

**ILLINOIS COMMERCE COMMISSION**

**DOCKET NO. 11-0767**

**IAWC EXHIBIT 5.00SUPP**

**SUPPLEMENTAL DIRECT TESTIMONY OF  
RICH KERCKHOVE**

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**ILLINOIS-AMERICAN WATER COMPANY**

**MARCH 9, 2012**

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**SUPPLEMENTAL DIRECT TESTIMONY  
OF  
RICH KERCKHOVE**

1                                   **I.     WITNESS INTRODUCTION**

2   **Q1.   Please state your name and business address.**

3   **A.**   My name is Rich Kerckhove. My business address is 727 Craig Road, St.  
4       Louis, Missouri 63141.

5   **Q2.   Are you the same Rich Kerckhove who previously filed direct**  
6       **testimony in this proceeding?**

7   **A.**   Yes.

8                                   **II.   PURPOSE OF SUPPLEMENTAL DIRECT TESTIMONY**

9   **Q3.   What is the purpose of your Supplemental Direct Testimony in this**  
10       **case?**

11   **A.**   The purpose of my supplemental direct testimony is to provide an  
12       overview of the Company's forecast update and to explain the approach  
13       used by the Company to detail the resulting updates to the Company's  
14       direct testimony and schedules filed on October 27, 2011. I discuss  
15       certain of the changes to the Company's forecast and provide summaries  
16       of the overall updates to rate base and operating income. In addition, I  
17       discuss certain corrections to the Company's testimony, exhibits and  
18       schedules that were identified during the forecast re-evaluation and in the  
19       course of discovery in this case. I also address updates regarding the  
20       Company's projected test year level of Service Company fees and

21 Business Transformation (“BT”) costs, and sponsor revised schedules  
22 reflecting that updated information, as well as address the impact on the  
23 updated forecast of the continued declining usage experienced by the  
24 Company. Finally, I adopt portions of the Direct Testimony of Edward J.  
25 Grubb (IAWC Exhibit 4.00), included with the Company’s October 27,  
26 2011 Part 285 filing.

27 **Q4. Are you sponsoring any revised schedules?**

28 **A.** Yes. I am sponsoring the following revised schedules:

- 29 • Schedule B-2.3;
- 30 • Schedule B-9;
- 31 • Schedule B-9.1;
- 32 • Schedule C-5;
- 33 • Schedule C-5.2;
- 34 • Schedule C-5.3; and
- 35 • Schedule C-5.4.

36 **Q5. Are you sponsoring any exhibits with your supplemental direct**  
37 **testimony?**

38 **A.** Yes. I am sponsoring the following exhibits:

- 39 • IAWC Exhibit 5.01SUPP, which summarizes the significant and  
40 material changes to the Company’s forecasted rate base;
- 41 • IAWC Exhibit 5.02SUPP, which summarizes the significant and  
42 material changes to the Company’s forecasted operating income  
43 statement; and

- 44           • IAWC Exhibit 5.03SUPP, which is the report of the audit of IAWC’s  
45           updated forecast performed by Certified Public Accountants Kerber,  
46           Eck & Braeckel LLP.

47                           **III.   OVERVIEW OF FORECAST CHANGES**

48   **Q6. Has IAWC determined that an update to its test year forecast is**  
49   **appropriate in this case?**

50   **A.** Yes. As discussed below, certain changes have occurred that affect the  
51   Company’s test year forecast. The Company’s management process  
52   includes the periodic re-evaluation of its projections, forecasts, costs, and  
53   other financial and operational data. As a result of a re-evaluation of the  
54   2012 and 2013 forecasts, the Company has determined that there are  
55   certain changes to the original forecast developed for the test year ending  
56   September 30, 2013. 83 Ill. Adm. Code Part 287 allows a utility using a  
57   future test year to update its projections in accordance with the  
58   established schedule if there is a significant and material change affecting  
59   its revenue requirement. IAWC has experienced significant and material  
60   forecast changes and, therefore, has updated its projections for the test  
61   year.

