

13 **Summary of Testimony**

14 **Q WHAT IS THE SUBJECT MATTER OF YOUR TESTIMONY?**

15 A My testimony will address Illinois-American's proposed depreciation rates and
16 expense. Specifically, I will address the net salvage ratios used to develop the
17 depreciation rates for selected water plant accounts. In addition, I will comment on
18 the Company's across-the-board revenue increase proposal. The fact that an issue
19 is not addressed should not be construed as an endorsement of Illinois-American's
20 position on that issue.

21 **Q PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATIONS**
22 **CONCERNING ILLINOIS-AMERICAN'S PROPOSED DEPRECIATION RATES.**

23 A My conclusions and recommendations are summarized as follows:

- 24 1. Illinois-American's proposed depreciation rates are based on excessive net
25 salvage ratios. The net salvage ratios of specific water plant accounts produce an
26 annual net salvage expense of \$8.153 million. However, Illinois-American's
27 average actual annual net salvage expense associated with these same plant
28 accounts over the last ten years has been \$0.958 million. Adjusting this historical
29 net salvage expense for inflation produces an annual net salvage expense of
30 \$1.256 million. This indicates that Illinois-American's proposed depreciation rates
31 contain an annual net salvage expense that is 6.5 times larger than
32 Illinois-American's actual experience adjusted for inflation.
- 33 2. Illinois-American's net salvage component of its proposed depreciation rates
34 reflects estimates of future inflation, which unnecessarily raises rates for today's
35 ratepayers and produces intergenerational inequities. These inequities result
36 from shifting cost burdens to today's ratepayers from future ratepayers.
- 37 3. Illinois-American's proposed net salvage ratios differ considerably from net
38 salvage ratios proposed and/or adopted through settlement by other
39 American-Water affiliates in neighboring states.
- 40 4. I recommend that the Commission, at a minimum, use an average of the net
41 salvage ratios adopted by other American-Water affiliates to calculate
42 Illinois-American's depreciation rates in this case. Even under this proposal, the
43 annual net salvage component of the depreciation rates will be \$3.317 million.
44 This is 2.5 times greater than Illinois-American's actual net salvage expense,
45 adjusted for inflation.

46 5. Including net salvage ratios, which have been proposed and adopted through
47 settlements by other American-Water affiliates and other commissions, reduces
48 Illinois-American's water plant depreciation expense by \$5.792 million.

49 **Q PLEASE SUMMARIZE YOUR CONCLUSION AND RECOMMENDATION**
50 **CONCERNING ILLINOIS-AMERICAN'S PROPOSED ACROSS-THE-BOARD RATE**
51 **DESIGN METHODOLOGY.**

52 A I do not take issue with Illinois-American's proposed across-the-board rate change
53 methodology. However, based on changes to the Company's costs since its last rate
54 case, an across-the-board rate design approach likely over-allocates increased cost
55 to large customer classes.

56 **Book Depreciation**

57 **Q PLEASE EXPLAIN THE PURPOSE OF BOOK DEPRECIATION ACCOUNTING.**

58 A Book depreciation is a recognition in a utility's income statement of the consumption
59 or use of assets used to provide utility service. Book depreciation is recorded as an
60 expense and is included in the ratemaking formula or the overall utility's revenue
61 requirement.

62 Book depreciation provides for the recovery of the original cost of the utility's
63 assets that are providing service. Book depreciation expense is not intended to
64 provide for replacement of the current assets, but provide for capital recovery or
65 return on current investment. Generally, this capital recovery occurs over the
66 average service life of the investments or assets. As a result, it is critical that
67 appropriate average service lives be used to develop the depreciation rates so no
68 generation of ratepayers is disadvantaged.

69 In addition to capital recovery, depreciation rates also contain a provision for
70 net salvage. Net salvage is simply the scrap or reused value less the removal cost of
71 the asset being depreciated. A utility will recover the net salvage over the useful life
72 of the asset.

73 **Q WHAT METHOD, PROCEDURE AND TECHNIQUE WAS USED TO CALCULATE**
74 **THE PROPOSED DEPRECIATION RATES FOR ILLINOIS-AMERICAN?**

75 A According to the Company witness Earl M. Robinson, the proposed depreciation
76 rates were calculated using the straight-line method, the broad group procedure, and
77 the average remaining life technique (Robinson Direct, Ex. 9.0 at 11). In addition, the
78 Company has included net salvage in the development of its proposed book
79 depreciation rates.

80 **Q BEFORE YOU BEGIN YOUR DISCUSSION ON ILLINOIS-AMERICAN'S**
81 **PROPOSED DEPRECIATION RATES, PLEASE DEFINE NET SALVAGE.**

82 A As indicated previously, net salvage is simply the value received from the sale or
83 reuse of retired property (salvage value), less the cost of retiring such property (cost
84 of removal) at the end of its useful life. Net salvage can either be positive or
85 negative. If the salvage value exceeds the cost of removal, the net salvage is
86 positive. If the cost of removal is greater than the salvage value received as a result
87 of retirement, the resulting net salvage is negative. For Illinois-American, negative
88 net salvage is a significant component of its proposed depreciation rates and
89 expense.

90 **Illinois-American Depreciation Rates**

91 **Q WHAT IS ILLINOIS-AMERICAN REQUESTING IN THIS PROCEEDING**
92 **REGARDING ITS DEPRECIATION RATES?**

93 A Using water and wastewater plant asset information as of December 31, 2005,
94 Illinois-American is proposing to revise its book depreciation rates. The revised
95 depreciation rates are based on updated parameters for average service lives,
96 retirement dispersions and net salvage ratios. The Company applies its proposed
97 book depreciation rates to forecasted June 2009 average depreciable plant balance
98 amounts to derive the ratemaking depreciation expense. The result of this analysis
99 produces a depreciation expense of \$31.4 million, which is nearly \$7 million larger, or
100 30% greater than the actual June 2006 depreciation expense.

