128,500	36,631	10,165,131	(834)	(44,367)	(7,520)	(105,638)	14,625	(1,354)	-	10,020,043	(1)	10,020,042	31,385	9,988,657
17	State Income Tax	375,802	7,840	383,642	61	3,239	549	7,712	(1,068)	(10,575)	21	383,581	-	383,581	242,655	140,926
18	Federal Income Tax	1,670,261	34,843	1,705,104	271	14,395	2,440	34,274	(4,745)	(47,000)	94	1,704,833	(1)	1,704,832	1,078,483	626,349
19	Deferred Taxes and ITCs Ne	(19,104)	-	(19,104)	-	-	-	-	-	-	-	(19,104)	-	(19,104)	-	(19,104)
20	Total Operating Expenses	12,155,459	79,314	12,234,773	(502)	(26,733)	(4,531)	(63,652)	8,812	(58,929)	115	12,089,353	(2)	12,089,351	1,352,523	10,736,828
21	NET OPERATING INCOME	$ 4,902,454	$ 101,795	$ 5,004,249	$ 502	$ 26,733	$ 4,531	$ 63,652	$ (8,812)	$ (87,285)	$ (115)	$ 5,003,455	$ 2	$ 5,003,457	$ 2,037,468	$ 2,965,989

Aqua Illinois, Inc. - Kankakee Division

Adjustments to Operating Income

For the Test Year Ending December 31, 2007

Line No.	Description	Interest Synchronization (ICC Staff Ex. 7.0 4R, Sch. 7.05)	Rate Case Expense (ICC Staff Ex. 13.0)	Incentive Compensation Expense (ICC Staff Ex. 7.0 4R, Sch. 7.09)	Sludge Hauling Expense (ICC Staff Initial Brief)	Contractual Services-Other Expense (Not Applicable)	Utility Plant in Service Depreciation Expense (Not Applicable)	Miscellaneous Expense-Charitiable Contributions (ICC Staff Ex. 8.0, Sch. 8.02)	Subtotal Operating Statement Adjustments
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(j)	(k)
1	Operating Revenues	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
2		-	-	-	-	-	-	-	-
3	Total Operating Revenue	-	-	-	-	-	-	-	-
4	Uncollectible Expense	-	-	-	-	-	-	-	-
5	Wages & Salaries	-	-	(71,876)	-	-	-	-	(71,876)
6	Employee Benefits	-	-	-	-	-	-	-	-
7	Contractual Services	-	-	-	(12,195)	-	-	-	(12,195)
8	Operation & Maintenence Expense	-	-	-	-	-	-	-	-
9	Depreciation & Amortization Expense	-	-	-	-	-	-	-	-
10	Regulatory Expense	-	(33,976)	-	-	-	-	-	(33,976)
11	Taxes Other than Income	-	-	-	-	-	-	-	-
12	Miscellaneous Expense	-	-	-	-	-	-	(6,563)	(6,563)
13		-	-	-	-	-	-	-	-
14		-	-	-	-	-	-	-	-
15	Total Operating Expense								
16	Before Income Taxes	-	(33,976)	(71,876)	(12,195)	-	-	(6,563)	(124,610)
								-	
17	State Income Tax	3,204	2,480	5,247	890	-	-	479	12,300
18	Federal Income Tax	14,242	11,024	23,320	3,957	-	-	2,129	54,672
19	Deferred Taxes and ITCs Net	-	-	-	-	-	-	-	-
20	Total Operating Expenses	17,446	(20,472)	(43,309)	(7,348)	-	-	(3,955)	(57,638)
21	NET OPERATING INCOME	$ (17,446)	$ 20,472	$ 43,309	$ 7,348	$ -	$ -	$ 3,955	$ 57,638

