

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Apple Canyon Utility Company)
)
Lake Wildwood Utilities Corp.)
)
) Docket Nos. 12-0603/12-0604 (Cons.)
Proposed general rate increase for)
water service.)
)

**REPLY BRIEF OF THE
STAFF OF THE ILLINOIS COMMERCE COMMISSION**

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The Staff of the Illinois Commerce Commission (“Staff”), by and through its counsel, and 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 (“RB”) in the above-captioned matter.

Introduction

On October 1, 2012, Apple Canyon Utility Company (“AC” or “Apple Canyon”) and Lake Wildwood Utilities Corp. (“LW” or “Lake Wildwood”) (collectively, the “Companies”) filed separate 285 Filings and separate direct testimony of Mr. Dimitry Neyzelman, which proposed general rate increases for the respective water services. On November 8, 2012, the Commission suspended both proposed tariffs to and including January 28, 2013. On November 13, 2012, Lake Wildwood Association, Inc. (“LWA”) filed a petition to intervene in Docket No. 12-0604. On December 3, 2012, Docket No. 12-0603 and Docket No. 12-0604 were consolidated.

Initial Briefs (“IB”) were filed on May 16, 2013 by the People of the State of Illinois *ex rel.* Lisa Madigan, Attorney General of the State of Illinois (the “AG”); the Lake Wildwood Association and Apple Canyon Lake Property Owners’ Association (LWA/ACLPOA); Staff; and Apple Canyon and Lake Wildwood. Some of the issues raised in the parties’ initial briefs were addressed in Staff’s Initial Brief and, in the interest of avoiding unnecessary duplication, Staff has not repeated every argument or response previously made in Staff’s Initial Brief. Thus, the omission of a response to an argument that Staff previously addressed simply means that Staff stands on the position taken in Staff’s Initial Brief.

Discussion

I. RATE BASE -- ADJUSTMENTS

Uncontested Issues

The AG’s IB includes tables on pages 5 and 6 outlining the undisputed adjustments they proposed in this case. For Lake Wildwood, the AG included the removal of a storage tank not in use as a rate base reduction of \$2,799 and an expense reduction of \$221. While the Company did agree with the AG adjustment in its rebuttal testimony, in surrebuttal testimony, the Company recognized that Staff’s adjustment to reflect the disallowances for Docket Nos. 90-0475/92-0402 (Cons.) also removed the same storage tanks from plant in service. Therefore, the AG adjustment should not also be approved as it would result in double disallowances. Utilities Ex. 3.0 at 3-4.

Contested Issues

Cash Working Capital

In IBs for both the Companies and the AG, arguments were presented regarding Invested Capital Tax (“ICT”) included in the Case Working Capital (“CWC”) calculation. In response to the AG’s argument that all Taxes Other Than Income should be removed from the CWC calculation, the Companies noted that ICT for Apple Canyon was understated. Therefore, while the AG argues that the CWC should be revised to omit the Taxes Other Than Income, the Companies argue that both Taxes Other Than Income and CWC should be increased for the Apple Canyon ICT that had been overlooked. Utilities IB at 6. As the Companies pointed out in testimony, the Commission has routinely allowed Taxes Other Than Income in the formula method for CWC calculation, adjusted for real estate tax, in many rate cases. Staff recommends that the AG adjustment be rejected.¹ Staff IB at 5.

With regards to the Companies’ recommendation to increase the revenue requirement for Apple Canyon for the understated ICT, that proposal was not made until the Companies’ surrebuttal testimony in response to the AG proposed adjustment. The Commission should not consider that information as it was not timely presented in the case for consideration.

The AG also took issue with the inclusion of income taxes in the CWC calculation. AG IB at 21. However, a review of Staff’s Revenue Requirement Schedules (Staff IB, App. A at 1, 8; Staff IB, App. B at 1, 8) reveal that income taxes are not included in the calculation.

¹ Staff notes that 77 – 87% of the Taxes Other Than Income in this case is made up of payroll tax expense.

