Rebuttal Testimony

of

Mike Luth

Rates Department

Financial Analysis Division

Illinois Commerce Commission

Aqua Illinois, Inc.

Petition for the Issuance of Certificate of Public
Convenience and Necessity to Operate Water Systems;
Approval of Asset Purchase Agreement;
Approval of Rates and Accounting Entries; and
Approval of a Variance to the Standard Main Extension Rules

Docket No. 07-0296

November 15, 2007

INTRODUCTION

Q. Please state your name and business address.

A. My name is Mike Luth. My business address is 527 East Capitol Avenue, Springfield, Illinois 62701.

Q. Are you the same Mike Luth who previously submitted Direct Testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your Rebuttal Testimony in this proceeding?

A. The purpose of my Rebuttal Testimony is to respond to the Rebuttal Testimony of Aqua Illinois, Inc. ("Aqua" or "Company") witness Gerard Connolly. Primarily, I will respond to Mr. Connolly's comments concerning my evaluation and recommendations for Illinois Commerce Commission ("Commission") approval of Aqua's proposed Large General Service tariff for the Kankakee Water Division.

Q. Did Mr. Connolly's Rebuttal Testimony indicate that Aqua agrees to account for revenues from, and plant additions to, the proposed acquisition of the Village of Sun River Terrace ("Village" or "Sun River") system separate from other Kankakee Water Division communities?

A. Yes. While Aqua does not believe separate accounting for Village revenues and plant additions is necessary, Mr. Connolly's Rebuttal Testimony indicates that Aqua will account for revenues and plant additions from the proposed acquisition of the Sun River water system separate from revenues and plant additions at other Kankakee Water Division communities. (Aqua Exhibit 4.0, page 2, lines 46-50) The Commission should require Aqua to account for Village revenues and plant additions separate from other Kankakee communities to determine whether Sun River should pay rates different from those paid by other Kankakee customers. If Aqua's projections of Sun River revenues and plant additions are sufficiently accurate until the next general rates proceeding concerning the Kankakee Water Division, the Commission may eliminate the separate accounting requirement for Sun River revenues and plant additions. Given the difficulty Aqua's predecessor, Consumers Illinois Water Company of Illinois ("Consumers"), had in forecasting the costs of acquiring the Ivanhoe Club development in Docket No. 00-0366, and given the inconsistencies in Aqua's projection of revenues from the Village that I noted in Direct Testimony (ICC Staff Exhibit 5.0, pp. 4-5, lines 77-87), the Commission should reserve the opportunity to review whether rates paid by Kankakee ratepayers would be adversely affected by the acquisition of the Sun River system.

Q. What were the difficulties Consumers had in forecasting the costs of acquiring the Ivanhoe Club development ("Ivanhoe") compared to the costs that were subsequently reported?

A. As shown in the following charts, there were some significant differences between the forecast in the net utility plant in service at Ivanhoe and what Consumers/Aqua reported:

Forecast:

	Acquisition	End of Year 4	Decrease
Water	$ 1,368,483	$ 1,336,570	$ (31,913)
Sewer	$ 2,146,477	$ 1,888,876	$ (257,601)
Combined	$ 3,514,960	$ 3,225,446	$ (289,514)

Source: Consumers Illinois Water Company Exhibit H from Docket No. 00-0366

Reported:

	Acquisition	End of Year 3	Increase
Water	$ 406,050	$ 496,036	$ 89,986
Sewer	$ 1,234,679	$ 1,297,587	$ 62,908
Combined	$ 1,641,729	$ 1,793,623	$ 152,894

Source: Consumers/Aqua Form 22ILCC, Annual Report to the Commission for the years ended December 31, 2002 and December 31, 2005

Instead of the forecasted combined $289,514 decrease over the first four years in Ivanhoe net water and sewer utility plant in service under Consumers/Aqua ownership, Ivanhoe net water and sewer utility plant in service increased $152,894 over only three years. The difference between a forecasted $289,514 decrease in Docket No. 00-0366 and a reported $152,894 increase three years after acquisition is $442,408.

