STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Aqua Illinois, Inc.	:	
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Proposed General Increase in Water And Sewer Rates	:	11-0436
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	:	
(Tariffs filed April 6, 2011).	:	

REPLY BRIEF OF THE STAFF
OF THE ILLINOIS COMMERCE COMMISSION

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Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned counsel, pursuant to Section 200.800 of the Illinois Commerce Commission's ("Commission" or "ICC") Rules of Practice (83 Ill. Adm. Code 200.800), respectfully submits its Reply Brief in the instant proceeding.

I. BACKGROUND

On April 6, 2011, Aqua Illinois, Inc. (the "Company" or "Aqua") filed with the Illinois Commerce Commission ("Commission" or "ICC") revised tariffs in order to petition for a general increase in water sewer rates, pursuant to Section 9-201 of the Illinois Public Utilities Act (the "Act"), 220 ILCS 5/9-201. On May 18, 2011, the Commission entered Suspension Orders commencing the investigation concerning the propriety of Aqua's proposed rate increase and on August 17, 2011 entered a Resuspension Order extending the suspension through March 2, 2012. In due course, the Administrative Law Judge assigned to this proceeding established a schedule for the submission of pre-filed testimony, hearings, and briefs (*Tr.*, Jun. 16, 2011, pp. 7-8).

In response to the Company's filings, the following parties filed Petitions to Intervene, which were granted: the Illinois Attorney General ("AG"), the Citizens Utility Board ("CUB"), the Village of University Park ("Village"), Viscofan USA, Inc. ("Viscofan"), and the County of Lake ("County").

At the October 25, 2010 evidentiary hearing in this matter, Christopher Boggs, Rates Analyst in the Rates Department of the Financial Analysis Division, testified on behalf of Staff. Prefiled testimony from Staff's other witnesses was also entered into the record.

The parties filed Initial Briefs ("IBs") on November 22, 2011. Staff will not respond to every argument proffered by every party in this Reply Brief. If Staff does not directly address each and every argument propounded, this does not mean that Staff is waiving its position, but rather that Staff feels it has previously adequately addressed such arguments or that the argument did not merit a response.

II. RATE BASE

A. Revenue Requirements

In its initial brief, Aqua recommends the Commission approve a single, consolidated rate base amount for its fully consolidated water division; and single, consolidated rate base amount for its fully consolidated sewer division. (Aqua IB at 7-8.) While there are no remaining contested issues regarding rate base itself, the consolidation of various rate divisions remains an area of disagreement. As such, Staff recommends that the Commission approve the rate base amounts set forth in the revenue requirements attached hereto as Appendix A, which incorporate the rate divisions proposed by Staff. These revenue requirements reflect Staff's rebuttal position, including the correction of two formulae affecting rate base and depreciation expense for Staff's proposed Consolidated Water Division on ICC Staff Ex. 7.0, Schedule 7.04.[1]

III. OPERATING EXPENSES

A. Incentive Compensation

Staff agrees with Aqua that the only contested operating expenses issue concerns incentive compensation. (Aqua IB, p. 8.) Although Aqua submits that Staff's total disallowance of $150,695 for incentive compensation should be rejected, the Company provided no testimony rebutting Staff's rationale for disallowing test year costs for the 2009 Omnibus Equity Compensation Plan ("ECP") and for the increase in the Management Improvement and Employee Recognition Plan ("MIP") for Dividend Equivalents, which amount to $60,879 and $11,741, respectively. Apparently, the Company does not disagree with Staff's testimony that: (1) the ECP is dependent upon financial goals of the Company that primarily benefit shareholders; and (2) Dividend Equivalents are a form of compensation under the ECP, not the MIP as presented in the Company's filing. (Staff IB, pp. 5-7.)

