

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Aqua Illinois, Inc.

Docket No. 14-0419

Proposed General Increase In Water Rates
For the Kankakee Service Area

REPLY BRIEF OF
AQUA ILLINOIS, INC.

TABLE OF CONTENTS

I. INTRODUCTION1

II. CONTESTED ISSUES1

 A. Rate Case Expense1

 B. Return on Equity3

 C. Affiliate Claims9

 1. Staff’s Proposed Adjustment to “Other” Revenues Should Be Rejected9

 a. The Facts Undermine Staff’s Speculation9

 b. Staff’s Proposal Violates Test Year Principles11

 c. Staff’s Calculated Level of Alleged Revenue is Wrong11

 d. Staff’s Reliance on a Commission Order Involving Another Utility is Misplaced14

 2. The Evidentiary Record Does Not Support Staff’s Request to Initiate Three Investigations15

III. CONCLUSION20

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Aqua Illinois, Inc. :
 : Docket No. 14-0419
Proposed General Increase In Water Rates :
For the Kankakee Service Area :

REPLY BRIEF OF
AQUA ILLINOIS, INC.

Aqua Illinois, Inc. (“Aqua Illinois” or the “Company”), by its counsel, in accordance with the Rules of Practice of the Illinois Commerce Commission (the “Commission” or “ICC”) and the Administrative Law Judge’s (“ALJ”) schedule, submits this Reply Brief.

I. INTRODUCTION

Aqua Illinois and the Staff of the Commission (“Staff”) are in agreement that the majority of issues concerning the proposed adjustment to the Kankakee Water Division’s (“Kankakee”) current rates have been resolved. Of those remaining unresolved contested issues, Aqua Illinois has presented substantial compelling evidence demonstrating that its positions are reasonable and should be adopted. In the interest of brevity, Aqua Illinois only will address those remaining unresolved issues in this Reply Brief. In sum, the evidentiary record and arguments below demonstrate that the Commission should adopt Aqua Illinois’ positions and conclude that proposed revenue requirement for Kankakee is prudent and reasonable.

II. CONTESTED ISSUES

A. Rate Case Expense

Aqua Illinois has submitted ample and compelling evidence that fully supports the recovery of \$351,000 in rate case expense. Staff has reviewed the expenses already incurred by Aqua Illinois and “found the amounts comprising the Company’s projected rate case

expense...to be just and reasonable.” Staff Initial Brief (“Init. Br.”) at 31. However, Staff proposes an adjustment based on the actual level of rate case expenses incurred in Kankakee’s 2010 rate case, Docket No. 10-0194, adjusted to 2014 levels using a 3% inflation rate. *Id.* at 29-30. Staff’s proposed adjustment is improper and disregards the Company’s evidence concerning its actual expenses incurred thus far, and the actual rate case-related work that must be undertaken to fully litigate this case. Aqua Init. Br. at 9-14.

Aqua Illinois demonstrated that its actual rate expense, based on invoices received at the time of the filing of Company surrebuttal testimony on November 12, 2014, was [REDACTED]. Notably, these expenses do not include costs related to: 1) preparing the Company’s Pre-Trial Memorandum, filed on November 14, 2014; 2) preparing for and participating in the evidentiary hearing, which took place on November 20, 2014; 3) preparing four rounds of briefs addressing the contested and uncontested issues in this proceeding and the Administrative Law Judge’s Proposed Order; 4) preparing a draft Order; 5) analyzing the Commission’s final Order in this proceeding and preparing and filing the compliance filing; and 6) preparing any post-Order pleadings that may be required. Aqua Init. Br. at 12; Hanley Reb., Aqua Exhibit (“Ex.”) 7.0, 6:118-127. Moreover, Aqua Illinois demonstrated that there has been a significant increase in discovery propounded on the Company in the instant proceeding, in contrast to Aqua Illinois’ historical rate case proceedings. Aqua Init. Br. at 13; Hanley Reb., Aqua Ex. 7.0, 10:211. In addition, although the Commission may have reviewed and approved certain issues in previous proceedings, Aqua Illinois has been required to address and litigate these issues for the first time in this proceeding. Aqua Init. Br. at 13. Staff does not refute or contest these points – in fact, Staff offers no criticism of the Company’s bases for its projected expenses save the comparison to the Company’s expenses in Docket No. 10-0194.

Staff fails to offer any compelling reason to adjust the projected rate case expenses in this proceeding. Instead, the sole basis for Staff's proposed disallowance rests on information unrelated to the current docket. Staff seeks to use data from a rate case litigated four years ago: a rate case that had far fewer discovery requests than the current case, and that did not involve extensive litigation over alleged affiliate issues. Aqua Init. Br. at 10-11, 13. Aqua Illinois submits that the Commission's assessment of the Company's rate case expense should be based on the actual facts and circumstances in this case, and not a case from years ago. The facts and circumstances related to this case, as reflected in the evidentiary record, demonstrate that the Company's estimated rate case expense of \$351,550 is just and reasonable and should be approved. As such, the Commission should reject Staff's proposed disallowance.