As a result of Staff's adjustments to recognize customer-financed plant in service prior to the Consumers/Aqua acquisition, the Commission's Order in Docket No. 00-0366 allowed only $1,098,615 in Ivanhoe combined net utility plant in service to be recorded at acquisition (Order, Docket No. 00-0366, pp. 9, 14, and 17, referencing ICC Staff Exhibit 3.0, Schedule 7 Revised), rather than $3,514,960 as proposed by Consumers. The $442,408 difference between the forecasted change in net utility plant in service compared to the reported change in net utility plant in service represents a difference of 40.27 percent of the authorized $1,098,615 acquisition balance. Additionally, Aqua's report of $1,793,623 net Ivanhoe combined plant in service was $695,008 higher than the Commission-authorized recorded acquisition balance of $1,098,615. Not only did Aqua report changes in net utility plant in service considerably different from its forecast in Docket No. 00-0366, but Aqua did not record the balances at acquisition that were authorized by the Commission. Clearly, there were some significant inconsistencies in the forecast of and accounting for Ivanhoe plant in service.

Q. Do you agree with Mr. Connolly's claim that the idea of Aqua separately tracking Sun River revenues and costs is against the principle of rate consolidation and creates unnecessary administrative burdens? (Aqua Exhibit 4.0, page 3, lines 57-60)

A. No, I do not. Aqua has a separate set of rates in effect for the previously discussed 115 to 245 residential customer Ivanhoe system. Additionally, Aqua has separate sets of rates in effect at the 2,600 customer Oak Run system, the 282 to 491 customer Hawthorn Woods system, the 1,770 customer Candlewick system, and the 133 customer Ravenna Woods system. I am not recommending separate rates at Sun River at this time, but if the Sun River revenues and cost forecasts in this docket are significantly under what revenues and costs result, rates paid by current Kankakee customers could be adversely affected by the purchase of the Sun River system when Kankakee rates are again under review at the Commission. While the goal of rate consolidation may be worthwhile from Aqua's administrative viewpoint, at this time, that goal is outweighed by a follow-up evaluation of the effect of Sun River costs and revenues on rates paid by current Kankakee customers.

<u>Large General Service rate</u>

Q. Do you agree with Mr. Connolly's assertion that the addition of the Alternative Energy Sources ("AES") ethanol facility will result in lower future rate increases for Kankakee customers?

A. According to the projections shown in Mr. Connolly's Direct Testimony (Aqua Exhibit 1.10), the AES facility could result in smaller increases at the Kankakee Water Division through the year 2011. Assuming those projections are accurate, the Large General Service rate applicable to the AES facility could have a positive effect on rates applicable to other Kankakee customers.

Q. Have you revised your estimate of the recovery of incremental costs from the AES facility, including a 25 percent of full cost recovery contribution to source of supply and water treatment plant?

A. Yes, I have as shown on the attached ICC Staff Exhibit 7.1. I have revised units of usage to the minimum required billed usage of 35,000 ccf, rather than converting 35,000 thousand-gallon units into ccf as was mistakenly done on ICC Staff Exhibit 5.1 in Direct Testimony. Additionally, I have reduced the amount of financial costs resulting from the extension to the AES facility and contribution to

Source of Supply and Water Treatment plant. The estimate I provided in Direct Testimony overstated the level of income taxes resulting from the Aqua capital structure.

Q. Do the results of your revised analysis of the AES facility revenues and costs differ from the results of Aqua Exhibit 1.10?

A. Yes, the results of my revised analysis differ somewhat from the results of Aqua Exhibit 1.10. My analysis of the AES facility revenues and costs begins with somewhat different assumptions than Aqua Exhibit 1.10. I estimated revenues and costs based upon the minimum required billed usage per month and the maximum estimated volume of 2 million gallons per day. My approach is designed to provide a view of the range of outcomes from differences in billings to AES at different usage levels. As shown, at the minimum billed usage, the AES facility does not cover the cost of adding the necessary plant to serve AES. At the maximum estimated usage, the AES facility provides a favorable return on the added plant necessary to serve AES if the expected contribution to Source of Supply and Water Treatment plant is only 25 percent of full cost of service allocated according to usage.

