STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

UTILITY SERVICES OF ILLINOIS, INC.	)	
	)	Docket No. 14-0741
Proposed Rate Increases for	)	
Water and Sewer Service.	)	

CORRECTED REPLY BRIEF OF
THE PEOPLE OF THE STATE OF ILLINOIS

The People of the State of Illinois

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The People of the State of Illinois ("AG" or "the People"), by Lisa Madigan, Attorney General of the State of Illinois, pursuant to the schedule set by the Administrative Law Judge and Section 200.800 of the Illinois Commerce Commission's ("the Commission" or "ICC") Rules of Practice, 83 Ill. Admin. Code § 200.800, hereby file their Reply Brief in this proceeding relating to the rate increase petition made by Utility Services of Illinois, Inc. ("USI" or the "Company") for its delivery of water and sewer service in several districts throughout Illinois.[1]

The People's Reply Brief responds to the initial briefs submitted by USI and the Commission Staff ("Staff") on June 16, 2015.

I. INTRODUCTION

II. RATE BASE

III. OPERATING REVENUE AND EXPENSES

A. Uncontested Issues

B. Contested Issues

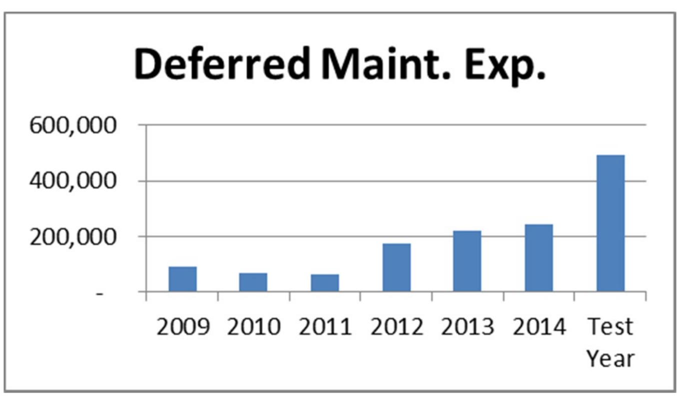
1. Deferred Maintenance Expense

In its Initial Brief, USI argues that AG witness Frank W. Radigan's proposal to reduce the Company's projected $494,339 deferred maintenance expense to $300,000 should be

[1] The AG's Reply Brief complies with the brief outline submitted to the Administrative Law Judge.

rejected. USI Init. Brf. at 4-5. USI claims that Mr. Radigan's proposed reduction should be rejected because he failed to show that any of the projects are not needed and he did not conduct any inspections of the facilities in question. *Id*. at 3. USI's argument flips the burden of proof on its head. Section 9-201(c) of the Public Utilities Act (the "Act") unequivocally states that the Company bears the burden of establishing the "justness and reasonableness of [its] proposed rates." 220 ILCS 5/9-201(c). Here, USI failed to meet its burden.

Mr. Radigan testified that the Company's projected deferred maintenance expense of $494,339 is significantly higher than it has been for the last several years. He included in both his Direct Testimony (AG Ex. 1.0 at 11:242) and his Rebuttal Testimony (AG Ex. 2.0 at 11:239) a graph showing that the Company's 2015 test-year projection is almost twice as high as the amount it incurred in 2014. AG Ex. 1.0 at 13:261. The graph also shows that the 2015 test-year projection is approximately four times greater than what was incurred in 2009, 2010, and 2011. *Id.* at 13:262-263. (The table is reproduced below.)



Mr. Radigan added that that given the large number of water and sewer facilities owned by the Company, it should be doing several deferred-maintenance projects like painting, testing, and inspecting each year, and its annual expense should be constant over time. *Id*. at 12:247-253. The graph shows that that is the case for the years 2009 through 2014, when USI's deferred maintenance expense was relatively consistent. In comparison to the previous five years, the 2015 test year projection is an obvious outlier. As the party with the burden of proof, it is USI's obligation to demonstrate that its anomalous projection is just and reasonable. The Company failed to provide such an explanation.