If the Commission has a concern about the Company's projected rate case expense, Aqua Illinois proposes that it could submit its actual rate case expense to Staff prior to the time it submits its Reply Brief on Exceptions. Given that the record has not been marked "Heard and Taken," the goal would be for Staff and the Company to arrive at an agreed-to rate case expense based upon Aqua Illinois' updated actual rate case expense at that time.

B. Return on Equity

Aqua Illinois has proposed a Return on Equity ("ROE") of 10.25% in the instant proceeding, based upon an analysis formulated using methodologies that the Commission commonly relies upon in its assessment of a reasonable ROE. This analysis is based upon a Discounted Cash Flow ("DCF") model, a Capital Asset Pricing Model ("CAPM"), and a Risk Premium ("RP") model. Aqua Init. Br. at 21-22. The Company's proposed ROE is reasonable, would provide the Company with a fair rate of return, and would incentivize the Company to continue to invest in infrastructure as well as troubled water and/or wastewater systems. In

contrast, Staff's proposed ROE, and its calculation of the same, represents a significant departure from its approach in previous rate cases. Staff proposes an ROE of 9.07% based upon a recommended range of return on common equity of 8.36% to 9.77%. Staff Init. Br. at 3; Kight-Garlich Dir., Staff Ex. 3.0, 26:480-483. Despite the flaws in Staff's analysis, Aqua Illinois has recommended that if the Commission gives any weight to the results of Staff's cost of common equity estimate, the Commission should give 100% weight to the upper end of Staff's range of return on common equity. This weighting would suggest a 9.77% ROE for Aqua Illinois. Aqua Init. Br. at 31.

Aqua Illinois has demonstrated the importance of establishing a just and reasonable ROE percentage in the instant proceeding. Small utilities such as Aqua Illinois must compete in capital markets to obtain the funding necessary to invest in infrastructure improvements that will benefit customers, and the authorization of a low ROE will make it difficult for Aqua Illinois to access the capital necessary to continue investing in infrastructure. Aqua Init. Br. at 20-21. Additionally, over the past several years Aqua Illinois has invested in troubled water and wastewater systems throughout Illinois in order to provide the customers of those troubled utilities efficient and effective water and sewer systems, to increase reliability and redundancy, and to invest in the replacement of aged infrastructure in the distribution system. *Id.* at 29-30. Staff's recommended ROE may negatively impact the Company's plans for further system investment. Faced with the prospect of obtaining limited capital, Aqua Illinois may be challenged to maintain the level of investment in infrastructure improvements, and reduce the incentive to acquire and repair troubled systems. In contrast, the Company's proposed ROE of 10.25% is reasonable, incentivizes such investment, would provide the Company with a fair rate of return, and should be approved.

Staff's Initial Brief offers no basis to reject the Company's proposed ROE. The Company has demonstrated that Staff's reliance on both a DCF and a non-constant growth discounted cash flow ("NCD CF") model is inconsistent with its approach in Aqua Illinois' last rate case, Docket No. 11-0436 ("AQUA2012"). *See* Aqua Init. Br. at 23-31. If Staff had solely relied upon a DCF model in the instant proceeding, as it did in AQUA2012, Staff's calculation would produce a DCF-based cost of common equity of 8.62% for the Water Sample and 8.46% for the Gas Sample, in contrast to Staff's current recommendation of a DCF-based cost of common equity of 8.15% for the Water Sample and 8.36% for the Gas Sample. Aqua Init. Br. at 25. An ROE based on a DCF model would result in a recommended ROE of 9.12%, based on an 8.46% to 9.77% range of return on common equity. *Id.* Further, Aqua Illinois has demonstrated that the small size of a company creates an additional element of risk for which investors should be compensated. *Id.* at 27. Staff's recommended ROE and supporting analysis does not recognize the additional risk associated with the Company's smaller size. Staff justifies these inconsistencies and errors by arguing that "[i]mplementation of DCF and NCD CF analyses do not require a comprehensive analysis of a utility's operating and financial risks since the market price of a utility's stock already embodies the market consensus of those risks." Staff Init. Br. at 4. This justification has no application in the instant proceeding – as Aqua Illinois has made clear, "Aqua Illinois' shares of common stock are not publicly traded." Aqua Init. Br. at 21; Walker Dir., Aqua Ex. 3.0 CORR, 2:38-39. Staff cannot appropriately evaluate Aqua Illinois' ROE based on its stock – thus, a full and complete evaluation of Aqua Illinois' size, risk, and capital needs are crucial to the development of a fair and reasonable ROE.