Q. What levels of usage are assumed in Aqua Exhibit 1.10?

A. Based upon the difference in estimated revenues with the Large User Rate Plan (page 1 of Aqua Exhibit 1.10) and without the ethanol plant (page 2 of Aqua Exhibit 1.10), for the years 2009, 2010, and 2011, it appears that Aqua is assuming that AES will respectively use 48.15 percent, 94.92 percent, and 76.93 percent of the maximum estimated usage of 2 million gallons per day. By comparison, the minimum billed usage is 43.06 percent of the maximum estimated usage.

Q. What conclusion can the Commission draw from the differences in your calculation and Aqua's calculation of return on incremental plant to serve AES?

A. Since both calculations are estimates, there is no certainty that AES will affect revenues and expenses in the manner shown on either my estimate or Aqua's estimate. Aqua Exhibit 1.10 indicates that AES usage is expected to vary, and my estimate shows that any benefit or subpar cost recovery that Aqua will experience with the addition of the AES facility will be affected by differences in AES usage. Since rates for other Kankakee customers have been recently reviewed before the Commission, current rates are likely to remain in effect and unaffected in the short-term future regardless of whether the Commission approves the proposed Large General Service rate. In future reviews of Kankakee rates, however, other Kankakee customers should not be expected to provide revenues to allow a discount to AES if AES usage, and therefore revenues from AES, is less than Aqua has shown it expects in this docket.

Q. What effect would a 4-inch meter have on revenues from AES compared to a 12-inch meter?

A. Depending upon whether a 4-inch positive displacement meter or turbine meter was installed, annual customer charge revenues would be either $19,807 or $20,523 lower with a 4-inch meter compared to a 12-inch meter. The current monthly 4-inch meter customer charge at Kankakee is $306.79 for a positive displacement meter and $366.51 for a turbine meter compared to the current 12-inch meter customer charge of $2,017.08 per month. Mr. Connolly discusses Aqua’s objection to a requirement that a Large General Service customer have a 12-inch meter. (Aqua Exhibit 4.0, page 4, lines 85-100)

If a meter smaller than 12-inches in diameter is installed at the AES facility, the minimum monthly charge should remain at the assumed 12-inch meter customer charge and 35,000 ccf in billed usage for a total of $33,958 exclusive of the Qualifying Infrastructure Plant Surcharge, fire protection charges, and state and local taxes and fees. At that minimum charge, revenues from the Large General Service rate will be consistent with the assumptions in Aqua Exhibits 1.9 and 1.10, and with the estimate of revenues that I developed in ICC Staff Exhibit 7.1.

Q. Should the proposed Large General Service tariff include a provision that rates are subject to revision as a result of a Commission Order, regardless of whether the 4-year service agreement with Aqua has expired?

A. Yes, the proposed Large General Service tariff should include a provision that rates are subject to revision as a result of a Commission Order, regardless of whether the 4-year service agreement with Aqua has expired. Mr. Connolly indicates that Aqua does not believe it is necessary to specify in the Large General Service tariff that rates are subject to revision as a result of a Commission Order. (Aqua 4.0, pp. 3-4, lines 76-84) A provision in the tariff that rates are subject to revision clarifies to the public and potential Large General Service customers that rates described in the required 4-year service agreement are subject to revision. A required 4-year service agreement could imply that rates would be in effect for the duration of the agreement. If the tariff specifies that rates are subject to revision, it is clear that any agreement between Aqua and the customer is subordinate to the tariff with respect to rates. Since Mr. Connolly indicates that Aqua is willing to include a provision in any agreement with a Large General Service customer that rates are subject to revision as a result of Commission action, it is somewhat puzzling that Aqua objects to a clarification within the tariff that rates are subject to change by Commission action before the expiration of the 4-year service agreement.