62   **Q7. Please summarize the effect of the update on the revenue**  
63   **requirement and rate increase proposed by IAWC in this proceeding.**

64   **A.** The update shows that the Company’s revenue requirement decreased to  
65   \$247,838,682 and that the revenue increase required to attain that level of  
66   revenue is \$35,736,332. IAWC witness Tyler T. Bernsen (IAWC Exhibit

67 7.00SUPP) discusses the ratemaking impact of the update on the revenue  
68 requirement.

69 **Q8. Please discuss the presentation of the forecast.**

70 **A.** The Company's forecast re-evaluation focused on the identification of  
71 significant and material forecast changes. The significant and material  
72 changes to the test-year forecast are summarized as follows:

- 73 • Reduction to Fuel and Purchased Power Expense (discussed by  
74 Mr. Bernsen (IAWC Exhibit 7.00SUPP));
- 75 • Organizational Restructuring (discussed by Karla Teasley (IAWC  
76 Exhibit 1.00SUPP) and Mr. Bernsen (IAWC Exhibit 7.00SUPP));
- 77 • BT costs (discussed below);
- 78 • Reduction to Service Company fees expense (discussed below);
- 79 • Increases to Pension and OPEB expenses (discussed by Scott  
80 Rungren (IAWC Exhibit 6.00SUPP));
- 81 • Rate case expense (discussed by Mr. Bernsen (IAWC Exhibit  
82 7.00SUPP));
- 83 • Municipal Village of Bolingbrook and Dana/Long  
84 Point/Reading/Ancona Public Water District sewer billing services  
85 revenue and expense (discussed below and by Mr. Bernsen (IAWC  
86 Exhibit 7.00SUPP));
- 87 • Valley Marina offload operating expenses (discussed below and by  
88 Mr. Bernsen (IAWC Exhibit 7.00SUPP)); and

- 89           • Capital structure change (discussed by Mr. Rungren (IAWC Exhibit  
90           6.00SUPP)).

91           These significant and material changes to the forecast (and certain  
92           necessary corrections) are reflected in the revised schedules referenced  
93           below and further described in the Company's collective supplemental  
94           direct testimony.

95           In addition to the revisions to the forecast that are listed above, the  
96           Company's capital structure and cash working capital needs were also  
97           revised as a result of the forecast revisions.

98   **Q9. Has the Company also identified forecast changes that are not**  
99   **deemed material?**

100   **A.** Yes. In addition to the material changes reflected in the revised schedules  
101           identified above, the Company has identified other changes that, on a net  
102           basis, are not deemed material and are, therefore, not reflected in revised  
103           schedules. These changes are discussed by IAWC witness Jeffrey T.  
104           Kaiser (IAWC Exhibit 3.00SUPP).

105           **IV. UPDATE OF FUTURE TEST YEAR PROJECTIONS**

106   **Q10. Please discuss the factors that resulted in the forecast changes.**

107   **A.** Certain of the changes are based on the availability of more recent data.  
108           In addition, the Company's ongoing cost reduction efforts, as discussed by  
109           Ms. Teasley in her direct testimony (IAWC Exhibit 1.00) and in her  
110           supplemental direct testimony (IAWC Exhibit 1.00SUPP), have resulted in  
111           changes to projected levels of operation and maintenance ("O&M")

112 expense in the test year, such as a lower cost for fuel and purchased  
113 power.

114 There are other factors affecting the forecast. Towers Watson has  
115 developed more current pension and OPEB expense amounts. BT capital  
116 costs have increased. In addition, the Company continues to experience  
117 declining customer usage and has updated its requested revenue  
118 increase to reflect the addition of 2011 non-winter usage into the  
119 forecasted amount. Rate case expense was adjusted for additional cost  
120 to perform the Commission-ordered demand study. I discuss other  
121 changes below.