101 **Q PLEASE SUMMARIZE THE PROPOSED CHANGES THAT YOU WILL BE MAKING**
102 **TO ILLINOIS-AMERICAN'S PROPOSED WATER DEPRECIATION RATES.**

103 A I take no exception with the proposed life characteristics which Illinois-American has
104 utilized in the development of water plant depreciation rates. My proposed revisions
105 revolve around the Company's proposed net salvage ratios. My analysis of certain
106 water plant accounts indicates that the annual net salvage expense, which
107 Illinois-American is requesting be built into its proposed depreciation rates, is
108 significantly greater than actual annual net salvage expense experience. In addition,
109 when compared with recent depreciation rate filings made by other American-Water
110 affiliates in other jurisdictions, it is evident that Illinois-American's requested net
111 salvage is excessive. As a result, I am proposing changes to certain net salvage
112 ratios that Illinois-American proposed. My proposed net salvage ratios should be
113 used to develop Illinois-American's book and ratemaking depreciation rates.

114 Q HAVE YOU ANALYZED ALL OF THE NET SALVAGE RECOMMENDATIONS
115 PROPOSED BY ILLINOIS-AMERICAN?

116 A No. Because of budget and time considerations, I only reviewed the major water
117 plant accounts. The water plant accounts included in my analysis comprise of
118 approximately 70% of the total company-wide proposed water plant depreciation
119 expense.

120 Q PLEASE EXPLAIN YOUR RATIONALE FOR CHOOSING WHICH WATER PLANT
121 ACCOUNTS TO INCLUDE IN YOUR ANALYSIS.

122 A My net salvage study focuses solely on the water plant accounts that have a June
123 2009 proposed depreciation expense of at least \$1 million (see Revised
124 Schedule C-12). Using this criteria limited my analysis to the following plant
125 accounts:

- 126 1. Account 304.3 – Structures & Improvements – WT
- 127 2. Account 311.2 – Pumping Equipment – Electrical
- 128 3. Account 320.1 – Water Treatment (Non-M)
- 129 4. Account 331.0 – T&D Mains Conversion
- 130 5. Account 333.0 – Services
- 131 6. Account 334.11 – Meters Bronze Case
- 132 7. Account 334.2 – Meter Installations
- 133 8. Account 335.0 – Hydrants
- 134 9. Account 340.3 – Computer Software

135 Even though Account Nos. 334.11 (Meters Bronze Case) and 340.3
136 (Computer Software) fell within my identified criteria, I excluded the two accounts

137 from my analysis because Illinois-American assigned a zero net salvage ratio to both
138 of those accounts. Therefore, no analysis was required for those accounts.

139 **Q WHAT CHANGES DO YOU RECOMMEND TO ILLINOIS-AMERICAN'S WATER**
140 **DEPRECIATION RATES?**

141 A For the water plant accounts that I have analyzed, I recommend that, at a minimum,
142 the Commission adopt the net salvage ratios proposed and adopted through
143 settlement by other American-Water affiliates in other jurisdictions. This conservative
144 approach will provide Illinois-American with a net salvage component in its
145 depreciation rates that will exceed its recent actual net salvage experience.

146 **Water Plant Net Salvage**

147 **Q HOW DID ILLINOIS-AMERICAN DETERMINE ITS PROPOSED NET SALVAGE**
148 **RATIOS?**

149 A Company witness, Mr. Robinson, indicated that the proposed net salvage ratios were
150 derived using a combination of historical cost trends along with future anticipated
151 changes (Robinson Direct, Ex. 9.0 at 15). Judgment generally plays a large role in
152 determining net salvage ratios used to calculate depreciation rates.

153 **Q DO YOU TAKE EXCEPTION TO THE NET SALVAGE RATIOS**
154 **ILLINOIS-AMERICAN USED TO DEVELOP ITS PROPOSED BOOK**
155 **DEPRECIATION RATES?**

156 A Yes. My analysis of the water plant accounts indicates that Illinois-American's
157 proposed annual net salvage component of depreciation expense is significantly
158 greater than its actual annual net salvage experience. In fact, the level of annual net

159 salvage expense to be included in the proposed depreciation expense is
160 approximately 8.5 times greater than the annual level of net salvage expense that
161 Illinois-American typically incurs. The actual annual level of net salvage expense was
162 measured over the last ten years of the Company provided study data.

163 The consequence of Illinois-American's proposed treatment of net salvage
164 expense is that it unnecessarily raises rates for today's ratepayers and produces
165 intergenerational inequities. These inequities result from shifting cost burdens to
166 today's ratepayers from future ratepayers. This shift in cost burden occurs because
167 the net salvage component of depreciation expense that Illinois-American has
168 included in its proposed depreciation rates includes an estimate of future inflation. As
169 a result, Illinois-American is asking current ratepayers to pay the costs associated
170 with estimates of future inflation in their proposed depreciation expense. I will discuss
171 this point in more detail later in my testimony.

172 **Q DOES ILLINOIS-AMERICAN'S PROPOSED NET SALVAGE RATIOS PRODUCE**
173 **DEPRECIATION RATES AND COSTS THAT ARE EXCESSIVE?**

174 A Yes. This is based on a comparison of the net salvage expense included in
175 Illinois-American's proposed depreciation rates and expense with the level of net
176 salvage expense Illinois-American has actually experienced. I performed this
177 analysis for the water plant accounts that I previously identified.

178 IWC Exhibit 2.1 shows historical annual net salvage costs for the period 1996
179 through 2005. The negative numbers shown on IWC Exhibit 2.1 indicate that the
180 cost of removal exceeds the gross salvage. This exhibit shows that for the selected
181 water plant accounts included in my analysis, the actual net salvage costs over the
182 past ten years has averaged \$0.958 million per year.

183 As shown on IWC Exhibit 2.2, column 1, the Company's proposed
184 depreciation expense contains an annual net salvage expense component of \$8.153
185 million for the selected water plant accounts included in my analysis. However, the
186 Company's average actual annual net salvage expense over the last ten years is only
187 \$0.958 million. Therefore, the Company's proposed depreciation rates provide for an
188 annual net salvage expense that is approximately 8.5 times larger than its actual
189 annual net salvage experience.

