

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

Great Northern Utilities, Inc.)	
)	
Camelot Utilities, Inc.)	
)	
Lake Holiday Utility Corp.)	Docket Nos. 11-0059
)	11-0141
)	11-0142
Proposed Increase in Water and Sewer Rates)	(cons.)
)	

BRIEF ON EXCEPTIONS

THE PEOPLE OF THE STATE OF ILLINOIS

Oral Argument Requested

**The People of the State of Illinois
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The People of the State of Illinois, by Attorney General Lisa Madigan, (“AG”) submit the following Exceptions and Initial Brief on Exceptions in response to the Proposed Order issued on September 14, 2011 (hereafter referred to as Proposed Order).

A. Introduction and Request for Oral Argument

This case involves three small water and sewer utilities owned by Utilities Inc. (“Companies”) that are looking to increase their rates. The increases that the Companies have asked for are shocking in their magnitude: 251.72% (Great Northern), 45.60% (Lake Holiday), 175.82% (Camelot Water), and 71.87% (Camelot Sewer). If these rates are approved by the Commission, the Companies’ customers will be paying rates that, in the case of Great Northern and Camelot Water, will be the highest in the state. These customers’ rates will have more than doubled (and in the case of Camelot Water, tripled), essentially overnight, if these increases are approved.

Not only are the Companies requesting extreme rate increases in this case, the Companies also failed to substantiate much of their requested increases. For example, Camelot has *failed to explain more than half* of its capital expenditures and Lake Holiday has *failed to explain almost 90%* of its capital expenditures. The Companies’ requests in this case violate established ratemaking principles of gradualism, affordability, and avoidance of rate shock. The Companies have failed to meet the basic burden of proof required of a utility to show that their requested rates are reasonable by substantiating their expenses. In a case with such facts, the Commission must not set the precedent of permitting increased recovery when the Companies have so thoroughly failed to satisfy basic ratemaking requirements.

a. Request for Oral Argument

The People of the State of Illinois request oral argument to present the issues associated with this increase to the Commission. The size of the increase, the burden on consumers, and the numerous contested issues all demonstrate the need for the Commission to hear directly from the parties. The Public Utilities Act requires the Commission to hear oral argument upon request of any party, including the Attorney General, who has submitted a post-hearing brief. Specifically, the law provides:

The utility, the staff of the Commission, the Attorney General, or any party to a proceeding initiated under this Section who has been granted intervenor status and submitted a post-hearing brief must be given the opportunity to present oral argument, if requested no later than the date for filing exceptions, on the propriety of any proposed rate or other charge, classification, contract, practice, rule, or regulation. 220 ILCS 5/9-201(c).

The People of the State of Illinois were granted intervenor status and filed a post-hearing Initial and Reply Brief. See e-docket filings on June 22, 2011 (granting intervention), and August 4 and 19, 2011. Accordingly, the People are entitled to oral argument under Section 9-201(c) and request that it be scheduled so all parties can address the Commission. See also 83 Ill. Adm. Code 200.850.

B. The Commission Should Reduce the Rate Base Due to the Large Amount of Unexplained Expenditures.

Whenever a utility requests a rate increase, it bears the burden of providing sufficient record evidence to support its request. 220 ILCS 5/9-201(c). When the increases requested are as substantial as those requested in this docket, the utility should identify and justify the major cost drivers. In this docket, the Companies offered only summary evidence that does not rise to the level required to meet their burden of proving that increases of as much as 250% are just and reasonable. In the AG's briefs, the AG showed that the Companies failed to justify the majority of their claimed capital expenditures, which alone increased by \$1.3 million (Great Northern),

\$1.3 (Camelot), and \$1.8 million (Lake Holiday). (GNUI Ex. 2.0 at 5; CUI Ex. 2.0 at 5; LHUC Ex. 2.0 at 5). Yet, the Proposed Order rejects the AG's recommendation to reduce the rate base for these systems, stating that not every single capital improvement must be itemized to justify a rate increase. Proposed Order at 7.