122 **Q11. Does the Company's presentation of forecast updates and**  
123 **corrections provide a reconciliation of changes to the original**  
124 **projection?**

125 **A.** Yes, it does. The revised schedules referenced below and sponsored by  
126 the Company's witnesses filing supplemental direct testimony show each  
127 change to the original operating income statement, rate base, and capital  
128 structure that are reflected as part of the update. In addition, as noted  
129 above, I sponsor IAWC Exhibits 5.01SUPP and 5.02SUPP, which  
130 summarize the significant and material changes to the Company's test  
131 year rate base and forecasted operating income statement, respectively.

132 **Q12. What aspects of the test year projections are affected by the**  
133 **update?**

134 **A.** There are certain material changes to the test-year projections that the  
135 Company is proposing to reflect in revised schedules. The Company's  
136 revenues have been adjusted. Certain O&M expenses also required  
137 adjustment. Other operating expenses, including depreciation, and  
138 income taxes, have to be updated, in part, because of the other updates  
139 being made. In addition, the Company's capital structure and cost rates  
140 for debt capital have been modified as explained by Mr. Rungren (IAWC  
141 Exhibit 6.00SUPP).

142 **Q13. In your opinion, are the updated projections reasonable and reliable?**

143 **A.** Yes, they are. The updated forecast was developed in accordance with  
144 the "Guide for Prospective Financial Information" (2009) issued by the  
145 American Institute of Certified Public Accountants ("2009 Guide").  
146 Furthermore, the projections are reasonable, reliable, and were made in  
147 good faith. All of the basic assumptions used in preparing the projections  
148 are reasonable, evaluated and justified in the exhibits, testimony and  
149 workpapers supporting this filing.

150 **Q14. Has this updated projection been verified by an independent**  
151 **auditor?**

152 **A.** Yes, it has. Certified Public Accountants Kerber, Eck & Braeckel LLP  
153 performed the audit and issued a report certifying that the update was  
154 prepared and presented in compliance with the 2009 Guide. The audit  
155 report is attached as IAWC Exhibit 5.03SUPP.

156

**V. UPDATES TO RATE BASE**

157

**Q15. Is the Company updating its proposed rate base for the test year?**

158

**A.** Yes. IAWC Exhibit 5.01SUPP summarizes the significant and material changes in the Company's forecasted rate base. The Company's updated test year rate base is further addressed by Mr. Rungren (IAWC Exhibit 6.00SUPP).

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**VI. UPDATES TO OPERATING EXPENSES AND REVENUES**

163

**Q16. Is the Company updating operating expenses and revenues?**

164

**A.** Yes. I address IAWC's updated level of test year present rate revenue below. IAWC Exhibit 5.02SUPP summarizes the significant and material changes in the Company's forecasted operating income statement. The Company's updated test year operating expenses and the revenue requirement resulting from the Company's update is further addressed by Mr. Bernsen (IAWC Exhibit 7.00SUPP).

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**VII. UPDATED SCHEDULES**

171

**Q17. As a result of the update, are there revisions to the Company's schedules?**

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173

**A.** Yes. The following schedules are being revised at this time:

174

- A-2 Overall Financial Summary;

175

- B-1 Jurisdictional Rate Base Summary by ICC Account;

176

- B-2 Summary of Utility Adjustments to Rate base;

177

- B-2.2 Adjustment for Pension Asset (Liability);

178

- B-2.3 Adjustment for FAS 109 Regulatory Asset – Net of Liability;

179

- B-2.4 Adjustment for OPEB Rate Base Deduction;

