

**REPORT TO THE COMMISSION
PURSUANT TO SECTION 200.520 OF THE RULES OF PRACTICE
OF THE ILLINOIS COMMERCE COMMISSION**

Docket No: 09-0251
Bench Date: 08-19-09
Deadline: None

R E P O R T

TO: The Commission

FROM: J. Stephen Yoder
Administrative Law Judge

DATE: August 11, 2009

SUBJECT: Illinois-American Water Company

Proposed implementation of a Qualifying Infrastructure Plan (QIP) Surcharge Rider

RECOMMENDATION: Deny Petition for Interlocutory Review filed on July 30, 2009 on behalf of the City of Champaign.

On April 23, 2009 Illinois American Water Company ("IAWC" or the "Company") filed tariffs to implement a Qualifying Infrastructure Plan ("QIP") for in its Champaign, Sterling, Pekin, Lincoln, South Beloit, and Chicago Metro Water and Waste Water districts. On May 20, 2009, the Commission suspended the tariffs, assigned the proceeding Docket No. 09-0251 and convened an investigation into the proposed tariffs.

On June 15, 2009, a verified petition to Intervene on behalf of City of Champaign, Illinois ("Champaign") was filed. On July 2, 2009, a petition for leave to Intervene on behalf of the Village of Bolingbrook, Illinois was filed. The People of the State of Illinois (the "AG"), by Lisa Madigan, Attorney General of the State of Illinois, also filed a petition to Intervene.

On July 7, 2009 a motion to consolidate this proceeding with IAWC's pending rate case, Docket No. 09-0319, ("Motion to Consolidate") was filed by Champaign. On July 14, 2009, the Staff of the Illinois Commerce Commission ("Commission") and IAWC filed responses objecting to the Motion to Consolidate. On that same day, the AG filed a response in support of the Motion to Consolidate. On July 17, 2009, Champaign filed a reply to the responses of IAWC and Staff, continuing to urge

consolidation of this case with Docket No. 09-0319. On July 20, 2009, a notice was issued denying the Motion to Consolidate.

Champaign's Petition for Interlocutory Review

On July 30, 2009, Champaign filed a Petition for Interlocutory Review ("IR Petition") of the July 20, 2009 ruling which denied the Motion to Consolidate. In its IR Petition, Champaign claims that failure to consolidate the two proceedings will result in the potential for four rate increases in a period of less than 14 months and require the Commission to conduct at least two reconciliation hearings, which Champaign asserts is not in the public interest. Champaign argues that consolidation of this docket with the rate case would not prejudice IAWC since the time that any QIP rider would be in effect prior to the final rates in IAWC's rate case is relatively short, so the costs to implement and to conduct required reconciliation hearings make the charges questionable at best.

According to Champaign, when IAWC filed its proposed QIP tariffs, it sought to impose the new QIP rider immediately, so that the rider would be in effect in the second half of 2009. Champaign says IAWC also proposed to change the QIP rider rate effective January 1, 2010, based upon a future test year of 2010. Champaign adds that IAWC claims it needs the QIP rider to recover the cost of investment in infrastructure put in place between rate cases.

Champaign notes that IAWC used a calendar year 2010 future test year for its pending rate case, which it says is identical to IAWC's projected QIP rates, 2010. Champaign states that the statutory deadline for the rate case is April 2010, which is only 35 days beyond the deadline for the QIP case.

Champaign says that IAWC's last rate case, Docket No. 07-0507, used a future test year ended June 30, 2009. Champaign avers that there only six months that are not part of either IAWC's last rate case or its current rate case, which uses a 2010 calendar year test year.

According to Champaign, when the rates in the rate case are established on approximately April 25, 2010, the QIP surcharge will be reduced to zero to avoid confusion regarding what 2010 expenses are being recovered under the QIP rider and the base rates. Champaign says this leaves a window of only 10 months, July 1, 2009 to April 2010, when the new QIP charges could have been imposed to recover the costs in the six months between base rate test years. Champaign contends that since IAWC has stated it would set the QIP rider based on the projected costs for the next calendar year, a QIP rider that would be in effect starting January, 2010 would be for the same time period as IAWC's future test year in the pending rate case. Champaign states that a QIP can only include items which "are not reflected in the rate base used to establish the utility's base rates." (citing Section 9-220.2 of the Public Utilities Act ("Act"))