190 **Q RELYING ON HISTORICAL DATA PROVIDES A COMPARISON OF ANNUAL**
191 **COSTS THAT ARE APPROXIMATELY FIVE YEARS OLD. DID YOU PERFORM**
192 **ANY ADDITIONAL ANALYSIS TO DEVELOP THE NET SALVAGE COSTS THAT**
193 **ILLINOIS-AMERICAN MAY INCUR WHEN THE PROPOSED WATER**
194 **DEPRECIATION RATES ARE IN PLACE?**

195 **A** Yes. The ten-year average annual net salvage figures produced in IWC Exhibit 2.1
196 are on average in 2000 dollars. This represents the mid-point of the range of
197 historical data included in my analysis (1996 through 2005). In order to reflect the net
198 salvage cost that Illinois-American may incur when a final order is issued in this case,
199 I inflated the historical ten-year average net salvage expense by ten years at an
200 annual inflation rate of 2.75%. The 2.75% annual inflation rate is the same annual
201 rate of inflation employed by the Company in its net salvage analysis in Section 8 of
202 Exhibit 9.01 attached to Mr. Robinson's direct testimony. This adjustment escalates
203 the historical ten-year average net salvage expense into 2010 dollars.

204 As shown on IWC Exhibit 2.2, the Company's inflation adjusted average
205 actual net salvage expense would be \$1.256 million as stated in 2010 dollars. This
206 indicates that the Company's proposed depreciation rates provide for an annual net

207 salvage expense that is approximately 6.5 times larger than Illinois-American's
208 inflation adjusted average annual net salvage expense. That is, on average
209 Illinois-American is proposing a depreciation expense that includes an annual
210 component for net salvage that is nearly \$7 million greater than their expected
211 inflated cost.

212 **Q WHAT CAUSES THE DISPARITY BETWEEN NET SALVAGE EXPENSE**
213 **INCLUDED IN DEPRECIATION RATES AND ACTUAL NET SALVAGE**
214 **EXPERIENCE?**

215 A This disparity is caused by including estimates of future inflation in the net salvage
216 component of the depreciation rates. The net salvage ratios that Illinois-American
217 used to develop its proposed depreciation rates include estimates of future inflation
218 based on historic inflation rates. That is, the net salvage expense, which is built into
219 the depreciation rates, reflects net salvage costs that Illinois-American is projecting it
220 will incur at the end of the average service life, and not the net salvage expense that
221 they expect to incur when the approved depreciation rates from this proceeding are
222 put into effect.

223 For example, the annual net salvage expense included in the development of
224 depreciation rates for Account 335 (Hydrants) is not based on net salvage costs that
225 the Company expects to incur over the next five years when the rates from this
226 proceeding are in effect. Instead, they are based on an estimate of net salvage costs
227 that could incur at the end of the assets' average service life, or in the case of
228 Hydrants 63 years in the future.

229 Q PLEASE EXPLAIN HOW ILLINOIS-AMERICAN'S PROPOSED NET SALVAGE
230 RATIOS INCLUDE AN ESTIMATE OF FUTURE INFLATION.

231 A To develop the net salvage component of depreciation rates, Illinois-American
232 analyzed the net salvage cost it experiences when retiring plant investment.
233 Illinois-American develops net salvage parameters by dividing the net salvage cost
234 associated with retiring an asset by the original cost of the asset. In this instance, the
235 net salvage cost is expressed in current dollars, while the original cost of the asset is
236 stated in the dollars for the year the asset was originally placed in service. This
237 translates into including estimates of future inflation in the net salvage component of
238 the depreciation rates.

239 In the case of Hydrants (Account 335), Illinois-American is proposing an
240 average service life of approximately 63 years for its Hydrant plant accounts. If an
241 asset is retired in 2005, Illinois-American compares the cost to remove the asset in
242 year 2005 dollars with the installed cost of the asset. If the asset was in service for
243 an average service life of 63 years, the cost of the asset is stated in 1942 dollars. As
244 a result, the net salvage ratio is developed from costs stated in dollars from different
245 time periods. Therefore, the net salvage ratio that is included in the water plant
246 depreciation rates is developed using removal costs in current dollars and a retired
247 asset expressed in historic cost dollars.

248 This net salvage ratio is used in developing the depreciation rates. Since the
249 cost of the asset and the cost to remove the asset are stated in dollars from different
250 time periods, the net salvage ratio provides an estimate of future inflation from
251 historical inflation experience. As a result, Illinois-American's net salvage ratios
252 require today's ratepayers to pay the estimated costs of future inflation based on
253 historic trends.

254 Q WHAT IS THE IMPACT ON THE VARIOUS VINTAGES OF RATEPAYERS OF
255 INCLUDING ILLINOIS-AMERICAN'S PROPOSED NET SALVAGE RATIOS IN THE
256 DEVELOPMENT OF DEPRECIATION RATES?

257 A With Illinois-American's proposal, future ratepayers benefit substantially because
258 accrued depreciation is an offset to rate base. As accrued depreciation builds up, the
259 rate base becomes smaller. Smaller rate base means that the Company's return "on"
260 investment and associated income taxes become less over time. All else equal, this
261 tends to make future rates for water service lower than they would otherwise be.
262 Because of this ratemaking consequence, future ratepayers benefit by including
263 Illinois-American's proposed net salvage ratios in the determination of depreciation
264 rates. This treatment causes intergenerational inequities.

265 Q PLEASE PROVIDE AN EXAMPLE SHOWING HOW FUTURE RATEPAYERS
266 BENEFIT FROM ILLINOIS-AMERICAN'S PROPOSAL.

267 A For Account 335, Illinois-American is proposing an average service life of 63 years
268 and a net salvage ratio of negative 100%. As a result, every year Illinois-American
269 would be accruing on average depreciation expense at a rate of 3.17% ($2 \div 63$). After
270 32 years of service, the Account 335 investment is fully depreciated. Therefore, for
271 the last 31 years, or 49% of the asset's life, the rate base is negative. After year 32,
272 the customers who are utilizing the assets are no longer paying a return "on"
273 investment and associated income taxes.

