

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

Charmar Water Company)	11-0561
Proposed General Increase in Water Rates)	
)	
Cherry Hill Water Company)	11-0562
Proposed General Increase in Water Rates)	
)	
Clarendon Water Company)	11-0563
Proposed General Increase in Water Rates)	
)	
Killarney Water Company)	11-0564
Proposed General Increase in Water Rates)	
)	
Ferson Creek Utilities Company)	11-0565
Proposed General Increase in Water And)	
Sewer Rates)	
)	
Harbor Ridge Utilities, Inc.)	11-0566
Proposed General Increase in Water And)	
Sewer Rates)	(Cons.)

STAFF'S REPLY BRIEF

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. Introduction

On June 29, 2011, Charmar Water Company ("Charmar"), Cherry Hill Water Company ("Cherry Hill"), Clarendon Water Company ("Clarendon"), Killarney Water Company ("Killarney"), Ferson Creek Utilities Company ("Ferson Creek"), and Harbor

Ridge Utilities Company (“Harbor Ridge”) (collectively, “UI”, “Utilities, Inc.” or “the Companies”) filed tariffs seeking a general increase in water and sewer rates.¹ On August 2, 2011, the Commission entered Suspension Orders commencing the investigation concerning the propriety of the Companies’ request for rate increases and on November 2, 2011 entered a Resuspension Order extending the suspension through May 27, 2012. At a status hearing on September 1, 2011, the Administrative Law Judge (“ALJ”) assigned to this proceeding granted Staff’s request to consolidate the six dockets. The ALJ established a schedule for the submission of pre-filed testimony, hearings, and briefs (*Tr.*, Sep. 1, 2011, p. 6-7).

The People of the State of Illinois (“AG”) intervened on September 8, 2011 and filed Direct and Rebuttal Testimony. On October 3, 2011, Antioch Golf Club Community Association intervened, but did not file testimony. The Companies, Staff, and the AG filed Initial Briefs (“IB”) on February 22, 2012.

This Reply Brief will respond to certain arguments made by the AG. If Staff does not directly address each and every argument propounded by any party, 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. Argument

A. Rate Case Expense

The AG’s conclusion on rate case expense must be rejected. The AG begins by criticizing the Company for what it calls a “highly unusual” treatment of labor and rate case internal expenses. (AG IB, p. 4.) The fact, however, is that the Company’s

¹ Only Ferson Creek and Harbor Ridge filed tariffs for rate increases in sewer rates.

treatment of internal labor in rate case expenses has not changed. This was an issue in past (*Id.*, p. 6) and present cases, but the Commission has never concluded the Company's methodology is unreasonable.

The AG misunderstands or misrepresents the evidence which shows that the Company's internal labor in rate case expense is reasonable. AG Table 4 is not a correct picture of the costs at issue. The AG recommends that "the Commission...add in \$13,947 as shown in the table above to fairly and accurately account for WSC rate case expenses." (AG IB, p. 8.) This amount is labeled "WSC Rate Case Captive Deduction" in column (d) and referenced to "w/p[b-2] and AG Cross Ex. 2." The only place in the record supporting this amount is AG Ex. 2.4, which is the AG's edited w/p[b-2].² The AG has not demonstrated that its calculation is correct. On the other hand, Staff's response to AG data requests,³ show each Company's captive deduction by specific line and column reference to w/p [b-2]. The AG conducted no cross examination purporting the correctness of its calculations in AG Ex. 2.4 over those presented by Staff in AG Cross Ex. 2. The data in AG's column (d) in Table 4 can only be traced in the record to its own manufactured data in an AG exhibit; it is not supportable for any adjustment to the test year.

Next, in Table 4 column (e), the AG purports that rate case expense internal labor totals \$537,826, and recommends "the Commission should reduce the utilities' labor expense by a total of \$537,826 as shown above by each utility." (AG IB, p. 7.) The \$537,826 amount, though, is the total internal rate case internal labor; only 20% is included in each Company's revenue requirement, since all rate case expenses are

² w/p [b-2] is Company workpaper titled "Calculation of Capitalized Time Allocation," entered into record as part of Staff Group Cross Ex. 1 Confidential

³ AG Cross Ex. 2

amortized over five years. The AG's recommendation reveals a lack of understanding of the evidence.

