

Before the
Illinois Commerce Commission

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In the Matter of

Approval of an Increase and
Adjustment of Rates and Charges for
Water Utility Service Sold by
Apple Canyon Utility Company within
Jo Daviess County

Direct Testimony of

Steven M. Lubertozi, CPA

for

Apple Canyon Utility Company

October 2009

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

2 A. My name is Steven M. Lubertozi. My business address is 513 S. Fair Ave.,
3 Elmhurst, IL 60126.

4

5 **Q. What is your occupation?**

6 A. I am the independent consultant providing financial, regulatory and operational
7 assistance to utility companies.

8

9 **Q. Please summarize your professional background?**

10 A. I was employed by Utilities, Inc. from June 2001 through September 2009. Since
11 September 15, 2009 I have been working as a consultant. Since June of 2001 I
12 have been involved in many phases of rate-making in several regulatory
13 jurisdictions. I graduated from Indiana University in 1990, and I am a Certified
14 Public Accountant. I earned my Master of Business Administration from
15 Northwestern's University's Kellogg School of Management.

16

17 **Background**

18

19 **Q. Please describe Apple Canyon Utility Company.**

20 A. Apple Canyon Utility Company is a wholly owned subsidiary of Utilities, Inc. (UI).
21 Water Service Corporation (WSC) manages the operation for all of UI's water and
22 wastewater systems, including Apple Canyon. WSC provides management,
23 administration, engineering, accounting, billing, data processing, and regulatory
24 services for the utility systems. WSC's expenses are assigned directly to a utility or
25 distributed to the various companies pursuant to a formula that has been
26 approved by the Commission.

27 Apple Canyon provides water usage service to approximately 890 customers and
28 water availability service to approximately 1,800 customers in JoDaviess County.
29 Apple Canyon's current rate structure was approved pursuant to an order
30 contained in Docket No. 03-0399 dated April 7, 2004.

31

32 **Q. Mr. Lubertozi, what is the purpose of your testimony here today?**

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1 A. The purpose of my testimony is to explain to the Commission why Apple Canyon
2 Utility Company has requested an increase in water rates. I will also discuss some
3 of the factors that have contributed to the need for the increase and the impact of
4 the increase on our customers. I will present and describe schedules showing the
5 overall cost of capital and proper rate of return on rate base, and I will also sponsor
6 the Utility's financial exhibits.

7

8 **Rate Relief**

9

10 **Q. Why is Apple Canyon Utility Company requesting rate relief at this time?**

11 A. A rate increase is necessary to allow the Utility to recover the reasonable and
12 prudent costs of providing service and an opportunity to earn a fair and reasonable
13 rate of return on its invested capital. Rates granted in 2004 do not reflect the 5
14 years of rising costs, many of which result from increased investment, and
15 inflation. For these reasons the Utility is not able to achieve a reasonable rate of
16 return on its investment. Rate relief is essential to ensure the continued
17 availability of capital at a reasonable cost and to maintain a high and professional
18 level of service. Under the present rate schedule, Apple Canyon is not earning a
19 fair and reasonable return on its investment. After making pro forma adjustments
20 to the December 2008 test year for known, fixed and measurable changes Apple
21 Canyon Utility Company has an overall negative return of 16.39%. The proposed
22 rates will allow the company to earn a 8.66% overall rate of return. This
23 information is supported in the financial statements attached hereto as **Utility**
24 **Exhibit One.**

25

26 **Q. Mr. Lubertozzi, what factors, or changes in the cost of service, can you point**
27 **to that have contributed to the need for the requested increase?**

28 A. The age of the system is a factor in the cost of maintenance to be done. As the
29 system ages, the cost of maintenance increases. In addition, Apple Canyon's
30 parent company Utilities, Inc. recently spent significant capital to replace their
31 aged accounting and customer, care and billing systems, which the Company
32 refers to as Project Phoenix. This change included both software and hardware
33 changes. Apple Canyon Utility Company is committed to maintaining clean, safe,
34 professional facilities. Our facilities are visible throughout the communities we
35 serve.