The Commission, Champaign argues, should not allow IAWC to squeeze authorization for a QIP surcharge into the short period between IAWC's rate cases. Champaign claims that if the Commission adopts IAWC's proposal, IAWC will be able to raise rate four times by January, 2011. Champaign says the first increase would be implementing the new QIP rider before year end 2009. The second increase, according to Champaign, would be when IAWC establishes new QIP surcharge effective January 1, 2010, based on its projected costs for 2010. The third increase, Champaign claims, would be in April 2010, when the new general rates take effect, and the QIP rider would presumably be reset to zero. The fourth rate increase would be on January 1, 2011 when IAWC implements yet another QIP rider rate based on its projected costs for 2011. Champaign alleges this would result in consumer confusion and would require the Commission to conduct reconciliation hearings for the rate prior to January 2010 and one for rate in effect from January to April 2010. Champaign believes this would waste consumer as well as Commission Staff time, energy, and funds.

Champaign alleges that in its rate case, IAWC says that if a QIP rider is approved in this proceeding, it should be set at zero until at least January 2011. Champaign claims that in this proceeding; however, IAWC indicates a desire to impose a QIP rider in the second half of calendar year 2009, then file and charge a new QIP rider beginning January 2010 based upon its projections for QIP plant in 2010. In Champaign's view, IAWC's filing raises the issue of how the QIP rider and its charges will be coordinated with and excluded from the rates to be set in the rate case, Docket No. 09-0319.

Champaign complains that by failing to consolidate the two dockets, Champaign is required to participate in two separate hearings, conduct separate discovery, provide potentially duplicative testimony and file briefs and exceptions in both dockets potentially on the same issues.

Champaign further alleges that multiple hearings and multiple rate increases for customers is contrary to the public statements by IAWC to ratepayers in Champaign. Champaign claims that IAWC assured customers that there would be "No rate adjustment until spring 2010."

According to Champaign, both the general rate case and the QIP case use the same IAWC witnesses to discuss capital and QIP projects. Champaign adds that the same witnesses discuss how QIP charges are to be treated. Champaign contends that both dockets will require the Commission to at least coordinate what costs are to be recovered from and/or excluded from base rates to prevent double recovery. Champaign believes this coordination can be best accomplished in one hearing rather than two.

Champaign argues that because the two dockets involve similar questions of law or fact the QIP rider docket should be consolidated with the general rate case docket. Champaign claims that the public interest will not be prejudiced by such a procedure.

Champaign maintains that it is in the public interest to consolidate these hearings to avoid the added expense of trying the same issues twice. Champaign also contends that it is in the public interest to avoid the potential for four rate increases for Champaign water customers in less than 14 months.

The AG's Response to the Petition for Interlocutory Review

On August 5, 2009, the AG filed a Response in support of Champaign's Petition for Interlocutory Review and in support of consolidation. The AG believes that the QIP tariff changes requested by IAWC in this docket are more properly considered in the context of the Company's pending rate case, docket 09-0319.

The AG argues that the Commission need not approve a QIP rider surcharge under section 9-220.2 of the Act, although it "may authorize" such a surcharge. The key issue in considering a QIP rider, according to the AG, should be whether it is necessary or appropriate to allow a company to increase rates to consumers between rate cases. The AG contends that the Commission should consider the interaction of rate cases, the Company's rate case history, the test years used, and the incentives and disincentives created by a surcharge method in reviewing a request for a QIP surcharge rider.

The AG notes that IAWC has a rate case pending before the Commission that is considering the Company's full range of tariffs and rates, including rate base, depreciation, and cost of capital. The history and trends of the Company's rate base investments and the condition of its plant are part of the rate case review. An analysis of whether a QIP rider is appropriate will necessarily involve the same facts and issues, and maintaining a separate docket to conduct that review will unnecessarily burden the parties and lead to duplicative efforts and possibly inconsistent results.

Given the history of IAWC's rate increase requests and test years, the AG argues that it is clear that there is no need for an expedited resolution of IAWC's request. The AG observes that the Company's last rate case, Docket No. 07-0507 used a future test year that ended June 30, 2009. The AG adds that the Company's pending rate case, Docket No. 09-0319, uses a future test year starting January 1, 2010, starting just 6 months after the last rate case test year. The AG states that when the rates in docket 09-0319 are established on or about April 25, 2010, the QIP surcharge will have to be reduced to zero to avoid double counting for 2010 expenses, leaving a window of only 10 months (July 1, 2009 – April, 2010) when QIP surcharges might be assessed and imposed. According to the AG, the law is clear that a QIP surcharge can only include items which "are not reflected in the rate base used to establish the utility's base rates."