The AG requests that the Commission reverse the Proposed Order's conclusion and exclude from the Companies' rate bases plant and costs that were not identified in the record. While the AG did not base its recommendation upon the argument that *every single* capital improvement must be itemized to justify a rate increase, the AG did take issue with the presumption that the Companies need only present final totals to increase rate base by the extraordinary amounts requested in this docket. The Administrative Law Judge should have reduced the Companies' rate bases because the Companies were only able to explain a small fraction of the capital expenditures they claim to have incurred. The Commission should conclude that such a small sampling does not satisfy the Companies' burden of proof under the Public Utilities Act. 220 ILCS 5/9-201(c).

In response to AG data requests asking the Companies to "identify the year of completion and the amount expended for each capital improvement identified in the Direct Testimony of Bruce Haas," the Companies only identify a small portion of the additional rate base claimed. Great Northern itemized \$936,593 out of the claimed \$1.3 million. AG Cross Ex. 1; Tr. at 25, July 13, 2011. Camelot itemized only \$538,956, *less than half* of the claimed \$1.3 million. AG Cross Ex. 2; CUI Ex. 2.0 at 5; Tr. at 311, July 13, 2011. The worst of all, Lake Holiday was only able to itemize \$192,949, *barely 10%* of the claimed \$1.8 million to which witness Bruce Haas testified. The record does not contain any evidence that explains the difference in the expenditures itemized and the total amount claimed. As a result, it is unknown whether the

unexplained expenditures were at all related to the service provided by the Companies. The Companies did not meet the burden of proof to establish *prima facie* reasonableness.

The AG agrees with the Proposed Order that not every single capital improvement must be itemized to justify a rate increase. This is not the basis for the AG's request that the rate bases be reduced. As detailed above, two of the Companies have not itemized even *half* of their claimed investment. It is this extraordinary failure to legitimize at least a majority of their expenditures that caused the AG to request a reduction of the rate base. The Commission should not set a precedent for future rate cases that allows a utility to raise rates by such an extraordinary amount when a large percentage of expenditures are not identified, are unsubstantiated, and are not explained.

C. The Commission Should Decline to Increase the Costs Associated with Revised Allocation Factors.

The Proposed Order accepts the Staff's proposal to increase the Companies' cost of service by increasing the allocation factors because the initial filing was based upon 2008 allocation factors instead of 2009 allocation factors. The bases for the initial allocation and for the change, however, are not adequately explained, and therefore, the allocation should not be increased.

A large portion of the Companies' expenses are allocated from their affiliated Water Services Company, where economies of scale should be realized. Yet, in response to a Staff data request, the Companies *increased* the costs allocated to Camelot water and sewer and to Lake Holiday, driving *up* expenses, rather than decreasing them. See Staff Ex. 2.0, Sch. 2.01 C-S, 2.01 C-W. The Joint Stipulation includes these increased allocations, which raised expenses in these areas despite Staff witness Bridal's testimony that (1) the Companies did not allocate costs

consistently with the method of allocation described by them and (2) the Companies should “provide in direct testimony in future rate cases a detailed explanation of how Utility and WSC salaries are determined in total, allocated to the individual Utility, and directly charged to rate case expense and other “cap time” categories, accordingly.” Staff Ex. 11.0 at 4 and 6. The Commission should reverse this Staff adjustment and reduce the allocations for operating expenses in light of the Companies’ failure to adequately explain the basis for the allocations.

D. The Commission Should Reduce the Companies’ Return on Equity to Reflect the Value of the Service.

The Proposed Order rejected the AG’s recommendation to reduce the Companies’ return on equity by 100 basis points to reflect poor management. The Proposed Order stated that the service quality concerns of the AG were understandable but reducing the revenue available to the Companies will not assist in attempting to resolve such concerns. Proposed Order at 24. First, contrary to this suggestion, reducing the Return on Equity (“ROE”) is an important tool available to the Commission to address the concern that poor management has led the Companies to request increases in this docket that will produce rate shock. The AG’s recommendation is based upon the fact that poor management has resulted in consumers facing overnight increases of 251.72% (Great Northern), 45.60% (Lake Holiday), 175.82% (Camelot Water), and 71.87% (Camelot Sewer). In addition to the unpredictable nature of the Companies’ rate requests, in the Camelot service area, a large number of consumers expressed dissatisfaction with the water quality provided by the utility. The Commission should not double the revenues consumers provide the Camelot utility without addressing the poor service quality described by consumer witnesses. Prepared Rebuttal Testimony on Behalf of Camelot Homeowner’s Association from Daisy Austin, Rhonda Baran, Linda Hawkinson, Pam Harvey, Toni Tully, Barb Studer, Kathryn