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Q. Please describe Project Phoenix.

A. Project Phoenix is the name of UI's initiative to evaluate the state of the Company's processes and systems.

Q. Why did Utilities, Inc. initiate Project Phoenix?

A. The Company had not made a significant investment in technology in quite some time. Antiquated systems, lack of integration, and the lack of standardization were beginning to have an adverse effect on the Company and its customers. Accordingly, UI set out to improve the Company's capabilities and processes in the accounting, customer service, customer billing and financial and regulatory reporting areas.

Q. When did Project Phoenix begin?

A. Project Phoenix began in early 2006 with a series of internal and external evaluations, which culminated in a business case presentation by Deloitte to the Company in September 2006. The business case identified: Drivers for Change, Current State Overview, Recommended Solutions, Future State, and Benefits to Stakeholders. The business case presentation confirmed UI's initial evaluations that: Fragmented and non-standardized processes were complex and inefficient, with an attendant risk of error and control breakdown. The infrastructure unnecessarily placed stress on the Company's human capital. The Company's legacy financial and customer care systems were either fully customized or unsupported, or both, which resulted in a risk of breakdown and impeded management's ability to obtain information to make decisions, and use of spreadsheets made ensuring accuracy and control difficult, resulting in the potential for errors in operation and regulatory reports. After the business case presentation and an evaluation of potential solutions, UI management selected JD Edwards Enterprise One ("JDE") as the financial system, including asset management, and Oracle's Customer Care and Billing System ("CC&B") as the customer information system. These systems are integrated in a manner that allows for the sharing of crucial information between the Company's different operational organizations.

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1 **Q. Please describe the JDE system for the commission and the parties of record.**

2 A. JDE is a web-based software system that allows easy access from multiple
3 locations. It is composed of the following modules: Accounts Payable, Human
4 Resources / Time Capture, Requisitioning, Capital Projects, Fixed Assets,
5 Equipment Management, and General Ledger.

6

7 **Q. What are the benefits of JDE?**

8 A. UI is excited about JDE. Each of the modules I described includes enhanced
9 tracking and integration components, which should improve the Company's ability
10 to record and retrieve data. Because of this functionality, UI, its customers and
11 regulators should see marked improvement. The system has enhanced record
12 keeping and retrieval functions, making production of financial and regulatory
13 reports easier. In addition, the reports should be more accurate, which benefits
14 customers by improving the management decision making process and allowing
15 the Company to more efficiently deliver reliable information to regulators. The
16 system also reduces manual effort and reliance on spreadsheets, which again
17 improves the reliability of reports. The Capital Projects module allows employees to
18 view and track projects in real-time. Employees should be able to manage projects
19 and costs in a more effective manner, which benefits the Company and customers

20

21 **Q. When was JDE placed into service?**

22 A. JDE was officially placed in service on December 3, 2007.

23

24 **Q. What is the total cost of the JDE project incurred by Utilities, Inc.?**

25 A. The total cost of the JDE system as of 12/31/08 was \$14,328,103.

26

27 **Q. What portion of the cost of JDE incurred as of December 31, 2008 was
28 allocated to Apple Canyon?**

29 A. Approximately \$129,168 or 0.90% of the total cost of the project was assigned to
30 Apple Canyon.

31

32 **Q. How was that allocation developed?**

33 A. UI uses an allocation process based on ERCs (equivalent customer connections).

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Q. Please describe the CC&B system for the commission and the parties of record.

A. CC&B is a web-based software system. The web-based feature allows for quicker return of information to the user and allows for "quicker fixes" should the system go down involuntarily, or need to go down for routine maintenance. CC&B is composed of the following modules: Customer Management and Service, Billing, Accounts Receivables & Collections, Device Management, and Meter Reading.

