

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois-American Water Company	:	
	:	
Proposed Rate Increase for Water	:	24-0097
and Sewer Service. (tariffs filed	:	
January 25, 2024)	:	

ORDER

December 5, 2024

TABLE OF CONTENTS

I.	INTRODUCTION	1
A.	Procedural History	1
B.	Nature of ILAWC's Operations.....	2
II.	LEGAL STANDARD	3
A.	ILAWC's Position	3
B.	Staff's Position	3
C.	AG's Position	4
D.	LAC's Position	6
E.	Bolingbrook's Position.....	7
F.	Commission Analysis and Conclusion	7
III.	CONTESTED ISSUES	8
A.	Rate Base	8
1.	Year-End Rate Base and Two-Step Rate Increase.....	8
2.	Post-Acquisition Investments	23
3.	Depreciation on Post-Acquisition Investments	39
4.	Cash Working Capital Methodology	46
5.	Staff's Adjustment for OPEB Related Expense	47
6.	AG Adjustment to Pension/OPEB Lead Days	50
7.	AG Adjustment to Service Company Expense Lead Days.....	52
8.	Capital Investment Projects - Jerseyville Raw Water Improvements	59
B.	Operating Revenues and Expenses	61
1.	Performance Pay	61
2.	Rate Case Expense (WTW Fee).....	74
3.	LTPP Payout Variance.....	78
4.	Miscellaneous Revenues	81
5.	Post-Acquisition Salaries and Wages	83
6.	Depreciation of Enterprise Solutions Software	85
7.	Unaccounted For Water	88
8.	Bank Service Fee Allocation	92
C.	Capital Structure and Rate of Return	93

1.	Capital Structure	93
2.	Cost of Short-Term Debt	106
3.	Cost of Long-Term Debt.....	108
4.	Cost of Common Equity	111
5.	Weighted Average Cost of Capital	149
D.	Cost of Service	150
1.	Peaking Factors	150
2.	Purchased Power Costs.....	156
3.	Industrial Distribution Multiplier	160
4.	One-Step vs. Two-Step Cost of Service Methodology	160
E.	Rate Design	163
1.	Wastewater Revenue Requirement Reallocation.....	163
2.	Meter Charges	177
3.	Volumetric Charges.....	181
4.	Bill Impacts.....	184
F.	Riders	189
1.	Rider VBA Modification	189
2.	Rider ATCR.....	198
G.	Low-Income Tariff	213
1.	Affordability Analysis	213
2.	Low-Income Discount Program	226
H.	Other Issues	234
1.	Pension/OPEB Deferral Accounting.....	234
IV.	UNCONTESTED ISSUES	241
A.	Rate Base	241
1.	Adjustment for 2023 Actuals	241
2.	Pension/OPEB Liability	242
3.	Adjustment for Property to be Sold	242
4.	2012-2020 Capitalized Incentive Compensation Previously Disallowed.....	242
5.	Corrections to Accumulated Deferred Income Taxes (“ADIT”)....	242
6.	Deferred Charges Corrections	243
7.	Reclassification of Upgrades to Plant Accounting Software	243

8.	Construction Work in Progress.....	243
9.	Mounds Acquisition Adjustment	243
10.	AFUDC on Post-Acquisition Improvements	243
11.	ADIT Proration	243
12.	Corporate Alternative Minimum Tax.....	244
13.	Investment Tax Credits ("ITC").....	244
B.	Operating Expenses and Revenues	244
1.	Employee Benefits Expense	244
2.	Mounds Acquisition Adjustment	244
3.	Depreciation Rates.....	244
4.	Lobbying Expenses.....	245
5.	Charitable Expenses	245
6.	Advertising Expenses.....	245
7.	Condemnation Costs.....	245
8.	Service Company Charges	245
9.	Rate Case Expense (Baryenbruch).....	246
C.	Cost of Capital	246
D.	Cost of Service	246
1.	Demand Study	246
2.	Billing Determinants	247
E.	Rate Design	248
1.	Removal of Riders from Sales for Resale Class	248
2.	Public Fire Charges.....	248
F.	Low-Income Tariff	248
1.	Reporting Requirements	248
G.	Other.....	249
1.	Depreciation Study.....	249
2.	Original Cost Determination	249
3.	Gross Revenue Conversion Factor	249
4.	Qualified Infrastructure Plant.....	249
V.	FINDINGS AND ORDERING PARAGRAPHS.....	250

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois-American Water Company	:	
	:	
Proposed Rate Increase for Water	:	24-0097
and Sewer Service. (tariffs filed	:	
January 25, 2024)	:	

ORDER

By the Commission:

I. INTRODUCTION

A. Procedural History

On January 25, 2024, Illinois-American Water Company (“ILAWC” or “Company”) filed revised tariff sheets (“Proposed Tariffs”) with the Illinois Commerce Commission (“Commission”) in which it proposed a general increase in water and sewer rates pursuant to Section 9-201 of the Public Utilities Act (“Act”). 220 ILCS 5/9-201. Simultaneous with and in support of the filing of the Proposed Tariffs, IAWC filed testimony, exhibits, and schedules intended to meet the requirements of 83 Ill. Adm. Code 285, 286, and 287. Notice of filing of the Proposed Tariffs was sent to customers, posted in ILAWC’s business offices, and published in a newspaper of general circulation within each of ILAWC’s service areas, in accordance with the requirements of Section 9-201(a) of the Act and 83 Ill. Adm. Code 255.

On February 8, 2024, the Commission entered an Order suspending the Proposed Tariffs to and including June 22, 2024. Subsequently, the Commission entered a Resuspension Order on May 30, 2024 extending the suspension to and including December 22, 2024.

Appearances or Petitions to Intervene were filed by the following: Commission Staff (“Staff”), the Attorney General of the State of Illinois (the “Attorney General” or “AG”); Illinois Industrial Water Consumers (“IIWC”); Citizens Utility Board (“CUB”); the Village of Bolingbrook (“Bolingbrook”); the Village of Homer Glen; Legal Action Chicago (“LAC”); the City of Champaign (“Champaign”); the City of South Beloit (“South Beloit”); and the City of Urbana, the Villages of Philo, Saint Joseph, Savoy, and Sidney (collectively, “Municipalities”). The administrator for the Consumer Intervenor Compensation Fund also filed an appearance as a non-party participant. All of the petitions were granted.

Pursuant to due notice, hearings were held in this matter on March 12, 2024, August 12, 2024, and August 13, 2024 before a duly authorized Administrative Law Judge (“ALJ”) of the Commission via videoconference. Testimony and exhibits filed by ILAWC, Staff, the AG, jointly IIWC, CUB, and Bolingbrook (collectively, “ICB”), Champaign, South

Beloit, IIRC, LAC, and Bolingbrook were admitted into evidence at the evidentiary hearing held on August 13, 2024. Thereafter, the record was marked “Heard and Taken” on October 21, 2024.

Public forums were held in Jerseyville, Illinois on June 26, 2024, Bolingbrook, Illinois on July 22, 2024, and Champaign, Illinois on July 23, 2024.

On September 4, 2024, ILAWC, Staff, the AG, LAC, jointly Champaign, South Beloit, and the Municipalities, IIRC, ICB, and Bolingbrook filed Initial Briefs. Bolingbrook and the Municipalities requested oral argument.

On September 20, 2024, ILAWC, Staff, the AG, LAC, the Municipalities, IIRC, and ICB filed Reply Briefs. Various motions were filed and briefed by the parties and subsequently ruled on by the ALJ, including ILAWC’s Motion for Entry of a Protective Order and its Motion to Strike, Bolingbrook’s Motion for Leave to File Amended Initial Brief and Statement of Positions Instantly (“Motion for Leave”), and Staff’s Motion to Compel Responses to Staff’s Data Requests (“Motion to Compel”). Staff’s Motion to Compel was withdrawn by Staff and all of the other motions were granted by the ALJ. A Petition for Interlocutory Review of the ALJ’s ruling on August 29, 2024 granting ILAWC’s Motion to Strike was filed by the AG and later granted by the Commission on September 12, 2024.

A Proposed Order was issued on October 24, 2024. The parties were directed by an ALJ Ruling to advise the Commission if they wanted to participate in oral arguments by October 31, 2024. ILAWC, the AG, the Municipalities and Bolingbrook requested oral argument. On November 7, 2024, the Commission granted oral argument which was held on November 20, 2024. Also on November 7, 2024, ILAWC, Staff, the AG, IIRC, ICB, and Bolingbrook filed Briefs on Exceptions. On November 14, 2024, ILAWC, Staff, the AG, IIRC, ICB, the Municipalities, and LAC filed Reply Briefs on Exceptions.

B. Nature of ILAWC’s Operations

ILAWC is an Illinois public utility regulated by the Commission that furnishes water and wastewater service to more than 383,000 residential, commercial, industrial, and governmental customers within its authorized service areas throughout the State. These service areas include Andalusia, Alton, Cairo, Champaign, Chicago Metro, Hardin County, Interurban (Belleville, East St. Louis, and Granite City), Villa Grove, Lincoln, Pekin, Peoria, Pontiac, South Beloit, Sterling, Streator, Hardin, Jerseyville, Godfrey, Grafton, Rosiclare, Tolono, Broadlands, and Fisher. The Company is incorporated in Illinois and its principal office is in Belleville.

ILAWC is a wholly owned subsidiary of American Water Works Company, Inc. (“American Water” or “AWK”), a holding company that owns the stock of regulated water and wastewater service utility subsidiaries operating in multiple states. American Water Works Service Company, Inc. (“Service Company”) provides services to ILAWC in accordance with a Commission approved general services agreement. ILAWC obtains debt financing through American Water Capital Corp. in accordance with the terms of a Commission approved agreement.

II. LEGAL STANDARD

A. ILAWC's Position

ILAWC states that the legal standard for utility rates in Illinois is that “[t]he rates and charges established by the Commission must be “just and reasonable.” 220 ILCS 5/9-201(c). Further “[t]he Commission, in any determination of rates or charges, shall include in a utility’s rate base only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers.” 220 ILCS 5/9-211. Illinois law provides that rates for utility services “should accurately reflect the cost of delivering those services and allow utilities to recover the total costs prudently and reasonably incurred.” 220 ILCS 5/1-102(a)(iv); *Citizens Util. Bd. v. Ill. Com. Comm’n*, 166 Ill. 2d 111, 121 (1995). With respect to rate design, the Commission has discretion to allocate costs that are supported by record evidence. *Id.* at 138.

ILAWC asserts that when a utility in a rate proceeding provides the requisite evidence relating to its prudent expenses, the burden on the opposing participants in a proceeding to successfully move for disallowance is great. Indeed, the Commission may disallow costs only if record evidence establishes unreasonableness or imprudence in the utility’s business decisions. *BPI v. Ill. Com. Comm’n*, 279 Ill. App. 3d 824, 829-830 (1st Dist. 1996).

The Company notes that the AG claims ILAWC has failed to meet its burden of proof. The Company states, however, that this is clearly incorrect. The AG asks the Commission to reduce ILAWC’s proposed phase one water rate increase by \$30 million and reduce its proposed phase one sewer rate increase by \$7 million (and disallow the entirety of ILAWC’s phase two rate increase). The Company argues that even accepting the AG’s positions (which, as discussed below, the Commission should not do), ILAWC has met its burden of proof with respect to the remainder of its proposed increase.

The Company observes that the AG also emphasizes that Illinois case law makes clear that “[t]he rate making process ... involves a balancing of the investor and the consumer interests.” The Company explains that ILAWC’s proposed rates and ratemaking proposals do exactly that, and it is more often than not the AG which opposes proposals to accomplish this balancing. The Company states that to the extent the AG wishes to emphasize the balancing required in ratemaking in Illinois, ILAWC requests that such balancing be applied in a fair, consistent, and objective manner.

B. Staff's Position

Staff observes that Section 9-201(c) of the Act states:

If the Commission enters upon a hearing concerning the propriety of any proposed rate or other charge, classification, contract, practice, rule or regulation, the Commission shall establish the rates or other charges, classifications, contracts, practices, rules or regulations proposed, in whole or in part, or others in lieu thereof, which it shall find to be just and reasonable. In such hearing, the burden of proof to establish the justness and reasonableness of the proposed rates or

other charges, classifications, contracts, practices, rules or regulations, in whole and in part, shall be upon the utility ...

220 ILCS 5/9-201(c).

Staff takes issue with the AG's argument that not only must costs be just and reasonable, but costs must also be "least cost." While the least cost standard is relevant in certain sections of the Act, for example in Section 8-406 (Certificates of Public Convenience and Necessity), the least cost standard is not set forth in Section 9-201 of the Act. Staff asserts that there is no requirement in that section that a utility perform a least cost analysis like is done under Section 8-406. In addition, Staff is not aware of any case law stating that in rate proceedings under Section 9-201, a utility must establish the rates are least cost or perform a least cost analysis.

Further, the AG derives its proposed "least cost" standard from Section 1-102 of the Act, entitled "Findings and Intent." See 220 ILCS 5/1-102. However, Staff contends that the Illinois Appellate Court has determined Section 1-102 to have "no substantive or positive legal force[.]" *Monarch Gas Co. v. Ill. Com. Comm'n*, 261 Ill. App. 3d 94, 99 (5th Dist. 1994). The Appellate Court's finding is consistent with the general principle of construction that legislative findings are considered prefatory language, which in turn, "generally is not regarded as being an operative part of statutory enactments." *Governor's Off. of Consumer Servs. v. Ill. Com. Comm'n*, 220 Ill. App. 3d 68, 74 (3d Dist. 1991), citing *Ill. Indep. Tel. Assoc. v. Ill. Com. Comm'n*, 183 Ill. App. 3d 220 (4th Dist. 1988). In other words, Section 1-102 cannot be used to manufacture a legal standard, as the AG proposes in this proceeding.

Staff asserts that this is not the first time the AG has attempted to apply a least cost standard to a rate case under Section 9-201 of the Act. In *Ameren Ill. Co.*, Docket No. 23-0067, the AG made an identical argument that rates must be "least cost." See *Ameren Ill. Co.*, Docket No. 23-0067, Order at 5 (Nov. 16, 2023). In response, although the Commission agreed that "statements of legislative intent and objectives in Article I guide the Commission's interpretation and implementation of the Act," the Commission stated:

[T]here is no express requirement in the Act for a least-cost analysis in rate cases, and the Commission has not previously required such an analysis in general rate cases. The Commission declines to do so now.

Id. Staff notes that the Commission similarly rejected this argument in other recent rate cases. *N. Ill. Gas Co.*, Docket No. 23-0066, Order at 7-8 (Nov. 16, 2023); *N. Shore Gas Co.*, Docket Nos. 23-0068/23-0069 (Cons.), Order at 10 (Nov. 16, 2023). Staff recommends that the Commission apply the just and reasonable standard in this proceeding and not subject the utility to a least cost standard.

C. AG's Position

The AG observes that it is a well-established principle of utility ratemaking that costs are only recoverable when the utility demonstrates they are reasonable and prudent. 220 ILCS 5/9-101; *Bus. & Prof'l People for the Pub. Int. v. Ill. Com. Comm'n*, 146 Ill. 2d 175, 247 (1991) ("*BPI II*"). In this proceeding, ILAWC is required to prove that

its costs are reasonable and prudent by a preponderance of the evidence. 5 ILCS 100/10-15. In other words, ILAWC must provide sufficient evidence for the Commission to find that the Company's spending and management decisions were more likely than not to be reasonable and prudent. The AG maintains that ILAWC failed to meet this burden.

Prudence is the standard of care which a reasonable person would be expected to exercise under the same circumstances encountered by utility management at the time decisions were made. *Ill. Power Co. v. Ill. Com. Comm'n*, 245 Ill. App. 3d 367, 371 (1993). Costs that are unnecessary to the provision of service, or that the utility has not justified in amount are not reasonable or prudent, and whether a decision is prudent is a fact-specific determination. *Id.* According to the AG, those cases that have disallowed utility costs have focused on management planning and decision-making during project implementation. *Bus. & Prof'l People for the Pub. Int. v. Ill. Com. Comm'n*, 279 Ill. App. 3d 824 at 832 (1996) ("*BPI 1996*"), citing *United Cities Gas Co. v. Ill. Com. Comm'n*, 163 Ill. 2d 1, 31 (1994). The AG claims the facts in this proceeding establish that ILAWC fell short of this required showing.

ILAWC insists:

When a utility in a rate proceeding provides the requisite evidence relating to its prudent expenses, the burden on the opposing participants in a proceeding to successfully move for disallowance is great. Indeed, the Commission may disallow costs only if record evidence establishes unreasonableness or imprudence in the utility's business decisions.

BPI 1996 at 829–830. The AG, however, maintains that this quote misstates the court's decision in *BPI 1996*. In that case, the court deferred to a Commission ruling that approved Commonwealth Edison's proposed fuel costs and found that the Commission did not shift the Company's burden of proof to the petitioners. Nowhere in that decision does the court state or even suggest that the burden shifts to other parties to prove "unreasonableness or imprudence in the utilities business decisions" as ILAWC suggests. The AG emphasizes that the Commission has made clear that "the burden ... shifted to intervenors is the burden of production (to present opposing evidence), not a reversal of the statutory burden of proof" and that "[a]t all times, the utility in a rate case has the statutory burden of proof and bears the risk of non-persuasion." See, e.g., *N. Shore Gas Co.*, Docket Nos. 23-0068/23-0069 (Cons.), Order at 9-10 (Nov. 16, 2023). It is the AG's position that the record shows that it presented sufficient evidence to support its proposed disallowances and recommendations in opposition to the Company's requests.

Illinois case law makes clear that "[t]he rate making process ... involves a balancing of the investor and the consumer interests." *Ill. Bell Tel. Co. v. Ill. Com. Comm'n*, 414 Ill. 275, 287 (1953), citing *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 at 603 (1944) ("*Hope*"). ILAWC provides essential monopoly water and sewer service, and customers lack the ability to decline the Company's service if the prices become burdensome and unaffordable. The AG states that it is for these reasons that the Illinois Supreme Court has held that "a just and reasonable rate can never exceed—perhaps can rarely equal—the value of the service to the consumer" *State Pub. Util. Comm'n ex rel. City of Springfield v. Springfield Gas & Elec. Co.*, 291 Ill. 209,

216 (1919). “[I]f the rightful expectations of the investor are not compatible with those of the consuming public, it is the latter which must prevail.” *Camelot Util., Inc. v. Ill. Com. Comm’n*, 51 Ill. App. 3d 5, 10 (3d Dist. 1977), see also *People ex rel. Madigan v. Ill. Com. Comm’n*, 2011 IL App (1st) 100654, ¶54 (When expenses are incurred “to achieve goals that primarily benefit shareholders, then it is reasonable to require that shareholders bear the cost of that [expense].”).

The AG contends that this is consistent with the State’s strong public interest in protecting residents’ access to affordable water and wastewater services. The Act demands that rates reflect “least-cost public utility services at prices which accurately reflect the long-term cost of such services and which are equitable to all citizens.” 220 ILCS 5/1-102, see also *N. Shore Gas Co.*, Docket Nos. 23-0068/23-0069 (Cons.), Order at 10 (Nov. 16, 2023) (Least-cost guides “the Commission’s determinations of whether costs and rates are just and reasonable or an investment is prudent and used and useful.”). The AG asserts that it has demonstrated that the Commission should reject multiple elements of ILAWC’s proposed rate increases because the Company has failed to meet its requisite statutory burden.

D. LAC’s Position

LAC note that the Act provides that a regulated utility like ILAWC may only recover through rates those costs to provide service which the utility proves are reasonable and prudent. 220 ILCS 5/9-101. Determining what is reasonable requires a balancing of investor and consumer interests. *Citizens Util. Bd. v. Ill. Com. Comm’n*, 276 Ill.App.3d 730, 658 N.E.2d 1194 (1st Dist. 1995) (“[T]he utility must show that ... its rate of return on capital is the reasonable cost of the capital needed to provide the services.”). The Commission’s decision regarding the Company’s rates must be supported by substantial evidence, that is, “evidence that a reasoning mind would accept as sufficient to support a particular conclusion.” *Commonwealth Edison Co. v. Ill. Com. Comm’n*, 405 Ill.App.3d 389, 398 (2d Dist. 2010). LAC also note that the Commission must follow the standards set forth in *Bluefield Waterworks Improvement Co. v. Pub. Serv. Comm’n of West Virginia*, 262 U.S. 679 (1923) (“*Bluefield*”) and *Hope*, 320 U.S. 591 (1944). Under these precedents, a utility may recover only what is sufficient to maintain its financial integrity and attract capital at reasonable terms, and the return must be equivalent to what investors could earn by investing in other companies of comparable risk. *Bluefield*, 262 U.S. at 692-92; *Hope*, 320 U.S. at 603. “The return should be ... sufficient to assure confidence in the financial soundness of the utility and ... adequate, under efficient and economical management, to maintain and supports its credit and enable it to raise the money necessary for the proper discharge of its public duties.” *Bluefield*, 262 U.S. at 693. However, LAC assert that the Illinois Supreme Court has established that a just and reasonable rate must be less than the value of the service to consumers. *State Pub. Util. Comm’n ex rel. City of Springfield v. Springfield Gas & Electric Co.*, 291 Ill. 209, 216, 125 N.E. 891 (1919). As a matter of law, in setting rates, ratepayer interests should usually come first. *Camelot Util., Inc. v. Ill. Com. Comm’n*, 51 Ill.App.3d 5, 10, 365 N.E.2d 312 (1977).

E. Bolingbrook's Position

Bolingbrook states that in passing the Act and amending it numerous times since 1970, the Illinois General Assembly has found that the health, welfare and prosperity of all Illinois citizens require the provision of adequate, efficient, reliable, environmentally safe and least-cost public utility services at prices which accurately reflect the long-term cost of such services and which are equitable to all citizens. 220 ILCS 5/1-102. The principles of equity direct a fair treatment of consumers and investors in order that “the public health, safety and welfare shall be protected” and “the rates for utility services are affordable and therefore preserve the availability of such services to all citizens.” 220 ILCS 5/1-102(d)(i) and (viii).

Pursuant to the Act, public utilities have a duty to furnish, provide, and maintain service instrumentalities, equipment, and facilities to promote the safety, health, comfort, and convenience of its patrons, employees, and public and shall be in all respects adequate, efficient, just, and reasonable. 220 ILCS 5/8-101.

Bolingbrook points out that the Illinois Supreme Court has found, “[a] public utility is entitled to just and reasonable compensation for the service given to the public; but on the other hand, the public is entitled to demand that no more be exacted from it than the services rendered are reasonably worth.” *United Cities Gas Co. v. Ill. Com. Comm’n*, 163 Ill. 2d 1, 23-24 (1994). Bolingbrook states that accordingly utility customers should not be required to pay more than the service provided is reasonably worth to them, nor should they pay for costs not legitimately incurred for their benefit. *Id.* at 24.

The Illinois Appellate Court has ruled that the Commission must ensure that consumers are treated fairly (220 ILCS 5/1-102(d)), that “the application of rates is based on public understandability and acceptance of the reasonableness of the rate structure and level” (220 ILCS 5/1-201(d)(ii)), and that “the rates for utility services are affordable and therefore preserve the availability of such services to all citizens” (220 ILCS 5/1-102(d)(viii)). *Apple Canyon Lake Property Owners’ Assn. v. Ill. Com. Comm’n*, 2013 IL App (3d) 100832, ¶ 41.

Bolingbrook argues that in accordance with the law, ILAWC’s customers should not be required to pay for costs that benefit the Company allowing it to obtain more communities and fix pipes that have no impact on the Village’s water. The residents of Bolingbrook are entitled to their equal protection and due process of the law, and must be treated equally as other customers of the Company who pay for less for water service.

F. Commission Analysis and Conclusion

There is no persuasive evidence in the record to support changing the legal standard to establish rates in this proceeding from the well-established just and reasonable standard to a least cost standard. Section 9-201(c) clearly provides that a just and reasonable standard is the applicable legal standard for this proceeding:

If the Commission enters upon a hearing concerning the propriety of any proposed rate or other charge, classification, contract, practice, rule or regulation, the Commission shall establish the rates or other charges, classifications, contracts, practices, rules or regulations proposed, in whole or in part, or

others in lieu thereof, which it shall find to be just and reasonable. In such hearing, the burden of proof to establish the justness and reasonableness of the proposed rates or other charges, classifications, contracts, practices, rules or regulations, in whole and in part, shall be upon the utility. . . .

220 ILCS 5/9-201(c). Additionally, as Staff notes, there is no requirement in Section 9-201 that a utility perform a least cost analysis like is done under Section 8-406 and no case law has been presented to support such an analysis in rate proceedings under Section 9-201.

To prevail on an issue, the utility must meet its burden of proof by a “preponderance of the evidence.” 5 ILCS 100/10-15. In a rate case, the Commission is obligated to determine, from the proposals and evidence of record, just and reasonable versions of the proposed rates and practices. The Commission may select, modify, or meld proposals, or craft from the record evidence, those rates or practices it finds just and reasonable. 220 ILCS 5/9-201(c) (“[T]he Commission shall establish the rates . . . [or practices] proposed, in whole or in part, or others in lieu thereof, which it shall find to be just and reasonable.”). On appellate review, the Commission's findings must be supported by “substantial evidence” based on the record. *Citizens Util. Bd. v. Ill. Com. Comm'n*, 166 Ill. 2d 111, 120 (1995) (citing 220 ILCS 5/10-201(e)(iv)(A)-(D)); see also *Rodriguez v. VA*, 8 F.4th 1290, 1298 (2021) (“‘Preponderance of the evidence’ is a burden of proof, while ‘substantial evidence’ is a standard of review”).

III. CONTESTED ISSUES

A. Rate Base

1. Year-End Rate Base and Two-Step Rate Increase

a. ILAWC’s Position

ILAWC explains that as part of a package to support and enhance the continued affordability of the Company’s rates over the long term by smoothing out rate increases for customers over time and also (all else being equal) reducing the frequency of the Company’s rate cases over time (and thus reducing the level of rate case expense that would be charged to customers), ILAWC is proposing a two-step rate implementation that uses a 2025 test year year-end rate base to set the two step rates. ILAWC Ex. 15.00 at 3.

The Company states that each step of its proposal is based on the future test year ending December 31, 2025. In the first step, the rate base used to derive the revenue requirement and rates would utilize a 13-month average for rate base related items. The Company further states that the first rate step would have an effective date of January 1, 2025. In the second step, the rate base used to derive the revenue requirement and rates would utilize test year ending balances for rate base related items (other components of the test year forecast remain the same in Step One and Step Two). The second step would have an effective date of January 1, 2026. The Company’s filed Part 285 Schedules reflect this proposal. ILAWC Ex. 4.00 at 14.

ILAWC explains that it is using a future test year in which plant additions are forecasted through December 31, 2025, with rates effective January 1, 2025. Because

ILAWC's test year plant additions will go into service over the course of the test year, the Company states that establishing the first step's rates using a 13-month average avoids a situation where ILAWC customers are paying rates that reflect plant additions that are not yet in service. *Id.* at 15. However, at the conclusion of 2025, the Company notes that the plant additions will be used and useful in the provision of service. Additionally, the Company notes that the second rate step provides for recovery of all utility plant in service that is used and useful at the end of the test year.

The Company points out that the Commission has found that its rules do not mandate use of an average rate base to calculate revenue requirement when electing a future test year. In Docket No. 04-0779, the Commission expressly addressed whether use of an average rate base was required and found that it was not. ILAWC believes the following discussion of the issue in the order in that docket is instructive. See *N. Ill. Gas Co.*, Docket No. 04-0779, Order at 8 (Sep. 20, 2005).

Similarly, ILAWC maintains, in Docket Nos. 12-0511/0512 (Cons.), the Commission again discussed the issue. See *N. Shore Gas Co.*, Docket No. 12-0511/0512 (Cons.), Order at 35 (June 18, 2013).

ILAWC highlights that these orders make clear that use of a year-end rate base is not prohibited. Rather, the Commission has rejected the use of a year-end rate base because the year-end rate base does not match the costs that customers pay during the test year. ILAWC states that its two-step proposal addresses this concern by setting test year 2025 rates based on the averaging convention, and 2026 and beyond rates based on the year-end amounts. In this way, the Company contends that customers are appropriately paying for plant that is being utilized to serve them. ILAWC Ex. 18.00 at 11.

The Company states that Staff witness Au, AG witnesses Selvaggio and Larkin-Connolly, and ILWC-CUB-Bolingbrook witness Leyko all recommend the Commission reject the Company's proposed two-step rate implementation proposal, generally asserting that:

- ILAWC's proposal is novel and adds additional complexity to this proceeding;
- ILAWC's proposal is not consistent with Part 285 and Part 287 of the Act regarding the election of ILAWC to use a future test year;
- the Commission has rejected similar proposals utilizing a year end rate base in prior cases;
- a future test year already provides sufficient flexibility to make a rate case forward looking for rates effective after the end of the test year;
- the time period for the components included in the calculation of the rates should match;
- customers do not have notice of the two-step increase; and
- even if the frequency of rate cases were to decrease, this is not a sufficient benefit.

ILAWC Ex. 18.00 at 11; ILAWC Ex. 31.00 at 4.

However, the Company points out that these concerns do not reflect the specifics of the Company's proposal. The two step proposal uses only one test year, calendar year 2025, for both steps of the rate increase. ILAWC Ex. 18.00 at 11. The Company explains that both steps are based on the same 2025 revenues, expenses, and year-end plant balances. In no way does the Company's proposal incorporate any items outside of the future test year. The Company contends that the only difference between Step One and Step Two is in the rate making convention applied to the test year rate base. In Step One, an averaging convention is applied. In Step Two, a year-end rate base is utilized. In both cases, however, the test year costs remain the same.

ILAWC states that its two-step increase is also designed to address the concern that a year-end rate base does not match the costs that customers pay during the test year, by setting test year 2025 rates based on the averaging convention, and 2026 and beyond rates based on the year-end amounts. The Company further states that in this way, customers are appropriately paying for plant that is being utilized to serve them. *Id.*

The Company argues that the proposal does not add unnecessary complexity. ILAWC explains that it has included a single set of investments in rate base that will be made during the future test year and will be used and useful in the provision of service prior to December 31, 2025. *Id.* at 14-15. The Company states that it has normalized and annualized revenues and expenses to reflect the forecasted conditions in the future test year of 2025 and beyond. The Company further states that its capital structure reflects the forecast of capital structure components during the future test year of 2025 at Step One and Step Two. The Company notes that it has modified its capital structure to reflect the 13-month average of its capital structure components at Step One and the year end balances at Step Two. This adjustment is appropriate as it matches the rate base investments at each step with the funding for those investments at each step. ILAWC highlights that it has used year-end measurements for billing determinants and number of customers. ILAWC Ex. 31.00 at 6. ILAWC explains that its deferred tax balances are updated as part of Step Two along with nearly all other rate base components. ILAWC further explains that its working capital allowance is based on year-end data along with revenues and expenses and therefore does not change. The Company points out that this is the only component of rate base that does not change between Step One and Step Two. *Id.* at 6-7.

In short, the Company states that all components of the Company's revenue requirement are matched and reflective of conditions forecast for the future test year of 2025. The Company states that the only difference is that at Step Two, or January 1, 2026, rates will be updated to reflect a change in the revenue requirement calculation to rely on a year-end rate base and investments that were made in 2025, rather than continue to rely on a 13-month average rate base.

The Company explains that customers received notice of both steps. ILAWC states that its customers were notified of the Company's rate increase proposal through a press release to the national wire service and local new media outlets, through a bill message printed on all customer bills, through a legal notice, published in local newspapers, and through the Company's website. The Company details that each of these communications notified ILAWC customers that the Company's proposed rate increase would occur in two steps or over two years. ILAWC further details that it has

also held three local public hearings in which it engaged with its customers on various case issues including the two-step rate increase. In addition, the Company states there have been numerous articles and communications written by other parties, including CUB, providing customers with notice of the Company's proposal for a two-step rate increase. ILAWC Ex. 31.00 at 7-8.

The Company contends that the proposal is also not novel, as similar stepped increases have been approved in other states such as Indiana and this Commission has stated that a year-end rate base is permitted under its rules. See *Petition of Ind.-Am. Water Co., Inc.*, Cause No. 45870, Order at 93 (Feb. 14, 2024). The Company argues that even if the proposal is novel, that is not dispositive: other established and accepted ratemaking mechanisms in Illinois, like low-income tariffs, were once considered novel also. Additionally, ILAWC contends that even if its proposal is "novel" or "extraordinary," it is worthy of consideration as part of ILAWC's package of proposals to support and enhance the continued affordability of its rates over the long term. Going forward, ILAWC's ratemaking proposals would not only smooth out rate increases for customers over time, but they could also (all else being equal) reduce the frequency of ILAWC's rate cases over time (and thus reduce the level of rate case expense that would be charged to customers). This supports customer affordability according to the Company, and it urges the Commission to consider the affordability implications of this package of mechanisms and proposals collectively, together with the Company's evidence that responds to specific proposals and arguments raised by Staff and Intervenors.

ILAWC states that regarding regulatory lag and "misalignment" with traditional rate of return regulation, and contrary to testimony that ILAWC's proposal is a "departure from the typical rate-setting practices in Illinois where the Commission sets rates based on a single test year, either historical or future," ILAWC's year-end rate base proposal does base rates on a single test year, 2025, and the Commission's rules do not prohibit use of year-end rate base. The Company explains that because ILAWC's use of a year-end rate base is permitted under the Commission's rules, arguments about regulatory lag and traditional ratemaking are not applicable. *Id.* at 8-9.

ILAWC notes that Staff, the AG, and ICB oppose ILAWC's proposed two-step rate increase. But ILAWC notes they point to no statute, Commission rule, or Commission order that prohibits ILAWC's proposal. Rather, the parties cite the same Commission orders as ILAWC, which found that its rules do not mandate use of an average rate base to calculate revenue requirement when electing a future test year. See Docket No. 04-0779, Order at 8 (emphasis added).

ILAWC states that the parties continue to overlook the reasons why the Commission rejected these proposals—because there was a mismatch of plant in service and rate base in the first year that rates were in effect. ILAWC reiterates that the Commission's decision in Docket No. 04-0779 counters this argument.

ILAWC explains that its proposal addresses this by not implementing the rates based on year-end rate base until the second year, thus matching rates in Step Two for 2026 with the actual cost of service and revenue requirements for that year.

The Company observes that although the AG opposes the Company's proposal, it points to nothing in the Act, Commission rules, or Commission orders that prohibit use of

an average rate base and end-of-year rate base from a single future test year to develop two revenue requirements. In fact, the AG acknowledges that the rules do permit use of something other than an average rate base. The Company states that further, the AG cites the same cases as ILAWC cited to support its position, which confirm that the Commission does not bar ILAWC's two-step approach.

The Company states that Staff and the AG also argue that ILAWC's proposal is inconsistent with test year rules because utilizing a year-end rate base can result in a mismatch of rate base and expenses. However, ILAWC's proposal matches test year revenues and expenses, thus it is not contrary to the test year rules.

ILAWC maintains that Staff's and the AG's position overlooks the fact that ILAWC is only using revenue and expense data from a single test year, 2025, for both steps of the rate increase. That test year rate base is derived from a single set of investments in rate base that will be made during the future test year and will be used and useful in the provision of service prior to December 31, 2025. ILAWC Ex. 18.00 at 14-15. The only difference between Step One and Step Two is that the average rate base is calculated by subtracting the beginning rate base from the ending rate base and dividing by 2, while the year-end rate base is calculated by subtracting the beginning rate base from the ending rate base. Both rate bases were included in the audit of the test year forecast, which confirms the reliability of both the average and final year rate bases. *Id.* at 10-11.

The Company states that Staff and the AG also appear to question the propriety of rate phase-ins. But according to ILAWC, use of a phase-in for rates is clearly permitted. In ILAWC's last rate case, Docket No. 22-0210, the Commission ordered a "phase down" of the reallocation of ILAWC's Central Zone wastewater revenue requirement across all ILAWC's wastewater customers statewide. *Ill.-Am. Water Co.*, Docket No. 22-0210, Order at 129 (Dec. 15, 2022); *see also Great N. Util., Inc.*, Docket Nos. 11-0059/11-0141/11-0142 (Cons.) at Order at 8 (Nov. 8, 2011) (approving a rate phase-in plan as an appropriate rate mitigation tool to address potential rate shock). The Company explains that as long as the utility can recover its full cost of service, and remain consistent with cost-causation, rates can be implemented in phased steps. *See id.* ILAWC maintains its two-step proposal does exactly that, by matching rates in effect for 2026 with the cost of plant actually in service for customers (based on a year-end rate base) for that year.

Lastly, the AG claims in briefing that ILAWC has not provided the support required for its proposal. ILAWC states that this concern was not raised in the AG's testimony and is inaccurate. The Company explains that this information was in fact provided in the Company's B-1 (rate base) schedules and supporting workpapers.

In sum, ILAWC argues, ILAWC's proposed increase will provide the Company with an opportunity to recover its cost of service and earn a reasonable return on the capital invested in the system. ILAWC is fully committed to continued investment in the Company's operations at the level and in the manner necessary to continue to provide safe and reliable service for its customers over the long term and is simply seeking the revenues to support doing so. The Company asserts that even with the requested increase, water service remains affordable, and the Commission should approve ILAWC's requested two-step rate proposal.

b. Staff's Position

Staff recommends the Commission reject the Company's proposed two-step rate increase proposal. Staff Ex. 1.0 at 9. Staff argues ILAWC is essentially asking for two separate rate increases.

Staff does not object to the first step of the Company's two-step rate increase because it follows the Commission's practice of using average rate base for a future test year. Staff Ex. 1.0 at 8. Staff used the date in the Company's filing to present the Company's requested increases in the future test year format, including the total increases in a single, consolidated step, using average rate base except for those items where the Company had already reflected in its rate base a thirteen-month average. *Id.*

However, Staff objects to the Company's second step rate increase because it utilizes year-end rate base for a future test year.

As an initial matter, Staff is unaware of any docket where a utility proposed to develop two revenue requirements based on a single test year. The Act, Part 285 of the Commission's Rules, and Part 287 of the Commission's Rules do not contemplate a utility using a single test year to develop two revenue requirements. Staff is similarly unaware of the Commission approving a similar proposal to the Company's two-step rate increase. Notably, the Company's Step Two proposal is no different than proposals the Commission has rejected in the past. Rather, the Company seemingly relies on a single line of dicta in a prior Commission Order rejecting the use of year-end rate base for a future test year where the Commission states that Part 285.2005(e) of the Commission's rules "does not purport to bar unconventional rate base proposals in future test year cases, it requires more rigorous support for such proposals than is required for future test year costs based on an average rate base." Docket Nos. 12-0511/12-0512 (Cons.), Order at 38.

Further, the Commission should not approve a rate increase that utilizes year-end rate base for a future test year. An average rate base, rather than a year-end rate base, better matches the level of rate base investment with the revenues and expenses for a future test year. Staff Ex. 1.0 at 9. This is because an average rate base better represents investment throughout the year whereas investment estimates from a single point in time, like year-end, does not represent investments incurred throughout the year. *Id.* Staff states that using year-end rate base for a future test year results in a mismatch of expenses accumulated throughout the year and a mismatch of the return on rate base provided to shareholders compared to the amount of time that rate base was used and useful in the provision of utility service. *Id.* at 10.

For example, if the Company puts a utility plant investment into service on July 1, and a year-end rate base is used, then the Company's shareholders would earn a full year rate of return on the entire amount of the plant placed into service on July 1. Staff Ex. 1.0 at 10. In contrast, using an average rate base accounts for the timing of Company investments. If a utility plant investment is placed in service on July 1, by using average rate base, the Company's shareholders would only earn a return on that investment for the second half of the year. *Id.* Similarly, depreciation expense and other operating and maintenance expense associated with the July 1 investment would represent only the six months the plant was actually in service. *Id.* at 10-11.

The Company argues that its proposal benefits ILAWC because the second step of the two-step increase “provides for recovery of all utility plant in service that is used and useful at the end of the test year.” ILAWC Ex. 4.00 at 15. However, Staff argues the Company fails to consider that the Company’s future test year is based on financial projections. Staff Ex. 1.0 at 11. As explained above, utilizing a year-end rate base can result in a mismatch of rate base and expenses. This mismatch is exacerbated when a future test year is used because one must guess what the Company’s expenses, sales, revenues, and other inputs will be in the future. Past Commission practice has permitted the use of year-end rate base when using a historical test year, when these inputs are known, but not a future test year, where these inputs must be predicted. *Id.*

Importantly, the Commission has previously rejected the use of a year-end rate base with a future test year. See *Liberty Utils. (Midstates Natural Gas) Corp. d/b/a Liberty Utils. d/b/a Midstates Gas*, Docket No. 14-0371, Order at 9 (Feb. 11, 2015). The Commission’s Order in Docket No. 04-0779 provides further context for why year-end rate base should not be used with a future test year. See Docket No. 04-0779, Order at 8.

ILAWC argues that its proposal is different than those previously rejected by the Commission because its proposal “does not utilize a year-end rate base to support the revenue requirement/rate design for rates in effect during the future test year of 2025.” ILAWC Ex. 18.00 at 13. In other words, ILAWC argues that its proposal should be approved because Step One of its two-step increase appropriately uses an average rate base rather than a year-end rate base for a single year of rates. However, the existence of Step One does not affect the legality of Step Two nor the issues with using a year-end rate base for a future test year. This is because ILAWC’s Step Two in the two-step increase is based on “forecasted conditions,” “projected” sales growth, and “projected” plant balances. ILAWC Ex. 18.00 at 14-15.

Staff asserts that ILAWC’s two-step rate increase lacks support and, importantly, would deprive parties of the opportunity to analyze and participate in a rate case. Similar to other proposals ILAWC has made in this proceeding, which Staff has also objected to, ILAWC’s stated objective for its two-step rate increase proposal is to “mitigate” the need to file for additional rate relief. ILAWC Ex. 4.00 at 15. However, avoiding future rate cases is not a sufficient rationale, especially when considering the extraordinary remedy ILAWC seeks: the use of a year-end rate base in a future test year. The AG aptly noted that the typical rate case structure of matching rate base, operating expenses, capital structure, and billing determinants allows the Commission and other parties an important opportunity to analyze the Company’s complex financials. See AG Ex. 1.00 REV PUBLIC at 9-10. As noted by ICB, rate cases allow for the opportunity to analyze how increases to the Company’s rate base can result in changes to other inputs, such as sales growth or cost offsets, and contrary to the Company’s assertion, simply adjusting to a year-end rate base will not accurately measure the Company’s cost of service. ICB Ex. 2.0 Public, at 16. The Act does not limit how often a utility can file a request for a rate increase and the Company is free to file a request for a rate increase anytime.

Staff argues ILAWC’s claim that its two-step rate proposal will make rates more affordable is false. Doubling the amount of test year plant additions in rate base—which

is the practical effect of ILAWC's proposal—does not result in more affordable rates. Instead, it results in a much larger rate increase for customers.

Furthermore, the Company's claim that rate case expense will be reduced if this two-step rate increase is approved is entirely speculative. ILAWC asks the Commission to simply take its word that future rate cases will be avoided should the Commission approve its two-step rate increase. However, even if the Commission approves the two-step rate increase, which it should not, ILAWC will still likely file for a rate increase if it incurs any unforeseen, not-yet-recoverable, significant costs in the future. Nothing in the Act or the Commission's Rules prevents ILAWC from coming in at any time to request a rate increase. Notably, ILAWC has filed two rate cases in the past two years: 2022 and 2024. *See generally* Docket No. 22-0210. The Commission should not be persuaded by ILAWC's speculative and unsupported claim that rate case expense will be reduced.

Staff states that even if ILAWC's proposal results in fewer rate cases, which it will not, the amount of rate case expense avoided is dwarfed by the amount of increased rate base the Company is requesting in this proceeding. ILAWC's second step would add approximately \$15.6 million to the revenue requirement. ILAWC Ex. 4.04. Rate case expense is approximately \$2.3 million. Staff Ex. 10.0 at 11. Assuming rate case expense would stay relatively similar, adding \$15.6 million in additional revenue requirement to "save" approximately \$2.3 million in future rate case expense is detrimental for ratepayers; specifically, the detriment of \$15.6 million in the additional revenue requirement without the appropriate, legally required scrutiny that occurs in a rate case far outweighs the speculative savings alleged from a reduced rate expense. Further, \$2.3 million in rate case expense could very likely be offset by at least \$2.3 million in disallowances in a future rate case, resulting in customers paying no more than they otherwise would for a second rate case.

ILAWC argues that its use of a year-end rate base with a future test year is permitted under the Act and Commission Rules. Staff notes that ILAWC cites the Commission's Order in Docket No. 04-0779 and Docket Nos. 12-0511/12-0512 (Cons.), in support of its argument. However, ILAWC mischaracterizes the Commission's prior rulings. Staff asserts the Commission has not approved a revenue requirement based on a future test year using a year-end rate base; further, the Company has failed to provide any additional support, let alone the "more rigorous support" that is required by Part 285 of the Commission's rules for Commission approval of ILAWC's two-step rate increase proposal.

The Company also claims a two-step rate increase is permitted because, in the Company's last rate case, Docket No. 22-0210, the Commission rejected its wastewater reallocation proposal and instead approved a rate phase-in plan to avoid rate shock. Staff contends this claim does not aid the Company. First, this rate phase-in is entirely irrelevant to the question the Commission must answer whether it is appropriate for ILAWC to request a second step rate increase based on a future test year using year-end rate base. Second, as recognized by the Commission, the wastewater reallocation problem was entirely "a result of IAWC's business decisions." Docket No. 22-0210, Order at 128. Staff states it is bold of the Company to claim that the Commission's novel solution to allow ILAWC to recover its revenue requirement—despite its poor business decisions—should now serve as a justification to allow ILAWC to increase its revenue

requirement without the appropriate Commission scrutiny. Third, the Commission's solution to ILAWC's wastewater reallocation issue in Docket No. 22-0210 is easily distinguishable from what ILAWC is requesting in this docket. The "rate phase-in" at issue in Docket No. 22-0210 impacted the Company's rate design, not its revenue requirement. The explicit reason why the Commission rejected Staff's wastewater reallocation proposal in Docket No. 22-0210 was that it would "result in IAWC being unable to recover its Commission-approved revenue requirement, and thus violate the Commission's policy of implementing cost-based rates." *Id.* The Commission's solution aimed to "avoid[] under-recovery by IAWC of its full revenue requirement and sunset[] the allocation of portions of [the] Central Zone's wastewater revenue requirement across all IAWC's wastewater customers within a fixed time-frame." *Id.* at 129. Even if the Commission's decision in Docket No. 22-0210 was precedential, which Commission decisions are not, the Commission's decision to modify ILAWC's rate design by phasing in higher rates to avoid rate shock is quite distinguishable from a modification of ILAWC's revenue requirement through a two-step rate increase in order to phase in a higher rate base. *See, e.g., Citizens Util. Bd. v. Ill. Com. Comm'n*, 166 Ill. 2d 111, 125-26 (Apr. 20, 1995) *citing Miss. River Fuel Corp. v. Ill. Com. Comm'n*, 1 Ill. 2d 509, 513 (1953).

Staff also takes issue with ILAWC's argument that the Company's proposal is not novel because "similar stepped increases have been approved in other states..." Staff points out the Company also relies heavily on one line of dicta in a Commission order from twenty years ago, stating that, "there is no codified requirement that an average rate base must also be adopted [when electing a future test year]." Docket No. 04-0779, Order at 7. Staff asserts that statutes and regulations in other states differ from those in Illinois, and what may be permissible in some other jurisdiction has no relevance or bearing as to what is permissible for Illinois utilities regulated under the Act.