Tank Painting

The AG argues that the cost for the tank painting proposed by the Companies is not known and measurable. AG IB at 7-9. The Company provided a copy of the bid they had accepted for the tank painting project and further explained that the bid they had accepted met the May 2013 deadline they had set for completion of the project while the lowest bid received could not meet that deadline. In fact, even the lowest bid was greater than the \$100,000 included for this project. Utilities Ex. 3.0 at 5. Staff recommends that the \$100,000 for tank painting amortized over 10 years be approved in the revenue requirement.

Additional Pro Forma Plant Additions

In its Initial Brief, AG and LWA/ACLPOA challenged the Companies' additions to rate base to replace pumping equipment in Apple Canyon's Well #1 for \$25,000 and to construct an addition to Lake Wildwood's Water Treatment Plant building for piping and chemical feed equipment modifications for \$80,000. The challenge is largely based on the argument that the cost of neither project is known and measurable. AG IB at 12-16; LWA/ACLPOA IB at 10-11.

In its Initial Brief, Staff noted that Staff witness Smith reviewed support for the two projects and found no reason to take issue with the additions. Staff IB at 7. The Company did indeed provide evidence of the cost of the two projects. Staff Ex. 11.0 at 2-3; Utilities Ex. 2.3. Staff recommended the projects be approved for inclusion in rate base in these cases since these projects either have been or will be completed within the time period necessary to be included as pro forma plant additions in these cases,

and the additions are required for the utilities to continue providing safe, reliable service.
Staff IB at 7-8.

II. OPERATING REVENUES AND EXPENSES -- ADJUSTMENTS

Contested Issues

Appeals Costs

Staff affirms its recommendation that the Commission adopt the Staff and Intervenor adjustments to remove the appeals costs related to the Companies' prior rate cases, Docket Nos. 09-0548/09-0549 (Cons.), from operating expenses for each utility. Staff IB at 14-18. The People of the State of Illinois support Staff's recommendation. AG IB at 22-25.

In their argument for recovery of appeals costs, the Companies quote lines from the Commission's decision in ICC Docket No. 11-0280/11-0281 (Cons.), a consolidated general rate case for North Shore Gas Company and Peoples Gas Company. Utilities IB at 3. However, the Companies conveniently quote only portions of those lines of the Commission Order and selectively omit important language that would give the full meaning of the Commission conclusion. The entirety of the Commission conclusion on the recovery of rehearing and appeal expenses in Docket Nos. 11-0280/11-0281 (Cons.) follows:

The Commission concludes that the rehearing and appeal expenses are a common part of litigation of a general rate case and the expenses are appropriate **on the particular facts of the 2009 rate cases rehearing and appeals**. Further, we find nothing in Section 9-229 that bars recovery of the costs in question. We note that rehearing and appeal expenses are part and parcel of the litigation expenses in most every significant rate case proceeding. **This conclusion is supported by the pending appeals in the Utilities' 2007 rate cases, the pending PLAs in the Utilities' 2009 rate cases, and the appeals from ComEd's 1999, 2001, 2005, 2007, and 2010 rate cases.** Moy Sur., NS-PGL Ex. 39.0 Corr.,

6:127 –7:131. As such the expenses are legally appropriate **on the particular facts of the 2009 rate cases rehearing and appeals.** Further, we find nothing in Section 9-229 that bars recovery of the costs in question.

Final Order at 85-86, Docket Nos. 11-0280/11-0281 (Cons.) (January 10, 2012) (emphasis added).