274 Q SHOULD NET SALVAGE RATIOS THAT ARE USED TO DEVELOP
275 DEPRECIATION RATES REFLECT EXCESSIVE ESTIMATES OF FUTURE
276 INFLATION?

277 A No. Including estimates of future inflation in the development of net salvage ratios
278 should be rejected for the following reasons.

- 279 1. Removal cost of net salvage for plant is often determined quite arbitrarily. That is,
280 judgment is utilized to develop net salvage ratios.
- 281 2. As previously demonstrated, reflecting future inflation in net salvage expense
282 results in net salvage allowances in depreciation rates that significantly exceed
283 current actual net salvage cost experiences.
- 284 3. The procedure essentially projects past inflation rates into the future. This may
285 not be a reasonable assumption.
- 286 4. Even adjusting the net salvage percentages for projections of future inflation still
287 requires ratepayers to have included in their rates undiscounted costs of future
288 inflation.
- 289 5. Commissions do not reflect similar estimates of inflation when establishing other
290 expense items included in a utility's ratemaking revenue requirement.

291 Q IN ADDITION TO REVIEWING THE COMPANY'S HISTORICAL NET SALVAGE
292 FIGURES, DID YOU PERFORM ANY OTHER ANALYSIS WHICH INDICATES
293 THAT THE COMPANY'S PROPOSED NET SALVAGE VALUES ARE EXCESSIVE?

294 A Yes. I compared Illinois-American's requested net salvage ratios with net salvage
295 ratios recently used by other American-Water affiliates in neighboring states.
296 Specifically, I have reviewed the depreciation net salvage ratios used by:
297 (1) Missouri-American Water (Docket No. WR-2007-0216); (2) Kentucky-American
298 Water (Case No. 2007-00143); and (3) Indiana-American Water (Cause No. 43081).
299 The net salvage ratios for Missouri-American Water and Kentucky-American Water
300 are the net salvage ratios which were included in the direct testimony phase of each
301 prospective rate filing. The net salvage ratios for Indiana-American Water are the net

302 salvage ratios which were adopted by the Indiana Commission as part of a settlement
303 agreement.

304 As shown on IIRC Exhibit 2.3, for all of the accounts I analyzed except 304.3
305 (Structures & Improvements), the net salvage ratios incorporated into
306 Illinois-American's depreciation rates are substantially greater than what has been
307 proposed and adopted through settlement by other American-Water affiliates and
308 commissions.

309 **Q HAS THE COMPANY EXPLAINED THE DIFFERENCES BETWEEN NET**
310 **SALVAGE RATIOS PROPOSED IN THIS PROCEEDING AND THOSE USED IN**
311 **THE DEVELOPMENT OF DEPRECIATION RATES BY OTHER**
312 **AMERICAN-WATER AFFILIATES?**

313 A No. In response to IIRC Data Request No. 4-1, which sought an explanation for the
314 differences in net salvage ratios used in this case and a recent 2007
315 Missouri-American Water case, the Company stated that "the necessary detailed
316 salvage information is not available to complete any analysis to identify potential
317 causes for the range of referenced net salvage factors" (Response to IIRC No. 4-1).

318 **Q BASED ON THE RESULTS OF YOUR ANALYSIS, WHAT LEVEL OF NET**
319 **SALVAGE ARE YOU PROPOSING BE INCORPORATED IN THE DEVELOPMENT**
320 **OF THE COMPANY'S DEPRECIATION RATES IN THIS PROCEEDING?**

321 A While, in general, I ultimately propose that net salvage expense should more closely
322 reflect actual net salvage expense levels, I propose that the net salvage ratios be
323 based on similar ratios proposed and/or adopted through settlement by other
324 American-Water affiliates.

325 IWC Exhibit 2.3, column 5, shows the net salvage ratios, which I am
326 proposing for each water plant account analyzed. The net salvage ratios shown in
327 column 5 represent an average of recent net salvage ratios used in establishing
328 depreciation rates for American-Water affiliates.

329 **Q WHY IS IT REASONABLE TO USE NET SALVAGE RATIOS FROM OTHER**
330 **JURISDICTIONS IN THE DEVELOPMENT OF NET SALVAGE RATIOS FOR AN**
331 **ILLINOIS UTILITY?**

332 A Given that judgment plays a role in the development of the net salvage ratios,
333 establishing net salvage ratios that are similar to the net salvage ratios utilized by
334 other American-Water affiliates provides a reliable benchmark to ensure that
335 judgment is being reasonably applied. In addition, relying on the net salvage ratios
336 used by other American-Water affiliates produces annual net salvage expense levels
337 which more closely align with the Company's expected net salvage cost.

338 Finally, using comparable utilities' data is regularly used in other ratemaking
339 functions such as the development of a utility's return on equity (ROE) or other
340 benchmarking costs. For example, in this proceeding, Illinois-American is basing its
341 requested ROE on a comparable group that includes comparable utilities from other
342 jurisdictions.

343 **Q HAVE YOU DEVELOPED DEPRECIATION RATES FOR THE SPECIFIC WATER**
344 **PLANT ACCOUNTS THAT YOU ANALYZED USING YOUR PROPOSED NET**
345 **SALVAGE RATIOS?**

346 A Yes. IWC Exhibit 2.4 shows the calculation of the revised depreciation rates using
347 net salvage ratios adopted by American-Water affiliates. These depreciation rates

348 use Illinois-American's proposed life characteristics. The revised depreciation rates
349 are shown in column 13.