Furthermore, the Company has failed to address the Commission practice, a practice employed for over 30 years, of always using an average rate base with a future test year. The Company has failed to provide record evidence to support a Commission decision that departs from this past practice and it would be a great departure from the Commission's prior decisions to permit the Company to establish a revenue requirement based on a future test year using year-end rate base. Staff notes that importantly, Commission decisions are entitled to less deference when the Commission drastically parts from past practice. *Bus. & Prof'l People for the Pub. Interest v. Ill. Com. Comm'n*, 136 Ill 2d 192 (1989).

The Company has also failed to provide the "more rigorous support" the Commission stated Part 285 of the Commission's Rules require to approve a revenue requirement based on a future test year using year-end rate base. Docket Nos. 12-0511/12-0512 (Cons.), Order at 38.

Finally, Staff states that ILAWC does little to address or rebut the concerns raised in this proceeding about its proposal other than restating its proposal. The Company also fails to acknowledge that every single party in this docket that offered an opinion about the Company's two-step rate increase recommends that the Commission reject it.

For all the foregoing reasons, Staff recommends the Commission reject the Company's two-step rate increase proposal.

c. AG's Position

The AG asks the Commission to adopt its position—which is also supported by Staff, ICB, and LAC—and reject the Company's unprecedented two-step rate increase. AG Ex. 3.00 at 6–10; AG Ex. 4.00 at 4–10; ICB Ex. 4.0 at 2–3; Staff Ex. 10.0 at 4–8. The proposal for a two-step rate increase that is based upon the future 2025 test year with a year-end rate base is not provided for within the Act, the Commission's rules for public utilities filing for an increase in rates (Part 285), or the Commission's test year rules (Part 287).

The AG also distinguishes this case from Docket No. 22-0210 and Docket Nos. 11-0059/11-0141/11-0142 (Cons.) which the Company argues as bases for its two-step proposal. See Docket No. 22-0210, Order at 129 *citing Great N. Util., Inc.*, Docket Nos. 11-0059/11-0141/11-0142 (Cons.), Order on Reh'g at 8 (May 2, 2012). The AG argues that ILAWC is not asking for a phase-in of a single revenue requirement. Rather, it is asking for a second rate increase that purports to use year-end rate base without modifying related costs, which violates the test year rule. The Company must present its rate data in accordance with a proposed one-year test rule to avoid mismatching revenue from one year with expense from another. *BPI II*, 146 Ill. 2d at 237–238. The Company's rates are a function of its annual revenues, but the Company is attempting to mismatch costs. *Id.*

ILAWC states it uses only one test year, calendar year 2025, for both steps of the rate increase, but acknowledges it uses an average convention for Step One and year-end rate base for Step Two. Regarding average versus year end data, Part 285 states:

If the rate base components of a future test year are not derived from average data for the test year or from monthly average data . . . provide work papers supporting Schedule B-1 that reflect the 13 month-end balances of all rate base items commencing with the month-end balance for the month prior to the beginning of the test year and ending with the month-end balance for the last month of the test year.

83 Ill. Adm. Code 285.2005(e).

The AG notes that the word, “if,” is used indicating that average data is the norm, and that either the average data or the year-end balances must be consistently used in the future test year. The Company's proposal to use average data for Step One and some average data and some year-end data for Step Two is not found in Illinois law.

Further, the AG shows that the issue of using a projected year-end rate base in a future test year—which ILAWC proposes for Step Two—has been rejected by the Commission when the use of an average rate base is more appropriate. In Docket No. 04-0779, a rate case proceeding for Nicor, the Commission rejected Nicor's proposal for a year-end rate base in a future test year because the future test year already provides sufficient flexibility to make the rate case forward-looking. Docket No. 04-0779, Order at 7-8.

While the use of a year-end rate base is not expressly prohibited (as the Company notes), Part 285 requires extra support when using a projected year-end rate base in a

future test year, as set forth in Section 285.2005(e) of Part 285 of the Commission rules. In Docket Nos. 12-0511/12-0512 (Cons.), rate case proceedings for North Shore Gas and The Peoples Gas Light and Coke Company (“North Shore,” “PGL,” or collectively “NS-PGL”), the Commission rejected the utilities’ request for a projected year-end rate base in a future test year; confirmed that there had been no previous Commission decisions that matched a year-end rate base in a future test year based on average test year data; and indicated that “more rigorous support” was required to support such a proposal. Docket Nos. 12-0511/12-0512 (Cons.), Order at 38.

Here, the AG demonstrates that the Company does not provide rigorous support or the 13 month-end balances of all rate base items, as required by the Commission’s rules. 83 Ill. Adm. Code 285.2005(e). The Company’s presentation of the underlying calculations supporting its two-step rate increase is incomplete, unsupported, and ignores basic regulatory principles. AG Ex. 1.00 REV at 5. The only support ILAWC essentially presents is that the year-end rate base is not prohibited and its discussion concerning when plant additions will be used and useful. ILAWC Ex. 1.00 at 7; ILAWC Ex. 4.00 at 4, 14–16. The Company generally repeats that this will result in matching rate base investments with the funding of those investments and compares this to other jurisdiction practices. ILAWC Ex. 18.00 at 10–16, ILAWC Ex. 31.00 Rev. at 3–11. The AG argues this is unpersuasive. In *BPI II*, the high court discusses the importance of the test year to prevent mismatching of revenue from one year with costs from another. *BPI II*, 146 Ill. 2d at 237-238. The Company’s arguments ignore that the future test year already accounts for future costs, consisting of “[a]ny consecutive 12 month period of forecasted data beginning no earlier than the date new tariffs are filed and ending no later than 24 months after the date new tariffs are filed.” 83 Ill. Adm. Code 287.20(b). The AG notes that ILAWC filed this case on February 8, 2024, meaning that its future test year data may extend to February 2026. ILAWC chose a 2025 test year and its rates will take effect in early 2025. It cannot now suggest that it wants to change its selected test year because it would like to include more costs.

ILAWC argues that its two-step increase is designed to address its alleged concern that a year-end rate base does not match the costs that customers pay during the test year, by setting test year 2025 rates based on the averaging convention, and 2026 and beyond rates based on the year-end amounts. The Company attempts to support this by pointing to when its investments will be used and useful, normalized and annualized revenues and expenses, and a capital structure that reflects the forecasted conditions of during the future test year of 2025 at Step One and Step Two. *Id.* But the Company’s hybrid approach does not reflect the normally required matching of rate base, operating expenses, capital structure, and billing determinants in a single test year. AG Ex. 1.00 REV at 9. In 2025, when rates are effective, the rates match the 2025 test year. For subsequent years, it is up to the Company to manage its operations within its revenue requirement. ILAWC already has mechanisms to charge customers for some changed costs between rate cases. Selectively changing how rate base is calculated violates the test year rule and is unjustified.

The AG explains that the Company attempts to support its two-step increase with a mostly year-end rate base (but not including cash working capital) with operating expenses occurring throughout the test year, and an average capital structure. *Id.* at 9–

10. However, operating expenses such as depreciation expense should be annualized if a year-end rate base is used. *Id.* at 10. The Company's approach also fails to consider the cost savings resulting from the plant improvements placed into service throughout the projected test year. *Id.* at 10.

The AG further explains that a revenue requirement represents the cumulative effect of all aspects of a utility's operations, including rate base, expenses, cost of capital, and annual revenues. *A. Finkl & Sons Co. v. Ill. Com. Comm'n*, 250 Ill. App. 3d 317, 330–331 (1993); *BPI II*, 146 Ill. 2d at 237–238. As some costs go up, others go down, and ILAWC should not be permitted to mismatch revenue from one year with expense from another. In *A. Finkl & Sons Co.*, the court noted that isolating one expense for full recovery without considering the effect on other revenues and expenses resulted in single-issue ratemaking. 250 Ill. App. 3d at 326. ILAWC is attempting to circumvent the cost-control incentives inherent in ratemaking and the basic premise that rates are based on cumulative costs by seeking to increase rates due to increased rate base while ignoring other costs.

The AG argues that ILAWC also presents multiple other undeveloped arguments and responses to the AG's recommendations outside of its primary matching argument. Regarding notice, ILAWC states that it provides notice of both steps. Commission rules, however, only account for notice requirements for one increase to occur days after the Commission enters its order. 83 Ill. Adm. Code 255.20; AG Ex. 3.00 at 8–9. Arguing against traditional Illinois ratemaking, the Company relies on Indiana law where it has an affiliated company. Indiana law has no bearing in Illinois. Each state has its own and often different regulatory practices and law. Regarding the novelty of the proposal, the Company merely states that the low-income tariff was once novel. The low-income tariff, however, is grounded in the statute as well as in Commission policy meetings and discussions and reports. See, e.g., 220 ILCS 5/9-241(d); ICC Low-Income Discount Rate Study Report to the General Assembly (Dec. 2022). The AG asserts that the Company's analogy of the two-step proposal to the low-income tariff is meritless, and likewise is no basis for the Commission to approve it.

Lastly, the Company argues that increasing its rates twice in two years will reduce the frequency of rate cases. ILAWC Ex. 15.00 at 3. The AG and Staff both maintain that this rationale is insufficient. Specifically, the AG notes that ILAWC already has a Qualifying Infrastructure Plant ("QIP") surcharge that covers substantial investment and allows it to regularly increase charges that its customers pay by up to 3.5% per year. In addition, the Commission's test year rules are intended to both ensure just and reasonable rates and to encourage rate stability. The Company seeks to undermine rate stability and avoid the regulatory process by implementing a second step based on some aspects of its test year combined with a year-end rate base balance, effectively changing its rates in violation of the test year and without a full Commission review.

Based upon the foregoing, the AG recommends the Commission reject the Company's two-step rate increase. AG Ex. 3.00 at 6–10; AG Ex. 4.00 at 4–10; AG IB REV at 7–14; AG RB 4–12. The Company's proposal is not permitted by Illinois law or Commission rules, lacks the rigorous support required by the Commission, contradicts many of the basic principles of ratemaking in Illinois, and attempts to bypass the Commission's regulatory functions.

d. LAC's Position

ILAWC makes a unique proposal for a two-part rate increase, seeking “approval of rates based on an average rate base for the 2025 future test year and then asks to increase those rates again a year later to incorporate an end of year rate base for rates in 2026 and beyond.” AG Ex. 2.00 REV at 8 *citing* ILAWC Ex. 1.00 at 22. LAC argues that this represents a departure from typical ratemaking principles, where rates are set based on a single historical or future test year. *Id.* at 9; *see also* AG Ex. 3.00 at 7; *see also* Staff Ex. 10.0 at 6.

LAC argues that the Company's reference to “regulatory lag” as a justification is meritless, as a lag in the rate-setting process is “normal,” (AG Ex. 2.00 REV at 10), reflecting the regulatory bargain any investor-owned utility makes as part of its monopoly. ILAWC's circumstances here are not special. Accordingly, LAC argues, they do not warrant special treatment, especially where the Company has failed to directly address other intervenors' valid critiques. *See, e.g.*, AG Ex. 4.00 at 6.

LAC further argues that the Company's QIP rider further limits the merit of any potential justification for this two-step process, (AG Ex. 2.00 REV at 11), as does the absence of any tangible, appreciable benefit for consumers in terms of cost savings. Staff Ex. 7.0 at 15 (chart of comparison of costs associated with one versus two-step increases). In fact, LAC argues, citing another intervenor's expert testimony, it appears that this proposal would primarily benefit the Company at the expense of ratepayers. ICB Ex. 2.0 at 15-16.

LAC thus agrees with the AG, Staff, and ICB that this two-step proposal should be rejected. *See also* ILAWC Ex. 18.00 at 10. LAC further agrees with the AG that the Company's Step One increase should be reduced by \$30,811,994 for water and \$8,087,609 for wastewater, for a total reduction of \$38,899,603. AG Ex. 3.00 at 4.

LAC argues that the Company has failed to demonstrate that its two-step proposal is reasonable or lawful. LAC notes that the Company cites a single stepped increase in Indiana to show that its request is not novel, but the proposal in the Indiana case was “unopposed” according to the Order, which contained no analysis of Indiana law, much less Illinois law. *Petition of Ind.-Am. Water Co., Inc.*, Cause No. 45870, Order at 93 (Feb. 14, 2024). The Company also argues that the establishment of low-income discount rates, which are not prohibited under Illinois law, somehow justifies the use of a two-step proposal. LAC agrees with Staff that this argument is not persuasive. It shows the Company's entire legal argument in support of its proposal is essentially founded upon a single line of dicta in a prior Commission Order and does not come close to providing the support the Company seeks.

In conclusion, LAC argues that the Company simply does not have a justifiable basis under Illinois law for its request, which would primarily benefit the Company and not ratepayers. It must therefore be rejected.

e. ICB's Position

ICB point out the Company is proposing a novel two-step rate increase. ICB argue the Company's proposal is unreasonable, inconsistent with Commission practice, and does not benefit customers in any way. ICB recommends the Commission reject

ILAWC's proposal for a two-step increase given the fact that Step Two rates reflect an end of year additional cost but fails to include an offset to give recognition to the fact there will be an increase in revenues at current rates due to customer growth during the 2025 test year. ICB Ex. 4.0 at 3.

ICB argue, in effect, the Company proposes to true up rates on January 1, 2026 and thereby account for all plant placed in service during 2025 and to update its capital structure. ICB points out that ILAWC customers would see an increase in rate base of the \$102.8 million on a total company basis between Step One and Step Two. ICB note the Step Two revenue increase is \$15,659,930. ICB Ex. 2.0 13.

ICB argue the Company's approach is unprecedented. ICB further argue the Company has not identified a single case where the Commission has approved this type of approach in the past. ICB note further, the Company's proposal to use the same test year to support a Step One and Step Two increase is not provided for in the Commission's rules or the Act. See AG Ex. 3.0 at 7.

ICB argue the proposal is unbalanced. As ICB witness Leyko explained, the Company did not make an adjustment to restate its revenues based on the end-of-year number of customers, as the Company did for rate base. ICB note ILAWC argued in surrebuttal that, "Contrary to AG witness Selvaggio's and ICB witness Leyko's contentions, ILAWC has used year-end measurements for billing determinants and number of customers." See ILAWC Ex. 31.0 at 6. ICB believe it is important to draw a distinction between the year-end number of customers and annualizing revenues associated with the year-end number of customers. ICB point out ILAWC's Part 285 Filing (Part 285, Section 285.5025, Sch. E-4 Water Support), supporting its forecasted revenues, shows the number of customers vary by month in the test year and the forecasted revenues are not annualized using the year-end number of customers. ICB suggests this means that to the extent the number of customers grew during the test year that ILAWC is not reflecting a full year of revenues for these new customers. ICB argue that therefore, ILAWC's proposal is unbalanced.

ICB argue the Company proposes a Step Two increase that reflects costs increases but does not consider any potential offsets. ICB witness Leyko offered additional revenues from new customers as any potential offsets. ICB witness Leyko offered additional revenues from new customers as one area that could serve as a potential offset to the Step Two rate increase that ILAWC ignored. ICB note the Company suggests that the only difference between Step One and Step Two rates is that it uses a year-end rate base in Step Two. ICB Ex. 4.0 at 3. ICB point out however, rate base assets in service at the end of the test year are used to serve the number of customers on the Company's system at the end of the test year. Thus, ICB argue the use of a year-end rate base to calculate Step Two rates overstates the rate base relative to the revenues generated. ICB suggest this is because Step Two rates rely on the same revenues as Step One rates. ICB note, however, under its proposal the Company increases rate base to reflect plant in service at the end of the year. ICB argue under such circumstances, if the number of customers increases in the 2025 test year, the Company will not be reflecting a full year of revenues for the new customers added during the test year, only partial year revenues. ICB argue that because the Company's approach is unbalanced and unprecedented it should be rejected, as recommended by

Staff witness Au, AG witness Selvaggio, and ICB witness Leyko. See Staff Ex. 1.0 at 9; AG Ex. 1.0 at 5; ICB Ex. 2.0 at 2.

f. Commission Analysis and Conclusion

ILAWC is proposing a two-step rate implementation that uses a 2025 test year year-end rate base to set the rates for the second step. The Company states that each step is based on the future test year ending December 31, 2025. In the first step, the rate base used to derive the revenue requirement and rates utilizes a 13-month average for rate base related items. The Company further states that the first step would have an effective date of January 1, 2025. In the second step, the rate base used to derive the revenue requirement and rates utilizes test year ending balances for rate base related items (other components of the test year forecast remain the same in Step One and Step Two). The second step would have an effective date of January 1, 2026.

Staff, the AG, LAC, and ICB all recommend the Commission reject the Company's proposed two-step rate implementation proposal.

The Company claims that Step Two is merely a rate phase in for customers. However, the Commission finds that Step Two is a rate increase resulting from distinct revenue requirement calculations. The Commission notes that ILAWC's proposed second step is, based on a future test year but using a year-end rate base. This is concerning because as Staff states, using year-end rate base for a future test year results in a mismatch of expenses accumulated throughout the year and a mismatch of the return on rate base provided to shareholders compared to the amount of time that rate base was used and useful in the provision of utility service.

The Commission observes that the use of year-end rate base when using an historical test year has been permitted previously because inputs are known, unlike in this proceeding where a future test year is proposed and the inputs must be predicted. Additionally, the Company's assurance that it will not need to file as many rate cases if this proposal is approved is unpersuasive. ILAWC can file a rate case at any time. Further, even if adoption of this proposal would result in fewer rate cases, the amount of rate case expense avoided would be insignificant compared to the amount of increased rate base the Company is requesting in this proceeding. The Company has also failed to provide sufficient detail as to any true savings to ratepayers under the two-step proposal. The Commission concurs with Staff and the AG that neither the Act nor Part 285 and Part 287 of the Commission's Rules provide for a utility using a single test year to develop two revenue requirements. The Commission agrees with the parties' arguments that adoption of the proposal would deprive parties of the opportunity to analyze how increases to the Company's rate base can result in changes to other inputs. The Company failed to show that the proposal would not constitute single-issue ratemaking.

The Commission agrees with Staff, the AG, LAC and ICB that the Company's two-step rate increase proposal should not be adopted. The Company has failed to show that the proposal is reasonable. The Company did not provide the "more rigorous support" the Commission required in Docket Nos. 12-0511/12-0512 (Cons.) or as required in Part 285 of the Commission's Rules for approval of a revenue requirement based on a future test year using year-end rate base. The Company also failed to show that the proposal

is consistent with Commission practices and will provide a benefit to ratepayers. The Commission rejects the Company's two-step proposal.

2. Post-Acquisition Investments

a. ILAWC's Position

ILAWC states that Illinois law is unambiguous that in setting rates, the Commission must determine that the rates accurately reflect the cost of service delivery and must allow the utility to recover costs prudently and reasonably incurred. 220 ILCS 5/1-102(a)(iv); *Citizens Util. Bd. v. Ill. Com. Comm'n*, 166 Ill.2d 111, 121-122 (1995). "The Commission, in any determination of rates or charges, shall include in a utility's rate base only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers." 220 ILCS 5/9-211. The rates and charges established by the Commission must be "just and reasonable," and "the burden of proof to establish the justness and reasonableness of the proposed rates or other charges ... shall be upon the utility." 220 ILCS 5/9-201(c). However, "[o]nce a utility makes a showing of the costs necessary to provide service under its proposed charges, it has established a prima facie case, and the 'the burden then shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith.'" *Apple Canyon Lake Property Owners' Ass'n.*, 2013 IL App (3d) 100832 at ¶ 54; *Ill. Bell Tel. Co. v. Ill. Com. Comm'n*, 327 Ill. App. 3d 768, 776 (3d Dist. 2002); *City of Chi. v. Ill. Com. Comm'n*, 133 Ill. App. 3d 435, 443 (1st Dist. 1985).

ILAWC states that it is seeking recovery of the cost of its prudent and reasonable investments in its systems since 2022. This includes the cost of investments in acquired water and wastewater systems. The Company explains that it has provided substantial, detailed, and compelling evidence in support of each dollar of the investments for which it seeks recovery. The Company explains that, in fact, ILAWC witness O'Neill provided a detailed exhibit containing information about the acquired systems that have been placed at issue in this proceeding as ILAWC Ex. 17.04. The Company details that this exhibit includes a breakdown of projects for each acquired system with accompanying costs, a description of each project identified, and the purpose of the project. ILAWC notes that no party contends that any individual post-acquisition investment project covered by the AG's proposed disallowance is unreasonable, imprudent, or not used and useful.

The Company states that, despite the evidence provided, the AG seeks a blanket disallowance of \$25,285,441 of the Company's post-acquisition investments based on an arbitrary calculation of what the AG characterizes as typical level of investments in a water system. AG Ex. 2.00 REV at 66: Table 12. ILAWC explains that any amount exceeding what the AG considers typical is an amount it recommends disallowing. The Company states that the AG, however, does not contend that any specific, individual investment in an acquired system is imprudent. ILAWC contends that by proposing to disallow recovery of costs prudently and reasonably incurred is contrary to the clear legal standards applicable to the establishment of rate base and just and reasonable rates. Additionally, the Company contends that the AG's proposed disallowance either ignores or misunderstands the reality of water and wastewater system operations—including the extent to which a large utility like ILAWC can determine 100% of the future needs of a system before it has acquired and actually operated the system.

ILAWC states that utilities, customers, and regulators across the country continue to face the reality of aging water and wastewater infrastructure, especially buried pipes. ILAWC explains that over the past 25 years, several studies have documented the investments called for to respond to this issue. The Company further explains that recent United States Environmental Protection Agency (“US EPA”) surveys tallied a 20-year need of over \$650 billion for water and sewer infrastructure improvement projects. ILAWC states that in 2022, the Illinois Section of the American Society of Civil Engineers released its Report Card, which assigned the State of Illinois’ drinking water systems a grade of D+ and its wastewater systems a grade of C-. The Company points out that the 2022 Report Card acknowledged that while there is state and federal funding available to finance water infrastructure projects, an underlying investment gap exists.

ILAWC contends that the funding shortfalls and ongoing (and worsening) investment needs in Illinois lead to one conclusion—that large utilities like the Company must contribute to the investment in and rehabilitation of struggling systems throughout the state, or else systems without technical, managerial, or operational expertise and access to funding will languish and deteriorate. The Company states that this reality is recognized by the Systems Viability Act (“SVA”), which provides a framework, ratemaking treatment, and incentives to large investor-owned public utilities to acquire and invest in water and/or wastewater systems, by establishing a streamlined regulatory process that provides efficiency and clarity to the valuation and timing of these acquisitions. See 220 ILCS 5/9-210.5. ILAWC further states that at the same time, the SVA provides a path by which customers of acquired systems gain the benefits of utility ownership with the means and expertise to own, operate, and invest in a system, ensuring the provision of safe and reliable service.

ILAWC notes that AG witness Larkin-Connolly recommends a disallowance of \$25,285,441 of the Company’s post-acquisition investments. AG Ex. 2.00 REV at 66: Table 12. These are investments that ILAWC determined were reasonable and prudent in order for the relevant systems to be brought into compliance with applicable requirements, address deferred maintenance to allow the operation of the systems using best practices after acquisition, or otherwise for ILAWC to be able to provide safe, reliable drinking water service to community members served by those systems.

The Company asserts that this proposed disallowance contravenes the SVA. As noted above, the SVA establishes a framework for the acquisition of water or wastewater systems by public utilities. It provides a means of valuation and various incentives for public utilities when they acquire a water or wastewater utility, including specific ratemaking incentives for post-acquisition investments in the acquired systems. 220 ILCS 5/9-210.5(i). The Company states that this demonstrates that the legislature was seeking to encourage these acquisitions when it passed the SVA. The Commission has interpreted the SVA similarly, stating that it “recognizes that the [SVA] promotes acquisitions . . . of small water and sewer systems by large public utilities, which benefit the customers of small acquired systems with improved service.” *Ill.-Am. Water Co. & Sundale Util., Inc.*, Docket No. 17-0113, Order at 3 (Jan. 25, 2018).

The Company notes that Mr. Larkin-Connolly’s proposed disallowance and the methodology that underlies it, however, would have the effect of disincentivizing water utilities from pursuing these acquisitions. As ILAWC witness O’Neill testified, Mr. Larkin-

Connolly's proposal would "harm customers by limiting ILAWC's ability to make investments in acquired systems." The Company maintains that this is not what the legislature intended when it passed the SVA.

The Company states that the AG's disallowance and underlying methodology are not only contrary to the plain language of the Act, but also ignore the intent and purpose of Section 9-211 of the Act in a way that renders that provision meaningless. The AG asks the Commission to ignore the prudence of the Company's individual projects and adopt a blanket and generic disallowance that would render meaningless Section 9-211 of the Act, which provides that ILAWC is entitled to include in its rate base the "value of such investment which is both prudently incurred and used and useful in providing service to public utility customers." 220 ILCS 5/9-211. The Company notes that this is contrary to Illinois law, which holds that that courts "must avoid an interpretation that would render a statute insignificant, meaningless, inoperative, or nugatory." *Pembroke Environ. Justice Coalition v. Ill. Com. Comm'n*, 2023 IL App (3d) 220108, ¶ 18; *Commonwealth Edison Co. v. Ill. Com. Comm'n*, 398 Ill. App. 3d 510 at 523 (2d Dist. 2009) ("[A] court may not interpret a statute in such a manner as to render any part of it meaningless"); *People v. Bartlett*, 294 Ill. App. 3d 435 at 439 (2d Dist. 1998).

AG witness Larkin-Connolly proposes a methodology that he claims accurately captures a typical level of investment in a recently acquired water or wastewater system. He then recommends that any spending above the level that he considers typical should be disallowed. This is the entire basis for his proposed \$25,285,441 disallowance and for his conclusion that the Company's due diligence process is inadequate. Mr. Larkin-Connolly's methodology is flawed, and should be rejected, for several reasons.

The Company asserts that aside from Mr. Larkin-Connolly's exclusion of recent water and wastewater systems in his calculation, there are several additional issues with Mr. Larkin-Connolly's analysis. The Company explains that it is flawed overall in the sense that a typical level of investment does not exist. Each system has unique challenges that must be addressed to support the provision of safe and reliable service to customers. These issues are not always foreseeable even after investigation into the system's attributes and capabilities. As ILAWC witness O'Neill testifies, there are certain issues that may not be known to the Company until it takes possession of, and tries to operate, a system. Once the Company undertakes its initial evaluation, it makes its best estimate to predict the amount of investment that will be required. However, the estimate is just that—an estimate. Unanticipated issues arise, and the Company must address them for safety and reliability reasons. The Company notes that there could be improvements that need to be made to address regulatory compliance and safety and security, which can be in addition to the initial investment the Company makes and anticipates.

Further, ILAWC notes that in his testimony, Mr. Larkin-Connolly only discusses acquired systems where the amount the Company is spending is higher than what he considers typical. He recommends disallowances on seven systems but does not acknowledge the six systems where the Company is spending less than his typical standard. This necessarily skews the results of his analysis because he suggests penalizing the Company for what he believes is overspending while failing to credit the Company for amounts below his threshold. If Mr. Larkin-Connolly were truly concerned

about the impact of post-acquisition investment on customers, then, similar to his development of the typical investments across all customers, he should be looking at investments in the acquired systems collectively, not just selecting the systems where investment was more than his typical standard.

The Company explains that in addition to the technical flaws with Mr. Larkin-Connolly's analysis, there are substantive flaws as well. Mr. Larkin-Connolly's analysis does not address the prudence, reasonableness, or necessity of any singular investment or group of investments in the systems for which he is proposing disallowances. Simply put, he does not contend that any of the Company's post-acquisition investments are imprudent, unnecessary, or unreasonable. Rather, he adopts a blanket approach to address investments that must be considered on an individual or project basis. The Company states that this violates the Act.

The Company notes that an additional problem with the blanket approach Mr. Larkin-Connolly proposes is that it would negatively affect the Company's customers in newly acquired systems. The Company explains that the blanket approach would arbitrarily limit recovery of the cost of improvements that the Company could make and needs to make in acquired systems, which are often in a state of disrepair and in need significant investment. The customers of these distressed systems (often systems in disadvantaged areas in downstate Illinois) often experience substandard service quality prior to acquisition, and in fact a common driver of the decision of system owners to sell is their inability to undertake the investment needed to comply with ever more stringent water and wastewater regulations. ILAWC states that its investments help ensure that these customers have access to safe, adequate, and reliable service going forward. The Company contends that Mr. Larkin-Connolly's proposal ignores the benefits provided to these customers in newly acquired systems.

The Company asserts that it has provided ample information to justify the post-acquisition costs at issue in this rate case. ILAWC Exhibit 3.02 details investment projects greater than \$1 million in value that the Company anticipated would go into service during 2024 and the Test Year. The Company states that not only did Mr. O'Neill provide justifications for these select improvements in Exhibit 3.02, but as an attachment to his rebuttal testimony, he also provided a specific breakdown of investments for the seven systems that the AG identified as above a typical level of investment. For each of these systems, ILAWC Exhibit 17.04 provides a list of recurring projects and a list of projects required to address safety, compliance, or operational issues. For each project, there is an estimated 2022-2025 cost, a project description, and project purpose, all in chart format. The Company also provided supporting justification in discovery.

The Company states that Mr. Larkin-Connolly also contends that his analysis demonstrates the Company's due diligence process is inadequate. This is because, in his view, the Company is investing more than is typical in several water and wastewater systems, so it follows that the Company must not be undertaking an adequate investigation to determine how much investment will be needed. The Company notes that, as an initial matter, it is improper to draw any such conclusion where, as explained above, Mr. Larkin-Connolly's methodology suffers from several fatal flaws. In addition, his conclusion that the Company's due diligence process is lacking is independently incorrect as well.

ILAWC witness O'Neill testified at length about the Company's due diligence process. He explained that for each acquisition, the Company conducts an on-site review and a review of available data that is provided by the water or sewer system. In an on-site review, representatives of Engineering, Operations, Water Quality, and Safety travel to the site of the water or sewer system. They conduct an in-depth, hands-on examination of the facilities and equipment and discussions with the staff for the system on its operation and any issues of which the Company needs to be aware.

With respect to data review, the Company explains that it requests detailed information from the owner/operator of the system it is considering acquiring, including: budgets (current and previous years); a detailed asset list including size, length, material, age, and manufacturer; operational data of the facilities; capital spend projections; permits and any compliance directives; facility layouts and equipment information; water quality and environmental compliance reports; Notices of Violation received over the past five years; Public Notices sent out over the past five years; maintenance records of facilities; records of system performance; parcel and easement information; and facility inspection information. The Company conducts a thorough review of these records. The Company explains that this list is not exhaustive. 220 ILCS 5/9-210.5(c)(3).

For distressed systems, once the on-site reviews and analysis of available data are complete, the Company discusses areas of concern that may lead to issues with regulatory compliance for the systems. For distressed systems, information regarding on-going Notices of Violation and operational reports is reviewed to determine what improvements or operational changes may be enhanced to improve the opportunity of the systems to meet regulatory compliance.

The Company notes that, while the Company endeavors to obtain as much information as possible about the system it is considering acquiring, it is not always feasible, especially where the system is in a state of disrepair.

The Company explains that, as noted above, certain issues may not be known to the Company until it attempts to operate a system. While the Company makes its best effort to predict the amount of investment that will be required, it is an estimate and is not guaranteed. The Company maintains that it is unreasonable to expect that the Company will be aware of every issue with a system before it takes possession. The Company observes that to suggest otherwise would be to ignore the nature of system acquisitions.

The Company states that the AG's argument that it does not provide sufficient information to the Commission in the underlying acquisition dockets because another water utility, Aqua Illinois, Inc. ("Aqua") provides capital plans that identify its planned system investments for its first five-to-ten years of ownership of the acquired systems is irrelevant. The Company explains that ILAWC and Aqua are two differently situated utilities operating in different areas and with different customer bases. What one utility decides to provide with its filing is not dispositive, and that does not alone require ILAWC to provide the same information. Moreover, the discovery process is available in the acquisition dockets if Staff seeks additional information. ILAWC looks to the Act, and specifically the SVA, to determine what is required in its acquisition filings, and such plans are not required by the statute. The Company notes that the AG does not argue otherwise. The Company further states that the AG does not contend, nor could it, that

ILAWC has failed to fully participate in the acquisition dockets or that it has failed to respond sufficiently to any discovery sought of it, including any discovery about its planned investments. The Company maintains that this comparison, is, therefore, inapt and should be disregarded.

The Company notes that AG witness Larkin-Connolly recommends certain additional requirements that the AG believes should be implemented in all future acquisition cases. The Company asserts these recommendations are both unnecessary and contrary to law. The AG first proposes that ILAWC be required to comply with additional reporting requirements both during and after the pendency of all future acquisition dockets. The Company states that this includes extensive reporting about the Company's capital plan, a new "detailed risk assessment," disclosure of expert qualifications, and post-acquisition annual reporting for the first 5-10 years after an acquisition has been approved.

The Company states that the AG also recommends that the Company implement contingency mechanisms; suggesting risk sharing arrangements in the transaction agreement ILAWC signs with prior owners, "the creation of a shareholder funded account that would be used to fund investments above a specified threshold" or an economic test to demonstrate that the revenues of a system over the first 5-10 years will be greater than its costs and so there is no cross-subsidization.

The Company asserts that, to begin with, Mr. Larkin-Connolly's proposals, which were raised for the first time in rebuttal testimony, are not sufficiently defined or explained to be meaningful. The Company argues that, in addition, the proposals, even in their summary form, are clearly unnecessary. As explained by the Company in briefing, the AG's conclusion that the due diligence process for system acquisitions is insufficient is without basis. First, it is based on Mr. Larkin-Connolly's flawed calculation of a typical level of investment into an acquired water system. Second, the Company has provided more than sufficient evidence and detail regarding the investigations it conducts into water systems it is considering acquiring, and the AG has failed to successfully rebut that evidence. Third, that the Company does not provide the same information as a separate water utility in its acquisition dockets does not indicate the Company's process is inadequate.

The Company maintains that these new acquisition docket requirements are premised on the argument that the Company's current process is flawed. Because the Company believes the AG has failed to establish that is the case, the entire premise for the recommendations fails, and so too must the recommendations themselves.

The Company further argues that both sets of recommendations—the reporting requirements and contingency mechanisms—are contrary to law, specifically the SVA, which is part of the Act, and the associated Part 285 regulations. The Commission's "acts or orders which are beyond the purview of the statute are void." *City of Chi. v. Ill. Com. Comm'n*, 79 Ill. 2d 213 at 217-18 (1980); 220 ILCS 5/10-201(e)(iv). The Company maintains that implementation of the AG's proposed requirements, being contrary to the Act, is therefore not permitted.

The Company explains that the SVA sets forth clear, detailed, and unambiguous statutory language governing the acquisition of water and/or wastewater systems by large

investor-owned utilities, including the establishment of ratemaking rate base of that water and/or sewer system, the valuation of those systems, the determination of rates applicable to the acquired systems, and accounting and reporting requirements associated with the acquisition of those systems. 220 ILCS 5/9-210.5. The SVA very clearly and unambiguously does not discuss, identify, or require cost-benefit or net present value tests, presentation of capital plans, investment projections, or cost variances when considering and approving the acquisition of a system under those statutory provisions. The Company maintains that the AG's efforts to impose what amount to new statutory requirements are contrary to the plain language of the SVA and are beyond the scope of what is relevant and proper in this Section 9-201 proceeding. The Company explains that further, this approach is contrary to Illinois law, which holds that courts "may not read out of a statute a limitation that the legislature expressed nor may we impose a condition that the legislature did not enact." *Commonwealth Edison Co.*, 398 Ill. App. 3d at 523; *McTigue v. Personnel Bd. of the City of Chi.*, 299 Ill. App. 3d 579 at 589 (1st Dist. 1998).

Additionally, the Company argues, Parts 285 and 287 of Title 83 already establish the minimum information requirements that the Company must provide in support of its proposed costs in a rate case. The Company explains that it has met and will continue to meet its direct filing requirements in this and future rate case proceedings. However, to the extent the AG seeks additional information about the Company's capital investments, the Company explains that the AG can and should avail itself of the existing procedural avenues available—through discovery, testimony, and cross-examination. The Company asserts that imposition of additional informational requirements is unnecessary, is in conflict with the Illinois Administrative Code and the Act and would result in unnecessary additional costs that are ultimately borne by the Company's customers. See ILAWC Ex. 30.00 at 10.

Similarly, the Company explains that the SVA does not mention any contingency mechanisms of the kind proposed in AG witness Larkin-Connolly's Table 4, and certainly does not make the approval of an acquisition dependent on whether the Company has met the conditions the AG discusses. The Company notes that the SVA is a detailed statute. See, e.g. 220 ILCS 5/9-210.5. It already includes specific provisions on the effect of acquisitions on the rates of the utility's existing customers. 220 ILCS 5/9-210.5(d). The AG's proposed conditions would improperly add to or change these statutory requirements. As stated, the Commission cannot read a requirement into the statute that was not contemplated by the legislature, and accordingly, it should reject the AG's recommendations. See *City of Chi.*, 79 Ill. 2d at 217-18.

The Company asserts that the AG's proposed contingency mechanisms are individually flawed as well. The Company maintains that requiring "risk sharing arrangements in the transaction agreement ILAWC signs with prior owners," would impose limitations on the ability of the Company to engage in arm's length transactions with system sellers. The Commission lacks the authority to order the "creation of a shareholder funded account that would be used to fund investments above a specified threshold" as that would improperly prevent the utility from recovering its prudently incurred and reasonable cost to serve customers. 220 ILCS 5/1-102(a)(iv); *Citizens Util. Bd. v. Ill. Com. Comm'n*, 166 Ill. 2d 111 at 121 (1995); *Ill. Bell Tel. Co. v. Ill. Com Comm'n*,

414 Ill. 275 at 286 (1953). An economic test to demonstrate that the revenues of a system over the first 5-10 years will be greater than its costs and so there is no cross-subsidization would improperly conflict with the existing SVA provisions regarding the impact of acquisitions on customer rates. The Company explains that moreover, such a requirement would represent a move away from the consolidated pricing for ILAWC's service areas, contrary to the Commission's long history of moving ILAWC towards single tariff pricing for all its service areas. Docket No. 22-0210, Order at 147.

b. AG's Position

The AG asks the Commission to disallow \$25,285,441 in unreasonable and imprudent water and sewer costs that resulted from ILAWC's failure to justify the level of spending or adequately assess the conditions of seven water and sewer systems it recently acquired. The AG notes that ILAWC asks the Commission to significantly increase its water utility plant-in service ("UPIS") to \$2,886 million (an increase of \$556 million, or 24% above its 2023 water UPIS) and its sewer UPIS to \$764 million (an increase of \$270 million, or 55% above its 2023 sewer UPIS). AG Ex. 2.00 REV at 46, 49. These increases primarily result from ILAWC's acquisition of and capital spending on purchased water and sewer systems, which "account for approximately 60%" of ILAWC's total requested rate base increase. *Id.* at 36, 38, ILAWC Ex. 1.0 at 9.

Between 2022 and year-end 2023, ILAWC spent \$20.6 million to acquire eight new water systems and an additional \$14.9 million in capital investments on those systems—representing 6.9% of ILAWC's total water plant investments since its last rate case. AG Ex. 2.00 REV at 47-48. These acquisitions added 5,305 new customers to ILAWC's service territory, representing 1.8% of the Company's 293,579 water customers. *Id.* at 48. In other words, 6.9% of ILAWC's plant investments were made to serve just 1.8% of its water customers. *Id.* ILAWC also included 2024 and 2025 plant investments in its 2025 future test year. *Id.* at 48–49. Out of the \$391.14 million in water plant additions that ILAWC plans to make in 2024 and 2025, \$10.93 million will be spent on its recently acquired water systems, and an additional \$1.06 million will be spent to acquire another water system—the City of Mounds' water system, which the Commission approved in March 2024, after ILAWC filed this rate case. Docket No. 23-0405, Order (March 21, 2024); *Id.* at 49. Together, the water acquisition and plant addition costs represent 3.1% of ILAWC's proposed 2024–2025 water plant additions. *Id.*

Over the same period, the AG notes that ILAWC spent \$12.9 million to acquire five new sewer systems and an additional \$12.44 million in capital investments on those systems—representing 11.6% of ILAWC's total sewer plant investments since its last rate case. AG Ex. 2.00 REV at 50–51. These acquisitions added 3,939 new customers to ILAWC's service territory, representing just 5.7% of the Company's 69,135 sewer customers. *Id.* at 51. In other words, 11.6% of ILAWC's sewer plant investments were made to serve just 5.7% of its sewer customers. *Id.* ILAWC also included 2024 and 2025 plant investments in its 2025 future test year. *Id.* at 51. Out of the \$236.35 million in sewer plant additions that ILAWC plans to make in 2024 and 2025, \$3.62 million will be spent on its recently acquired sewer systems, and an additional \$97.87 million will be spent to acquire the Granite City wastewater treatment plant, Metro East Sanitary District, and City of Madison sewer system. *Id.* at 51–52; Docket No. 23-0304, Order (Jan. 31,

2024). Together, the sewer acquisition and plant addition costs represent 41.4% of ILAWC's proposed 2024–2025 sewer plant additions. *Id.*

The AG points out that ILAWC failed to provide the Commission with any specifics on the conditions of the seven water and sewer systems for which the AG recommends disallowances, nor did ILAWC tell the Commission the amount that it intended to invest in these systems. AG Ex. 2.00 REV at 55. Instead, in each case, ILAWC witness Brent O'Neill stated only that the Company had not developed a "comprehensive list of improvements" and that it expected to make capital investments that were "typical for this type and size" of system. *Id.* This lack of information is inconsistent with the information provided by other utilities. The AG explains that ILAWC's failure to provide any guidance on its planned investments aside from the generic statement that investments would be "typical for this type and size" of systems does not give the Commission, the AG, or other parties any benchmark to measure the reasonableness of the Company's plant additions.

With this lack of guidance in mind, AG witness Larkin-Connolly—a regulatory economist—assessed ILAWC's historical spending to estimate typical system investments. AG Ex. 2.00 REV at 56–57. ILAWC now argues that "a typical level of investment does not exist" and attempts to paint Mr. Larkin-Connolly's use of typical spending levels in his disallowance calculation as irrational. The AG iterates that the record establishes that Mr. Larkin-Connolly's analysis to determine typical investments is in response to Mr. O'Neill's repeated representations of this to the Commission, which the Company has since conspicuously refused to provide its own analysis for.

ILAWC claims that when acquiring a new system, it undertakes its initial evaluation, it makes its best estimate to predict the amount of investment that will be required. But the estimate is just that—an estimate. The AG argues that in seeking approval to acquire these systems, ILAWC did not provide any estimates to the Commission. Instead, the evidence shows it repeatedly referred the Commission to vague, general references of typical spending levels for each type and size of system. ILAWC now insists that typical spending levels do not exist. The AG maintains that the Company's circular position demonstrates its unreasonableness and imprudence, and it raises even more questions and concerns about what information the Company knew or should have known when it acquired these systems. The AG states Mr. Larkin-Connolly's analysis to determine typical spending levels is both reasonable and appropriate and that the Commission should reject ILAWC's position as the record strongly suggests that the Company either did not attempt to calculate its anticipated investments when acquiring these systems or has since failed to provide any quantitative evidence of anticipated spending to the Commission.

The AG contends that Mr. Larkin-Connolly's method for calculating typical spending levels is not flawed. Mr. Larkin-Connolly looked at the costs of average additions per customer and average additions per thousand gallons ("kGAL") on ILAWC's existing system and compared these to the additions on its newly acquired systems. *Id.* at 57–59. He applied a weighted average of the per customer and per kGAL amounts to derive the combined typical spending levels that reflected both the size and usage of each system. *Id.* at 60. As shown on the Tables 1 and 2 of this exhibit, for the seven systems where the AG recommends disallowances, ILAWC exceeded its typical level of

investment in amounts ranging from 73.28% to an astonishing 1,168.71%. *Id.* at 63: Table 11; *Id.* at 61: Table 8.

Based on his analysis, Mr. Larkin-Connolly testified that the data strongly suggested that ILAWC failed to conduct reasonable due diligence into system conditions, resulting in investment levels well above the Company's typical investments. ILAWC claims that Mr. Larkin-Connolly's analysis is flawed because he excluded the thirteen recently acquired systems when determining the Company's typical spending levels. However, the AG points out that the purpose of Mr. Larkin-Connolly's analysis was to compare the Company's spending on these new systems to the amounts that the Company has historically (or typically) spent. The AG asserts that had Mr. Larkin-Connolly included the other systems within his historical assessment, that would incorrectly skew the results by preliminarily and unreasonably labeling the Company's recent spending as typical. While the Company claims Mr. Larkin-Connolly's analysis was designed to support a pre-determined conclusion, the AG explains that the record evidence shows that Mr. Larkin-Connolly took the most reasonable approach to determine the Company's typical spending levels, absent any estimated spending data from the Company.

The AG states the Company's claim is untrue that Mr. Larkin-Connolly only discusses the seven acquired systems where the amount the Company is spending is higher than what he considers typical but does not acknowledge the six systems where the Company is spending less than his typical standard. Mr. Larkin-Connolly's testimony shows that he reviewed all thirteen of the Company's recently acquired systems, determined that the Company spent above typical levels in seven of the thirteen systems, and recommended disallowances for those seven systems. AG Ex. 2.00 REV at 59:Table 6, 60:Table 7. The AG notes the Company has a duty to adequately manage its system and ensure that its costs are reasonable and prudent. 220 ILCS 5/1-102; *id.* at 9-201(c). The AG asserts that it is unreasonable for the Company to claim that it should be excused from prudently managing its spending on some acquired systems because it claims it controlled its spending on other acquired systems; and that ILAWC cannot support \$25 million in imprudent spending by highlighting these other unchallenged investments.

ILAWC seeks to justify its outsized investments by emphasizing that the Commission approved these acquisitions under Section 9-210.5 (or the SVA) and that system conditions were allegedly undiscoverable at the time of acquisition. The AG explains that ILAWC failed to establish that these costs were justified by Section 9-210.5, that the Company conducted reasonable due diligence before acquiring these systems—or that the costs of ILAWC's failure to adequately and accurately assess the conditions of acquired systems were reasonable and prudent and should be shifted to ratepayers.

The AG states that Section 9-210.5 allows the utility to collect the accumulated or deferred cost of capital related to post-acquisition investments in the next rate case but does not allow it to depreciate that investment for ratemaking purposes until the next rate case or four years, whichever is sooner. This is a major departure from traditional ratemaking, which prohibited the deferral and accumulation of the cost of capital on investment. See *BPI II*, 146 Ill.2d 175, 240 (1992).

The AG explains that aside from implementing this non-recovery period for depreciation expenses, Section 9-210.5 does not mandate how the Commission treats the effect of post-acquisition investments on ratepayers. However, it does indicate an expectation that existing customers will not be unreasonably impacted by acquisition costs as state below:

Any acquisition of a water or sewer utility that affects the cumulative base rates of the large public utility's existing ratepayers in the tariff group into which the water or sewer utility is to be combined by less than (1) 2.5% at the time of the acquisition for any single acquisition completed under this Section or (2) 5% for all acquisitions completed under this Section before the Commission's final order in the next rate case shall not be deemed to violate Section 7-204 or any other provision of this Act.

220 ILCS 5/9-210.5(d). ILAWC's sewer acquisitions account for 15.62% of its step one revenue requirement and 15.08% of its step two revenue requirement. Therefore, the AG notes that this provision does not protect ILAWC's request to include its sewer acquisition and post-acquisition costs in its test year rate base. The AG further explains that while ILAWC's water acquisitions fall below this threshold this does not mean that these investments are *per se* reasonable. Instead, like in all cases, ILAWC must demonstrate with a preponderance of the evidence that its costs are reasonable and prudent. 220 ILCS 5/9-101; 220 ILCS 5/at 9-201(c); *id.* at 9-211. The AG concludes that the record evidence demonstrates that ILAWC failed to meet its burden.

The AG states that the General Assembly's concerns about the rate impacts of acquisition costs demonstrate that it did not intend to allow large water and sewer utilities like ILAWC to drive up the rates of existing customers by overshooting their typical spending levels by as much as 1,168.71%. Doing so contravenes the basic requirement of the Act that rates be provided in a manner that is equitable and affordable for all customers. 220 ILCS 5/1-102.