Q. What are the benefits of CC&B compared to Utilities, Inc.'s legacy system?

A. UI's legacy customer care and billing system was fully customized and unsupported. The system had several weaknesses. Customer and premise information were linked in one account. As residents moved, the service order history at the premise was purged and prior service activities eventually became unavailable for viewing. This resulted in the loss of valuable information. In addition, field personnel were sent daily service orders either through email or fax. They did not have access to the legacy billing system. Upon completion of the service orders, the information was emailed or faxed back to the billing office for closure of the orders. The process was manually intensive and led to untimely responses due to incomplete fax transmissions. Additionally, as residents moved from one premise to another within the Company, they were issued a new account number. There was no efficient means of tracking a customer and transferring payment information, service history and billed services (debt) from one account to another.

CC&B offers the ability to focus on either a customer or a premise. Field activity information at a premise is stored in the records indefinitely, allowing field personnel to retain prior history of past service issues at a residence. This allows them to act in a cost effective manner when considering repair or replacement of equipment or lines at a premise. In addition, CC&B automates field activities to the field. A background process makes key decisions about assignments and timing. CC&B automates field activity dispatching and allows for uploading and downloading to hand-held devices. The system allows the field operators to complete field activities in a live environment so that CSR's (customer service

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1 representatives) have the information available to them as soon as the order is
2 completed. In this regard, UI deployed "tough books" in each field vehicle.

3

4 **Q. When did work on CC&B begin?**

5 A. Functional workshops to identify the needs of the organization began in June
6 2006. The workshops were designed to gather information and aid in the vendor
7 selection process. In January 2007, UI selected the Oracle customer information
8 system and design work began on CC&B in February 2007.

9

10 **Q. When was CC&B placed into service?**

11 A. CC&B was placed into service on June 2, 2008.

12

13 **Q. Have UI employees used CC&B in fulfilling their daily responsibilities?**

14 A. Yes. The Office Managers indicate that CC&B is used on a daily basis to look up
15 customer accounts to answer billing questions. Billing issues are identified and
16 resolved immediately before the customer receives their bill. Mail and walk in
17 payments are posted to the customer's account in real time. All corrections or
18 adjustments to a customer's account are entered into CC&B and, again, posted in
19 real time.

20

21 Customer Service personnel use CC&B to look up customer's accounts and review
22 meter reads, payment history, consumption history and mailing addresses. All
23 pertinent information is displayed on one screen which helps Customer Service
24 answer questions quickly. New customers are signed up through CC&B.
25 Customers discontinuing their service are also taken care of through CC&B.
26 Payments are posted in real time to a customer's account through CC&B.

27

28 **Q. What is the total cost of the CC&B project incurred by Utilities, Inc.?**

29 A. The total cost of the CC&B system as of 12/31/08 was \$7,124,532.

30

31 **Q. What portion of the cost of CC&B incurred AS OF 12/31/08 was allocated to**
32 **Apple Canyon?**

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1 A. Approximately \$64,228 or 0.90% of the total cost of the project was assigned to
2 Apple Canyon.

3

4 **Q. How was that allocation developed?**

5 A. The allocation was developed in the same manner as the JDE allocation.

6

7 **Rate Analysis**

8 **Q. What are the present water rates for Apple Canyon Utility Company and when
9 did they become effective?**

10 A. The present usage and availability rates became effective on April of 2004, and are
11 as follows:

12 Base Facility Charges (stated monthly):

13 Residential:

14 5/8" Meter \$5.51

15 Commercial:

16 5/8" Meter \$5.51

17 3/4" Meter \$6.06

18 1" Meter \$6.61

19 1.5" Meter \$7.16

20 3" Meter \$8.82

21 Gallonage Charges: \$4.66 per 1,000 gallons

22 Availability Charges: \$5.51

23

24 It should be noted that these rates are billed quarterly, but stated as a monthly
25 rate in the Company's tariff. The current monthly average consumption for 5/8"
26 residential customers in Apple Canyon is approximately 1,767 gallons. This
27 equates to a monthly bill of \$13.75. I have attached to the filing an example of a
28 customer's bill.