The balance of Staff's incentive compensation disallowance, $78,075, is for test year costs related to the MIP (also called the Annual Cash Incentive Plan, or ACIP, by

[1] In response to Aqua-Staff Data Request 3.01, Staff provided corrections to ICC Staff Ex. 7.0, Schedule 7.04. Those corrections were agreed to by Aqua (Aqua Ex. 14.0, lines 23-29) and attached to Aqua surrebuttal testimony as Aqua Ex. 14.2.

the Company). According to the Company, payment of incentive compensation for meeting performance goals is no longer dependent on Aqua achieving a targeted net income. (Aqua IB, p. 9.) Staff agrees that Aqua removed explicit language regarding financial triggers from the plan. (*Id.*, p. 7.) However, Aqua included a mechanism in the plan that achieves the same end: language was added to the plan that allows the Company to decrease a participant's award based on "other factors" that are undefined. As more fully explained in Staff's IB, a participant's award depends exclusively on the Board of Directors' assessment of the participant's performance against the participant's objectives, and "other factors" as deemed appropriate by the Board of Directors. (*Id*.) Aqua failed to provide any information to dispel the ambiguity surrounding the "other factors," nor did the Company deny that the "other factors" could include financial goals which, if not met, would result in the Board of Directors reducing the points a participant had earned by meeting stated goals that provide a benefit to ratepayers. (*Id*., p. 8.) The result would be the same as when there were explicit financial triggers: the amount of incentive compensation paid out would be reduced or eliminated, regardless of how well a participant met his/her stated goals.

The Commission has made it clear that incentive compensation should provide tangible benefits to ratepayers and should not be related to financial goals, affiliate goals or shareholder goals. (*Id*.) Staff believes its three-part adjustment to disallow incentive compensation is appropriate and should be approved by the Commission.

Staff recommends that the Commission approve the operating expenses presented in the revenue requirements, based on the rate divisions proposed by Staff, attached hereto as Appendix A.

IV. COST OF CAPITAL/RATE OF RETURN

Staff's proposed ROE of 9.43% is reasonable, consistent with prior Staff positions and recent Commission orders and fully supported by the record evidence. In contrast, Aqua's analysis suffers from the fundamental flaws that Staff pointed out in its Initial Brief (at 20-30). Staff, accordingly, recommends that the Commission reject Aqua's proposed ROE and adopt Staff's proposed ROE.

In its Initial Brief, Aqua makes many allegations regarding Staff witness Ms. Kight-Garlisch's analysis supporting her proposed ROE. Most of these allegations are fatally vague and thus difficult to respond to. Moreover, Aqua includes a few threats of "capital fleeing the State" and potentially negative reactions of investment advisory firms and the like if Staff's proposed ROE is accepted. (Aqua IB, at 17.) These scare-tactics are entirely misguided. If the Commission provides Aqua a fair rate of return, and there is no evidence that Staff's proposal is not fair, then no capital will flee the states and the investment advisory firms are unlikely to offer negative assessments. As such, Staff recommends the Commission summarily reject such tactics.

Furthermore, as demonstrated below, Aqua's allegations that are sufficiently defined as to allow a response are unfounded.

Undue Reliance on Zack's Projected Growth Rates

Aqua alleges that Staff's Water Sample would have been larger if Ms. Kight-Garlisch would not have restricted it to companies with Zacks long-term analyst growth rates. (Aqua IB, at; Aqua Ex. 11.0, at 9.) Aqua assumes that credible growth estimates were available through another source for the water companies that Ms. Kight-Garlisch eliminated because they lacked Zacks growth rate estimates. Mr. Walker used three sources for consensus forecast of analyst long-term growth rates. However, one of his sources, Yahoo! (First Call), forecast are not reliable because of its policy on updating analyst growth estimates. (Staff Ex. 8.0C at 3.) As shown in Attachment A, to Staff Ex. 8.0C, Yahoo! indicated that it does not replace or remove analyst growth estimates until a new estimate is provided. Consequently, some of the growth rates that Yahoo! publishes can be out of date. (Staff Ex. 8.0C at 3.)

