ILLINOIS COMMERCE COMMISSION

Docket No. 14-______

Exhibit No. 1.0

Direct Testimony of

Steven Lubertozzi

on behalf of

UTILITY SERVICES OF ILLINOIS, INC.

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**PREPARED DIRECT TESTIMONY
OF STEVEN LUBERTOZZI
ON BEHALF OF
UTILITY SERVICES OF ILLINOIS, INC.**

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Steven Lubertozzi. I am the President of Utility Services of Illinois, Inc. ("USI" or "Company"). My business address is 2335 Sanders Road, Northbrook, IL 60062.

Q. PLEASE DESCRIBE YOUR DUTIES IN YOUR CURRENT POSITION.

A. As President I am responsible for all aspects of the Company's business culminating in the ongoing provision of safe drinking water and environmentally responsible wastewater service to all of our customers.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I graduated from Indiana University in 1990, and I am a Certified Public Accountant. I earned my Master of Business Administration from Northwestern University's Kellogg School of Management. I am a member of the American Institute of Certified Public Accountants. I have been employed by Utilities, Inc. since June of 2001.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY OTHER PUBLIC UTILITY COMMISSIONS?

A. Yes. I have provided written and oral testimony before public utilities commissions throughout the United States, including the Illinois Commerce Commission ("Commission"), on topics ranging from cost of equity, capital structure, cost of debt, acquisition adjustments, divestment strategies, appropriate levels of operations and maintenance expense, parent company allocations, affiliate transactions, income taxes and most every aspect of utility operations. The other state commissions where I have presented testimony include Florida, Indiana, Kentucky, Maryland, Nevada, New Jersey, New Mexico, North Carolina and South Carolina.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony will provide an overview of the reasons for the rate increase requested by USI; address the transition from 23 Illinois Operating Subsidiaries ("UI Operating Subsidiaries") to one consolidated company; propose the return on equity ("ROE") that the Commission should authorize the Company to earn on its investment, consumption decline, HomeServe, USI Cost of Service Study, and to introduce the other witnesses who will testify in support of our requested rate increase.

Q. PLEASE DESCRIBE THE HISTORY OF UTILITY SERVICES OF ILLINOIS, INC.

A: USI is an Illinois corporation and is a wholly owned subsidiary of Utilities, Inc. ("UI"). UI is an Illinois corporation created and existing under the laws of the State of Illinois that owns approximately 63 water and sewer utilities operating in 15 states, including USI. UI has been involved in the water and sewer industry for over 40 years and has approximately 300,000 customers.

On April 12, 2012, Corix Utilities (Illinois) LLC; Hydro Star, LLC; UI; and each of the UI Operating Subsidiaries (collectively, "Joint Applicants") filed a verified joint application with the Commission for approval of a proposed reorganization pursuant to Section 7-204 of the Public Utilities Act, 220 ILCS 5/7-204 ("Transaction") in Docket 12-0279. On October 26, 2012, a Stipulation among the Commission Staff, Joint Applicants and the Illinois Attorney General was executed and filed with the Commission. The Stipulation included, among other action items, a requirement that the UI Operating Subsidiaries propose a business plan (the "Plan") for consolidating the separate companies into a single corporate entity for purposes of reducing the costs that are included in such companies' revenue requirements, including costs associated with the regulatory process in the State of Illinois. According to the Stipulation, the Plan would include all of the UI Operating Subsidiaries, address future capital budgeting (including local investment options and the bill impact related to major capital investments), operation and maintenance budgeting, rate continuity, timing options, and the treatment of recent and pending rate proceedings for the UI Operating Subsidiaries. On November 28, 2012, the Commission approved the Transaction including the Stipulation. On November 8, 2013 the Company and the UI Operating Subsidiaries filed an application for Approval of Agreement and Plan of Merger.