Careful reading of the Commission's conclusion demonstrates that the Commission was very deliberate in stating that its conclusion was **based on the particular facts of the 2009 Peoples Gas/North Shore Gas rate cases rehearing and appeals**, and that the Commission's conclusion was supported by those utilities' and ComEd's history of appeals. The facts in the current proceeding have not been shown to be similar in any fashion to the facts in the Peoples Gas/North Shore Gas proceedings. To the contrary, the record is devoid of any evidence of similarity between the proceedings. Further, Staff pointed out that going back to as early as 2000, encompassing twenty-three separately filed Utilities, Inc.² general rate cases prior to the current proceedings and including two general rate cases each for Apple Canyon and Lake Wildwood, the only appeals that occurred relate to the 2009 proceedings at issue here. Staff Ex. 9.0 at 6. As such, unlike Docket Nos. 11-0280/11-0281 (Cons.), there is absolutely no history of appeals that would support a conclusion to allow recovery of appeals costs.

The Companies argue that the non-recurring nature of the appeals costs should not be a reason for disallowing the recovery of what the Companies claim are legitimate business expenses. Utilities IB at 4. Staff disagrees. Pro-forma adjustments are

² Utilities, Inc. is the parent company of Apple Canyon, Lake Wildwood, and several other water and sewer utilities that operate in Illinois. In this instance, "Utilities, Inc." refers to those Illinois utilities in their entirety.

routinely included in the test year to ensure that test year costs are representative of costs that will be in effect during the first year that rates set in the case are in effect. In fact, the Companies themselves proposed similar pro-forma adjustments in their own direct testimony:

- Q. Please explain how test year expenses were adjusted.**
A. Pro forma adjustments were made to the test year expenses based on known and measurable changes to actual expenses.

Utilities Ex. 1.0 AC at 4; Utilities Ex. 1.0 LW at 4. As such, the Companies are aware that adjustments for known and measurable changes to actual test year expenses are appropriate. The appeals costs in question are non-recurring costs incurred in the test year that are not reasonably expected to recur during the period in which rates determined in the current proceeding will be in effect. Staff IB at 16-17. Consequently, the appeals costs should be removed from the test year.

The Companies further argue that appeals costs are legitimate business expenses which represent a valid and reasonable exercise of a right provided by the legislature to defend the Companies' position, as well as the right to seek guidance from the Court regarding the proper interpretation and application of the Public Utilities Act and the Commission Rules. They continue, stating that by not allowing recovery of appeals costs, the Commission would effectively inhibit the Companies from exercising their legal right to support or challenge a Commission Order. Utilities IB at 4. However, the Companies fail to grasp the thrust of Staff's position. Staff is not suggesting that the Companies be inhibited from seeking whatever legal recourse is available to them. Nor is Staff suggesting that appeals costs are not legitimate business expenses. Staff's position is that the ratepayers should not be forced to pay for the Companies' decision

to pursue such recourse. Staff has already fully addressed this argument in its Initial Brief, and will not repeat that discussion here. Staff IB at 15-16.

The People of the State of Illinois agree with Staff, stating that the policy effects of allowing the recovery of appeals costs from ratepayers are far reaching. AG IB at 25. The Commission could find itself in a position where every order that goes against a utility could be appealed, creating a situation where the ratemaking authority of the Commission is shifted to the courts. *Id.* Finally, the Commission routinely disallows recovery of legitimate business costs that are not shown to provide customer benefits, but rather appear to be entirely for stockholder benefit. One such example is incentive compensation cost similar to those originally described in Staff's direct testimony in this proceeding.^{3,4}

III. RATES AND COST OF SERVICE ("COS") STUDIES

Response to UI IB

Staff's proposed rate designs, which are based on cost of service ("COS") studies, should be adopted by the Commission despite the Companies' opposition to them because Staff's proposed rate designs better reflect cost causation. The Companies' proposed rate designs have no cost foundation whatsoever. Staff Ex. 4.0 at 19; Staff Ex. 10.0 at 4-5. Instead, the Companies proposed a rate design modeled on an equal-percentage increase for all customers. Utilities IB at 12-14. Although, a similar rate design was previously approved by the Commission in Docket Nos. 11-0561 through 11-0566, at the same time, the Commission made it clear that in the future, rate

³ See Final Order at 54, Docket Nos. 11-0280/11-0281 (Cons), (January 10, 2012) (*stating* "The Commission finds that the Utilities should not be allowed to recover all of their expenses related to the Executive Incentive Compensation Plan inasmuch as they fail to address the ratepayer benefit required by the Commission in prior cases for such costs to be recovered from ratepayers.").