DCF Methodologies

The Company argues that Staff "flip-flopped DCF methodologies between direct and rebuttal testimony." (Aqua IB, at 17.) The Company's argument is wrong. Staff presented an updated analysis in response to the Company's assertion that Staff's Water Sample should be the same as approved in Docket No. 09-0319 ("IAWC2009") or Docket No.10-0194 ("Aqua2010") and that Staff should use a non-constant DCF model. (Aqua Ex. 11.0 at 2 and 6-7.) As Ms. Kight-Garlisch explained, she used the same methodology to develop her Water Sample as Staff used in IAWC2009 and Aqua2010; however, data availability necessitated a change in the composition of the sample. She also noted that the data available had changed again between when she performed the analyses presented in her direct testimony and her rebuttal testimony. Therefore, she presented an updated analysis. (Staff Ex. 8.0C, at 1-2.) As Ms. Kight-Garlisch explained, it is necessary to use a NCDCF in her updated analysis since the sustainability of growth rates is questionable. The use of a constant growth or non-constant growth DCF analysis is not based on past use, but on what is appropriate given the data available at the time of analysis. Staff has consistently used the non-constant DCF when growth rate sustainability is questionable and the constant growth

DCF when the growth rate is sustainable. As can be seen from Ms. Kight-Garlisch's updated analysis, the results of the NCDCF analysis performed about two-months after the constant growth DCF analysis support her recommended cost of equity for Aqua. (Staff Ex. 8.0C at 4, 13-18.)

Long-Term Growth of the Economy

Aqua claims that "Staff places undue reliance on short term recent economic conditions in determining a long term sustainable growth of the economy." (Aqua IB at 16) Aqua witness Mr. Walker's long-term growth rate of 6.08% is based on the historical growth in real GDP of 3.32% from 1929-2009 and a long-term projected inflation rate of 2.8%. (Aqua Ex. 5.0, Schedule 17) As discussed in Ms. Kight-Garlisch direct testimony, historical data should not be used to estimate the forward-looking rate of return on common equity. In comparison to forecasted real GDP growth, EIA forecasts real GDP growth will average 2.6% during the 2021-2035 period and Global Insight forecasts real GDP growth will average 2.6% during the 2021-2041 period. These projected growth rates for real GDP indicate that Mr. Walker's historical real GDP growth estimate overstates the level of growth expected over the long-term and thereby overstates his investor-required rate of return. (Staff Ex. 8.0C at 4-5.)

Ms. Kight-Garlisch further explained that an economy-wide growth rate, whether 4%, 5%, 6% or even more, is not sustainable on a per share basis if a company is not reinvesting a portion of its earnings. That is, the growth rate per share of a company that pays out 100% of its earnings as dividends equals 0% regardless of the magnitude of economy-wide growth. In this case, Mr. Walker's calculated earnings retention ratios of 29% for his water group and 43% for his gas group are too low for his water and gas group companies to sustain the long-term growth rates he employs. (Staff Ex. 8.0C at 5.)

Together with the dividend payout rate that Mr. Walker assumed, the 6.08% growth rate requires an average ROE of 20.97% for his water group and 14.14% for his gas group. In contrast, Value Line projects a rate of return on common equity of 12.0% for his water group and 11.7% for his gas group for the 2013-2015 time-frame. (Staff Ex. 8.0C at 5-6.)

Moreover, the data Mr. Walker relied upon suggests that the companies composing his sample groups are below average growth companies relative to the overall market. Specifically, relative to the overall market, which has a retention ratio of 67.44%, the retention rate for his water group of 29% and gas group of 43% are well below average. Further, one would expect utilities overall to earn below average returns due to the below average risk reflected in their below average betas (i.e., betas less than one), such as the 0.72 water group beta and the 0.67 gas group beta Mr. Walker presented. Since growth is a function of those below average earnings retention rates and the below average return on those earnings, one would expect *below average* growth for utilities. (Staff Ex. 8.0C at 6.)

The investor-required rate of return is a function of investor's expectations of the future, not a mish-mash of historical averages. Moreover, current economic forecasts by professional forecasters do not support use of a 6.00% long-term growth rate estimate. As discussed in Ms. Kight-Garlisch direct testimony, and used in calculating the 4.80% long-term growth rate, the Energy Information Administration ("EIA") projects nominal economic growth of 4.5% for the 2021-2035 period and Global Insight forecasted nominal economic growth of 4.4% for the 2021-2041 period. (Staff Ex. 8.0C at 6-7.)

