IIWC Exhibit 5.0

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

ILLINOIS-AMERICAN WATER COMPANY	**:**	
	:	**Docket No. 07-0507**
Proposed general increase in water rates.	**:**	

Rebuttal Testimony of

James W. Collins, Jr.

On Behalf of

Illinois Industrial Water Consumers
Fosterburg Water District
Jersey County Rural Water Co., Inc.
Bond-Madison Water Company

March 4, 2008
Project 8888

BRUBAKER & ASSOCIATES, INC.
ST. LOUIS, MO 63141-2000

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Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q PLEASE STATE YOUR OCCUPATION.

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

Q ARE YOU THE SAME JAMES COLLINS WHO PREVIOUSLY FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A Yes, I am.

Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A I am appearing on behalf of the Illinois Industrial Water Consumers (IIWC). IIWC consists of large water users taking service from Illinois-American Water Company (Illinois-American or Company). I am also appearing on behalf of three water districts: Fosterburg Water District, Jersey County Rural Water Co., Inc., and

Bond-Madison Water Company, who are also large water users taking water service from the Company.

Q WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A The purpose of my rebuttal testimony is to respond to the rebuttal testimony of Illinois-American's witness Earl M. Robinson (IAWC Exhibit 9.10).

Q PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A My rebuttal testimony may be summarized as follows:

1. Contrary to Mr. Robinson's suggestion, I am not recommending in this proceeding that the Commission formulate the Company's depreciation rates using the cash based accounting method for the recovery of net salvage expense.

2. The Commission should approve net salvage ratios comparable to those used by other American-Water affiliates because they reflect a more efficient and/or cost effective approach to retiring plant.

3. Mr. Robinson's comments about intergenerational inequities are erroneous because he ignores the time value of money or the diminishing purchasing power of the dollar.

Q ON PAGE 6 OF MR. ROBINSON'S REBUTTAL TESTIMONY HE CRITICIZES THE USE OF THE CASH ACCOUNTING APPROACH TO DEVELOP FUTURE NET SALVAGE EXPENSE LEVELS, IS YOUR PROPOSAL FOR THE DEVELOPMENT OF ALTERNATIVE NET SALVAGE RATIOS IN THIS PROCEEDING BASED ON THE CASH-BASED ACCOUNTING METHOD?

A No, it is not. As stated in my direct testimony, for certain water plant accounts, I used the cash accounting approach to make a comparison of the level of net salvage expense the Company actually incurs to the level of net salvage expense that the Company is requesting in its proposed depreciation rates. Based on the results of

this comparison I concluded that a substantial difference existed between the Company's actual annual net salvage expense incurred and the net salvage expense that the Company seeks to include in its proposed depreciation rates.

As stated in my direct testimony, my proposal is to utilize an average of recent net salvage ratios used in the development of depreciation rates by other American-Water affiliates in neighboring states for similar types of plant investments.

Q MR. ROBINSON CRITICIZES YOUR USE OF NET SALVAGE RATIOS FROM OTHER AMERICAN-WATER AFFILIATES IN LIEU OF COMPANY SPECIFIC DATA. BASED ON A REVIEW OF THE NET SALVAGE RATIOS USED BY OTHER AMERICAN-WATER AFFILIATES IN THE DEVELOPMENT OF THEIR DEPRECIATION RATES, DOES IT APPEAR THAT THE NET SALVAGE RATIOS REQUESTED BY ILLINOIS-AMERICAN ARE EXCESSIVE?

A Yes. Illinois-American's proposed net salvage ratios are excessive when compared to the net salvage ratios used by other American-Water affiliates to develop Commission approved depreciation rates. Because of this comparison, the Commission must ask itself – why are the net salvage ratios of the American-Water affiliates so much lower than those proposed by the Company? A comparison of the net salvage ratios seems to indicate that the American-Water affiliates are more cost efficient since they are able to retire similar plant assets at significantly lower net salvage costs than Illinois-American.

Q HOW DO YOU RESPOND TO MR. ROBINSON'S ARGUMENT THAT YOUR PROPOSAL TO BASE THE COMPANY'S NET SALVAGE RATIOS ON SIMILAR AMOUNTS UTILIZED BY OTHER AMERICAN-WATER AFFILIATES IS SIMPLY A RESULTS ORIENTED DRIVEN APPROACH AND RECOMMENDATION?

A As highlighted in my direct testimony given that judgment plays a role in the development of net salvage ratios, establishing net salvage ratios that are similar to ratios utilized by other American-Water affiliates provides a reliable benchmark to ensure that judgment is being reasonably applied. In my opinion, using comparable net salvage ratios of other American-Water affiliates provides a reliable benchmark since they have the same parent company, are all regulated water utilities, depreciate similar kinds of plant investment, and likely have similar operating characteristics. Further, given that there is a significant unexplained difference between the net salvage costs incurred by Illinois-American and other American-Water affiliates, this approach ensures that current customers will not disproportionately have higher net salvage costs built into their depreciation rates for similar types of plant assets when compared with the net salvage costs built into the current depreciation rates of other American-Water affiliates.