⁴ See Staff Ex. 3.0 at 3-7.

design should be based on COS studies. Final Order at 27, Proposed increase in water and sewer rates, Docket Nos. 11-0561-11-0566 (Cons.) (May 22, 2013). Specifically, “[t]he Commission order[ed] UI to work with Staff and other interested parties to review and analyze UI’s [then] current method of cost of service and rate design methodology. UI should develop a [Cost of Service Study] with Staff and other interested parties for use in future UI rate cases.” *Id.*

The Companies express concern, while providing only minimal insight into this concern, that Staff’s rate designs will shift more cost recovery to availability customers. Utilities IB at 13; Staff Ex. 10.0 at 2-3. Nonetheless, Staff’s rate design for Apple Canyon moves customers toward recovering the cost to provide service, based on the results of the COS studies, while maintaining current rates for customers that are already paying more than full COS. For instance, Staff’s COS study for Apple Canyon showed the 5/8” meter customers are already paying more than their share of the cost to provide service. As a result, Staff recommended a higher percent increase to the availability customers in order for the availability customer class rates to more accurately reflect the cost to provide availability service. If the 5/8” meter customer’s rates are increased just to ensure an equal percentage increase across all customer classes, then they will be paying even greater amounts over the cost to provide their service, which would unnecessarily cause continued subsidization of other customer classes.

Moreover, the Companies’ arguments are contradicted by the testimony of their own witness. The Companies contend that if the Commission uses Staff’s rate designs, then all the rates for availability customers will be too high. Utilities IB at 13. However,

UI witness Neyzelman also stated that “[i]f the Commission does approve Staff’s recommended COS Study, then the rates that the COS Study produces should be used without an arbitrary shift of revenues from the fixed component to the variable component.” Utilities Ex. 3.0 at 12. The logical conclusion of this, however, would produce availability charges for Apple Canyon that are higher than the availability charges proposed by Staff, which the Companies already criticize as being too high.

Finally, the Companies have had ample opportunity throughout this case to propose changes to Staff’s COS studies or to present their own COS studies. The model Staff used for its COS studies is not new. It has been used in some of the Companies’ previous rate cases. Staff Ex. 4.0 at 11-12. Staff’s COS studies also use the format being discussed in the on-going workshop related to the Final Order in Docket Nos. 11-0561 – 11-0566 (Cons.) (May 22, 2013). Staff Ex. 4.0 at 11. The Companies have simply chosen not to discuss the COS studies in this proceeding.

Response to LWA/ACLPOA IB

LWA/ACLPOA argue that no change should be made to the rate designs currently in place, noting concern about the increases in the availability charges. LWA/ACLPOA then encourages the Commission to require the Companies to complete a COS study. LWA/ACLPOA IB at 11-13. However, as Staff has explained, Staff has already performed COS studies and recommended rates based on those COS studies. At this point, there is little to nothing gained by requiring the Companies to do what Staff has already done. Staff’s proposed rate design for Apple Canyon moves the rates closer to COS while still moderating the magnitude of the increases for all customer classes to avoid increases between 77% - 500%. Staff Ex. 10.0 at 8. Additionally, Staff

recommends all customers for Lake Wildwood be set at full COS, which has been determined by the COS study because, as explained previously, Lake Wildwood customers would not experience the same level of increases at full COS that Apple Canyon customers would. Staff Ex. 10.0 at 9. Thus, the Commission should adopt Staff's rate designs.

Conclusion

WHEREFORE, for all the foregoing reasons, Staff of the Illinois Commerce Commission respectfully requests that the Commission's order in this proceeding reflect all of Staff's recommendations and they be adopted in their entirety consistent with the arguments set forth herein.

Respectfully submitted,

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