

Docket Nos. 07-0620/07-  
0621/08-0067 (Cons.)  
ICC Staff Exhibit 2.0

DIRECT TESTIMONY

OF

DIANNA HATHHORN

Accountant

Accounting Department

Financial Analysis Division

Illinois Commerce Commission

Aqua Illinois, Inc.

Proposed General Increase in Water and Sewer  
Rates for the Hawthorn Woods and Willowbrook Divisions  
and

Proposed General Increase for Water  
Rates for the Vermilion Division

Docket Nos. 07-0620/07-0621/08-0067 (Cons.)

May 8, 2008

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1 **Witness Identification**

2 **Q. Please state your name and business address.**

3 A. My name is Dianna Hathhorn. My business address is 527 East Capitol  
4 Avenue, Springfield, Illinois 62701.

5

6 **Q. By whom are you employed and in what capacity?**

7 A. I am currently employed as an Accountant in the Accounting Department of  
8 the Financial Analysis Division of the Illinois Commerce Commission (“ICC”  
9 or “Commission”).

10

11 **Q. Please describe your professional background and affiliations.**

12 A. I am a licensed Certified Public Accountant. I earned a B.S. in Accounting  
13 from Illinois State University in 1993. Prior to joining the Commission Staff  
14 (“Staff”) in 1998, I worked as an internal auditor for another Illinois state  
15 agency for approximately 3.5 years. I also have roughly 1.5 years  
16 experience in public accounting for a national firm.

17

18 **Q. Have you previously testified before a regulatory body?**

19 A. Yes. I have testified on several occasions before the Commission.

20

21 **Purpose of Testimony**

22 **Q. What is the purpose of your testimony in this proceeding?**

23 A. The purpose of my testimony is to review Aqua Illinois, Inc.'s ("Aqua" or  
24 "Company") filings for a proposed general increase in rates for its Hawthorn  
25 Woods Water Division, Hawthorn Woods Sewer Division, Willowbrook Water  
26 Division, Willowbrook Sewer Division and Vermilion Water Division and to  
27 propose adjustments regarding tank painting, uncollectibles expense, and  
28 parent company service charges.

29

30 **Schedule Identification**

31 **Q. Are you sponsoring any schedules with your testimony?**

32 A. Yes. I prepared the following schedules that show data as of, or for the test  
33 year ending, December 31, 2008 for the Willowbrook Water and Sewer  
34 Divisions and as of, or for the test year ending December 31, 2009 for the  
35 Vermilion Water Division:

36 Schedule 2.01 VW Adjustment for Tank Painting Projection

37 Schedule 2.01 WW Adjustment for Tank Painting Projection

38 Schedule 2.02 VW Adjustment to Uncollectibles Expense

39 Schedule 2.02 WW Adjustment to Uncollectibles Expense

40 Schedule 2.02 WS Adjustment to Uncollectibles Expense

41 Schedule 2.03 VW Adjustment to Parent Company Service Charges

42

43 **Q. Please explain the VW, WW, and WS suffixes that appears in your**  
44 **schedule numbers.**

45 A. The Company filed for rate increases in several different rate areas. The  
46 letters that follow the schedule numbers identify the respective rate areas as  
47 follow:

48 HW – Hawthorn Woods Water

49 HS – Hawthorn Woods Sewer

50 WW – Willowbrook Water

51 WS – Willowbrook Sewer

52 VW – Vermilion Water

53 Thus, Schedule 2.01 VW provides information for the Vermillion Water rate  
54 area. The rate area designation is a part of each schedule number to ease  
55 identification of which rate areas are affected by specific adjustments.

56

57 **Q. Are you including any attachments as part of ICC Staff Exhibit 1.0?**

58 A. I have included the following attachments that present information provided  
59 by the Company in response to ICC Staff Data Requests.