The AG maintains that Section 9-210.5 does not excuse ILAWC from the Act's basic prudence requirements, nor does it state that large utilities must purchase small water and wastewater systems regardless of the costs to repair and maintain those systems. 220 ILCS 9-201(c). The AG contends it is imprudent for a sophisticated buyer like ILAWC to purchase water or sewer systems without conducting sufficient due diligence as to the systems' conditions and needed investments.

A basic premise of utility regulation is that these essential, capital-intensive services can be provided at a lower cost if the utility can utilize economies of scale to minimize unit costs. See AG Ex. 2.00 REV at 65-66. In light of this basic concept, one would expect that reasonable and prudent acquisitions would provide benefits to both the acquired customers (by spreading costs over more customers and sales) and existing customers (by increasing economies of scale and so decreasing unit charges). However, in this docket, the facts show that the magnitude of investments in the new systems undermines these benefits. The AG points to the record, which demonstrates that ILAWC is seeking to significantly increase the rates for all ratepayers because it did not

sufficiently investigate the conditions of these systems before acquiring them, resulting in post-acquisition investments that substantially exceed the Company's typical investment amounts. The AG argues that ILAWC's poor planning and overspending will inevitably (and unfairly) shift the risk of the Company's lack of knowledge about the acquired systems entirely on its customers, primarily its existing customers. AG Ex. 2.00 REV at 65.

While the AG does not ask the Commission to disallow the costs that ILAWC spent to acquire these systems—which were previously approved by the Commission in the relevant acquisition dockets—the AG maintains it would be unjust and unreasonable for the Commission to allow ILAWC to shift to ratepayers an additional \$25 million resulting from its poor management decisions. To remove the Company's imprudent investment costs, the AG asks that the Commission disallow \$22,450,477 in unreasonable and imprudent water capital costs and \$2,834,964 in unreasonable and imprudent sewer capital costs, for a total rate base disallowance of \$25,285,441.

The AG maintains that the record establishes that ILAWC failed to “conduct thorough due diligence on the level of underinvestment in the systems it seeks to acquire to ensure its investment does not burden the Company, its investors, and its customers.” AG Ex. 2.00 REV. at 64. “The core regulatory issue here is not just about the limitations ILAWC faced [when assessing acquired systems], but how ILAWC accounted for these limitations in its decision-making process and, crucially, how it communicated these uncertainties to the Commission during the approval process.” AG Ex. 4.00 at 37. “The fact that ILAWC is now seeking to recover investments far exceeding what should be considered ‘typical’ is either a failure in due diligence or a lack of transparency in its original acquisition proposals.” *Id.* at 37. The AG iterates that ILAWC has failed to meet its requisite burden of proof in this proceeding.

The AG further explains that the project-specific evidence that ILAWC provided in this proceeding also does not support the prudence of its \$25 million in excessive spending. Mr. O'Neill provided two examples of instances where ILAWC's excessive spending was allegedly justified. For the Villa Grove water system, ILAWC spent \$5.8 million (or 276%) above its typical investment amount. Mr. O'Neill claimed that \$3.1 million resulted from the Company discovering 559 lead service lines after acquiring the system. ILAWC Ex. 17.00 at 30–31. Mr. O'Neill stated that, prior to acquiring this system, the Company reviewed reports from the Illinois Environmental Protection Agency (“IEPA”) and spoke with the system's personnel, both of whom stated that there were no lead service lines in the system. *Id.* He did not state whether the Company examined any service lines prior to acquisition—only that these lines were discovered later “as the Company was working to change the existing meters.” *Id.* The AG notes that Mr. O'Neill's explanation also does not explain what issues caused ILAWC to spend the other \$2.7 million (or 74%) above its typical spending levels that is not accounted for by the lead service line replacements. While ILAWC Ex. 17.04 provides tables for each system showing the project type, amount, description, and purpose, the AG points out that it lacks the requisite detail on whether the projects were anticipated or not, what information the Company obtained about system conditions prior to acquisition, how projects were prioritized, or how the Company ensured that the costs were reasonable and prudent. The AG maintains that the lack of material information exemplifies the Company's failure

to conduct thorough due diligence and establishes the deficiencies and inadequacies of ILAWC's alleged visual inspections and discussions with sellers.

Similarly for the Village of Hardin water system, ILAWC spent \$5.6 million (or 1,169%) above the typical investment amount for a system of that size. Mr. O'Neill stated that \$2.275 million of these costs resulted from the Company discovering that it needed to replace pressure filters after acquiring the system. ILAWC Ex. 17.00 at 31. According to Mr. O'Neill, the Company originally planned to repair the filters, but later discovered "the interior mechanics of the pressure filters were found to be heavily corroded and, in most cases, unrepairable due to the loss of material on the inside of the lower portion of the vessels." *Id.* Again, Mr. O'Neill does not indicate the extent to which the filters were examined prior to acquisition or provide any additional information what due diligence, if any, the Company conducted on this infrastructure. Further, his testimony does not explain the remaining \$3.3 million (or 596%) that the Company spent above its typical investment level on this system. The AG asserts that the information provided in ILAWC Exhibit 17.04 does nothing to address and alleviate the material concerns it raised as to what and whether ILAWC knew about these improvements at the time of acquisition, whether these were included in the Company's projected typical investments, or whether these were part of the \$25 million in additional costs that ILAWC now seeks to wrongly shift onto ratepayers. In any instance, the AG asserts that what evidence is in the record is insufficient for ILAWC to meet its burden and does not enable the Commission to conclude that ILAWC's atypically large capital costs for these systems were reasonable and prudent.

The AG contends that a determination of reasonableness and imprudence must include addressing what the Company did (or did not do) to address "the relative costs of alternatives", which necessarily includes consideration of whether a utility's requests "constitute the least-cost means of meeting the utility's service obligations." Docket Nos. 23-0068/23-0069 (Cons.), Order at 10; 220 ILCS 5/8-401. The Commission has determined that a utility's failure to conduct due diligence is grounds to reject cost recovery. *See, e.g., N. Ill. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 20-0330, Order at 41 (June 15, 2023). The AG explains that ILAWC has failed to meet its burden that its post-acquisition costs are reasonable and prudent, and it cannot do so because the record establishes that ILAWC failed to "conduct thorough due diligence on the level of underinvestment in the systems it seeks to acquire to ensure its investment does not burden the Company, its investors, and its customers." AG Ex. 2.00 REV. at 64.

The AG challenges ILAWC's claims that its investments are supported by the American Society of Civil Engineers' ("ASCE") 2022 Infrastructure Report Card ("ASCE Report") which assigned Illinois' drinking water systems a D+ grade and the State's wastewater systems a C- grade. The AG explains that nowhere in the ASCE Report does it state or even imply that increased private capital investments from companies like ILAWC are the solution—or even a solution—to addressing the State's infrastructure needs. To the contrary, the ASCE Report focuses primarily on these systems accessing and relying on state and federal funds, and ensuring that "every citizen, stakeholder and decision-maker in Illinois understand the state of our infrastructure and where we can collectively work to improve it" and provides a "snapshot [that] enables us to track how our investments are doing while engaging in conversations about where we want to be

going in the future.” ILAWC Ex. 15.02 at 4. The ASCE Report expressly supports state and federal funding solutions, and not shareholder-owned utilities, to address the State’s infrastructure issues.

The AG asserts that the ASCE Report properly focuses on publicly owned systems. Further, while the ASCE Report suggests that small service providers could combine their resources to provide savings to their communities, nowhere in these recommendations does ASCE state—or even imply—that increased privatization is a solution, let alone a desirable one. *Id.* at 35. The ASCE Report emphasizes the necessity for utilities to take advantage of all available federal and state funding opportunities. ILAWC Ex. 15.02 at 35. It also includes a table that shows available federal funds to improve drinking water infrastructure from 2017–2021, noting “[h]istorically, Illinois receives approximately 4% of the available funding in this area.” *Id.* at 35–36.

The AG notes that available federal funding to improve Illinois’ drinking water systems increased by \$92.8 million or more than 15,000% from its low point in 2018 to 2021 and the ASCE Report notes that the Infrastructure Investment and Jobs Act (“IIJA”) should further increase funding over the coming years. The IEPA also provided an additional \$95 million in 2022 to help communities replace lead service lines. *Id.* at 35. The IEPA similarly provides \$20 million per year for communities to invest in wastewater infrastructure. The State also runs a Water Pollution Control Loan Program and two Unsewered Communities Grant Programs, which provide funding for the construction and improvement of wastewater treatment facilities. *Id.* at 104–109. The AG points out that IIJA and other federal programs have more than doubled federal funds available for wastewater projects in recent years. *Id.*

For these reasons, the AG request that the Commission disallow \$22,450,477 in water capital costs and \$2,834,964 in sewer capital costs, for a total rate base disallowance of \$25,285,441. In addition, the AG recommends that the Commission adopt Mr. Larkin-Connolly’s recommendations as set forth in Table 3 in AG Exhibit 4.0 on 42-43, which are comprised of items the Commission should request from the Company when considering future acquisition proposals. Mr. Larkin-Connolly’s recommendations are designed to enable the Commission to assess the effect of an acquisition on future rates by having ILAWC provide detailed information about its capital spending plans, acquisitions, and system conditions. AG Exhibit 4.0 at 42. The AG maintains that requiring this information from ILAWC will improve the analysis and review of its future acquisitions so that they are “fair” and “balanced,” which will, in effect, benefit and protect not only the Company’s customers, but also benefit the Company and its shareholders. *Id.* at 41.

c. Commission Analysis and Conclusion

ILAWC is seeking recovery of the cost of its investments in its systems since 2022. This includes the cost of investments in acquired water and wastewater systems. The Company explains that it has provided substantial and detailed evidence in support of the investments for which it seeks recovery. The Company explains that ILAWC provided a detailed exhibit containing information about the acquired systems in this proceeding. The Commission acknowledges that, following ILAWC’s acquisitions, some level of post-acquisition improvements may be required to repair and maintain existing distribution

facilities. Pursuant to Section 9-211 of the Act, the Commission must determine whether ILAWC's post-acquisition investments were prudently incurred and used and useful such that the costs should be included in the Company's rate base.

Each capital investment project is subject to a prudence review and should stand on its own merits. See e.g., *The Peoples Gas Light and Coke Co.*, Docket No. 17-0137, Order, at 17 (Aug. 14, 2024); *Northern Ill. Gas Co. d/b/a Nicor Gas Co.*, Docket No. 20-0330, Order, at 20 (June 15, 2023). A utility may recover only investments that are prudently incurred and used and useful in providing service to customers. See 220 ILCS 5/9-211. The burden of proving prudence is always borne by the Company while other parties have the opportunity to support or challenge the prudence of the investment. The AG has not engaged with the evidence supporting the prudence of the Company's investments or proposed project-specific adjustments. The AG has not objected to the work performed as imprudent or not used and useful.

The Commission finds the AG's methodology for calculating a "typical" level of investment unconvincing because it is technically flawed and obscures the relevant standard of review in this docket. The AG's calculation and analysis omitted the eight water and five sewer acquisitions completed since Docket 22-0210. Further, the methodology includes systems with post-acquisition investment proposals higher than what it considers "typical" while omitting systems where the Company is spending less than the "typical amount." AG Ex. 2.00 REV at 59-63. The unique nature of each system acquired by ILAWC and historical underinvestment in these systems call into the question the usefulness and accuracy of a "typical" system investment calculation. The Commission finds that capital project investments are not inherently imprudent due to the magnitude of spending beyond a generalized level. Rather, the Commission must review the Company's justification for each investment to determine it was prudently incurred and used and useful.

ILAWC's post-acquisition investments were needed to comply with regulatory standards, address safety risks, improve system resiliency and operational efficiency, and replace failing infrastructure. For each post-acquisition investment since 2022, ILAWC provided project descriptions and rationale, the purpose of each project, and corresponding dollar figures. See ILAWC Ex. 3.02; ILAWC Ex. 17.0; ILAWC Ex. 17.04. The Company has demonstrated the prudence and used and usefulness of each post-acquisition investment it seeks to recover. For these reasons, the AG's proposed adjustments are rejected, and ILAWC's costs are approved as proposed.

The AG recommends that the Commission adopt additional reporting requirements and standards for future acquisitions under the SVA, including: (1) a report on system investment needs assessment and capital investment plan; (2) a risk assessment and mitigation plan; (3) disclosure of the expert qualifications; (4) post-acquisition reporting; and (5) approval of future ILAWC acquisition agreement should be contingent on a mechanism that protects existing customers from the amounts identified in the acquisition capital plan.

The Commission is authorized to establish reporting requirements to assist in review of system acquisitions and subsequent investments in those systems. The

Commission is statutorily tasked with general supervision and ensuring public utilities are prioritizing reasonable investments and practices. See e.g., 220 ILCS 5/4-101 (the Commission shall generally supervise all public utilities and may keep itself informed as to various aspects of each utility); 220 ILCS 5/9-201(c) (rates and charges must be just and reasonable); 220 ILCS 5/9-210 (the Commission may ascertain the value of the property, new construction, extensions, and additions to every public utility and every fact which in its judgment may or does have any bearing on such value). The Commission has broad investigatory authority and “shall inquire into the management of the business thereof and shall keep itself informed as to the manner and method in which the business is conducted.” 220 ILCS 5/4-101. The Commission holds plenary power to determine rules or practices to be observed “and it shall fix the same by its order, decision, rule, or regulation.” 220 ILCS 5/8-501. “It is a well-established rule that the express grant of authority to an administrative agency also includes the authority to do what is reasonably necessary to accomplish the legislature’s objective.” *Abbott Lab. v. Ill. Commerce Comm’n.*, 289 Ill. App. 3d 705, 712 (1st Dist. 1997).

A prudent decision requires assessment of system conditions and realistic investment forecasts, particularly when those costs will ultimately be borne by ratepayers. In the system acquisition approval proceedings, ILAWC did not provide any specific information on the investment needs of each system. AG Ex. 2.0 at 55. The Commission shares the AG’s concerns about ILAWC’s due diligence and investigation prior to and during acquisition of each system and finds more information during the approval proceeding is necessary. Consideration of the Company’s planning and due diligence is not a new standard of review. See e.g., *Nicor Gas Co.*, Docket No. 20-0330, Order at 26. An understanding of the Company’s planning process from acquisition through post-acquisition investments is relevant to the Commission’s prudence review. The Commission notes that ILAWC does not have an inherent obligation to acquire smaller water systems simply because they are at risk. The SVA expressly provides that a utility is not required to acquire a system under the act. See 220 ILCS 5/9-210.5(k).

The Commission finds that four of the AG’s reporting requirements are reasonable. Accordingly, for all acquisitions under the SVA following the date of this final Order, the utility shall provide: (1) a comprehensive report on the system to be acquired, including an investment needs assessment and a capital investment plan; (2) a risk assessment and mitigation plan identifying potential areas of concern or uncertainty in system evaluations; (3) explanation of the Company’s investigation into the system, including disclosure of the qualifications of any investigators or members involved in system assessment or auditing; and (4) post-acquisition reporting, including an update to Commission Staff if estimated costs are exceeded.

In this proceeding, multiple parties have raised concerns regarding the affordability of ILAWC’s water and wastewater rates. See *generally* Village of Bolingbrook’s Position Statement; AG Position Statement at 2. The Commission received hundreds of public comments in this docket from ILAWC customers, many of which allege rates are already too high. The Commission acknowledges the AG’s assertion that there are federal and State funding programs available to improve Illinois’ water and wastewater systems. The Commission encourages ILAWC to examine these opportunities in future acquisitions to supplement or substitute ratepayer costs.

3. Depreciation on Post-Acquisition Investments

a. ILAWC's Position

The Company explains that Section 9-210.5(i) of the SVA, 220 ILCS 5/9-210.5(i), incentivizes post-acquisition investment by postponing depreciation on post-acquisition investments for four years or until a rate case, whichever is sooner. Specifically, the Company points out that Section 9-201.5(i) states that: “[a]ny post-acquisition improvements made by the large public utility in the water or sewer utility shall not be depreciated for ratemaking purposes from the date on which the expenditure was incurred by the large public utility until the investment has been in service for a 4-year period or, if sooner, until the time the rates are implemented in the large public utility’s next rate case.”

ILAWC states that based on its understanding of the intent of Section 9-210.5(i), to postpone depreciating post in-service acquisition improvements for a period of time after the assets are placed in service and the accounting rules that dictate that depreciation must begin once the assets are placed in-service, the Company determined that Section 9-210.5(i) requires the establishment of a regulatory asset (“deferral”) as an offset.

ILAWC states that both Staff and the AG proposed alternatives to the Company’s approach. Staff witness Siebert proposed an alternative approach to deferred depreciation on post-acquisition improvements. The Company further states that this adjustment removes its proposed regulatory asset for depreciation and a portion of the related amortization expense, resulting in an adjustment that allows one year of depreciation expense and one year of accumulated depreciation on the post-acquisition improvements for the 2025 test year and zero accumulated depreciation or depreciation expense for the years between the in-service date of the post-acquisition improvements and the 2025 test year. ILAWC understands that Staff believes this proposed adjustment follows the intent of the SVA of delaying the impacts of post-acquisition improvements depreciation. Staff Ex. 11.0 at 23.

The Company states that it has accepted Staff’s proposed adjustment for the purposes of this proceeding. However, the Company contends that implementation of this proposal will cause the Company to have to reevaluate its accounting on this matter specific to the definition and interpretation of “for ratemaking purposes” as used in the SVA, and therefore ILAWC reserves the right in future rate cases to revisit the appropriate treatment of delaying depreciation expense on post-acquisition improvements. ILAWC Ex. 32.0 at 11.

The Company states that it opposes the AG’s adjustment, which, because it simply removes the depreciation deferral, completely removes the opportunity for the Company to benefit from postponing depreciation expense. The Company details that this is contrary to the SVA’s express benefit to the Company allowing it to postpone depreciation expense on improvements made to acquired systems.

ILAWC understand that Staff also disagrees with the AG’s adjustment. The Company points out that in testimony, Staff witnesses stated that the AG’s adjustment does not remove the accumulated depreciation on post-acquisition improvements from the time the improvements were placed into service to the time they are being placed into

rate base. Absent removal of this accumulated depreciation, the Company explains that SVA would have no effect on the rate base value of the Post-Acquisition Improvements, and so would be treating them the same as any other utility plant placed into service between rate cases. ILAWC agrees with Staff's conclusions on this issue, which confirm that the AG's proposal would be contrary to the requirements of the SVA.

The Company notes that, in briefing, the AG appears to offer a new interpretation of Section 9-210.5(i) of the Act, one not previously raised in testimony. The Company states that, to begin, the AG's interpretation is not entirely clear from the AG's Initial Brief, which starts by saying Section 9-210.5(i) represents a change from normal accounting but then concludes by saying compliance with Section 9-210.5(i) should follow normal accounting. AG IB at 30, 35. Nevertheless, according to ILAWC, the AG appears to advocate for an interpretation of Section 9-210.5(i) that would render the provision "post-acquisition improvements made by the large public utility in the water or sewer utility shall not be depreciated for ratemaking purposes" meaningless. ILAWC Ex. 32.0 at 11. This would obviously be contrary to fundamental principles of statutory construction. *Sylvester v. Indus. Comm'n*, 197 Ill. 2d 225, 232 (2001).

The Company notes that the AG recognizes the plain language of the statute states that the post-acquisition improvements "shall not be depreciated for ratemaking purposes" during the first four years or, if less than four years, the time between the date the expenditure was incurred, and the date rates are implemented in the utility's next rate case. However, the Company explains, the AG then proposes that the purported "plain language" means something totally different from what it actually says, and includes words not contained anywhere in the actual language: that ILAWC cannot defer, delay, or in any manner cause the accrual of depreciation expense during the Non-Recovery Period to be recovered from ratepayers. Clearly, ILAWC maintains, the provision does not say this which violates fundamental principles of statutory construction since the Commission cannot read words into the statute that are not there. *Land v. Bd. of Educ. of City of Chi.*, 202 Ill. 2d 414 at 421 (2002).

ILAWC states that with little citation to the record, and no obvious basis in their witnesses' testimony, the AG suggests various accounting and ratemaking consequences of ILAWC's and Staff's proposed approach. The Company maintains that the meaning of the "shall not be depreciated for ratemaking purposes" language is much simpler than the AG's convoluted discussion of accounting for depreciation suggests. The Company notes that, as Staff agrees, it means that for ratemaking purposes the asset is depreciated starting at four years or, if less than four years, the time between the date the expenditure was incurred, and the date rates are implemented in the utility's next rate case. The Company explains that Staff's proposal accomplishes this, by allowing one year of depreciation expense and one year of accumulated depreciation on the post-acquisition improvements for the 2025 test year and zero accumulated depreciation or depreciation expense for the years between the in-service date of the post-acquisition improvements and the 2025 test year. The Company observes that this is also consistent with the intent of Section 9-210.5(i) to incentivize post-acquisition investment.

ILAWC asserts that the AG's position is also flawed because it argues that the statutory language does not authorize 'deferral' or 'delay' of depreciation or imply that depreciation from the Non-Recovery Period can be recovered after the end of the asset's

depreciable life. According to ILAWC, Section 9-210.5(i) authorizes exactly this. It delays depreciation for ratemaking purposes for a period of time—either four years or until the next rate case.

The Company explains that the AG's concern that for ratemaking purposes, depreciation would be recovered after the end of an asset's book depreciation life is unfounded, for two reasons. First, the Company explains that it is the logical outcome of "shall not be depreciated for ratemaking purposes." Second, any benefit to the utility at that point is not unreasonable: although there may be test year depreciation expense for ratemaking purposes for the asset, almost the entire value of the asset in rate base would be offset by accumulated depreciation.

The Company also explains that the AG's proposal causes the exact concern that Staff was worried about. According to ILAWC, the AG interprets the depreciation provision of Section 9-210.5(i) to require ordinary ratemaking treatment. The Company maintains that if that were the case, there would be no need for the provision, and therefore the AG's interpretation renders it meaningless. The Company states that this is contrary to the basic rules of statutory interpretation and should be rejected.

The Company thus opposes the AG's adjustment, because it completely removes the opportunity for the Company to benefit from postponing depreciation expense. AG Ex. 1.01 REV, Schedule A-11; ILAWC Ex. 32.00 at 11. This is contrary to the SVA's express benefit to the Company allowing it to postpone depreciation expense on improvements made to acquired systems. ILAWC agrees with Staff's conclusions on this issue, which confirm that the AG's proposal would be contrary to the requirements of the SVA. Staff Ex. 11.0 at 25. For these reasons, ILAWC recommends that the Commission adopt Staff's proposed treatment, as agreed to by the Company, for the purposes of this case, and reject the AG's adjustment.

b. Staff's Position

Staff recommends the Commission approve the deferred depreciation on Post-Acquisition Improvements presented in Staff Cross Exhibit 3.0 at 5.

Staff explains that the Company requested authorization to amortize deferred balances for post-in-service Allowance for Funds Used During Construction or ("AFUDC") and post in-service deferred depreciation on Post-Acquisition Improvements on acquired systems in the Central Water and Central Wastewater divisions. ILAWC Ex. 5.00 at 5. ILAWC requests amortization of the balances over a four-year period arguing that request is allowed by Section 9-210.5(i) of the Act. *Id.*

In response to the AG, Staff presented an alternative approach. Staff's adjustment removes the Company's proposed regulatory asset for depreciation on the Post-Acquisition Improvements, a portion of the related amortization expense, the accumulated depreciation on the Post-Acquisition Improvements for the 2025 test year, and zero accumulated depreciation or depreciation expense for the years between the in-service date of the Post-Acquisition Improvements and the 2025 test year. Staff Ex. 11.0 at 23. Staff's adjustment was updated to remove the entire related amortization expense and accumulated deferred income tax. Staff Cross Ex. 3.0 at 5. Staff's adjustment delays the depreciation on the Post-Acquisition Improvements until 2025, the approximate time that

rates from this rate case will be implemented. *Id.* Staff's alternative approach allows for a balance between the ratepayer's interests and the Company's interests and follows the intent of the SVA, of delaying the impacts of Post-Acquisition Improvements depreciation. 220 ILCS 5/9-210.5.

The AG argues that the SVA does not authorize the deferral of depreciation expense for future recovery. AG Ex. 3.00 at 24-25. Staff disagrees with the AG's position because the AG's adjustment does not remove the accumulated depreciation on Post-Acquisition Improvements from the time the Post-Acquisition Improvements were placed into service to the time they are being placed into rate base. Staff Ex. 11.0 at 25. Absent removal of this accumulated depreciation, the SVA would have no effect on the rate base value of the Post-Acquisition Improvements because, essentially, the Post-Acquisition Improvements would start depreciating at the time they are placed into service. *Id.* That is exactly the same treatment as any other utility plant placed into service between rate cases. *Id.*

Staff states that according to the SVA, Post-Acquisition Improvements shall not start depreciating until four years after being placed into service or until the time rates are implemented in the next rate case, whichever is sooner. This language provides a delayed approach to depreciation. Staff argues its adjustment follows the SVA and strikes a balance between ratepayer and Company interests.

Staff notes that the AG's primary argument is that Staff's adjustment, as agreed to by the Company, allows the utility to recover the financing costs on improvements after the project has been placed in service without reducing that cost for depreciation expense and also to recover the depreciation expense for the same period up to four years after the end of the asset's depreciable life. *Id.* at 32. The AG argues that Staff's adjustment, as agreed to by the Company, is a major departure from traditional ratemaking and provides a significant benefit to the Company and its shareholders. However, Staff highlights that as explicitly mentioned by the AG, this "departure" is required by Section 9-210.5(i) of the Act. *Id.* at 28. Absent a legislative change to the statute, the Company is permitted to delay depreciation on Post-Acquisition Improvements. Staff also notes that its alternative approach follows the intent of the SVA and balances the ratepayer's interests and the Company's interests, insofar as much as the SVA permits.

The AG laments the significant benefits the SVA provides to the Company. However, Staff asserts the AG's arguments cannot overcome the Commission's requirement to follow its enabling statute. An administrative agency has only such powers as allowed under its enabling statute. *Cont'l Mobile Tel. Co. v. Ill. Com. Comm'n*, 269 Ill. App. 3d 161, 167 (1st Dist. 1994). On the contrary, the AG's adjustment completely removes deferral of depreciation expense, entirely removing the incentive offered to the Company in the SVA and treating depreciation exactly the same as any other utility plant placed into service between rate cases. AG Ex. 1.01 REV, Schedule A-11. Staff concludes that its adjustment, as accepted by the Company, is the only proposal that follows the SVA.

For these reasons, Staff recommends the Commission approve its adjustment to the Company's Post-Acquisition Depreciation, as accepted by the Company.

c. AG's Position

The AG points to Section 9-210.5(i) which states, “post-acquisition improvements made by [ILAWC] . . . shall not be depreciated for ratemaking purposes from the date on which the expenditure was incurred by the large public utility until the investment has been in service for a 4-year period or, if sooner, until the time the rates are implemented in the large public utility's next rate case.” 220 ILCS 5/9-210.5(i). The AG recommends that book depreciation commence at the in-service date, the accepted practice, wherein the gross balance of the asset is reduced by the accrual of depreciation during the Non-Recovery Period and shareholders fund the recovery of depreciation expense during the Non-Recovery Period, as affirmed by the Illinois Supreme Court in *BPI II*. See 146 Ill. 2d at 231; see also *id.* at 239 (emphasis added).

The AG asserts that in this manner, under ordinary ratemaking principles, the post-acquisition improvements are not depreciated for ratemaking purposes. However, Section 9-210.5(i) allows the utility to recover the cost of capital or “carrying charges” after the plant is placed in service, but before it is recognized in rates. The relevant portion of Section 9-210.5(i) provides that the utility may “accrue a cost for financing set at the large public utility's determined rate for allowance for funds used during construction, inclusive of the debt, equity, and income tax gross up components, after the date on which the expenditure was incurred by the large public utility until the investment has been in service for a 4-year period or, if sooner, until the time the rates are implemented in the large public utility's next rate case.” 220 ILCS 5/9-210.5(i).

The AG maintains that contrary to the Company's assertion, ILAWC's initial approach to the above depreciation—creation of a regulatory asset—is contrary to Section 9-210.5(i), as the language of the statute does not “require” or otherwise authorize this form of cost recovery. Moreover, the AG contends that the alternative approach presented by Staff and accepted by ILAWC, is also contrary to Section 9-210.5(i) and would allow ILAWC to collect the depreciation expense that accumulated between rate cases, or during the Non-Recovery Period. Much of the Company's capital investment was made within four years of this rate case, but contrary to the clear and unambiguous language of Section 9-210.5(i)—which expressly prohibits depreciation for ratemaking purposes from the date on which the expenditure was incurred by ILAWC until the investment has been in service for a 4-year period or, if sooner, until the time the rates are implemented in the Company's next rate case—ILAWC asks the Commission to adopt an unusual accounting approach to allow it to set the depreciation reserve for these assets to zero through January 1, 2025, despite the fact that they were in-service months and years before that date. ILAWC Ex 32.00 at 11; Staff Ex. 11.0 at 22–26. The AG argues ILAWC would begin depreciating the assets in the test year in this rate case, thereby extending the depreciable life by up to four years. ILAWC Ex 32.00 at 11; Staff Ex. 11.0 at 22–26.

The AG explains that under this proposal, the Company delays recording book depreciation, resulting in a larger rate base because the investment is not offset by any depreciation despite being placed in-service up to four years earlier. Further, ratepayers would pay the depreciation expense up to four years longer than the asset's depreciable life, effectively recovering the depreciation that accumulated during the Non-Recovery Period for ratemaking purposes. See ILAWC Ex. 32.00 at 12.

The AG maintains that the Commission should reject both ILAWC's and Staff's proposal because the statute does not authorize this recovery. The AG avers that it is evident that when viewing Section 9-210.5 through the lens of well-established principles of statutory construction that ILAWC's request should fail. The plain language of the statute could not be clearer: post-acquisition improvements "shall not be depreciated for ratemaking purposes" during the first four years or, if less than four years, the time between the date the expenditure was incurred, and the date rates are implemented in the utility's next rate case. *Id.* Yet, the AG states, Staff and the Company maintain that the language somehow provides for a delayed approach to depreciation. Put simply, nothing in the statute supports this interpretation. The Company cannot depreciate post-acquisition improvements for ratemaking purposes, meaning it cannot defer, delay, or in any manner cause the accrual of depreciation expense during the Non-Recovery Period to be recovered from ratepayers. The AG contends this means that the depreciation on the full amount of the improvements begins when the asset is placed in-service, consistent with ordinary ratemaking practices when an asset is placed in-service between rate cases.

The AG explains that ILAWC's interpretation would allow the Company to recover the depreciation that accrued between rate cases and during the Non-Recovery Period at the end of the asset's depreciable life, which reads into the statute a benefit that is nowhere to be found. The Company argues its interpretation is correct and that the AG's interpretation is contrary to Section 9-210.5's express benefit to the Company allowing it to postpone depreciation expense on improvements made to the acquired systems. Contrary to this assertion, there is nothing in the statute that expressly or implicitly allows the Company to postpone depreciation expense for ratemaking purposes. The statutory language does not authorize postponement, deferral, or delay of depreciation or imply that depreciation from the Non-Recovery Period can be recovered after the end of the asset's depreciable life. See 220 ILCS 5/9-210.5(i).

The AG notes that ILAWC believes it is entitled to a benefit from the statute, but neither the Company nor Staff acknowledge carrying charges, which is a substantial benefit to the Company. In suggesting the Company can recover deferred depreciation, ILAWC seeks to effectively recover depreciation for the Non-Recovery Period in addition to carrying charges on the undepreciated asset and the deferred depreciation that it recovers from ratepayers. The Company's request, in effect, nullifies the language that the improvements "shall not be depreciated for ratemaking purposes" during the Non-Recovery Period. It also results in charging customers a carrying charge on the same costs twice.

The AG further notes that the statute explicitly states that the utility "shall accrue a cost for financing" for four years or until the next rate case (when financing costs would be included in rates). 220 ILCS 5/9-210.5(i). The statute treats depreciation differently, stating that the post-acquisition improvements "shall not be depreciated for ratemaking purposes" during the Non-Recovery Period. The authorization to accrue the cost for financing post-acquisition improvements represents a substantial benefit to the utility in that the utility is allowed to continue to accrue a carrying charge, AFUDC, after the project has been placed in service but before it is included in rates. See *BPI II*, 146 Ill. 2d at 231, 237–241. In *BPI II*, the court noted that depreciation is an expense subject to test-year

principles, and while specific deferred post-in service carrying costs were allowed to be recovered in that case, the “recovery of deferred depreciation violates the test-year principles.” *Id.* at 239. The AG states that the Company’s proposal in this proceeding (i) would allow the utility to recover the financing costs on improvements after the project has been placed in service without reducing that cost by depreciation expense, and also to recover the depreciation expense for the same period up to four years after the end of the asset’s depreciable life. It is the AG’s position that recovery of the deferred depreciation upsets the balance of shareholder and ratepayer interests that is part of the statutory plan, violates the plain terms of the statute, and is contrary to *BPI II*.

The AG contends that ILAWC’s proposal creates confusion and raises multiple accounting issues also. Despite adopting Staff’s approach, ILAWC expressed concerns about this approach. The Company indicates that this proposal will cause ILAWC to have to reevaluate its accounting on this matter specific to the definition and interpretation of “for ratemaking purposes” as used in the Section 9-210.5(i). Notably, ILAWC cites issues concerning used and useful plant. ILAWC Ex. 32.0 at 12. ILAWC even notes the “negative impacts to customers” as an accounting concern. *Id.* The AG states that its recommendation resolves these concerns. Along with being the approach that complies with the language and intent of Section 9-210.5(i), the AG’s recommendation uses straightforward and well-established accounting procedures and complies with test-year principles. See *BPI II*, 146 Ill. 2d at 237-243.

For these reasons, the AG requests that the Commission adopt the AG’s recommendation. In its Initial Brief, the AG’s recommended adjustment for deferred depreciation was based on the Company’s post-surrebuttal position. AG IB Attach (Sch. A-11); See AG IB REV at 35. However, the AG clarifies that if the Appendix to the Order begins with the Company’s surrebuttal position, the AG recommends the adoption of its deferred depreciation adjustment as presented in AG Exhibit 3.01 (Sch. A-11). The AG explains that the Company adopted Staff’s position on deferred depreciation in surrebuttal testimony but did not reflect that adjustment in its surrebuttal revenue requirement. The Company included the adjustment in its post-surrebuttal revenue requirements provided as AG Cross Ex. 2 (DRR AG 12.01). If the Appendix to the Final Order begins with the Company’s surrebuttal position, the Commission should adopt the AG’s position premised on the Company’s surrebuttal numbers that was presented in Ms. Selvaggio’s rebuttal testimony as AG Exhibit 3.01 (Sch. A-11), which reduces rate base by \$1,570,601 and reduces depreciation expense by \$46,072. See AG Ex. 3.01 (Sch. A-11).

d. Commission Analysis and Conclusion

The Commission finds Staff’s recommended adjustments to the Company’s Post-Acquisition Depreciation to be consistent with the statutory language of Section 9-210.5(i) of the Act. Staff’s adjustment removes the Company’s proposed regulatory asset for depreciation on the Post-Acquisition Improvements, a portion of the related amortization expense, the accumulated depreciation on the Post-Acquisition Improvements for the 2025 test year, and zero accumulated depreciation or depreciation expense for the years between the in-service date of the Post-Acquisition Improvements and the 2025 test year. Staff’s adjustment was updated to remove the entire related amortization expense and accumulated deferred income tax. Staff’s adjustment delays the depreciation on the Post-Acquisition Improvements until 2025, the approximate time that rates from this rate case

will be implemented. The Commission cautions that the Company's references to "deferred" depreciation and use of a regulatory asset for depreciation on the Post-Acquisition Improvements may be misleading.

The AG's interpretation of the SVA is not persuasive. The AG added a term "Non-Recovery Period" which is not a part of the SVA. Commencing depreciation at the Post-Acquisition Improvement in-service date, as the AG recommends, is clearly contrary to the plain language of the SVA. The AG's interpretation of the SVA is to treat Post-Acquisition Improvements the same as a traditional plant investment. However, this interpretation renders that section of the SVA irrelevant. No additional statutory guidance would have been necessary if the legislative intent of the SVA was to maintain the status quo regarding Post-Acquisition Improvements depreciation.

The Commission agrees with Staff that the SVA is a deviation from traditional ratemaking and requires the delay of depreciation on the Post-Acquisition Improvements. The Commission does not agree with the AG's argument, and Staff's recommended adjustments to the Company's Post-Acquisition Depreciation are approved.

4. Cash Working Capital Methodology

a. ILAWC's Position

ILAWC states that cash working capital ("CWC") is the amount of funds necessary to finance the day-to-day operations of the Company and is included in the determination of a utility's rate base. ILAWC states that CWC bridges the gap between the time when funds are provided to the Company by investors to allow the Company to provide service to customers, and the time revenues are received from customers as reimbursement for these services. ILAWC further states that working capital is included in rate base to compensate investors for the use of their funds over and above their investment in plant, and to provide investors with a return on the funds required by the Company for daily operations.

CWC witness Walker determined ILAWC's CWC requirement by conducting four lead-lag studies to determine the timing of ILAWC's cash inflows and outflows, and analyzing the level of funding required to operate on a day-to-day basis. The Company points out that ILAWC Exhibit 40.01 summarizes ILAWC's CWC requirements reflecting updated revenues and expenses from the Company's recommended revenue requirement. The Company states that the CWC requirement in Central Division is \$6,399,000. The Company details that the CWC requirement in the Chicago Metro is - \$215,000 (negative); the CWC requirement in the Central Wastewater is \$713,000; and the CWC requirement in the Pekin is \$126,000. ILAWC Ex. 41.00 at 14.

b. Staff's Position

Staff recommends the Commission approve the CWC adjustments presented on Staff's Initial Brief Appendices, Schedule 8.

Staff presented an adjustment to CWC to reflect Staff's proposed level of operating expense. Staff Ex. 10.0 at 4; Staff Sched. 10.08. There is no dispute between Staff and the Company on the method of calculating CWC. Staff Ex. 10.0 at 4; ILAWC Ex. 28.00 at 2. However, CWC is contingent on contested revenue requirement items. The final

balance will be established using the revenue requirement and methodology that is ultimately approved by the Commission in this proceeding.

c. Commission Analysis and Conclusion

No parties dispute the use of ILAWC's lead/lag methodology for calculating CWC. The Commission finds ILAWC's methodology is reasonable and it is adopted. The CWC is contingent on contested revenue requirement items as well as certain lead/lag days as discussed further below. The final balance will be established using the revenue requirement and methodology that is ultimately approved by the Commission in this proceeding.

5. Staff's Adjustment for OPEB Related Expense

a. ILAWC's Position

In direct testimony, ILAWC explains, Staff supported using the Company's total Group Insurance expense 11.4 lead days, which was a weighted composite that included both Group Insurance and Other Post-Employee Benefits ("OPEB"). ILAWC Ex. 14.01, Sch. HW-10.

Then in rebuttal testimony, ILAWC states, Staff changed its recommendation to include the OPEB negative expense in revenues as a positive amount to offset the OPEB negative expense included in the CWC formula. Staff Ex. 11.0 at 3-4; Staff Sch. 11.01, 2, line 6. In response, ILAWC witness Walker stated that OPEB related negative expenses should not be included in determining net revenues, but he could not respond to the proposal because Staff had not explained it. Mr. Walker further noted that there were flaws in the calculation. ILAWC Ex. 40.00 at 2-3.

According to ILAWC, Staff now presents a third position—one which was never introduced on the record. The Company explains that for the first time in its Initial Brief, Staff introduces an "alternative proposal" that revises its rebuttal position to disaggregate the negative OPEB expense from the Group Insurance category in determining CWC. Staff's Initial Brief contends that "The Company should have completed the same disaggregation for OPEB negative expense from the Group Insurance expense and provide the expense lead days accordingly. Staff IB at 13. Because the Company rejected Staff's proposal to include the noncash OPEB negative expense in CWC revenues in its surrebuttal testimony, Staff did not have an opportunity to respond or provide any alternative. Thus, Staff now recommends disaggregating the negative OPEB from the Group Insurance category and assign zero OPEB lead days as the Company agrees that no cash payment is necessary for the test year. Staff's alternative proposal is provided in Schedule 8 to its Initial Brief. *Id.*

ILAWC states Staff's position in its brief discussing the disaggregation of OPEB expense in CWC was not presented in the testimony of any witness and Staff's Brief Schedule 8, although it includes certain data points from the evidentiary record, is not itself part of the evidentiary record. Thus, ILAWC maintains, Staff's proposed treatment of OPEB expense in the CWC calculation represents an improper post-record proposal that is not supported by the record evidence and should be rejected.

The Company further notes that Staff's presentation of a new, alternative proposal on CWC is inconsistent with Staff's position on the treatment of post-record corrections

related to ADIT proration. On that issue, despite acknowledging the need for corrections to the ADIT proration, Staff recommends the Commission rely on ILAWC's surrebuttal exhibits which Staff alleges are incorrect.

The Company explains that, in other words, Staff recommends the Commission adopt a post-record alternative for OPEB expense in CWC, but also argues the Commission should not adopt post-record corrections to ADIT proration.

The Company notes it has agreed that the prorated ADIT adjustment provided in the Company's surrebuttal testimony exhibits should be used. The Company stands by that position. However, should the Commission adopt Staff's post-record alternative on OPEB expense in CWC, the Company maintains that the Commission should also, in the interests of fairness, consistency, and a complete and accurate record, also adopt ILAWC's corrected ADIT proration, which was provided in the Appendix to ILAWC's Reply Brief.

b. Staff's Position

In rebuttal testimony, Staff recommended the OPEB negative expense be included in revenues as a positive amount to offset the OPEB negative expense included in the CWC formula. Staff Ex. 11.0 at 3-4; Staff Sch. 11.01 at 2, line 6. The Company rejected Staff's proposal, claiming that Staff did not explain or justify the inclusion of OPEB related negative expenses in determining net revenues in the current case. Staff Cross Ex. 2.0 at 3.

Staff argues that the Company's CWC calculation is flawed because the Company includes a positive OPEB expense within the Group Insurance component and assigned lead days as a prorated amount. See Staff Cross Ex. 2.0 at 2. No party objects to the fact that OPEB is a negative (i.e. noncash) expense in the revenue requirement. See *id.* at 3. However, the Company fails to recognize the impact on CWC for the noncash nature of OPEB negative expense.

It is not reasonable in Staff's view to assign an expense lead higher than zero to a noncash component of CWC due to the lack of a cash component of the expense transaction. CWC reflects cash flows, and without a determinable cash outflow (i.e. when the Company is making no cash contribution), the expense lead becomes zero days.

Further, there is no reasonable basis to assign the same expense lead days to the noncash OPEB expense within the other Group Insurance payments. The OPEB payment cycle is different (due to actuarial calculations) and can become negative as observed in this proceeding. The other Group Insurance costs, which are traditionally monthly billing of premiums, are primarily positive expense costs.

Staff explains that the Company appropriately disaggregated other CWC components. The Company should have completed the same disaggregation for OPEB negative expense from the Group Insurance expense and provide the expense lead days accordingly.

Staff asserts that because the Company rejected Staff's proposal to include the noncash OPEB negative expense in CWC revenues in its surrebuttal testimony, Staff did not have an opportunity to respond or provide any alternative. Thus, Staff now recommends disaggregating the negative OPEB from the Group Insurance category and

assigning zero OPEB lead days as the Company agrees that no cash payment is necessary for the test year. Staff's alternative proposal is provided in Schedule 8 in the Appendices to its Initial Brief. Staff recommends the Commission approve this alternate proposal.

Staff agrees with ILAWC that, given Staff's removal of OPEB expense from the Group Insurance expense line item, the lead days for the Group Insurance expense line item should be 10.5 days. Staff's use of 10.5 lead days is reflected in Staff's Initial Brief Appendices. See, e.g., Staff IB, Appx. A, Sch. 8. From Staff's Initial Brief and Initial Brief Appendices, Staff maintains the OPEB lead days should be zero days. See, e.g., Staff IB at 12; Staff IB, Appx. A, Sch. 8 at line 18. Staff notes that the AG supports its recommendation of zero lead days for OPEB.

c. Commission Analysis and Conclusion

The Commission typically does not consider proposals raised for the first time in briefs. However, the Commission agrees with Staff that circumstances in this docket warrant a different approach.

The Company submitted a substantial update to its Part 285 schedules for the first time in rebuttal testimony. Such updates, while permitted by Part 287.30 of the Commission's rules, are conditioned on "whether the Illinois Commerce Commission staff and other participants will have an adequate opportunity to review the updated information." 83 Ill. Adm. Code 287.30(b)(3). The Company's update resulted in significantly less time for Staff and Intervenors to review the Company's proposals. On this truncated schedule, Staff and Intervenors only had one opportunity to file testimony concerning the Company's updated proposals, instead of two.

In rebuttal testimony, Staff submitted corrections to the Company's schedules because the Company failed to recognize the impacts of its OPEB negative expense on its CWC calculation. Staff argues that CWC reflects cash flows, and it is not reasonable to assign an expense lead higher than zero to a noncash component of CWC due to the lack of a cash component of the expense transaction. As explained by Staff, the Company should have disaggregated the OPEB negative expense from the Group Insurance expense and provided the expense lead days accordingly, like it had disaggregated other CWC calculation components. In surrebuttal testimony, the Company objected to Staff's proposal, stating that Staff had failed to fully explain it. However, the Company failed to provide any justification for its decision to disaggregate other CWC calculation components and not disaggregate OPEB expense from the Group Insurance expense. Due to the schedule in this proceeding, Staff had no opportunity in testimony to respond to the Company's argument or to offer a counterproposal.

The Commission agrees that refusal to consider Staff's proposal under these circumstances would be prejudicial to Staff. "The core of due process is the right to notice and a meaningful opportunity to be heard; no person may be deprived of a protected interest by an administrative adjudication of rights unless these safeguards are provided." *Adams Cty. Prop. Owners & Tenant Farmers v. Ill. Com. Comm'n*, 2015 Ill App (4th) 130907, ¶ 45 (Jul. 20, 2015) (internal quotations omitted). "[I]n the context of an administrative proceeding, due process is satisfied when the party concerned has the

opportunity to be heard in an orderly proceeding which is adapted to the nature and circumstances of the dispute.” *Id.*, (internal quotations omitted).

The Commission must ensure fairness and avoid prejudice to parties’ ability to respond to testimony. See 83 Ill. Adm. Code 200.25(b). In this docket, Staff was afforded less time and fewer opportunities to be heard due to the Company’s Part 285 schedule update. Part 287.30 of the Commission’s rules permit the Company to make such an update, but the Commission’s rules cannot be used as a method to prevent a party from an opportunity to be heard. Instead, Section 200.25 of the Commission’s rules dictate that Commission discretion shall be exercised to accomplish integrity, fairness, expedition, convenience, and cost-effectiveness. See 83 Ill. Adm. Code 200.25.

There is no requirement in the Act or the Commission’s rules that the Commission may only approve proposals that are explicitly and completely stated in a witness’s testimony. The Commission’s rules dictate “[t]he hearing process should be tailored where practicable to accommodate the parties, staff witnesses, the Hearing Examiner and the Commission itself.” 83 Ill. Adm. Code 200.25(d). The Commission often approves modifications to parties’ proposals that were not explicitly endorsed by any one witness in testimony. The Commission is authorized to approve such proposals, but only if they are supported by sufficient record evidence.

The Commission finds that Staff’s proposal to disaggregate the negative OPEB from the Group Insurance category and assign zero OPEB lead days is supported by the record. Accordingly, Staff’s proposal as laid out in Staff’s IB Appendices, Schedule 8 is approved. Although Staff first made this proposal in its Initial Brief, both Staff and the Company agree that the proposal is based on data within the record.