Q. Please summarize your recommendations for the proposed Large General Service rate.

A. The Commission should:

- approve the Large General Service rate, with the advisory that other Kankakee ratepayers should not be held responsible for providing a discount to customers that qualify for the Large General Service rate but do not provide revenues that result in adequate cost recovery,

- specify that the minimum monthly charge in the Large General Service rate should be $33,958 exclusive of the Qualifying Infrastructure Plant Surcharge, fire protection charges, and state and local taxes and fees, regardless of the diameter of meter installed, and

- specify within the tariff that rates are subject to revision as a result of Commission action before the expiration of the required 4-year service agreement.

Q. Does this conclude your prepared Rebuttal Testimony?

A. Yes.

Aqua Illinois, Inc.

Analysis of Cost Recovery under Company-proposed
Large General Service Rate

For the Kankakee Southern Expansion Area

Summary:

Line No.	Minimum Usage	Estimated Usage	
1	$ 470,746	$ 470,746	Return and Income Taxes on incremental ethanol facility plant in service
2	$ 117,130	$ 272,018	Incremental Purchased Power and Chemicals
3	$ 75,600	$ 75,600	Depreciation on incremental ethanol facility plant in service
4	$ 27,845	$ 57,700	25 percent of full cost of service share of margin on source of supply and water treatment plant in service
5	$ 8,302	$ 17,203	25 percent of full share of cost of service depreciation on source of supply and water treatment plant in service
6	$ 699,622	$ 893,267	Total expenses and 25 percent of full cost of service share of margin on source of supply and water treatment plant in service
7	$ (407,497)	$ (914,356)	less: billed revenues
8	$ 292,125	$ (21,089)	Additional Revenue necessary to recover incremental costs and 25 percent of full cost of service share of margin on source of supply and water treatment plant in service
9	420,000	975,401	divided by: billed ethanol facility annual usage
10	$ 0.69554	$ (0.02162)	Additional charge per CCF necessary to recover incremental costs and 25 percent of full cost of service share of margin on source of supply and water treatment plant in service

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Line No.	Minimum Usage	Estimated Usage	
11	$ 111,380	$ 230,801	Full cost of service share of margin on source of supply and water treatment plant in service
12	$ 33,207	$ 68,812	Full share of cost of service depreciation on source of supply and water treatment plant in service
13	$ 808,063	$ 1,117,977	Total expenses and full cost of service share of margin and depreciation on source of supply and water treatment plant in service (line nos. 1-3, 11, and 12)
14	$ (407,497)	$ (914,356)	less: billed revenues
15	$ 400,566	$ 203,621	Additional Revenue necessary to recover incremental costs and full cost of service share of margin on source of supply and water treatment plant in service
16	420,000	975,401	divided by: billed ethanol facility annual usage
17	$ 0.95373	$ 0.20876	Additional charge per CCF necessary to recover incremental costs and full cost of service share of margin and depreciation on source of supply and water treatment plant in service

Aqua Illinois, Inc.

Analysis of Cost Recovery under Company-proposed
Large General Service Rate

For the Kankakee Southern Expansion Area

Line No.						
	Minimum Revenues to be received:					
1	Customer Charge	$ 2,017.08	12		$ 24,204.96	1 12-inch meter
2	Usage Charge	$ 0.9126	35,000	12	$ 383,292.00	35,000 ccf monthly minimum
3	Total annual minimum revenues				$ 407,496.96	
	Estimated Revenues to be received:					
4	Customer Charge	$ 2,017.08	12		$ 24,204.96	1 12-inch meter
5	Usage Charge	$ 0.9126	81,283	12	$ 890,151.02	2 million gallons per day, 30.4 days per month
6	Total estimated annual revenues				$ 914,355.98	

Return and Income Taxes on $4 million plant installation to serve ethanol facility:

Line No.	Amount	Description
7	$ 4,000,000	
8	0.02664	weighted cost of debt, docket no. 06-0285
9	$ 106,560	Interest cost
10	0.0549	weighted cost of equity, docket no. 06-0285
11	$ 219,440	
12	0.6026	divided by: income taxes conversion factor
13	$ 364,186	additional necessary pre-income tax margin
14	$ 106,560	Interest cost
15	$ 470,746	Financial costs of additional ethanol-related plant