Aqua Illinois, Inc. - Kankakee Division

Adjustments to Operating Income

For the Test Year Ending December 31, 2007

Line No.	Description	Subtotal (page 1)	Miscellaneous Expense-Advertising (ICC Staff Ex. 8.0, Sch. 8.03)	Miscellaneous Expense-Affilate Transactions (Not Applicable)	Industry Association Dues (ICC Staff Ex. 8.0, Sch. 8.05)	Power and Chemical Expense (ICC Staff Ex. 11.0 R, Sch. 11.03)	Amortization Expense CIAC (ICC Staff Ex. 7.0 4R Sch. 7.12)	Franchise Taxes (ICC Staff Ex. 11.0 R, p. 13)	Subtotal Operating Statement Adjustments
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(j)	(k)
1	Operating Revenues	$ -	$ -	$ -	$ -	$ -	$ -	$ (52,431)	$ (52,431)
2		-	-	-	-	-	-	-	-
3	Total Operating Revenue	-	-	-	-	-	-	(52,431)	(52,431)
4	Uncollectible Expense	-	-	-	-	-	-	(485)	(485)
5	Wages & Salaries	(71,876)	-	-	-	-	-	-	(71,876)
6	Employee Benefits	-	-	-	-	-	-	-	-
7	Contractual Services	(12,195)	-	-	-	-	-	-	(12,195)
8	Operation & Maintenence Expense	-	-	-	-	(120,534)	-	-	(120,534)
9	Depreciation & Amortization Expense	-	-	-	-	-	1,656	-	1,656
10	Regulatory Expense	(33,976)	-	-	-	-	-	-	(33,976)
11	Taxes Other than Income	-	-	-	-	-	-	(54,004)	(54,004)
12	Miscellaneous Expense	(6,563)	(33,396)	-	(1,571)	-	-	-	(41,530)
13		-	-	-	-	-	-	-	-
14		-	-	-	-	-	-	-	-
15	Total Operating Expense								
16	Before Income Taxes	(124,610)	(33,396)	-	(1,571)	(120,534)	1,656	(54,489)	(332,944)
17	State Income Tax	12,300	2,438	-	115	8,799	(121)	150	23,681
18	Federal Income Tax	54,672	10,835	-	510	39,107	(537)	668	105,255
19	Deferred Taxes and ITCs Net	-	-	-	-	-	-	-	-
20	Total Operating Expenses	(57,638)	(20,123)	-	(946)	(72,628)	998	(53,671)	(204,008)
21	NET OPERATING INCOME	$ 57,638	$ 20,123	$ -	$ 946	$ 72,628	$ (998)	$ 1,240	$ 151,577

Aqua Illinois, Inc. - Kankakee Division

Adjustments to Operating Income

For the Test Year Ending December 31, 2007

Line No.	Description	Subtotal (Page 2)	Contingencies Depreciation Expense (ICC Staff Ex. 8.0, Sch. 8.06)	Date in Svc. Depreciation Expense (Not Applicable)	Canceled Plant Depreciation Expense (ICC Staff Ex. 8.0, Sch. 8.08)	Miscellaneous Other Exp. (ICC Staff Ex. 8.0, Sch. 8.09)	287 Filing (ICC Staff Initial Brief)	Disallowed Obsolete Utility Plant (ICC Staff Initial Brief)	Total Operating Statement Adjustments
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(j)	(k)
1	Operating Revenues	$ (52,431)	$ -	$ -	$ -	$ -	$ (181,109)	$ -	$ (233,540)
2		-	-	-	-	-	-	-	-
3	Total Operating Revenue	(52,431)	-	-	-	-	(181,109)	-	(233,540)
4	Uncollectible Expense	(485)	-	-	-	-	(1,677)	-	(2,162)
5	Wages & Salaries	(71,876)	-	-	-	-	-	-	(71,876)
6	Employee Benefits	-	-	-	-	-	-	-	-
7	Contractual Services	(12,195)	-	-	-	-	-	-	(12,195)
8	Operation & Maintenence Expense	(120,534)	-	-	-	-	-	-	(120,534)
9	Depreciation & Amortization Expense	1,656	(8,166)	-	(428)	-	(34,954)	(2,083)	(43,975)
10	Regulatory Expense	(33,976)	-	-	-	-	-	-	(33,976)
11	Taxes Other than Income	(54,004)	-	-	-	-	-	-	(54,004)
12	Miscellaneous Expense	(41,530)	-	-	-	(1,876)	-	-	(43,406)
13		-	-	-	-	-	-	-	-
14		-	-	-	-	-	-	-	-
15	Total Operating Expense								
16	Before Income Taxes	(332,944)	(8,166)	-	(428)	(1,876)	(36,631)	(2,083)	(382,128)
17	State Income Tax	23,681	596	-	31	137	(7,840)	152	16,757
18	Federal Income Tax	105,255	2,649	-	139	609	(34,843)	676	74,485
19	Deferred Taxes and ITCs Net	-	-	-	-	-	-	-	-
20	Total Operating Expenses	(204,008)	(4,921)	-	(258)	(1,130)	(79,314)	(1,255)	(290,886)
21	NET OPERATING INCOME	$ 151,577	$ 4,921	$ -	$ 258	$ 1,130	$ (101,795)	$ 1,255	$ 57,346