60 Attachment A Company response to Staff Data Request DLH-1.01

61 Attachment B Company response to Illinois Attorney General Data  
62 Request 1.8 V

63

64 **Adjustment for Tank Painting Projection**

65 **Q. Please describe Schedules 2.01 VW and WW Adjustment for Tank**  
66 **Painting Projection-Vermilion Division and Willowbrook Water.**

67 A. Schedule 2.01 VW and WW present my adjustments to tank painting  
68 amortization expense and deferred charges to reflect the actual cost of the  
69 projects reflected in the Company's responses to Staff Data Request DLH-  
70 1.09 (Vermillion) and DLH-6.01 (Willowbrook Water). Page 1 of Schedule  
71 2.01 VW and WW reflects the difference in amortization expense based on  
72 the actual bid or invoices, rather than Company projections. Page 2  
73 calculates the average cost of the deferred balance based on the actual bid  
74 or invoices as well. I am not opposing the Company's proposed ten year  
75 amortization schedule for these projects. My adjustments only reflect the  
76 change in the cost of the projects.

77

78 **Adjustment to Uncollectibles Expense**

79 **Q. Please describe Schedules 2.02 VW, WW, and WS Adjustment to**  
80 **Uncollectibles Expense.**

81 A. Schedules 2.02 VW, WW, and WS present my adjustments to reduce the  
82 Company's proposed uncollectibles expense to a normal level. The  
83 Company stated that its transition to a new Call Center/Billing & Work Order  
84 System has temporarily caused some bills to be delayed or questioned,

85 resulting in delayed payments and ultimately, increased uncollectibles  
86 expense. (Company response to Staff Data Request DLH-1.01, Attachment  
87 A to this testimony.) This short term increase in expense due to a temporary  
88 circumstance is not appropriate to be reflected in rates on a going forward  
89 basis. Therefore, I calculated an average four-year uncollectible expense  
90 amount based on the Company's methodology. (Schedules 2.02 VW, WW,  
91 WS line 6.)

92

93 **Q. Does your adjustment also affect the Gross Revenue Conversion**  
94 **Factor ("GRCF")?**

95 A. Yes. Since the Company's GRCF is also based upon above normal  
96 uncollectibles expense, it is necessary and appropriate to adjust this factor  
97 as well; otherwise, the increase in uncollectibles expense due to the revenue  
98 increase granted in this case would still be overstated. I calculate revised  
99 uncollectible rates at Schedules 2.02 VW, WW, and WS line 10. This rate is  
100 used in Staff witness Pearce's revenue requirement schedules.

101

102 **Adjustment to Parent Company Service Charges**

103 **Q. Please describe Schedule 2.03 VW Adjustment to Parent Company**  
104 **Service Charges-Vermilion Division.**

105 A. Schedule 2.03 VW presents my adjustment to reduce the Company's  
106 proposed allocated contractual expenses for charges it receives for services  
107 from its parent, Aqua America Inc. ("Aqua America"), and allocated charges  
108 for Illinois corporate costs from Aqua to reflect a more reasonable increase,  
109 based on the expected customer levels for the Illinois divisions receiving  
110 these charges and the Company's expected inflation rate.

111

112 **Q. How do the Aqua America and Illinois corporate costs for the test year**  
113 **compare to prior periods?**

114 A. Both projections are considerably higher than the 3% inflationary rate that  
115 the Company proposes for most operating and maintenance accounts.  
116 (Aqua Exhibit 2.2.) In response to Illinois Attorney General ("AG") Data  
117 Request 1.8 V, inquiring about the increase in these and other accounts, the  
118 Company only discussed the change in customer numbers that I address  
119 below. (Attachment B.) No other explanation was provided to support the  
120 increases below:

121

Table 1 Vermillion Division only	Aqua America Inc.	Illinois corporate costs
2007 (a)	\$393,111	\$389,248
2009 Test Year (b)	\$547,787	\$515,589
Percentage Increase	39%	32%

122 (a) Source: Aqua document 001180 and Part 285.305 (c),  
123 respectively

124 (b) Source: Company Schedule C-4 and response to Staff Data  
125 Request DLH-1.06, respectively  
126

127 **Q. How did the Company calculate its allocation of charges to the**

128 **Vermillion Division?**

129 A. According to the Company's response to AG Data Request AG 1.8 V, it  
130 assumed that the entire Woodhaven Operations and 90% of its University  
131 Park Sewer Operations would be sold, and therefore eliminated about  
132 13,600 customers or about 18% of its customer base from the allocation of  
133 Aqua America service charges. The Illinois corporate costs allocation is  
134 based on this same allocation of customer count.