Further, Staff's criticisms of Company witness Mr. Walker's analysis of Aqua Illinois' cost of common equity are unfounded. Staff argues that Mr. Walker improperly relied upon the

use of historical data in each of his models; that the analyst growth rates Mr. Walker applied in his DCF analysis are unsustainably high based on current expectations of overall economic growth; that Mr. Walker's CAPM analysis suffers from certain errors, including an inappropriate size premium; and that the leverage adjustment that Mr. Walker added to the results of the DCF, CAPM, and RP models is inappropriate. Staff Init. Br. at 12-13. These criticisms are wrong, and provide no basis for undermining the Company's proposed ROE.

First, historical data are commonly used in making or forming investment decisions – Aqua Illinois' use of historical data is consistent with investors' behavior and financial theory. Walker Reb., Aqua Ex. 8.0, 28:568-570. A comparison to historical data is essential in order to evaluate the reasonableness of a projection or forecast – notably, a comparison to historical data in the instant proceeding demonstrates that Staff's projected growth of the GDP varies significantly from historical trends. Aqua Init. Br. at 26-27. These trends are relevant and place Staff's projection into context. Second, a size premium is appropriate in light of the undisputed fact that a company's small size is a recognized and meaningful element of risk that should be reflected in a company's cost of equity. Walker Reb., Aqua Ex. 8.0, 29:588-591. The CAPM size premium reflects the value of the additional risk associated with Aqua Illinois' smaller size. Aqua Init. Br. at 27. Because Staff's recommended ROE does not recognize this risk, Staff's CAPM necessarily must be adjusted to account for it. *Id.* Further, although Staff cites to certain articles as support for its proposed ROE, Aqua Illinois has demonstrated that these articles have been rebutted by additional related research. *See* Walker Reb., Aqua Ex. 8.0, 30:594-616. For example, Staff relies upon a *Jensen* article that opines that the size premium is related to monetary policy and specifically notes the existence of the size premium during periods of monetary expansion. Staff Init. Br. at 16-17. However, the Federal Reserve is clearly following

a monetary expansion policy given their “zero interest rate” policy and the large purchase and holdings of US treasury debt. Walker Reb., Aqua Ex. 8.0, 30:594-616. Similarly, Staff cites to a 1998 article by *Fernholz*. Staff Init. Br. at 15-16. However, a subsequent 2006 article by *Fernholz* acknowledges the existence of the size premium but concludes it is related to their liquidity premium:

Over the long term, the returns on smaller stocks are likely to be higher than the returns on larger stocks. This phenomenon has been called the size effect, and a number of explanations have been proposed to account for it. Here we show that the difference in return between the larger and the smaller stocks is likely to be due to a liquidity premium for the smaller stocks, and we estimate the value of this premium using structural parameters for the capital distribution of the U.S. stock market during the 1990s.¹

Walker Reb., Aqua Ex. 8.0, 30:600-610. Lastly, Staff also cites to a 1993 article by *Wong* to support for the assertion that the size premium is not applicable to utilities. Staff Init. Br. at 17-18. However, *Wong's* conclusion is specifically rebutted by a 2002 article by T. M. Zepp.² Walker Reb., Aqua Ex. 8.0, 30:611-613. The *Zepp* article explains that size premium does exist, and presented research on water utilities that support a small firm effect. *Id.* at 30:613-615. In addition, a 1995 article by M. Annin provides additional support for the use of a size premium for utilities. *Id.* at 30:615-616. Finally, a leverage adjustment is necessary in the instant proceeding. Both Aqua Illinois and Staff agree that capital structure and firm value are related. *Id.* at 31:619-622; Kight-Garlich Dir., Staff Ex. 3.0, 39:725-741. As Mr. Walker explained in testimony, because capital structure and firm value are related, a leverage adjustment is necessary when a cost of common equity model is based on market value and its results are then applied to book value. Walker Reb., Aqua Ex. 8.0, 31:620-622.

¹ Fernholz, Robert and Karatzas, Ioannis, “The Implied Liquidity Premium for Equities,” *Annals of Finance*, January 2006, Volume 2, Issue 1, pp 87-99.

² See Zepp (2002), “Utility stocks and the size effect: revisited”, *Economics and Finance Quarterly*, 43, 578-582.