29

30 **Q. What are the proposed water rates for Apple Canyon Utility Company and
31 their impact on the average customer?**

32 A. The proposed rates are as follows:

33 Base Facility Charges (stated monthly):

34 Residential:

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1	5/8" Meter	\$29.86
2	3/4" Meter	\$32.85
3	Commercial:	
4	5/8" Meter	\$29.86
5	3/4" Meter	\$32.85
6	1" Meter	\$35.83
7	1.5" Meter	\$38.81
8	3" Meter	\$44.82
9	<u>Gallage Charges:</u>	\$9.09 per 1,000 gallons
10	<u>Availability Charges:</u>	\$6.56

11

12 These rates will be billed monthly pending the Commission's approval of the

13 Company's request to convert the current quarterly billing cycle to a monthly

14 billing cycle. However, the Company plans to continue billing availability

15 customers quarterly or semi-annually. Based on an average consumption of 1,767

16 gallons per month, the customers' monthly bill will be \$45.93 or an increase of

17 \$32.19 per month.

18

19 **Cost of Capital**

20

21 **Q. What is the cost of capital of Apple Canyon Water Company?**

22 A. The cost of capital of Apple Canyon Utility Company is determined by using UI's

23 capital structure. These cost of capital percentages are then used to ascertain the

24 overall cost of capital for Apple Canyon Utility Company. The capital structure and

25 cost rates that I proposed to use in this proceeding are as follows:

26

	<u>Weight</u>	<u>Cost</u>	<u>Weighted Cost</u>
Debt	53.04%	6.58%	3.49%
Equity	<u>46.96%</u>	<u>11.70%</u>	<u>5.49%</u>
Overall	<u>100.0%</u>		<u>8.98%</u>

27

28

29

30 **Q. Why must one determine the overall cost of capital for a public utility?**

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1 A. The proper balance of rate payer and shareholder interest occurs when the
2 Commission authorizes a public utility a rate of return on its rate base equal to its
3 overall cost of capital. If the authorized rate of return on rate base exceeds the
4 overall cost of capital, then rate payers bear the burden of excessive prices.
5 Conversely, if the authorized rate of return on rate base is lower than the overall
6 cost of capital, then the Utility will be unable to raise capital at a reasonable cost.
7 Ultimately, the Utility may be unable to raise sufficient capital to meet demands for
8 service, thereby impairing service quality. Therefore, ratepayers' interests are
9 served best when the authorized rate of return on rate base is neither higher nor
10 lower than the overall cost of capital.

11

12 **Q. Please define "overall cost of capital"?**

13 A. The overall cost of capital equals the sum of the costs of the components of the
14 capital structure (debt and common equity) after each is weighted by its proportion
15 to total capital.

16

17 **Q. How does Apple Canyon raise capital?**

18 A. Capital for Apple Canyon is raised by Utilities, Inc. Apple Canyon Utility Company
19 is a wholly owned subsidiary of Utilities, Inc. The source of this capital is banks
20 and large lending institutions

21

22 **Q. How did you determine the cost of debt to Apple Canyon?**

23 A. The 6.58% cost of debt is the embedded cost of debt of the Utilities, Inc., the parent
24 company of Apple Canyon, as of December 31, 2008. This percentage is consistent
25 with past Illinois Commerce Commission practice.

26

27 **Q. How did you derive the cost of equity used in your calculation?**

28 A. Today's embedded cost of debt of the consolidated group is approximately 6.58%.
29 The equity investor is entitled to a premium over the return to the debt holder
30 because of the additional risk he or she takes. The debt holder has first claim on
31 the assets and earnings of the Utility. These claims must be satisfied before funds
32 are available to the equity shareholder. Therefore, the return on equity must be
33 greater than 6.58%.

