

**RECEIVED**

JAN - 4 2010

ILLINOIS COMMERCE COMMISSION  
CHIEF CLERK'S OFFICE

Before the  
Illinois Commerce Commission

Docket No. \_\_\_\_\_

In the Matter of

Proposed Increase and Adjustment  
of Rates and Charges for  
Water Utility Services Sold by  
**Whispering Hills Water Company**

Prepared Direct Testimony of

Steven M. Lubertozzi, CPA

For

**Whispering Hills Water Company**

December 31, 2009

RECEIVED

JAN - 4 2010

ILLINOIS COMMERCE COMMISSION  
CHIEF CLERK'S OFFICE

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 Whispering Hills Water Company.**

20 A. Whispering Hills Water 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 Whispering Hills. 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 Whispering Hills provides water usage service to approximately 2,300 customers in  
28 McHenry County. Whispering Hills's current rate structure was approved  
29 pursuant to an order contained in Docket No. 94-0271 dated March 22nd, 1995.

30  
31 **Q. Mr. Lubertozi, what is the purpose of your testimony here today?**

JAN - 4 2010

ILLINOIS COMMERCE COMMISSION

CHIEF CLERK'S OFFICE

1 A. The purpose of my testimony is to explain to the Commission why Whispering Hills  
2 Water 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 Whispering Hills Water 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 1995 do not reflect the 14  
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, Whispering Hills 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  
21 Whispering Hills Water Company has an overall negative return of 1.38%. The  
22 proposed rates will allow the company to earn a 8.99% overall rate of return. This  
23 information is supported in the financial statements attached hereto as **Utility**  
24 **Exhibit One.**

25

26 **Q. Mr. Lubertozi, 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, Whispering Hills'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. Whispering Hills Water Company is committed to maintaining clean,  
34 safe, professional facilities. Our facilities are visible throughout the communities  
35 we serve.

RECEIVED

JAN - 4 2010

ILLINOIS COMMERCE COMMISSION  
CHIEF CLERK'S OFFICE

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
29  
30  
31  
32  
33  
34

**9. 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.

**9. 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.

**9. 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.

RECEIVED

JAN - 4 2010

ILLINOIS COMMERCE COMMISSION  
CHIEF CLERK'S OFFICE

1 **9. 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 **9. 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 **9. When was JDE placed into service?**

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

23  
24 **9. 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 **9. Please describe the CC&B system for the commission and the parties of  
28 record.**

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

RECEIVED

JAN - 4 2010

1

2 **9. What are the benefits of CC&B compared to Utilities, Inc.'s legacy system?** ILLINOIS GOVERNMENT COMMISSION

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

17

18 CC&B offers the ability to focus on either a customer or a premise. Field activity  
19 information at a premise is stored in the records indefinitely, allowing field  
20 personnel to retain prior history of past service issues at a residence. This allows  
21 them to act in a cost effective manner when considering repair or replacement of  
22 equipment or lines at a premise. In addition, CC&B automates field activities to  
23 the field. A background process makes key decisions about assignments and  
24 timing. CC&B automates field activity dispatching and allows for uploading and  
25 downloading to hand-held devices. The system allows the field operators to  
26 complete field activities in a live environment so that CSR's (customer service  
27 representatives) have the information available to them as soon as the order is  
28 completed. In this regard, UI deployed "tough books" in each field vehicle.

29

30 **9. When did work on CC&B begin?**

31 A. Functional workshops to identify the needs of the organization began in June  
32 2006. The workshops were designed to gather information and aid in the vendor  
33 selection process. In January 2007, UI selected the Oracle customer information  
34 system and design work began on CC&B in February 2007.

RECEIVED

JAN - 4 2010

ILLINOIS COMMERCE COMMISSION  
CHIEF CLERK'S OFFICE

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26  
27  
28  
29  
30  
31  
32  
33  
34

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

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

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

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

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

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

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

**Rate Analysis**

**Q. What are the present water rates for Whispering Hills Water Company and when did they become effective?**

A. The present usage are as follows:

Base Facility Charges (stated monthly):

Residential:

5/8" Meter \$5.14

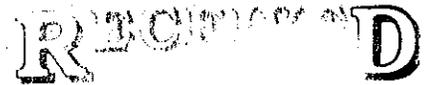
Commercial:

5/8" Meter \$5.14

3/4" Meter \$7.25

1" Meter \$10.10

1.5" Meter \$17.50



JAN - 4 2010

ILLINOIS COMMERCE COMMISSION  
CHIEF CLERK'S OFFICE

1	2" Meter	\$41.12
2	3" Meter	\$77.10
3	4" Meter	\$128.50
4	<u>Gallonge Charges:</u>	\$3.14 per 1,000 gallons

5  
6 It should be noted that these rates are billed bimonthly, but stated as a monthly  
7 rate in the Company's tariff. The current bimonthly average consumption for 5/8"  
8 residential customers in Whispering Hills is approximately 10,000 gallons. This  
9 equates to a bimonthly bill of \$41.68. I have attached to the filing an example of a  
10 customer's bill.