Kittler, Dawn Kraklio, Beth Stuchly, Michelle Ulatowski, Jim Simmons, Leah Glasgow, Lynn Wright, Douglas Hawkinson, Janine Downing, Bobbe Marion, and Linda Weis. It is important that the Commission not set a precedent of allowing a company to recover increasing and unsubstantiated rates while continuing to provide substandard service.

A balance must be maintained between the rates charged by utilities and services performed. *Citizens Utils. Co. of Ill. v. O'Connor*, 121 Ill. App. 3d 533, 540, 459 N.E.2d 682, 688, 76 Ill. Dec. 767 (2d Dist. 1984). Although public utilities may not be required to charge a rate that is so low it can be considered confiscatory and in violation of the United States Constitution, public utilities cannot charge customers more than what the services rendered are reasonably worth. *Island Lake Water Co. v. Ill. Commerce Comm'n*, 65 Ill. App. 3d 853, 857, 382 N.E.2d 835, 838, 22 Ill. Dec. 445 (2d Dist. 1978).

When there are competitors for a non-essential service, prices are constrained because customers are free to decline to take service from a high priced provider, or avoid the service altogether if the price becomes unacceptably high. Competition also keeps providers operating efficiently in order to keep their prices low. The Commission and utility regulation in general are designed to protect consumers from the abuses that can arise when there is a single provider of an essential service like water. It is important that rates for utilities are regulated so that they can provide adequate service while keeping inefficiencies to a minimum.

Here, the 7.71% rate of return derived by the Staff financial analyst did not account for the water quality, management performance, or any other measure of what the services rendered by the Companies are reasonably worth. Tr. at 168, July 13, 2011. This profit level does not reflect a just and reasonable return under the circumstances of this case and should be lowered by this Commission to a rate that reflects the management problems revealed by this record. The

AG recommends that the return on equity be reduced by 100 basis points to protect consumers from paying an overly generous profit to a company that has failed to manage its operations to control its costs, and failed to propose rate increases that respect the concept of gradualism and affordability. 220 ILCS 5/1-102(d)

The AG recommends that the Commission reduce the ROE in the Proposed Order by 100 basis points. The reasonableness of this adjustment is shown by the fact that the Staff DCF analysis for water utilities produced a return on equity of 8.59%, which is only 3 basis points higher than the AG recommends in this docket. Staff Ex. 3.00, Sch. 3.7. An 8.56% ROE and an overall rate of return of 7.26% for the Companies is reasonable, is supported by the record, and is in no way confiscatory. An adjustment to the ROE is necessary to protect consumers from paying excessive profits to a utility that has failed to control costs and honor the regulatory compact.

Furthermore, as stated above, the Companies have failed to substantiate most of their expenditures. Therefore, it is unknown whether the Companies actually require the additional revenue they are requesting to meet their duties. The Proposed Order's concern that reducing the Companies' revenue will not allow them to provide better service misses the point. Because the Companies have not substantiated their expenditures and business practices to the extent required to meet their burden of proof, increasing their revenue merely rewards them for inefficient and substandard service. It does not guarantee that the service will improve because it is unclear where the Companies are spending their revenue. In a competitive market a company will face decreased profit levels as a spur to better performance. The same approach is appropriate here.

As the Companies' expenditures are such an unclear picture, the only equitable solution to this is to allow the Companies a rate of return that is commensurate with what their service is

reasonably worth. The Commission should reduce an otherwise appropriate rate of return both to protect consumers and to impose the discipline that a competitive market would impose.