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1 In addition, a risk free investment, thirty-year treasury bonds, currently yields
2 approximately 4.24%, as of September 21, 2009. Utility bonds available to
3 investors are a higher risk than government bonds. Also available to investors are
4 equity securities of large companies. These are publicly traded securities paying
5 dividends and having the advantage of liquidity. Naturally, the market would favor
6 any of these securities over the equity in a small company with non-traded
7 securities, such as Apple Canyon. It would be reasonable to add a premium to the
8 cost of 30-year treasury bonds or Utilities, Inc's current cost of debt to determine
9 the cost of equity to Apple Canyon.

10

11 **Q. Did the Company prepared a DCF or other risk premium models, or do they**
12 **plan to in the future?**

13 A. The Company has not prepared a DCF or other risk premium models due to the
14 limited number of customers and the rate case expense attributed to preparing
15 such models. However, the Company intends to hire an addition cost of capital
16 expert witness, during this rate case process if necessary.

17

18 **Billing Cycles**

19

20 **Q. What is the current billing schedule for the customers of Apple Canyon Utility**
21 **Company?**

22 A. Apple Canyon's usage customers are currently billed at the end of each quarter.

23

24 **Q. What billing schedule is the utility proposing?**

25 A. The Utility is proposing a change from a quarterly billing cycle to a monthly billing
26 cycle for Apple Canyon usage customers. The Utility believes that billing for
27 availability customers should remain on their current cycle.

28

29 **Q. Why is the Utility proposing a monthly billing cycle?**

30 A. The Utility believes that a monthly billing cycle will enable the Utility to provide
31 better service to the customers of Apple Canyon. First, a monthly billing cycle will
32 permit Apple Canyon customers to properly budget for water utility expenses each
33 month. Second, customer service representatives will be able to appropriately
34 address customer concerns as issues can be promptly detected. Third, the Utility
35 will be able to locate and resolve system problems as customer billing and

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1 consumption data will be available monthly as opposed to quarterly. Finally, Apple
2 Canyon will be able to respond sooner to unaccounted for water and water loss
3 issues, which will benefit the customer, the utility and the environment.

4
5 **Q. Is this change in billing cycles consistent with the Utility's focus on providing**
6 **quality service to its customers?**

7 A. Yes, it is. The Utility believes that this change is beneficial to the customers and
8 the quality of their service.

9
10 **Q. What impact will this change in billing cycles have on operating expenses?**

11 A. The change to a monthly billing cycle will increase office expenses due to an
12 increase in postage, bank charges, and office stock, such as paper and envelopes,
13 which results from additional mailings and deposits made throughout the year. In
14 addition, there will be an increase in meter reading expense; however, no additional
15 employees are required to handle the increased number of billings.

16
17 **Rules, Regulations, and Conditions of Service Tariffs**

18
19 **Q. Does the Utility plan to update the Rules, Regulations, and Conditions of**
20 **Service tariffs for Apple Canyon Utility Company?**

21 A. Yes, it does.

22
23 **Q. Please explain why the Utility is proposing to update Apple Canyon's Rules,**
24 **Regulations, and Conditions of Service tariffs.**

25 A. The Utility is proposing to make a few minor adjustments to its Rules, Regulations,
26 and Conditions of Service tariffs so they are more in line with the Company's
27 business practices. These changes are addressed in Paul Burris' Direct Testimony.

28
29 **Filing Procedures**

30
31 **Q. Why is Apple Canyon Utility Company filing under the Standard Rate Case**
32 **Procedures instead of the Short Form Procedures that are in place for a**
33 **company the size of Apple Canyon Utility Company?**

34 A. Utilities, Inc. has determined that our short form filings are conducted in the same
35 manner as a general rate filing. This is because Utilities, Inc. has a staff of

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1 accounting and ratemaking professionals. Additionally, under the short form
2 process there is no formal procedure for seeking a mediation of disputed
3 adjustments made by the Staff to the Utility's revenue requirement. This can be
4 unfair to the Utility.

5

6 **Q. Does this conclude your testimony?**

7 **A. Yes it does.**

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