Alleged Exclusive Reliance on the DCF Model

Aqua also alleges that Staff's entire analysis relies exclusively on the DCF, since the market return used in Ms. Kight-Garlisch's Risk Premium model was derived through a DCF calculation. (Aqua IB at 16 and Aqua Ex. 11.0, at 2 and 20.) This is simply wrong. Ms. Kight-Garlisch's risk premium model uses a DCF calculation only to derive the market return ("R_M"), one of its three inputs. The other two inputs, the risk-free rate ("R_f") and beta ("β"), do not appear in the DCF formula. Also, this criticism is disingenuous since in addition to using an historical market return, Mr. Walker's Capital Asset Pricing Model also use DCF-derived market returns. (Staff Ex. 8.0C at 7.) R_M is forward-looking because it measures investors' rate of return requirement; therefore, R_M can only be estimated through a DCF calculation without resorting to untimely, obsolete historical data. Thus, if contrary to previous Orders, the Commission determines that the DCF-derived R_M should not be applied within the risk premium model, then Ms. Kight-Garlisch would have to substitute a R_M derived from an historical risk premium. According to Mr. Walker's direct testimony, the Ibbotson historical risk premium is 6.7%, which added to the 4.4% U.S. Treasury bond yield from Ms. Kight-Garlisch's direct testimony would result in an R_M estimate of 11.10%. Thus, Ms. Kight-Garlisch's risk premium analysis using the historical R_M would produce cost of common equity estimates of 8.69% for her Water Sample and 9.29% for her Utility Sample, both of which are below the 9.81% and 10.58% estimates obtained with Ms. Kight-Garlisch methodology. (Staff Ex. 8.0C at 7-8.)

Commission Authorized Cost of Equity

Aqua alleges that Staff's proposed return on equity is a "significant and unreasonable" departure from the returns on equity granted by the Commission in 2010 and other recent water utility rate cases.[2] (Aqua IB, at 18.)

Generally, such results-based comparisons are of limited value, as the previously authorized returns are based on facts that differ from those in this proceeding and are, thus, likely inapplicable (i.e., they represent authorized returns for *other* companies, in *other* jurisdictions, at *other* times representing *other* market environments). But, in this case, Aqua's comparisons are meaningless, as the critical facts needed to assess the degree of comparability are unknown. Specifically, Aqua (1) failed to provide evidence to show that Aqua is similar in overall risk to any of the companies whose authorized returns are reflected; and (2) included ROE's for very small companies with no access to the public equity market, neither directly nor indirectly through affiliates.. (Staff Ex. 8.0C at 9)

Moreover, Aqua fails to consider Staff's most recent cost of equity analysis for a water company. The Order in Docket Nos. 11-0059/11-0141/11-0142 Consolidated. approved a cost of common equity of 9.56%.[3] The 9.56% cost of equity recommendation is for a subsidiary of a holding company that has financial strength commensurate with a credit rating of Baa3/Ba1. (Staff Ex. 8.0C at 9.)

Spot Prices

Aqua also argues that Staff places undue reliance on "spot date" interest rates.

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[2] Aqua Ex. 11.0, p. 13.
[3] Order, Docket Nos. 11-0059/11-0141/11-0142 Consolidated, November 8, 2011, p. 23.

(Aqua IB, at 16.) However, Ms. Kight-Garlisch explained the market value of common stock equals the cumulative value of the expected stream of future dividends after each is discounted by the investor-required rate of return. New information becomes available every day and investors rethink their projections of future cash flows, the risk level of the company, and the price of risk. Thus, only a current stock price will reflect all information that is available and relevant to the market. (Staff Ex. 8.0C, at 10-11.)

Further, Ms. Kight-Garlisch pointed out that research has found that the last observed stock price is the best time series estimator of future stock prices. (*Id.*) The Commission has appropriately adopted costs of capital based on the most recent spot data much more frequently than it has relied on outdated historical data. In fact, the Commission has repeatedly ruled against the use of historical data in estimating the forward-looking cost of common equity estimate.[4] The case that the Company cites where the Commission rejected Staff's use of spot prices, Docket No. 10-0467 ("ComEd Rate case") and Docket No. 07-0241/07-0242 (Cons.) ("North Shore case"), are exceptions to the rule. (Aqua Ex. 11.0 at 18 and Aqua IB, at 16-17) While the Company emphasizes that the Commission rejected spot data in the 2007 North Shore case, the Company neglects to mention crucial language from the order in that case which explains that decision:

> **We note that the Commission has traditionally relied upon a single day's data in applying the DCF analysis, and we are very reluctant to deviate from Commission ratemaking practice.** However, the whole point of conducting such analyses is to develop a proxy for the appropriate ROE. When it can be shown that the proxy itself strays from a zone of reasonableness to the degree where it

[4] Order, Docket NO. 03-0403, April 13, 2004, p. 42; Order, Docket Nos. 06-0070/06-0071/06-0072 (Cons.), November 21, 206, pp. 142-143.

> offers an unreliable estimate of the appropriate ROE, as the Utilities have demonstrated with Staff's DCF analysis in this case, deviation from accepted practice may be warranted. We encourage parties to continue to provide reliable DCF analyses for the Commission's ROE deliberations. (Order, Docket Nos. 07-0241/07-0242 (Cons.), February 8, 2008, p. 92, emphasis added)

Based on the Commission's language, the Commission is not opposed to using spot data at all; to the contrary, it deviates from the practice of using spot data only with reluctance. Moreover, the standard established in that order for deviating from that Commission ratemaking practice – "when it can be shown that the proxy itself strays from a zone of reasonableness to the degree where it offers an unreliable estimate of the appropriate ROE" - has not been met in this proceeding.

Here, the Commission should once again reject the Company's non-constant DCF analysis due to its over-reliance on historical data, particularly given that Staff has demonstrated that spot stock prices have not produced aberrant estimates. (Staff Ex. 8.0C at 12-13.)

For all of the reasons noted above and elsewhere in Staff testimony and briefs, Staff recommends that the Commission reject Aqua's proposed ROE and adopt Staff's proposed ROE of 9.43%, which is reasonable, consistent with prior Staff positions and recent Commission orders and fully supported by the record evidence.

V. RATE DESIGN

A. Separate Books for Each Tariff Group

The Company's request to consolidate its books and records is consistent with its request for a single, consolidated revenue requirement for its water and sewer divisions.

(Aqua IB, pp. 3-4.) However, 83 Ill. Adm. Code Part 285 is unambiguous regarding the filing requirements for an increase in rates: separate rate base schedules and separate operating schedules must be provided for each applicable service and for each service area for which separate tariffs exist (e.g., district, division, etc.) where a requested increase in rates is being proposed. (Staff IB, p. 31.) The need to comport with the requirements of Part 285 was recently affirmed by the Commission in its Order in Docket No. 10-0517. (*Id.*) The Company should keep its books and records in such a manner as will allow it to comply with those requirements, by rate area, in future rate proceedings.

VI. RATES ISSUES

A. Water Division Consolidation

Aqua presents a number of arguments in support of its proposal to create a single revenue requirement for the nine water divisions included in this rate case (Candlewick Water, Fairhaven Water, Hawthorn Woods Water, Ivanhoe Water, Oak Run Water, Ravenna Water, Vermilion Water Division, University Park Water and Willowbrook Water). First, it contends that a single revenue requirement for the water divisions would allow Aqua to operate as one water company which the Company indicates would decrease rate case expenses going forward. (Aqua IB, p. 20.) Second, the Company contends that consolidation creates increased efficiencies that would offer numerous benefits to customers. (*Id.*, p. 21.) Third, Aqua contends that its proposed water consolidation is unlikely to create an unbearable rate shock to customers in smaller divisions. (*Id.*)

Staff generally agrees with Aqua's arguments that a single revenue requirement for the water divisions would decrease rate case expenses going forward and would create increased efficiencies that would offer numerous benefits to customers. (Staff IB, pp. 34-35.) However, the Company's argument that its proposed water consolidation is unlikely to create an unbearable rate shock to customers in smaller divisions is not supported by the record. Under the Company's proposed revenue requirements and rate design, many customers would face sizeable increases in their monthly water bills if the Commission approves the proposed consolidation. Specifically, for a 5,000 gallon/month residential customer, Staff noted that such customers in the Candlewick, Fairhaven, Ivanhoe, Willowbrook and Vermilion Divisions would face larger monthly bill percentage increases (e.g., from 18.83%-137.42%) under the Company's proposed Consolidated Tariff Group than if each of these divisions remained as stand alone divisions (e.g., from 0.894%-108.15%). (Staff Ex. 9.0R-C, p. 7.) Thus, Staff does not agree with the Company's contention that a 137.42% increase resulting from the Company's consolidation proposal would not be considered "unbearable rate shock" to customers.