E. The Commission Should Reduce the Rate Increases Due to Rate Shock

The Proposed Order states that a rate increase cannot be denied because the resulting rates are deemed too high. The Commission should reverse this erroneous statement and follow existing precedent to acknowledge that rate shock is indeed an appropriate reason for reducing rates, especially when viewed in light of the unexplained rate increases requested by the Companies and the fact that the resulting rates would be some of the highest in the state. *See* ICC Docket No. 10-0517 Final Order at 19.

The avoidance of “rate shock” is a well-established regulatory principle and has guided the Commission in determining appropriate utility rates. *See Citizens Utils. Bd. V. Ill. Commerce Comm’n*, 276 Ill. App. 3d 730, 738 (1st Dist. 1995); *Camelot Utils., Inc. v. Ill. Commerce Comm’n*, 51 Ill. App. 3d 5, 10 (3d Dist. 1977). The Illinois Supreme Court has confirmed that, “the fixing of ‘just and reasonable’ rates, involves a balancing of the investor and the consumer interests.” *Illinois Bell Telephone Co. v. Ill. Commerce Comm’n*, 414 Ill. 275, 287 (Ill.1953) (quoting the US Supreme Court in *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944)). Consumer interests must be taken into account when determining just and reasonable rates.

In this case, the rate increases are extreme. Under the proposed rates, customers are facing increases of 251.72% (Great Northern), 45.60% (Lake Holiday), 175.82% (Camelot Water), and 71.87% (Camelot Sewer). This would result in customers of Great Northern and Camelot Water having the highest rates in the state. In the case of Great Northern, this means that its customers would be paying more than twice the state average and in the case of Camelot

Water, its customers would be paying three times the state average. The customers of Camelot Sewer would have one of the highest rates in the state and also be paying more than twice the state average rate. To allow such increases when the Companies' expenditures are not adequately explained fails to take consumer interests into account at all, contrary to established Commission precedent and contrary to the intent of the Public Utilities Act. See, e.g., 220 ILCS 5/1-201(d), 9-101 (rates must be "just and reasonable.").

The large percentage of unsubstantiated expenditures that the Companies are claiming as part of their large increase in rates combined with the well-established principle of rate shock make it prudent for the Commission to reduce the rate base and the return on equity in this case. The Commission should not set a precedent for utilities to receive such large rate increases that they constitute rate shock when the increase in rates is unexplained and unjustified by a utility.

F. The Commission Should Expressly Consider the Public Comments Filed by Consumers in Connection with these Rate Increase Requests.

On August 17, 2011 the Administrative Law Judge granted Staff's Motion to Strike Portions of the AG's Initial Brief. The AG opposed that motion on the grounds that the Staff's motion ignores recent statutory changes that open Commission rate proceedings to public participation and misapplies the Administrative Procedure Act as well as the Public Utilities Act. The AG requests that the Commission include a section in its final order reversing that decision and specifically considering the public comments about the requested increase. The AG specifically discussed public comments in the AG's Initial Brief at pages 5-7 and 16.

G. Conclusion

The Proposed Order states that a utility is entitled under the Public Utilities Act to recover its cost of providing utility service and earn a fair rate of return on assets used to provide

such service. The AG does not dispute this. However, this does not tie the Commission's hands and require it to approve the requested increases when the resulting rates would double and triple existing rates, would be among the highest in the state, and would result in rate shock. Nor should the Commission allow the Companies a full ROE when the Companies' management has proven so poor that consumers are facing increases of this magnitude and the service provided is of such low value. In addition, because the rate base the Companies are requesting is so unsubstantiated by the Companies' filings, it is unclear whether the revenues the Companies are requesting are actually necessary to provide utility service, and the Commission should not permit the Companies to recover for unjustified revenues. The Commission should balance the interests of ratepayers and investors so that the rates are not increased to cover costs that have increased unreasonably, especially when the increases are so large as to cause extreme rate shock.

The AG requests that the Commission reverse the Proposed Order's conclusions as provided in the attached Exceptions.

Respectfully Submitted,

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