USI was incorporated in 2013 solely for implementation of the merger into a single entity of the 23 separate wholly owned subsidiaries of UI listed in USI Exhibit 2.3 that provided water and sewer services in Illinois (the "constituent Illinois utilities"). The merger was approved by the Commission on October 7, 2014 in Docket 13-0618. Pursuant to the terms of the approved Agreement and Plan of Merger (the "Merger"), the Illinois utilities merged with and into USI, the surviving corporation. All of the common stock of the former UI Operating Subsidiaries was cancelled and retired and ceased to exist, and the separate corporate existence of each of the absorbed Illinois utilities ceased. By operation of law, from and after the effective time of the merger all the assets, rights, powers, duties, obligations, liabilities and debts of the constituent Illinois Utilities transferred to and were assumed by USI. Thus, no certificate of public convenience and necessity was needed to be issued or cancelled due to the Merger. Under the approved Merger, the existing rates of each of the constituent Illinois utilities remain in effect for the customers located in divisions of USI corresponding to the service areas formerly served by the former UI Operating Subsidiaries.

UI continues to provide seasoned management and necessary funding to USI. The former UI Operating Subsidiaries relied on Water Service Corp. ("WSC"), an affiliate of UI, for essentially all operational services. WSC provided these services pursuant to a contract (the "Affiliated Interest Agreement" or ("AIA") originally approved by the Commission on March 14, 1979, and approved as modified by the Commission in Docket Nos. 94-0157, 08-0335 and 13-0618. As a result of the Commission's approval of the Merger and modified AIA, USI relies on the same management, technology, processes and people that provided the high quality service enjoyed by the former UI Operating Subsidiaries' customers. USI provide water service to approximately 12,000 customers and almost 3,000 availability customers via almost fifty wells and more than 1.39 million ("mm") linear feet of water distribution mains and wastewater service to approximately 4,000 customers via more than .240 mm linear feet of wastewater collection mains and seven wastewater treatment facilities, in twelve different counties throughout Illinois. The twelve counties include DuPage, Jo Daviess, Kane, Lake, LaSalle, Marshall, McHenry, Peoria, Stephenson, Vermillion, Will and Winnebago.

Q. WHO ARE THE OTHER WITNESSES?

A. Dimitry Neyzelman will present the accounting schedules that support the requested revenue increase and address how the Company developed the new consolidated rates that are necessary to recover the requested revenues. Justin Kersey explains the procedures and major assumptions used in preparing the projections incorporated in the future test year developed by the Company. Bruce Haas will describe the improvements and expenditures recently made and anticipated to be placed in service during the future test year in connection with the water and wastewater systems to assure reliable, adequate, environmentally safe and least cost service to customers. John F. Guastella of Guastella Associates, LLC presents the results of his depreciation analysis.

Q. WHY WAS THE DEPRECIATION ANALYSIS NECESSARY IN THIS CASE?

A. As discussed in more detail in Mr. Guastella's testimony:

> "...the goal of depreciation for rate setting purposes is to allow utilities to recover the original cost of the assets that are used and useful in providing service to their customers, and at a level that spreads the recovery of the cost over the estimate life of the assets..."

In Docket No. 10-0280, based on Staff testimony the Commission encouraged one of UI's operating subsidiaries Galena Territory Utilities, Inc., to confer with Staff regarding the best way to implement new depreciation rates. Representatives of UI and its Illinois Operating Subsidiaries discussed this issue with Staff on multiple occasions and it was determined that the best and most cost effective way to implement new depreciation rates would be to conduct a statewide depreciation analysis and allocate those costs over all the Illinois customers. Therefore, the costs to engage Mr. John Guastella are included as a known and measurable change to the test year and should be recoverable.

Q. WHAT WERE THE RESULTS OF THE DEPRECIATION ANALYSIS?

A. As more fully described in Mr. Guastella's testimony his recommendation would not have a significant impact. Additionally, his recommended depreciation rates are similar to other rates approved by the Commission.