Aqua Illinois has proposed a reasonable and appropriate ROE of 10.25% that takes into account the Company's unique risk characteristics, regulatory policy, and the ROE necessary to provide Aqua Illinois with a fair rate of return. Based on the foregoing, and Aqua Illinois' Initial Brief, the Commission should approve Aqua Illinois' ROE of 10.25%. In the event the Commission applies Staff's methodology, then it should:

1. recognize that Staff deviated from the evidence supporting their own liquidity premium, which supports a ROE of 9.42% to 9.77% (Walker Reb., Aqua Ex. 8.0, 11:214, 12:227);
2. give the upper end of Staff's recommended range of cost rate a majority of weighting, or 9.77% (*Id.* at 11:214);
3. recognize that Staff's types of growth rate used is not consistent with the types of growth rates utilized in similar cases, and if Staff were consistent their ROE would be 9.38% (*Id.* at 16:299);
4. recognize that Staff's DCF methodology is not consistent with the DCF model utilized in other cases, and that if Staff were consistent their ROE would be 9.12% (*Id.* at 15:279);
5. recognize that Staff used an unrealistic estimate of economic growth, and that a realistic estimate of growth would produce a ROE of 9.56% (*Id.* at 22:428); and
6. recognize that Staff's CAPM methodology is not consistent with the financial theory underlying CAPM analyses, and that a CAPM methodology consistent with financial theory would produce a ROE of 10.01% (*Id.* at 23:454).

Adopting these adjustments would result in an ROE of 10.01%. This result is reasonable and appropriate, for all of the reasons discussed herein and in the Company's Initial Brief. However, as the Company noted in its Initial Brief, if the Commission is going to give any weight to the results of Staff's cost of common equity estimate, the Commission should give 100% weight to the upper end of Staff's range of return on common equity. Aqua Init. Br. at 31. Doing so would suggest a 9.77% ROE for Aqua Illinois.

C. Affiliate Claims

Staff makes four recommendations based upon legally and factually flawed assessments of historical interactions between Aqua Illinois and its affiliates. Staff Init. Br. at 48. Indeed, Staff's sole basis for making these recommendations is founded on the claims that such interactions resulted in "negative financial consequences" to customers, and then goes so far as speculating about the "possibility" of other "negative financial consequences." Staff Init. Br. at 47. Staff's recommendations are based on opinion, not facts, and disregard the ample evidence that serves to undermine its claims. In fact, Staff cannot point to one fact showing that Aqua Illinois customers actually suffered any "negative financial consequences" associated with historical affiliate transactions. Staff's recommendations fall into two categories: 1) a proposal to impute additional revenues into the Kankakee's 2015 test year revenue requirement; and 2) a proposal to initiate investigations into various historical activities undertaken pursuant to Commission-approved affiliate interest agreements ("AIA"). As discussed in detail below, these proposals are baseless and should be rejected.

1. Staff's Proposed Adjustment to "Other" Revenues Should Be Rejected.

a. The Facts Undermine Staff's Speculation

Staff argues that the Commission should impute \$79,732 of revenue to offset the Kankakee test year requirement based on the belief that the adjustment is "the most reasonable method to prevent ratepayers from subsidizing shareholders." Staff Init. Br. at 34. Staff's claim has no basis in fact. Neither Aqua Illinois customers, generally, nor Kankakee customers, specifically, subsidize shareholders, and Staff can point to no facts to support this claim. Rather, Staff acknowledges that this adjustment reflects *an attempt* to "credit ratepayers for all money that reasonably *might be* received by Aqua Resources from HomeServe USA ("HomeServe")

related to or derived from Aqua Illinois' position as a utility in the State of Illinois." *Id.* at 34 (emphasis added). Such speculation has no basis in fact. Moreover, the proposal to impute alleged revenues violates basic test year principles, and the proposed level of revenues – if somehow appropriate – is unreasonably inflated. Aqua Init. Br. at 15-20.

The facts belie Staff's claim. It is undisputed that only for a limited 22-month period (September 2010 – June 2012) certain customer information was provided to HomeServe for a small fee credited to Aqua Illinois.³ Aqua Init. Br. at 15. It also is undisputed that there is no contractual relationship between the Company and HomeServe. *Id.* at 16; Kahoun Reb., Aqua Ex. 6.0, 6:130-138. Further, there have been no affiliate transactions between the Company and Aqua Resources.⁴ *See, e.g.*, Tr. at 46:12-15. Staff did not, and cannot dispute the fact that HomeServe stopped marketing its warranty product to new customers in Illinois in June 2012. Aqua Init. Br. at 15; Kahoun Sur., Aqua Ex. 10.0, 4:83-86; Tr. at 80:19-21. Additionally, there is no dispute that the HomeServe warranty product is sold pursuant to a contract that is one year in duration. Aqua Init. Br. at 16. Furthermore, there is no dispute that "Aqua Illinois has never received any of those revenues" that Staff now seeks to impute. Staff Init. Br. at 33. Finally, Staff did not, and cannot dispute the fact that the Company is not contractually entitled to receive the amount Staff claims, either in the 2015 test year or any other year.