135

136 **Q. What evidence did the Company present to establish that these sales**  
137 **would occur by December 31, 2009?**

138 A. The Company recently filed in Docket No. 08-0281 for approval of an Asset  
139 Purchase Agreement for the sale of the Woodhaven division. However, the  
140 Company does not have such an agreement in place for the sale of the  
141 University Park sewer system according to its response to Staff Data  
142 Request DLH-4.02. Calculating a revised allocation factor assuming only the  
143 Woodhaven sale will take place in the test year period results in a 32.45%  
144 allocation to the Vermillion Division, as opposed to the Company's 33.38%  
145 which also excludes 90% of the University Park sewer customers. This

146 relatively small change in the allocation factor does not provide adequate  
147 support for the 39% and 32% increases in these charges.

148

149 **Q. Please describe how your adjustment is calculated.**

150 A. I calculate the Aqua America and the Illinois corporate costs components  
151 separately due to the data available. For the Aqua America costs, first I  
152 determine the allocation factor based on customer counts including the  
153 University Park customers, but excluding Woodhaven customers due to the  
154 pending sale. On Schedule 2.03 VW, page 2, I calculate the new factor  
155 based on these assumptions to be 32.45%. On page 1 of Schedule 2.03  
156 VW, I apply the 3% escalation factor to the average Aqua America charges  
157 from the years 2006 and 2007 to determine a new test year level of charges.  
158 Finally, I apply Staff's customer allocation factor from page 2 to determine  
159 the Vermillion division amount of Aqua America charges for the test year.  
160 For the Illinois corporate costs, since I do not have the total amount of this  
161 component, I calculate the 3% inflationary increase from the Company's Part  
162 285.305 (c) data. I am willing to consider revisions to this adjustment in my  
163 rebuttal testimony provided the revisions are supported with appropriate  
164 evidence of all facts and calculations therein.

165

166 **Q. Do you also believe it is appropriate to adjust the Parent Company**  
167 **Service Charges for the Hawthorn Woods and Willowbrook divisions?**

168 A. Probably. My data requests on the amounts in the test year for these  
169 divisions are still outstanding. However, assuming that the methodology to  
170 determine the test year increase was applied consistently to all divisions,  
171 then it will be necessary to reflect adjustments to all divisions as well.

172

173 **Conclusion**

174 Q. Does this question end your prepared direct testimony?

175 A. Yes.

Aqua Illinois, Inc. - Vermilion Water Division  
Adjustment for Tank Painting Projection  
For the Test Year Ending 12/31/09

Line No.	Description	Amount	Source
	(a)	(b)	(c)
1	Tank Painting Amortization, Lynch Road, per Staff	\$ 7,000	Company response to Staff data request DLH-1.09
2	Tank Painting Amortization, Lynch Road, per Company	<u>14,000</u>	Company document AQUA 001767
3	Staff Proposed Adjustment to Misc. Expense	<u><u>\$ (7,000)</u></u>	Line 1 - line 2

Aqua Illinois, Inc. - Vermilion Water Division  
 Adjustment for Tank Painting Projection  
 For the Test Year Ending 12/31/09

Line No.	Description (a)	Amount (b)	Source (c)
1	Average Unamortized Tank Painting Balance Lynch Road per Staf	\$ 66,500	Line 6
2	Average Unamortized Tank Painting Balance Lynch Road per Compan	<u>133,000</u>	Line 9
3	Staff Proposed Adjustment to Rate Base-Deferred Charges	<u><u>(66,500)</u></u>	Line 1 - line 2
4	Unamortized Tank Painting Balance Lynch Road, at 12/31/2008, per Staff	\$ 70,000	Company response to Staff data request DLH-1.09
5	Unamortized Tank Painting Balance Lynch Road, at 12/31/2009, per Staff	<u>63,000</u>	Company response to Staff data request DLH-1.09 and Schedule 2.01 VW, p. 1
6	Average Unamortized Tank Painting Balance Lynch Road per Staff	<u><u>66,500</u></u>	(Line 4 + line 5) / 2
7	Unamortized Tank Painting Balance Lynch Road, at 12/31/2008, per Company	\$ 140,000	Company document AQUA 001766
8	Unamortized Tank Painting Balance Lynch Road, at 12/31/2009, per Company	<u>126,000</u>	Company document AQUA 001767
9	Average Unamortized Tank Painting Balance Lynch Road per Company	<u><u>133,000</u></u>	(Line 7 + line 8) / 2