6. AG Adjustment to Pension/OPEB Lead Days

a. ILAWC’s Position

ILAWC complains that the AG also presents post-record adjustments for the lead days for pension and OPEB expense, which the AG claims are supported by AG Cross Exhibit 2. However, the Company states it did not accept using zero lead days for pension and OPEB expense. Further, ILAWC explains, the AG’s own CWC witness, Ms. Selvaggio, recommended in testimony the same lead days for pension and OPEB expense as recommended by the Company. AG Ex. 1.01 REV, Sch. A-6.

ILAWC states that for the first time in its Initial Brief, the AG proposes that the Commission order the Company to use zero lead days for pension and OPEB expense in calculating CWC. This proposal was not raised in the testimony of AG’s witnesses, or any other witness. ILAWC explains that instead, the AG relies on a cross exhibit data response to support its position. AG Cross Ex. 2 at 34-35. As a result of not presenting the proposal in testimony, ILAWC contends that it has been deprived of the opportunity to fully investigate and respond to the proposal, including through discovery, expert analysis, responsive testimony, and cross examination. Cf. Docket No. 24-0097, Commission Findings on Petition for Interlocutory Review (Sep. 12, 2024) (allowing testimony from AG witness Larkin-Connolly because parties had the “opportunity to address Mr. Larkin-Connolly’s rebuttal testimony through discovery and cross-examination...”). ILAWC notes that, as the Commission recently concluded in this docket,

“parties should litigate issues in good faith so that testimony is not needlessly delayed or curtailed and comprehensive responses to requests for information are timely provided, as required by the Commission’s rules.” *Id.* The Company maintains that the AG’s introduction of a new proposal in its Initial Brief would seem inconsistent with this directive.

ILAWC further explains that the consequences of waiting until briefs to make new proposals can be seen in the incomplete record on this issue. The Company notes that the AG relies on two prior Commission decisions as the basis for its proposal, Commonwealth Edison Co., Docket No. 14-0312, Order (Dec. 10, 2014). The Company explains that, in so doing, the AG ignores the most recent and on point Commission decision—ILAWC’s last rate case, Docket No. 22-0210, where the Commission approved a CWC calculation that did not set the pension and OPEB lead days to zero. See Docket No. 22-0210, Order, Appendix A at 8.

Regardless, ILAWC explains that the facts and circumstances underlying the decisions in Docket Nos. 14-0312 and 17-0124 are not similar to ILAWC’s facts and circumstances in this case. AG Cross Ex. 2 at 34. For example, the ComEd docket was decided under the formula rate law, not Article IX of the Act. Docket No. 14-0312. In the Nicor docket, Nicor had a pension asset—here ILAWC has a pension liability. Cf. Docket No. 17-1024, Order at 21. Nicor also had a positive OPEB expense; ILAWC has a negative. Cf. Docket No. 17-1024, Order App., Sch. 9 at 1 and AG Cross Ex. 2 at 3. The Company adds that had the AG proposed the change in OPEB expense lead days in testimony, these differences could have been addressed in a more complete record. With only briefing on the subject, the perspective of both ILAWC’s expert witness and the AG’s witness is missing (and in fact the filed testimony supports ILAWC’s position).

ILAWC explains that the rationale behind the Commission’s conclusion in both cases that the AG relies on—to avoid double counting a reduction in rate base, is exactly what the AG is proposing to do in this proceeding. ILAWC has agreed to deduct its pension liability from rate base, and the AG’s proposal reduces rate base a second time. For these reasons, ILAWC recommends the AG’s proposed change to OPEB expense in the CWC calculation be rejected.

b. Staff’s Position

Staff states the Company’s CWC calculation is flawed because the Company includes a positive OPEB expense within the Group Insurance component and assigned lead days as a prorated amount. See Staff Cross Ex. 2.0 at 2. No party objects to the fact that OPEB is a negative (i.e. noncash) expense in the revenue requirement. See *id.* at 3. However, the Company fails to recognize the impact on CWC for the noncash nature of OPEB negative expense. Staff argues it is not reasonable to assign an expense lead higher than zero to a noncash component of CWC due to the lack of a cash component of the expense transaction. CWC reflects cash flows, and without a determinable cash outflow (i.e. when the Company is making no cash contribution), the expense lead becomes zero days. Staff maintains the OPEB lead days should be zero days. See, e.g., Staff IB at 12; Staff IB, App. A, Sched. 8, line 18. Staff notes the AG supports its recommendation of zero lead days for OPEB. AG IB (Rev.) at 36.

c. AG's Position

The AG requests that the Commission order the Company to use zero lead days for pension and OPEB expense in CWC to ensure the Company is accurately reflecting its rate base reduction. AG Cross Ex. 2 at 34-35. Staff also recommends this proposal, although Staff's appendix does not reflect this. Staff IB at 12; Staff IB App. A-D, Sch. 8. The Company proposes using negative 2.5 lead days for pension and 8.9 lead days for Other Benefits. ILAWC Ex. 14.01. ILAWC's proposal is incorrect and causes an increase in CWC, thereby increasing rate base, which results in higher costs for ratepayers. The AG points out that this approach has been rejected by the Commission in favor of applying zero lead days to pension and OPEB expense when a pension and/or OPEB liability is included as a reduction to rate base. See Docket No. 14-0312, Order at 10; Nicor Gas Company d/b/a Nicor Gas, Docket No. 17-0124, Order at 21 (Jan. 31, 2018).

The AG avers that its recommendation to use zero lead days for pension and OPEB expense in CWC is most consistent with Commission practice and will ensure the Company's CWC balance is accurately reflected and does not inaccurately increase rate base to the detriment of ratepayers. Thus, the AG asks the Commission to adopt its position and reduce rate base by \$39,030 as shown on AG IB Attach (Sch. A-5).

d. Commission Analysis and Conclusion

As discussed in Section III.B.4 of this Order, there is no requirement in the Act or the Commission's rules that the Commission may only approve proposals that are explicitly and completely stated in a witness's testimony. The Commission is authorized to approve only proposals supported by sufficient record evidence. The Commission may consider the AG's proposal to assign zero lead days to pension and OPEB expense even though it was offered for the first time in the AG's Initial Brief. While the Commission retains discretion to consider such proposals, the Commission strongly cautions parties that proposals submitted outside of witness testimony may not be accepted.

The issue before the Commission, therefore, is whether the AG's proposal is supported by sufficient record evidence. The Commission finds it is not. The AG attempts to support its proposal based on a cross-exhibit data response. AG Cross Ex. 2 at 34-35. However, the AG fails to provide a clear explanation or record support of its proposal. The scant testimony on this matter has left the Commission with an incomplete record for consideration. For these reasons, the AG's proposal is rejected, and the Commission adopts the Company's proposed pension lead days. The Commission adopts zero lead days for OPEB expenses, as described in Section III.B.4.c.

7. AG Adjustment to Service Company Expense Lead Days

a. ILAWC's Position

The Company explains that AG witness Selvaggio recommends increasing the lead days for service company expense by 36.42 days, which would change the lead days for service company expense from -3.2 (negative) days to 33.22 days. ILAWC Ex. 28.00 at 3. The recommended 33.22 lead days for service company expense was based on the weighted average expense leads for the payment of general office expense, maintenance – other expense, and miscellaneous expense. ILAWC states that Ms.

Selvaggio claimed the “Company is paying its affiliates quicker than its non-affiliated vendors and represents a form of cross-subsidization,” but provides no evidence substantiating any asserted cross-subsidization. ILAWC Ex. 28.00 at 3.

ILAWC notes the AG does not dispute the amounts owed by ILAWC to the Service Company—the AG’s only concern is timing of the payments. But, ILAWC explains, the AG made similar arguments in a previous ILAWC rate case, Docket No. 11-0767. In that case, the Commission rejected a similar proposed reduction in ILAWC’s service company expense lead days, and the Commission should do the same in this case.

In Docket No. 11-0767, ILAWC states, Staff testified, “[t]he evidence in this proceeding supports the Company’s position to base the payment lag on prepayments to the service company. The Company prepays their service company as required in the service company agreement approved by the Commission.” ILAWC Ex. 48.00 at 8-9; *also see* Docket No. 11-0767, Staff Ex. 9.0 at 9. In Docket No. 11-0767, the Company’s lead-lag study determined the lead days for service company expense was -9.22 (negative) days and the AG recommended increasing it by 22.29 days because, “The payment lag applied to [Service Company] payments should be adjusted to commercially reasonable terms; this substantial affiliated transaction should not be permitted to unnecessarily increase rate base via the creation of an unreasonable CWC requirement.” ILAWC Ex. 48.00 at 9; *also see*, Docket No. 11-0767, AG Exs. 2.0 at 48; 2.2, Sch. B-4 at 1. In Docket No. 11-0767, the Commission agreed with the Company’s and Staff’s positions. See Docket No. 11-0767, Order at 28.

ILAWC explains that the AIA between the Service Company and ILAWC remains unchanged since its approval in 2005, and by extension since the Order was issued in Docket No. 11-0767. However, the AG now believes the expense lead days for service company expense should be changed. Given that the Commission previously rejected the AG’s proposal, and that the AIA has not changed, ILAWC maintains the Commission should reject the AG’s proposals for that reason alone. Regardless of the prior decision, ILAWC notes that the AG proposes an adjustment that conflicts with the terms of the approved AIA, and the adjustment should also be rejected for that reason.

Next, ILAWC explains that notwithstanding the Docket No. 11-0767 Order, ILAWC’s lead days for service company expense (*i.e.*, -3.2) reflects the terms of the Commission approved AIA which was approved by the Commission in Docket No. 04-0595. *Ill.-Am. Water Co.*, Docket No. 04-0595, Order (Oct. 19, 2005). The AIA establishes that payment of service company expenses shall be paid by Water Company within a reasonable time after receipt of bill. According to ILAWC, a reasonable time after receipt of the bill is defined as the amount of time which is fairly necessary, conveniently, to do whatever is required to be done, as soon as circumstances permit.

ILAWC elaborates that the Service Company exists to provide services to American Water affiliates at cost. The Service Company’s billing terms match expenses with the receipt of payments from affiliates, which are the beneficiaries of the services provided. The Service Company makes no profit from the provision of services. A payment of three days before (*i.e.*, 3.2) the mid-point of the service period for the at-cost Service Company bill is a reasonable provision to support cash expenses and payroll incurred on behalf of ILAWC by the Service Company according to the Company. Similar

services provided by a private company include a markup for profit on their services provided. Therefore, services provided by the Service Company reduce the cost of the services provided relative to similar services provided by a private company. Conversely, according to ILAWC, AG witness Selvaggio recommends delaying payment arbitrarily which is a clear contract violation. Since ILAWC is bound by a Commission-approved contract, the Company must follow the terms of it and does not have the option of delaying payment as advocated by Ms. Selvaggio. Accordingly, ILAWC states adopting Ms. Selvaggio recommendation simply bars ILAWC recovery of a prudently incurred cost. ILAWC Ex. 41.00 at 12-13.

The Company maintains that Ms. Selvaggio's theory that ILAWC should have the lead days for service company expense increased because the average payment time for non-affiliates is longer also ignores that the circumstances are not parallel. ILAWC explains that the types of services non-affiliate vendors provide are vastly different, as are their billing practices. Ms. Selvaggio's developed her recommended 33.22 lead days for service company expense based on the weighted average expense leads for the payment of general office expense, maintenance – other expense, and miscellaneous expense. The Company notes that private companies provide the services provided by general office expense, maintenance – other expense, and miscellaneous expense service providers. As such, these private companies include a markup for profit on their services provided along with the cost of their other cost of service items, including working capital.

Additionally, ILAWC explains, expense lead days are comprised of three components: service period lead days; billing lead days; and payment lead days. Two of these ILAWC has no control over. ILAWC only has partial control of the payment lead days component of the expense lead days, assuming it is within the terms of service. The Company adds that Ms. Selvaggio's recommendation did not consider the fact that ILAWC's partial control of the payment lead days portion of the expense lead days is dependent on the ease of verification of the invoiced service provided, including requisition, quality, quantity, and pricing. The Company explains that the time it takes for invoice payment depends on the invoicing details provided and the documentation provided with an invoice. In addition, depending on the type of service invoiced, different personnel and a different number of personnel are required for approval of each invoice's payment.

ILAWC also argues the decision in Docket No. 11-0721 relied on by the AG is not applicable in this proceeding. *Commonwealth Edison Co.*, Docket No. 11-0721, Order (May 29, 2012). In that proceeding, Staff proposed, and the Commission approved increasing intercompany payment lead days by 15 days. ILAWC explains that Staff's adjustment was based on analysis of differences in payment lead days, not expense lead days. Conversely, Ms. Selvaggio's recommended adjustment in this proceeding is based solely on differences in expense lead days, not differences in payment lead days. ILAWC explains that the wide variation in expense lead days for hypothetical vendors that all experienced the same payment lead days (*i.e.*, 15 days) yet have expense lead days ranged from 8.0 to 38.0 days. The Company contends that Ms. Selvaggio did not analyze differences in payment lead days, but rather only focused on differences in expense lead

days. Accordingly, the AG's recommended adjustment is not consistent with Docket No. 11-0721.

For these reasons, ILAWC recommends the AG's proposal be rejected.

b. Staff's Position

Staff states that the AG's adjustment to service company expense lead days should be approved. Staff Ex. 10.0 at 4-5. The Company argues that, because its AIA requires ILAWC to pay service company expenses "within a reasonable time after receipt of the bill," paying three days before the mid-point of the service period is reasonable and delaying that payment would be a clear contract violation.

Staff disagrees with ILAWC that this would be a clear contract violation of its AIA. First, the AG's adjustment is based on the weighted average expense leads for the payment of similar bills to outside contractors. If that is a reasonable amount of time to wait before paying its general office outside contractors, it stands to reason that it is a reasonable amount of time to wait before paying its service company affiliate. Second, all ILAWC's AIA requires is payment to its service company within a reasonable time after receipt of the bill. Despite ILAWC's reliance, USLegal.com does not determine how much time is reasonable; the Commission determines how much time is reasonable.

ILAWC further argues that the AG's adjustment should be rejected because: (a) the Service Company provides services to ILAWC at cost while other providers provide services to ILAWC for profit; and (b) two components of expense lead days ((i) service period lead days and (ii) billing lead days) are in the control of the vendor rather than ILAWC. Staff maintains the Company's reasons to continue to allow the Company to pay its own affiliate earlier than it pays outside vendors are unpersuasive. The Company should be reviewing the bills it receives from its service company with the same scrutiny that it applies to bills it receives from outside vendors. Furthermore, service lead days and billing lead days are in its own affiliate's control. ILAWC, through its affiliate, should not be allowed to manipulate its CWC in order to pay its own service company affiliate earlier than it pays outside vendors.

Staff observes that ILAWC attempts to distinguish this docket from Docket No. 11-0721. However, ILAWC's distinguishing points are either inaccurate or irrelevant. Most notably, ILAWC incorrectly states that there is no evidence of cross-subsidization in this docket. However, the fact that ILAWC pays its own affiliate much quicker than it pays outside vendors is *per se* cross-subsidization; that is the explicit Commission holding in Docket No. 11-0721. Docket No. 11-0721, Order at 48.

ILAWC further attempts, Staff says, to confuse the issue by claiming that Staff's recommendation of the AG's adjustment is based on a misunderstanding. However, this is not the case; Staff's understanding is clear as is Staff's recommendation. Staff Ex. 10.0 at 4-5. Staff asserts that ILAWC tries to misinterpret Staff's recommendation as a debate about payment lead days rather than expense lead days. However, Staff's choice to explain its proposal in a clear manner does not affect its recommendation for the Commission to adopt the AG's adjustment. Furthermore, if ILAWC had questions about Staff's recommendation or believed it to be based on a misunderstanding, Staff submits

that ILAWC had ample opportunity to clarify Staff's position both before and at the evidentiary hearing.

Staff concludes that ILAWC is currently paying its own affiliate service company much quicker than it pays outside contractors. If permitted, this allows the Company a higher CWC charge for early payment, which represents a form of cross-subsidization; is generally prohibited in affiliated interest agreements; and results in additional costs to ratepayers. Contrary to the Company's arguments, it is not a clear contract violation of ILAWC's AIA to require the Company not to pay its affiliate bills early. For these reasons, Staff recommends the Commission approve the AG's adjustment for service company expense lead days.

c. AG's Position

The AG asks the Commission to adopt its recommendation and order ILAWC to change the expense lead days for service company costs to a weighted average expense lead of 33.22 days based on the weighted average expense lead days for the payment of general office expense, maintenance - other expense, and miscellaneous expense. AG Ex 1.00 REV at 23–23; AG Ex. 1.01 REV, Sch. A-6; Staff IB App. A-D, (Sch. 8). ILAWC proposes negative 3.2 lead days (or "-3.2") for service company costs. ILAWC Ex. 14.01. The Company's proposal results in it paying its bills to its affiliated service company before the middle of the month in which the services were received, and in paying its affiliates faster than its non-affiliated vendors. AG Ex 1.00 REV at 22. The AG notes that this represents a form of wrongful cross-subsidization that the Commission has repeatedly rejected.

ILAWC relies on its AIA as its basis for its request for negative 3.2 lead days. According to the Company, the agreement provides that service company expenses will be paid within "a reasonable time after receipt of the bill," and ILAWC contends that its definition of reasonable time supports its proposal. The Company adds that the service company does not profit from its provision of services because it exists to provide services to American Water affiliates at cost whereas "a private company include a markup for profit on their services provided."

The AG demonstrates that the Company's arguments fall short. First, providing a generic definition is not justification; it is a circular and unreasoned position. ILAWC points to its service company offering services at cost and contorts this phrase to argue it makes no profit. This is misleading because the service company offers services to captive customers and is likewise not constrained or vulnerable to market forces that would traditionally challenge unaffiliated vendors. In other words, the service company avoids significant risks that unaffiliated vendors must routinely deal with (e.g. guaranteed recovery of actual cost of services provided in the revenues received for those service).

The AG states that ILAWC offers no justifiable reason for the stark contrast between lead days for its affiliated service company costs and lead days for non-affiliated vendors. It is far more reasonable for the Company to pay its service company in a similar fashion to how it pays other vendors—or the average time unaffiliated vendors receive payment. There is nothing just and reasonable about making ratepayers pay the cost for ILAWC to pay its own service company faster than non-affiliated vendors.

The AG notes that the Company states the AG's recommendation would result in an arbitrary delay of payment and contract violation. However, as the Company states, the service company contract only requires payment within a reasonable time. The AG's recommendation is reasonable because it is within the same or similar payment periods for other vendors. ILAWC states that it has only partial control of the payment lead days component of the expense lead days, which it alleges is dependent on the ease of verification of the invoiced service provided, including requisition, quality, quantity, and pricing in addition to amount of personnel required for approval of an invoice. However, the Company appears to reference other vendors when it makes this argument. The AG is not disputing the expense lead days for other vendors, only that for the Company's service company. The Company argues that the AG did not consider the three components of expense lead days or the differences of services provided by the service company versus the services provided by other vendors. The AG responds that it understands the components of expense lead days. Further, the differences in services only show why the other vendors have varying expense lead days. The Company notably fails to distinguish why the Service Company costs should be paid so much sooner to the detriment of ratepayers.

The AG notes that the Act iterates that utility service rates should be least-cost as well as just and reasonable. 220 ILCS 5/1-102, 1-102(a), 9-201. Under the Company's proposal to pay its affiliated vendors earlier, ratepayers would be subject to higher costs and higher rates, which is inconsistent with providing customers with least-cost service, and likewise results in unjust and unreasonable rates. In Docket No. 11-0721, a formula rate update proceeding for ComEd, ComEd posited a proposal similar to ILAWC's. Docket No. 11-0721, Order. The Commission changed the number of lead days for the payment to affiliates and noted that allowing ComEd to pay its affiliated vendors earlier amounted to a form of wrongful cross-subsidization. *Id.* at 48.

ILAWC attempts to distinguish this case from Docket No. 11-0721. Generally, the Company alleges that the case is inapplicable because of factual differences. ILAWC points to such differences—such as the number of payment lead days at issue; presence of an AIA; the number of contesting parties; lead day components; discussion of cross subsidization—as reasons why the decision should be ignored. The AG observes that the Company adds that the Commission should otherwise reject the AG's recommendation merely because it has not adjusted its service company expense lead days in prior cases.

The AG explains that the Company's attempts fail. None of its alleged factual differences dispel the application of Docket No. 11-0721, which directly addresses and rejects a utility's request to pay its affiliated vendors earlier than non-affiliated ones. The Company's alleged factual differences, on the other hand, are all irrelevant, misleading, or both. To begin, that there are different numbers of payment lead days at issue between the cases is not surprising, and whether there are more (or less) days at issue is not the bases for the Commission's decision. The Company also misleads the Commission by pointing to other alleged factual differences. ILAWC suggests there is no AIA in Docket No. 11-0721, but there is a general services agreement. *Id.* at 24; AG Ex. 3.00 at 16. The AG opines that it is comparable to Article IV, Section 4.1 of the AIA between the Service Company and ILAWC because Article IV similarly provides that payment shall be

paid by the Water Company within a reasonable time after receipt of the bill with there being no definition of what is reasonable.

In addition, the AG argues that it does not matter how many parties contested the issue, and that ultimately, the number of parties for or against an issue does not preclude this Commission from adopting its recommendation. The AG contends that it is also misleading for the Company to argue that discussion of cross subsidization in Docket No. 11-0721 somehow renders it distinguishable. The record provides that the Company's request amounts to cross subsidization. The AG notes that Ms. Selvaggio testified that "payments to the Service Company ... prior to the mid-point of the service period is a form of cross-subsidization" because "[t]he Service Company, while not making a profit, charges a price that provides recovery of 100% of its costs and has an almost guaranteed source of revenue," and "ratepayers should not incur higher costs in the form of CWC to obtain services from the Service Company due solely to the Company's quick payments to its affiliate." AG Ex. 3.00 at 15.

Lastly, the AG asserts that the Company's suggestion that the Commission is obligated to allow it to maintain an unreasonable and self-serving approach merely because it did not adjust its request in a prior proceeding is untenable. The Company refers to the Commission permitting prepayment to its service company in Docket No. 11-0767. *Ill.-Am. Water Co.*, Docket No. 11-0767, Order (Sep. 19, 2012). Notably, nothing in the Order states that this prepayment was mandated or required, which suggests it was not challenged by any party. In the instant case, the AG argues that the record shows its recommendation is just and reasonable and consistent with ensuring least-cost service to ratepayers.

The AG urges the Commission to continue to use Docket No. 11-0721 as a guide in the instant case. That case is applicable to the instant case and supports the Commission rejecting the Company's request to serve and pay its affiliate vendors earlier than non-affiliated vendors.

The AG requests that the Commission to adopt its recommendation (which Staff supports regarding service company expense lead days) and change the number of lead days to the weighted average expense lead of 33.22 days and reduce the CWC requirement and rate base by \$2,981,626. See AG IB Attach (Sch. A-6).

d. Commission Analysis and Conclusion

The Commission agrees with Staff and the AG that the Company should not receive a benefit for paying its Service Company sooner than other vendors. The Company's process of paying its bills to its affiliated service company before the middle of the month in which the services were received, and in paying its affiliates faster than its non-affiliated vendors is done so at the Company's own discretion. This does not entitle the Company to a higher level of CWC at ratepayer expense. Moreover, the Commission finds that if the Company's proposal is permitted it will allow the Company a higher CWC charge for early payment, which represents a form of cross – subsidization which is generally prohibited in affiliated interest agreements and which the Commission has previously rejected, notably in Docket No. 11-0721. The Company has not provided any persuasive evidence or law to support a change in the Commission's practice. It has also failed to show that it would not result in additional costs to ratepayers.

The Company argues that the AG's adjustment would be a violation of its affiliated interest agreement. However, this is not supported by the record evidence. The Company's affiliated interest agreement simply requires that, ILAWC must pay its Service Company, within a reasonable time after receipt of the bill. ILAWC Ex. 28.00 at 4, n. 4. The Company is free to pay its affiliated vendors whenever it chooses to do so to ensure compliance with its own interpretation of its affiliated interest agreement but the calculation of CWC will reflect the same expense leads used to pay non-affiliated vendors. The AG's adjustment is based on the weighted average expense leads for the payment of similar bills to outside contractors.

The Commission adopts the AG's recommendation and ILAWC is directed to change the expense lead days for Service Company costs to a weighted average expense lead of 33.22 days based on the weighted average expense lead days for the payment of general office expense, maintenance - other expense, and miscellaneous expense.

8. Capital Investment Projects - Jerseyville Raw Water Improvements

a. ILAWC's Position

The Company notes that Staff witness Miller reviewed ILAWC's capital investments in detail. Following Staff's review, the Company understands that Staff only proposes to disallow the cost of one project, the Jerseyville Raw Water Improvements Project ("Jerseyville Project"), in the amount of \$2,500,000. Staff Ex. 17.0 at 2. The Company explains that Staff's concern is that although this project consists of addressing the lack of access to two of the three raw water wells (wells 1 and 2) for the Jerseyville Water Treatment Plant and an inspection for well 3, the project does not definitively include plant in service based on the results from the inspection of well 3 and the associated costs for the inspection should be removed from rate base. Staff Ex. 8.0 at 23. Because the costs for the inspection are not identified separately from the rest of the project costs, Staff contends that the full cost of the project should be removed from rate base.

The Company maintains that Staff's adjustment should be rejected. ILAWC explains that its evidence shows the Jerseyville Raw Water Improvements project is a prudent investment and necessary to ensure safe, adequate, and reliable service. The project will address the lack of dedicated access to two of the three raw water wells for the Jerseyville Water Treatment Plant. The need for dedicated access to each of the wells was recommended in a recent IEPA sanitary survey. Along with the roadway, a detailed inspection for well 3 will be done to allow for development of improvements to the well that will address operational challenges that have occurred over the past year. ILAWC Ex. 3.02 at 8.

The Company states that more specifically, two of the three Jerseyville raw water wells are in agricultural fields that have no dedicated access roadway to them. This creates challenges for maintenance and repairs as well as monthly testing of wells for compliance with the growth of crops around the wells and limited access during periods of the year. The Company notes that during a recent IEPA sanitary survey of the facilities it was noted that the lack of access needed to be addressed. Due to the issues with crops

and wet conditions, well #1 was out of service for nearly 3 months as a result of limited access and inability to approach the well with the proper equipment needed to perform work on the well. The Company explains that in addition to the issues with access to the well, each well has reliability issues with the existing motor controls which are impacted due to the inability to perform routine maintenance activities. Isolation valves and check valves associated with the wells are original to the initial installation of the three wells and have reached their life expectancy and are experiencing issues in proper operations that impact the ability to isolate the wells as needed for maintenance and emergency activities

b. Staff's Position

Staff recommends the Commission accept its adjustment to reduce the Company's rate base due to unsupported plant in service costs as presented on Staff Initial Brief, Adjustment Schedules, Schedule 13.

Staff recommends that the Commission approve the costs associated with the Company's capital investment projects, with the exception of the Jerseyville Project, which is a contested issue.

Staff recommended in direct testimony that the full cost of the Jerseyville Project (\$2,500,000) be removed from rate base because the project did not definitively include plant in service based on the results from the inspection of one of the three wells. Staff Ex. 8.0 at 23. Specifically, the Company did not identify what costs were associated with the inspection; therefore, Staff recommended the full cost of the project be removed from rate base. The Company did not address Staff's adjustment in its rebuttal testimony. ILAWC Ex. 17.00.

Since the Company did not contest the adjustment in its rebuttal testimony, the disallowance for Jerseyville Project was excluded from rate base in Staff's rebuttal testimony. Staff Ex. 17.0 at 2. Once again, the Company again did not address Staff's adjustment in its surrebuttal testimony. ILAWC Ex. 31.00 Rev. Thus, Staff understands that this issue remains contested. The Company seeks to recover the cost of this project in rate base, yet failed to substantively address Staff's proposed adjustment in testimony. The Company has improperly included these costs in its rate base despite its lack of a response to Staff.

Staff asserts that ILAWC argues that because the work needed on two of the three raw water wells at issue in the Jerseyville Project is not disputed, Staff's proposed adjustment to exclude the entire Jerseyville Project cost would, "... improperly exclude costs that are prudent and reasonable and that ILAWC is therefore entitled to recover." ILAWC IB at 40.

Staff states the Company did not address its concerns related to the well 3 inspection, although it had ample opportunity to do so. Staff could not determine the prudence and reasonableness of the Jerseyville Project as a whole due to ILAWC's lack of response to Staff's concerns. Staff argues the Company simply fails to point to any record evidence that would identify what costs are assigned to the well 3 inspection. Because Staff could not (and still cannot) calculate an adjustment to exclude the well 3 inspection from the Jerseyville Project costs, the Commission should exclude the entire Jerseyville Project from rate base.

c. Commission Analysis and Conclusion

The Commission finds that the Company has failed to provide sufficient evidence that shows the Jerseyville Project costs are prudent and reasonable. The Company points out that only well 3 is disputed but the rest of the project is not. The Company argues that the whole project should not be excluded because of the concerns with well 3 costs. However, the Company failed to disaggregate and support the costs of any individual part of the project. Without the requisite evidence to support the costs of the well 3 inspection, the Commission cannot make a determination of the remaining aspects of the project costs. The Company was given ample opportunity to provide this information about well 3 and did not. The Company failed to point to any record evidence that would identify the costs assigned to the well 3 inspection. Therefore, the Commission finds that the costs associated with the Jerseyville Project should be excluded from rate base.

B. Operating Revenues and Expenses

1. Performance Pay

a. ILAWC's Position

ILAWC states that it should be afforded full and complete recovery of its market-based employee compensation costs, including costs related to Service Company performance pay and costs related to performance pay linked to financial metrics. The Company maintains that this is especially true when no party has introduced any evidence that the Company's performance pay has created imprudent levels of employee compensation. The Company notes that, to the contrary, the record contains uncontested evidence, including a compensation study, establishing that ILAWC's employee compensation costs are prudently incurred, just and reasonable. The Company explains that it should be permitted to fully recover the totality of these costs, because:

- the Company's total direct compensation program is consistent with market practices of other similarly-sized utilities and of industry generally;
- the target total direct compensation provided to ILAWC employees is at the low end of the competitive range of the market;
- Service Company costs to ILAWC, which include employee compensation at cost, are considerably below the market prices for such services;
- the Company's ability to manage O&M costs and strategically grow its customer base has mitigated expense increases for and created greater efficiencies in operations that have allowed the Company's O&M cost per customer to remain virtually flat (adjusted for inflation) over the past decade; and
- the level of excellence motivated, in part, by performance pay has reaped the desired results since ILAWC received the J.D. Power award for ranking highest in customer satisfaction among water utilities in the Midwest.

ILAWC Ex. 2.00 at 44-45.

ILAWC asserts that accordingly, the Company's total market-based compensation costs should be recoverable like all other operating costs. Under the standard articulated by the Commission in its order in the Company's last general rate case, disallowance of cost recovery for the performance pay component of the Company's total market-based compensation program is not justified here because the performance plans, including components tied to both operational and financial goals, produce tangible benefits for customers. ILAWC Ex. 16.00 at 6-7. Concomitantly, where Service Company costs have also been shown to be below market levels, there is simply no reason to look behind those costs at the employee compensation plans that underlie them as a rationale for disallowing clearly reasonable costs. *Id.* at 14-15.

The Company explains that employee compensation is a necessary cost of providing utility service. Therefore, it should be assessed through the same lens as other operating costs: if it is prudently incurred and reasonable as measured relative to what the industry pays for the same services, it should be recoverable through rates. Accordingly, if the Company's total compensation level is in line with the market, regardless of the combination of fixed and variable payments that the employees earn, then the Company's total compensation expense should be fully recoverable.

ILAWC recognizes that the Commission has in the past disallowed costs associated with performance pay that are tied to financial goals, on the grounds that they "primarily benefit" shareholders. *Ill.-Am. Water Co.*, Docket No. 07-0507, Order at 25 (July 30, 2008); *see also* Docket No. 22-0210, Order at 34.

ILAWC explains that, in order to attract and retain committed, dedicated, and highly qualified employees, it must offer compensation that is on par with that offered by the market relative to companies with which ILAWC competes for employees. The Company, therefore, targets its total direct compensation (base and variable compensation) for near the market median (50th percentile). By using a combination of fixed and variable compensation that includes performance compensation, ILAWC satisfies a dual objective of reasonably compensating employees while motivating them to achieve goals that improve performance and efficiency to benefit customers.

The Company explains that there are three classifications of employees at ILAWC: bargaining unit hourly employees, non-bargaining unit hourly employees, and exempt employees. Hourly employees receive base pay and variable pay in the form of overtime pay and are eligible for performance pay. Exempt employees receive base pay and are eligible for performance pay. Each classification of employees' total compensation, therefore, includes fixed pay (base pay) and some form(s) of variable pay (e.g., overtime, shift pay, or performance pay). Performance pay may be awarded under two plans—the Annual Performance Plan ("APP") and the Long Term Performance Plan ("LTPP"). All full-time employees participate in the APP. This includes bargaining unit employees, who became eligible for APP in 2018, with their first payments in 2019. Eligibility for the LTPP is limited to certain exempt employees. The LTPP consists of restricted stock units ("RSUs") and performance stock units ("PSUs") based on three-year vesting periods. RSUs are based on time-based vesting and PSUs are based on time and performance vesting conditions.

ILAWC points out that it submitted a study by Willis Towers Watson (“WTW”) that assessed both the Company’s total market-based compensation program and its performance compensation program. The findings of WTW’s compensation study are described in the Direct Testimony of Robert V. Mustich. The Company notes that the results of this study were not contested.

Mr. Mustich and WTW’s study reached the following conclusions:

- ILAWC’s overall total direct compensation, which includes base compensation and all forms of variable compensation, is at the low competitive market range.
- American Water’s total compensation program, which includes APP and LTPP, is comparable to other utilities and general industries with whom ILAWC competes for employees.
- ILAWC’s total direct compensation programs are comparable to and competitive with market practices of other similarly sized utilities and general industries, and therefore are reasonable, market-based compensation.

The Company states that its performance compensation plans align the interests of customers, employees, and investors. The plans emphasize customer service, environmental compliance, a safe work environment, other operational goals, and financial goals. All of the APP and LTPP Plans’ performance objectives, both operational and financial, focus employees’ efforts in ways that benefit customers.

The Company explains that the operational goals of the APP are designed to focus plan participants on the performance results that can most directly influence customer satisfaction, health and safety, environmental performance, and workforce diversity. Customers benefit from the plan goals because operational performance is improved by controlling costs, capturing efficiencies, promoting effective safety and risk management practices, enhancing customer service, and doing so with a diverse workforce that reflects the communities served. Performance is determined by goals that directly benefit customers by creating a more productive workforce that is focused on customer satisfaction and achieving efficiency, environmental and safety goals.

The Company states that goals such as reducing OSHA incidents increases both customer and employee safety. Maintaining and improving high quality customer satisfaction and service quality also provide customer benefits. The Company asserts that no one can credibly dispute the benefits of improved safety. The Company’s OSHA recordable injury rate decreased from an average of 1.09 for the period of 2018 to 2020 to an average of 0.75 for the period of 2021 to 2023. Further, reduced accidents decrease the attendant costs—workers’ compensation, damage repair, etc.—which mitigates the operating costs that customers pay through rates. ILAWC states that it continues to improve its performance in reporting near misses, which is another illustration of the Company’s high-performing safety culture. Exceptional safety performance reflects an engaged workforce that is focused on providing safe, reliable, and affordable service to ILAWC’s customers.

ILAWC's customer satisfaction performance goals measure customer contacts at ILAWC's customer service centers and in the field. They are benchmarked against other utilities' performance, as reported by third-party customer satisfaction surveys. In 2023, ILAWC again ranked first in the Midwest Region for customer satisfaction in J.D. Power's Water Utility Residential Customer Satisfaction Study.

The Company explains that all of its goals, operational and financial, benefit the customer, employees, and investors (debt and equity). The goals focus employees' efforts on controlling costs, capturing efficiencies, promoting effective safety and risk management practices, and enhancing customer service. The financial goals of the APP and LTPP are thus complementary to the operational goals, and benefit customers in many ways.

The Company notes that, importantly, achieving performance pay financial goals, such as targeted earnings per share ("EPS") performance, demands attention to operating efficiency. That is, unless the utility controls its operating costs, it likely will not achieve a targeted EPS. Financial goal-based performance pay ensures that employees at all levels of the organization, and not just the upper ranks, remain focused on increasing efficiency, decreasing waste, and boosting overall productivity while providing excellent customer service. The Company posits that as a result, incentivizing employees to control operating costs unquestionably benefits customers. Consequently, when companies like ILAWC achieve financial performance through efficiency, the interests of customers, employees, and investors are aligned.

The Company explains that every company has financial targets. ILAWC's rate case is driven by investments the Company is making in the communities it serves to help strengthen those systems. Growth targets are in place to help measure and manage the pace at which the Company makes those investments and to communicate that to the investment community. The Company posits that meeting those targets will help attract the ongoing capital investments needed to maintain and improve its water and waste water systems. Furthermore, as Mr. Mustich testified, the performance goals of most utilities and companies in general industry are aligned, so ILAWC's inclusion of financial goals in the APP program is aligned with the market for how employees are compensated.

The Company avers that, despite cost pressures associated with acquisitions, and new challenges, including maintenance costs post-acquisition for systems in need of upgrades, increased fuel, power and chemical costs, and compliance with changing regulatory standards, ILAWC has been highly successful in managing its O&M costs. The Company states that given its record of controlling its per customer O&M costs over the last decade, it is apparent that ILAWC's intense focus on customers, improving water efficiency, and financial performance has benefited ILAWC customers, thus satisfying the Commission's standard for allowing recovery of these costs.

The Company explains that the efficiency promoted and incentivized by the Company's performance pay, including financial goals, also permits increased infrastructure investment without increased rates. Specifically, every dollar of operating expenses saved can fund over \$8 of investment—without increasing customer bills. This benefits both customers and investors.

The Company notes that, furthermore, because water and wastewater operations are capital-intensive and must constantly and consistently access the capital markets at reasonable costs, customers benefit from a utility's financial health.

The Company states that the analysis of the affordability of the Company's historical and proposed rates performed by Company witness Rea demonstrates that the Company's efforts have provided net benefits to its customers. Mr. Rea's analysis demonstrates that ILAWC's water service, overall, has become more affordable over time and will remain affordable under the Company's proposed rates. The Company notes that an important way that ILAWC maintains the affordability of water and wastewater service is by continuously seeking to improve business processes and make investments that improve operational efficiencies.

The Company notes that Staff and Intervenors argue that the Company should not be afforded full recovery of its reasonable market-based compensation costs. The Company maintains that there are at least four flaws in the arguments advanced by these parties. The Company states that first, the Commission's standard for recovery of performance pay has never been an absolute bar to recovery, and the fact that the Commission has previously disallowed such costs does not mean they should be reflexively disallowed in this case.

Second, contrary to the assertion that these metrics provide "no appreciable benefit" to customers, the Company states that its evidence in this case establishes that Company's financial metrics tied to performance pay benefit all stakeholders including customers, employees, and investors. The Company explains that it is difficult to quantify exactly how much benefit customers have received from the Company's use of these metrics as part of its performance-based compensation, but that does not mean the benefits are not tangible and real.

The Company further explains that increased efficiency benefits customers because every dollar of operating expenses saved can fund over \$8 of investment—without increasing customer bills. Customers therefore benefit from ILAWC's enhanced ability to invest in the infrastructure that it needs to meet its service obligations to customers. The Company notes that customers also benefit from the Company's access to capital at reasonable rates, which enables the utility to meet its service obligations at reasonable financing costs. The availability of sources of capital at reasonable costs depends on the utility's financial performance, which includes profitability at or above what regulators authorize. The Company states that ILAWC's and American Water's strong management have produced stable profitability (of which EPS is a measure) that has contributed to strong credit ratings. A tangible part of driving this strong management is linking compensation to EPS. The Company's management would lose a portion of its compensation if the business were not managed to produce returns at the level approved by the Commission, and lower credit ratings would result in more expensive capital.

The Company maintains that it is unreasonable to ignore those benefits and take the position that they provide zero benefit for customers, or to argue as Staff does, without any evidence, that the metrics somehow incentivize the Company to maximize cost and seek higher rate increases.

The Company states that third, no party has suggested that the Company's employee compensation costs overall are unreasonable. The Company explains that the Commission should rightly be concerned when total compensation is too high, which may unreasonably increase rates, and when employee compensation is too low, which may impact service to customers. The Company states that if the Company's overall compensation level is reasonable, because it is in line with the market, regardless of the combination of fixed and variable payments that the employees earn, or the specific metrics those payments are tied to, then, by definition, the Company's overall compensation expense is reasonable and prudently incurred and should be recoverable. The Company notes that the parties do not dispute the reasonableness of the Company's overall compensation package. Accordingly, it is inappropriate to disallow a component of that cost simply because it does not comport with their view of how employee compensation should be structured.

Finally, the Company explains that requiring shareholders to pay for performance-based compensation tied to financial metrics out of the return authorized by the Commission eliminates their opportunity to be appropriately compensated for their investment, unless the return were increased to recognize the additional risk imposed on investors (which the Company does not understand any of these parties to advocate). For this reason, ICB's argument that excluding the costs of these metrics "from cost of service, does not harm employees or shareholders because shareholders will still be able to pay for the incentives to employees and achieve the same and benefits" does not present an accurate picture of how shareholders would "pay for" these costs. ICB IB at 8. The Company maintains that on this issue, it is important to note that ILAWC is only proposing to recognize payment of this portion of compensation at target for ratemaking purposes. Target compensation results when the Company achieve financial targets, which occur when the Company earns the return authorized by the Commission. The compensation is structured such that results that exceed target performance levels can result in higher compensation levels. ILAWC Ex. 16.00 at 6. The Company explains that shareholders bear the cost of payments that are greater than the target and must absorb those costs out of the financial performance that exceeded expectations. The Company notes that, as with quantification of benefits, while the precise impact of requiring shareholders to pay for this compensation is difficult to quantify, that does not mean it does not exist.

The Company explains that all of this evidence establishes that the Company has, in fact, met the Commission's standard and should be allowed to fully recover its total market-based employee compensation costs, inclusive of performance pay. The Company states that accordingly, the adjustments to employee compensation costs proposed by Staff and Intervenors should be rejected.

b. Staff's Position

Staff recommends the Commission accept its adjustment to reduce the Company's operating expenses to remove incentive compensation costs that are based upon financial metrics as presented on Staff IB, Adjustment Schedules, Schedule 9. Staff Ex. 10.0 at 8.

The Company had two incentive compensation plans covering 2023: the 2023 APP and the 2023 LTPP. The APP is “designed to recognize and aware performance against key performance goals and targets that drive the Company’s strategy.” ILAWC Ex. 2.00 at 40. 50% of APP strategy is based on EPS. *Id.* The LTPP provides RSUs and PSUs as long-term variable compensation. Staff Ex. 1.0 at 14-15. RSUs utilize time-based vesting and PSUs utilize time-and performance-based vesting. ILAWC Ex. 2.00 at 41. The Company states that RSUs represent 30% of the eligible employees’ LTPP and PSUs represent 70% of the eligible employees’ LTPP. Staff Ex. 1.0 at Attach. B. PSUs are comprised of three components: 35% tied to Earnings Per Share, 20% tied to Total Shareholder Return (“TSR”), and 15% tied to Return on Equity. *Id.*

Staff recommends the Commission disallow 50% of APP expense plus payroll tax and 70% of the LTPP expense plus payroll tax. Staff Ex. 1.0 at 13. Ratepayers should not be required to fund incentive compensation plans linked to the financial performance goals of the Company. *Id.* at 16.

Staff argues that linking incentive compensation to these types of goals establishes an inappropriate circular relationship between rates and the expenses such rates are designed to recover. *Id.* The larger the rate increase granted, the more success the Company will have in increasing earnings and in reaching its financial goals. *Id.*

All else equal, Staff states, a rate increase that includes financial goal-based incentive compensation costs will enhance the Company’s ability to award incentive compensation linked to financial performance. *Id.* Further, the Company would have an inherent incentive to maximize costs and seek higher rate increases. *Id.* Staff argues that because financial performance goals primarily benefit shareholders, the shareholders should bear the cost of incentive compensation plans based on such financial performance goals. *Id.*

Staff notes that this is not the first time the Company has sought recovery of these costs. The Commission approved a disallowance for the Company’s LTPP program in the Company’s last rate case because the Company did not demonstrate that the costs provide tangible benefits for ratepayers. Docket No. 22-0210, Order at 35. The Company’s LTPP framework and performance criteria has not significantly changed since its last rate case. Staff Ex. 1.0 at 15. As such, Staff recommends in this docket that the Commission disallow all PSUs in the LTPP costs plus payroll tax associated with those PSUs, and it does not recommend disallowing the LTPP RSU costs, which is consistent with the Commission’s decision in the Company’s last rate case. *Id.*

Staff further notes that the Commission has repeatedly disallowed incentive compensation costs in the past. In Docket No. 16-0093, the Commission adopted Staff’s proposed adjustment, finding that “[t]he Commission agrees with the AG that when incentive compensation seeks to achieve goals that primarily benefit shareholders, it is reasonable to require that shareholders bear the cost of that incentive compensation.” *Ill.-Am. Water Co.*, Order, Docket No. 16-0093 at 37-38 (Dec. 13, 2016). The same incentive compensation issue was raised by Staff in Docket No. 07-0507, where the Commission adopted Staff’s proposed adjustment. See *Ill.-Am. Water Co.*, Order, Docket No. 07-0507 at 25-26 (July 30, 2008); see also *N. Shore Gas Co.*, Docket Nos. 23-0068/23-0069 (Cons.), Order at 152-53 (Nov. 16, 2023).

As explained in these Orders, the Commission has repeatedly found that when incentive compensation is based on the financial performance of the public utility or its affiliate, ratepayers receive no appreciable benefit. Instead, the financial performance of the public utility or its affiliate primarily benefits shareholders. Therefore, Staff argues the shareholders should bear the cost of compensation based on that performance. Additionally, Staff states that the Commission has found that incentive compensation that relies on financial performance of a company or its affiliate may create incentives for a public utility to seek a larger rate increase. Staff contends that an increase in public utility costs is not beneficial to ratepayers.

Staff adds that a vague allegation that ratepayers benefit from an incentive compensation program is insufficient to demonstrate savings or benefits and thereby justify recovery of costs from ratepayers. Docket No. 04-0779, Order at 44. Notably, both the AG and ICB agree that the Commission should disallow incentive compensation costs. ICB Ex. 2.0 Public at 12; AG Ex. 1.00 REV PUBLIC at 11-12, 17.)

Contrary to the Company's claim, there is ample record evidence to support Staff's disallowance. Similarly, both the AG and ICB provided extensive record evidence to support their recommendation to disallow incentive compensation tied to financial goals. See AG IB (Rev.) at 38-40; ICB IB at 3-9.

Further, Staff states that whether ILAWC's compensation packages are "in line" or "considerably below" market prices for such services is irrelevant to the question of whether performance pay should be allowed. ILAWC has provided no evidence whether other utilities earn a recovery on performance pay or incentive compensation. And even if they did, utility laws and regulations in other states may differ from those in Illinois, and the decisions of other state utility commissions do not bind the Commission.