In addition, Staff does not support Aqua's claim that its proposed tariff design and movement to a simpler tariff would ease customer understanding. (Aqua IB, p. 20.) Staff opines that the Company's proposal to consolidate nine of its ten water divisions (all but the Kankakee Division, which is not part of this proceeding) with two different tariffs would more likely be confusing to customers rather than simpler to understand. For example, the Company's proposed Customer Charge for a customer from Willowbrook is $15.94 (5/8" meter); the Company proposed Customer Charge for a customer who is in the University Park Division is $12.50 (5/8" meter). The Company has not illustrated how easy it will be for customers to comprehend as to why there are two different Customer Charges for these two customers even though they are all part of the same Consolidated Water Group.

The record evidence shows that many customers would face sizeable increases in their monthly water bills (Staff Ex. 9.0R-C, Table 9.1, p. 4), and the Company's claim that a simpler tariff would ease customer understanding has not been substantiated. (Aqua IB, p. 20.) For these reason, the Company's proposal to consolidate all nine water divisions in this proceeding to operate as one water company should not be adopted.

The Commission should instead adopt Staff's proposal to consolidate the six water divisions of Oak Run, Ravenna, Hawthorn Woods, Willowbrook, Ivanhoe and Vermilion into one tariff group, the Fairhaven and Candlewick Water divisions should be consolidated to form their own water division and the University Park Division should remain as a stand alone division. (Staff Ex. 9.0R-C, p. 7; Staff IB, pp. 33-34.)

Staff concludes that the three water divisions it has proposed in its water consolidation recommendation should be approved by the Commission for the following reasons:

(1) The customers of Ravenna and Hawthorn Woods would have larger monthly bill increases if they remained as stand alone divisions than if they were included in Staff's proposed Consolidated Tariff Group. One exception is the Vermilion Division, whose customers would have a slightly larger monthly bill increase if it was included in Staff's proposed Consolidated Tariff Group than if it remained a

standalone. However, its increase in either scenario (consolidation or standalone) would be less than the overall increase that the Company proposes to revenues in this proceeding and it is by far the largest division; thus, the benefits of adding its large customer base to the Consolidated Tariff Group provides an economies of scale benefit that allows the Company to spread out the recovery of costs of service to a larger group.

(2) Oak Run customers are going to experience a rate and revenue reduction whether it stands alone or whether it is consolidated with other divisions so this is a good time to include them in the Consolidated Tariff Group.

(3) Willowbrook and Ivanhoe customers would face only a slightly larger increase in their monthly bills in the Consolidated Tariff Group than if they stood alone, but their small customer bases would benefit more from their costs being spread out over a larger group in the event a major water system improvement is needed in the future.

(4) Fairhaven and Candlewick customers would have significantly larger monthly bill increases if they were made part of the Consolidated Tariff Group than if they remained as stand alone divisions. Therefore, Consolidating Candlewick with Fairhaven provides each with the benefit of having a larger customer base to spread out costs while avoiding the larger rate shock that would occur if these divisions were included in the Consolidated Tariff Group.

(5) Staff agrees with the Company's proposal to keep the University Park Division a stand alone division. (Staff Ex. 9.0R-C, pp. 8-9; Staff IB, pp. 33-35.)

B. Sewer Division Consolidation

The Company insists that its proposal to consolidate all six sewer divisions involved in this rate case (Candlewick Sewer, Ellwood Greens Sewer, Hawthorn Woods Sewer, Ivanhoe Sewer, University Park Sewer and Willowbrook Sewer) will not create significant rate shock to any of its operating divisions. (Aqua IB, p. 22.) Staff disagrees with the Company's argument that its proposed sewer consolidation is unlikely to create significant rate shock to any of its operating divisions.

