

Before the
Illinois Commerce Commission

Docket No. _____

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In the Matter of

Approval of an Increase and
Adjustment of Rates and Charges for
Water Utility Service Sold by
Lake Wildwood Utilities Corp. within
Marshal County

Direct Testimony of

Steven M. Lubertozi, CPA

for

Lake Wildwood Utilities Corp.

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 Lake Wildwood Utilities, Corp.?

20 A. Lake Wildwood Utilities, Corp. 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 Lake Wildwood. 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 Lake Wildwood provides water usage service to approximately 460 customers and
28 water availability service to approximately 950 customers in Marshall County.
29 Lake Wildwood's current rate structure was approved pursuant to an order
30 contained in Docket No. 01-0663 dated August 7, 2002.

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 Lake Wildwood
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 Lake Wildwood 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 2002 do not reflect the 7
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, Lake Wildwood 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 Lake
21 Wildwood Utility Company has an overall negative return of 9.70%. The proposed
22 rates will allow the company to earn a 8.98% 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, Lake Wildwood'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. Lake Wildwood 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 Lake Wildwood?**
- 29 A. Approximately \$68,540 or 0.48% of the total cost of the project was assigned to
- 30 Lake Wildwood.
- 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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2 **Q. Please describe the CC&B system for the commission and the parties of**
3 **record.**

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

9

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

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

25

26 CC&B offers the ability to focus on either a customer or a premise. Field activity
27 information at a premise is stored in the records indefinitely, allowing field
28 personnel to retain prior history of past service issues at a residence. This allows
29 them to act in a cost effective manner when considering repair or replacement of
30 equipment or lines at a premise. In addition, CC&B automates field activities to
31 the field. A background process makes key decisions about assignments and
32 timing. CC&B automates field activity dispatching and allows for uploading and
33 downloading to hand-held devices. The system allows the field operators to
34 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 **Lake Wildwood?**

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1 A. Approximately \$34,081 or 0.48% of the total cost of the project was assigned to
2 Lake Wildwood.

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 Lake Wildwood Utility Company and
9 when did they become effective?**

10 A. The present usage and availability rates became effective in August of 2002, and
11 are as follows:

12 Base Facility Charges (stated monthly):

13 Residential:

| | |
|---------------|---------|
| 14 5/8" Meter | \$10.34 |
|---------------|---------|

15 Commercial:

| | |
|---------------|---------|
| 16 5/8" Meter | \$10.34 |
| 17 1" Meter | \$19.69 |
| 18 1.5" Meter | \$36.25 |

19 Gallage Charges: \$3.62 per 1,000 gallons

20 Availability Charges: \$7.47

21

22 The current monthly average consumption for 5/8" residential customers in Lake
23 Wildwood is approximately 2,200 gallons. This equates to a monthly bill of \$11.57.
24 I have attached to the filing an example of a customer's bill.

25

26 **Q. What are the proposed water rates for Lake Wildwood Utility Company and
27 their impact on the average customer?**

28 A. The proposed rates are as follows:

29 Base Facility Charges (stated monthly):

30 Residential:

| | |
|---------------|---------|
| 31 5/8" Meter | \$45.07 |
|---------------|---------|

32 Commercial:

| | |
|---------------|---------|
| 33 5/8" Meter | \$45.07 |
| 34 1" Meter | \$85.82 |

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| | |
|------------------------------|--------------------------|
| 1.5" Meter | \$157.99 |
| <u>Gallage Charges:</u> | \$9.09 per 1,000 gallons |
| <u>Availability Charges:</u> | \$7.47 |

Based on an average consumption of 2,200 gallons per month, the customers' monthly bill will be \$65.47 or an increase of \$53.90 per month.

Cost of Capital

Q. What is the cost of capital of Lake Wildwood Water Company?

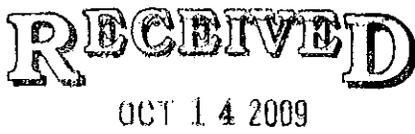
A. The cost of capital of Lake Wildwood Utility Company is determined by using UI's capital structure. These cost of capital percentages are then used to ascertain the overall cost of capital for Lake Wildwood Utility Company. The capital structure and cost rates that I proposed to use in this proceeding are as follows:

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

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

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

Q. Please define "overall cost of capital"?



1 A. The overall cost of capital equals the sum of the costs of the components of the
2 capital structure (debt and common equity) after each is weighted by its proportion
3 to total capital.
4

5 **Q. How does Lake Wildwood raise capital?**

6 A. Capital for Lake Wildwood is raised by Utilities, Inc. Lake Wildwood Utility
7 Company is a wholly owned subsidiary of Utilities, Inc. The source of this capital is
8 banks and large lending institutions
9

10 **Q. How did you determine the cost of debt to Lake Wildwood?**

11 A. The 6.58% cost of debt is the embedded cost of debt of the Utilities, Inc., the parent
12 company of Lake Wildwood, as of December 31, 2008. This percentage is
13 consistent with past Illinois Commerce Commission practice.
14

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

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

22

23 In addition, a risk free investment, thirty-year treasury bonds, currently yields
24 approximately 4.24%, as of September 21, 2009. Utility bonds available to
25 investors are a higher risk than government bonds. Also available to investors are
26 equity securities of large companies. These are publicly traded securities paying
27 dividends and having the advantage of liquidity. Naturally, the market would favor
28 any of these securities over the equity in a small company with non-traded
29 securities, such as Lake Wildwood. It would be reasonable to add a premium to
30 the cost of 30-year treasury bonds or Utilities, Inc's current cost of debt to
31 determine the cost of equity to Lake Wildwood.

32

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

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

5

6 **Rules, Regulations, and Conditions of Service Tariffs**

7

8 **Q. Does the Utility plan to update the Rules, Regulations, and Conditions of**
9 **Service tariffs for Lake Wildwood Utility Company?**

10 A. Yes, it does.

11

12 **Q. Please explain why the Utility is proposing to update Lake Wildwood's Rules,**
13 **Regulations, and Conditions of Service tariffs.**

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

17

18 **Filing Procedures**

19

20 **Q. Why is Lake Wildwood Utility Company filing under the Standard Rate Case**
21 **Procedures instead of the Short Form Procedures that are in place for a**
22 **company the size of Lake Wildwood Utility Company?**

23 A. Utilities, Inc. has determined that our short form filings are conducted in the same
24 manner as a general rate filing. This is because Utilities, Inc. has a staff of
25 accounting and ratemaking professionals. Additionally, under the short form
26 process there is no formal procedure for seeking a mediation of disputed
27 adjustments made by the Staff to the Utility's revenue requirement. This can be
28 unfair to the Utility.

29

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

31 A. Yes it does.

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