11  
12 **9. What are the proposed water rates for Whispering Hills Water Company and**  
13 **their impact on the average customer?**

14 A. The proposed rates are as follows:

15	<u>Base Facility Charges (stated monthly):</u>	
16	Residential:	
17	5/8" Meter	\$15.47
18	Commercial:	
19	5/8" Meter	\$15.47
20	3/4" Meter	\$21.82
21	1" Meter	\$30.40
22	1.5" Meter	\$52.68
23	2" Meter	\$123.77
24	3" Meter	\$232.07
25	4" Meter	\$378.66
26	<u>Gallonge Charges:</u>	\$4.71 per 1,000 gallons

27  
28 These rates will be billed monthly pending the Commission's approval of the  
29 Company's request to convert the current billing cycle to a monthly billing cycle.  
30 Based on an average consumption of 10,000 gallons (bimonthly), the customers'  
31 bimonthly bill will be \$78.04 or an increase of \$36.36 per bimonthly billing.

32  
33 **Cost of Capital**

34  
35 **9. What is the cost of capital of Whispering Hills Water Company?**

1 A. The cost of capital of Whispering Hills Water Company is determined by using its  
 2 capital structure. These cost of capital percentages are then used to ascertain the  
 3 overall cost of capital for Whispering Hills Water Company. The capital structure  
 4 and cost rates that I proposed to use in this proceeding are as follows:  
 5

	<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>

6  
 7  
 8

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

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

20

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

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

25

26 **Q. How does Whispering Hills raise capital?**

27 A. Capital for Whispering Hills is raised by Utilities, Inc. Whispering Hills Water  
 28 Company is a wholly owned subsidiary of Utilities, Inc. The source of this capital is  
 29 banks and large lending institutions

30

31 **Q. How did you determine the cost of debt to Whispering Hills?**

JAN - 4 2010

ILLINOIS COMMERCE COMMISSION  
CHIEF CLERK'S OFFICE

1 A. The 6.58% cost of debt is the embedded cost of debt of the Utilities, Inc. the parent  
2 company of Whispering Hills, as of December 31, 2008. This percentage is  
3 consistent with past Illinois Commerce Commission practice.  
4

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

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

12  
13 In addition, a risk free investment, thirty-year treasury bonds, currently yields  
14 approximately 4.24%, as of September 21, 2009. Utility bonds available to  
15 investors are a higher risk than government bonds. Also available to investors are  
16 equity securities of large companies. These are publicly traded securities paying  
17 dividends and having the advantage of liquidity. Naturally, the market would favor  
18 any of these securities over the equity in a small company with non-traded  
19 securities, such as Whispering Hills. It would be reasonable to add a premium to  
20 the cost of 30-year treasury bonds or Utilities, Inc's current cost of debt to  
21 determine the cost of equity to Whispering Hills.

22  
23 **Q. Did the Company prepared a DCF or other risk premium models, or do they  
24 plan to in the future?**

25 A. The Company has not prepared a DCF or other risk premium models due to the  
26 limited number of customers and the rate case expense attributed to preparing  
27 such models. However, the Company intends to hire an addition cost of capital  
28 expert witness, during this rate case process if necessary.  
29

30 **Billing Cycles**

31  
32 **Q. What is the current billing schedule for the customers of Whispering Hills  
33 Water Company?**

34 A. Whispering Hills's usage customers are currently billed bimonthly.  
35

RECEIVED

JAN - 4 2010

ILLINOIS COMMERCE COMMISSION  
CHIEF CLERK'S OFFICE

1 **9. What billing schedule is the utility proposing?**

2 A. The Utility is proposing a change from a quarterly billing cycle to a monthly billing  
3 cycle for Whispering Hills usage customers.  
4