In its Initial Brief, Staff agrees with Mr. Radigan's testimony that "the Company's level of deferred maintenance expense forecast for the test year was beyond what should be expected." Staff Init. Brf. at 14. Yet, after conceding that Mr. Radigan's analysis is correct, Staff states no position as to whether Mr. Radigan's proposal should be adopted. Rather, Staff argues that the Commission should adopt its proposed adjustment regarding deferred maintenance expense. *Id*. at 14-15.

Staff witness Bridal recommended reducing deferred maintenance expense by almost exactly $200,000 largely based on an extension of the amortization period on certain tank painting projects from 5 years to 10 years. ICC Staff Ex. 1.0 at 17:351-358; ICC Staff Schedule 1.14 W at page 1, line 3; Tr. at 72:17-73:6. After including rate base effects, the net effect on revenue requirement of Mr. Bridal's adjustment is around $155,000. Tr. at 74:13-18; ICC Staff Ex. 1.0, Schedule 1.05W, line 7.

As noted in the AG's Initial Brief (at page 3), the People do not object to the Commission adopting Staff's Mr. Bridal's extended amortization period accepted by USI. However, accepting Staff's proposal should be *in addition to* Mr. Radigan's proposed reduction, which considers the justness and reasonableness of the *amount* of the Company's proposed cost recovery for deferred maintenance and is based on an analysis of actual historic expenses for deferred maintenance.

The Commission should adopt Mr. Radigan's proposal that USI be permitted to recover $300,000 for test-year deferred maintenance expense, which is over 20% higher than the 2014 actual expense amount of $245,000. AG Ex. 1.0 at 13:276-284.

2. Fuel Expense

In its Initial Brief, Staff recommends that Staff witness Everson's recommended fuel expense forecast of $2.66 per gallon for the 2015 test year be adopted. Staff Init. Brf. at 15-16. In his Surrebuttal Testimony, Company witness Justin Kersey testified that "the Company does not oppose [Ms. Everson's] adjustment." USI Ex. 14.0 at 3:57-58. In the AG's Initial Brief, the People analyzed the Energy Information Agency's most recent Short-Term Energy Outlook, dated June 2015. AG Init. Brief at 5. The AG's analysis shows that the 18-month average gasoline price forecast is $2.69 per gallon. Given that Staff's recommendation and the most recent forecasted data are comparable, the AG agrees that Staff's recommended forecasted fuel price average should be adopted by the Commission.

3. Rate Case Expense

In its Initial Brief, USI states that the Commission rejected the AG's argument in Docket Nos. 11-0561 through 11-0566 (consol.) that certain of Water Service Corporation's ("WSC") employee costs should be excluded from rate case expense because those costs were being recovered as part of Wages and Salaries expense. USI Init. Brf. at 6. USI is incorrect. In its Order in Docket Nos. 11-0561 through 11-0566 (consol.), the Commission did not address arguments concerning "double-counting" because the companies in that case did not provide enough evidence to establish that their proposed rate case expense was just and reasonable. *Charmar Water Company, et. al., Proposed General Increase in Water Rates*, ICC Docket Nos. 11-0561 through 11-0566 (consol.), Final Order at 20 (May 22, 2012). The Commission stated that it was mindful of the "double-counting" concern raised by the AG in the consolidated cases, but it did not address that issue, because "[t]he Commission cannot make an informed judgment regarding that initial "single"-counting of these labor expenses, as that information is not in the record." *Id.*

As discussed in more detail in part III.B.5 of this Reply Brief, USI did not establish that certain WSC employees' salaries are included in both rate case expense and as part of Wages and Salaries. Mr. Radigan observed that without a showing that there is no double counting of internal staff time allocated to both Wages and Salaries expense and rate case expense, all rate case expense costs should be excluded from the test-year revenue requirement. AG Ex. 2.0 at 18:388-394. Because USI failed to show that there is no "double-counting," the Commission should adopt Mr. Radigan's recommendation that the internal staff component of rate case expense be removed from the test-year revenue requirement – a downward adjustment of one-fifth of $195,470, or $39,094. AG Ex. 1.0 at 10:195-207.