Staff's claim is premised *entirely* on speculation that customers' decisions in 2013, 2014 and 2015 to renew their purchase of the HomeServe warranty product is inextricably linked to the Company's providing certain customer data to HomeServe years earlier for a very limited

³ Staff argues that the Company witnesses' lack of knowledge as to how the information was provided merits the initiation of an investigation by the Commission. Staff Init. Br. at 34. As discussed below, that claim is without merit.

⁴ While an affiliate of Aqua Illinois, Aqua Resources provides no services to Aqua Illinois. The Company does not provide services to Aqua Resources. Aqua Resources otherwise engages in activities that are not subject to Commission jurisdiction.

period of time. Staff offers no facts, and there are none, to support this assumption. Indeed, Staff fails to consider that customers who chose the HomeServe product did so based upon any number of reasons entirely unrelated to Aqua Illinois – *i.e.*, they evaluated the product and its price-point and determined that there was value in the product. Aqua Init. Br. at 16. Similarly, these same customers may have decided to renew the product based upon considerations that have nothing to do with the Company – *i.e.*, customers like the HomeServe product and the value it provides.

The unreasonableness of Staff’s assumption is made clear when taken to its logical extreme. Under Staff’s approach, if a customer continued to renew purchasing the HomeServe product for another 20 years, Staff would have the Commission impute some level of revenue to Aqua Illinois. This, despite the fact that Aqua Illinois neither has a contractual right to such revenue, nor would it have provided any customer data to HomeServe in more than two decades. Simply put, there is no reasonable basis to impute, in perpetuity, a level of revenues to the Company associated with a customer’s independent decision to purchase a product from an unaffiliated entity that is not subject to Commission regulation.

Staff’s Proposal Violates Test Year Principles

Staff’s brief fails to address the fact that its proposal to impute revenues into the Kankakee test year revenue requirement violates basic test year principles. The Company’s Initial Brief described in detail why it is inappropriate to impute revenues that are not attributable to the 2015 test year activities for Kankakee. Aqua Init. Br. at 15-17.

Staff’s Calculated Level of Alleged Revenue is Wrong

There is no basis to impute any level of revenue associated with the activities of HomeServe, an unaffiliated entity that is not subject to Commission jurisdiction. However, if it is determined that some level of revenue is properly included in Kankakee’s 2015 test year, the

Company has demonstrated that Staff's calculation of its proposed adjustment was wrong and based on incorrect assumptions and outdated pricing information. Aqua Init. Br. at 17-19. In response to Staff's "estimated" adjustment, the Company presented a figure that represents the actual number that would result from Staff's calculation if Staff were to use the correct pricing figures and eliminate the incorrect assumptions. Aqua Init. Br. at 18-20. The seven months of data that Staff refers to is unrelated to this calculation, and does not form the basis of any proposed alternative adjustment. Staff Init Br. at 33. Instead, those figures represent the level of revenues "related to Aqua Illinois that Aqua Resources received from HomeServe." Kahoun Reb., Aqua Ex. 6.0, 8:160-165. As Staff previously admitted, Aqua Illinois never received these revenues. Staff Init. Br. at 33. Thus, such revenues do not and should not form the basis of any adjustment to Kankakee's operating revenues.

Pointing to the revenues received by Aqua Resources pursuant to its contract with HomeServe, Staff argues that "the revenues are increasing, despite the cessation of the marketing using ratepayer information." Staff Init. Br. at 33. As a result, Staff asserts that "the logical explanation for this increase is that HomeServe is selling its existing customers more products." *Id.* There are no facts to support Staff's assumption, and this argument provides no basis to impute revenues to Aqua Illinois. The fact that customers, on their own volition, are choosing to participate in a business transaction, well after Aqua Illinois' limited role in HomeServe's marketing practices concluded, is entirely unrelated to the Company's actions years earlier. Staff did not demonstrate otherwise. Additionally, Staff's adjustment ignores the fact that Aqua Illinois has had no involvement in the business transactions between customers and HomeServe at any point, let alone since HomeServe ceased its marketing practices in June 2012. Instead, Staff's proposal is punitive in nature. It would penalize Aqua Illinois because customers have

independently decided to renew a product on a yearly basis since 2012. Moreover, Staff's position implicitly degrades the business judgment of these customers by assuming that customers are incapable of deciding which products and services best suit their individual needs. Such an assumption is not appropriate, and the evidentiary record certainly does not support this view.