## IAWC Exhibit 5.00SUPP

- 180 • B-2.5 Adjustment for Unamortized Balance of ICC Service
- 181 Company Audit Cost;
- 182 • B-4 Summary of Adjustments to Plant in Service;
- 183 • B-5 Gross Additions, Retirements, and Transfers;
- 184 • B-6 Depreciation Reserve;
- 185 • B-8 Cash Working Capital;
- 186 • B-9 Accumulated Deferred Income Taxes;
- 187 • B-9.1 Detailed Listing of Balance Sheet Assets and Liabilities;
- 188 • B-10 Deferred Charges;
- 189 • C-1 Jurisdictional Operating Income Summary;
- 190 • C-2 Summary of Utility Proposed Adjustments to Operating Income;
- 191 • C-2.1 Rate Case Expense;
- 192 • C-2.2 Steel Structure Maintenance Amortization;
- 193 • C-2.6 Depreciation Expense;
- 194 • C-2.8 Unaccounted For Water – Fuel & Power and Chemicals;
- 195 • C-2.9 Annual Incentive Plan Adjustment;
- 196 • C-5 Calculation of Federal Income Tax Expense;
- 197 • C-5.2 Deferred Income Tax Expense;
- 198 • C-5.3 Difference Between Book and Tax Depreciation;
- 199 • C-5.4 Interest Synchronization;
- 200 • C-7 Charitable Contributions;
- 201 • C-8 Demonstration and Selling, Advertising, and Miscellaneous
- 202 Sales Expenses;
- 203 • C-10 Rate Case Expense;
- 204 • C-10.1 Rate Case Expense Comparisons;
- 205 • C-11.3 Employee Benefits;
- 206 • C-12 Depreciation Expense;
- 207 • C-16 Uncollectible Expense;
- 208 • C-18 Taxes Other Than Income;
- 209 • D-1 Weighted Average Cost of Capital;
- 210 • D-2 Cost of Short-Term Debt;

- 211 • D-12 Statement of Returned Earnings;
- 212 • G-2 Statement From the Independent Certified Public Accountant;
- 213 • G-5 Assumptions Used in the Forecast; and
- 214 • G-7 Proration of Accumulated Deferred Income Taxes.

215 **Q18. Are there any new schedules?**

216 **A.** Yes. The Company has prepared Schedule C-22 Cost Savings Programs  
217 to reflect costs and savings resulting from the organizational restructuring  
218 discussed by Ms. Teasley (IAWC Exhibit 1.00SUPP). Mr. Bernsen  
219 sponsors and further discusses Schedule C-22 (IAWC Exhibit 7.00SUPP).  
220 In addition, the following new schedules were prepared to reflect either  
221 updates to the forecast or to remediate corrections:

- 222 • C-2.14 Miscellaneous Labor;
- 223 • C-2.15 Valley Marina Offload;
- 224 • C-2.16 Municipal Billing Services; and
- 225 • C-2.17 Customer Usage.

226 **VIII. CORRECTIONS**

227 **Q19. Has the Company identified corrections which should be made to the**  
228 **schedules filed in this proceeding?**

229 **A.** Yes. In the course of discovery and its periodic forecast re-evaluation  
230 discussed above, the Company identified certain corrections that should  
231 be made to its originally-filed schedules.

232 **Q20. Please summarize the corrections being made by the Company and**  
233 **further discussed as appropriate in its supplemental direct**  
234 **testimony.**

## IAWC Exhibit 5.00SUPP

235 **A.** The Company has made the following corrections which are reflected in its  
236 update schedules:

- 237 • Corrected the amount of interest expense reflected in Cash  
238 Working Capital, Schedule B-8;
- 239 • Corrected a 13-month average calculation on Deferred Charges,  
240 Schedule B-10;
- 241 • Added the \$465,899 2011 Valley View tank painting that had been  
242 inadvertently omitted from Deferred Charges, Schedule B-10;
- 243 • Corrected the amount of income tax expense reflected in Cash  
244 Working Capital, Schedule B-8;
- 245 • Corrected the unamortized balance of the Company's cost of the  
246 Commission-ordered Service Company audit included in rate base;
- 247 • Corrected deferred income taxes to reflect the corrected book and  
248 tax depreciation amounts. The correction affects Deferred Income  
249 Taxes, Schedule B-9;
- 250 • Removed Long-Term portion of AIP that should have been included  
251 on Schedule C-2.9;
- 252 • Removed fully depreciated Service Company Shared Services  
253 Center and Customer Service Center transition costs on schedules  
254 B-4, B-5, B-6, and C-12;