4. Insurance Expense

In its Initial Brief, USI asserts that it met its burden of proof by showing that that USI's share of WSC total customer equivalent base has increased from 6.90% in 2014 to 7.07% in 2015. USI Init Brf. at 7. According to the Company, this purported increase offsets a projected

2.2% decrease in insurance costs for all of Utilities, Inc.'s subsidiary companies.[2] The Company's numbers do not add up.

AG witness Radigan testified that USI's insurance expense increased from $187,804 in 2014 to a projected $196, 978 in the 2015 future test year, a 4.88% increase. AG Ex. 1.0 at 10-11:212-221. According to USI, its share of WSC's insurance costs for all of the UI subsidiaries increased from 6.90% to 7.07%, a 2.46% increase.[3] USI Ex. 14.0 at 2:34-35. USI provided no explanation as to how a 2.46% increase in its share of overall WSC insurance costs coupled with a 2.2% *decrease* in WSC overall insurance costs yields an almost 5% increase in insurance expense for the Company.

Moreover, USI's evidentiary presentation concerning insurance costs is part of a pattern the Company followed in this case on several issues. USI presented minimal information supporting certain increased expenses in its direct case. When Staff and/or the AG challenged certain of those expenses in their respective direct cases, USI provided additional information regarding the challenged items. When Staff and/or the AG argued that the additional information was not sufficient, USI provided even more detail in its surrebuttal case.

That is precisely what USI did with insurance expense. In its rebuttal testimony, Staff agreed with the theoretical basis of Mr. Radigan's adjustment to insurance expense. Staff Ex. 8.0 at 8:147-152. However, in its Initial Brief, Staff states that the additional information USI submitted in surrebuttal testimony satisfies its concerns on this issue and it is "withdrawing its adjustment." Staff Init. Brf. at 19.

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[2] Utilities, Inc. is the parent company of USI.

[3] As the People noted in their Initial Brief at 6, USI did not provide data showing how the 7.07% figure was derived.

The Commission should not reward such "hide-the-ball" tactics. Utilities should be required to submit all supporting information in their direct cases. Staff and Intervenors should not have to expend scarce resources extracting additional information from utilities for explanations that purportedly support their requested rate increases.

Furthermore, as explained above, the additional information USI provided in its surrebuttal testimony does not explain its projected increase in insurance expense. Because the Company did not meet the burden of proof on this issue, the Commission should reject its proposed test-year expense level. Instead, the Commission should adopt the more reasonable proposal made by Mr. Radigan, using the average of USI's actual insurance expense for the most recent two years.

The average of insurance expense over the past six years from 2009-2014 was just $154,000, and the average over the past two years was $174,525. AG Ex. 1.0 at 11:221-226. Mr. Radigan thus recommended using the $174,525 two-year average as the test-year insurance expense in the Company's revenue requirement. *Id.*

5. Wages and Salaries Expense

USI's argument regarding Wages and Salaries attempts to reverse the burden of proof. The Company's entire argument is a critique of Mr. Radigan's alleged failures to conduct additional discovery or to review information provided. USI Init. Brf. at 8-9. USI has the burden of proof in this case. Criticizing a Staff or Intervenor witness for failing to conduct additional discovery to see if a utility can fill holes in its case does not qualify as satisfying that burden. It is the utility's unequivocal obligation to prove its case. USI has not done so here.

Moreover, in his Rebuttal Testimony, Mr. Radigan explained that he did review the discovery response and other information USI submitted in this case that the Company claimed provided the detail he said was missing. Mr. Radigan stated that after reviewing that information, he found it wanting. For example,

- Mr. Radigan testified that while the Company's response to Staff data request 4.03 included a detailed salary schedule, the schedule included costs allocated to companies not included in this proceeding and no explanation as to how the costs were allocated to the 23 service areas that make up USI. AG Ex. 2.0 at 15-16:330-336.