The AG essentially argues nothing more than a comparison of apples and oranges. It claims that a mix-match exists because "the full cost of WSC employees has already been accounted for in the 2009 test year." (AG IB, p. 6.) The test year, though, represents only WSC 2009 internal labor costs other than rate case expense internal labor. This is evidenced by the calculation of salary and benefits workpaper and workpapers [b] and [b-4]⁴ wherein WSC 2009 labor costs are distributed via the equivalent residential connection ("ERC") allocator. Further, these costs are reduced for captime for any WSC labor spent on rate cases other than the Companies (workpaper [b-2]).⁵ The direct billed labor expenses from 2011 and 2012 are *incremental* to the 2009 allocated WSC internal labor costs. (*Id.* and Company IB, pp. 8-9.) The AG either misunderstands or ignores this fact.

The AG also misses the mark further when it attempts to compare total test year costs prior to rate case expense labor of \$213,533 to internal rate case labor of \$537,826 and declares this comparison unreasonable. (AG IB, p. 6.) The result, though, is quite logical. For example, due to Charmar's low number of customers, it receives only a 0.02% ERC allocation of Water Service Corporation labor. (Staff Group Ex. 1 Confidential, w/p [b-2]). In years where Charmar files no rate case, WSC personnel would not spend significant time on Charmar; however during the time of litigating a rate case, WSC would spend substantial time preparing schedules, testimony, responding to discovery, etc.—all prudent and reasonable costs that would

⁴ All entered into record as part of Staff Group Cross Ex. 1 Confidential

⁵ *Id.* and shown aggregated on AG Cross Ex. 2

not be incurred but for the rate case process. The AG's conclusion ignores this fact. The AG's proposed adjustments are unfounded and should be rejected by the Commission.

B. Cash Working Capital

Staff agrees with the Company when it states that the AG attempts to discredit the 45-day formula approach by selectively discussing isolated lead-lag elements. (Company IB, p. 8.) The AG's assertion that the 45-day method is obsolete disregards past Commission precedent. (Company IB, pp. 7-8.) The undisputed cost savings to small utilities and ultimately ratepayers for the use of the simplified method should not be tossed aside and replaced with zero rate recovery of cash working capital for the Companies due to the AG's unsupported theories of what a costly study *might* produce. (Staff IB, p. 10.) The AG's proposed adjustments on cash working capital should be rejected by the Commission.

C. Phase-In Plan

The evidence in this proceeding demonstrates that Staff's proposed revenue requirement is just and reasonable and should be adopted. While Staff is mindful that the increases are not small, the Commission simply cannot deny a rate increase in its entirety because the resulting rates are deemed "too high" by one or more parties. The Commission must "consider the revenues and expenses of the utility." *BPI v. ICC*, 136 Ill. 2d 192, 219 (1989). In the words of Commissioner O'Connell-Diaz:

We can't just say 'no.' We need to go through each piece of evidence that is presented by the Company in their rate request. It's our obligation. It is our charge when we come into the office as Commissioners.

Regular Open Meeting (May 24, 2011), at 37.

Staff, accordingly, continues to recommend that the Commission not adopt a rate mitigation plan at this time to mitigate the resulting rate increase from this proceeding.

The AG's plan, moreover, phases in the rate increase in over a four-year (Harbor Ridge) to nine-year (Charmar) period, deferring revenues that under traditional ratemaking would have been collected immediately and putting them off instead into the future. The evidence provided by the AG in this proceeding, while extensive, is nonetheless unpersuasive on the proposition that its proposed mitigation plan is beneficial to UIs customers in the long run. In general, Staff believes that the long term consequences of any phase-in plan are fiscally unsound. Any rate mitigation proposal adopted in this proceeding may in fact place undue future financial stress on ratepayers and also compromise the Companies' ability to make timely infrastructure investments to maintain a safe, adequate and reliable water or sewer system. The Commission should reject AG's phase-in plan because it: (a) represents a fundamental departure from the Commission's reliance on cost-based rates development; (b) may not allow the Companies to timely recover their revenue requirement, which may result in a level of revenues insufficient to operate and maintain the Companies' water and sewer systems in a safe, adequate, and reliable manner; and (c) a customer who defers rate increases pays lower rates today at the cost of much higher rates in the future, particularly because they must pay back all deferred rate increases with interest.