As discussed in its Initial Brief and above, Aqua Illinois corrected certain assumptions and financial rates that were inaccurately relied upon in Staff's calculation of its adjustment. Aqua Init. Br. at 18. Specifically, Aqua Illinois demonstrated that the net commission rate in effect during the time of HomeServe's program in the Aqua Illinois territory was [REDACTED] instead of [REDACTED], that the actual sign-up rate from 2012 was [REDACTED], not [REDACTED], and that the proper allocation factor for any properly imputed revenues is 45.56%. *Id.* at 18-19. In addition, Aqua Illinois demonstrated that it would be improper to assume that the Company can or will receive a [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]. *Id.* at 19. Despite this evidence, Staff claims that the Company has presented an "alternative adjustment [that] reflects an older, lower Net Commission rate that is not currently effective, ignores bonuses that may be achieved by Aqua Resources in the Test Year, and...ignores the fact that HomeServe customers may sign up for more products than just the basic one." Staff Init. Br. at 33. These contentions have no bearing on Staff's adjustment.

First, the Company presented the net commission rate that was in effect at the time that HomeServe was marketing to Aqua Illinois customers. Aqua Init. Br. at 18. It is illogical to impose a higher net commission rate on these revenues, as Staff's proposed net commission rate

was not in effect at the time those revenues were incurred. Second, as explained above, Aqua Illinois has not and will not receive any signing bonuses in the 2015 test year. Further, whether Aqua Resources receives such bonuses in 2015 is wholly irrelevant to this case and to Kankakee's 2015 test year. Staff has offered no reasoning or analysis to prove or even suggest why these bonuses should be assigned to Aqua Illinois. Third, the statement that Aqua Illinois ignores that HomeServe customers may sign up for additional products implicitly penalizes the Company for independent business choices that certain customers may make.

d. Staff's Reliance on a Commission Order Involving Another Utility is Misplaced

Staff cites to an inapposite and irrelevant Commission Order entered in a separate proceeding as justification for its adjustment. Staff Init. Br. at 35. As an initial matter, it is well-established in Illinois that prior Commission Orders are not precedential. *See, e.g., Commonwealth Edison Co. v. Illinois Commerce Comm'n*, 405 Ill. App. 3d 389 (2d Dist. 2010) ("Illinois courts have consistently held that 'decisions of the Commission are not res judicata'.") (*citing A. Finkl & Sons Co. v. Illinois Commerce Comm'n*, 250 Ill. App. 3d 317, 323 (1st Dist. 1993)). *See also* 220 ILCS 5/10-103 ("any finding, decision or order made by the Commission shall be based exclusively on the record for decision in the case"). Moreover, Docket No. 13-0618 is irrelevant – the Commission's Order entered in Docket No. 13-0618 is based upon a separate and unrelated evidentiary record and concerns an unrelated utility. In addition, Docket No. 13-0618 addresses certain agreements between that unrelated utility and HomeServe that have no bearing on Aqua Illinois nor on the marketing program run by HomeServe that was suspended in 2012. For example, Docket No. 13-0618 concerned an application for approval of a proposed reorganization, not a request for a general increase in water rates. Moreover, Docket No. 13-0618 concerns Utilities, Inc., while the instant proceeding clearly concerns Aqua Illinois.

Aqua Illinois is unrelated to Utilities, Inc. – the utilities have no commonality in their business or management processes, and any comparisons between the two are irrelevant and inappropriate. It is indisputable that the evidentiary records in the two proceedings are separate and distinct. Aqua Illinois has no knowledge or familiarity with the evidentiary record in Docket No. 13-0618 – in fact, the terms of the Marketing Agreement in Docket No. 13-0618, which “controls or outlines the provision of customer information from the Service Company to HomeServe,” are confidential and unavailable to Aqua Illinois. *See* ICC Docket No. 13-0618, May 7, 2014 Tr. at 24:6-26:22. Moreover, the terms and provisions of any existing agreements or contracts between HomeServe and Utilities, Inc. have no impact or bearing on HomeServe’s limited activities with respect to customers within the Aqua Illinois service territory. Lastly, the affiliate interest agreement at issue in Docket No. 13-0618 has no bearing on the issue of: (1) whether revenues from a program that ceased operating in 2012 should be imputed to the 2015 test year, and (2) whether Aqua Illinois properly acted in accordance with its Commission-approved affiliate interest agreements. Thus, Staff’s reliance on the Commission’s Order in Docket No. 13-0618 is meritless.