Aqua Illinois, Inc. - Willowbrook Water Division  
Adjustment for Tank Painting Projection  
For the Test Year Ending 12/31/08

Line No.	Description (a)	Amount (b)	Source (c)
1	Tank Painting Amortization, Village Woods and Dixie Dells, per Staff	\$ 11,560	Company response to Staff data request DLH-6.01
2	Tank Painting Amortization, Village Woods and Dixie Dells, per Company	<u>13,650</u>	Company Schedule C-26
3	Staff Proposed Adjustment to Misc. Expense	<u>\$ (2,090)</u>	Line 1 - line 2

Aqua Illinois, Inc. - Willowbrook Water Division  
 Adjustment for Tank Painting Projection  
 For the Test Year Ending 12/31/08

Line No.	Description (a)	Amount (b)	Source (c)
1	Average Unamortized Tank Painting Balance Village Woods and Dixie Dells per Staff	\$ 109,820	Line 6
2	Average Unamortized Tank Painting Balance Village Woods and Dixie Dells per Company	<u>125,694</u>	Line 9
3	Staff Proposed Adjustment to Rate Base-Deferred Charges	<u><u>\$ (15,874)</u></u>	Line 1 - line 2
4	Unamortized Tank Painting Balance Village Woods and Dixie Dells, at 12/31/2007, per Staff	\$ 115,600	Company response to Staff data request DLH-6.01
5	Unamortized Tank Painting Balance Village Woods and Dixie Dells, at 12/31/2008, per Staff	<u>104,040</u>	Line 4 - Schedule 2.01 WW, page 1 line 1
6	Average Unamortized Tank Painting Balance Village Woods and Dixie Dells per Staff	<u><u>\$ 109,820</u></u>	(Line 4 + line 5) / 2
7	Unamortized Tank Painting Balance Village Woods and Dixie Dells, at 12/31/2007, per Company	\$ 132,519	Company Schedule B-10
8	Unamortized Tank Painting Balance Village Woods and Dixie Dells, at 12/31/2008, per Company	<u>118,869</u>	Company Schedule B-10
9	Average Unamortized Tank Painting Balance Village Woods and Dixie Dells per Company	<u><u>\$ 125,694</u></u>	(Line 7 + line 8) / 2

Aqua Illinois, Inc. - Vermilion Water Division  
 Adjustment to Uncollectibles Expense  
 For the Test Year Ending 12/31/09

Line No.	(a)	Amount (b)	Source (c)
1	2004 Net Uncollectible Expense	\$ 64,413	(1)
2	2005 Net Uncollectible Expense	84,469	(1)
3	2006 Net Uncollectible Expense	133,745	(2)
4	2007 Net Uncollectible Expense	<u>236,527</u>	(3)
5	Total	\$ 519,154	Sum of line 1 through 4
6	Four-year average per Staff	\$ 129,789	Line 5 / 4
7	Uncollectibles Expense per Company	<u>\$ 189,632</u>	(2)
8	Staff Proposed Adjustment to Uncollectibles Expense	<u><u>\$ (59,844)</u></u>	Line 6 - line 7
9	Company Pro Forma Present Revenues	\$ 12,885,863	Company Sch. C-1
10	Uncollectibles Percent for Gross Revenue Conversion Factor	1.0072%	Line 6 / line 9

(1) Source: Company response to Staff data request BAP-8.05 and Company document Aqua 001861

(2) Source: Company Schedule C-16

(3) Source: Company response to Staff data request BAP-7.08 and Company document Aqua 001180

Aqua Illinois, Inc. - Willowbrook Water Division  
 Adjustment to Uncollectibles Expense  
 For the Test Year Ending 12/31/08