In the AG's view, the Commission should not allow IAWC to squeeze authorization for a QIP surcharge, and allow the Company to impose QIP surcharges, into the short period between IAWC's 2007 and 2009 rate cases. In addition to the fact that there are very few months during which the rates and the test year do not match,

The AG says that the amount of time after this docket is resolved shortens the window yet further. The AG notes that the deadline for approval of the filed tariffs is March 20, 2010, leaving barely a month for the QIP charge to be in effect. Even if the review is expedited, the AG claims it is unlikely that review can be completed before the beginning of 2010, leaving only four months before the new rates, reflecting the 2010 test year rate base, are in place. The AG contends that in the interests of administrative efficiency and economy, the Commission should not allow what the AG calls an "interim rate proceeding" while a general rate case is ongoing, particularly when the rates under consideration will be in effect for a very short period before the rate case is resolved.

If a QIP surcharge is added in the areas requested, the AG says consumers in those areas will first see a new charge on their bill, and then shortly thereafter see a major revision in rates and disappearance of that charge. The AG states that IAWC, the Commission and intervenors will then have to review a reconciliation of costs and recovery for that short period of time, and consumers will see the QIP charge reappear on their bills the following year. The AG expresses concern that this will cause consumer confusion to a customer group that is already acutely aware of and sensitive to the rate changes for water service.

The AG asserts that the Commission's rules authorize consolidation in this situation. According to the AG, the rate case and this docket both involve the review of IAWC's rate base and infrastructure needs and its tariffs. In the AG's view, consolidation would allow the Commission to consider "similar questions of law or fact" in one docket, that is, the interplay of the rider surcharge and base rates and whether a QIP surcharge rider is the best way to encourage economic investment by the Company.

The AG suggests that in the alternative, given the slightly different time frames governing the rate case and this QIP request, the Commission can reject the QIP tariff, with leave to the Company to refile it in the context of the rate case. The AG asserts that it took time for IAWC to plan and prepare for its rate case, and the Company's failure to coordinate its QIP request by either filing it earlier or with the rate case should not drive the Commission to conduct an expedited hearing that may not provide a comprehensive review, may conflict with rate case considerations, and that will result in consumer confusion and dissatisfaction as they see extreme short term variability in their rates.

Staff's Response to Petition for Interlocutory Review

It is Staff's position that Champaign's unfounded request for consolidation ignores the Act, the Commission's Rules of Practice, and the Commission's rules regarding QIP surcharges. Staff also asserts that Champaign's Petition is insufficient on its face because it fails to address the Administrative Law Judge's ("ALJ's") reasons for denying consolidation. According to Staff, the very nature of a request for interlocutory review is a dispute with the basis for an ALJ's ruling on a particular matter.

Staff states that the ALJ's Ruling in the instant proceeding denied Champaign's request for consolidation because: (1) Champaign's allegations of double collection of revenues were overstated, and (2) the two proceedings have different statutory deadlines. Staff contends that Champaign's Petition does not challenge either of the ALJ's reasons. Staff says that instead, Champaign advances new arguments based on its own misunderstanding of both the Act and the Commission's rules. Staff urges the Commission to uphold the ALJ's Ruling, as Champaign cannot refute the ALJ's rationale.

According to Staff, it is unclear what point Champaign is attempting to make regarding plant additions in the portion of its Petition that primarily pertains to the procedural history of the instant proceeding. In Staff's view, the fact that IAWC's plant additions for its initial QIP may be in the test year of its rate case is probative of nothing, including consolidation of the two matters, since recovery through both QIP and base rates is prohibited.

Staff observes that the Company's proposed implementation of a QIP Surcharge Rider as requested in the instant proceeding is specifically authorized by Section 9-220.2 of the Act. Staff also notes that the Commission has promulgated rules at 83 Ill. Adm. Code 656, "Qualifying Infrastructure Plant Surcharge," implementing Section 9-220.2 of the Act and that the Commission has also promulgated rules at 83 Ill. Adm. Code 285, which provide filing requirements for public utility rate cases.

Staff argues that pursuant to the Act and the Commission's rules, IAWC's plant additions projected for 2010 are in the Company's rate case Rate Base and cannot be included in QIP calculations. As such, Staff believes that Champaign's point that IAWC's QIP case and rate case both use 2010 plant projections is meaningless and should be rejected by the Commission.