2. The Evidentiary Record Does Not Support Staff’s Request to Initiate Three Investigations

Staff argues that the Commission should initiate three separate investigations related to Aqua Illinois’ actions pursuant to its current, Commission-approved AIAs. These agreements include: (1) the Service Agreement between Consumers Illinois Water Company (“CIWC”) and Consumers Water Company (“CWC”), approved by the Commission in Docket No. 85-0491 and assumed by acquisition to remain in place following the merger of CWC and Philadelphia Suburban Corporation (“PSC”) that was approved in Docket No. 98-0602; and (2) the Service Agreement between CIWC and CWC approved by the Commission on March 19, 1985 in

Docket No. 85-0492. Aqua Init. Br. at 35. Specifically, Staff urges the Commission to: (1) initiate an investigation into the existing Commission-approved AIAs and request approval of the updated agreements; (2) initiate an investigation into Aqua Illinois' historical activities pursuant to the Commission-approved AIAs; and (3) initiate an investigation into the 2003 Marketing Agreement between HomeServe and PSC. Notably, the Company has committed to filing an updated AIA within 90 days of the entry of a final Order in this proceeding in order to clarify and update those AIAs that the Commission previously approved. Aqua Init. Br. at 35-36. The Commission should reject Staff's recommendations and decline to initiate any investigation. Instead, any review of the Company's affiliate agreements should be focused on the updated AIA that the Company has agreed to file with the Commission.

Aqua Illinois has demonstrated that the Company's interactions with its affiliates is, and has been, consistent with its Commission-approved affiliate interest agreements. With regard to the first two proposed investigations, Staff offers no response or rebuttal to the fact that the Company's affiliate transactions, and the costs associated with those transactions, have been the subject of Commission and intervenor review for more than a decade as part of rate case proceedings.⁵ Aqua Init. Br. at 36-38. Indeed, Staff, the Commission, and any other intervening party have had multiple opportunities and all of the necessary information to determine whether Aqua Illinois' customer service and billing operations were conducted properly and in compliance with the law. *Id.* at 37. In fact, the reasonableness of these costs is apparent when viewed in light of similar costs incurred by other Illinois utilities. For example, in Kankakee's previous rate case, Docket No. 10-0194, the Company analyzed similar costs incurred by

⁵ Please see rate case proceedings in Docket No. 03-0403 (final Order 4/13/2004); Docket No. 04-0442 (final Order 4/20/2005); Docket Nos. 05-0071 & 05-0072 (Cons.) (final Order 11/08/2004); Docket No. 06-0285 (final Order 12/20/2006); Docket Nos. 07-0620, 07-0621, & 08-0067 (Cons.) (final Order 11/13/2008); Docket No. 10-0194 (final Order 12/02/2010); Docket No. 11-0436 (final Order 2/16/2012) (final Order on Rehearing 8/21/2012)

Illinois-American related to service company charges as reflected in Illinois-American's Docket No. 09-0319. Hanley Reb., Aqua Ex. 7.0, 13:281-282. This analysis determined that Illinois-American's costs for management fees on a per customer basis were \$63 annually. *Id.* at 13:282-284. In comparison, Aqua Illinois' management fees in Docket No. 10-0194 were \$45 per customer. *Id.* at 13:286-14:287. Thus, the comparable service company costs in 2010 for Illinois-American were 40% higher than those costs incurred by Aqua Illinois. *Id.* at 14:287-289. As a result of the Commission's review and approval of these costs, the Company has properly recovered these costs for over a decade. Indisputably, at no point has any party, including Staff, challenged those services or the costs associated with them. Aqua Init. Br. at 37.

Next, Staff argues that Aqua Services' provision of billing and customer services are outside of the scope of the "specialized services" contemplated by the AIAs. Staff Init. Br. at 42. As support for this claim, Staff attempts to provide various justifications, including extensive citations to cases detailing the law of contract interpretation in Illinois, reliance upon the language contained in the Commission's final Orders in Docket Nos. 85-0491 and 85-0492 and in Docket No. 98-0602, and reference to testimony previously filed by the Company in previous dockets. *Id.* at 40-46. Staff fails to provide any evidentiary support for this argument, and in fact notes that the Commission's final Orders, entered in the proceedings in which the AIAs were approved, "specify that the types of services to be provided by the affiliate are those that otherwise would be provided by third party experts or outside firms." *Id.* at 43. Staff's arguments are unsupported by evidence, rely solely upon the subjective opinion of a single Staff witness, and provide no basis for the allegation that the Company has acted outside of the scope of the AIAs. As discussed extensively above and in the Company's Initial Brief, the Commission has reviewed the Company's costs associated with the provision of billing and

customer services in multiple rate cases over the last decade, and has approved those costs as properly recoverable.