## IAWC Exhibit 5.00SUPP

- 255 • Corrected FAS 109 amount to include the forecasted September  
256 2013 balance as the Accumulated Amortization of Regulatory  
257 Assets used the September 2012 forecasted balance for 2013 on  
258 Schedule B-2.3;
- 259 • Corrected Deferred Income Taxes to reflect the 33.3% tax  
260 depreciation rate for BT;
- 261 • Removed from Schedules B-4, B-5, B-6, and C-12 the effect of the  
262 BT Comprehensive Planning Study that was included twice;
- 263 • Corrected the weighted average cost of short-term debt for the  
264 correct amount of 2012 and 2013 CWIP accruing AFUDC;
- 265 • Removed IAWC labor that is expected to be incurred on behalf of  
266 American Lake Water Company during the test year. The labor  
267 was inadvertently included in the original filing;
- 268 • Adjusted the Amortization of Regulatory Assets/Liabilities on  
269 Schedule C-5.2 for the cumulative effect of the above corrections;
- 270 • Corrected overstated "Other" rate case expense amount associated  
271 with the current proceeding and understated actual "Other" rate  
272 case expense amount associated with IAWC's last rate case;
- 273 • Corrected for revised External Affairs expense amounts that were  
274 not reflected in the original filing; and



298 customer per day for each month January 2003 through December 2010.  
299 The “base” usage trend was continued for each month January 2011  
300 through December 2013. The next step was to estimate customer usage  
301 that is impacted by weather and layer that usage on top of the “base”  
302 usage. In order to estimate the updated summer usage for the months  
303 May through December, the calculated trend line amounts described  
304 above were first subtracted from the actual usage per customer per day  
305 for 2003 through 2011 May through December months. Including the  
306 2011 May through December months resulted in a lower average for the  
307 combined months May through December than using the monthly 2003  
308 through 2010 months. Finally, the average May through December  
309 monthly difference amounts were added back to the respective “base”  
310 amount for each month May through December for 2011 through 2013.

311 **Q24. Are there other changes which will impact the projected test year**  
312 **present rate revenues?**

313 **A.** Yes. All IAWC billing agreements, under which IAWC handles sewer or  
314 other bill collections for municipalities and other outside parties, will end in  
315 October 2012 (with the exception of collections for the Village of  
316 Bolingbrook (“Bolingbrook”) and Dana/Long Point/Reading/Ancona Public  
317 Water District (“Dana”) which will continue to be handled by a third party  
318 vendor, as I discuss below). As a result, IAWC will no longer receive  
319 revenues from the municipalities and other third parties covered under  
320 billing agreements after October 2012. Thus, the Company has adjusted

321 its expected test year level of present rate revenues to reflect the fact that  
322 it will no longer be collecting billing revenues.

323 **Q25. Will IAWC continue to incur some expense related to billing**  
324 **agreements?**

325 **A.** Yes. Because IAWC anticipates that Bolingbrook and Dana will request  
326 that IAWC continue to provide sewer billing service for those  
327 municipalities, IAWC anticipates engaging an outside vendor to provide  
328 the service to Bolingbrook and Dana. In addition to including the revenues  
329 for this billing service in the updated forecast, IAWC has included the  
330 vendor's cost to provide those services. There is no revenue requirement  
331 impact as the amount of billing revenue is offset by an equal amount of  
332 billing expense.

333 **X. BUSINESS TRANSFORMATION COSTS**

334 **Q26. Does IAWC project a change in costs related to BT which were not**  
335 **incorporated in the Company's initial filing?**

336 **A.** Yes. Since the Company's initial filing, the BT program budget has been  
337 revised. The Company's initial filing was based on an enterprise-wide BT  
338 cost of \$286 million of which \$27.5 million is allocated to IAWC. The  
339 estimated BT program costs have increased enterprise-wide from \$286 to  
340 \$300 million, which results in an additional \$1.4 million allocation to IAWC.