Most importantly, according to Staff, ILAWC has failed to explain why the Commission should rule any differently on performance pay than it has in past dockets. Staff reiterates that there are many dockets in which the Commission has rejected recovery of performance pay or incentive compensation based on financial goals. This includes the Company's last rate case, where the Commission disallowed ILAWC's LTPP program costs because the Company had not demonstrated that the costs provide tangible benefits to ratepayers. Docket No. 22-0210, Order at 35. The Company's LTPP framework and performance criteria has not significantly changed since its last rate case. Staff's recommendation in this docket is consistent with the Commission's decision in the Company's last rate case and past Commission decisions. *Id.*

Finally, Staff clarifies that although ICB's and Staff's stated LTPP disallowance percentages are different, the amounts are the same. Both Staff and ICB recommend disallowing \$5,809,049 for incentive compensation/performance pay. Staff IB, Adjustment Schedules, Schedule 9; ICB Ex. 2.01. Additionally, the AG recommends the same adjustment. AG IB (Rev.), Attach., Sch. A-2.

c. AG's Position

The AG requests that the Commission adopt its adjustments and remove \$5,396,237 in O&M expense and \$412,812 in payroll taxes from ILAWC's revenue requirement to eliminate costs for incentive compensation expense based on financial

metrics. Specifically, \$5,080,017 in the Central Water division, \$253,623 in the Pekin Water Division, \$27,521 in the Chicago Metro Wastewater division, and \$35,076 in the Central Wastewater division. AG Ex. 1.01 REV Sched. A-2; see AG IB Attach (Sched. A-2). The Company's proposals would require ratepayers to reward its employees for achieving goals that primarily benefit ILAWC's shareholders. According to the AG, the Commission has repeatedly and consistently prohibited such cost recovery in both rate base and operating expenses.

AG witness Selvaggio recommended that the Commission remove APP costs based on earnings per share EPS and LTPP costs of PSUs based on TSR and EPS because those parts of the plans are based on financial metrics which benefit shareholders (who should thus fund the plan), not ratepayers. *Id.* at 11. The AG asserts that incentive compensation based on financial goals to maximize profitability and growth is designed to benefit shareholders by increasing equity per share. *Id.* at 12. If the incentive program is successful in increasing earnings, shareholders, not ratepayers, will benefit. *Id.* The AG opines that ILAWC expects ratepayers to bear the costs related to the achievement of such financial goals while all that ratepayers receive from these parts of ILAWC's incentive compensation program is higher rates.

The AG notes that the Commission has repeatedly stated that costs based on financial metrics are not recoverable unless the Company can demonstrate that the costs of incentive compensation provide cost savings or other tangible benefits to customers. See, e.g., Docket No. 22-0210, Order at 34–35; Docket No. 23-0066, Order at 83–84. The AG states that the Company argues simply that its compensation costs are prudently incurred, just and reasonable. Generally, the Company claims that its costs are consistent with market practices of other similarly sized utilities, that its compensation is on the low-end of the competitive range of the market, and that service company costs, including employee compensation costs, are below market prices. ILAWC IB at 41–42. ILAWC's arguments all suffer a fatal flaw in that the relevant inquiry is not whether these costs are at or below what other utilities or employers pay.

The AG maintains that the fundamental inquiry is whether these costs provide tangible benefits to ratepayers; and the record here shows these benefit shareholders—not ratepayers. The Company states its “ability to manage O&M costs and strategically grow its customer base has mitigated expense increases for and created greater efficiencies in operations that have allowed the Company's O&M cost per customer to remain virtually flat (adjusted for inflation) over the past decade” and “the level of excellence motivated, in part, by performance pay has reaped the desired results since ILAWC received the J.D. Power award for ranking highest in customer satisfaction among water utilities in the Midwest.” *Id.* at 40.

The AG explains that the Company continues to put forward generic, undeveloped arguments for these costs and attempts (unsuccessfully) to tie them to customer satisfaction. Nowhere does the Company show any correlation between these costs, that are incurred only if shareholder value increases, and tangible benefits to ratepayers. The Company repeatedly asserts unsubstantiated claims concerning its plan's goals, the plan's purported relationship to recruiting and retaining high quality employees, and that the plan focuses on items like customer service, health and safety, environmental compliance, and efficiency despite the fact it is only the portion of the plan for which

compensation is based on achieving the Company's financial goals that is disallowed. The AG maintains that the Commission has repeatedly and consistently rejected these exact, generic assertions. See *N. Shore Gas Co.*, Docket Nos. 23-0068/23-0069 (Cons.), Order at 152-153 (Nov. 16, 2023). The AG notes that it is worth mentioning that in ILAWC's 2022 rate case, Staff and the AG proposed an adjustment to rate base and depreciation expense to remove incentive compensation related to financial metric, which ILAWC agreed to. Docket No. 22-0210, Order at 41. The AG notes that Staff, ICB, and LAC all acknowledge that incentive compensation based on financial goals benefit shareholders, and such costs should be borne by shareholders.

The AG states that ILAWC even attempts to tie its incentive compensation costs to ongoing capital investments/acquisitions, which the AG demonstrates are a significant driver of ILAWC's continuous rate increases and serve only to make services less affordable for more of its customers. *Id.* at 47. The AG challenges the Company's claims that it has maintained affordability stating that ILAWC water and sewer rates are actually quite high and the subject of substantial requested increases of more than 30% respectively. The AG asserts that its adjustments do not disallow incentive compensation costs associated with performance objectives that benefit customers—only costs associated with incentive compensation based on increasing shareholder value (financial metrics). AG IB REV at 39.

Finally, the AG submits that the Company once more misses the relevant inquiry with its complaint about opposition to Service Company performance pay costs related to financial metrics. The fundamental inquiry is whether these costs provide tangible benefits to ratepayers. According to the AG, all the Company's arguments reveal one fact only: that ILAWC's evidence related to incentive compensation based on financial metrics is woefully deficient to demonstrate the tangible benefits to ratepayers which the Commission requires.

d. ICB's Position

ICB assert it is reasonable for a utility to include its budgeted incentive compensation in its test year cost of service if, and only if, the incentive compensation awards are based on goals or metrics which benefit customers. ICB argue, however, in this case, only a portion of the Company's incentive compensation expenses conform to this standard. ICB declare therefore, it is inappropriate for ILAWC to recover 100% of its incentive compensation costs from customers. Approximately 55% of ILAWC's incentive compensation is tied to the financial performance of the Company. ICB Ex. 2.0 at 5-6. ICB maintain incentive compensation tied to financial goals and achieving certain financial metrics do not benefit customers because the award of such compensation is primarily intended to align the interest of employees with shareholders, and not customers. ICB advance that under such circumstances, these costs should not be paid by customers but should be borne by shareholders.

ICB confirms that the Commission has historically denied a utility's recovery of the cost of incentive compensation that is based on the utility's financial performance because the incentive primarily benefit shareholders. *Id.* at 6; see *also* Docket No. 23-0066, Order at 83-84. ICB point out the Commission also disallowed recovery of incentive compensation tied to financial goals in the last ILAWC case, Docket No. 22-0210, Order

at 34-35, and in the most recent NS-PGL cases, Docket No. 23-0068/23-0069 (Cons.), Order at 152-153 (Nov.16, 2023).

ICB assert that the Company tracks the growth in EPS which is clearly a financial metric and any incentives awarded on the achievement of that metric should be charged to customers. The record shows that EPS represents 50% of APP. ICB Ex. 2.0 at 7. With regard to the LTPP it provides long-term incentives in the form of RSUs and PSUs. PSUs are 70% of LTPP. ICB Ex. 2.0 Conf. at 8; *Id.* ICB note the LTPP is focused primarily on financial goals, but part of the plan is tied to continued employment. ICB point out that on the other hand, APP includes a mix of operational goals, such as customer satisfaction and safety, and financial goals, such as the EPS of ILAWC's parent company, American Water. ICB also point out that Company witness Matthews argued in her testimony that the financial goals portion of LTPP and the 50% of APP that is tied to American Water's EPS still benefit customers. ILAWC Ex. 2.0 at 42-43.

ICB further note Company witness Matthews also suggests the financial goal portion of the APP and LTPP are complimentary to the customer-focused goals and that the goals can be achieved only if ILAWC is operating efficiently. ILAWC Ex. 2.0 at 42-43.

However, ICB witness Leyko assert there are flaws in this argument. First ICB note, the subject financial goals do not directly relate to ILAWC's retail operations. ICB point out they are based on the operational performance of American Water. Thus, ICB contend that not only should these costs be excluded from the Company's revenue requirement, because they primarily benefit shareholders, they should also be excluded because such costs are unlikely tied to the performance of ILAWC and its employees in ILAWC's service area in Illinois. ICB suggest rather, they are tied to the performance of American Water and its other affiliates. ICB Ex. 2.0 at 9.

ICB declare, under the circumstances, there is no direct correlation between (i) the payment of incentive compensation for achieving a financial reward at the parent company and (ii) the results and efficiency of ILAWC operations in the State of Illinois. ICB argue that under such circumstances, it is inappropriate to ask customers to pay for these costs. *Id.*

ICB note, furthermore, while the Company witnesses allude to cost savings, they did not show how those savings are reflected in ILAWC's revenue requirement in this case. ICB argue that while Company witness Matthews proposed to include recovery of financial-based incentive compensation in rates, because the Company could increase investment without increasing rates, the impact on rates under the Company's approach has not been quantified. ICB point out that while customer rates are being increased to reflect the incentive compensation expense, they do not appear to include the offset in rates described by the Company. *Id.* at 9-10.

However, ICB importantly observe, ILAWC was apparently able to quantify customer benefits when it comes to achievement of operational goals. Company witnesses observed that the Company's OSHA recoverable injury rate decreased and that ILAWC ranked first in the Midwest region for customer satisfaction. ILAWC Ex. 2.0 at 44. Thus, as suggested by ICB witness Leyko, "... in addition to excluding ILAWC's financial base incentive compensation costs, because they are designed to primarily

benefit the interest of shareholders, there is also reason to exclude them on the basis of developing just and reasonable rates.” ICB Ex. 2.0 at 10.

ICB further argue, while the inclusion of financial incentive compensation payments in the ILAWC cost of service, does not produce measurable benefits to customers, and would result in increased rates, excluding them from cost of service, does not harm employees or shareholders because shareholders will still be able to pay for the incentives to employees and achieve the same and benefits. However, ICB reason that if the expense of incentive compensation tied to financial performance is excluded from ILAWC rates, shareholders would be able to pay such incentive compensation costs out of higher earnings created by Company employees achieving the incentive financial goals and if the goals are not achieved, shareholders would not incur any incentive compensation costs. ICB Ex. 2.0 at 11.

Lastly, ICB point out the Company’s argument that its compensation program is consistent with programs of other utilities and industry generally and, therefore, should be adopted. However, ICB suggest that the issue here is not whether the ILAWC program is consistent with, or similar to, programs of other utility companies. ICB assert the question is whether, in the context of appropriate ratemaking in Illinois, 100% of the incentive compensation expenses should be included in rates. ICB maintain it has been the policy in Illinois, that the utility proposals to recover the cost of such incentive compensation in rates have been rejected which ICB argue the Commission should continue to do in this case. *See, e.g., N. Ill. Gas Co.*, Docket No. 04-0779, Order at 45 (Sept. 20, 2025).

In sum, it is the recommendation of ICB that about \$5.8 million in incentive compensation be excluded from ILAWC’s rates. This adjustment reflects the revenue requirement impact of removing 50% of APP and 80% of LTPP incentive compensation tied to financial goals from the 2025 test year cost of service in this case. The split of this adjustment among the ILAWC divisions in Illinois is set forth in ICB Ex. 2.1.

e. LAC’s Position

LAC supports the AG’s proposal to remove incentive compensation from the Company’s rate increase, just as the Commission did in the Company’s last rate case in Docket No. 22-0210. Docket No. 22-0210, Order at 34-35. LAC notes that the Company made and withdrew a similar request in 2016, did not object to a similar change proposed by Staff and adopted by the Commission in 2012, and lost a bid to recover performance plan costs when the Commission disallowed them in 2008. *See* Docket No. 16-0093, Order at 23,37; Docket No. 11-0767, Order at 58; Docket No. 07-0507, Order at 25-26 (July 30, 2008). As explained by AG witness Selvaggio, the “Commission has consistently concluded that costs of incentive compensation based upon metrics related to financial performance are not recoverable from ratepayers.” AG Ex. 1.00 REV at 12. Moreover, the “Company’s choice to base a portion of compensation on incentive compensation related to financial performance from the Company’s customers does not transform an incentive related to shareholder benefits to a ratepayer cost.” AG Ex. 3.00 at 12. LAC opposes recovery of these costs through this proceeding on this basis. According to AG witness Selvaggio, this adjustment would “reduce [O&M] expense by \$5,396,237 and payroll taxes by \$412,812.” AG Ex. 3.00 at 13.

LAC proposes disallowing performance pay costs, including \$5,396,237 in O&M expense and \$412,812 in payroll taxes. See *also* AG IB at 40; AG IB Attach (Sch. A-2). These costs are, LAC argues, unequivocally tied to financial metrics that will benefit the Company's shareholders, not ratepayers, and are therefore non-recoverable. See *also* AG Ex. 10.0 at 11-12.

f. Municipalities' Position

As it did in its previous rate case, Docket No. 22-0210, the Company seeks to include in its incentive compensation expenses paid by ratepayers costs associated with meeting the Company's financial market goals. The Municipalities request that the inclusion of financial market goals be rejected as the Commission did in the Company's last rate case, Docket No. 22-0210 at 34.

The Municipalities state that the Commission's finding in Docket No. 22-0210 that incentive compensation tied to market performance is not an appropriate expense is consistent with other Commission decisions. For example, the Commission rejected an incentive compensation plan that included financial goals requested by Nicor. See *N. Ill. Gas Co.*, Docket No. 04-0779, Order at 45 (Sept. 20, 2005).

The Municipalities argue that ILAWC's request for ratepayers to fund an incentive compensation program that includes a market matrix likewise should be rejected in this docket. They note that Intervenor and Staff witnesses in this docket uniformly testified against including such market-goal costs as part of ILAWC's revenue requirements, noting that the Commission has consistently disallowed imposing onto ratepayers the costs of incentive pay based on financial metrics. The Municipalities agree with these witnesses that those costs should be excluded. See *e.g.* ICB Ex. 2.0 at 9; see *also* AG Ex. 3.00 at 11-12.

The Municipalities assert that because the Commission historically has disallowed incentive compensation based on financial metrics in revenue requirements and because such incentives benefit shareholders, not ratepayers, the Commission should not allow ILAWC to recover those costs in this docket.

g. Commission Analysis and Conclusion

The Commission has consistently found that incentive compensation programs related to financial goals primarily benefit shareholders and those costs should not be recovered by the utility from ratepayers. The testimony and evidence presented by ILAWC do not distinguish this case from the Commission's prior rulings on this issue, and the Commission once again finds that incentive compensation based on financial metrics should be removed and not recoverable from ratepayers.

The Company argues that ILAWC's compensation costs are prudently incurred, just and reasonable. ILAWC claims that its costs are consistent with market practices of other similarly sized utilities, that its compensation is on the low-end of the competitive range of the market, and that service company costs, including employee compensation costs, are below market prices.

The Commission has repeatedly stated that costs based on financial metrics are not recoverable unless the Company can demonstrate that the costs of incentive compensation provide cost savings or other tangible benefits to customers. The

adjustment proposed by Staff disallows the incentive compensation that is based upon EPS, ROE, and TSR, all of which are financial metrics which the Company fails to refute. Nor does the Company provide any tangible evidence that these financial metrics create ratepayer benefit beyond a vague allegation of such. The Commission has also rejected arguments similar to ILAWC's that its performance pay plans, including the financial goals, are needed to attract and retain a skilled workforce to provide safe and reliable service. In doing so, the Commission found that such arguments ignore the standard for recovery and the legal duty of a utility to provide safe, adequate, and reliable service. See Docket No. 04-0779, Order at 45-46.

The AG, ICB, LAC and the Municipalities all support the proposed adjustments for different reasons. Therefore, the Commission accepts Staff's proposed adjustment to ILAWC's performance pay.

2. Rate Case Expense (WTW Fee)

a. ILAWC's Position

The Company notes that the AG proposes to disallow the \$80,000 of rate case expense associated with WTW's provision of and support for a compensation study. ILAWC further notes that AG witness Selvaggio contends that the hourly rate for the witness for WTW in this case is "excessive." AG IB at 42.

ILAWC states that it engaged WTW to provide the following services:

- Provide compensation study and analysis, supported by appropriate direct testimony and exhibits;
- Respond to data requests from Staff and any intervenors (if required);
- Review and analyze direct, rebuttal, and surrebuttal testimonies of parties to the case (if required);
- Prepare rebuttal and surrebuttal testimony (if required);
- Testify before the Commission on issues related to compensation (if required); and
- Review legal briefs (if required).

ILAWC explains that in determining the reasonableness of WTW's fees, ILAWC considered Mr. Mustich's extensive qualification and experience in the presentation of testimony and analyses regarding utilities' compensation philosophy and compensation and benefit levels. ILAWC further explains that Mr. Mustich has over 30 years of industry and compensation consulting services experience, including performing such studies for other utilities, including on behalf of ILAWC in past rate cases. ILAWC contends that it also considered Mr. Mustich's cost to perform the services. ILAWC argues that the level of expense for Mr. Mustich and WTW's services, \$80,000, is reasonable, as it is consistent with the level of WTW's rate case expense approved in ILAWC's prior rate case, Docket No. 22-0210, which was \$78,000. See Docket No. 22-0210, Order at 39; Docket No. 22-0210, IAWC Ex. 25.03 at 8.

ILAWC further argues that the claim that Mr. Mustich's rate is excessive is conclusory. The AG offers no comparison to market rates for similarly experienced experts or to rates charged for similar services in other Illinois rate cases. Moreover, ILAWC contends that the focus on Mr. Mustich's hourly rate ignores the fact that he did not provide services by himself—other WTW personnel also supported the compensation study and related services. ILAWC states that even if the concern with Mr. Mustich's rate was justified, and it is not, it is not appropriate to propose disallowance of the entirety of WTW's fees based on concerns with Mr. Mustich's rate.

ILAWC argues that Ms. Selvaggio's focus on hourly rates is misplaced. ILAWC explains that the appropriate consideration is the total overall cost of providing the study, which, at \$80,000, is consistent with the range of fees for ILAWC's other experts who provide studies, analysis, and testimony. ILAWC indicate that the WTW fee in this case is virtually the same as the WTW fee approved for recovery in ILAWC's last rate case.

The Company further notes that the compensation study itself is necessary to demonstrate the reasonableness of ILAWC's compensation levels. The Company explains that these expenses are a significant operating expense for the Company, and Mr. Mustich's analysis provides evidence that these expenses are prudent and reasonable. The Company observes that Staff concluded that the compensation study is essential to the Company's rate case filing as Section 9-229 of the Act requires the Commission to address the justness and reasonableness of attorney and expert compensation, and that for this reason, Staff recommends the Commission reject the AG's proposed adjustment.

The Company concludes that it retained a well-qualified expert witness who provided a thorough compensation study and analysis and testimony during the course of this proceeding, and ILAWC has complied with the requirements set forth in Part 288. Thus, the Company maintains, the Commission should reject the AG's arguments and proposed disallowance.

b. Staff's Position

Staff recommends the Commission approve the Company's rate case expense in this proceeding. Staff Ex. 10.0 at 10.

Staff explains that WTW serves clients in the utility industry and provides competitive industry compensation and benefits information which enables it to benchmark ILAWC against similar companies in the United States. ILAWC Ex. 12.00 at 1. Utilities engage with WTW to evaluate the competitiveness of the utility's compensation philosophy, compensation and benefit levels, variable compensation design, and pay structures and other consulting services. *Id.* In this docket, WTW presented a "Total Compensation Study", which was admitted into the record as ILAWC Exhibit 12.01.

Staff argues the AG's adjustment should be rejected as the compensation study provided by WTW is essential to the Company's rate case filing. Staff Ex. 10.0 at 10. A compensation study is necessary to determine whether the Company's employee compensation packages are competitive enough to ensure the Company can hire and

retain talent, and reasonable enough that ratepayers are not overpaying for employee compensation. See ILAWC Ex. 31.00 at 22-23.

Section 9-229 of the Act requires the Commission to expressly address the justness and reasonableness of the attorney and expert compensation expended by the public utility to prepare and litigate a rate case. 220 ILCS 5/9-229. Staff does not object to the documents the Company provided to support its rate case expense. See ILAWC Rebuttal Sch. C-2.1; ILAWC Rebuttal Sch. C-10; ILAWC Rebuttal Sch. C-10.1. The Schedules present \$3,296,632 of rate case expense amortized over three years, which includes \$975,807 for the unamortized rate case expense remaining from Docket No. 22-0210, \$500,000 for the Consumer Intervenor Compensation Fund payment, and an estimated \$2,320,825 rate case expense for the current proceeding. See Staff Ex. 10.0 at 11. Therefore, Staff proposes that the Order in this proceeding include a Commission conclusion stating:

The Commission has considered the estimated costs to be expended by [ILAWC] to compensate attorneys and technical experts to prepare and litigate rate case proceedings and assess that the amount included in the total revenue requirement of \$3,296,632 as rate case expense, which is inclusive of the total required \$500,000 Consumer Intervenor Compensation Fund Payment and amortized over a three-year period, is just and reasonable pursuant to Section 9-229 of the Act.

If the Commission makes any adjustments to the overall total of rate case expense, those adjustments should be reflected in the Commission's statement that sets forth the amount of rate case expense included in the revenue requirement. Staff Ex. 10.0 at 11-12.

Staff observes that the AG again recommends the Commission disallow the costs of WTW's Compensation Study. AG IB (Rev.) at 40. Specifically, the AG argues that: (a) the use of an outside witness for a compensation study is unnecessary and an ILAWC witness could have sponsored testimony based on WTW data; (b) the witness charges and excessive hourly rate; and (c) the Company's proposals to recover incentive compensation based on financial metrics has been repeatedly denied in the past. *Id.* at 40-41.

Staff disagrees with the AG's rationale. First, the compensation study is necessary to determine whether the Company's employee compensation packages are competitive enough to ensure the Company can hire and retain talent, and reasonable enough that ratepayers are not overpaying for employee compensation. This is a separate issue from performance pay and incentive compensation based on financial goals. Regardless of whether the Commission allows or disallows recovery of incentive compensation based on financial goals, the Commission still needs to determine whether ILAWC's employee compensation, including compensation that is not incentive compensation based on financial goals, is reasonable. Staff notes that the Company has utilized WTW's compensation studies in past dockets without issue. Docket No. 22-0210 at 39; see also Docket No. 22-0210, ILAWC Ex. 25.03 at 8 (filed August 5, 2022).

Second, the rate case expense for WTW is not significantly higher than what it was in the Company's last rate case, where the Company's rate case expense was approved. See ILAWC IB at 52. Additionally, the rate case expense for WTW is similar to the other outside consultants ILAWC has retained for this rate case. ILAWC Ex. 31.02.

For these reasons, Staff recommends the Commission approve the Company's proposed rate case expense.

c. AG's Position

The AG requests that the Commission remove the projected cost of \$80,000 for WTW's compensation study in rate case expense because the WTW cost is unnecessary and excessive. AG Ex. 1.00 REV at 23; 24-26; AG Ex. 3.00 at 19; 19-20; AG Ex. 3.01, Sch. A-7.

The AG argues the use of an outside witness for a compensation study is unnecessary. For example, in Docket No. 23-0066, a rate case proceeding for Nicor, the utility's witness sponsoring the revenue requirement schedules also sponsored testimony that Nicor's compensation levels were reasonable. The AG does not believe ILAWC has offered anything to support why it is reasonable for ratepayers to pay an outside witness (at an extraordinarily high hourly rate) to testify on the reasonableness of compensation. The Company only points to WTW's expertise, and that the fee was approved in a prior rate case. The Company continues to offer no justifiable explanation for why it did not use a witness within its own company, who would be more familiar with its operations and pay scale, which would have resulted in lower costs to ratepayers. Also—contrary to Staff's assertion—the AG has established that use of an outside witness for a compensation study is unnecessary (see AG IB REV at 41, *citing* Docket No. 23-0066), nor is it a requirement for a rate case filing. Such a study was not filed in Docket No. 23-0066, Docket No. 23-0067, Docket No. 23-0068/23-0069 (Cons.), or Docket No. 24-0044.

Moreover, the AG maintains that ILAWC's proposed cost is rendered further unreasonable by the witness' excessive hourly rate. See AG IB REV at 42, *citing* AG Ex. 1.03 Conf. In addition to being objectively high, the Company admits that the hourly rate at issue "includes costs of other WTW personnel who also supported the compensation study and related services." *Id.* This only further supports the AG's position that the rate is excessive and raises questions about whether other authorized or unauthorized consultants are billing for the compensation study. The AG asserts that it is unreasonable for such costs to be incurred solely to seek recovery for the Company's performance pay program based on financial metrics given the Commission's well-established policy to reject recovery of such costs. AG IB REV at 39. In ILAWC's last rate case, the Company raised these arguments, and the Commission held that ILAWC's arguments "ignore[d] the standard for recovery previously established by the Commission," and that "[t]he financial goals included in ILAWC's performance pay that Staff and the AG seek to exclude primarily benefit shareholders, not ratepayers." *Id.*

The AG requests the Commission to adopt its recommendation and order the Company to reduce \$80,000 in O&M expense on a total company basis amortized over three years, or \$26,667 per year. AG Ex. 3.00 at 19; 19-20; AG Ex. 3.01, Sch. A-7. See AG IB Attach (Sch. A-7).

d. Commission Analysis and Conclusion

The AG requests that the Commission make an adjustment to remove the costs of WTW's compensation study prepared on behalf of the Company in this proceeding. The AG argues that the use of an outside witness for a compensation study is unnecessary. The AG points to other recent rate cases where the utility used a Company witness to provide this testimony.

The Commission is not persuaded by the AG's arguments. Based on the record, the AG's adjustment is rejected. The record shows that the compensation study provided by WTW is essential to the Company's rate case filing. Specifically, it was necessary to determine whether the Company's employee compensation packages are competitive enough to ensure the Company can hire and retain talent, and reasonable enough that ratepayers are not overpaying for employee compensation. Moreover, it appears WTW performed the services it was contracted to provide and the rate case expense for WTW appears to be similar to the other outside consultants ILAWC has retained for this rate case.

As Staff points out, the Company has relied on compensation studies in the past without objection, including studies prepared by WTW. The Commission has considered the estimated costs to be expended by ILAWC to compensate attorneys and technical experts to prepare and litigate rate case proceedings and assess that the amount included in the total revenue requirement of \$3,296,632 as rate case expense, which is inclusive of the total required \$500,000 Consumer Intervenor Compensation Fund Payment and amortized over a three-year period, is just and reasonable pursuant to Section 9-229 of the Act.

3. LTPP Payout Variance

a. ILAWC's Position

ILAWC explains that it provides a long-term performance pay plan known as the LTPP. Under the LTPP, American Water provides restricted stock units RSUs and PSUs long-term variable compensation, based on three-year vesting periods.

ILAWC explains that AG witness Selvaggio proposed an adjustment to ILAWC's LTPP test year amounts using a three-year actual payout compared to budget for the period 2021 through 2023. ILAWC further explains that Staff witness Au adopted the AG's adjustment in his rebuttal. ILAWC Ex. 31.00 Rev at 25.

ILAWC argues that this adjustment to ILAWC's LTPP test year expense proposed by AG witness Selvaggio and Staff witness Au should be rejected. First, ILAWC argues that the adjustment proposed by Staff and the AG ignores merit increases and current/forecast employee levels and salaries. In addition, the Company has forecasted its LTPP expense levels using program targets. ILAWC explains that past performance is not indicative of future expense therefore it is not appropriate to base forecast expense levels on prior period results. ILAWC notes that it has consistently forecast its LTPP expense levels using program targets. ILAWC argues that adopting the adjustment would require abandoning ILAWC's reasonable test year forecast in favor of amounts that may be higher or lower than forecast. ILAWC argues that if past performance had exceeded program target levels, for example, the test year amount would need to be increased.

ILAWC asserts that adoption of an adjustment in this case using a three-year actual payout average would establish this as the methodology going forward, and so would require increasing the level of LTPP expense reflected in rates where the payouts exceed target. Therefore, ILAWC argues the adjustment should be rejected.

b. Staff's Position

Staff recommends the Commission approve the AG's adjustment to base the test year LTPP amounts using actual payout percentages, as presented in Staff IB, Adjustment Schedules, Schedule 10. Staff Ex. 10.0 at 17-18. The adjustment only modifies the projected LTPP that is not based on financial metrics by average payout variance or percentage from 2021-2023. *Id.* at 17.

The AG argues that because the 2023 actual LTPP payout was 24.79% less than budgeted, the revenue requirement should only include the cost of LTPP that will be reflective of the amount that will be paid out rather than the total possible payout. AG Ex. 1.00 REV PUBLIC at 37.

Staff notes that the Company disagrees with the AG's adjustment. ILAWC Ex. 31.00 Rev. at 25. Specifically, the Company argues that (1) the adjustment ignores merit increases and current/forecast employee levels and salaries; (2) the Company's forecasts should be based on future expense rather than past performance; and (3) no similar adjustment has been made to ILAWC's LTPP expense levels in prior cases. *Id.*

Staff recommends the Commission approve the AG's adjustment. Staff Ex. 10.0 at 18. Because the 2023 actual payout was significantly less than budgeted, it would be more appropriate to base the test year LTPP amounts using the actual payout percentages. *Id.*

ILAWC claims that it has "consistently forecast its LTPP expense levels using program targets." ILAWC Ex. 31.00 Rev. at 25. However, ILAWC does not provide any explanation for why the Company's 2023 actual payout was significantly less than budgeted or provide evidence to support its claim that it will reach its program targets in the future. In the past, the Commission has approved costs based on forecasts where a utility has provided significant record support for both future increases and why it failed to meet targets in the past. See, e.g., *Ameren Ill. Co.*, Order at 111, Docket No. 23-0067 (Nov. 16, 2023). Staff asserts the Company has failed to provide that level of evidentiary support in this docket.

Staff states that ratepayers should not have to pay incentive compensation costs that the Company is not reasonably expected to pay due to the Company's over-budgeting. The revenue requirement should only include the cost of LTPP that reflects the amount that will be paid out rather than the total possible payout.

For these reasons, Staff maintains the Company should approve the AG's adjustment to base the test year LTPP amounts using actual payout percentages, as presented in Staff IB, Adjustment Schedules, Schedule 10.

c. AG's Position

Concerning LTPP, the AG asks the Commission to adopt AG witness Selvaggio's recommended adjustment, supported by Staff witness Kendrick Au, to reflect that the

LTPP variance only paid out a portion of total possible compensation. AG Ex. 1.00 REV at 37; AG Ex. 1.00 at 27–28; Staff Ex. 10.0 at 17–18. The Company’s target level of the LTPP expense and actual level of past LTPP expense has varied. In 2023, the actual LTPP payout was 24.79% less than budgeted. AG Ex. 1.02 at 51, 54. The Company proposes forecasting LTPP expense levels using program targets without regard to payout history. ILAWC Ex. 31.00 Rev. at 25.

The AG notes that the Company first argues that past performance is not indicative of future expense. However, the Company bases various revenues and expenses using prior periods. For example, the Company derived its miscellaneous revenues using a prior period of 2020-2022. Second, the Company states that the AG’s and Staff’s adjustment ignores “merit increases and current/forecast employee levels and salaries.” ILAWC IB at 53. Contrary to this assertion, the AG’s recommendation actually accounts for them by considering the amount actually paid out between 2022 and 2023 as a percentage or variance. The AG asserts that the revenue requirement should only include the cost of LTPP that reflects the amount that will be paid out rather than the total possible payout. AG Ex. 1.00 at 38; Staff Ex. 10.00 at 18. Like Staff, the AG argues that ratepayers should not have to pay incentive compensation costs that the Company forecasts but that are not likely to be paid and thus over-budgeted. AG IB REV at 43; AG RB at 43. Accordingly, the AG requests the Commission adopt its recommendation and reduce salaries and wages expense by \$178,909 and taxes other than income by \$13,687 for a total reduction to operating expenses before income taxes of \$192,595. AG Ex. 1.01, Sch. A-13; AG Ex 3.01, Sch. A-13; See AG IB Attach (Sch. A-13).

d. Commission Analysis and Conclusion

The Company states that the way it forecasts its LTPP expense levels using program targets is more accurate than the AG’s proposal which averages the last three years of expenses for the program. ILAWC claims that the AG’s adjustment fails to take into account merit increases and current/forecast employee levels and salaries. The Company also points out that it has forecasted the LTPP expense levels using program targets many times in the past.

Staff supports the AG’s proposal. The AG argues that because the 2023 actual LTPP payout was 24.79% less than budgeted, the revenue requirement should only include the cost of LTPP that will be reflective of the amount that will be paid out rather than the total possible payout. Staff points out that ILAWC failed to provide any details as to why the payout was so much lower than budgeted or that it will reach its program targets in the test year.

The Commission agrees with the AG and Staff finding that the average from the last three years is a more accurate portrayal of the Company’s costs for LTPP. The Commission finds that revenue requirement should only include the cost of LTPP that reflects the amount that will be paid out rather than the total possible payout. Therefore, the AG’s recommended adjustment is approved.

4. Miscellaneous Revenues

a. ILAWC's Position

The Company explains that AG witness Selvaggio has proposed adjustments to late payment charges, collections for others, non-sufficient funds check charges, reconnection fees, after hours charges, and miscellaneous service revenues, based on concerns with use of a three-year average (2020-2022) when deriving its test year amounts for these items.

ILAWC asserts that this adjustment should be rejected. The Company explains that it used a consistent approach to establishing a test year amount for these miscellaneous revenue items. ILAWC asserts that Ms. Selvaggio has used a mix of 2023 actual levels for certain items and a three-year average (2021-2023) for others. The Company argues that its approach of applying a consistent average for each miscellaneous revenue item is appropriate and should be approved.

The Company notes that Staff witness Au also recommends the Commission reject the AG's adjustment and supports ILAWC's use of a consistent three-year average (2020-2022) for all miscellaneous revenue items. For these reasons, ILAWC asserts the adjustment should be rejected.

b. Staff's Position

Staff recommends the Commission reject the AG's miscellaneous revenue adjustments. Staff Ex. 10.0 at 22-23. Staff notes that the Company also disagrees with the AG's adjustments. ILAWC Ex. 31.00 Rev. at 28.

Staff asserts that the AG's method of estimating miscellaneous revenue is not consistent and should be rejected. In some instances, actual 2023 revenues were used to project 2025 revenues, while in other instances, a 3-year average from either 2021 to 2023 or 2020 to 2022 was used to project 2025 revenues. The Company's method of projecting 2025 revenues is consistent and more reasonable for projecting rates for a future period.

In support of its position, the AG contends that the Covid-19 pandemic (the "pandemic") and moratorium on service disconnection and late fees between 2020 and March 2021 make those years not representative and therefore they should not be treated as normal years to be used for a 3-year, 2020-2022 average.

Staff argue the AG's position is unpersuasive. First, the AG has failed to quantify what exactly the pandemic and moratorium on service disconnection and late fees effect was on each of the categories of revenues. There is no record evidence to support how much those revenues were affected or whether, post-pandemic and post-moratorium, those revenues have returned to pre-2020 levels, or have increased or decreased when compared to pre-2020 levels.

Second, the AG's adjustment ignores the reason why averages are used. Assuming the AG is correct that the pandemic impacted these revenues, the use of averaging reduces the pandemic's impacts on the numbers that will be used for the 2025 test year. In other words, because the pandemic's impacts lasted less than a year (sometime after March 1, 2020 through, as the AG claims, March 2021), the use of a 3-

year average lessens those impacts. Considering the effect of using a 3-year average, the AG has failed to explain why the use of 2023 actual numbers are any more representative of what the Company's 2025 actual revenues will be than using a 3-year average. 2023 actual revenues could be skewed for any number of reasons, and the record lacks evidence concerning how 2023 actual revenues compare to pre-2020 revenues, post-pandemic and post-moratorium revenues, and what revenues may be in the 2025 test year.

Finally, the AG fails to explain why some revenues should use 2023 actual numbers and other revenues should use a 3-year average from 2021-2023. It is Staff's position that the AG uses an inconsistent approach to reach its desired results.

Staff recommends that the Commission reject the AG's miscellaneous revenue adjustments and instead approve the 3-year average methodology which is consistent across revenue categories. No one knows what will happen in the future, whether it be another pandemic or another event that impacts certain ILAWC revenue categories. Without specific, quantifiable data about whether the specific impacts on revenues were caused by the pandemic or moratorium and specific evidence explaining why and how those 3-year averages will differ from the 2025 test year, the Commission should rely on a 3-year average. The 3-year average balances out effects caused by the pandemic, the moratorium, and other externalities that are not exactly quantified in the record.

c. AG's Position

The AG asks the Commission to adopt its recommendation and increase miscellaneous revenues by \$430,615 to ensure accurate rates that reflect all sales. AG Ex. 3.00 at 22; AG Ex. 3.01, Sch. A-9. Miscellaneous revenues are revenues received other than from base rates and include late fees, returned check fees, and after-hours connection fees. AG Ex. 1.0 at 27-29. The Company derived most categories of its projected 2025 miscellaneous revenues based upon the three-year actual revenues from 2020–2022 and states that this is the more consistent approach. ILAWC Ex. 31.0 Rev. at 27–28.

However, because of the COVID-19 pandemic and the moratorium on service disconnection and late fees from 2020 through July 2021, the AG contends that both 2020 and 2021 are not representative of certain "other revenues" such as late fees, non-sufficient funds check fees, and reconnection and after-hours charges and should not be treated as normal years to be used for a 3-year average to project 2025 revenues. AG Ex. 1.00 REV at 27; Docket No. 20-0309, Order on Reopening, App. B (March 18, 2021). ILAWC, however, does exactly this, resulting in a lower level of other revenues than is reasonable and representative.

According to the AG, the Company's argument for applying its proposal is simply that applying the average of the same three years is consistent. Staff also argues that this is a consistent approach for projecting revenues for a future period. The AG maintains that the main question is not whether these three years are used consistently with some other analysis, but whether these three years are representative of the test year. Due to the Covid-19 pandemic and the Commission's moratorium on service disconnections and imposition of late fees, among other terms, the AG argues that years 2020 and 2021 are not representative of ordinary operations, ordinary revenues, or

expected test year miscellaneous revenues. AG Ex. 1.00 REV at 28. According to the AG, the annual revenues for late fees, reconnection fees, after-hours fees, and NSF fees demonstrate that the Covid-19 moratorium years—2020 and 2021—consistently had lower revenue levels compared to 2022 and 2023. *Id.* at 27-29. Further, the Company derived its 2025 projected amount of Collection for Others based upon a 3-year average of actual amounts for 2020–2022, but the amount for the 2023 Collection for Others Gross Receipts tax was a significant increase over the prior three years due to ILAWC’s base rates increase in mid-2023. AG Ex. 1.00 REV at 27. The AG states that the Commission should base the Collection for Others revenues on the most recent rate level, and not underestimate based on rates that were superseded in 2023.

In short, the AG asserts that its recommendation correctly bases the projected 2025 miscellaneous revenues on the actual 2023 revenues, a time period that fairly represents expected miscellaneous revenues for the future test year. According to the AG, this is because, as made evident above, the Company’s 3-year average of 2020–2022 is unrepresentative of ordinary operations and the projected 2025 test year. AG Ex. 1.00 REV at 29–30. The AG argues that its recommendation is the more accurate recommendation as it is based on actual 2023 revenues. The AG asks the Commission to adopt the AG’s recommendation and order the Company to increase miscellaneous revenues by \$430,615, in order to ensure that ratepayers are credited for an accurate level of revenues. An increase in late payment charge revenues by \$282,215, an increase the revenue for the collection of others by \$32,735, an increase in the test year NSF check charges by \$17,385, an increases in the 2025 reconnection fees by \$76,493, an increase in 2025 reconnection fees by \$9,072 related to After Hours Charge, and an increase in the miscellaneous service revenues by \$12,715. AG Ex. 3.00 at 22; AG Ex. 3.01, Sch. A-9; see AG IB Attach (Sch. A-9).

d. Commission Analysis and Conclusion

The Company used a three-year (2020-2022) average to project its 2025 miscellaneous revenue. ILAWC argues that this method more accurately reflect the miscellaneous revenue than the AG’s miscellaneous revenue adjustments using various time periods. Staff supports the Company use of a consistent time period instead of the AG use of different time periods.

While the AG was trying to factor in the impact of the pandemic, it is difficult to determine this impact without additional information that was not included in the record. The Commission determines that 3-year averages supported by Staff will more accurately reflect the 2025 miscellaneous expenses for the Company than the AG’s miscellaneous revenue adjustments using various time periods. Therefore, the Company’s three-year average is approved.

5. Post-Acquisition Salaries and Wages

a. ILAWC’s Position

ILAWC states that the AG proposes an adjustment to the cost of salaries and wages for employees of acquired systems to the ILAWC rate of pay, rather than the rate of the former employer (because positions will be paid at the ILAWC rate rather than the rate of former employers), and to capitalize the salaries and wages of the acquisitions

based in ILAWC's proposed capitalization percentage (to be consistent with the Company's general treatment of salaries and wages).

The Company asserts that the adjustment is not supported. ILAWC explains that its proposed revenue requirement reflects the revenue, expense, and purchase price information that was included within each acquisition docket. ILAWC Ex. 31.00 Rev at 26. The Company asserts that its approach maintains consistency with what was/is provided in those dockets. *Id.* The Company explains that the salaries and wages included within this information contain assumptions on capitalization and use ILAWC wage assumptions. *Id.* The Company further explains that any deviation from the assumption would be detailed within the Asset Purchase Agreements filed with ILAWC's petitions in the acquisition dockets. *Id.* According to ILAWC, any such deviation would therefore be based on an agreement in the Asset Purchase Agreement, which would provide a reasonable, contractual basis to forecast wage and salary costs for acquired systems at something different than standard ILAWC pay rates. In addition, the Company explains that the Data Requests cited by AG witness Selvaggio that underlie her adjustment use ILAWC wage amounts in the derivation of the reflected salaries and wage expense. Therefore, ILAWC argues that the proposed adjustment should be rejected.

b. AG's Position

The AG requests that the Commission adopt its recommendation to match the salaries and wages of the employees of the acquired systems to that of ILAWC, as it is consistent with actual cost. The AG asks the Commission to order the Company to (1) adjust the cost of salaries and wages to its rate of pay for the positions of the acquisition employees rather than the rate of pay of the former employer, and (2) to capitalize the salaries and wages of the acquisitions based on the Company's projected capitalization percentage. AG Ex. 1.00 REV at 36. ILAWC proposes to treat Post-Acquisition Salaries and Wages in a manner which is inconsistent with actual cost. The AG states that the Company claims that its approach maintains consistency with the acquisition dockets and any deviation from wage assumption would be detailed within the Asset Purchase Agreements.

Under the AG's recommendation, the employees of the acquired systems would be paid at ILAWC's corresponding rates of pay, and not the rate paid by the former employers. AG Ex. 1.00 REV at 37. Further, the salaries and wages paid to acquisition employees will not be 100% expensed and will be capitalized in 2024 by the same capitalization percentages as ILAWC's salaries and wages. Thus, it is inappropriate to expense 100% of the salaries. Unlike the Company's position, the AG's position is consistent with actual cost. AG Ex. 1.01 REV (Sch. A-12); AG Ex. 1.02 at 16; AG Ex. 1.03 CONFIDENTIAL (DR R AG 7.03). Pursuant to the above, the AG asks the Commission to reduce salaries and wages expense by \$1,411,292 and taxes other than income by \$28,997 and increase depreciation expense by \$7,458 for the Central WW rate zones. See AG Ex. 1.01 REV (Sch. A-13). In addition, the AG asks the Commission to increase the Central WW average 2025 rate base by \$512,395 consisting of a reduction in plant of \$516,124 offset by a reduction in the depreciation. See AG Ex. 1.01 REV (Sch. A-13).

c. Commission Analysis and Conclusion

The AG is requesting that the Commission require that the Company match the salaries and wages of the employees of the acquired systems to that of ILAWC. The AG claims that this is consistent with actual costs.

The Company claims that its proposed revenue requirement reflects the revenue, expense, and purchase price information that was included within each acquisition docket. ILAWC argues that the salaries and wages are determined in the Asset Purchase Agreements filed with ILAWC's petitions in the acquisition dockets.

The Commission finds that there is merit to the AG's proposal. The Company should use the actual salaries of the acquired employees to more accurately reflect the costs in this area. The Commission agrees with the AG that the Company should not be able to expense 100% of these salaries since the wages and salaries paid to the acquired employees will not be 100% expensed. The Commission also finds that the wages and salaries of the acquired workers will be capitalized in 2024 by the same capitalization percentages as ILAWC's salaries and wages. The Commission agree with the AG's adjustments, and they are approved.

6. Depreciation of Enterprise Solutions Software

a. ILAWC's Position

ILAWC explains that Staff witness Vargas recommends that certain software assets, specifically the upgrades to the Company's Enterprise Solutions plant accounting software, be depreciated over 5 years. ILAWC further explains that the ILAWC witness Kennedy, who prepared ILAWC's depreciation study, recommended that small software packages, included in Asset Class 340.33, be depreciated over 5 years. The Company explains that Mr. Kennedy also recommended that large enterprise systems, included in Account 340.30 be depreciated over 15 years. ILAWC Ex. 37.00 at 1. The Company explains that the inclusion of two classes for software assets allows ILAWC to depreciate software assets at the appropriate rate for the individual asset. *Id.* at 1-2. The Company asserts that all assets related to enterprise systems such as plant accounting are depreciated in Account 340.30, with an average service life of 15 years. This includes any costs related to updates of the enterprise system.

The Company argues that Staff's proposed depreciation life for Enterprise Solutions related updates should be rejected. ILAWC states that Mr. Vargas asserts that the enterprise system related updates have a life of 5 years because technology changes rapidly and it is unreasonable to believe that the program will still be useful after such an extended period of time. The Company explains that while the enterprise systems will have further updates prior to the end of the 15-year depreciable life, updates often do not require the replacement of the previous system. The Company further explains that updates are often built on the assets currently in place. As such, the Company explains that the expectation that future updates will occur within a five-year period is not a reason to shorten the life of these assets. The Company states that while elements of the Enterprise Solutions software may be updated prior to the 15-year period, it is the expectation that the software system as a whole will remain in service for 15 years. The Company states that updates to the system will not require the retirement of the system

as a whole, and as such, the system should be depreciated over the expected life of the Enterprise assets.

Moreover, the Company argues the dollar value of the portion of the plant accounting software updates in question is approximately \$118,160, which represents 0.16% of the total original \$74.3M original cost of Account 340.30. The Company asserts that while the depreciation study selected a depreciable life that is appropriate for all assets within any asset class, it is expected that there will be some variation. The Company states that any over or under recovery of depreciation expense related to this variation is recovered over the remaining life of the relevant vintage. The Company explains that this true up mechanism is embedded in all remaining life depreciation calculations recommended in the ILAWC depreciations study. The Company further explains that consequently, if the enterprise systems upgrades are retired prior to the end of the 15-year period, the depreciation rate calculations will recover any difference through the use of this true up mechanism. The Company asserts that for these reasons, Staff's proposal should be rejected.

The Company further states that if the Commission orders that the portion of the plant accounting software upgrade in question be depreciated over a period of 5 years, these assets should be moved into Account 340.33, rather than depreciating Account 340.30 at 5 years. The Company explains that this would allow the remaining assets in Account 340.30 to continue being depreciated appropriately at 15 years, which would prevent a significant over-accrual from occurring. The Company explains that revising the depreciable life for Account 340.30 to 5 years results in a significant increase in the composite depreciation rate for ILAWC, which would unfairly burden customers.

b. Staff's Position

Staff notes that ILAWC seeks a 15-year amortization period for balances related to an upgrade to ILAWC's plant accounting software, known as Enterprise Solutions. ILAWC Ex. 5.00 at 5.