Q PLEASE PROVIDE YOUR RESPONSE TO MR. ROBINSON'S CLAIM THAT ILLINOIS-AMERICAN'S ESTIMATED FUTURE NET SALVAGE FACTORS INCLUDED IN ITS PROPOSED DEPRECIATION RATES WILL NOT PRODUCE INTERGENERATIONAL INEQUITIES.

A Mr. Robinson clearly misses the point of the intergenerational inequity argument. Mr. Robinson continues to argue that today's ratepayers should have included in their depreciation and water rates the costs of inflation that may occur, in the case of

Hydrants, over the next 60 plus years. For example, Mr. Robinson developed a net salvage ratio for Account 335, Hydrants, by dividing the net salvage or removal cost, stated in current dollars by the original cost of the retired asset some 60 years ago. By applying this net salvage ratio to today's investment, Illinois-American is asking today's ratepayers to pay costs associated with future anticipated inflation since dividing the current removal cost by the original cost of the asset produces net salvage ratios that contain the effects of past inflation.

Q COULD YOU PLEASE PROVIDE AN EXAMPLE TO HELP DEMONSTRATE THIS POINT?

A Assume that Illinois-American installed a piece of equipment in 1978 at a cost of $1,000. Further, assume that Illinois-American removed the equipment in 2008 at the end of its useful life of 30 years at a cost of $500. This would produce a net salvage ratio of negative 50% ($500 / $1000). Now assume because of inflation, that piece of equipment that was installed in 1978 at a cost of $1,000 now costs $2,500. Using Mr. Robinson's approach, we would apply a negative 50% net salvage factor to this $2,500 to produce an estimated future net salvage value of $1,250 and recover this net salvage amount over the useful life of 30 years. Clearly, the $1,250 must reflect future inflation because we just removed a similar piece of equipment in current 2008 dollars at a cost of $500. Now, dividing the $1,250 by 30 years, Illinois-American would collect from each vintage of ratepayers $41.67 per year. Therefore, the ratepayers in 2008, just as the ratepayers in 2033, would be required to pay the company $41.67 per year in removal costs.

However, in terms of real dollars, the ratepayers in year 2033 are paying much less. In fact, at an annual inflation rate of 2.75%, the payment in 2033 dollars is

only $21.15, or 51%, of the level requested from the 2008 ratepayers. This results in an overpayment from current customers because the value of a dollar is worth much more in 2008 than it will be in 2033. This further highlights that Mr. Robinson's proposed method of net salvage cost recovery not only ignores future inflation but also ignores the diminishing purchasing power of the dollar.

It is inequitable to charge ratepayers in 2008 $41.67 and ratepayers in the year 2033 $21.15 for the cost of removal associated with the same piece of equipment. As this demonstration proves, collecting future inflation from today's ratepayers and ignoring the effect of the diminishing purchasing power of the dollar does nothing but benefit future ratepayers and penalizes today's ratepayers.

Q HAS MR. ROBINSON CONDUCTED AN ANALYSIS WHICH HE CLAIMS PROVES THAT HIS NET SALVAGE RATIOS PRODUCE AN APPROPRIATE LEVEL OF END OF LIFE COST RECOVERY WHILE YOUR PROPOSED NET SALVAGE RATIOS, WHICH ARE BASED ON AN AVERAGE OF NET SALVAGE RATIOS USED BY AMERICAN-WATER AFFILIATES, DO NOT?

A Yes. On pages 12-15 of Mr. Robinson's rebuttal testimony, he describes an analysis he conducted, which in his estimation proves his point that my proposed net salvage ratios produce an inadequate level of future net salvage expense while his levels produce an appropriate level.

Q DO YOU HAVE ANY COMMENTS WITH REGARDS TO MR. ROBINSON'S ANALYSIS?

A Yes. The major problem with Mr. Robinson's analysis is that it assumes his negative 100% net salvage factor is what will actually occur. He specifically states that in the

development of Exhibit 9.14[1] "to remain consistent with the Exhibit 9.13[2] calculation, the negative 100 percent net salvage factor was utilized to calculate the level of cost of retire/removal flowing into the depreciation reserve…" (IAWC Exhibit 9.10 at 15). Based on this fact, it would be obvious that using any net salvage level substantially below 100% would produce a significant shortfall in the level of cost recovery over the life of the asset. As previously stated, my position is that the Company's proposed net salvage ratios are excessive when compared to net salvage ratios used by Illinois-American affiliates in the development of depreciation rates for similar assets.

Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A Yes, it does.

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[1]IAWC Exhibit 9.14 is Mr. Robinson's analysis which incorporates a negative 40% net salvage factor.

[2]IAWC Exhibit 9.13 is Mr. Robinson's analysis which incorporates a negative 100% net salvage factor.