- Mr. Radigan added that the Company includes costs for vacant positions that may have not been filled for years. *Id.* at 16:344-347.

- In addition, the Company's information showed that a portion of the costs of certain employees are being recovered as part of rate case expense and another portion as part of Wages and Salaries. For at least one employee, USI charged 100% of his time to Wages and Salaries while also charging $6,125 to rate case expense, raising the specter of double counting. *Id.* at 16-17:349-360.

- As to USI's assertion that the large increase is partially explained by its purchase of the Oakwood system, Mr. Radigan said that USI provide no details showing that the acquisition increased headcount. *Id.* at 17:362-266.

- With respect to the 3% pay increase, Mr. Radigan testified that he reviewed five years of Wages and Salaries expense. Mr. Radigan stated that although there had been salary increases during those five years, overall Wages and Salaries expense remained relatively flat, perhaps due productivity increases. *Id.* at 17:368-371.

In sum, contrary to USI's claim in its Initial Brief that he did not review available information to satisfy his questions about the Company's requested increase in Wages and Salaries expense, Mr. Radigan did review the information and concluded that it was not sufficient.

The Company's proposed Wages and Salaries expense is overstated. Mr. Radigan explained that Wages and Salaries expense is comprised of two components: (1) Salaries and Wages and (2) Maintenance Expense Charged to Plant. AG Ex. 1.0 at 14:290-291. Salaries and Wages are the payroll costs for a company and Maintenance Expense Charged to Plant is employee time spent on a project that is capitalized and as Wages and Salaries expense become part of the project over time. *Id.* at 14:293-296. Net Wages and Salaries expense is calculated by subtracting the Maintenance Expense Charged to Plant from Salaries and Wages.

Mr. Radigan testified that for its 2015 test year, the Company is forecasting a Net Wages and Salaries level of $1,133,588, a 45% increase over the annualized value from the most recent 18-month period available. *Id.* at 15:310-16:318. USI's explanation of this dramatic increase is an increase in anticipated levels of staffing for 2015 along with a 3% annual increase in straight labor costs (USI Exhibit 3.1 at 6), and the Company's forecast of capitalized time developed by assuming that its staff will spend time on this rate case, capital projects, and for some replacement (*id.*). As to the Wages and Salaries component, the Company projects a forecasted increase from $1.226 million to $1.684 million – a 37% increase, far in excess of a 3% annual labor cost increase. AG Ex. 1.0 at 16:326-328.

Mr. Radigan proposed a far more reasonable Net Wages and Salaries expense level. He recommended using the most recent 18-month period available, January 2013 through June 2014, as a basis for setting a Net Wages and Salaries expense level for the test year. This results in an expense level of $781,934 for the test-year revenue requirement. AG Ex. 1.0 at 17:343-350.

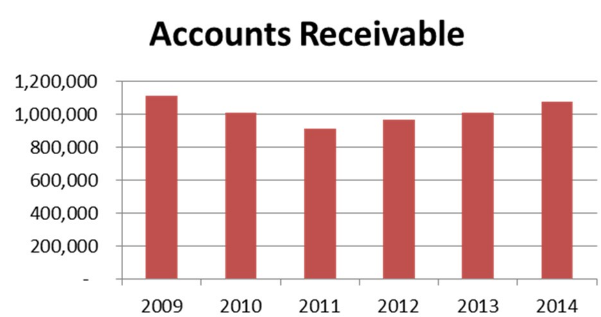
Because the Company did demonstrate that its 45% increase in Wages and Salary expense level is just and reasonable, the Commission should adopt Mr. Radigan's downward adjustment of $351,654 to test-year wage and salary expense.