In sum, the Commission is charged by the legislature with setting rates which are "just and reasonable" not only to the ratepayers but to the utility and its stockholders. A utility is entitled under the Act to recover its cost of providing utility service and earn a fair rate of return on assets used to provide such service. The record evidence supports

the Companies' and Staff's position that the Companies cannot recover their costs of service under their current rates and that the rates proposed by Staff are necessary for the Companies to recover the costs incurred in meeting their public utility service obligations, including a reasonable rate of return on utility assets. The Commission is required to ensure fair treatment and to protect against any undue or sustained adverse impact on utility earnings.

In fact, Staff finds that the AG's plan inconsistent with the regulatory goals and objectives set forth by the General Assembly in the Public Utilities Act ("Act"). Specifically, Staff is concerned about the emphasis placed by the AG almost exclusively on UI customers by its phase-in plan. While Staff agrees that the Commission should consider fairness when making its determinations with regard to rate shock facing customers, the proper focus in this case should be on what is fair to *both* customers and the Companies, in light of the previously approved revenue requirement in this proceeding. In a recent 2007 North Shore Gas Company and Peoples Gas Light and Coke Company rate case, the Commission stated the following:

In the final analysis, we are simply unable to approve only those measures that benefit ratepayers and wholly ignore what the impacts of these benefits will have on the Utilities. To do so could well be unlawful as this Commission is put to the obligation of balancing both the interests of consumers and the interests of the Utilities. See *BPI*, 146 Ill. 2d 175, 208 (1991) (stating that the Commission is charged with setting rates which are just and reasonable not only to the ratepayers but to the utility and its shareholders).

Order, Docket Nos. 07-0241/07-0242 (Cons.), at 152 (emphasis added).

Hence, the Commission must weigh the evidence and arguments from both sides and determine a reasonable and fair outcome.

Nevertheless, should the Commission conclude that some form of a rate mitigation plan be implemented in this proceeding, Staff respectfully requests the Commission to consider the following:

- a. Participation in any rate mitigation plan should be voluntary, where customers can decide whether to opt in to partake in the program or pay now and avoid paying much higher rates in the future. The AG does not oppose this idea. (AG IB, p. 25)
- b. Although the AG's rate mitigation plan may reduce rate shock in the deferral period, the AG's plan creates very high future rate impacts when deferrals must be repaid. Therefore, in order to reduce the deferrals individual customers must repay in future years, Staff recommends the Commission to set much higher phase-in annual rate caps thereby considerably shortening the deferral period.
- c. Even if the Commission considers and adopts a rate mitigation proposal in these proceedings, there should be nothing to prevent any party, Staff, and even the Commission from considering a new or different proposal in the Companies' next delivery service rate cases.

In contrast to the unfair and customer skewed AG proposed phase-in plan in this proceeding, a phase-in plan mindful of the factors above,⁶ may diminish the effects of rate shock on UI customers, while being more balanced to both UI and its customers.

III. Conclusion

For the reasons set forth above, Staff respectfully requests that the Commission's Final Order in the instant proceeding reflect Staff's recommendations above and that the Company's proposed tariff changes be modified in accordance with Staff's overall recommendations.

⁶ In fact, in Docket Nos. 11-0059 (Cons.), the Commission ordered rehearing and directed UI and the parties to address ways to alleviate the rate shock. (Order on Rehearing, Dec. 21, 2011.) Although Staff's primary recommendation on rehearing was for the Commission to keep the approved revenue requirement and corresponding rates intact, Staff did provide the Commission with an alternative phase-in plan to mitigate rates. Staff's suggestions (a) through (c) provided for Commission's consideration in the reply brief stage of this proceeding mirror certain elements proposed by Staff's in its alternative plan in Docket Nos. 11-0059 (Cons.) on rehearing.

Respectfully submitted,

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