Line No.	(a)	Amount (b)	Source (c)
1	2003 Net Uncollectible Expense	\$ 1,691	(1)
2	2004 Net Uncollectible Expense	2,527	(1), (3)
3	2006 Net Uncollectible Expense	1,330	(2)
4	2007 Net Uncollectible Expense	<u>3,633</u>	(2)
5	Total	\$ 9,181	Sum of line 1 through 4
6	Four-year average per Staff	\$ 2,295	Line 5 / 4
7	Uncollectibles Expense per Company	<u>\$ 3,651</u>	(2)
8	Staff Proposed Adjustment to Uncollectibles Expense	<u><u>\$ (1,356)</u></u>	Line 6 - line 7
9	Company Pro Forma Present Revenues	\$ 528,287	Company Sch. C-1
10	Uncollectibles Percent for Gross Revenue Conversion Factor	0.4345%	Line 6 / line 9

(1) Source: Company response to Staff data request DLH-5.02 and Company document Aqua 001911

(2) Source: Company Schedule C-16

(3) Note: 2005 Net Uncollectible Expense of 364 excluded due to its appearance as an outlier

Aqua Illinois, Inc. - Willowbrook Sewer Division  
 Adjustment to Uncollectibles Expense  
 For the Test Year Ending 12/31/08

Line No.	(a)	Amount (b)	Source (c)
1	2004 Net Uncollectible Expense	\$ 4,473	(1)
2	2005 Net Uncollectible Expense	5,339	(1)
3	2006 Net Uncollectible Expense	3,230	(2)
4	2007 Net Uncollectible Expense	<u>4,462</u>	(2)
5	Total	\$ 17,504	Sum of line 1 through 4
6	Four-year average per Staff	\$ 4,376	Line 5 / 4
7	Uncollectibles Expense per Company	<u>\$ 4,490</u>	(2)
8	Staff Proposed Adjustment to Uncollectibles Expense	<u><u>\$ (114)</u></u>	Line 6 - line 7
9	Company Pro Forma Present Revenues	\$ 649,806	Company Sch. C-1
10	Uncollectibles Percent for Gross Revenue Conversion Factor	0.6734%	Line 6 / line 9

(1) Source: Company response to Staff data request DLH-5.02 and Company document Aqua 001912

(2) Source: Company Schedule C-16

**Aqua Illinois, Inc. - Vermilion Water Division**  
**Adjustment to Parent Company Service Charges**  
**For the Test Year Ending 12/31/09**

Line No.	Description (a)	Amount (b)	Source (c)
1	Aqua America Service Charges, per Staff	\$ 465,887	(1)
2	Aqua America Service Charges, per Company	<u>547,787</u>	Company Schedule C-4, p. 3
3	Staff Proposed Adjustment to Contractual Services Expense	<u>\$ (81,900)</u>	Line 1 - line 2
4	Illinois corporate costs, per Staff	\$ 412,953	(2)
5	Illinois corporate costs, per Company	<u>515,589</u>	Company response to Staff data request DLH-1.06
6	Staff Proposed Adjustment to Misc. Expense	<u>\$ (102,636)</u>	Line 1 - line 2
<u>(1) See calculation below</u>			
	2006 Total Expense per Aqua document 001804	\$ 1,435,622	
	2007 Total Expense per Aqua document 001806	<u>1,423,203</u>	
	Average Management Fees per Staff	\$ 1,429,413	
	3% Inflation for 2008	\$ 1,472,295	
	3% Inflation for 2009	\$ 1,516,464	
	Allocation Factor per Staff Sch. 2.03 VW p. 2	<u>32.45%</u>	
	Allocated Charges per Staff	<u>\$ 465,887</u>	
<u>(2) See calculation below</u>			
	11/06 through 10/07 Expense per Company response to Part 285.305 (c)	\$ 389,248	
	3% Inflation for 2008	\$ 400,925	
	3% Inflation for 2009	<u>\$ 412,953</u>	

**Aqua Illinois, Inc. - Vermilion Water Division**  
**Adjustment to Parent Company Service Charges**  
 For the Test Year Ending 12/31/09

Line No.	Description (a)	Amount (b)	Source (c)
1	2009 Customer Count-All Divisions	63,096	WP-A5
2	Add Back Excluded University Park Sewer Customers	<u>1,800</u>	Aqua document AQUA 001860 and WP-A5
3	Adjusted Customer Count per Staff	<u><u>64,896</u></u>	Line 1 + line 2
4	2009 Vermillion Customer Count per Company	21,060	WP-A5
5	Allocation Factor per Staff	<u><u>32.45%</u></u>	Line 4 / line 3
6	Allocation Factor per Company	33.38%	

Aqua Illinois, Inc.  
Docket Nos. 07-0620/0621/08-0067 (Vermilion)

Response to Illinois Commerce Commission  
Data Requests

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- DLH 1.01 For the Vermilion Water Division, referring to the Company's document AQUA 001180, footnote e) states "Aqua has experienced an increase in bad debt expense as we transition into our new billing software; implemented in May 2007."
- a) Explain the Company's rationale that its new billing software results in higher bad debt expense.
  - b) Explain all differences between the Company's old billing software and its new billing software, focusing on how those differences would lead to a higher rate of bad debt.