341 **Q27. How does the Company plan to account for the increased BT costs**  
342 **in this proceeding?**

343 A. These BT costs will be capitalized along with the rest of the BT capital  
344 amounts. The updates regarding these additional BT-related costs are  
345 reflected on Schedules B-5 First Revised and B-6 First Revised.

346 **XI. SERVICE COMPANY FEES**

347 **Q28. Is the Company updating its projected test year level of Service**  
348 **Company fees?**

349 A. Yes. The Company is reducing its projected level of Service Company  
350 fees by \$392,294. Effective November 1, 2011, the Service Company  
351 announced a change in divisional structure that includes the merging of  
352 the four divisions into three, to be known as the Northeast Division, the  
353 Mid-Atlantic Division, and the Central Division. The impact of this  
354 reorganization on the revenue requirement of IAWC for the test year  
355 ending September 30, 2013 is a reduction of Service Company fees in the  
356 amount of \$392,294. As explained by Ms. Teasley (IAWC Exhibit  
357 1.00SUPP), this reduction reflects IAWC's and the Service Company's  
358 ongoing efforts to control costs and mitigate the impact of rate increases  
359 on customers. The update to the test year level of Service Company fees  
360 is reflected on Schedule C-2 First Revised.

361 **XII. VALLEY MARINA SEWER OFFLOADING**

362 **Q29. Please discuss the effect on the forecast of IAWC's expected**  
363 **offloading of sewer treatment to a local sewage treatment district in**  
364 **Chicago Metro.**

365 **A.** Another factor impacting the forecast relates to the Company's Valley  
366 Marina sewage treatment facility in the Chicago Metro district, referenced  
367 in Mr. Kaiser's direct testimony (IADC Exhibit 3.00 (2d Rev.), p. 34). At  
368 the time it prepared its original forecast, the Company expected to  
369 decommission the Valley Marina facility and offload treatment to a local  
370 sewage treatment district; however, IADC was still engaged in  
371 negotiations with the local district. Since that time, the Company  
372 confirmed that offloading was the lowest cost option. The initial rate case  
373 filing reflected the expected capital cost of the connection to the local  
374 sewage treatment district for offloading, but included a level of operations  
375 and maintenance expense which assumed that the sewage would be  
376 treated at the Company's own facility. The updated forecast now reflects  
377 the capital cost of the offloading connection based upon the offload  
378 contract life, and incorporates the operations and maintenance expenses  
379 associated with the offload, while excluding the operations and  
380 maintenance expense associated with Company treatment of sewage at  
381 its own facility.

382 **XIII. ADOPTION OF DIRECT TESTIMONY OF EDWARD J. GRUBB**

383 **Q30. Is IADC witness Mr. Grubb still with the Company?**

384 **A.** No. Mr. Grubb retired effective November 29, 2011. As a result, IADC is  
385 proposing that two witnesses adopt his direct testimony (IADC Exhibit  
386 4.00).

387 **Q31. Which portions of Mr. Grubb's direct testimony are you adopting?**

388 **A.** I am adopting his testimony regarding Business Transformation Costs,  
389 Service Company Costs and the Revenue Adjustment Clause, specifically,  
390 pages 2 through 12 and 17 through 20 of his direct testimony.

391 **Q32. Do you adopt the portions of IAWC Exhibit 4.00, the Direct Testimony**  
392 **of Edward J. Grubb, which you identified above as your own**  
393 **testimony in this proceeding?**

394 **A.** Yes.

395 **Q33. Which portion of Mr. Grubb's direct testimony will be adopted by**  
396 **another witness?**

397 **A.** IAWC witness Mr. Bernsen will be adopting Mr. Grubb's direct testimony  
398 regarding IAWC's Service Company Audit costs.

399 **Q34. Does this conclude your supplemental direct testimony?**

400 **A.** Yes, it does.