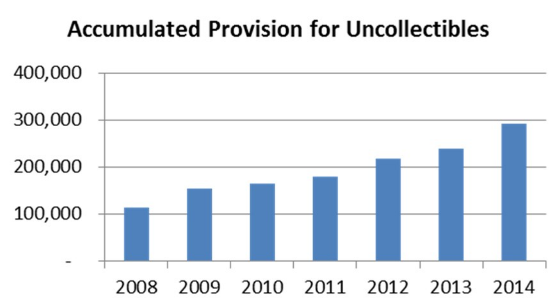
6. Uncollectibles Expense

With respect to Uncollectibles Expense, USI asserts that Mr. Radigan's proposed adjustment should be rejected because he "refused to consider Uncollectible Accounts Accrual Expense." USI Init. Brf. at 9. USI's claim is patently false.

In his Rebuttal Testimony, Mr. Radigan responded to the Company's criticism that he did not consider Uncollectible Accounts Accrual Expense. He explained that the Uncollectible Accounts Accrual Expense is "the costs the Company is reserving for the write-off of customers' account balances prior to stopping service." AG Ex. 2.0 at 9:188-189. Mr. Radigan testified that in deciding whether to include Uncollectible Accounts Accrual Expense in setting rates, one must look at Accounts Receivable. Accounts Receivable is the running balance of money owed to a company. *Id*. at 9:195-199. If Accounts Receivable are increasing (*i.e.*, more bills are going unpaid), a company should set aside larger amounts in case the unpaid bills become an Uncollectible. The decision whether to increase Uncollectible Accounts Accrual Expense is discretionary and if that account is rising while Accounts Receivable is steady, the company is putting too much in reserve. *Id*. at 9-10:203-207.

Mr. Radigan testified that this is precisely what is happening with USI. Mr. Radigan included two graphs in his testimony demonstrating this phenomenon. The graphs are reproduced below.





Id. at 10:207-210.

The graphs show that the Company's level of Accounts Receivable has been relatively steady for the period 2009-2014, while the Accumulated Provision for Uncollectable Accounts has almost tripled between 2008 and 2014. Mr. Radigan testified that the Company has sufficient money in the Accumulated Provision for Uncollectible Accounts to stop setting aside any money in the Uncollectible Accounts Accrual and bring the Accumulated Provision for Uncollectible Accounts back down to the 2008 level (from almost $300,000 in 2014 to $100,000 in 2008). Because bad debt expense has averaged approximately $30,000 per year, this draw down could occur for as long as five years with no more Uncollectible Accounts Accrual. Mr. Radigan concluded that including the Uncollectibles Accounts Accrual in this case would result in a windfall to the Company. *Id.* at 10:212-222

Thus, contrary to USI's claim, Mr. Radigan did consider "Uncollectible Accounts Accrual Expense" in his analysis. In doing so, Mr. Radigan concluded, rightly, that it should not be used in setting rates in this case.

The Commission should adopt Mr. Radigan's proposal for Uncollectibles Expense. USI is forecasting uncollectible revenues of ($109,149), or uncollectible expense of $109,149. AG Ex. 1.0 at 6:130. The Company estimates that 1.01 percent of its bills will not be paid during the rate year, based on an alleged historical comparison between bad debt and revenues. USI Exhibit 3.1 at 4. However, Mr. Radigan found that the absolute level of bad debt expense and the level of bad debt expense as a percentage of billed revenues vary widely from year to year. For instance, bad debt expense was approximately $51,000 in 2009, $35,000 in 2011, $46,000 in 2013 and $14,000 in 2014. *Id.* at 7:132-136. In no year did the bad expense level come near the Company's $110,000 projection for this case. AG Ex. 1.0 at 7:138-140. The Company's forecast is also grossly overstated on a percentage basis; bad debt levels have been as low as

0.2% of revenues. *Id.* at 7:143-144. Mr. Radigan thus suggested that the Commission adopt a more reasonable estimate of uncollectible expense in the test year: $30,000, roughly equal to recent averages. *Id.* at 7:146-149. In his Rebuttal Testimony, Mr. Radigan updated this to $31,400 in his rebuttal testimony to include agency costs. AG Ex. 2.0 at 8:184-185.