Also, despite Staff's assertion, the question of whether CWC provided billing and customer service to CIWC prior to the merger between CWC and PSC (which took place nearly two decades ago) is not in dispute in this proceeding. Even if this issue was relevant and disputed, which it is not, Mr. Hanley testified that CWC adopted a service company model wherein certain customer service and billing provisions were provided by CWC's service company. Hanley Sur., Aqua Ex. 11.0, 13:274-280. Similarly, the question of whether Aqua America has provided billing and customer services activities since 1999 is unrelated to the instant case. These issues are entirely unrelated to Kankakee's 2015 test year, and have no bearing on the Commission's evaluation of Aqua Illinois' proposed rates. Further, Staff's recommendation that the Commission initiate an investigation and name Aqua America, Aqua Services, and Aqua Resources as parties is improper and beyond the scope of the Commission's jurisdiction. Pursuant to the Act, the Commission has general supervision of all public utilities located within the state of Illinois. *See* 220 ILCS 5/3-105; 5/4-101. This jurisdiction does not extend to Aqua America, Aqua Resources, or Aqua Services, entities that are undeniably not regulated by the Commission. Moreover, Staff bases its improper recommendation on the fact that "it is unclear what role Aqua America has played in the unauthorized provision of billing and customer services." Staff Init. Br. at 48. Staff utilizes this uncertainty as grounds for its recommendation that the Commission unlawfully extend its jurisdiction to investigate the "interactions of Aqua Illinois with Aqua America." *Id.* This proposal is meritless and should be rejected. Similarly, Staff fails to identify any compelling reason to initiate a broad investigation into the practices of Aqua Services and Aqua Resources, two other unregulated entities. For all

of these reasons, it would be unreasonable and inappropriate to adopt Staff's recommendations. Instead, any review of the Company's affiliate agreements should be focused on the updated AIA that the Company has agreed to file with the Commission within 90 days of the entry of a final Order in this proceeding.

Staff's recommendation that the Commission initiate an investigation into costs that have been properly recovered by Aqua Illinois also amounts to retroactive ratemaking. Illinois courts are clear that "once the Commission establishes rates, the Act does not permit refunds if the established rates are too high, or surcharges if the rates are too low." *Business & Professional People for the Public Interest v. Ill. Commerce Comm'n*, 146 Ill. 2d 175, 242 (1991). These findings are consistent with the notion that "the act of setting rates is 'legislative in character and prospective in its operation.'" *Illinois Bell Tel. Co. v. Ill. Commerce Comm'n*, 203 Ill. App. 3d 424, 435 (2nd Dist. 1990); citing *Mandel Brothers, Inc. v. Chicago Tunnel Terminal Co.*, 2 Ill. 2d 205, 210 (1954). The Commission has reviewed and approved the recovery of the costs associated with the provision of services pursuant to the AIAs for many years. Thus, Staff cannot suggest that the Commission revisit rates set in the Company's previous rate cases to: (1) determine that such rates did not adequately account for alleged revenues that Staff is currently imputing to Aqua Illinois; and (2) impose fines or penalties as a result. *See, e.g., Sackett Dir., Staff Ex. 5.0 CORR, 23:553-555.*

Finally, Staff's additional recommendation, that the Commission initiate an investigation into the 2003 Marketing Agreement between HomeServe and PSC, is improper and irrelevant to this proceeding. No party disputes that Aqua Illinois is not and has never been a party to this agreement – indeed, the evidence demonstrates that any involvement by Aqua Illinois with respect to this agreement was limited at best. Rather, the Marketing Agreement was entered into

between two entities that are not regulated by the Commission. Staff acknowledges this fact, noting that: “Aqua America’s predecessor, [PSC] entered into a so-called Marketing Agreement with HomeServe...Aqua Illinois’ affiliate, Aqua Resources, an unregulated subsidiary of Aqua America provides the services under the Marketing Agreement and receives the revenues from HomeServe in return.” Staff Init. Br. at 32. Simply put, the Commission has no statutory authority to initiate an investigation into the activities of two entities that are not subject to Commission regulation, and Staff offers none. Accordingly, the Commission should reject Staff’s proposal to investigate an agreement between two unregulated entities.

III. CONCLUSION

For all reasons set forth above, Aqua Illinois respectfully requests that the Commission reject Staff’s recommendations. Instead, the Commission should enter findings and make conclusions on all uncontested and contested issues consistent with the Company’s positions taken in testimony and/or stated in the Company’s Initial Brief or herein regarding the evidence in the record and the applicable law.

Dated: December 18, 2014

Respectfully submitted,
AQUA ILLINOIS, INC.

By: /s/ John E. Rooney
One of the attorneys for
Aqua Illinois, Inc.

John E. Rooney
Maris J. Jager
ROONEY RIPPIE & RATNASWAMY LLP
350 West Hubbard Street, Suite 600
Chicago, Illinois 60654
(312) 447-2800
john.rooney@r3law.com
maris.jager@r3law.com