Staff recommends that the proposed useful life, and thus the amortization (or "depreciation") period, of the Enterprise Solutions upgrade be reduced from 15 to 5 years to avoid allowing ILAWC to recover costs after the Enterprise Solutions upgrade has become outdated. Staff Ex. 9.0 at 6. Further, Staff recommends the Commission accept its adjustment to reduce the Company's rate base and increase the operating expenses for the change in useful life to 5 years as presented on Staff IB, Adjustment Schedules, Schedule 12, pages 1 and 2. Staff Ex. 2.0 at 6; Staff Ex. 11.0 at 20.

Staff maintains that a 5-year amortization period is well supported, while a 15-year amortization period is not. First, according to ILAWC's own depreciation study, the useful life of software is listed at 5 years. Staff Ex. 9.0 at 4; ILAWC Ex. 11.02 at 24. Second, according to Staff expertise, the useful life of software upgrades like Enterprise Solutions are typically useful no more than 5 years. Staff Ex. 9.0 at 5. Finally, according to the Financial Accounting Standards Board, "given the history of rapid changes in technology, software often has had a relatively short useful life." Staff Ex. 2.0 at 6. Thus, Staff IB, Adjustment Schedules, Schedule 12 reflects the necessary adjustments to shorten the amortization period of the Enterprise Solutions upgrade from 15 to 5 years. Staff Ex. 2.0 at 6; Staff Ex. 11.0 at 20.

ILAWC does not adequately address its own depreciation study, explaining only that “small software packages” be depreciated over 5 years while “large enterprise systems” be depreciated over 15 years. ILAWC Ex. 25.00 at 1. Staff avers that ILAWC also admits that there will likely be further updates to the Enterprise Systems prior to 15 years, but that “updates often to do not require the replacement of the previous system . . . updates are often built on the assets currently in place . . . that future updates will occur within a five-year period it not a reason to shorten the life of these assets”. *Id.* at 2. ILAWC also states that “the software system as a whole will remain in service for 15 years.” ILAWC Ex. 37.00 at 1. However, Staff is not proposing that the Enterprise System as a whole be depreciated over 5 years; rather, Staff is proposing that the Enterprise Solution upgrade be depreciated over 5 years, which according to ILAWC, there is “little doubt” that more upgrades will occur prior to 15 years. Further, large upgrades often occur more frequently than 15 years. Staff Ex. 18.0 at 3.

Staff avers that the Company admits that it expects to update the Enterprise Solutions software again within 5 years, while at the same time arguing that a 5-year depreciation period should be rejected. If the Company expects to update its software within 5 years, there is no reason to oppose Staff’s proposal to depreciate the upgrade over 5 years. Further, Staff does not argue that the system “as a whole” should be depreciated over 5 years, only the upgrade. Thus, ILAWC’s argument that because “[u]pdates to the system will not require the retirement of the system as a whole . . . the system should be depreciated over the expected life of the Enterprise assets” is irrelevant.

ILAWC also argues that because there will be some variation for depreciation of assets within an asset class, there is a true up mechanism that will recover any over or under recovery if the upgrade is retired prior to the 15-year period. Staff states that ILAWC seems to assert that the depreciation period does not matter due to this true up mechanism. By using ILAWC’s logic, there is no reason not to use Staff’s proposed period, as this true up mechanism would also work if a 5-year depreciation period were used. Thus, the Commission should adopt Staff’s proposed 5-year depreciation period, which is more appropriate than ILAWC’s proposed 15-year depreciation.

If the Commission finds that the Enterprise Solutions upgrade should be amortized over a 5-year period, those assets should be moved to Account 340.33, which uses a 5-year amortization period. *Id.* at 5. However, if the Commission finds that the Enterprise Solutions system be amortized using a 15-year amortization period, the assets should remain in Account 340.30, which uses a 15-year amortization period. ILAWC Ex. 25.00 at 3.

c. AG’s Position

The AG disagrees with Staff’s recommendation to depreciate the Enterprise Solutions software over 5 years rather than the Company’s proposed 15 years.

d. Commission Analysis and Conclusion

The Commission agrees with Staff that a five-year amortization period is well supported. With the ever-changing technology the five years is more appropriate. Even the Company’s own depreciation study agreed with the five-year amortization period because software becomes outdated. Therefore, the Commission accept Staff’s

adjustment to reduce the Company's rate base and increase the operating expenses for the change in useful life to 5 years and it is approved. Although the Company's proposal reduces depreciation expenses, it also would allow the Company to continue recovering costs after the upgrade has become outdated. The Commission further notes that both Staff and the Company agree that if Staff's adjustment is adopted, then these assets should be moved to Account 340.33. Staff's proposal is adopted, and these assets should be moved as agreed to by the parties.

7. Unaccounted For Water

a. ILAWC's Position

The Company explains that it has a structured process in place to work on managing water loss— Unaccounted-For Water ("UFW")—to improve water efficiency.

The Company notes that the AG proposes an adjustment for UFW percentages above the tariffed threshold, removing 1.6% of the chemical and fuel and power expenses in the Central Water Division. As the AG acknowledges, however, the tariff provides that "rates or surcharges approved shall not include charges for [UFW] in excess of the foregoing Maximum Percentage without well-documented support and justification for the Commission to consider in any request to recover charges in excess of this Maximum Percentages." AG IB at 47. ILAWC maintains it has provided the necessary "well-documented support and justification.

ILAWC explains that this support includes process improvements in several areas to allow the Company to address and ultimately reduce UFW. The Company continues to perform lead detection activities, develop pressure management techniques within its distribution systems, utilize newer meter technology, explore the creation of district metering areas, and conduct analysis of data and system information. More specifically, the Company has performed pressure management in two systems by making modifications to pressure boundaries and reducing pressure in areas that have had pressures above 100 psi. In East St. Louis, the Company has made improvements to the Edgemont Pump Station and continues to make distribution improvements that allow for areas near the Belleville and East St. Louis pressure gradients to be adjusted and reduce the likelihood of leaks and water main breaks. ILAWC states that a similar pressure management project was conducted in Peoria where improvements in the northern portion of the High Service Gradients has allowed areas of higher pressure to be reduced to limit the impact on the distribution system and reduce the likelihood of leaks and water main breaks in these areas.

Given that the Company is continuing to make investments to reduce UFW and develop tools to track it, and the Company's efforts to reduce water loss, ILAWC believes it has provided sufficient justification and an adjustment for UFW is not necessary.

b. Staff's Position

Staff recommends the Commission approve the AG's proposed adjustment for UFW. Staff Ex. 17.0 at 8.

Staff notes that legally the Company must calculate UFW. The Act, the Commission's Rules, and the Company's tariffs all require the Company to track UFW so that it can represent the UFW percentage for ratemaking purposes. See AG Ex. 1.00

REV PUBLIC at 31. Notably, the Company was able to calculate UFW in a prior rate case. See *Ill.-Am. Water Co.*, Docket No. 16-0093, Order at 19 (Dec. 13, 2016). at 19.

The Company, however, has failed to calculate UFW in this docket, therefore, the AG calculated a UFW percentage of 16.6% in the Central Water division. AG Ex. 1.00 REV PUBLIC at 31. This is based on the difference between the amount of water sold plus the default percentage of 1.25% of the supplied total for authorized, unbilled water per the American Water Works Association (“AWWA”) from the total amount of water provided to the Central Water division. *Id.*; see also ILAWC Ex. 17.00 at 34. Because the Company’s tariff only permits 15% UFW, the AG’s adjustment removes the excess 1.6% of chemical and fuel power expenses for the Central Water Division, or \$544,684. AG Ex. 1.00 REV PUBLIC at 31-32; AG Ex. 1.01 REV, Schedule A-10. The AG did not propose a UFW adjustment for the Pekin Water division because the same calculation did not result in UFW greater than 15% as permitted by ILAWC’s tariffs. *Id.* at 32.

Staff recommends the Commission approve the AG’s adjustment for UFW. The Company’s tariff is clear — rates approved shall not include charges for UFW in excess of the 15% threshold without well-documented support and justification for the Commission to consider in any request to recover charges in excess of 15%. *Ill.-Am. Water Co.*, ILL.C.C. No. 24, Section No. 1 (Central Division Water), Fourth Revised Sheet No. 16; Section No. 4 (Pekin Water), Original Sheet No. 16.

Staff asserts the Company failed to provide any record evidence of UFW in this proceeding. The Company failed to provide any record evidence of the percentage of Non Revenue Water (“NRW”), and thus did not provide any justification for the percentage of NRW nor any method to estimate UFW based on NRW. The Company provides a vague list of “areas” it is “engaged” in to reduce UFW, and a description of two “pressure management” projects it claims, without any direct evidence, “reduce the likelihood of leaks and water main breaks.” ILAWC Ex. 17.00 at 36. However, these claims do not rise to the level of “well-documented support and justification” necessary for the Commission to approve recovery of excess UFW.

Moreover, ILAWC attempts to argue that, because it is making efforts to reduce leaks on its system, it has provided well-documented support and justification legally required to avoid a disallowance for UFW over 15%. However, while ILAWC’s arguments may be relevant to a conversation about what its UFW percentage threshold should be, the Company’s arguments hardly justify its failure to provide evidence of its level of UFW.

Staff points to a recent docket in which the Commission heard detailed arguments about UFW in *Util. Servs. of Ill., Inc.*, Docket No. 21-0198. The Commission decided two issues in that docket: (a) whether Utility Services of Illinois, Inc.’s (“USI”) increased 20% UFW threshold for the Apple Canyon and Galena districts, which was previously approved by the Commission in a prior rate case, should remain in effect or should be reduced to 15%, which was the threshold for the rest of the system; and (b) whether a disallowance was appropriate for water loss in excess of the maximum UFW percentage thresholds set in the Company’s last rate case. See *generally Util. Servs. of Ill., Inc., Order*, Docket No. 21-0198 at 28-42 (Dec. 1, 2021).

USI offered a multitude of arguments in support of preserving its UFW percentage thresholds for its Apple Canyon and Galena service territories, but unlike ILAWC, USI

agreed with Staff's adjustment to disallow costs associated with water loss in excess of its UFW percentage threshold, per its existing tariff. *Id.* at 29. The Commission ultimately rejected proposals to reduce USI's UFW percentage thresholds, and approved Staff's adjustment for water loss in excess of what was permitted by USI's existing tariff. *Id.* at 42.

In this docket, no party objects to ILAWC's 15% UFW percentage threshold. ILAWC's arguments may be relevant if it sought to increase its UFW percentage threshold, but the Company's arguments are not relevant to whether the Commission should allow the Company to recover UFW in excess of its percentage thresholds as permitted by its tariff. Instead, Staff states, the issue in this docket is that ILAWC provided no evidence about what its UFW percentage actually is, and thus, the Company failed to meet its burden of proof. As stated before, ILAWC is legally required to calculate UFW per its tariff, and the Commission must determine whether ILAWC's UFW percentage is in excess of the amount of UFW allowed per ILAWC's tariff. ILAWC has failed to offer justification for UFW in excess of 15% because it failed to provide evidence of its UFW percentage.

Because ILAWC failed to provide any evidence of its actual percentage of UFW, the AG calculated an estimated UFW percentage of 16.6% in the Central Water division by using American Water Works' default UFW percentage of 1.25% of water supplied. AG IB (Rev.) at 46. Thus, the AG's disallowance would remove 1.6% of the chemical and fuel and power expenses for the Central Water division. *Id.* at 47. Staff agrees with this adjustment. Oddly enough, while ILAWC disagrees that an adjustment is necessary (ILAWC IB at 60), it admitted in testimony that if an adjustment were ordered, the AG's disallowance would be reasonable. ILAWC Ex. 31.00 Rev. at 30.

Staff emphasizes the Commission has repeatedly approved adjustments for expenses related to chemicals, purchased power and fuel, and purchased water when water loss exceeds the UFW threshold. *See, e.g., Ill.-Am. Water Co.*, Docket No. 09-0319, Order at 53-54 (Apr. 13, 2010); *Util. Servs. of Ill., Inc.*, Docket No. 14-0741 Order at 7 (Sept. 22, 2015); *Apple Canyon Util. Co. & Lake Wildwood Util. Corp.*, Docket Nos. 09-0548/09-0549 (Cons.), Order at 18 (Sept. 9, 2010); Docket Nos. 11-0059 (Cons.), Order at 15; *Charmar Water Co.*, Docket Nos. 11-0561 (Cons.), Order at 14 (May 22, 2012); *Apple Canyon Util. Co. & Lake Wildwood Utils. Corp.*, Docket Nos. 12-0603/12-0604 (Cons.), Order at 21 (Aug. 14, 2013). Staff recommends the Commission make a similar adjustment in this docket.

For these reasons, Staff recommends the Commission approve the AG's adjustment.

c. AG's Position

The AG requests the Commission require the Company to adjust costs stemming from its UFW to 15% for two reasons. First, the AG notes that ILAWC only achieved a 16.6% UFW, as calculated by AG witness Selvaggio, which is higher than the 15% cap set by the Company's own tariff, and the Company failed to provide support to justify a higher UFW. Second, the AG also notes the Company claims it is unable to calculate the UFW percentage. AG Ex. 1.02. The AG argues that this is unacceptable. According to the AG, the Act, the Commission rules, and the Company's tariffs all require the Company

to track UFW so that it can represent the UFW percentage for ratemaking purposes. AG Ex. 1.00 REV at 31.

The AG explains that UFW is the amount of water that enters a utility's distribution system but is not sold to customers nor used for other known purposes. AG Ex. 1.00 REV at 30. Critically, the AG points out that the Company's own tariff expressly states that the maximum percentage of UFW to be considered in rates or surcharges shall not exceed 15%. *Ill.-Am. Water Co.*, ILL.C.C. No. 24, Section No. 1 (Central Division Water), Fourth Revised Sheet No. 16; Section No. 4 (Pekin Water), Original Sheet No. 16. is a violation of mandates that a water utility's rates shall exclude "charges for [UFW] in excess of [the maximum UFW in the utility's tariff] without well-documented support and justification." 220 ILCS 5/8-306(m). The AG argues that the Company's request that it be provided a higher UFW merely because it is unable to quantify costs in excess of 15% is unpersuasive, raises serious questions about ILAWC's management of water resources, and demonstrates that it cannot meet its burden of proof in this docket.

Staff supports the AG's recommendation. The recommendation ensures the Company remains incentivized to measure, manage, and limit both the amount of treated water lost or unaccounted for and the costs associated with that wasted water. The AG contends ratepayers should not be expected to pay higher costs for the Company's continued failures to address and minimize the amount of lost water costs.

The AG argues that the Company appears to suggest that it only needs to state a general justification to recover a higher UFW percentage, but that is wrong. The statute and tariff both require that ILAWC must supply "well documented support" and "justification" which it did not do here. Indeed, the record shows the Company failed to provide any documented support besides several broad, general statements in testimony. ILAWC Ex. 2.00 at 27–28. ILAWC notes it replaces and/or repairs old infrastructure and main breaks (*id.* at 57) and mentions "efforts in large meter testing and profiling, pressure zone management and zonal studies" and "monitor[ing]" billing processes (*id.* at 57, 59)—among some other operations and maintenance practices.

The AG contends that the record is devoid of "well documented support," let alone justification, showing that the Company actually tracks and knows its UFW and takes action specifically to address its currently excessive UFW factor. In the absence of testimony about how the Company manages its UFW, the AG asserts that its request for a higher UFW percentage is unsupported and should be denied. The AG believes it has shown that AG witness Selvaggio's estimated UFW percentage of 16.6% in the Central Water Division is appropriate. See AG Ex. 1.00 REV at 31–32. The AG mentions that even the Company noted in testimony, while still supporting no adjustment, that "if the Commission were to recommend an adjustment to be made, AG witness Selvaggio's proposed adjustment is a reasonable alternative at this time." ILAWC Ex. 31.0 at 29–30.

For these reasons, the AG asks the Commission to adopt its recommendation to remove 1.6% of the chemical and fuel and power expenses in the Central Water Division. Based on updated amounts for chemicals expense and fuel and power expense, the Commission should reduce O&M expense by \$454,613 for the Central Water rate zone. See AG IB Attach (Sch. A-10); Staff IB at 11.

d. Commission Analysis and Conclusion

The Commission is not persuaded by the reasons that ILAWC provided for going above the threshold. The Commission has repeatedly approved adjustments for expenses related to chemicals, purchased power and fuel, and purchased water when water loss exceeds the UFW threshold. The Commission also finds that it is a violation of Section 8-306(m) of the Act. 220 ILCS 5/8-306(m). The Company's own tariff clearly states that approved rates cannot include charges for UFW in excess of the 15% threshold set without well-documented support and justification for the Commission to consider any request to recover charges in excess of the 15% threshold. The Company failed to provide the requisite support in this proceeding and the Commission finds the AG's calculated estimate UFW percentage is reasonable. The Commission agrees with the AG and adopts the 1.6% adjustment to UFW for the Central Water Zone.

8. Bank Service Fee Allocation

a. ILAWC's Position

The Company explains that in her direct testimony, AG witness Selvaggio recommended an adjustment to allocate bank service charges (e.g., lockbox charges, bank service charges, and credit card fees) to both the water and wastewater divisions, instead of only the water division as reflected in the Company's initial filing. In his rebuttal testimony, Staff witness Au agreed with Ms. Selvaggio, and noted that the Company provided a response to discovery that explained that the Company adopted the AG's adjustment in its rebuttal filing but also stated that Bank Service charges are not allocated to both water and wastewater.

The Company explains that it did, in fact, adopt the AG's adjustment as reflected on the updated Schedule C-4 provided on rebuttal. The Company states that the referenced statement in discovery that bank service charges had not been allocated to both water and wastewater was unintended.

b. Staff's Position

Staff states that this issue should now be considered uncontested, and the Commission should approve the AG's adjustment as reflected on ILAWC Rebuttal Schedule C-4, which is already accounted for in Staff's IB Appendices. Therefore, the adjustments presented in Staff's IB Adjustment Schedule 11 are not necessary and should not be adopted.

c. AG's Position

The AG recommended an adjustment to allocate bank service charges to both the water and wastewater divisions. The AG notes that the bank service charges were allocated to all rate zones in ILAWC's rebuttal Sch. C-4 (Page 7, Line 54).

d. Commission Analysis and Conclusion

This issue is no longer in dispute as the Company has accepted the AG's adjustment. Therefore, the Commission approves the AG's adjustment as reflected on ILAWC Rebuttal Schedule C-4 for bank service charges.

C. Capital Structure and Rate of Return

1. Capital Structure

a. ILAWC's Position

ILAWC explains that because the Company is proposing a two-step rate increase in this proceeding, it is proposing a separate capital structure for each step. Company witness Furia presented the Company's proposed capital structures. ILAWC proposes to use the following capital structures: in Step One, the projected thirteen-month average capital structure for the forecasted test year ending December 31, 2025, and for Step Two, the projected capital structure as of the twelve months ending December 31, 2025, of the forecasted test year. ILAWC Ex. 9.00 at 3. The Step One proposed thirteen-month average of the forecasted test-year ending December 31, 2025, capital structure comprises 0.51% short-term debt, 47.07% long-term debt, and 52.42% common equity. The Step Two proposed forecasted test year ending December 31, 2025, capital structure comprises 0.05% short-term debt, 45.49% long-term debt, and 54.46% common equity.

ILAWC asserts that its proposed Step One and Step Two capital structures are reasonable for ratemaking purposes. Mr. Furia examined the average common equity ratios of the operating subsidiaries of the proxy group of companies used by Company witness Bulkley for her analysis of the Company's cost of equity. Specifically, Mr. Furia compared the Company's proposed common equity ratio for ILAWC to that of the utilities owned by Ms. Bulkley's proxy group. For the year 2022, the average common equity ratio of Ms. Bulkley's proxy group was 54.15%. ILAWC's proposed Step One and Step Two common equity ratios are within the range of equity ratios found in Ms. Bulkley's proxy group. Thus, Mr. Furia found the Company's proposed capital structure is reasonable and should be used to compute the Company's WACC in this proceeding.

Ms. Bulkley also reviewed the Company's projected capital structures and the capital structures of the utility operating subsidiaries of the proxy companies. She calculated the mean proportions of common equity, long-term debt, and short-term debt over the past three years for each of the companies in the proxy group at the operating subsidiary level. She found that the average equity ratios for the operating subsidiaries of the proxy group range from 44.57% to 59.79%, with a mean of 53.50%. Accordingly, ILAWC states its proposed equity ratios are well within the equity ratio range established by the utility operating subsidiaries of the proxy group. Ms. Bulkley concluded that the Company's proposed ratemaking capital structures are reasonable and should be used for setting rates in this case.

ILAWC states that both Staff and ICB proposed unreasonable hypothetical capital structures that should be rejected. Staff witness Bista proposed a capital structure with a common equity ratio of 49.00%. ICB witness Walters proposed a common equity ratio of 50.00%. The Company argues there is no valid reason to substitute a hypothetical capital structure for the Company's actual capital structure, which IAWC reiterates is reasonable.

Staff witness Bista challenged the Company's proposed equity ratios. He argued that the Company's parent company is riskier but had common equity ratio of only about 44.00% in 2023. He argued that, in comparison to its peers, the Company's proposed

capital structure indicates a relatively low degree of financial risk for a water utility. He concluded the Company's proposed capital structures contain more common equity than needed to support a financially strong water utility.

ILAWC notes that Mr. Bista also contended that the Company's proposed capital structure is not appropriate because ILAWC's proposed capital structure would violate Section 9-230 of the Act. He contended the effect of the Company's affiliations with unregulated or non-utility companies on its cost of capital is evident in comparing its implied Moody's credit rating of A2 to the Moody's Baa1 rating for American Water. He argued that a similar effect can be seen in the ratings of two of ILAWC's sister water utility subsidiaries. Staff Ex. 3.0 at 12. In his view, since the Company's forecasted equity ratios of around 52.00% and 54.00% are higher than its parent company's common equity ratio of only about 44.00%, both the Company's implied credit ratings and financial ratios indicate that its affiliation with unregulated or non-utility companies has increased its risk.

The Company states that Staff has it backwards. Staff bases its conclusion on the fact that the Company's proposed Step One and Step Two equity ratios of 52.42% and 54.46% are greater than the 44.31% equity ratio of ILAWC's parent company. However, applying that same logic, Staff's proposed equity ratio of 49.00% would also violate Section 9-230 of the Act since Staff's proposal is also greater than the equity ratio maintained by AWK.

The Company claims that its forecasted capital structure is consistent with the way that the Company's assets are actually capitalized. And ILAWC states that Mr. Bista has not demonstrated Section 9-230 applies in this context. The mere fact that ILAWC is affiliated with its parent company or that ILAWC's capital structure is different from the American Water consolidated capital structure is not a sufficient basis for an adjustment to ILAWC's proposed capital structure.

ILAWC explains that the Company's capital structure does not reflect increased risk from its association with its parent. ILAWC is financially independent from American Water: ILAWC is a separate legal entity that maintains an independent capital structure, approved by its Board, which supports the continued provision of safe, reliable, and affordable water and wastewater service for the benefit of its Illinois customers. ILAWC is a stand-alone business enterprise in all material respects including, but not limited to, its independent state operations, capital investments, management, and corporate governance. ILAWC's forecasted capital structure represents how it finances its independent operations and capital investments, and therefore is the appropriate capital structure to be used for rate making purposes. ILAWC's capital structure includes the costs incurred for both debt and equity financing based on the risk factors relevant to ILAWC and is in line with its peer utilities with similar risk profiles. Moreover, the Illinois regulatory scheme contains various provisions that are intended to ensure the independence of Illinois public utilities from affiliate decision making, including Article 6 of the Act (on capitalization) and Article 7 (on intercorporate relations) of the Act. 220 ILCS 5/6-101 *et seq.*; 220 ILCS 5/7-101 *et seq.*

ILAWC also explains, the Company faces greater operating risk than American Water. ILAWC has its own unique operating risk, since the factors that impact operating risk vary across jurisdictions, including unforeseen maintenance expense, spikes in

power and chemical costs, and so forth. If ILAWC were the only utility owned by American Water, the operating risk profile of the parent and subsidiary entities would essentially be identical. But American Water's operating risk profile reflects the risk of all its regulated subsidiaries. In addition to its regulated utility subsidiaries, American Water also includes a Military Services Group, which operates on 18 military installations under 50-year contracts with the U.S. government. The Company does not believe that American Water's provision of services to the U.S. government is source of unusual or troubling risk. If one subsidiary goes bankrupt, American Water's overall loss would be mitigated as long as the other utilities remained financially viable. In this respect, American Water's ownership of multiple utilities in multiple jurisdictions is a form of diversification that allows it to mitigate its operating risk. ILAWC Ex. 27.00 (Corr.) at 94. ILAWC states it cannot mitigate its operating risk in this fashion; it bears 100% of whatever its operating risk is. Since ILAWC cannot diversify its operating risk, its operating risk profile is greater than that of its parent.

ILAWC notes that Mr. Bista argued that "both the Company's implied credit ratings and financial ratios indicate that its affiliation with unregulated or non-utility companies has increased its risk." Staff Ex. 3.0 at 12. This assertion does not survive serious scrutiny. Mr. Bista acknowledges that utilities with higher debt ratios (and so lower common equity ratios) are riskier. Thus, Mr. Bista is imputing a riskier capital structure to ILAWC, because ILAWC's proposed capital structure has an Implied Moody's Credit rating of A1, while Staff's proposed capital structure has a lower implied rating of A2.

Moreover, ILAWC maintains, Mr. Bista has not quantified any incremental risk or increased cost of capital that results from this comparison or ILAWC's affiliation with American Water. Rather, his analysis hinges on his development of "implied" credit ratings and thus his ability to predict precisely how a credit rating agency would assess a utility in certain circumstances. Mr. Bista compared the Company's proposed forecasted funds from operations ("FFO") interest coverage, FFO to net debt, FFO less dividends to net debt coverage, and debt to capitalization derived from data forecasted by the Company, to the 2023 and 3-year average financial ratios for: ILAWC, American Water, the Staff Proxy Group, ILAWC Proxy Group and the Water Industry. He also compared the implied Moody's credit rating for each, based on those four ratios, using the Moody's Benchmark Ratios for regulated water utilities. According to Mr. Bista, his analysis implies credit ratings of A1 and A2 for the Company, Baa2 and Baa1 for American Water, A3 and A3 for the Proxy Group, and A3 and A3 for the Water Industry, based on 2023 data only and 2021-2023 data for each, respectively.

ILAWC explains, the Moody's Rating Methodology Scorecard relied upon by Mr. Bista involves multiple scoring categories in addition to a variety of other factors when contemplating its ratings. ILAWC Ex. 23.00 at 6. In fact, the categories relied on by Mr. Bista only represent 40.00% of the preliminary scoring outcome before Moody's considers other factors typically reflected in their ratings, but not listed in the scorecard criteria. Despite this, Mr. Bista appears to only rely on a subset of those methodologies, namely the financial ratios. The Moody's report makes it very clear that it does not include an exhaustive treatment of all factors that are reflected in the Company's ratings and further states that the scorecard is a summary that does not include every rating consideration and that the scorecard outcome is not expected to match the actual rating of each

company. In other words, Staff is trying to produce what they believe Moody's might have produced in its ratings analysis without using all of Moody's ratings criteria, both objective and subjective. Accordingly, ILAWC contends, any conclusions that Staff draws from this analysis are not sound.

Mr. Bista also contended that the Company's proposed capital structure is not appropriate because the Company's proposed capital structure indicates a relatively low degree of financial risk for a water distribution utility, and that, in comparison, the Company's proposed common equity ratios are much higher than those of the Staff Proxy Group, ILAWC Proxy Group and Water Industry. ILAWC states Mr. Bista's argument is flawed, for at least two reasons. First, his peer group capitalization ratios are invalid. Second, he fails to account for the specific risks that the Company faces.

ILAWC states that the peer group capitalization ratios utilized by Mr. Bista are not comparable to ILAWC's proposed ratemaking capital structure, resulting in an invalid and misleading comparison. Mr. Bista included as part of the debt component in his capitalization ratios the full amount of short-term debt for each utility. Pursuant to 83 Ill. Adm. Code 285.4020, for ratemaking purposes, ILAWC has reduced its short-term debt balance by the amount of construction work in progress ("CWIP") accruing AFUDC. This adjustment has an effect on the other components of ILAWC's ratemaking capital structure as that reduction shifts some of the short-term capitalization balance to the other components, primarily common equity. By not making a comparable reduction to short-term debt to remove CWIP accruing AFUDC, the total debt ratios included within the peer group capitalization ratios utilized by Mr. Bista are overstated and the common equity ratios are understated. In addition, not all jurisdictions include short-term debt within the capital structure at all.

ILAWC notes that Staff purported to compare the Company's proposed common equity ratios to the average common equity component for water utilities. It is unclear to ILAWC, however, how Mr. Bista has calculated his average authorized equity ratio of 46.53% from 2021 to 2023 because he provided no support for the calculation. Ms. Bulkley reviewed Mr. Bista's workpapers and determined that he incorrectly characterized the average actual equity ratio for the water utilities included at the holding company level as an average authorized equity ratio. Accordingly, the Commission should disregard Mr. Bista's calculation since the average is not based on authorized equity ratios over the period 2021 to 2023.

Further, Ms. Bulkley reviewed the authorized equity ratios for water and natural gas utilities across the U.S. from 2013 through 2023, excluding both limited issue rider cases and authorizations in Arizona, Indiana, Michigan, and Florida due to the inclusion of zero-cost capital in the capital structure. She found that the Company's proposed Step One and Step Two equity ratios of 52.42% and 54.46%, respectively, are well within the range of the authorized equity ratios for water and natural gas utilities from 2013 through 2023.

Moreover, ILAWC explains, there is a fundamental problem with comparing the Company's capital structure with those of the proxy group, as both Staff and ICB did. First, it is not appropriate to compare the proposed Step One and Step Two equity ratios of the Company to the average equity ratio of the proxy group at the holding company

level. Second, even though it is not appropriate, if the capital structures at the holding company level are considered, the market value of debt and equity must be used to estimate the percentage of debt and equity in the capital structure, not the book value of debt and equity such as both Staff and ICB have done. The holding company data on which Staff and ICB rely includes corporate-level debt that is not part of the regulated or financial capital structure of the operating utilities. The relevant capital structure for comparison purposes to the Company is at the operating company level, not the holding company. *Id.* ILAWC argues that under Section 9-230 of the Act, the Commission must establish the ratemaking capital structure for the Company, the operating company, on a stand-alone basis. Therefore, it is reasonable and appropriate to rely on the operating company capital structures that have been used to fund utility operations for the comparison of the Company to the proxy group. *Id.* In contrast, Mr. Bista's and Mr. Walters's approach would result in a ratemaking capital structure for the Company that would reflect the capital structures, risks, and capital costs of unregulated affiliates, contrary to Section 9-230 of the Act.

Additionally, ILAWC states that Mr. Bista failed to consider the Company's operating risks, of which there are at least two: the Company's substantial capital expenditure program and risks associated with the regulatory environment. Ms. Bulkley explained that these should be considered with respect to their overall effect on ILAWC's risk profile relative to the proxy group.

ILAWC notes that although ICB recommended that the Commission adopt Staff's proposed common equity ratio of 49.00%, ICB witness Walters recommended an imputed capital structure with a common equity ratio of 50.00%. His recommendation was based on the common equity ratios authorized by the Commission for six utilities in 2023. Of those six utilities, four utilities had equity ratios authorized at 50.00%, one had an equity ratio authorized at 50.79%, and the sixth one had a 52.58% authorized equity ratio. Mr. Walters argued that these rulings mean this Commission undoubtedly recognized the need for its regulated utilities to maintain a balanced capital structure.

While it is important for the capital structures and included common equity ratios used for ratemaking purposes in this case to be reasonable and comparable, in terms of risk and calculation method, ILAWC states that Mr. Walters has not provided a comparable data set to assess the reasonableness of his proposal as compared to ILAWC's proposal. ILAWC's proposed capital structure is consistent with how the Company's rate base has actually been financed and is reasonable and in line with its peer utilities. Mr. Walters presented no examination of the Company's specific operating risks, capital needs, and market conditions. ILAWC states that he did not identify the utilities for the decisions on the six utilities he references and the equity ratios he quoted, nor did he provide the data to support the ratios to determine whether or not the stated ratios are comparable (i.e., are equivalent adjustments made for CWIP accruing AFUDC) with the ratios ILAWC is proposing in this case.

The Company also notes that for the water utility operating companies included in Mr. Walters' Proxy Group, the average equity ratio is 52.38% and the range of equity ratios for the group is 62.1% to 42.7%, both of which suggest that the ILAWC proposed Step One equity ratio of 52.28% and Step Two equity ratio of 54.43% in the capital structures are reasonable in comparison.

b. Staff's Position

Staff recommends the Commission approve a capital structure containing 49.00% common equity. Staff's recommended capital structure appropriately balances investor and consumer interests while allowing the utility to maintain and support its credit, allowing it to raise needed capital to run its business. Staff presents a proposed table for the Company's capital structure and component costs in Staff Exhibit 12.0, Sch. 12.01.

Staff explains that an optimal capital structure would minimize the cost of capital and maintain a utility's financial integrity. Staff Ex. 3.0 (PUBLIC) at 5. Determining whether a capital structure is optimal remains difficult because (1) the cost of capital is a continuous function of the capital structure, rendering its precise measurement along each segment of the range of possible capital structures problematic; (2) the optimal capital structure is a function of operating risk, which is dynamic; and (3) the relative costs of the different types of capital vary with dynamic market conditions. *Id.* at 5-6. Consequently, Staff opines that it is necessary to determine whether the capital structure is consistent with the financial strength necessary to access the capital markets under most economic conditions and, if so, whether the cost of that financial strength is reasonable. *Id.* at 6.

To evaluate the Company's proposed capital structure, Staff compared the Company's proposed common equity ratio for Step One and Step Two of its proposed two-step increase to the authorized equity ratios for the water industry over the last three years. *Id.* at 8. The average authorized equity ratio for water utilities for the years 2021-2023 is 46.53%, which is lower than ILAWC's proposed common equity ratio for Step One and Step Two of its proposed two-step increase capital structures. *Id.* Staff also compared the level of financial strength implied by the financial ratios of the Company to Moody's Investors Service ("Moody's") Benchmark Ratios for regulated water utilities. *Id.*

Staff explains that Moody's publishes ratio ranges that may generally be seen at different rating levels for regulated water utilities. *Id.* Staff presented each benchmark ratio for ILAWC, its parent company, American Water, Staff's Proxy Group, ILAWC's Proxy Group, and the Water Industry for both 2023 and a three-year average from 2021 through 2023. *Id.* at 8-9. The Moody's financial ratios imply a credit rating of A2 (2023) and A2 (average) for the Company, A3 (2023) and Baa1 (average) for American Water, A3 (2023) and A2 (average) for both Staff's Proxy Group and ILAWC's Proxy Group, and A3 (2023) and A3 (average) for the Water Industry. *Id.* at 9. The Company has higher overall cash flow ratios and lower debt ratios (both indicative of higher financial strength) than the Staff Proxy Group, ILAWC Proxy Group, American Water, and the Water Industry. *Id.* at 9-10.

The Company's proposed equity ratio is much higher than its riskier parent company's common equity ratio of 44.31% in 2023. *Id.* at 10. In comparison to its peers, the Company's proposed capital structure indicates a relatively low degree of financial risk for a water utility. *Id.* Specifically, the average 2023 equity ratios for the Staff Proxy Group, ILAWC Proxy Group, and Water Industry are 45.52%, 45.63%, and 47.37%, respectively. *Id.* The most recent three-year average equity ratios for the Staff Proxy Group, ILAWC Proxy Group, and Water Industry are 44.22%, 44.51%, and 46.53% respectively. *Id.* at 10-11. This denotes a higher degree of financial risk than a common

equity ratio of 52.42% for Step One and 54.46% for Step Two, as ILAWC proposes for itself. *Id.* at 11. Thus, Staff concludes, the Company's proposed capital structure contains much more common equity than needed to support a financially strong water utility.

Staff recommends using an imputed capital structure that contains 0.78% short-term debt, 50.22% long-term debt, and 49.00% common equity. *Id.* Staff imputes a capital structure because the Company's proposed capital structures are not appropriate for determining the Company's capital structure for ratemaking purposes. *Id.* Each of the Company's proposed capital structures would produce a rate of return that violates Section 9-230 of the Act.

Section 9-230 of the Act provides:

In determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges, the Commission shall not include any (i) incremental risk, (ii) increased cost of capital, or (iii) after May 31, 2003, revenue or expense attributed to telephone directory operations, which is the direct or indirect result of the public utility's affiliation with unregulated or nonutility companies.

220 ILCS 5/9-230.

Staff adds that ILAWC has less financial risk than American Water. *Id.* at 13. ILAWC's ratios imply financial strength equal to an A2 Moody's credit rating, whereas American Water's ratios imply financial strength consistent with credit ratings of A3 (2023) and Baa1 (average). *Id.* All else equal, a company with less risk can carry a lower percentage of equity on its balance sheet than a company with greater risk. *Id.* Yet, the Company's forecasted equity ratio is much higher than its riskier parent company's common equity ratio of only 44.31%. *Id.* Both the Company's implied credit ratings and financial ratios indicate that its affiliation with unregulated or non-utility companies has increased its risk. *Id.* Staff asserts that pursuant to Section 9-230 of the Act, the cost associated with that increased risk cannot be reflected in the Company's rates. 220 ILCS 5/9-230.

Staff asserts that ILAWC's assertions that its forecasted stand-alone capital structure should be used for ratemaking purposes and that Staff has not demonstrated Section 9-230 applies is without merit. ILAWC Ex. 23.00 at 4. Corporations have an incentive to maintain relatively low equity ratios (i.e., high debt levels) at the holding company level while maintaining relatively high equity ratios at the utility operating company level. Staff Ex. 12.0 (PUBLIC) at 5. This is because the corporation can borrow at low rates at the holding company and, in turn, invest that capital in the utility, where it will earn relatively high equity returns, which is the concept of "leveraged investing." *Id.* Thus, to service its parent's obligations, the utility subsidiary will often maintain a higher equity ratio than it otherwise would have needed, thereby increasing the utility's cost of capital. *Id.* Staff notes that Illinois courts have held that reflecting even a small amount of that increased cost of capital in the utility's rates violates Section 9-230 of the Act. See, e.g., *Ill. Bell Tel. Co. v. Ill. Com. Comm'n*, 283 Ill. App. 3d 188, 207 (2nd Dist. 1996).

Further, contrary to ILAWC's assertion, Section 9-230 of the Act does not state that ratemaking capital structures must be established on a stand-alone basis; rather, it states that no increased cost of capital resulting from a utility's association with non-utility affiliates can be reflected in the utility's rates. 220 ILCS 5/9-230. The purpose of Section 9-230 of the Act is not to remove positive effects of a utility's unregulated affiliations from the utility's rates, but rather to protect Illinois utility ratepayers from any negative effects of those affiliations.

Additionally, the Company's proposed capital structure indicates a relatively low degree of financial risk for a water distribution utility. Staff Ex. 3.0 (PUBLIC) at 13. In comparison, the average capital structures of the Company and Staff Proxy Groups are not as conservative. *Id.* at 13-14. The equity ratios in 2023 for the Staff Proxy Group, ILAWC Proxy Group, and the Water Industry are 45.52%, 45.63%, and 47.37%, respectively. *Id.* at 14. The recent three-year average equity ratios for the Staff Proxy Group, ILAWC Proxy Group, and the Water Industry are 44.22%, 44.51%, and 46.53%, respectively. *Id.* Thus, the Company's proposed common equity ratios of 52.42% and 54.46% in Step One and Step Two capital structures, respectively, are much higher than those of the Proxy Groups and the Water Industry, which indicates a higher degree of financial risk for the Proxy Groups and Water Industry relative to the Company. *Id.*

To determine whether a capital structure is consistent with a reasonable degree of financial strength, Staff compared the financial strength implicit in the capital structures proposed by Staff and the Company. Staff Ex. 3.0 (PUBLIC) at 15. Staff compared the financial strength implicit in the following two revenue requirements to the Moody's benchmarks for regulated water utilities: (1) Staff's proposed revenue requirement, including Staff's recommended capital structure; and (2) Staff's proposed revenue requirement when the Company's proposed Step One capital structure is substituted for Staff's recommended capital structure. *Id.* Using Staff's proposed capital structure comprised of 49.00% common equity would provide a degree of strength that is consistent with ILAWC's implied A2 Moody's rating while the Company's proposed capital structure indicates a higher degree of financial strength. *Id.* at 16. Staff states that the Company is entitled only to a return sufficient to maintain its financial integrity and attract capital on reasonable terms. *Bluefield*, 262 U.S. at 693; *Hope*, 320 U.S. at 591. The Company has not provided the evidence required to establish that its proposed common equity ratio of 52.42% for Step One and 54.46% for Step Two are necessary to maintain its financial strength. Staff contends that because the Commission should approve no higher equity ratio than is necessary and reasonable to support and maintain the Company's financial strength, the Commission should approve Staff's proposed 49.00% common equity ratio. *Id.* at 16-17.

Staff states that the Commission has repeatedly found in the past that it is a violation of Section 9-230 to approve a proposed capital structure that contains more common equity than needed to support a financially strong utility due to its affiliate relationships. *See, e.g.*, Docket No. 22-0210, Order at 66-67.

Because the Company's proposed capital structure violates Section 9-230 of the Act, Staff recommends using an imputed capital structure. The Commission has repeatedly approved an imputed capital structure in similar circumstances. *See, e.g.*,

Docket No. 22-0210, Order at 66-67; Docket No. 23-0066, Order at 107; *Ameren Ill. Co.*, Docket No. 13-0301, Order at 121 (Dec. 9, 2013).

Staff points to Docket Nos. 11-0280/11-0281 (Cons.) in which the Commission determined that Staff's proposed imputed capital structure was reasonable and adhered to statutory requirements. *N. Shore Gas Co.*, Docket Nos. 11-0280/0281 (Cons.), Order at 108-09 (Jan. 10, 2012). In that docket, Staff proposed an imputed capital structure because the companies' proposed capital structure reflected the increased risk of its affiliated parent corporation. *Id.* at 103. In addition to the companies' proposed capital structure being in violation of Section 9-230, Staff determined an implied credit rating for the companies and argued that the companies' proposed capital structure was unreasonable since it would have resulted in a lower degree of financial risk than its peers in the gas distribution industry, which causes the companies' overall cost of capital to be unnecessarily expensive. *Id.* at 103-04.

The Commission agreed with Staff that both the companies' credit ratings and financial ratios indicate that their affiliation with the unregulated corporate parent has increased its risk. Docket Nos. 11-0280/11-0281, Order at 109. Thus, the Commission determined that it "is prevented by the Act and precedent from adopting a capital structure that reflects the increased risk of [the unregulated corporate parent]." *Id.* The Commission determined that Staff's analysis was reasonable and adhered to the statutory requirements. *Id.* Staff maintains that the Commission should do the same here.

Staff notes that ILAWC argues that Staff's Moody's credit analysis is not persuasive because the categories relied on by Staff only represent 40.00% of the preliminary scoring outcome. The Moody's benchmark ratio analyses performed and relied upon by Mr. Bista are described in the Staff IB at 37-38. However, the factors Staff utilized in its analysis are the factors that are "usually most important for ratings in this sector," as described by Moody's. Staff Ex. 12.0 (PUBLIC) at 8; Attach, E; see *also* Staff IB at 37-38. Further, Staff presented only the financial ratios because the other qualitative measures should not change or will improve as a result of this rate case. *Id.*

Moreover, the business risk factors that Moody's notes reduce operating risk for ILAWC's regulated sister companies, New Jersey American Water Company ("NJAW") and Pennsylvania Water Company ("PAWC"), also apply to ILAWC. Staff Ex. 12.0 (PUBLIC) at 8-9. According to the June 2024 AWK Investor Presentation (Staff Exhibit 12.0 (PUBLIC) at Attach. F), 75.00% of the capital recovery for AWK's expected capital plan of \$34-38 billion in 2024-2033 is expected to be recovered from infrastructure surcharge mechanisms and future test years, which reduces regulatory lag and operating risk for water utilities. Staff Ex. 12.0 (PUBLIC) at 9. Notably, both ILAWC and PAWC are permitted to use future test years in rate proceedings. *Id.* In addition, ILAWC, PAWC, and NJAW are subject to state legislation and regulation that enables growth by fair value and consolidated tariffs. *Id.* Because ILAWC has the same operating risk-reducing features as NJAW and PAWC, ILAWC, PAWC, and NJAW possess a lower degree of operating risk than their parent company, AWK. *Id.*

Staff sees that ILAWC alleges that Staff's peer group common equity capitalization ratios are understated because Staff did not remove CWIP accruing AFUDC from the short-term debt whereas ILAWC reduced its short-term debt balance by CWIP accruing

AFUDC. Staff counters stating that its proportion of short-term debt is the actual proportion of short-term debt in the Company's forecasted average 2025 capital structure. See Staff Ex. 3.0 (PUBLIC) at 14. Further, Staff's historical ratio analysis calculated all capitalization ratios in the same manner. *Id.* Thus, the Company is not correct and the Commission should find that a 49.00% common equity is sufficient to support and maintain the Company's financial strength in this case, similar to the Commission's decision in ILAWC's last rate case, Docket No. 22-0210.

In conclusion, the Company's proposed equity ratio is much higher than its riskier parent company's common equity ratio of 44.31% in 2023. In comparison to its peers, the Company's proposed capital structure indicates a relatively low degree of financial risk for a water utility. *Id.* Further, the Company's proposed equity ratio is much higher than the Proxy Groups and Water Industry for 2023 and 2021-23. *Id.* at 41. The Company's proposed capital structure contains much more common equity than needed to support a financially strong water utility.

For the foregoing reasons, Staff recommends the Commission reject ILAWC's proposed capital structure because it includes more common equity than necessary to maintain ILAWC's financial condition. Instead, Staff recommends the Commission approve Staff's recommended capital structure comprised of 0.78% short-term debt, 50.22% long-term debt and 49.00% common equity.

c. AG's Position

The AG supports ICB witness Walters' proposed ROE of 9.35% and a common equity ratio of 50.00%. ICB Ex. 1.0 at 76. It is unreasonable and unnecessary for ILAWC to have a ROE of 10.75% and a common equity ratio above 50.00% when its captive ratepayers are already struggling to pay their already high bills and the Company has not demonstrated that these proposals are reasonable. See Public Comments. Therefore, the AG requests that the Commission adopt ICB's capital structure and ROE.

d. ICB's Position

ICB argue the Company's proposed ratemaking capital structures in this case are excessively weighted with common equity, resulting in an inflated cost of capital that burdens ratepayers. Further, ICB contend the Company's novel attempt to include a second increase in the equity ratio, inflating it even further beyond the Company's excessive initial test year proposal, provides no benefit to the ratepayers. ICB state the Commission should reject the Company's proposed ratemaking capital structures in favor of a ratemaking capital structure with a reasonable mix of debt and equity that lowers cost to customers while continuing to support the utilities' credit rating and financial integrity.

ICB argue the record in this case demonstrates that the Company's proposed ratemaking equity ratios of 52.28% and 54.43% produce an excessive cost of capital and is more expensive than necessary to support its credit rating and financial integrity. ICB assert the Commission should reject the Company's proposed capital structures and adopt instead Staff's proposed equity ratio of 49% or, in the alternative, an equity ratio no greater than 50%. ICB note Staff demonstrated that its recommended ratemaking capital structure is adequate to support IAWC's credit ratings and financial integrity but at a much lower cost than the Company's proposals. ICB point out Staff's structure is further

supported by ICB witness Walters' recommendation. ICB contend both Staff and ICB demonstrated the Company's continued financial strength does not require bloated equity ratios.