Champaign argues that IAWC's QIP Surcharge Rider can only cover the six-month period that is neither part of the Company's last rate case nor part of the Company's current rate case. Staff believes that Champaign must misunderstand the Commission's rules, which Staff says provide that QIP recovery begins on the effective date of the rider until the effective date of the new rates, and on plant additions after the test year. Staff sees no reason why different recovery periods in different dockets would support the argument for consolidation. In Staff's view, Champaign's point that IAWC's QIP can only cover the six months between the Company's test years is incorrect and inappropriate, and should be rejected by the Commission.

Champaign complains that customers will see four rate increases in 14 months, along with five reconciliation hearings. According to Staff, Champaign is confused. Staff says IAWC's rate case will determine base rates from a revenue requirement derived from test year rate base. The purpose of the instant QIP proceeding, Staff contends is to consider allowing the Company to issue tariffs that provide for the recovery of plant investment that is incurred after the end of a test year. Staff claims that these tariffs, if authorized, will allow the Company to recover plant cost and a return

on that cost, until these costs can be included in rate base and recovered through base rates as will be determined in a future rate case. In Staff's view, the instant proceeding is concerned only with whether the Company meets the requirements to initiate a QIP surcharge tariff as provided by the Commission's rules at 83 Ill. Adm. Code 656, it has none of the elements of a rate case filed pursuant to 83 Ill. Adm. Code 285.

Staff states that IAWC already has QIP Surcharge Riders at its Alton, Cairo, Interurban, Peoria, Streator, and Pontiac districts, which were approved by the Commission in Docket No. 04-0336. In the instant proceeding, Staff says the Company merely seeks to add practically identical riders at its Champaign, Sterling, Pekin, Lincoln, South Beloit, and Chicago Metro Water and Waste Water districts. While Champaign complains that approval of the QIP Surcharge Rider will result in multiple reconciliation proceedings, Staff contends that not only does this situation already exist, but it is also the process provided by Section 9-220.2 of the Act and the Commission's rules at 83 Ill. Adm. Code 656. According to Staff, Champaign's misconception that IAWC's request for the application of the QIP Surcharge Rider to seven additional of its districts is a request for a rate increase should be rejected by the Commission.

Staff states that while 83 Ill. Adm. Code 200.600 provides that "two or more proceedings involving a similar question of law or fact" may be consolidated, Staff does not believe that the two dockets involved in this instance contain similar issues of law or fact. Staff asserts that while both IAWC's QIP proceeding and its rate case proceeding are concerned with providing for a return on investment, there are no similarities in substance of the two cases. Staff states that while the rate case determines base rates from a revenue requirement derived from test year rate base, the QIP case considers only allowing the Company for the recovery of plant investment occurring outside of a test year pursuant to a rider. In Staff's view, the argument for consolidation because Company witnesses in the two proceedings are similar, is absurd. Staff avers that while the witnesses may be similar, the issues are not.

IAWC's Response to Petition for Interlocutory Review

With regard to Champaign's concerns regarding double collections, IAWC contends that under Part 656 there is no risk of double recovery. IAWC claims that the ability to confirm the appropriateness of revenue recovery, or to verify the absence of double recovery, is provided in both the QIP rider approval proceeding and subsequent QIP rider reconciliation proceedings. IAWC believes that not only is consolidation of this proceeding with the rate case unwarranted, but it would prejudice IAWC.

IAWC asserts that Champaign's IR Petition fails to address or challenge the reasons for the Administrative Law Judge's ruling; rather, IAWC claims that Champaign uses its IR Petition to raise entirely new arguments in favor of consolidation. IAWC believes that Champaign's IR Petition is procedurally inappropriate. IAWC says that Champaign address for the first time in its IR Petition, that standard governing consolidation of Commission proceedings.