In fact, Staff demonstrated that under the Company's proposed revenue requirements and rate design, Ellwood Greens and University Park customers would face significant increases in their monthly sewer bills if the Commission approves the Company's proposed consolidation. (Staff IB, pp. 35-37.)

Staff further explained that a 5,000 gallon/month Ellwood Greens waste water customer would see the percentage increase in his/her monthly bill nearly double if Ellwood Greens was included in the Company's proposed consolidation. (*Id.,* pp. 35-36.) Likewise, the revenues that have been proposed by the Company to be recovered from the Ellwood Greens customers would also double if Ellwood Greens was included in the consolidation. (*Id.*) Staff also showed that if Ellwood Greens was not in the Consolidated Sewer Division, the monthly Customer Charge for the remainder of the customers in the Company's proposed Consolidated Sewer Division would only increase slightly by $0.35 for the Usage Charge and $0.05 per 1,000 gallons. (*Id*., p. 36.)

Staff also recommends the Commission reject the Company's proposal to include University Park in the Consolidated Sewer Division. Referring to Table 9.6 (Staff Ex. 9.0R-C, p. 22), University Park Sewer would require a 19.92% increase in revenues at the Company's proposed rates if the division remained a stand alone division but a 38.21% revenue increase if it was included in the Consolidated Sewer Division. In addition, under the Company's consolidation proposal, a University Park residential customer that uses 5,000 gallons of waste water/month would realize a 37% increase from the average current monthly bill of $45.55. If University Park remained a stand alone division, however, the same customer would experience a 20% increase in his/her monthly bill (i.e., $54.68). (*Id.*) Therefore, Staff recommends leaving University Park Sewer as a stand alone division. (*Id.,* p. 37.)

Staff maintains that the sewer customers of University Park and Ellwood Greens would experience no additional advantages by being consolidated with the Company's recommended Consolidated Sewer Division. (*Id.*)

For the reasons stated above and those arguments previously stated in Staff's Initial Brief, Staff recommends that the Commission reject Aqua's sewer consolidation proposal. Instead, Staff recommends that the Commission approve a Consolidated Sewer Division that includes Candlewick, Hawthorn Woods, Ivanhoe and Willowbrook and leave Ellwood Greens and University Park as stand alone divisions.

C. AG's recommendation that the Commission moderate the American Water Works Association ("AWWA") Meter ratios in this Docket.

Staff recommends that increases to the Customer Charges in each of its proposed divisions be based on AWWA meter factors, where the allocation of costs among customer types be done through the application of meter factors. The application of meter factors relates the flow for meters larger than 5/8" to that of the volume of flow for 5/8" meter. In other words, Staff used equivalent meter ratios expressed in terms of the ratio of related meter capacity for each meter size relative to a 5/8" meter size.[5] (Staff Ex. 9.0R-C, p. 18.) This approach has been approved by the Commission in recent Utilities, Inc. rate cases. (Docket Nos. 11-0059/11-0141/11-0142 Cons. Final Order, November 8, 2011, p. 35; Docket No. 10-0280, Final Order, December 15, 2010, pp. 10-11.)

The AG recommends that the Commission should moderate the meter differential and phase in the AWWA ratios for the various meter sizes that determine the Customer Charge more gradually. (AG IB, p. 16) The AG's recommendation is based on the fact that the Company has installed, without explanation, more expensive ¾" residential meters in lieu of the more traditional 5/8" meters that utilities typically install for residential customers. Therefore, the AG maintains that "[t]he installation of the larger meter size pushes an already sizable rate yet higher." (*Id.*)

Staff recognizes that most residential customers currently have the same Customer Charges, no matter the meter size, in their respective divisions. Staff also recognizes that those customers are not necessarily requesting larger meter sizes prior to the Company installing them. Consequently, Staff does not object to the AG's recommendation to moderate the meter differential and more gradually phase in the AWWA meter ratios recommended by Staff.

VII. CONCLUSION

For the reasons set forth *supra*, Staff respectfully requests that the Commission's

[5] American Water Works Association, AWWA Manual M1, 2000, p. 202.

Final Order in the instant proceeding reflect Staff's recommendations consistent with this Reply Brief.

Respectfully submitted,

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