ICB argue the Commission must consider the appropriate ratemaking capital structure in light of the prevailing law, including the Act and legal precedent. ICB note the Act mandates the Commission to only approve rates that are just and reasonable. 220 ILCS 5/9-101. ICB attest Illinois courts have articulated this principle further. In *Citizens Util. Bd. v. Ill. Com. Comm'n*, the Illinois Appellate Court found, "the Act requires the Commission to establish rates which are just and reasonable for both the investors and the consumers." 276 Ill. App. 3d 730, 737 (1995). Accordingly, ICB urge the Commission to adopt an equity ratio that appropriately balances the Company's debt and equity capital, is consistent with the average capital structure that regulatory jurisdictions around the country have authorized and will not cost customers more than is needed to support the Company's financial integrity and access to capital markets.

ICB also note the Appellate Court has found, "The Commission should disallow recovery of any cost of capital in excess of that reasonably necessary for the provision of services. If a utility has included excessive equity in its capital structure, it has inflated the rate of return and its capital cost." *Id.* at 74. ICB contend the Appellate Court has been clear that the Act requires an equity ratio that is no higher than necessary to assure the Company's financial integrity. *Id.* at 737-746.

ICB witness Walters noted in his testimony that average and median Commission-authorized equity ratios around the country have floated between 50.00% and 52.00% since 2013. ICB Ex. 1.0 at 6-7: Table CCW-2. ICB note, meanwhile, credit ratings have improved steadily across the natural gas utility industry since 2009. *Id.* at 8. ICB point out that natural gas utilities have more analytical coverage than water utilities and are often used as proxy groups for water utilities and are therefore a good reference point on this issue. *Id.* ICB note the Regulatory Research Associates' November 2023 Utility Capital Expenditures Report found that "capex estimates for both 2024 and 2025 indicate successively higher spending levels," "[t]he nation's electric, gas, and water utilities are investing in infrastructure," and "[m]ultiple drivers are expected to impel elevated spending over the next several years." *Id.* at 9. ICB witness Walters' Figure CCW-2 from his direct testimony, illustrates the upward trend in utility capital expenditures, demonstrating just how effective utilities have been in attracting capital.

ICB argue the utilities rate base expenditure growth, and the ensuing growth in shareholder profits, cast serious doubt on any utility company's alleged need to increase its ratemaking equity ratio or return. See *Id.* at 10-11. ICB point out that as shown in Figure CCW-2, capital investments for the utility industry continue to stay at elevated levels, and these are expected to fuel utilities' profit growth into the foreseeable future. *Id.* ICB assert that this shows that the capital investments are enhancing shareholder value and are attracting both equity and debt capital to the utility industry in a manner that allows for funding these elevated capital investments. *Id.* ICB argue this makes the Commission's role all the more important – they must be careful to maintain reasonable prices and tariff terms and conditions to protect customers' need for reliable utility service at reasonable rates in the context of this sky-rocketing profits. *Id.* If this is not done, utility

rates will expand beyond the ability of customers to pay, resulting in revenue constraints for utilities, which will impact their financial integrity. *Id.*

Mr. Walters' review of metrics such as price-to-earnings, price-to-cash flow, and market price-to-book ratios also showed a strong current utility security valuation that is robust relative to the last several years. *Id.* at 11. ICB suggest further, these strong valuations of utility stocks indicate that utilities have access to equity capital under reasonable terms and at lower costs. *Id.* ICB contend market data reflects that credit standing and access to capital have been quite robust for utilities over the last several years, even throughout the duration of the global pandemic. *Id.* at 12.

Mr. Walters also reviewed the Federal Reserve and found the Fed has implemented procedures to support the economy's effort to achieve policy objectives of achieving maximum employment and managing long-term inflation to the 2% level. *Id.* at 12-15. ICB point out that independent analyst consensus reflect that interest rate increases are happening more modestly compared to pre-pandemic levels. *Id.* at 15-19. ICB note credit rating agencies have noted increased concerns about rate affordability when assigning credit ratings. *Id.* at 19-22. Further, as Mr. Walters noted, considering the make up of the utility market, utilities have been able to deliver generally positive and relatively stable returns during a period of elevated inflation, rising interest rates, and uncertainty because of geopolitical events around the world. *Id.* at 23-24. ICB assert that taking these factors together, any assertion that the Company needs to increase its capital costs beyond what the market currently requires, in anticipation of foreseeable future market fluctuations, finds no support in the record.

ICB point out that in Staff testimony, Mr. Bista noted the average authorized equity ratio for water utilities for the years 2021-2023 is 46.53%, far below the requested ratios of 52.27% and 54.43% from the Company. Staff Ex. 3.0 at 7. ICB suggests additionally, the average authorized equity ratio for the same time period for the Staff Proxy Group is just 44.22%. *Id.* ICB argue these differences highlight the egregious nature of the Company's request.

ICB note Mr. Bista, when developing his recommended equity ratio, compared the relative financial strength implied by the Company's standing according to Moody's Benchmark Ratios for regulated water utilities. *Id.* at 8. ICB point out the four metrics Moody's focuses on are (1) cash flow from operations before changes in working capital ("CFO pre-WC") interest coverage, (2) CFO pre-WC to total debt, (3) CFO pre-WC less dividends to total debt coverage, and (4) debt to capitalization. *Id.* at 8. ICB note Mr. Bista demonstrated that these metrics implied a credit rating for the Company of A2. *Id.* at 8-10. ICB further note the metrics also implied credit ratings of A2 or A3 for the Proxy Group used by Staff and the Company. *Id.* ICB contend this suggests higher levels of financial strength of the Proxy Group and the Company. *Id.*

ICB point out that Mr. Bista also notes that the Company requests a significantly higher equity ratio, for both proposed steps, than that of its parent company, American Water. *Id.* at 10. ICB note American Water's equity ratio was just 44.31% in 2023. *Id.* ICB note further, the Company's requested equity ratios are far greater than those of the Proxy Groups, which ranged from 45.52% to 47.37%. *Id.* at 10. ICB maintain the lower

equity ratios reflect a higher level of risk, reflecting the Company's proposal contains more equity than needed to support a financially strong water utility. *Id.* at 11.

ICB note that because of the issues noted above, Mr. Bista recommends the Commission use an imputed capital structure that contains 0.78% short-term debt, 50.22% long-term debt, and 49.00% common equity. *Id.* at 11. Mr. Bista showed this imputed capital structure would allow the Company to maintain its current implied credit rating. *Id.* at 15-17.

ICB observe that U.S. Supreme Court precedent and the text of the Act and past Commission interpretations of the Act are clear that the Commission is not to approve a ratemaking equity ratio higher than necessary to support the Company's finances, under the assumption of prudent management. The Company has not and cannot justify the proposed equity ratios. For the foregoing reasons, ICB recommend that the Commission adopt a 49.00% ratemaking equity ratio for IAWC, as proposed by Mr. Bista, and certainly no greater than 50% as detailed by Mr. Walters. See *Id.* at 11; ICB Ex. 1.0 at 31. ICB estimate this adjustment would reduce IAWC revenue requirements by \$7.7 million.

e. Commission Analysis and Conclusion

The Commission notes that a proper capital structure minimizes the cost of capital while maintaining a utility's financial integrity. The Company is proposing a two-tier capital structure. The Company proposed a common equity ratio of 52.42% for Step One and 54.46% for Step Two. Staff recommends that the Commission reject the Company's two step approach and approve a common equity ratio of 49.00%. ICB also recommend that the Commission reject the Company's proposed capital structures and adopt instead Staff's proposed equity ratio of 49.00% or, in the alternative, an equity ratio no greater than 50.00%. The AG supports the common equity proposed by ICB of no more than 50.00%. The Commission must determine whether ILAWC's proposed common equity ratio is more than needed to support the Company's financial stability.

To evaluate the Company's proposed capital structure, Staff compared the Company's proposed common equity ratio for Step One and Step Two of its proposed two-step increase to the authorized equity ratios for the water industry over the last three years. The average authorized equity ratio for water utilities for the years 2021-2023 is 46.53%, which is lower than ILAWC's proposed common equity ratio for Step One and Step Two of its proposed two-step increase capital structures. Staff also compared the level of financial strength implied by the financial ratios of the Company to Moody's Benchmark Ratios for regulated water utilities. Staff found that ILAWC's proposed equity ratio is much higher than its riskier parent company's common equity ratio of 44.31% in 2023. By proposing a much higher common equity ratio than its riskier parent company, the Company's proposal reflects an increased cost of capital due to its affiliation with its parent company, which violates Section 9-230 of the Act. Staff notes that in comparison to its peers, the Company's proposed capital structure indicates a relatively low degree of financial risk for a water utility. According to Staff, the Company's proposed capital structure contains much more common equity than needed to support a financially strong water utility.

ICB argues that ILAWC's proposed capital structure is excessively weighted with common equity, resulting in an inflated cost of capital that burdens ratepayers and that

the proposed second common equity ratio increase provides no benefit to ratepayers. ICB argues that the Company's proposed capital structure contains more common equity than necessary to support its credit rating and financial integrity and that the record does not support a common equity ratio greater than 50.00%.

The Commission adopts Staff's proposed capital structure. The Company failed to show that higher common equity ratios are needed to support its financial integrity. The two-tier proposal would not provide savings to ratepayers and is rejected. The Company's requested equity ratios are much higher than those of its water utility peers, which indicates that the water utility peers have a higher financial risk than the Company. The Company challenged Staff's quantitative analysis; however, it did not provide its own quantitative analysis to be evaluated. Further, ILAWC's proposed equity ratios are much higher than its riskier parent company's common equity ratio of 44.31% in 2023. Since common equity is a utility's most expensive type of capital, authorizing a higher equity ratio than necessary would improperly increase the utility's overall cost of capital. Staff showed that the proposed equity ratio is high due to the utility's affiliate relationships, which is a violation of Section 9-230 of the Act. The record indicates that a 49.00% common equity is consistent with ILAWC's implied A2 Moody's rating while the Company's proposed capital structure comprising more than 52.00% common equity indicates a higher degree of financial strength. The Commission finds that a capital structure of 49.00% common equity would be consistent within a reasonable degree of financial strength for the Company. Staff's recommendation supports rate affordability and supports the utility's financial integrity and credit rating.

Accordingly, the Commission adopts Staff's recommended capital structure that contains 0.78% short term debt, 50.22% long term debt and 49.00% common equity.

2. Cost of Short-Term Debt

a. ILAWC's Position

The Company proposes a cost of short-term debt of 4.851% at Step -One1 and 4.50% at Step Two. ILAWC Ex. 23.00 at 15; Update Part 285 Schs. D-1 at 1-2, D-2 at 1; Staff Ex. 12.0, Sch. 12.01. Staff recommends a cost of short-term debt of 5.55%. Staff Exs. 3.0 at 17; 12.0, Sch. 12.01. The Company explains that it opposes Staff's recommendation as it does not reflect market expectations for short-term borrowing rates and is based on historical information.

The Company states it updated short-term debt cost rate reflects more recent projections based on the Overnight Index Swap ("OIS") forward curve with the current credit spread applied. The OIS forward curve is the only observable future risk-free rate available universally. The OIS forward curve is the market benchmark for risk-free rates because it does not consider the credit quality of banking partners; it is entirely void of any credit component. While, according to ILAWC, it is difficult to predict future rates with precision, market data—including economic performance, Federal Reserve monetary policy, and other indicators—are embedded into the OIS forward curve. Therefore, it is a frequently used market convention as a basis for forecasting future rates when required. ILAWC recommends that its forecasted short-term debt rate be used.

ILAWC states that Staff bases its position on a series of Commission orders that Staff says show a preference for current, observable market interest rates. But ILAWC contends it is unclear how strong this preference really is—in recent rate orders, the Commission has approved use of short-term debt costs based on forecasted interest rates. *Ameren III. Co.*, Docket No. 22-0487(Cons), Order at 270 (Dec. 14, 2023). ILAWC states that Staff’s concerns about use of forecasts are undermined by routine use of forecasted information elsewhere. For example, for his constant growth DCF model, Mr. Bista relied on projected quarterly dividends and projected EPS growth rates from Zacks Investment Research (“Zacks”), S&P Market Intelligence, and Value Line, as well as projected dividend per share (“DPS”) growth rates from Value Line. Therefore, ILAWC recommends its cost of short-term debt be approved.

b. Staff’s Position

Staff recommends a cost of short-term debt of 5.55%. Staff Ex. 3.0 (PUBLIC) at Sch. 3.01; Staff Ex. 12.0 (PUBLIC) at 3. ILAWC obtains short-term debt through a line of credit from American Water Capital Corp. (“AWCC”), American Water’s financing subsidiary. Staff Ex. 3.0 (PUBLIC) at 17. AWCC’s commercial paper rating is P-2 from Moody’s. *Id.* The average term for ILAWC’s short-term debt for 2023 is 19 days. *Id.* Thus, to estimate ILAWC’s cost of short-term debt using AWCC’s cost of commercial paper, Staff converted the April 2, 2024 15-day P-2 commercial paper discount rate of 5.46% into an annual yield of 5.55%, using the formula set forth on pages 17-18 of Staff Ex. 3.0 (PUBLIC).

Staff recommends the Commission reject the Company’s projected cost of short-term debt. Given the difficulty of accurately forecasting interest rates, the Commission should instead continue to rely on current, observable market interest rates which, unlike forecasts, reflect market forces and investors’ expectations for the future. See Staff Ex. 3.0 (PUBLIC) at 52. Staff opines that the use of current, observable market interest rates renders the use of forecasted interest rates unnecessary as it reflects all relevant, available information, including analysts’ appraisals of the value of current expectations for the future. *Id.* In other words, if investors believe that the forecasts are valuable, that belief would be reflected in current market interest rates. *Id.* at 52-53. Conversely, if investors believe the forecasts are not valuable, that belief would also be reflected in current market interest rates. *Id.* at 53.

To support its position, Staff argues the Commission has repeatedly stated its preference for using current observable interest rates over forecasted interest rates. See, e.g., Docket No. 23-0067, Order at 194-95; Docket No. 22-0210, Order at 100; Docket No. 21-0198, Order at 81-82; see also *Util. Servs. of Ill., Inc.*, ICC Final Order, Docket No. 21-0198 at 69 (Dec. 1, 2021); see also *N. Shore Gas Co.*, Docket Nos. 14-0224/14-0225 (Cons.), Order at 111 (Jan. 21, 2015).

Staff contends the Company has failed to provide any new evidence to support its use of forecasted interest rates. For these reasons, Staff recommends that the Commission continue to rely on current, observable market interest rates which, unlike forecasts, reflect market forces and investors’ expectations for the future, and adopt Staff’s recommended 5.55% cost of short-term debt.

Staff notes that ILAWC argues that its proposed cost of short-term debt reflects more-recent projections based on the OIS forward curve with the current credit spread applied. *Id.* However, ILAWC admits that actual interest rates may be higher or lower than the OIS forward curve due to market factors and other unforeseen events. ILAWC IB at 70. Given the difficulty of accurately forecasting interest rates, rather than rely on forecasted interest rates, Staff states the Commission should instead continue to rely on current, observable market interest rates which, unlike forecasts, reflect market forces and investors' expectations for the future. It is Staff's position that the Company has failed to provide any new support for its use of forecasted interest rates.

c. ICB's Position

ICB support the adoption of Staff witness Bista's proposed 5.55% cost of short-term debt for IAWC (see Staff Ex. 3.0 Schedule 3.01) and the rejection of ILAWC's proposed 4.55% cost of short-term debt.

d. Commission Analysis and Conclusion

The Company proposes a cost of short-term debt of 4.851% at Step One and 4.50% at Step Two. Staff proposes a cost of short-term debt of 5.55%, which is supported by ICB. The Company opposes Staff's recommendation as it does not reflect market expectations for short-term borrowing rates and is based on historical information.

The Commission adopts Staff's cost of short-term debt of 5.55%. Staff relies on market rates instead of forecasting that reflect market forces and investors' expectations for the future. The Commission agrees with Staff that, the use of current, observable market interest rates renders the use of forecasted interest rates unnecessary as it reflects all relevant, available information, including analysts' appraisals of the value of current expectations for the future. The Commission has consistently rejected forecasted interest rates. The Commission has previously determined that interest rates that are forecasted are notoriously inaccurate. It is difficult if not impossible to predict whether interest rates will rise or fall. The Company has not provided any basis for the Commission to deviate from its practice. The Commission finds that the Company's cost of short-term debt should be based on market rates and not forecasting. The Company cites to the Ameren multi-year rate case, Docket Nos. 22-0487/23-0082/24-0238 (Cons.), to support its position. However, the Commission notes that that docket is not an Article 9 rate case, and it is not relevant to this type of proceeding.

3. Cost of Long-Term Debt

a. ILAWC's Position

ILAWC proposes a cost of long-term debt of 4.62%. ILAWC Ex. 23.00 at 14; Staff Ex. 12.0, Sch. 12.01. ILAWC explains this is based on updated long-term debt cost rate information. In May 2024, ILAWC received long-term 10-year and 30-year debt at a market cost rate of 5.15% and 5.45%, respectively. Long-term interest rates for 2024 decreased by 75 basis points for both the ten- and thirty-year bonds. The assumed cost rates at initial filing for the ten- and thirty-year issuances were 5.90% and 6.20%. Due to changing market conditions, the Company states it is also updating its forecasted rates for 2025 and 2026. Long-term interest rates for 2025 decreased by 30 basis points for the ten-year bond and basis points bps for the thirty-year bond. The assumed cost rates

at initial filing for the ten- and thirty-year issuances were 5.80% and 6.10%. The updated cost rates for the ten- and thirty-year issuances are 5.50% and 5.65%.

Staff proposes a long-term debt rate of 4.46%, based on applying current long-term debt rates to ILAWC's projected 10-year and 30-year long-term debt issuances expected to occur in 2025. The Company states it does not agree with this approach of applying the 2024 issuance coupons to the forecast 2025 debt issuances. While forecasting interest rates can be difficult, according to ILAWC, it is a widely used and accepted practice across regulatory jurisdictions. ILAWC maintains that using a single data point, as Mr. Bista suggests, is akin to taking an average of a sample size of one. It easily is distorted by anomalies. In this case, the credit spreads that were achieved in the 2024 debt issuance were 14 and 16 basis points lower than the 10-year average of historical credit spreads. At the time of the 2024 issuance, ILAWC explains investment grade credit spreads were at near historic lows, a trend that is widely expected to reverse as the Federal Reserve tries to ease inflation and cool economic activity. Additionally, the underlying treasury rate in the coupons are a single point estimate whereas the forecast used by ILAWC is essentially an average of market participants' expectations for what interest rates will be in 2025. Staff contends there is a Commission preference for using current rates, ILAWC explains that in a time of changing market conditions, use of near-term (2025) forecasted interest rates for long-term debt is more appropriate.

b. Staff's Position

Staff recommends the Commission approve an embedded cost of long-term debt of 4.46%. Staff Ex. 12.0 (PUBLIC) at 12. Staff's recommendation reflects the Company's recent issuance of 10-year and 30-year long-term debt in May 2024 at coupon rates of 5.15% and 5.45%, respectively. *Id.*; ILAWC Ex. 23.00 at 14.

To calculate the Company's embedded cost of long-term debt, Staff relied on current interest rates for the long-term debt the Company expects to issue in 2025 rather than the projected interest rate the Company used. Staff Ex. 12.0 (PUBLIC) at 18. Staff applied these current long-term debt rates to the projected 10-year and 30-year long-term debt issuances the Company expects to occur in 2025. *Id.* Next, Staff adjusted the Company's 2023 cost of long-term debt to reflect the end-of-year amounts from ILAWC's Form 22 annual report for the unamortized balances of the debt discount or premium and debt expense and the corresponding amortization amounts, using straight-line amortization to calculate the annual amortization expense for each debt series. Staff Ex. 3.0 (PUBLIC) at 18-19.

Staff explains that ILAWC originally recommended embedded costs of long-term debt of 4.70% (Step One) and 4.72% (Step Two), then updated those costs to 4.62% (Step One) and 4.63% (Step Two) after the Company issued its long-term 10-year and 30-year debt during May 2024 at market rates of 5.15% and 5.45%, respectively. ILAWC Sch. D-1; ILAWC Ex. 23.00 at 14. The long-term interest rates in May 2024 were 75 basis points lower for both the 10-year and 30-year bonds issuances than the Company's original projections of 5.90% and 6.20%, respectively. ILAWC Ex. 23.00 at 14.

Due to changing market conditions, the Company updated its forecasted rates for 2025 and 2026. The Company reduced projected long-term interest rates for 2025 issuances by 30 basis points for the 10-year bond and 45 basis points for the 30-year

bond. ILAWC Ex. 23.00 at 14. The updated cost rates for the 10-year and 30-year bond issuances are 5.50% and 5.65%. *Id.* at 15. The Company's forecasted long-term debt rates are based on the forward curves of the 10 and 30-year U.S. Treasury bonds plus a credit spread. ILAWC Ex. 9.00 Rev. at 8.

ILAWC disagrees with Staff's approach of applying the current interest rates for the May 2024 bond issuances to the forecast 2025 debt issuances and argues the Commission should use forecasted interest rates for expected debt issuances during 2025. ILAWC Ex. 36.00 at 15. Using forecasted interest rates for 2025 rather than current interest rates in May 2024 would increase the long-term 10-year and 30-year debt issuances by 35 basis points and 20 basis points, respectively. ILAWC Sch. D-3. The use of current, observable market interest rates renders the use of forecasted interest rates unnecessary as it reflects all relevant, available information, including analysts' appraisals of the value of current expectations for the future. Further, Staff asserts that the Commission has repeatedly stated its preference for using current observable interest rates over forecasted interest rates. *Id.* Staff reincorporates and restates its arguments in Section III.C.2., above in favor of current interest rates rather than forecasted interest rates. *Id.*

Staff states current interest rates have proven to be better predictors of future interest rates than forecasts and the Commission has repeatedly rejected the use of interest rate forecasts and approve the use of current interest rates.

Staff explains that its recommendation uses current interest rates as proxies for the Company's projected interest rates. ILAWC proposes a cost of long-term debt of 4.62% based on forecasted long-term interest rates for 2025. ILAWC Using forecasted interest rates rather than current interest rates results in an increase of 35 basis points for 10-year debt issuances and 20 basis points for 30-year debt issuances.

Staff takes issue with ILAWC's argument that using multiple interest rates and averaging them together is a better approach than using a single interest rate because the single, current, observable market interest rate is easily distorted by anomalies. Staff does not believe averaging multiple interest rates from different points in time is groundless. Current, observable market interest rates reflect all relevant, available information, including analysts' appraisals of current value and expectations of future value. There is only one current, observable market interest rate at any given point in time. If Staff were required to average multiple interest rates, it would need to either incorporate (a) past observable market interest rates, which are based on outdated information; or (b) forecasted future market interest rates, which are unreliable. Using past interest rates or forecasted future market interest rates would distort the single, current, observable market interest rate because it would alter that current rate based on either outdated information or unreliable information.

c. ICB's Position

ICB support the adoption of Staff witness Bista's proposed 4.46% cost of long-term debt for IAWC (see Staff Ex. 3.0 Schedule 3.01) and the rejection of IAWC's proposed 4.62% cost of long-term debt.

d. Commission Analysis and Conclusion

ILAWC proposes a cost of long-term debt of 4.62%. Staff recommends the Commission approve an embedded cost of long-term debt of 4.46%. ICB supports Staff's proposed cost of long-term debt.

Staff's recommendation is based on current interest rates for the May 2024 bond issuances to forecast 2025 debt issuances. The Company uses forecasted interest rates for 2025 to calculate its long-term debt. The Commission has repeatedly rejected the use of forecasted interest rates because they tend to inflate the debt issuance. The Company failed to provide any basis for the Commission to deviate from the practice of using current rates instead of forecasted rates. Therefore, the Commission adopts Staff's recommended embedded cost of long-term debt of 4.46%.

4. Cost of Common Equity

a. ILAWC's Position

ILAWC states that the parties presented a wide range of estimates of the return on equity (ROE): ILAWC requested an ROE of 10.75%; Staff recommended an ROE of 9.84%, which is slightly higher than what the Commission approved in the Company's last rate case two years ago; and ICB, despite the significant changes that have occurred in the financial markets since the Company's last case, recommended that the Commission reduce ILAWC's ROE to 9.34%. ILAWC asserts that its proposed ROE of 10.75% is the most reasonable of the alternatives and is supported by sound, clear and convincing evidence. The Company also argues that Staff's proposal would understate investors' required return, and ICB's proposal would be far below what is reasonable.

ILAWC's ROE Analysis and Response to Staff's and ICB's Critique of the Analysis

ILAWC witness Ann Bulkley prepared and presented the Company's ROE analysis and recommendation. Ms. Bulkley used established standards for determining a fair and reasonable authorized ROE for public utilities, including consistency of the allowed return with the returns of other businesses having similar risk, adequacy of the return to provide access to capital and support credit quality, and the requirement that the result lead to just and reasonable rates. *Bluefield*, 262 U.S. 679, 692-93; *Hope*, 320 U.S. 591, 603.

To develop her ROE recommendation in this proceeding, Ms. Bulkley first developed a proxy group of utility companies, which included both water utilities and electric and gas utilities that face risk comparable to that faced by ILAWC. To that proxy group, she applied the Constant Growth form of the Discounted Cash Flow ("DCF") model, the Capital Asset Pricing Model ("CAPM"), and the Empirical Capital Asset Pricing Model ("ECAPM"). She established a range of results produced by this financial modeling. Her conclusion as to the appropriate ROE for ILAWC within that range of results was based on Company's business and financial risk relative to the proxy group and her assessment of market conditions. Although the companies in her proxy group are generally comparable to ILAWC, each company is unique. Accordingly, she considered the Company's business, financial and regulatory risk in aggregate relative to that of the proxy group companies when determining where the Company's ROE should fall within the reasonable range of analytical results to appropriately account for any residual differences in risk.

ILAWC explains that Ms. Bulkley also considered the current and projected capital market conditions on investors' return requirements. Capital market conditions are expected to affect the results of the cost of equity estimation models. ILAWC states it is appropriate to consider all of these factors when estimating a reasonable range of the investor-required cost of equity and the recommended ROE for ILAWC. ILAWC Ex. 13.00 at 7-8.

Ms. Bulkley concluded that, considering the analytical results of her modeling, and the regulatory, business, and financial risk faced by ILAWC's water and wastewater operations relative to the proxy group, and current capital market conditions, a range from 10.00% to 11.25% is reasonable, and an authorized ROE of 10.75% for ILAWC is appropriate. *Id.* at 8. Subsequently, she updated her cost of equity analyses based on market data through May 31, 2024. The results of her updated analyses demonstrated that the cost of equity was consistent with the filing of her direct testimony and that no change to her range or recommendation was warranted.

ILAWC explains that the United States Supreme Court's *Hope* and *Bluefield* decisions established the standards for determining the fairness or reasonableness of a utility's authorized ROE. Among the standards established by the Court in those cases are: (1) consistency of the return with other businesses having similar or comparable risks; (2) adequacy of the return to support credit quality and access to capital; and (3) the principle that the specific means of arriving at a fair return are not important, only that the end result leads to just and reasonable rates.

But the Company recognizes that fixing a fair rate of return is not just about protecting the utility's interests. As the Court noted in *Bluefield*, a proper rate of return not only assures "confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit [but also] enable[s] the utility] to raise the money necessary for the proper discharge of its public duties." *Bluefield*, 262 US 679, 693 (1923). As the Court went on to explain in *Hope*, "[t]he rate-making process ... involves balancing of the investor and consumer interests." *Hope*, 320 US 591, 603 (1944). ILAWC notes the Commission has provided similar guidance in establishing the appropriate return on common equity. See *Ameren III. Co.*, Docket No. 20-0308, Order at 168 (Jan. 13, 2021).

ILAWC explains that the ratemaking process is premised on the principle that, if investors and companies are to commit the capital needed to provide safe and reliable utility services, a utility must have a reasonable opportunity to recover the return of, and the market-required return on, its invested capital. Accordingly, the Commission's order in this proceeding should establish rates that provide the Company with a reasonable opportunity to earn a ROE that is: (1) adequate to attract capital at reasonable terms; (2) sufficient to ensure its financial integrity; and (3) commensurate with returns on investments in enterprises with similar risk.

According to ILAWC, regulatory commissions and analysts recognize that current market conditions affect the results of the cost of equity estimation models. As a result, it is important to consider the effect of the market conditions on these models when determining an appropriate range for the ROE and the recommended ROE for ratemaking purposes for a future period. If investors do not expect current market conditions to be

sustained in the future, it is possible that the cost of equity estimation models will not provide an accurate estimate of investors' required return during that rate period.

ILAWC explains that the cost of equity for regulated utility companies is affected by several factors in the current and prospective capital markets, including: (1) changes in monetary policy; (2) relatively high inflation; and (3) increased interest rates that also are expected to remain relatively high over the next few years. These factors affect the assumptions used in the cost of equity estimation models.

Core inflation increased steadily beginning in early 2021, rising from 1.41% in January 2021 to a high of 6.64% in September 2022, which was the largest 12-month increase since 1982. Since that time, while core inflation has declined in response to the Federal Reserve's monetary policy, it continues to remain above the Federal Reserve's target level of 2%. While inflation has declined from its peak, it still is above the Federal Reserve's target of 2%, and therefore, the Federal Reserve anticipates maintaining short-term interest rates higher for longer in order to achieve its goal of 2% inflation over the long-run.

As the Federal Reserve has substantially increased the federal funds rate in response to increased levels of inflation that have persisted for longer than originally projected, ILAWC explains, longer term interest rates have also increased. ILAWC notes that since the Company's last rate proceeding, long-term interest rates have increased approximately 93 basis points.

Moreover, ILAWC explains, leading equity analysts have noted that they expect the yields on long-term government bonds to remain elevated. ILAWC states that if interest rates remain relatively high as expected, then the share prices of utilities would be expected to decline. If the prices of utility stocks decline, then the DCF model, which relies on historical averages of share prices to calculate the dividend yield, is likely to understate the dividend yield and thus the cost of equity.

ILAWC states that because the cost of equity in this proceeding is being estimated for the future period that the Company's rates will be in effect, and because the cost of equity is expected to increase over the near term for utilities, cost of equity estimates based in whole or in part on historical or current market conditions, as opposed to projected market conditions, will likely understate the cost of equity during the future period that the Company's rates will be in effect. Therefore, these current and expected market conditions support consideration of the higher end of the range of cost of equity results produced by the DCF models, and warrant consideration of forward-looking cost of equity estimation models such as the CAPM and ECAPM, which better reflect expected market conditions.

Staff explains that because the ROE is a market-based concept, and given the fact that ILAWC is not a publicly-traded entity, it was necessary for Ms. Bulkley to establish a group of companies that is both publicly-traded and comparable to the Company in certain fundamental business and financial respects to serve as its "proxy" for purposes of the ROE estimation process. ILAWC states that the proxy companies used in Ms. Bulkley's analyses all possess a set of operating and financial risk characteristics that are substantially comparable to ILAWC, and, therefore, provide a reasonable basis for deriving the appropriate ROE.

Ms. Bulkley's selection of a proxy group began with the group of 16 U.S. utilities that Value Line classifies as "Water Utilities" and "Natural Gas Distribution Companies." She simultaneously applied the following screening criteria to select companies that:

- pay consistent quarterly cash dividends because companies that do not cannot be analyzed using the Constant Growth DCF model;
- have investment grade long-term issuer ratings from S&P and/or Moody's;
- are covered by at least two utility industry analysts;
- have positive long-term earnings growth forecasts from at least two utility industry equity analysts;
- derive more than 70.00% of their total operating income from regulated operations; and
- were not parties to a merger or transformative transaction during the analytical periods relied on.

ILAWC Ex. 13.00 at 31-32.

In determining which electric utilities would qualify for inclusion in the proxy group, ILAWC explains, Ms. Bulkley started by relying on the criteria used to screen the water and natural gas utilities. She then applied two additional screening criteria to only include electric utilities that would be considered risk comparable to ILAWC which:

- have owned generation comprising less than 10% of the Company's MWh sales to ultimate customers to ensure that the electric utilities included did not own a substantial amount of generation and therefore had operations that were primarily transmission and distribution; and
- own water and wastewater operations.

Id. at 32.

The screening criteria discussed above resulted in a proxy group consisting of the following companies: Atmos Energy Corporation, NiSource Inc., Northwest Natural Gas Company, ONE Gas, Inc., Spire, Inc., Eversource Energy, American States Water Company, California Water Service Group, Middlesex Water Company, SJW Group and Essential Utilities, Inc.

Ms. Bulkley explained that she included electric utilities and natural gas distribution companies in the proxy group because Value Line currently classifies only seven companies as water utilities. *Id.* Therefore, the universe of water utilities was already small before the screening criteria were applied. She noted that, additionally, there has been a recent trend towards consolidation in the utility industry, which reduces the number of available proxy companies. *Id.* Accordingly, she also considered electric utilities and natural gas distribution companies that met the screening criteria, such as Eversource Energy, which has electric distribution and water utility operations. *Id.* at 34.

Ms. Bulkley further explained that it is reasonable to rely on a combined proxy group because the electric utilities and natural gas distribution companies included in her

proxy group generate a large portion of their operating income from regulated operations similar to ILAWC and the water utilities that are included in the proxy group. *Id.* As a result, it was appropriate to include relevant natural gas and electricity distribution companies in the proxy group. She also observed that in ILAWC's last rate proceeding (Docket No. 22-0210), the Commission agreed that a proxy group of water and public utility companies was a reasonable sample upon which to apply the various ROE estimation models. Docket No. 22-0210, Order at 102.

ILAWC explains that the required cost of equity should be estimated by using multiple analytical techniques that rely on market-based data to quantify investor expectations regarding required equity returns, adjusted for certain incremental costs and risks. Informed judgment is then applied to determine where the given company's cost of equity falls within the range of results produced by multiple analytical techniques. The key consideration in determining the cost of equity is to ensure that the methodologies employed reasonably reflect investors' views of the financial markets in general, as well as the subject company (in the context of the proxy group), in particular.

Ms. Bulkley considered the results of the Constant Growth DCF model, the CAPM and the ECAPM. She explained that it is important to use more than one analytical approach because the cost of equity is not directly observable and must be estimated based on both quantitative and qualitative information. ILAWC explains that current market conditions increase the importance of using more than one analytical approach. Therefore, it is important to use multiple analytical approaches to ensure that the cost of equity results reflect market conditions that are expected during the period that the Company's rates will be in effect.

ILAWC states that the DCF approach is based on the theory that a stock's current price represents the present value of all expected future cash flows. The Constant Growth DCF model, which Ms. Bulkley employed, requires the following assumptions: (1) a constant growth rate for earnings and dividends; (2) a stable dividend payout ratio; (3) a P/E ratio; and (4) a discount rate greater than the expected growth rate. ILAWC Ex. 13.00 at 40. To the extent any of these assumptions is violated, considered judgment and/or specific adjustments should be applied to the results.

The dividend yield in Ms. Bulkley's Constant Growth DCF model is based on the proxy companies' current annual dividend and average closing stock prices over the 30-, 90-, and 180-trading days as of November 30, 2023. She used an average of recent trading days to calculate the term P0 in the DCF model to reflect current market data while also ensuring that the result of the model is not skewed by anomalous events that may affect stock prices on any given trading day. She adjusted the dividend yield to account for periodic growth in dividends.

Ms. Bulkley explained that it is important to select appropriate measures of long-term growth in applying the DCF model. In its Constant Growth form, the DCF model assumes a single growth estimate in perpetuity. To reduce the long-term growth rate to a single measure, one must assume that the payout ratio remains constant and that earnings per share, dividends per share and book value per share all grow at the same constant rate. Over the long run, however, dividend growth can only be sustained by

earnings growth. Therefore, it is important to consider a variety of sources in arriving at a singular long-term earnings growth rate for the Constant Growth DCF model.

Ms. Bulkley also explained her Constant Growth DCF model incorporated the following sources of long-term growth rates: (1) consensus long-term earnings growth estimates from Zacks Investment Research; (2) consensus long-term earnings growth estimates from Thomson First Call (provided by Yahoo! Finance); and (3) long-term earnings growth estimates from Value Line.

Ms. Bulkley relied on EPS growth rates rather than dividend growth rates in the Constant Growth DCF analyses because dividend growth ultimately depends on earnings growth. Dividend growth can fluctuate from year-to-year as a utility company responds to changes in the economic environment and the capital needs of its business. Over time, however, earnings growth rates and dividend growth rates should be approximately the same.

Ms. Bulkley calculated the expected dividend yield by adjusting the dividend yield to reflect the growth rate that was being used in that particular scenario. This ensured that the growth rate used in the dividend yield calculation and the growth rate used as the “g” term of the DCF model are internally consistent.

She calculated a low-end result for her DCF model using the minimum growth rate of the three sources (i.e., the lowest of the Zacks, Yahoo Finance, and Value Line projected earnings growth rates) for each of the proxy group companies. She used a similar approach to calculate a high-end result, using the maximum growth rate of the three sources for each proxy group company. The mean results were calculated using the average growth rate from all three sources for each proxy group company.

The mean and median DCF results using the average growth rates range from 9.28% to 10.16%, and the mean and median results using the maximum growth rates range from 10.64% to 11.31%. While she also summarized the DCF results using the minimum growth rates, given the expected underperformance of utility stocks going forward and thus the likelihood that the DCF model is understating the cost of equity, she did not believe it was appropriate to consider these understated DCF results.

According to ILAWC, one primary assumption of the DCF models is a constant price-to-earnings ratio. That assumption is heavily influenced by the market price of utility stocks. Because utility stocks are expected to underperform the broader market over the near-term as interest rates remain elevated and yields on long-term government bonds exceed utility dividend yields, it is important to consider the results of the DCF models with caution. Therefore, although Ms. Bulkley gave weight to the results of the Constant Growth DCF model, her recommendation also gave weight to the results of other cost of equity estimation models that take into greater consideration current and expected market conditions.

ILAWC states that ICB witness Walters incorrectly claimed that the analyst growth rates used in Ms. Bulkley’s constant growth DCF analysis are “unsustainably high.” The results of those DCF analyses belie Mr. Walters’ claim. The results of both Mr. Walters’ multi-stage model and his constant growth DCF analysis using sustainable growth rates

are well below the range of comparable authorized ROEs that have been approved for water utilities since at least 2010.

ILAWC explains that the CAPM is a risk premium approach that estimates the cost of equity for a given security as a function of a risk-free return plus a risk premium to compensate investors for the non-diversifiable or “systematic” risk of that security. Systematic risk is the risk inherent in the entire market or market segment—which cannot be diversified away using a portfolio of assets. Unsystematic risk is the risk of a specific company that can, theoretically, be mitigated through portfolio diversification.

According to the theory underlying the CAPM, since unsystematic risk can be diversified away, investors should only be concerned with systematic risk. ILAWC Ex. 13.00 at 45. Systematic risk is measured by beta, which is a measure of the volatility of a security as compared to the market as a whole. Ms. Bulkley relied on three sources for her estimate of the risk-free rate: (1) the then-current 30-day average yield on 30-year U.S. Treasury bonds, which was 4.77%; (2) the average projected 30-year Treasury bond yield for the first quarter of 2024 through the first quarter of 2025, which was 4.48%; and (3) the average projected 30-year Treasury bond yield for 2025 through 2029, which was 4.10%.

Ms. Bulkley used the beta coefficients for the proxy group companies as reported by Bloomberg are calculated using ten years of weekly returns relative to the S&P 500 Index. Value Line’s calculation of the beta coefficients is based on five years of weekly returns relative to the New York Stock Exchange Composite Index. Additionally, she considered a CAPM analysis that relies on the long-term average utility beta coefficient for the companies in the proxy group, which is calculated as an average of the Value Line beta coefficients for those companies from 2013 through 2022.

Ms. Bulkley estimated the Market Risk Premium (“MRP”) as the difference between the implied expected equity market return and the risk-free rate. The expected return on the S&P 500 Index was calculated using the Constant Growth DCF model discussed *infra* for the companies in the S&P 500 Index. Based on an estimated market capitalization-weighted dividend yield of 1.69% and a weighted long-term earnings growth rate of 10.78%, the estimated required market return for the S&P 500 Index as of November 30, 2023 was 12.56%. Based on the three risk-free rates considered, the implied market risk premium ranged from 7.78% to 8.46%.

ILAWC notes that Staff witness Bista disagreed with Ms. Bulkley’s reliance on published betas (Value Line and Bloomberg) that are calculated using weekly return intervals, and argued that she should have also considered betas that are calculated using monthly return intervals. ILAWC states that Staff provided no evidence to support Mr. Bista’s conclusion that Ms. Bulkley’s CAPM results are biased due to her reliance on beta coefficients from Value Line and Bloomberg calculated using weekly returns, or that averaging such coefficients with others based on monthly returns results is necessary. Academic research fully supports the use of weekly betas for companies that are similar in size to the proxy group companies.

ILAWC notes that Mr. Walters contended that the use of a DCF-derived expected market return to estimate the market risk premium ultimately inflates Ms. Bulkley’s market

risk premium. Mr. Walters argued that she should have instead considered multiple methodologies to estimate the expected market return and market risk premium.

ILAWC explains that there are numerous reasons why the market return, and thus market risk premium, that Ms. Bulkley relied on in her CAPM analyses are reasonable. For example, in ILAWC's last rate case, the Commission relied on Staff's estimated CAPM results to determine the ROE for ILAWC. Docket 22-0210, Order at 102. To develop the CAPM, Staff estimated a forward-looking market return of 12.97% using a single stage constant growth DCF model of the companies in the S&P 500. *Id.* at 86. It is also important to note that in the current proceeding, Mr. Bista has also developed his CAPM relying on a market return (12.67%) estimated using a constant growth DCF model of the companies in the S&P 500.

Also, ILAWC states, various regulatory commissions have supported the use of a constant growth DCF model to estimate the market return in the CAPM such as Ms. Bulkley did. See *Ass'n. of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 569-A, 171 FERC ¶ 61,154 (2020) at 85. Likewise, ILAWC maintains, state utility regulatory commissions have also supported the use of a constant growth DCF model to estimate the market return in the CAPM. The Bureau of Investigation and Enforcement of the Pennsylvania Public Utility Commission and the Staff of the Maine Public Utilities Commission have each supported the forward-looking market risk premium, and the market return estimates using the constant growth DCF model. In each of these cases, the respective regulatory commission relied on the estimated CAPM results by these parties to determine the authorized ROE and did not dispute the use of the constant growth DCF model to calculate the market return. Ms. Bulkley considered another form of the CAPM in her analysis. Specifically, she considered the results of an ECAPM, to estimate the cost of equity for the Company. The ECAPM calculates the product of the adjusted beta coefficient and the market risk premium and applies a weight of 75.00% to that result. The model then applies a 25.00% weight to the market risk premium, without any effect from the beta coefficient. The results of the two calculations are summed, along with the risk-free rate, to produce the ECAPM result.

In essence, ILAWC states, the ECAPM addresses the tendency of the "traditional" CAPM to underestimate the cost of equity for companies with low beta coefficients such as regulated utilities. In that regard, the ECAPM is not redundant to the use of adjusted betas; rather, it recognizes the results of academic research indicating that the risk-return relationship is different (in essence, flatter) than estimated by the CAPM, and that the CAPM underestimates the "alpha," or the constant return term.

As with the CAPM, Ms. Bulkley's application of the ECAPM used the forward-looking market risk premium estimates, the three yields on 30-year Treasury securities noted earlier as the risk-free rate, and the Bloomberg, Value Line, and long-term average beta coefficients.

Ms. Bulkley's traditional CAPM analyses produced a range of returns from 10.28% to 11.28%. The ECAPM analysis results ranged from 10.85% to 11.60%.

According to ILAWC, Mr. Bista argued that Ms. Bulkley's ECAPM analysis is flawed because it adjusts beta twice, once through the use of adjusted betas from Value

Line and Bloomberg and a second time through the weighting adjustment in the ECAPM formula, which takes the risk-free rate and adds: (i) 25% of the market risk premium multiplied by a beta of 1.0; and (ii) 75% of the market risk premium multiplied by the adjusted beta. For this reason, Mr. Bista recommended that the Commission reject Ms. Bulkley's ECAPM analysis.

Ms. Bulkley explained that, to the contrary, the ECAPM analysis does not double count the adjustment to betas. The purpose of adjusting beta in the CAPM is to account for the tendency of beta to trend back over time to the market beta of 1.00. The betas published by Value Line include this adjustment. The use of adjusted betas in the CAPM is important because if beta trends towards 1.00, then the adjusted beta will be more reflective of the beta that can be expected over the near-term. This is equally important in the specification of the CAPM in this case since it involves estimating the cost of equity for the Company over the near-term.

In contrast, ILAWC explains, the ECAPM does not account for the tendency of beta to trend toward 1.00. The purpose of the ECAPM is to account for the fact that the risk-return relationship is flatter than what is estimated by the CAPM, even when using adjusted betas. While beta is not observable and must be estimated, the theory behind the ECAPM is that even if the true value of a stock's beta were observable, the CAPM would understate the results for stocks with betas less than 1.00 and overstate the results for stocks with betas greater than 1.00. Therefore, contrary to the assertions of Mr. Bista, the purpose of each adjustment is different and thus applying both adjustments in the ECAPM is not duplicative.

ILAWC notes that Mr. Walters also criticized Ms. Bulkley's ECAPM, arguing that the use of an adjusted beta in the ECAPM is duplicative and thus produces overstated results. In addition, Mr. Walters contended that reliance on an adjusted beta in the ECAPM is not widely accepted in regulated rate proceedings of which he is aware. As discussed previously, adjusting betas and adjusting the slope of the risk/return relationship through the ECAPM are two distinct adjustments and are not duplicative as alleged by Mr. Walters.

Based the results from these methodologies and the qualitative analyses she performed, Ms. Bulkley found that a reasonable range of ROE results for ILAWC is from 10.00% to 11.25%. She specifically recommended that the Commission set the Company's rate of return on common equity at 10.75%, which considers current and prospective capital market conditions as well as ILAWC's company-specific risks relative to the proxy group.

Ms. Bulkley explained that, taken alone, the cost of equity estimation models for the proxy group do not provide an appropriate estimate of the cost of equity for ILAWC. Rather, these results provide only a range for the appropriate estimate of the ILAWC's cost of equity. There are several additional factors that must be taken into consideration when determining where the ILAWC's cost of equity falls within the range of results.

First, Ms. Bulkley considered flotation costs when she made her recommendation. Flotation costs are the costs associated with the sale of new issues of common stock. These costs include out-of-pocket expenditures for preparation, filing, underwriting, and other issuance costs. To the extent that a company is denied the opportunity to recover

prudently incurred flotation costs, actual returns will fall short of expected (or required) returns, thereby diluting equity share value. While her final ROE results do not incorporate an explicit adjustment for flotation costs, Ms. Bulkley considered the effect of flotation cost on ROE in identifying a recommended ROE within the range of ROE estimates from the various models.

ILAWC notes that Staff opposed the consideration of flotation costs. Although Mr. Bista acknowledged that Ms. Bulkley did not make an explicit adjustment for flotation costs in her ROE recommendation for flotation costs, he argued that a flotation cost adder would not be justified or reasonable because the flotation cost calculation is not based on actual issuance costs that the Company has incurred and has not previously been recovered through rates. As Ms. Bulkley explained, however, the great majority of a utility's flotation costs is incurred prior to the test year but remains part of the cost structure that exists during the test year and beyond. As such, flotation costs should be recognized for ratemaking purposes. Reflection of the cost in rates is appropriate regardless of whether an issuance occurs during, or is planned for, the test year. To the extent ILAWC is denied the opportunity to recover prudently incurred flotation costs, the Company's actual returns will fall short of expected (or required) returns, thereby diminishing ILAWC's ability to continue to attract adequate capital on reasonable terms. As a result, it remains appropriate to consider flotation costs when establishing the authorized ROE for ILAWC.