350 **Q WHAT IS THE IMPACT ON ILLINOIS-AMERICAN'S REVENUE REQUIREMENT**
351 **AS A RESULT OF YOUR PROPOSED DEPRECIATION RATES?**

352 A As shown on IWC Exhibit 2.5, on a total Company basis my proposed depreciation
353 rates reduce the Company's depreciation expense by approximately \$5.792 million.

354 **Q WHEN COMPARED WITH HISTORICAL NET SALVAGE COST LEVELS, DO**
355 **YOUR PROPOSED DEPRECIATION RATES PRODUCE NET SALVAGE**
356 **EXPENSE THAT EXCEEDS ILLINOIS-AMERICAN'S ACTUAL NET SALVAGE**
357 **EXPENSE EXPERIENCE?**

358 A Yes. IWC Exhibit 2.6 indicates that the resulting annual net salvage expense
359 associated with my proposed net salvage ratios produce an annual net salvage
360 expense of \$3.317 million for the water plant accounts included in my analysis. As
361 previously mentioned, the Company's inflation adjusted average annual net salvage
362 expense should be approximately \$1.256 million per year over the next several years.
363 Therefore, my revised depreciation rates are conservative in that they provide for an
364 annual net salvage expense that is approximately 2.5 times larger than
365 Illinois-American's expected annual net salvage expense.

366 **Cost of Service Study and Rate Design**

367 **Q FOR ALL SERVICE DISTRICTS WHERE A RATE INCREASE OR DECREASE IS**
368 **PROPOSED, HOW HAS ILLINOIS-AMERICAN PROPOSED TO DESIGN**
369 **INDIVIDUAL CUSTOMER RATES?**

370 A According to Company witness Edward J. Grubb, revisions to customer rates are
371 based on an across-the-board approach (Grubb Direct at 39).

372 **Q WHAT IS THE COMPANY'S RATIONALE FOR THEIR PROPOSED**
373 **ACROSS-THE-BOARD RATE DESIGN APPROACH IN THIS PROCEEDING?**

374 A Mr. Grubb states in his direct testimony that since the previous Illinois-American rate
375 case (Docket 02-0690), in which rates were designed based on the results of a cost
376 of service study, there have been no change in circumstances that would require an
377 alternative design of the Company's rates (Grubb Direct at 39).

378 **Q HAS THE COMPANY PRESENTED THE RESULTS OF AN UPDATED COST OF**
379 **SERVICE STUDY IN THIS CASE?**

380 A No. According to Mr. Grubb, the requirement of the Company to present the results
381 of an updated cost of service study in this proceeding has been waived (Grubb Direct
382 at 41).

383 **Q BASED ON YOUR REVIEW OF THE COMPANY'S HISTORICAL AND**
384 **FORECASTED RATE BASE CHANGES, WHAT APPEARS TO BE THE PRIMARY**
385 **COST DRIVERS IN THIS CASE?**

386 A Upon reviewing Schedule B-5 from the Company's standard filing requirement, the
387 majority of the Company's planned rate base additions are associated with plant

388 accounts: (1) 331.001 – T&D Mains Conversion; (2) 333 – Services; and (3) 334 –
389 Meters. In fact, when comparing June 2005 rate base figures with forecasted June
390 2009 rate base figures, in the Southern/Peoria/Pontiac/Streator/South Beloit service
391 district, the above accounts represent 70% of the expected change in rate base.

392 **Q DO THESE COST CHANGES SUPPORT THE COMPANY'S PROPOSED**
393 **ACROSS-THE-BOARD RATE DESIGN APPROACH?**

394 A No. The majority of the increased costs associated with mains, services and meters
395 are primarily attributable to providing service to Residential and Commercial
396 customers. However, under Illinois-American's proposed across-the-board rate
397 design approach, the rates of larger customers increase more than their likely
398 proportionate allocation of these increased costs.

399 **Q ARE YOU RECOMMENDING THAT CUSTOMER RATES BE DESIGNED BASED**
400 **ON SOMETHING OTHER THAN AN ACROSS-THE-BOARD APPROACH IN THIS**
401 **PROCEEDING?**

402 A No. Because of budget considerations, I do not take issue with the Company's
403 proposed rate design approach.

404 **Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

405 A Yes.

Qualifications of James W. Collins, Jr.

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A James W. Collins Jr. My business address is 1215 Fern Ridge Parkway, Suite 208,
3 St. Louis, Missouri 63141.

4 **Q PLEASE STATE YOUR OCCUPATION.**

5 A I am a consultant in the field of public utility regulation with the firm of Brubaker &
6 Associates, Inc. (BAI), energy, economic and regulatory consultants.

7 **Q PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL
8 EMPLOYMENT EXPERIENCE.**

9 A I graduated magna cum laude from the University of Missouri-St. Louis in 2002 where
10 I received a Bachelor of Science degree in Business Administration with a Finance
11 Emphasis. Upon graduation, I accepted a position with Brubaker & Associates, Inc.
12 Since that time, I have participated in numerous rate cases involving regulated and
13 competitive electricity, natural gas and water related issues. From January 2000 to
14 August 2001, I was employed by Edward Jones as an Operations Specialist.

15 In May 2007, I completed a Master of Business Administration degree from
16 the University of Missouri-St. Louis.

17 The firm Brubaker & Associates, Inc. provides consulting services in the field
18 of energy procurement and public utility regulation to many clients including industrial
19 and institutional customers, some utilities and, on occasion, state regulatory
20 agencies.

21 More specifically, we provide analysis of energy procurement options based
22 on consideration of prices and reliability as related to the needs of the client; prepare
23 rate, feasibility, economic, and cost of service studies relating to energy and utility
24 services; prepare depreciation and feasibility studies relating to utility service; assist
25 in contract negotiations for utility services, and provide technical support to legislative
26 activities.

27 In addition to our main office in St. Louis, the firm also has branch offices in
28 Phoenix, Arizona and Corpus Christi, Texas.