According to IAWC, in addition to being procedurally inappropriate, the new arguments set forth in the IR Petition display a misunderstanding of the operations of the QIP under Part 656 and IAWC's proposal regarding the rules, as well as, a misapplication of the Commission rules regarding consolidation of cases. IAWC asserts that the focus of the instant proceeding should be to consider whether IAWC's requests meet the requirements to implement a QIP surcharge pursuant to the provisions of Section 9-220.2 of the Act and Part 656. IAWC believes it has met its burden in complying with the requirements in those sections

IAWC argues that Champaign's complaint that implementing a QIP rider would require the Commission to conduct multiple reconciliation hearings is without merit and is not cause to overturn the decision of the Administrative Law Judge. Even if Champaign's arguments about multiple reconciliations had merit, which IAWC claims they do not, IAWC asserts that any QIP surcharges implemented would be implemented in accordance with the requirements of Part 656. IAWC says that under those requirements, reconciliations are held annually and cover the operation of the QIP rider in the prior year. IAWC contends that the reconciliation for a QIP rider in effect in 2010 would take place in 2011, and the reconciliation for a QIP rider in effect in 2011 would take place in 2012. IAWC says this is a period of three years, not 14 months as Champaign asserts.

IAWC indicates that it currently has in place QIP surcharge riders in its Alton, Cairo, Interurban, Peoria, Streator and Pontiac districts. QIP states that pursuant to Section 656.220.20, the reconciliation proceedings are currently conducted on an annual basis. IAWC says it intends to add the new districts to the current established reconciliation process. In IAWC's view, the concerns raised by Champaign are overstated and reflect Champaign's misunderstanding of the QIP reconciliation process.

IAWC says Champaign's new concerns also suggest customers would be subject to multiple rate increases in a short period. IAWC claims this also misunderstands the nature of a QIP rider. IAWC contends that once implemented, operation of the QIP rider may produce surcharges that go either up or down from previous years. IAWC asserts that a surcharge percentage may actually decrease from one year to the next. In IAWC's view, Champaign's discussion of continual increases is purely speculation on its part.

IAWC believes that Champaign's concerns about coordination of findings in the rate case and the instant proceeding are unwarranted. IAWC argues that Part 656 ensures that IAWC does not recover the costs for any project that is in IAWC's approved rate base, and sets the QIP surcharge to zero at the time new base rates go into effect. IAWC insists there is nothing to coordinate. IAWC maintains that the present proceeding and the rate case are substantively different. IAWC states that this case only seeks authorization to put a QIP rider into effect, while the rate case addresses entirely separate issues related to a general rate increase.

Discussion and Recommendation

In its IR Petition, Champaign claims that failure to consolidate the two proceedings will result in the potential for four rate increases in a period of less than 14 months and require the Commission to conduct at least two reconciliation hearings, which Champaign asserts is not in the public interest. Champaign argues that consolidation of this docket with the rate case would not prejudice IAWC since the time that any QIP rider would be in effect prior to the final rates in IAWC's rate case is relatively short, so the costs to implement and to conduct required reconciliation hearings make the charges questionable at best.

One of Champaign's primary concerns, the prevention of double recovery, is at the core of both Section 9-220.2 of the Act and Part 656. In any event, if Rider QIP is approved and has a positive value before the conclusion of IAWC's rate case, Docket No. 09-0319, it will be reset to zero at the conclusion of that docket and thus, there will be no opportunity for double recovery. In my view, consolidating the two proceedings would provide no meaningful advantage or benefit with regard to preventing double recovery of utility costs.

Champaign also expresses concerns about the possibility of multiple rate changes during a short period of time. One of the rate changes Champaign identifies would only occur if Rider QIP is approved and becomes effective before December 31, 2009, which is not certain. Additionally, Champaign seems to believe that through consolidation, the deadline for a final order in this proceeding, Docket No. 09-0251, will somehow be extended to coincide with the deadline for a final order in the rate proceeding, Docket No. 09-0319. Champaign provides no basis for this assumption, and it does not appear possible to extend the statutory deadline in Section 9-201 of the Act. It appears that if the two cases were consolidated, the opposite would be true. That is, the rate case, which had a deadline of April 25, 2010, would have to be accelerated to coincide with the deadline for the instant proceeding, March 20, 2010. Champaign does not address the potential adverse implications of accelerating the rate case by over one month. In my view, the significant negative implications of accelerating the rate case by over one month outweigh any potential benefits of consolidating this proceeding with the rate case. Shortening the rate case schedule by over one month would adversely impact the parties participating in that proceeding, would impair the development of a complete record, and ultimately inhibit the Commission's ability to render a high quality decision in a complex general rate case proceeding.

I recommend that the Commission deny the Petition for Interlocutory Review and affirm the ruling that the instant proceeding should not be consolidated with IAWC's rate case, Docket No. 09-0319.

JSY