Additional Purchased Power and Chemicals to service ethanol facility:

Line No.	Amount	Description
16	$ 635,546	docket no. 06-0285 purchased power -- pumping and water treatment
17	427,621	docket no. 06-0285 chemicals -- water treatment
18	102,568	docket no. 06-0285 materials and supplies -- water treatment
19	$ 1,165,735	
20	4,180,059	divided by: docket no. 06-0285 usage in ccf
21	$ 0.2789	purchased power, chemicals, and materials and supplies per ccf

Line No.	Minimum Usage Billed	Estimated Usage Billed	
22	$ 0.2789	$ 0.2789	purchased power, chemicals, and materials and supplies per ccf
23	35,000	81,283	multiplied by: monthly ccf
24	$ 9,760.80	$ 22,668.21	additional operating costs
25	12	12	multiplied by: 12 months
26	$ 117,130	$ 272,018	additional annual operating costs at minimum usage billing

Depreciation on Additional Plant to serve ethanol facility:

Line No.	Plant Balance	Depreciation Rate	Incremental Depreciation Expense	
27	$ 4,000,000	0.0189	$ 75,600	from Docket No. 06-0285, Mains depreciation rate

Aqua Illinois, Inc.

Analysis of Cost Recovery under Company-proposed
Large General Service Rate

For the Kankakee Southern Expansion Area

Line No.

Return and Income Taxes on Source of Supply and Treatment Plant in Service to serve ethanol facility:

Line No.	Amount	Description
28	$ 10,365,640	docket no. 06-0285 net cost of source of supply and treatment plant
29	0.02664	weighted cost of debt
30	$ 276,141	Interest cost
31	0.05486	weighted cost of equity
32	$ 568,659	
33	0.60255	divided by: income taxes conversion factor, docket no. 06-0285
34	$ 943,754	pre-income tax margin
35	$ 276,141	Interest cost
36	$ 1,219,895	Financial coverage on net source of supply and treatment plant

Line No.	Minimum Usage Billed	Estimated Usage Billed	Description
37	35,000	81,283	Monthly billed CCF
38	12	12	multiplied by: 12 months
39	420,000	975,401	Annual billed CCF
40	4,180,059	4,180,059	divided by: docket no. 06-0285 usage
41	0.10048	0.23335	percentage of docket no. 06-0285 usage
42	1.00000	1.00000	plus: 1
43	1.10048	1.23335	increase in docket no. 06-0285 usage to include ethanol facility
44	0.09130	0.18920	ethanol facility percentage of adjusted docket no. 06-0285 usage
45			pre-income tax margin on source of supply and
46	$ 1,219,895	$ 1,219,895	water treatment plant in service
			full cost of service share of source of supply and
47	$ 111,380	$ 230,801	water treatment plant in service margin
48	0.25	0.25	multiplied by: 25 percent of full cost of service
			25 percent of full cost of service share of source of supply and
49	$ 27,845	$ 57,700	water treatment plant in service margin

Depreciation on Source of Supply and Treatment Plant in Service to serve ethanol facility:

Line No.	Description	Minimum Usage Billed	Estimated Usage Billed	Source
50	Source of Supply Plant Depreciation	$ 7,215	$ 7,215	from Docket No. 06-0285
51	Water Treatment Plant Depreciation	$ 356,488	$ 356,488	from Docket No. 06-0285
52		$ 363,703	$ 363,703	
53	Multiplied by: Percentage of Ethanol Facility CCF	0.09130	0.18920	
	Full share of Source of Supply and Water Treatment			
54	Plant Depreciation	$ 33,207	$ 68,812	
55	Multiplied by: 25 percent	0.25	0.25	
	25 percent of Full share of Source of Supply and			
56	Water Treatment Plant Depreciation	$ 8,302	$ 17,203	