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**ILLINOIS-AMERICAN WATER COMPANY
(ALL DIVISIONS)**

ACTUAL ANNUAL NET SALVAGE COSTS FOR PERIOD 1996 - 2005

Line	Year	Acct 304.30 (1)	Acct 311.20 (2)	Acct 320.10 (3)	Acct 331.00 (4)	Acct 333.00 (5)	Acct 334.20 (6)	Acct 335.00 (7)	Total (8)
1	1996	\$ 39,983	\$ (23,529)	\$ (107,710)	\$ (108,821)	\$ (333,502)	\$ (49,634)	\$ (91,356)	
2	1997	\$ (30,081)	\$ (48,116)	\$ (472,442)	\$ (62,882)	\$ (370,010)	\$ (57,149)	\$ (76,001)	
3	1998	\$ (10,839)	\$ (29,616)	\$ (171,777)	\$ (290,584)	\$ (379,244)	\$ (55,819)	\$ (43,097)	
4	1999	\$ -	\$ (59,404)	\$ (17,720)	\$ (397,847)	\$ (356,906)	\$ (43,929)	\$ (44,634)	
5	2000	\$ (88,702)	\$ (9,024)	\$ 10,080	\$ (161,079)	\$ (519,721)	\$ (60,037)	\$ (51,744)	
6	2001	\$ (10,025)	\$ (45,125)	\$ (16,941)	\$ (255,905)	\$ (518,635)	\$ (51,467)	\$ (55,358)	
7	2002	\$ (2,300)	\$ (1,097,959)	\$ (27,163)	\$ (340,255)	\$ (536,886)	\$ (47,559)	\$ (80,256)	
8	2003	\$ (1,693)	\$ (26,445)	\$ (13,481)	\$ (200,623)	\$ (538,920)	\$ (63,677)	\$ (67,921)	
9	2004	\$ (387)	\$ (43,077)	\$ (30,107)	\$ (278,325)	\$ (565,540)	\$ (109,009)	\$ (53,592)	
10	2005	\$ 34,508	\$ 154	\$ -	\$ 21,251	\$ 7,378	\$ (1,443)	\$ 9,953	
11	10 Yr Ave	\$ (6,954)	\$ (138,214)	\$ (84,726)	\$ (207,507)	\$ (411,198)	\$ (53,972)	\$ (55,401)	\$ (957,972)

Source: Exhibit 9.01, Section 8

ILLINOIS-AMERICAN WATER COMPANY

Comparison of Company Proposed Annual Net Salvage Expense With Actual Inflation Adjusted Net Salvage Expense

Line	Account	Description	Company Proposed Annual Net Salvage Expense ¹	10-Year Average Historical Net Salvage Expense ²	Forecasted Annual Inflation Rate ³	10-Year Cumulative Inflation Rate	Inflated Annual Actual Net Salvage Expense ⁴
			(1)	(2)	(3)	(4)	(5)
1	304.30	Structures & Improvements - WT	\$ 271,466	\$ 6,954	2.75%	1.312	\$ 9,121
2	311.20	Pumping Equip - Electrical	\$ 496,452	\$ 138,214	2.75%	1.312	\$ 181,289
3	320.10	Water Treatment (Non-Material)	\$ 534,288	\$ 84,726	2.75%	1.312	\$ 111,131
4	331.00	Total Mains	\$ 1,838,996	\$ 207,507	2.75%	1.312	\$ 272,177
5	333.00	Services	\$ 3,548,637	\$ 411,198	2.75%	1.312	\$ 539,349
6	334.20	Meter Installations	\$ 855,604	\$ 53,972	2.75%	1.312	\$ 70,793
7	335.00	Hydrants	\$ 608,099	\$ 55,401	2.75%	1.312	\$ 72,666
8	Total		\$ 8,153,542	\$ 957,972			\$ 1,256,525

Source/Notes:

¹ Exhibit 9.01, Section 2, Table 2 - COR, Column k

² IWC Exhibit 2.1

³ Exhibit 9.01, Section 8

⁴ Column 2 x Column 4

ILLINOIS-AMERICAN WATER COMPANY

COMPARISON OF ILLINOIS-AMERICAN REQUESTED NET SALVAGE RATIOS WITH NET SALVAGE RATIOS USED BY OTHER AMERICAN-WATER AFFILIATES

Line	Account	Description	Company Requested	American-Water Affiliates - Net Salvage Ratios			
			Net Salvage Ratios Illinois ¹	Missouri Affiliate ²	Kentucky Affiliate ³	Indiana Affiliate ⁴	Average
			(1)	(2)	(3)	(4)	(5)
1	304.30	Structures & Improvements - WT	-20.00%	-30.00%	-20.00%	-30.00%	-27.00%
2	311.20	Pumping Equip - Electrical	-35.00%	-10.00%	-15.00%	-10.00%	-12.00%
3	320.10	Water Treatment (Non-Material)	-30.00%	-25.00%	-15.00%	-25.00%	-22.00%
4	331.00	Total Mains	-50.00%	-35.00%	-20.00%	-35.00%	-30.00%
5	333.00	Services	-300.00%	-100.00%	-120.00%	-120.00%	-113.00%
6	334.20	Meter Installations	-250.00%	3.00%	-10.00%	-40.00%	-16.00%
7	335.00	Hydrants	-100.00%	-25.00%	-25.00%	-70.00%	-40.00%

Source:

¹ Exhibit 9.01, Section 2, Table 2 - COR, Column d

² 2007 Missouri-American Water Rate Case, Docket No. WR-2007-0216, Depreciation Study, Page III-4, Column 3

³ 2007 Kentucky-American Water Rate Case, Case No. 2007-00143, Exhibit JJS-1, Page III-4, Column 3

⁴ 2007 Indiana-American Water Depreciation Case, Cause No. 43081, October 27 Settlement Agreement, Attachment A, Column 3

ILLINOIS-AMERICAN WATER COMPANY
(ALL DIVISIONS)