Q WHY IS THE COMPANY REQUESTING RATE RELIEF AT THIS TIME?

A. Under present rates, the Company is not able to meet its operating costs and earn a reasonable return on its investment. For the 12 months ended June 30, 2014, USI earned a 3.12% return on equity, which is far below the ROEs authorized by this Commission in August of 2013, which was 9.25%. Without appropriate rate relief, USI's ability to continue to provide environmentally safe, reliable and efficient water and sewer utility services to its customers and meet its financial obligations will be placed in jeopardy. Mr. Neyzelman's testimony shows that during the 12 months ended June 30, 2014, which is referred to as the "per books test year" in our testimony, the Company realized an overall 4.63% rate of return on the funds that finance the assets used in providing service to our customers. This compares to the 8.23% overall rate of return the Company should be earning.

Q. WHAT IS THE RELATIONSHIP OF USI AND UTILITIES, INC., AND HOW DOES THIS RELATIONSHIP BENEFIT THE COMPANY'S CUSTOMERS?

A USI is wholly owned subsidiary of UI. UI is unique in that for over 40 years its business has been owning and operating smaller water and sewer companies. It is an advantage to USI to be part of an organization whose sole focus is on its type and size of operations. UI has the expertise needed in areas of importance to small water and sewer companies, such as in construction and engineering, accounting, data processing, billing and customer services, and regulation. Having its sole focus on its water and sewer businesses, UI's personnel have the knowledge and ability to meet the challenges facing this industry today. USI benefits financially from the services provided by WSC, the service company of UI. If the Company were to be operated totally on a "stand alone" basis, it would have to retain outside consultants to provide many of the services provided by WSC.

Q. WHAT ARE SOME OF THE DRIVERS CAUSING USI TO SEEK RATE RELIEF AT THIS TIME?

A. Let me start by saying that USI understands that no one likes rate increases, certainly in difficult economic times. USI makes every effort to keep operating expenses to a reasonable minimum while maintaining a system that produces safe and reliable service. USI has invested over $4 million in capital improvements, since 2011. These improvements have provided a benefit to the customers in the form of reduction to service disruptions due to main breaks, reduced inflow and infiltration to the wastewater treatment plant, having an extra source of power in event of power outages and upgrades to electrical systems.

Q. ARE THE IMPROVEMENTS DISCUSSED BY MR. HAAS REFLECTED IN THE REVENUE REQUIREMENT OF THE COMPANY AS PRESENTED IN MR. NEYZELMAN'S TESTIMONY?

A. Yes. Mr. Neyzelman's testimony and exhibits show that in order for the Company to realize a fair rate of return, the Company's annual revenues need to be increased by approximately $2.9M. The Company realizes that our customers do not welcome a rate increase of any size. However, in order for our customers to continue receiving quality utility service, the costs of necessary improvements and the increased operating costs need to be recovered through the Company's rates.

Q. HOW HAS THE COMPANY DETERMINED THE FAIR RATE OF RETURN IT HAS PROPOSED?

A. The Company decided during the consolidation case, Docket No. 12-0279, which included conversations with the Commission Staff and representatives from the Attorney General's office that the Company would not engage a cost of equity witness. If we were to hire a cost of capital witness to prepare testimony, respond to data requests and travel and testify at the hearing, these costs would ultimately be borne by ratepayers, which would only serve to increase rates. In lieu of a rate of return witness, the Company instead used a formulaic approach to determine the appropriate ROE, which is common practice in other jurisdiction wherein UI operating entities operate.