7. Sales Adjustment

USI argues that Mr. Radigan's proposal to eliminate the Company's projected 2.65% reduction in annual sales should be rejected because it is inconsistent with the past six years of sales data it reviewed in concluding that its sales are declining. USI Init. Brf. at 11. The Company adds that six years of data is sufficient such that "any variations in weather are likely to offset each other." *Id.* Again flipping the burden of proof, USI also criticizes Mr. Radigan for not examining whether the "weather patterns over [the] six years were unusual [or] abnormal." *Id.*

In his Rebuttal Testimony, Mr. Radigan responded that USI's assertion that six years of data are sufficient to support its projected sales decline may or may not be true. AG Ex. 2.0 at 4-5:88-95. The problem is that USI conducted no analysis to determine whether "weather patterns over [the] six years were unusual [or] abnormal." That is USI's obligation, not Mr. Radigan's.

Mr. Radigan argued in his Direct Testimony that USI did not prove that its projected sales decrease is warranted, because the Company did not normalize its recent sales data against rainfall over the same time period. Consumption and rainfall have a negative correlation; USI witness Kersey's own analysis found a bivariate correlation of 0.25 between these two variables. USI Ex. 8.0, Schedule 8.3, column c, line 22. Moreover, as Mr. Radigan showed, the Galena territory, for example, has seen generally higher rainfall than normal during the past five years.

AG Ex. 1.0 at 7-10:151-190. Such a finding is consistent with high rains in recent years driving lower usage. A six-year sample of sales is predictive of future sales only if the rainfall and temperature during the six-year sample were consistent with average rainfall and temperature over a longer time period. AG Ex. 2.0 at 4-5:89-93. The Company has not shown that in its presentation. Although USI witness Kersey admitted in cross-examination that, in his words, "a greater sample size would probably increase your accuracy in a projection" (Tr. at 40:4-5) he did not attempt to look at historic usage earlier than mid-2008, because the Company's software has no data prior to that year. Tr. at 40:17-22.

Mr. Kersey admitted in cross-examination that the Company did not prepare any multivariate regression analysis attempting to include both temperature and rainfall as explanatory variables driving consumption. Tr. at 42:5-9. In re-direct examination, Mr. Kersey stated that the Company "look[ed] at the six-year weather" over the same time period and "compared those to "10, 20, and 100-year averages for both rainfall and temperature, and did not see any abnormalities or a reason to adjust the consumption for weather." However, upon cross-examination, Mr. Kersey admitted that "abnormality" in his telling meant a deviation greater than five percentage points from long-term historic averages and that it is likely that he would have ignored any deviation from normal of less than five percentage points when examining rainfall over the past six years. Tr. at 48:12-50:3; tr. at 50:11-18. A deviation of 4.9%, then, would have escaped Mr. Kersey's attention – but such a deviation would swamp the alleged 2.65% decline in usage, meaning that his examination of the representativeness of recent rainfall trends had little value.

USI's complaints about Mr. Radigan's testimony that the Commission should eliminate the Company's projected decrease in sales are not supported by the record. USI failed to meet its burden of proving that its projected sales decrease is just and reasonable. Accordingly, consistent with Mr. Radigan's recommendation, the Commission should use the actual 2014 sales level, without any reduction, as the test-year billing determinants in setting new rates to achieve the approved revenue requirement.

IV. RATE OF RETURN

V. RATE DESIGN

VI. OTHER

VII. CONCLUSION

Wherefore, for the reasons stated in this Reply Brief and the AG's Initial Brief, the People of the State of Illinois respectfully request that the Commission enter a Final Order consistent with the arguments included in this Reply Brief.

Respectfully submitted,

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