DEVELOPMENT OF ANNUAL DEPRCIATION RATES BASED ON REVISED NET SALVAGE RATIOS

Line	Account	Description	Original Cost Per Depr. Study	Cost of Removal in Book Reserve ²	Estimated Future Net Salvage % ³	Estimated Future Net Salvage Amount	Estimated Future Net Salvage Less Removal	Plant Only Book Reserve ²	Net Original Cost Less Reserve	Average Remaining Life ⁴	Annual Net Salvage Depreciation	Annual Net Salvage Depreciation Rate	Annual Plant Depreciation	Annual Plant Depreciation Rate	Annual Depreciation Rate
		Formula	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
						1 x 3	4 + 2		1 - 6		5 / 8	9 / 1	7 / 8	11 / 1	10 + 12
1	311.20	Pumping Equip - Electrical	\$ 32,177,415	\$ 886,257	-12%	\$ (3,861,290)	\$ (2,975,033)	\$ 10,200,323	\$ 21,977,093	20.9	\$ (142,346)	0.44%	\$ 1,051,536	3.27%	3.71%
2	304.30	Structures & Improvements - WT	\$ 49,542,599	\$ -	-27%	\$ (13,376,502)	\$ (13,376,502)	\$ 13,944,269	\$ 35,598,330	36.5	\$ (366,479)	0.74%	\$ 975,297	1.97%	2.71%
3	320.10	Water Treatment (Non-Material)	\$ 57,939,509	\$ 3,810,935	-22%	\$ (12,746,692)	\$ (8,935,757)	\$ 18,403,919	\$ 39,535,590	25.4	\$ (351,801)	0.61%	\$ 1,556,519	2.69%	3.30%
4	331.71	Mains - Valves 4" & Under	\$ 1,388,351	\$ 35,597	-30%	\$ (416,505)	\$ (380,909)	\$ 368,602	\$ 1,019,749	39.4	\$ (9,668)	0.70%	\$ 25,882	1.86%	2.56%
5	331.72	Mains - Valves 6" - 8"	\$ 12,500,369	\$ 275,968	-30%	\$ (3,750,111)	\$ (3,474,142)	\$ 2,857,655	\$ 9,642,714	53.1	\$ (65,426)	0.52%	\$ 181,595	1.45%	1.97%
6	331.73	Mains - Valves 10" - 16"	\$ 6,178,713	\$ 122,173	-30%	\$ (1,853,614)	\$ (1,731,441)	\$ 1,265,104	\$ 4,913,609	58.6	\$ (29,547)	0.48%	\$ 83,850	1.36%	1.84%
7	331.74	Mains - Valves 18" & Over	\$ 2,116,424	\$ 47,578	-30%	\$ (634,927)	\$ (587,349)	\$ 492,671	\$ 1,623,753	65.1	\$ (9,022)	0.43%	\$ 24,942	1.18%	1.61%
8	331.75	Mains - Valves Boxes	\$ 976,195	\$ 36,670	-30%	\$ (292,858)	\$ (256,189)	\$ 379,716	\$ 596,479	48.3	\$ (5,304)	0.54%	\$ 12,349	1.27%	1.81%
9	331.80	Mains - Manholes, Pits & Vaults	\$ 517,885	\$ 11,094	-30%	\$ (155,365)	\$ (144,271)	\$ 114,882	\$ 403,003	65.8	\$ (2,193)	0.42%	\$ 6,125	1.18%	1.60%
10	331.91	Mains-All Material Types - 4 In & Unc	\$ 10,518,663	\$ 389,538	-30%	\$ (3,155,599)	\$ (2,766,061)	\$ 4,033,664	\$ 6,485,000	55.6	\$ (49,749)	0.47%	\$ 116,637	1.11%	1.58%
11	331.92	Mains-All Material Types - 6 In - 8 In	\$ 149,834,096	\$ 3,026,716	-30%	\$ (44,950,229)	\$ (41,923,513)	\$ 31,341,661	\$ 118,492,434	83.3	\$ (503,283)	0.34%	\$ 1,422,478	0.95%	1.29%
12	331.93	Mains-All Material Types - 10 In - 16	\$ 91,918,549	\$ 1,621,266	-30%	\$ (27,575,565)	\$ (25,954,298)	\$ 16,788,222	\$ 75,130,327	85.4	\$ (303,915)	0.33%	\$ 879,746	0.96%	1.29%
13	331.94	Mains - All Material Types 18" & Ove	\$ 32,555,533	\$ 583,346	-30%	\$ (9,766,660)	\$ (9,183,314)	\$ 6,040,554	\$ 26,514,980	98	\$ (93,707)	0.29%	\$ 270,561	0.83%	1.12%
14	331.95	Mains-Special Crossings	\$ 51,501	\$ 1,676	-30%	\$ (15,450)	\$ (13,775)	\$ 17,353	\$ 34,148	43.2	\$ (319)	0.62%	\$ 790	1.53%	2.15%
15		Total 331 Mains	\$ 308,556,279	\$ 6,151,622		\$ (92,566,884)	\$ (86,415,262)	\$ 63,700,084	\$ 244,856,195		\$ (1,072,133)	0.35%	\$ 3,024,956	0.98%	1.33%
16	333.10	Services - 1" & Under	\$ 61,701,675	\$ 15,671,955	-113%	\$ (69,722,893)	\$ (54,050,938)	\$ (333,390)	\$ 62,035,066	65.5	\$ (825,205)	1.34%	\$ 947,100	1.53%	2.87%
17	333.20	Services - Over 1"	\$ 24,980,557	\$ 3,474,517	-113%	\$ (28,228,030)	\$ (24,753,513)	\$ (73,914)	\$ 25,054,471	74.3	\$ (333,156)	1.33%	\$ 337,207	1.35%	2.68%
18		Total 333 Services	\$ 86,682,232	\$ 19,146,472		\$ (97,950,923)	\$ (78,804,451)	\$ (407,304)	\$ 87,089,537		\$ (1,158,361)	1.34%	\$ 1,284,307	1.48%	2.82%
19	334.21	Meter Installations - 1" & Under	\$ 19,249,974	\$ 2,283,425	-16%	\$ (3,079,996)	\$ (796,571)	\$ 3,985,046	\$ 15,264,927	63.2	\$ (12,604)	0.07%	\$ 241,534	1.25%	1.32%
20	334.22	Meter Installations - Over 1"	\$ 4,009,399	\$ 305,845	-16%	\$ (641,504)	\$ (335,659)	\$ 533,763	\$ 3,475,637	74.6	\$ (4,499)	0.11%	\$ 46,590	1.16%	1.27%
21		Total 334 Meter Installations	\$ 23,259,373	\$ 2,589,270		\$ (3,721,500)	\$ (1,132,230)	\$ 4,518,809	\$ 18,740,564		\$ (17,103)	0.07%	\$ 288,124	1.24%	1.31%
22	335.00	Hydrants	\$ 32,456,861	\$ 2,781,651	-40%	\$ (12,982,744)	\$ (10,201,094)	\$ 83,751	\$ 32,373,110	48.8	\$ (209,039)	0.64%	\$ 663,383	2.04%	2.68%