Q. WHY MUST ONE DETERMINE THE OVERALL COST OF CAPITAL FOR A PUBLIC UTILITY?

A. The proper balance of ratepayer and shareholder interests occurs when the Commission authorizes a public utility to earn a rate of return on its rate base equal to its overall cost of capital. If the authorized rate of return on rate base exceeds the overall cost of capital, then ratepayers bear the burden of excessive prices. Conversely, if the authorized rate of return on rate base is lower than the overall cost of capital, then the utility will be unable to raise capital at a reasonable cost. Ultimately, the utility may be unable to raise sufficient capital to meet demands for service, thereby impairing service quality. Therefore, ratepayer interests are best served when the authorized rate of return on rate base is neither higher nor lower than the overall cost of capital.

Q. HOW DID YOU DETERMINE COST OF CAPITAL FOR USI?

A. Consistent with our practice in prior rate proceedings in Illinois, the Company used the capital structure and embedded debt cost for UI.

Q. WHAT ARE YOU REQUESTING FOR RETURN ON EQUITY (ROE)?

A. We are requesting a 10.58% return on equity.

Q. HOW WAS THIS ROE CALCULATED?

A. In an effort to keep rate case expense lower, the Company chose not to hire a return on equity expert. Instead, the Company relied on a leverage formula. A leverage formula is a calculation that provides a range of returns for a utility company based on that company's capital structure. For example, based on the formula, a company that is highly leveraged will generate a higher return than a company that has a high equity percentage. The range also has a control factor to it – while the floor for the formula is 100% equity, the ceiling is 40% equity (or 60% debt). This means that a company that has over 60% debt is limited to a 60%/40% debt/equity structure in the formula. A reasonable ROE is determined using the following formula:

Return on Common Equity = 7.13% + (1.610 / Equity Ratio)

The variables are more fully discussed in the Florida Public Service Commission's Order No: PSC-14-0272-PAA-WS issued on May 29, 2014. This formulaic approach generated a range of returns on common equity of 8.74% to 11.16%.

Q. HAS THE LEVERAGE FORMULA BEEN APPROVED AND USED IN OTHER STATES?

A. Yes, the leverage formula has been used in Florida for over a decade. The Florida Public Service Commission's formula is what the Company has proposed in this proceeding and provides a reasonable and fair return to USI's shareholders and ratepayers. The formula and exactly how the formula is derived and contained in Order No: PSC-14-0272-PAA-WS.

The Order states:

> "We continue to believe the leverage formula is a sound, workable methodology that reduces the costs and administrative burdens in water and wastewater ("WAW") utilities rate cases by eliminating the need for cost of equity testimony. Many of the WAW utilities under our jurisdiction are small operations that find it beneficial to avoid the costs associated with presenting cost of equity testimony."

Q. HAVE OTHER STATES ADOPTED A LEVERAGE FORMULA?

A. Yes they have. A leverage formula was accepted by the Nevada Public Utilities Commission in Sky Ranch Water Service in Docket No. 10-03032. Sky Ranch is a wholly owned subsidiary of UI and a sister company to USI.

Q. WILL YOU ALSO ADDRESS THE DECREASE CONSUMPTION?

A. Yes. As the Commission is aware decreasing consumption is a common topic on the national and local level when attending water conferences or meetings like NAWC, NARUC or the Institute for Regulatory Policy Studies. USI, like its peers in the water space, have seen a steady decline in water consumption, which similar to lag, can eliminate a utility's ability to earn its authorized return. For the purposed of this rate case USI analyzed average annual consumption from July 2008 to July of 2014. From the trailing twelve month periods ending July 2008 to the trailing twelve month periods ending July 2014 USI saw an average decline in consumption of 2.65%. USI then assumed the 2.65% decline would continue to the future test period.

Q. IN YOUR OPINION, IF THE COMMISSION EXCLUDES THE DECLINE IN WATER CONSUMPTION WOULD USI EARN ITS AUTHORIZED ROE?

A. No. If the decline in water usage isn't included to set rates USI will be forced to file for a rate case soon, which will only drive rates to increase.