Aqua Illinois, Inc. - Kankakee Division

Rate Base

For the Test Year Ending December 31, 2007

Line No.	Description	Company Rebuttal Pro Forma (ICC Staff IB Appendix, Sch. 3, p. 2)	Staff Adjustments (ICC Staff IB Appendix, Sch. 4)	Staff Pro Forma Rate Base (Col. b+c)
	(a)	(b)	(c)	(d)
1	Utility Plant in Service	$ 90,620,033	$ (1,540,419)	$ 89,079,614
2	Accum. Amortization and Depreciation	(22,387,566)	51,087	(22,336,479)
3		-	-	-
4	Net Plant	68,232,467	(1,489,332)	66,743,135
5	Additions to Rate Base			
6	Deferred Charges	568,361	-	568,361
7	Materials & Supplies	516,575	-	516,575
8	Cash Working Capital	900,924	(37,751)	863,173
9	Amortization of CIAC	2,455,356	-	2,455,356
10		-	-	-
11		-	-	-
12		-	-	-
13		-	-	-
14		-	-	-
15		-	-	-
16	Deductions From Rate Base	-	-	-
17	FAS 87 Pension	(807,588)	-	(807,588)
18	Customer Advances	(530,566)	-	(530,566)
19	CIAC	(10,715,694)	87,612	(10,628,082)
20	Deferred Income Taxes	(5,161,956)	53,390	(5,108,566)
21		-	-	-
22		-	-	-
23	Rate Base	$ 55,457,879	$ (1,386,081)	$ 54,071,798

Aqua Illinois, Inc. - Kankakee Division

Rate Base

For the Test Year Ending December 31, 2007

			Part 287 Filing		Rebuttal Adjustments			
		Company Direct	Part 287 Filing	Company Part 287 Update	Adjustments			Company Rebuttal
Line No.	Description	Pro Forma Present (Co. Sch. B-1)	Change (Attachment D-2)	Pro Forma Proposed (Co. Ex. R-2.1)	Additional Retirements Co. Ex. 7.0	Cash Working Capital -	Unexplained Difference -	Pro Forma Rate Base (Co. Ex. 7.14)
	(a)	(b)	(c)		(d)	(e)		(d)
1	Utility Plant in Service	$ 89,412,098	$ 1,216,542	$ 90,628,640	$ (8,608)	$ -	$ (1)	$ 90,620,033
2	Accum. Amortization and Depreciation	(22,347,595)	(49,831)	(22,397,426)	8,608	-	(1,252)	(22,387,566)
3		-	-	-	-	-	-	-
4	Net Plant	$ 67,064,503	$ 1,166,711	$ 68,231,214	$ -	$ -	$ (1,253)	$ 68,232,467
5	Additions to Rate Base							
6	Deferred Charges	568,361	-	568,361	-	-	-	568,361
7	Materials & Supplies	516,575	-	516,575	-	-	-	516,575
8	Cash Working Capital	911,110	-	911,110	-	(10,186)	-	900,924
9	Amortization of CIAC	2,455,356	-	2,455,356	-	-	-	2,455,356
10		-	-		-	-	-	-
11	Deductions From Rate Base	-	-		-	-	-	-
12	FAS 87 Pension	(807,588)	-	(807,588)	-	-	-	(807,588)
13	Customer Advances	(530,566)	-	(530,566)	-	-	-	(530,566)
14	CIAC	(10,715,694)	-	(10,715,694)	-	-	-	(10,715,694)
15	Deferred Income Taxes	(5,123,683)	(38,426)	(5,162,109)	-	-	(153)	(5,161,956)
16		-	-		-	-	-	-
17		-	-	-	-	-	-	-
18	Rate Base	$ 54,338,374	$ 1,128,285	$ 55,466,659	$ -	$ (10,186)	$ (1,406)	$ 55,457,879

Aqua Illinois, Inc. - Kankakee Division
Adjustments to Rate Base
For the Test Year Ending December 31, 2007