Source:

¹ Exhibit 9.01, Section 2, Table 1, Column c

² Exhibit 9.01, Section 2, Table 1a

³ IIRC Exhibit 2.3, Column 5

⁴ Exhibit 9.01, Section 2, Table 2 - COR, Column j

ILLINOIS-AMERICAN WATER COMPANY

**COMPARISON OF REVISED ANNUAL DEPRECIATION EXPENSE
WITH COMPANY'S REQUESTED ANNUAL DEPRECIATION EXPENSE**

Line	Acct	Description	Revised Annual Depreciation Rate ¹	Total Company Avg. Depreciable Plant for Year June 09 ²	Calculated Annual Depreciation Expense	S/P/P/S/SB Average Depreciable Plant for Year June 09 ²	Calculated Annual Depreciation Expense	Champaign Average Depreciable Plant for Year June 09 ²	Calculated Annual Depreciation Expense	Other Districts Avg. Depreciable Plant for Year June 09 ²	Calculated Annual Depreciation Expense
		Formula	(1)	(2)	(3) 1 * 2	(4)	(5) 1 * 4	(6)	(7) 1 * 6	(8)	(9) 1 * 8
1	311.20	Pumping Equip - Electrical	3.71%	\$ 35,864,726	\$ 1,330,581	\$ 25,564,179	\$ 948,431	\$ 5,080,203	\$ 188,476	\$ 5,220,344	\$ 193,675
2	304.30	Structures & Improvements - WT	2.71%	\$ 60,197,487	\$ 1,631,352	\$ 44,628,276	\$ 1,209,426	\$ 8,700,765	\$ 235,791	\$ 6,868,446	\$ 186,135
3	320.10	Water Treatment (Non-Material)	3.30%	\$ 88,694,379	\$ 2,926,915	\$ 53,225,159	\$ 1,756,430	\$ 25,542,294	\$ 842,896	\$ 9,926,926	\$ 327,589
4	331.00	T&D Mains Conversion	1.33%	\$ 371,324,578	\$ 4,938,617	\$ 204,279,558	\$ 2,716,918	\$ 59,767,483	\$ 794,908	\$ 107,277,537	\$ 1,426,791
5	333.00	Services	2.82%	\$ 104,797,075	\$ 2,955,278	\$ 61,527,525	\$ 1,735,076	\$ 16,549,855	\$ 466,706	\$ 26,719,695	\$ 753,495
6	334.20	Meter Installations	1.31%	\$ 27,867,632	\$ 365,066	\$ 19,809,254	\$ 259,501	\$ 3,968,399	\$ 51,986	\$ 4,089,979	\$ 53,579
7	335.00	Hydrants	2.68%	\$ 38,165,295	\$ 1,022,830	\$ 18,664,455	\$ 500,207	\$ 5,320,338	\$ 142,585	\$ 14,180,502	\$ 380,037
8		Total		\$ 726,911,172	\$ 15,170,638	\$ 427,698,406	\$ 9,125,991	\$ 124,929,337	\$ 2,723,346	\$ 174,283,429	\$ 3,321,301
9		Company Proposed Depreciation Expense for Above Accounts ²			\$ 20,962,917		\$ 12,580,366		\$ 3,659,707		\$ 4,722,844
10		Required Adjustment (Column 8 - Column 9)			\$ (5,792,279)		\$ (3,454,375)		\$ (936,361)		\$ (1,401,543)

Source:¹ IIRC Exhibit 2.4, Column 13² Schedule C-12 First Revised

ILLINOIS-AMERICAN WATER COMPANY

Comparison of Company Proposed Annual Net Salvage
Expense With Net Salvage Expense Based on Net Salvage
Ratios Used by Other American-Water Affiliates

Line	Account	Description	Company Proposed Annual Net Salvage Expense ¹ (1)	IIRC Proposed Annual Net Salvage Expense ² (2)	Inflated Actual Annual Net Salvage Expense ³ (7)
1	304.30	Structures & Improvements - WT	\$ 271,466	\$ 366,479	\$ 9,121
2	311.20	Pumping Equip - Electrical	\$ 496,452	\$ 142,346	\$ 181,289
3	320.10	Water Treatment (Non-Material)	\$ 534,288	\$ 351,801	\$ 111,131
4	331.00	Total Mains	\$ 1,838,996	\$ 1,072,133	\$ 272,177
5	333.00	Services	\$ 3,548,637	\$ 1,158,361	\$ 539,349
6	334.20	Meter Installations	\$ 855,604	\$ 17,103	\$ 70,793
7	335.00	Hydrants	\$ 608,099	\$ 209,039	\$ 72,666
8	Total		\$ 8,153,542	\$ 3,317,264	\$ 1,256,525

Source/Notes:¹ Exhibit 9.01, Section 2, Table 2 - COR, Column k² IIRC Exhibit 2.4, Column 9³ IIRC Exhibit 2.2, Column 5