RESPONSE:

- a) The transition to the new Call Center / Billing & Work Order System, including use of new Banner CIS software, has temporarily caused some bills to be delayed or questioned, resulting in delayed payments. The transition also resulted in a delay of delinquent shut offs. Aged receivables have consequently increased during this transitional period while billing issues/questions are resolved and the shut off process resumes to normal. As aged receivables increase, the uncollectible expense reserve is increased as well. The offset to increased uncollectible accounts reserve is bad debt expense.
- b) The new billing software is Banner CIS which uniformly replaces various types of other than Banner billing software systems used throughout Aqua America, Inc. which were no longer supportable. (Banner is a tier one software provider in the utility space). Aqua America Inc. Consolidated Call Center practices/billing software utilization brings with it improved overall customer service levels and Call Center availability (relating to load balancing, systems down time recovery, hours of operation etc.). Any of Aqua America, Inc.'s three Call Centers may be utilized to handle customer inquiries and requests for Aqua Illinois.

A major transition such as converting to the new Call Center Billing & Work Order System, including use of new Banner CIS, brings with it a learning curve for new and existing employees. As was the case many years ago when Reflections was introduced as Aqua Illinois' billing software, numerous programs must be written and / or modified to adapt to Banner and meet ever-increasing needs of various internal and external customers for the next several years. The Company is still in the process of perfecting these programs as well as processes related to the new Call Center. Throughout the transitional period aged receivables / bad debt expense has increased as explained in part (a) response.

March 18, 2008

Aqua Illinois, Inc.  
Docket No. 08-0067

Response to Illinois Attorney General  
Data Requests

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1.8 V Referring to Schedule C-4, Page 3, please explain the increases in the following expenses from 2007 to 2008: 634 – Contractual Services-Management , 635&636 – Contractual Services-Other, 670 – Bad Debt Expense, 675 – Miscellaneous Expenses, 403 – Depreciation, and 408 – Taxes Other Than Income Taxes.

RESPONSE:

With regard to Account 634 – Contractual Services-Management, the increase is due in large part because Aqua Illinois is anticipating the sale of its Woodhaven Operations and 90% of its University Park Sewer Operations. The result is a loss of about 13,600 customers or about 18% of its customer base. The end result is a smaller customer base to spread the management services, and therefore an increase to the remaining divisions.

With regard to Accounts 635 & 636 – Contractual Services – Other, the increase pertains to the Call Center / billing & work order system implemented in May 2007. The increase in 2008 reflects a full year of costs associated with these processes.

With regard to Account 670 – Bad Debt Expense, an increase is projected due to the transition to the new Call Center / billing & work order system. This transition has temporarily caused some bills to be delayed or questioned, resulting in delayed payments. Aged receivables have consequently increased during this transitional period while billing issues / questions are resolved. As aged receivables increase, the uncollectible expense reserve is increased as well. The offset to increased uncollectible accounts reserve is bad debt expense.

With regard to Account 675 – Miscellaneous Expense; When the Illinois Corporate charges are allocated to the operating divisions, these costs are recorded in Miscellaneous Expenses. Because the total customer base for Illinois will decrease by 18% in 2008, Vermilion is picking up a larger portion of the Illinois Corporate Charges.

With regard to Account 403 – Depreciation Expense, increase results from additional depreciable additions as shown on Schedule B-5.

With regard to Account 407 – Taxes Other Than Income, Aqua Illinois closed on a \$17,000,000 bond financing in December 2007. The increase in long-term debt affects the calculation of the Invested Capital Tax with the State of Illinois. The increase in the ICT tax is the reason for the increase in Taxes Other Than Income.