5 **9. Why is the Utility proposing a monthly billing cycle?**

6 A. The Utility believes that a monthly billing cycle will enable the Utility to provide  
7 better service to the customers of Whispering Hills. First, a monthly billing cycle  
8 will permit Whispering Hills customers to properly budget for water utility expenses  
9 each month. Second, customer service representatives will be able to appropriately  
10 address customer concerns as issues can be promptly detected. Third, the Utility  
11 will be able to locate and resolve system problems as customer billing and  
12 consumption data will be available monthly as opposed to quarterly. Finally,  
13 Whispering Hills will be able to respond sooner to unaccounted for water and water  
14 loss issues, which will benefit the customer, the utility and the environment.  
15

16 **9. Is this change in billing cycles consistent with the Utility's focus on providing  
17 quality service to its customers?**

18 A. Yes, it is. The Utility believes that this change is beneficial to the customers and  
19 the quality of their service.  
20

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

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

27 **Depreciation**

28  
29 **9. What is the current method of calculating depreciation expense?**

30  
31 A. Currently, the Company multiplies all plant-in-service accounts by a composite  
32 rate of 1.50% to calculate annual depreciation expense.  
33

34 **9. What method of calculating depreciation expense is the Utility proposing?**

RECEIVED

JAN - 4 2010

ILLINOIS COMMERCE COMMISSION  
CHIEF CLERK'S OFFICE

1 A. The Utility is proposing a change from using a composite rate of 1.56% to  
2 separate depreciation rates for each primary account. These rates range from  
3 1.89% to 7.69%. This method of calculating depreciation expense is consistent  
4 with prior rate proceedings approved by the Commission, including Docket No. 01-  
5 0663, Lake Wildwood Water Company, and Docket No. 02-0592, Del-Mar Water  
6 Company.

7  
8 **Q. Why is Whispering Hills Water Company proposing this change in**  
9 **depreciation rates in order to calculate depreciation expense in this rate**  
10 **proceeding?**

11 A. The Utility has proposed these modified depreciation rates based on testimony filed  
12 by Staff witness King in Docket Nos. 01-0663 and 02-0592. According to this  
13 testimony, separate depreciation rates for primary accounts are more sensitive to  
14 the service life and retirement in a specific account than a composite rate. As  
15 such, rates by primary accounts result in a more accurate allocation and recovery  
16 of depreciation expense. Therefore, the Utility's calculation of depreciation expense  
17 was prepared using the average service lives, salvage values, and calculations  
18 utilized in ICC Staff Exhibit 6.00, Schedules 6.01 and 6.02 of Docket No. 01-0663  
19 and ICC Staff Exhibit 4.00, Schedule 4.04, pages 1 and 2 of Docket No. 02-0592.

20  
21 **Q. How do the depreciation rates proposed by the Utility compare to the rates**  
22 **approved by the Commission in prior rate proceedings?**

23 A. The depreciation rates proposed by the Utility are consistent with the average  
24 service lives, salvage values, and calculations that were approved for Consumers  
25 Illinois Water Company, Northern Illinois Water Corporation, Illinois-American  
26 Water Company, Lake Wildwood Water Company, and Del-Mar Water Company.

27  
28 **Q. What is the effect on Whispering Hills Water Company's depreciation expense**  
29 **using the proposed depreciation rates?**

30 A. The overall composite depreciation rates will increase from 1.5% to 2.75%. This  
31 increase is consistent with prior rate proceedings approved by the Commission.

32  
33 **Rules, Regulations, and Conditions of Service Tariffs**

34  
35 **Q. Does the Utility plan to update the Rules, Regulations, and Conditions of**

RECEIVED

JAN - 4 2010

ILLINOIS COMMERCE COMMISSION  
CHIEF CLERK'S OFFICE

1 **Service tariffs for Whispering Hills Water Company?**

2 A. Yes, it does.

3  
4 **Q. Please explain why the Utility is proposing to update Whispering Hills's Rules,**  
5 **Regulations, and Conditions of Service tariffs.**

6 A. The Utility is proposing to make a few minor adjustments to its Rules, Regulations,  
7 and Conditions of Service tariffs so they are more in line with the Company's  
8 business practices.

9  
10 **Filing Procedures**

11  
12 **Q. Why is Whispering Hills Water Company filing under the Standard Rate Case**  
13 **Procedures instead of the Short Form Procedures that are in place for a**  
14 **company the size of Whispering Hills Water Company?**

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

21  
22 **Q. Does this conclude your testimony?**

23 A. Yes it does.