Line No.	Description	Cash Working Capital (ICC Staff Ex. 7.0 4R Sch. 7.07)	Not Used and Useful Plant (Not Applicable)	Not Used and Useful Plant Accumulated Depreciation (Not Applicable)	Not Used and Useful Plant Accumulated Deferred Income Tax (Not Applicable)	CIAC-PFC Charge (ICC Staff Ex. 7.0 4R Sch. 7.12)	Contingencies Plant (ICC Staff Ex. 8.0, Sch. 8.06)	Date in Svc. Plant (Not Applicable)	Subtotal Rate Base Adjustments
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(k)
1	Utility Plant in Service	$ -	$ -	$ -	$ -	$ -	$ (245,251)	$ -	$ (245,251)
2	Accum. Amortization and Depreciation	-	-	-	-	-	-	-	-
3		-	-	-	-	-	-	-	-
4	Net Plant	-	-	-	-	-	(245,251)	-	(245,251)
5	Additions to Rate Base								-
6	Deferred Charges	-	-	-	-	-	-	-	-
7	Materials & Supplies	-	-	-	-	-	-	-	-
8	Cash Working Capital	(37,751)	-	-	-	-	-	-	(37,751)
9	Amortization of CIAC	-	-	-	-	-	-	-	-
10		-	-	-	-	-	-	-	-
11		-	-	-	-	-	-	-	-
12		-	-	-	-	-	-	-	-
13		-	-	-	-	-	-	-	-
14		-	-	-	-	-	-	-	-
15		-	-	-	-	-	-	-	-
16	Deductions From Rate Base	-	-	-	-	-	-	-	-
17	FAS 87 Pension	-	-	-	-	-	-	-	-
18	Customer Advances	-	-	-	-	-	-	-	-
19	CIAC	-	-	-	-	87,612	-	-	87,612
20	Deferred Income Taxes	-	-	-	-	-	14,180	-	14,180
21		-	-	-	-	-	-	-	-
22		-	-	-	-	-	-	-	-
23	Rate Base	$ (37,751)	$ -	$ -	$ -	$ 87,612	$ (231,071)	$ -	$ (181,210)

Aqua Illinois, Inc. - Kankakee Division

Adjustments to Rate Base

For the Test Year Ending December 31, 2007

Line No.	Description	Subtotal (page 1)	Canceled Plant (ICC Staff Ex. 8.0, Sch. 8.06)	WTP AFUDC Rate Error Correction (ICC Staff Initial Brief)	Canceled Plant Accumulated Depreciation (ICC Staff Initial Brief)	287 Filing (ICC Staff Initial Brief)	Disallowed Obsolete Utility Plant (ICC Staff Initial Brief)	-	Total Rate Base Adjustments
	(a)	(l)	(m)	(n)	(o)	(p)	(q)	(r)	(u)
1	Utility Plant in Service	$ (245,251)	$ (13,660)	$ (6,618)	$ -	$ (1,216,542)	$ (58,348)	$ -	$ (1,540,419)
2	Accum. Amortization and Depreciation	-	-	-	214	49,831	1,042	-	51,087
3		-	-	-	-	-	-	-	-
4	Net Plant	(245,251)	(13,660)	(6,618)	214	(1,166,711)	(57,306)	-	(1,489,332)
5	Additions to Rate Base						-	-	-
6	Deferred Charges	-	-	-	-	-	-	-	-
7	Materials & Supplies	-	-	-	-	-	-	-	-
8	Cash Working Capital	(37,751)	-	-	-	-	-	-	(37,751)
9	Amortization of CIAC	-	-	-	-	-	-	-	-
10		-	-	-	-	-	-	-	-
11		-	-	-	-	-	-	-	-
12		-	-	-	-	-	-	-	-
13		-	-	-	-	-	-	-	-
14		-	-	-	-	-	-	-	-
15		-	-	-	-	-	-	-	-
16	Deductions From Rate Base	-	-	-	-	-	-	-	-
17	FAS 87 Pension	-	-	-	-	-	-	-	-
18	Customer Advances	-	-	-	-	-	-	-	-
19	CIAC	87,612	-	-	-	-	-	-	87,612
20	Deferred Income Taxes	14,180	784	-	-	38,426	-	-	53,390
21		-	-	-	-	-	-	-	-
22		-	-	-	-	-	-	-	-
23	Rate Base	$ (181,210)	$ (12,876)	$ (6,618)	$ 214	$ (1,128,285)	$ (57,306)	$ -	$ (1,386,081)