Q. IS USI RECOMMEDING A CONSOLDIATED RATE STRUCTURE?

A. Yes, USI is proposing a consolidated rate structure for its customers.

Q. ARE THERE BENEFITS ASSOCIATED WITH A CONSOLIDATED RATE STRUCTURE?

A. Yes, consolidated rates are common place in other regulated utilities like gas and electric. Consolidated rates will allow USI to spread capital costs over a larger base of customers, which ultimately benefits all customers and can protect customers from rate shock. If a small standalone utility requires a significant capital improvement these costs can be spread these costs over a larger base of customers. In the long-term consolidated rates will strengthen USI and allow the customers to enjoy lower rates via fewer rate cases and lower rate case expense.

Q. WOULD PLEASE EXPLAIN TO THE COMMISSION USI'S COST OF SERVICE STUDY?

A. USI and the Commission Staff engaged in a workshop to discuss the Cost of Service Study Model that UI's Illinois operating subsidiaries would use for ratemaking purposes. USI used the Cost of Service Study Model that was prepared by the Commission's Staff; however, while reviewing the Model USI noted some calculations that we didn't agree with.

Q. CAN YOU EXPLAIN THESE CALCULATIONS THAT YOU DIDN'T AGREE WITH?

A. The Model calculates rates and allocates the revenue requirement to the customer's based facility charge, which is fixed and the customer's per gallon charge, which is variable. However, the Cost of Service Study Model, as originally created, had certain components of USI rate base that were only recovered from availability customers or full service customer's variable per gallon charge. For example USI's water treatment facilities were included these components.

Q. IN YOUR OPINION IS THAT APPROPRIATE?

A. No, a majority of a utilities costs and investments are fixed, and therefore a portion of these costs and investments need to be recovered via the base facility charge. Therefore, USI relied upon the Florida Public Service Commission's practice to allocate to 40% of the water revenue requirement from the base facility charges.

Q. DID USI ASSIGN 40% OF THE TOTAL WATER REVENUE REQUIREMENT TO THE BASE FACILITIES CHARGES?

A. No, USI only adjusted certain components of the Cost of Service Study Model wherein no cost of service was assigned to a full service customer's base facility charge.

Q. ARE THERE OTHER ISSUES THAT YOU WOULD LIKE TO ADDRESS?

A. Yes. In Commission order from October 7, 2104 USI was ordered to address the costs related to Home Serve. The Rider attached to the Order stated that USI "is required to include all payments received from Home Serve USA for current Illinois HomeServe contracts as revenues" and "is required to exclude all allocations from WSC for the HomeServe USA contract operating costs".

Q. DID THE COMPANY MAKE THE ADJUSTMENT TO REVENEUS?

A. Consistent with previously concluded rate cases of UI's operating subsidiaries in Illinois USI included test year revenue from HomeServe. From July of 2013 to June of 2014 USI customers paid for services that resulted in $9,118 of commission that have been included in this case to reduce customer's rates.

Q. DID THE COMPANY MAKE THE ADJUSTMENT TO OPERATING COSTS?

A. WSC did not incur any measurable incremental expenses to receive the $9,118 of commission. Although WSC incurred no additional costs to produce information to HomeServe, one WSC employee does incur time to send data to HomeServe. This one employee provides data to HomeServe every 4 to 6 weeks and reviews HomeServe materials every 4 to 6 weeks. These tasks take less than 2 hours per instance, so that would amount to approximately 18 to 24 hours annually. This employee has an hourly capitalized time rate of approximately $70.00. Therefore, the annual internal costs associated with HomeServe would be $1,820, based on the maximum of 24 hours annually. This amount would be for all of UI's customers, not just USI customers. At the end of

June of 2014, UI had approximately 271,000 equivalent residential customers ("ERC") of which approximately 19,000 are located in Illinois. Therefore 7.02% of the $1,820, or $127.71, would be allocated to Illinois as a reduction to the allocated expenses.

Q. DOES THIS CONCLUDE YOUR PREPARED DIRECT TESTIMONY?

A. Yes. It does.