In addition to flotation costs, Ms. Bulkley also considered risks associated with the Company's capital spending program. She observed that, while the Company has capital tracking mechanisms in place to recover some of the projected capital expenditures, the size of the capital additions imposes financial strains and risks on the Company. She further considered risks associated with the regulatory environment. Equity investors require that the authorized return be adequate to provide a risk-comparable return on the equity portion of the utility's investments. Because equity investors are the residual claimants on the utility's cash flows, they are particularly concern with the strength of regulatory support. An analysis of Illinois' rankings shows a slightly greater risk than the average for the proxy group.

ILAWC's Response to Staff's and ICB's ROE Analyses

Staff and ICB recommended ROEs materially lower than the Company's required ROE. ILAWC argues both witnesses engaged in arbitrary, results-oriented manipulations of their methodologies in order to produce lower ROEs.

The Company states that even a cursory review of the Staff and ICB recommendations shows how inappropriately low their recommendations are. As discussed above, significant increases in long-term bond yields since the Company's 2022 rate proceeding demonstrate an increase in the cost of capital since that time, and Mr. Bista's and Mr. Walters' own model results demonstrate that. Since the Company's last rate case, Staff's DCF and CAPM results have increased by 90 basis points and 59 basis points, respectively, and Mr. Walters's DCF and CAPM results have increased by 65 basis points and 77 basis points, respectively. Despite this substantial increase in their own model results, however, Mr. Bista's ROE recommendation is just 6 basis points higher than Staff's recommendation in the Company's 2022 proceeding, while Mr.

Walters' ROE recommendation is unchanged from the prior proceeding, defying the undeniable increase in the cost of capital.

ILAWC states that the reason that the ROE recommendations of both Staff and Mr. Walters do not reflect the increase as demonstrated by their own model results is because both implement arbitrary changes that are inconsistent with their prior approaches in establishing their ROE recommendations. Mr. Bista places two-thirds weight on the average result of his DCF analyses and one-third weight on his CAPM results when calculating his recommended ROE. However, Staff weighted both of its cost of equity analyses equally in the Company's prior case. Furthermore, the circumstances Mr. Bista's relies on to support a different weighting in this proceeding were also present in the Company's last proceeding, thus demonstrating that Mr. Bista's change in weighting of the model results in this proceeding is arbitrary.

ILAWC states that neither Staff nor ICB directly attempts to square the changes in the cost in the capital markets to their recommendations in this case. Staff makes what can best be described as an indirect attempt, which contradicts Staff's position about the data that should be used to develop the ROE. Staff argues generally that the key consideration in determining the cost of equity is to ensure that the methodologies used to calculate ROE reasonably reflect investors' views of the market generally as the subject company. In that regard, Staff criticizes the Company's witness for presenting a mismatch of historical stock price with current growth expectations. Staff's objection is that historical data favors outdated information that the market no longer considers relevant over the most recently available information and reflects conditions that may not continue into the future. But, the Company states, that is what Staff itself is doing when it manipulates its analysis to reduce the impact of current data in search of a result more consistent with the way things used to be. The Company states that Staff improperly reweights the results of its financial modeling to minimize the effect of its own CAPM analysis, which Staff contends, reflects unusually high current beta estimates. Thus, the Company notes, Staff demeans the use of current data—which reflects investors' views of the market—in favor of unspecified historical data. Staff's concern about unusually high current beta estimates thus reflects an implicit assumption that betas will soon return to usual—whatever that might be.

The Company claims that Staff makes no secret that its rejection of the reliability of current data led it to manipulate the process to reduce its ROE result. Staff states that it deviated from its typical practice to reduce the weight given to the CAPM to avoid overstating the ROE. But Staff's assertion implies that Staff thinks it knows, or at least has a very good idea of, what the required ROE is without the benefit of the financial modeling it now doubts. And, the Company contends, it means that Staff does not believe investors' views—which are reflected in the data inputs—even though the point of the exercise is to determine what investors' views are.

The Company states that the contrast between the changes in the cost of lower-risk investments and the recommendations of Mr. Bista and Mr. Walters is stark and undeniable, as Ms. Bulkley showed.

ILAWC states that neither Mr. Bista nor Mr. Walters provided any coherent, convincing explanation for why their respective recommended ROEs in this proceeding

contradict the clear trend in market conditions and their own cost of equity model results. Consequently, ILAWC asks the Commission to carefully consider the weight that it affords both Mr. Bista's and Mr. Walter's ROE recommendations in this proceeding, and refrain from allowing these recommendations to materially influence the ROE determination in this case.

The Company states that Mr. Bista focused on his use of current market data in his DCF and CAPM analyses as being reflective of investors' expectations but failed to address the main concern, which is that Mr. Bista made methodological changes to the models that Staff relied on in the Company's last rate proceeding to mitigate the effect of the recent changes in market conditions on his ROE recommendation. The Company explains that had Mr. Bista relied on the same approach as Staff relied on in Docket No. 22-0210 for ILAWC (i.e., set the recommended ROE based on the average of the constant growth DCF and CAPM results), his recommended ROE in this case, without making any adjustment to those analyses for other issues, would have been 10.53%. Therefore, the Company argues, Mr. Bista's model results clearly demonstrate that the cost of equity has increased significantly since 2022.

ILAWC explains that Mr. Bista relies upon a constant growth DCF, a non-constant growth DCF, and a CAPM analysis to develop his ROE recommendation for ILAWC. Staff Ex. 3.0 at 42. Ms. Bulkley identified problems with Mr. Bista's analysis in the following areas:

- The composition of the proxy group;
- The dividend yield and growth rates used in the constant growth DCF model;
- Mr. Bista's application of the non-constant growth DCF model;
- Reasonable inputs and assumptions for the CAPM analysis; and
- Mr. Bista's weighting of his DCF and CAPM results when determining his recommended ROE for ILAWC.

ILAWC Ex. 27.00 Corr. at 17-18.

According to ILAWC, Mr. Bista's proxy group is flawed because he included AWK, the parent company of ILAWC. It is not appropriate to include AWK in the proxy group because of the circular logic that would occur. In this proceeding, the ROE for ILAWC is being determined, which in turn contributes to the ROE of its parent company, AWK. If AWK were included in the proxy group, AWK would be used to determine its own ROE. The Company states that therefore, to avoid the circular logic, AWK should be excluded from the proxy group.

Mr. Bista suggested that because the Company's ROE witness and Staff included AWK in the proxy groups used to estimate the cost of equity in ILAWC's 2016 and 2011 rate cases, it is reasonable to include AWK in the proxy group he has relied on in the current proceeding. The Company notes, however, in the Company's last rate proceeding, Docket No. 22-0210, both the Staff witness and the ILAWC witness excluded AWK from the proxy group used to estimate the cost of equity for ILAWC. Further, in its decision, the Commission agreed that the proxy group which excluded AWK was a

reasonable sample upon which to apply the various ROE estimation models. Docket No. 22-0210, Order at 102.

ILAWC notes that Mr. Bista relied on the results of two forms of the DCF model: (1) a constant growth DCF model; and (2) a non-constant growth DCF model. ILAWC states that Mr. Bista's application of the DCF model raises two primary concerns: (1) his reliance on projected DPS growth rates from Value Line in both his constant growth and non-constant growth DCF models; and (2) his application of the non-constant growth DCF model which increases the number of subjective inputs required to calculate the DCF model and, thus creates greater opportunity for an analyst to influence the results of the DCF model.

The Company explains that Ms. Bulkley identified several reasons why reliance on Value Line projections of DPS growth is not appropriate:

- Earnings are the fundamental determinant of a company's ability to pay dividends, and over the long-term dividend growth can only be sustained by earnings growth.
- Management decisions to conserve cash for capital investments, to manage the dividend payout for the purpose of minimizing future dividend reductions, or to signal future earnings prospects can influence dividend growth rates in near-term periods. These decisions affect the dividends and the payout ratio in the short term but are not necessarily indicative of a firm's long-term earnings growth. For example, forty S&P 500 companies suspended dividend payments in 2020 as a result of the increased uncertainty due to COVID-19. These dividend suspensions occurred because companies believed earnings over the short term would decline and, therefore, elected to conserve cash to offset the financial effects of COVID-19.
- There is significant academic research demonstrating that EPS growth rates are most relevant in stock price valuation. The use of DPS growth rates ignores the academic research demonstrating that EPS growth rates are most relevant in stock price valuation.
- Investment analysts report predominant reliance on EPS growth projections. In a survey completed by 297 members of the Association for Investment Management and Research, the majority of respondents ranked earnings as the most important variable in valuing a security (more important than cash flow, dividends, or book value).
- Mr. Bista relied on projected DPS growth rates from Value Line, which are the views of an individual analyst. In contrast, projected EPS growth rates from Yahoo! Finance, Zacks and S&P Market Intelligence are based on consensus estimates available from multiple sources. In other words, projected EPS growth rates include the contributions of more than one analyst and thus the results are less likely to be biased in one direction or another. Moreover, the fact that projected EPS growth estimates are available from multiple sources on a consensus basis

attests to the importance of projected EPS growth rates to investors when developing long-term growth expectations.

The Company maintains, therefore, that projections of EPS growth provide a more robust estimate of total company growth since it is earnings growth that will influence DPS growth. For all of these reasons, Ms. Bulkley relied on projected EPS growth rates for purposes of her constant growth DCF analysis. ILAWC states that Mr. Bista should have also.

Further, ILAWC explains, Mr. Bista should not have relied on a non-constant growth form of the DCF. The utility industry is considered a mature industry due to its regulated status and relatively stable demand. Thus, financial projections such as earnings growth rate projections are also likely to be relatively stable over the long-term. The relative stability of the financial forecasts for utilities supports the use of a constant growth DCF model to estimate the cost of equity for a mature industry like utilities.

ILAWC states that the inappropriateness of the non-constant growth model is evident from Mr. Bista's results. Mr. Bista's non-constant growth DCF result of 8.47% is well below any comparable ROE authorized for a water distribution company since 2010, and thus is not reflective of the cost of equity for ILAWC. In addition, that result is below any comparable authorized ROE for an electric utility or natural gas utility in the U.S. since at least 1980. As discussed above, the *Hope* and *Bluefield* decisions require the authorized return to be just and reasonable, as well as comparable to other returns available to investors in companies with similar risk. Mr. Bista's non-constant growth DCF result would clearly violate this standard.

Mr. Bista contended that use of the non-constant growth DCF model is appropriate because the growth rates Ms. Bulkley relied on in her constant growth DCF model are not sustainable in perpetuity. ILAWC states that there are two significant problems with Mr. Bista's argument, and it should be rejected. First, the Company notes that Mr. Bista relied on Value Line's projected DPS and EPS to estimate the retention ratio for each of the companies included in Ms. Bulkley's proxy group. However, Value Line's projected DPS growth rates deviate from the projected EPS growth rates for a majority of the companies and therefore, it is not reasonable to assume Value Line's projected DPS growth rates in perpetuity. The Company explains that since Mr. Bista relied on projected DPS to estimate his retention ratio, a change in the growth of projected DPS would affect his calculation of the retention ratio. As a result, Mr. Bista has not developed an estimate of the retention ratio that can be assumed in perpetuity which would be necessary to estimate the return on book equity implied by projected EPS growth rate in perpetuity. Second, the Company explains that ROE is calculated as net income divided by common equity.

ILAWC reasons that since Mr. Bista has estimated the return on book equity, the common equity value assumed in the denominator would be based on book value. The Company notes, however, the market value of common equity exceeds the book value of common equity for each of the companies in Ms. Bulkley's proxy group. This means that the return on the book value of equity will exceed the return on the market value of equity. The Company states that therefore, it is reasonable to expect that the return on book equity will exceed her recommended ROE which is based on the market value of equity.

ILAWC notes that Mr. Bista explained that he gave two-thirds weight to the average of his constant growth and non-constant growth DCF results and one-third weight to his CAPM results when calculating his recommended ROE because the beta coefficients that Mr. Bista relied on (i.e., Value Line, Zacks, and Staff-derived betas) had been affected by the changes in the market that occurred in 2020 as a result of COVID-19 and therefore are unusually high. To support his conclusion, Mr. Bista noted that the weekly and monthly betas have increased from the Company's 2016 rate proceeding to the Company's 2022 rate proceeding and then again from the Company's 2022 rate proceeding to the current proceeding.

The Company maintains that Mr. Bista's reliance on COVID-era impacts in this case is misplaced. The Staff witness in the Company's 2022 rate proceeding relied on the average of his DCF and CAPM analyses to estimate his recommended return and his weekly and monthly beta coefficients would have included the changes in the market that occurred in 2020 as a result of COVID-19. Similarly, the Staff witness in North Shore's 2023 rate proceeding also relied on the average of her DCF and CAPM analyses to estimate her recommended return. Furthermore, in both the Company's 2022 rate proceeding and North Shore's 2023 rate proceeding, the Commission relied on an average of the DCF and CAPM results to determine the authorized return. Given that equal weight has been placed on the CAPM analysis in several proceedings since the market dislocation that occurred as a result of COVID-19 in 2020, Mr. Bista has provided no evidence for changing the weighting of the DCF and CAPM analyses that Staff has historically relied on to determine its recommended ROE.

ILAWC also points out that Mr. Walters relied on the same proxy group that Ms. Bulkley used, except he excluded NiSource because, earlier this year that company completed the sale of a 20% ownership interest in Northern Indiana Public Service Company ("NIPSCO"). The Company maintains that Mr. Walters' exclusion of NiSource is inappropriate. While significant merger and acquisition ("M&A") activity that materially affects a company's finances should be excluded from use in a proxy, that screen should not exclude NiSource from the proxy group. The purpose of applying a M&A screen is to isolate companies that are involved in transformative transactions that cause a fundamental change in a company and its financials. However, excluding companies based on non-transformative transactions unnecessarily and inappropriately reduces the size of the proxy group and eliminates companies that investors would consider alternatives.

ILAWC states it is clear that the NiSource transaction was not transformative. NiSource announced the sale of a minority ownership interest in one of its subsidiary utilities on June 20, 2023. However, this sale of a noncontrolling interest in NIPSCO did not affect the stock price of NiSource when the transaction was announced, and thus there is no reason to exclude from the proxy group.

Mr. Walters contended that the sale was transformative because it represented 18.6% of NiSource's total market capitalization. The Company states that again, NiSource's sale of a noncontrolling interest in NIPSCO did not affect its stock price when the transaction was announced, and thus there is no reason to exclude NiSource from the proxy group.

ILAWC explains that a principal problem with Mr. Walters' DCF analyses is the weighting that he placed on each of his individual DCF analyses for purposes of establishing his ROE recommendation. Specifically, Mr. Walters gave primary weight to his constant growth DCF using sustainable growth rates and his multi-stage DCF. Mr. Walters stated that he placed less weight on his constant growth DCF that relies on analysts' projected EPS growth rates because the average projected EPS growth rate exceeded his projected GDP growth rate.

The Company states that Mr. Walters' justification for this lopsided weighting is unfounded. It is not appropriate to rely on a sustainable growth rate in the constant growth DCF because academic research and empirical evidence indicate that projected EPS growth rates are the most appropriate growth rates for use in the DCF model.

Further, according to ILAWC, Mr. Walters' sustainable growth rate calculation assumes that future earnings will increase as the retention ratio increases; however, empirical evidence has shown that is not the case. Thus, counter to Mr. Walters' assumption, a company's management will alter dividend policy to respond to changes in earnings, and therefore dividend growth will not always reflect earnings growth (and vice versa).

ILAWC explains, it is not appropriate to consider a multi-stage (non-constant growth) DCF model for establishing the Company's ROE in this proceeding for several reasons:

- The utility industry is considered a mature industry due to its regulated status and relatively stable demand. Thus, the relative stability of the financial forecasts for utilities supports the use of the constant growth DCF model to estimate the cost of equity for a mature industry like utilities.
- Mr. Walters' multi-stage DCF model requires the introduction of multiple additional assumptions, with each having a significant effect on the results.
- The mean and median results of Mr. Walters' multi-stage DCF of 8.24% and 7.93%, respectively, are well below any comparable authorized ROE for a water utility since at least 2010.

ILAWC notes that Mr. Walters produced nine different cost of equity estimates from his CAPM analysis, relying on different estimates of the risk-free rate, beta, and market risk premium. Specifically, for the risk-free rate, Mr. Walters relied on a projected 30-year Treasury yield in six scenarios, and a Kroll "normalized" risk-free rate in the remaining three scenarios. For beta, Mr. Walters relied on three estimates: (1) current betas published by Value Line; (2) current beta estimates from S&P Market Intelligence's Beta Generator ("Market Intelligence"); and (3) historical average betas published by Value Line. For the market risk premium, Mr. Walters also relied on three estimates: (1) the long-term historical arithmetic average real return on the S&P 500 plus an expected inflation rate; (2) a constant growth DCF-derived return on the S&P 500, averaging the method prescribed by the Federal Energy Regulatory Commission ("FERC") in Order No. 569-A with an alternative where all the companies in the S&P 500 are used rather than

just the dividend-paying companies, less the risk-free rate; and (3) a “normalized” market risk premium published by Kroll Mr. Walters’s CAPM results produce a cost of equity range from 8.47% to 11.48%.

Mr. Walters contended that he gave primary consideration to the results of his CAPM analyses that relied on the historical average Value Line betas and Market Intelligence betas because, he argued, the current Value Line betas have been affected by the changes in the market that occurred in 2020 as a result of COVID-19. Mr. Walters does not identify the specific ROE that his CAPM analyses support.

ILAWC explains that the primary areas of concern with Mr. Walters’s CAPM analyses are: (1) his reliance on the Kroll normalized market risk premium; (2) his use of his “forward-looking” Risk Premium-derived market return and thus market risk premium; and (3) his reliance on Market Intelligence betas.

The Kroll “normalized” market risk premium, ILAWC states, is inconsistent with the well-established inverse relationship between interest rates and the market risk premium. Specifically, in the CAPM scenarios in which Mr. Walters relied on the Kroll “normalized” market risk premium of 5.50%, he also relied on the current yield on the 20-year Treasury bond of 4.56% as the estimate of the risk-free rate. However, the long-term historical arithmetic average income-only return on long-term government bonds as published by Kroll is 4.87% and the corresponding long-term historical arithmetic average market risk premium over that same time period is 7.17%. Thus, the risk-free rate relied on by Mr. Walters of 4.56% is lower than the long-term historical arithmetic average interest rate of 4.87%, indicating that a lower interest rate would correspond to a higher market risk premium than 7.17%. Mr. Walters relied on a market risk premium of 5.50%, which is substantially lower than 7.17%, meaning his market risk premium in these CAPM scenarios does not reflect the inverse relationship between interest rates and the market risk premium and is understated.

b. Staff’s Position

Staff recommends the Commission adopt its recommendation for an ROE of 9.84%. Staff contends the Company’s analysis overstates the investor-required ROE for ILAWC’s operations. On the other hand, Staff’s approach is based on models and inputs that the Commission and Illinois courts have repeatedly endorsed in estimating ROE for Illinois utilities.

Staff notes that the United States Supreme Court has opined on the means by which a regulatory body, such as the Commission, should evaluate the reasonableness of a utility’s authorized ROE. Authorized ROEs must meet the following objectives: (1) be consistent with other businesses which experience comparable risk; (2) support credit quality and ensure access to capital; and (3) lead to just and reasonable rates for consumers. *Bluefield*, 262 U.S. at 679; *Hope*, 320 U.S. at 591. Simply stated, a Company’s ROE should allow it to attract equity capital on reasonable terms so a company is able to provide safe, reliable service at just and reasonable rates.

Staff’s ROE Analysis

Staff estimated ILAWC’s investor required rate of return on common equity to be 9.84%. Staff Ex. 3.0 (PUBLIC) at 19. Staff measured the investor-required rate of return

on common equity with DCF and CAPM models. *Id.* Because the Company does not have market-traded common stock, DCF and risk premium models cannot be applied directly to ILAWC. *Id.*; see also ILAWC Ex. 13.00 at 30.

For this reason, and to reduce measurement error, Staff applied both models to the same sample of public utility companies that the Company used, with one exception. Staff Ex. 3.0 (PUBLIC) at 19. Staff added the parent company of ILAWC, American Water, because it meets ILAWC's sample selection criteria. Staff Ex. 3.0 (PUBLIC) at 20; see also ILAWC Ex. 13.00 at 31-32. Staff also notes that both the Company and Staff witnesses have included American Water in their proxy groups for ILAWC rate proceedings in the past.

Thus, the following companies compose Staff's sample (the "Staff Proxy Group"): American States Water Company, American Water, Atmos Energy Corporation, California Water Service Group, Eversource Energy, Essential Utilities, Inc., Middlesex Water Company, NiSource Inc., Northwest Natural Gas Company, ONE Gas, Inc., SJW Group, and Spire Inc. Staff Ex. 3.0 (PUBLIC) at 20.

Staff explains DCF analysis assumes that the market value of common stock equals the present value of the expected stream of future dividend payments. Staff Ex. 3.0 (PUBLIC) at 21. Because DCF analysis incorporates time-sensitive valuation factors, it must correctly reflect the timing of the dividend payments that stock prices embody. *Id.* The Companies in the Staff Proxy Group pay dividends quarterly; therefore, Staff applied a quarterly constant-growth DCF model and a quarterly non-constant DCF ("NCDCF") model to measure the annual required rate of return on common equity. *Id.*

The constant-growth DCF model assumes dividends will grow at a constant rate into perpetuity and the market value of a common stock (*i.e.* stock price) equals the sum of the discounted value of each dividend. Staff Ex. 3.0 (PUBLIC) at 22. Staff used a constant growth DCF model in which he measured the market-consensus expected growth indirectly, with 3-5 year growth rates published by Zacks Investment Research ("Zacks"), S&P Global Market Intelligence ("MI"), and Value Line. *Id.* at 23. The resulting analysts' growth rates average 6.34% for the Staff Proxy Group. Staff Sch. 3.04.

For the NCDCF analysis, Staff modeled three stages of dividend growth. Staff Ex. 3.0 (PUBLIC) at 23. The first, a near-term growth stage, is assumed to last five years. *Id.* The second stage is a transitional growth period lasting from the end of the fifth year to the end of the tenth year. *Id.* The third, or "steady-state" growth stage, is assumed to begin after the tenth year and continue into perpetuity. *Id.* An expected stream of dividends is estimated by applying these stages of growth to the current dividend. *Id.* The discount rate that equates the present value of this expected stream of cash flows to the company's current stock price equals the market-required return on common equity. *Id.*

For the first stage of its NCDCF analysis, Staff used the average of the analysts' growth rate estimates as of April 2, 2024—the same that were used in Staff's constant growth DCF analysis. Staff Ex. 3.0 (PUBLIC) at 23. For the second stage, Staff used the average of the analysts' growth rate estimates and the economy-wide third stage growth rate. *Id.* at 23-24.

For the third stage, Staff used a nominal overall economic growth rate of 4.37%. Staff Ex. 3.0 (PUBLIC) at 26. The overall economic growth rate is composed of two parts: the expected growth rate and the expected inflation rate. *Id.* at 24. Staff estimated the expected real growth rate from the Energy Information Administration's ("EIA") forecasts of real gross domestic product ("GDP"). *Id.* EIA forecasts that real GDP will average 2.07% over the 2034-2050 period. *Id.*

Staff extrapolated an estimate of the expected inflation rate from the difference in yields on U.S. Treasury bonds, which contain a premium for expected inflation, and U.S. Treasury Inflation-Protected Securities ("TIPS"), which do not contain a premium for expected inflation. Staff Ex. 3.0 (PUBLIC) at 24. The estimate of long-term expected inflation is 2.20%. *Id.* at 25. Using a formula from the long-term estimates of real GDP growth and expected inflation, the long-term estimate of overall economic growth is 4.32%. *Id.* Finally, Staff averaged the 4.42% EIA forecast with the 4.32% nominal economic growth estimate to derive a 4.37% long-term estimate of overall economic growth. *Id.* at 25-26. Staff's growth rate estimates for its constant growth DCF analysis and the first stage of Staff's NCD CF analysis is found in Staff Schedule 3.04. Staff's calculation of the steady-state, third stage growth rate estimate for its NCD CF analysis is found in Staff Schedule 3.05.

Staff's DCF models utilize a current stock price reflecting all information that is available and relevant to the market; thus, it represents the market's assessment of the common stock's current value. *Id.* Staff measured each company's current stock price with its closing market price from April 2, 2024, and those results are available in Staff Schedule 3.06.

Staff estimates the next four expected quarterly dividends by assuming the current declared dividend rate will remain in effect for a minimum of four quarters and then adjusting during the same quarter it changed during the preceding year; if the utility did not change its dividend during the last year, Staff assumed the rate would change during the next quarter. *Id.* at 27-28. This is because most utilities declare and pay the same dividend per share for four consecutive quarters before adjusting the rate. *Id.* at 27. The average expected growth rate was applied to the declared dividend rate to estimate the expected dividend rate. *Id.* at 28. Staff's quarterly dividends for the prior year and expected quarterly dividends for the upcoming year are presented on Staff Schedule 3.06 and Staff Schedule 3.07, respectively.

Based on Staff's DCF analysis for Staff's Proxy Group, the constant growth DCF estimate is 10.09% and the NCD CF estimate is 8.47%. *Id.* at 28. Staff's DCF estimate of the required rate of return on common equity for the Staff's Proxy Group was based on the average of the constant growth DCF and the NCD CF estimates, which was 9.28%. *Id.* Staff used the average of the constant growth DCF and NCD CF estimates for the sample because the 6.34% average growth rate for Staff's Proxy Group is approximately 45% higher than the long-term economic growth rate of 4.37% and is unlikely to be sustainable over the long-term. *Id.* at 29. Staff states that by including the NCD CF results, it avoids overstating the ROE. *Id.*

Staff explains that the CAPM is a one-factor risk premium model based on the theory that the market-required rate of return for a given security equals the risk-free rate

of return plus a risk premium that investors expect in exchange for assuming the risk associated with that security. *Id.* at 29. Mathematically, the required rate of return equals the risk-free rate plus a company-specific risk premium. *Id.* In the CAPM, the risk factor is market risk, which cannot be eliminated through portfolio diversification. *Id.* at 30. To implement the CAPM, one must estimate the risk-free rate of return, the expected rate of return on the market portfolio, and a security or portfolio-specific measure of market risk (*i.e.* the “beta”). *Id.*

Betas utilized in DCF analyses are estimates of the true beta, which measures investors’ expectations of the quantity of non-diversifiable risk inherent in a security. Staff Ex. 12.0 (PUBLIC) at 22. Because the true beta is unobservable, it is unknowable which beta estimates are more accurate. *Id.* at 22-23. Thus, just as the analysts in this proceeding used multiple models to determine the cost of equity, Staff used multiple approaches to estimate beta. *Id.*

Staff examined the suitability of the yields on four-week U.S. Treasury bills and thirty-year U.S. Treasury bonds as estimates of the risk-free rate of return. Staff Ex. 3.0 (PUBLIC) at 30. Staff observed a 5.52% yield on four-week U.S. Treasury bills and the 4.56% yield on thirty-year U.S. Treasury bonds, as of April 2, 2024. *Id.* at 33. Staff reasons that in terms of interest rate risk, U.S. Treasury bill yields more accurately measure the risk-free rate. *Id.*

Staff reviewed the EIA forecasts and the Survey of Professional Forecasters (“Survey”). *Id.* at 33-35. Although EIA and Survey do not forecast the real risk-free rate, they do forecast real GDP growth, which is a proxy for the real risk-free rate. *Id.* at 34. EIA forecasts real GDP growth will average 2.0% during the 2024-2050 period, and Survey forecasts real GDP growth will average 1.98% over the next ten years. *Id.* These forecasts imply a long-term, nominal risk-free rate between 4.1% and 4.3%. *Id.* EIA and Survey forecasts of inflation and real GDP growth expectations suggest that, currently, the U.S. Treasury bond yield of 4.56% more closely approximates the long-term risk-free rate. Staff notes that the U.S. Treasury bond yield is an upwardly biased estimator of the long-term risk-free rate due to the inclusion of an interest rate risk premium associated with its relatively long term to maturity. Staff Ex. 3.0 (PUBLIC) at 34-35. Thus, Staff used the U.S Treasury bond yield to estimate the risk-free rate of return. *Id.* at 16-17.

Staff estimated the expected rate of return on the market by conducting a DCF analysis on the firms composing the S&P 500 Index as of March 29, 2024. *Id.* at 35. Staff eliminated firms not paying dividends or firms for which neither Zacks nor Zacks growth rates were available and eliminated companies with growth rates greater than 20% or less than 0%. *Id.* at 35-36. The resulting company-specific estimates of the expected rate of return on common equity were then weighted using market value data from Zacks. *Id.* at 36. The estimated weighted average expected rate of return for the remaining firms, composing 66.55% of the market capitalization of the S&P 500, equals 12.67%. *Id.*

Staff notes that beta measures risk in a portfolio context. *Id.* at 36. When multiplied by the risk premium, a security’s beta produces a market risk premium specific to that security. *Id.* Staff used betas from Value Line, Zacks, and a regression analysis to estimate the beta for the Staff Proxy Group. *Id.*

Value Line calculates its betas in two steps. *Id.* at 37. First, the returns of each company are regressed against the returns of the New York Stock Exchange Composite Index (“NYSE Index”) to estimate a raw beta. *Id.* The Value Line regression analysis employs 260 weekly observations of stock price data. *Id.* Then, an adjusted beta is estimated through the equation detailed in Staff Ex. 12.0 (PUBLIC) at 37.

Staff asserts that it relied on multiple methods to estimate beta because true betas are forward-looking measures of investors’ expectations of market risk. *Id.* at 39. That is, betas that Staff calculates and betas that Value Line, Zacks, and other financial information services publish are proxies for true betas. *Id.* Therefore, like all proxies, beta estimates are subject to measurement error. *Id.* Thus, there is no single, definitively “correct” beta for a given company. *Id.* Beta measurements can overstate a security’s risk and consequently its cost at times (and understate it at other times). *Id.* The inevitable presence of measurement error is why Staff recommends against reliance on any single model to estimate the cost of common equity. *Id.* at 39-40.

Because both the Zacks beta and regression beta estimates were calculated using monthly returns rather than weekly returns (as Value Line uses), Staff averaged those results to avoid over-weighting the monthly time interval data. *Id.* at 40. The average of those two estimates is 0.73. *Id.* Staff then averaged that result with the Value Line beta (0.85) to obtain a single estimate of beta for the Staff Proxy Group (0.79). *Id.* at 40-41. For the Staff Proxy Group, the regression beta estimate 0.73, the Value Line beta estimate is 0.85, and the Zacks beta estimate is 0.73. *Id.* at 40. Based on Staff’s CAPM analysis, the estimated ROE for the Staff Proxy Group is 10.97%. *Id.* at 40-41.

Staff’s ROE recommendation weighs Staff’s recommended DCF-derived results (9.28%) two-thirds and weighs Staff’s CAPM-derived result (10.97%) one-third weight in order to avoid overstating ROE. *Id.* at 42, 43. According to Staff, this is necessary due to unusually high current beta estimates—a result primarily attributable to the Covid-19 pandemic. *Id.*

Because credit ratings reflect a company’s overall risk, Staff compared the credit ratings of the Staff Proxy Group and ILAWC. *Id.* at 42. Staff does not recommend adjusting ILAWC’s ROE for risk. Specifically, this is because Staff recommends an adjustment to align ILAWC’s capital structure with the financial risk of the Staff Proxy Group. *Id.* at 43; Section III.C.1. With that adjustment to capital structure, no adjustment to ILAWC’s ROE based on risk would be necessary. *Id.* However, if the Commission does not adopt Staff’s capital structure recommendation, Staff urges the Commission to adopt a downward adjustment to ILAWC’s ROE based on its lower risk when compared to the Staff Proxy Group. *Id.*

Staff’s Response to ILAWC’s and ICB’s ROE Analysis

The Company requests a 10.75% ROE for ILAWC, based on various analyses the Company claims indicate a ROE in the range of 10.25% to 11.25%. ILAWC Ex. 13.00 at 69. ILAWC relies on DCF, CAPM, and ECAPM analyses to estimate its ROE. *Id.* at 2. The Company performed its analyses on the same companies as in the Staff Proxy Group (“ILAWC Proxy Group”), with the exception of American Water, which is included in the Staff Proxy Group but not the ILAWC Proxy Group. See Staff Ex. 3.0 (PUBLIC) at 20.

Although the Company discussed risks associated with flotation costs, capital expenditures, and its regulatory environment, the Company did not propose any specific ROE adjustments based on those risk factors. *Id.* at 51-62. Staff states that because ILAWC did not recommend any adjustments based on these risk factors, Staff has not responded to ILAWC's arguments regarding risks associated with flotation costs, capital expenditures, and regulatory environment. Staff's choice to not respond to the Company's arguments regarding these specific risk factors should not be construed as agreement with the Company's arguments.

Staff argues the Commission should reject the Company's 10.75% ROE proposal. The Company's analysis contains significant flaws which led its witness to over-estimate the Company's ROE, including:

- ILAWC's DCF analysis employs unsustainable growth rates and average historical stock prices, and does not reflect quarterly dividend payments;
- ILAWC's CAPM analysis relies exclusively on betas calculated using weekly returns and includes forecasted U.S. Treasury bond yields as a proxy for the risk-free rate;
- ILAWC employs an Empirical CAPM ("ECAPM") analysis that has been repeatedly rejected by the Commission, and that ECAPM improperly applies adjusted beta estimates.

Staff Ex. 3.0 (PUBLIC) at 47.

In addition, Staff opines that ICB's DCF analysis is flawed because it uses improper historical stock prices and its CAPM analysis uses projected U.S. Treasury yields as proxy for the risk-free rate and relies exclusively on weekly betas. Staff Ex. 12.0 (PUBLIC) at 27-28. Staff's criticisms of these inputs in the Company's analysis equally apply to the ICB analysis.

The Commission should approve Staff's DCF analysis, which incorporates current average stock prices, rather than the Company's DCF analysis, which incorporates historical average stock prices.

The Value Line growth rates ILAWC uses in its DCF analysis are inflated and should be averaged with the Value Line DPS growth rates for the ILAWC Proxy Group. Staff Ex. 3.0 (PUBLIC) at 47. Doing so would decrease ILAWC's recent Value Line mean growth estimate by approximately 54 basis points and would lower the average constant DCF results from 9.99% to 9.72%. *Id.*

ILAWC's use of 30-, 90-, and 180-day average stock prices increases the inaccuracy of the estimate of the market-required rate of return on common equity by the mismatch of historical stock price with current growth expectations. *Id.* at 48. Historical data favors outdated information that the market no longer considers relevant over the most recently available information and reflects conditions that may not continue in the future. *Id.* Only the most recent stock price can reflect the most recently available information. *Id.* Thus, introducing old stock prices into an analysis simply substitutes one

alleged source of measurement error, volatile stock prices, for another, irrelevant stock prices. *Id.* at 49.

Moreover, Staff notes the Commission has repeatedly rejected the use of historical data in determining a company's cost of capital. See, e.g., *Ameren III. Co.*, Docket No. 23-0067, Order at 196 (Nov. 16, 2023). Specifically, the Commission consistently rejects the use of historical data in determining a company's cost of capital because, as stated in Docket No. 03-0403:

The instant objective...is to estimate a forward-looking cost of common equity. For this reason, the Commission has consistently rejected the use of average common stock prices, and has accepted the use of spot common stock prices when implementing the DCF model. The Commission continues to believe that the use of spot common stock prices in the DCF model is superior to the use of average prices.

Consumers III. Water Co., Docket No. 03-0403, Order at 42 (Apr. 13, 2004.)

Staff argues that in the current docket, the Commission should again reject the use of average historical stock prices. Commission-approved ROEs are designed to estimate a forward-looking cost of common equity. Average historical stock prices are based on outdated, obsolete information. Staff Ex. 3.0 (PUBLIC) at 48-49. ILAWC has failed to provide any evidence that this obsolete information is superior to current information, and there is no evidence in the record to support the Commission departing from its long-standing practice of using spot common stock prices in DCF analyses.

The Commission should approve Staff's DCF analysis, which assumes quarterly dividend payments, rather than the Company's DCF analysis, which assumes annual dividend payments.

Staff asserts ILAWC's DCF model is flawed because it assumes annual, rather than quarterly, payment of dividends. *Id.* at 47-48. As explained by ILAWC in a prior rate case, while an annual, single stage DCF model assumes that stock dividends are paid annually; virtually every utility pays dividends on a quarterly basis, and the DCF analyses here should account for quarterly dividend payments. *III.-Am. Water Co.*, Docket No. 07-0507, Order at 143 (July 30, 2008). Because utility companies pay cash flows (i.e. dividends) over the course of a year and not all at the end of the year, use of a quarterly DCF model is not only appropriate for rate setting purposes, but necessary for a utility to recover its true cost of common equity. *Id.* at 191.

Further, the Commission has repeatedly rejected the use of an annual DCF model. See, e.g., Docket No. 07-0507, Order at 237-38; Docket Nos. 23-0068/23-0069 (Cons.) at 199. Specifically, the Commission rejects the use of an annual DCF model because, as stated in Docket No. 07-0507:

The Commission believes that the quarterly model accurately recognizes the timing of cash flows to investors that is necessary to estimate the investor required rate of return. The Commission believes that using an annual DCF model would

unnecessarily introduce measurement error and downward bias to the results.

Docket No. 07-0507, Order at 237-38.

Staff contends that in the current docket, the Commission should again reject the use of an annual DCF model. The Company has not provided any testimony in the record addressing why the Commission should approve an annual DCF model, like ILAWC uses, rather than a quarterly DCF model, like Staff uses in this docket which is an approach that has been approved many times in the past.

The Commission should approve Staff's DCF analysis, which averages Value Line EPS and Value Line Dividends Per Share ("DPS"), rather than the Company's DCF analysis, which only uses Value Line's EPS.

Staff states that ILAWC's failure to average Value Line EPS with Value Line DPS growth rates overstates ILAWC's DCF result and consequently its ROE recommendation. Academic research has shown that Value Line's long-term stock return projections are extremely over-optimistic and have no predictive power. Staff Ex. 12.0 (PUBLIC) at 14-15. Further, Value Line's forecasting record of earnings changes over 3-5 year horizons was found to be only marginally better than their stock return prediction record, and the earnings projections were even more upwardly biased than their stock return predictions. *Id.* at 15. Value Line acknowledges this when it cautions investors against using its long-run return forecasts as the primary consideration in making investment decisions because of the risks in making accurate earnings forecasts 3-5 years out. *Id.*

As such, Value Line's long-term stock return projections are over-optimistic in this docket. When Staff incorporated the Value Line DPS growth rates in ILAWC's DCF analysis, ILAWC's Value Line average growth estimate was reduced by approximately 54 basis points and, consequently, ILAWC's average DCF results were reduced from 9.99% to 9.72%. Staff Ex. 3.0 (PUBLIC) at 47.

Staff warns that Value Line DPS should not be ignored as ILAWC suggest. The Value Line EPS growth rate is higher than the Value Line DPS growth rate. DCF theory holds that dividend growth will equal earnings growth when the payout ratio is constant. See *N. Shore Gas Co.*, Docket No. 14-0224/14-0225 (Cons.), Order at 122 (Jan. 21, 2015). When Value Line projects declining dividend payout ratios, Value Line's forecasted EPS growth rate exceeds its forecasted DPS growth rate. See *id.* If the lower payout ratio persists, long-term dividend growth will eventually converge to the level of earnings growth. *Id.* This is because growth is directly related to the earnings retention ratio: $\text{Growth} = \text{Rate of Return on New Investment} * \text{Earnings Retention Rate}$. *Id.*

This higher, long-term earnings growth cannot be achieved without slowing near-term dividend growth. *Id.* Because the DCF is a dividend discount model rather than an earnings discount model, ignoring the slowing in the growth of dividends that is necessary to increase the earnings retention rate leads to an upwardly biased estimate of the investor-required ROE. *Id.*

The Commission has repeatedly rejected arguments that Value Line DPS growth rates should not be considered as part of a utility DCF analysis. See, e.g., *N. Shore Gas Co.*, Docket No. 20-0810, Order at 68-69, 73, 75, 86-87 (Sep. 8, 2021); Docket No. 14-

0224/14-0225 (Cons.), Order at 132-34. Accordingly, Staff states that in the current docket, the Commission should once again endorse Staff's DCF analysis which averages Value Line's EPS and DPS.

Staff also challenges the Company's CAPM analysis. Staff asserts there are two issues with this analysis: (1) the Company's CAPM relies exclusively on betas calculated using weekly returns; and (2) the Company's use of historical and projected U.S. Treasury bond yields as proxies for the risk-free rate. Each of these shortcomings add unnecessary measurement error to the Company's CAPM estimates.

The Commission should approve Staff's CAPM analysis, which uses a combination of weekly and monthly beta estimates, rather than the Company's CAPM and ECAPM analysis, which uses only weekly beta estimates.

Both beta estimates used in the Company's CAPM analysis, i.e. Value Line and Bloomberg, are calculated using weekly return intervals. ILAWC Ex. 13.00 at 46-47; see *also* Staff Ex. 3.0 (PUBLIC) at 50. This is problematic because the major reason for observed variation among published betas is the interval effect (i.e., monthly returns versus weekly returns due to non-synchronous trading, which is greater for weekly data than for monthly data. Staff Ex. 3.0 (PUBLIC) at 50. By relying exclusively upon betas calculated using weekly data, the Company witness has introduced bias into her CAPM analysis that could have been mitigated by including a beta estimate derived from monthly return intervals. *Id.* at 51.

Because of this bias, the Commission has expressed its preference for using a combination of weekly and monthly beta estimates. See Docket No. 14-0224/14-0225 (Cons.), Order at 133. In Docket Nos. 09-0306 through 09-0311 (Cons.), the Commission provided additional rationale for routinely adopting beta parameters that reflect both weekly and monthly beta estimates:

The Commission further finds that Staff's use of both monthly and weekly beta estimates is superior to the use of only one or the other. It appears from the testimony that there are weaknesses present in both monthly and weekly beta estimates; however, use of both should ameliorate those weaknesses and assist the Commission in identifying this input which measures investor's expectations of the quantity of non-diversifiable risk inherent in a security.

Cent. Ill. Light Co., Docket Nos. 09-0306 through 09-0311 (Cons.), Order at 213 (Apr. 29, 2010). Staff notes that the Commission has endorsed the use of weekly and monthly betas in many past dockets, including the Company's last rate case. See, e.g., Docket No. 22-0210, Order at 101; *N. Gas Co.*, Docket Nos. 09-0166/09-0167 (Cons.), Order at 126-27 (Jan. 21, 2010).

The Commission should approve Staff's CAPM analysis, which relies on current 30-year U.S. Treasury bond yields, rather than the Company's CAPM and ECAPM analyses, which rely on historical and projected 30-year U.S. Treasury bond yields.

ILAWC relies on three estimates of the risk-free rate of return: (1) the 30-day historical average yield on 30-year U.S. Treasury bonds as of November 30, 2023

(4.77%) from Bloomberg; (2) an average projected 30-year U.S. Treasury bond yield for the first quarter of 2024 through the first quarter of 2025 (4.48%) from Blue Chip Financial Forecasts (“Blue Chip”); and (3) an average projected 30-year U.S. Treasury bond yield for 2025 through 2029 (4.10%) from Blue Chip. ILAWC Ex. 13.00 at 46.

Staff argues ILAWC’s reliance on historical and projected 30-year U.S. Treasury bond yields, instead of using a current 30-year U.S. Treasury bond yield, is problematic for the same reasons historical average stock prices are problematic in ILAWC’s DCF analysis. Forward-looking expectations cannot be deduced from past experience with any reasonable degree of accuracy, and using historical data in cost of equity analysis should be avoided. Staff Ex. 3.0 (PUBLIC) at 52. Use of forecasted interest rates is unnecessary because current interest rates already reflect investors’ current expectations for the future. *Id.* Using current market interest rates renders speculation of what future interest rates will be unnecessary. *Id.* at 53. Moreover, as difficult as it is to estimate investors’ current required rates of return on common equity, the use of forecasted interest rates essentially attempts to predict investors’ future required rates of return, which compounds the difficulty.

Staff states the Commission has repeatedly endorsed the use of current observable U.S. Treasury bond yields to estimate the risk-free rate because it is impossible to accurately predict future interest rates. See, e.g., Docket No. 23-0067, Order at 194-95; Docket No. 22-0210, Order at 100. Thus, the Commission should once again utilize current observable U.S. Treasury bond yields to estimate the risk-free rate rather than historical or projected yields. The Company has not provided an adequate rationale for why historical and projected bond yields are a better proxy for the risk-free rate than current bond yields.

In addition to the issues discussed *supra*, Staff criticizes the Company’s ECAPM analysis which employs adjusted betas published by Value Line and Bloomberg. ILAWC Ex. 13.00 at 48-49. Staff states that according to Litzenberger, a properly applied ECAPM requires using unadjusted betas, or “raw betas.” Staff Ex. 3.0 (PUBLIC) at 54.

Staff continues, stating that the Company’s ECAPM analysis ostensibly attempts to adjust the CAPM for the flatness of the empirically measured security market line (“SML”) relative to the predicted SML. *Id.* However, a study by Litzenberger suggests that use of adjusted betas is a solution to the discrepancy between the theoretically predicted and empirically observed relationship between risk and return. *Id.* In other words, by using adjusted betas in the traditional CAPM, the Company has already effectively transformed its traditional CAPM into an ECAPM. *Id.*

Therefore, the Company’s use of adjusted betas in the ECAPM is a double adjustment that overcompensates for the observed flatness of the security market line and leads to an overstated estimate of the cost of common equity whenever the raw beta is less than one, since the weight of the raw beta is being reduced in favor of the market beta of 1.0. *Id.* at 55-56. This double-adjustment results in ILAWC’s ECAPM estimate being, on average, 45 basis points higher than the Company’s corresponding CAPM estimate. *Id.* at 56. For these reasons, Staff recommends the Commission reject the Company’s ECAPM results.

Staff notes that the Commission has repeatedly rejected the use of adjusted betas in the ECAPM to determine the cost of common equity in several prior proceedings. See, e.g., Docket No. 11-0767, Order at 109; Docket No. 22-0210, Order at 101-02; Docket No. 21-0098, Order at 94-95; *Consumers III. Water Co.*, Docket No. 03-0403, Order at 41-42 (Apr. 13, 2004). Staff argues the Commission should also reject the use of the Company's ECAPM analysis in this docket. The use of adjusted betas in the ECAPM is inappropriate and result in inflated estimates of the proxy groups' ROE. Additionally, the Company has failed to provide adequate evidence to support the Commission changing its long-standing position on ECAPM.

Staff argues the Commission should not authorize a flotation cost adjustment as the Company proposes or otherwise approve a higher ROE based on flotation costs. The Company has no unrecovered cost of common equity issuance costs. ILAWC Sch. D-5. Further, the Commission has repeatedly rejected flotation cost adjustments in previous cases. See, e.g., Docket No. 23-0067, Order at 194-95; *Ameren III. Co. d/b/a Ameren III.*, Docket No. 11-0282, Order at 126 (Jan. 10, 2012).

Because ILAWC's calculation is not based on issuance costs that the Company has incurred but has not previously recovered through rates, it should not be considered in setting the investor-required rate of return on common equity. *Id.* at 58-59.

Staff's Response to ILAWC's Criticisms of Staff's Analysis

ILAWC claims the following aspects of Staff's ROE analysis are problematic: (1) weighting of the DCF and CAPM results when determining Staff's ROE recommendation for ILAWC; (2) composition of the proxy group; (3) dividend yield and growth rates used in the constant growth DCF model; (4) application of the non-constant growth DCF ("NCD CF") model; and (5) reasonable inputs and assumptions for the CAPM analysis.

ILAWC argues that Staff used an arbitrary approach to weighting its DCF and CAPM estimates. Specifically, Staff placed two-thirds weight on its DCF estimate and one-third weight on its CAPM estimate in this case, while in ILAWC's last rate case, Staff weighted the DCF and CAPM estimates equally to calculate its ROE recommendation.

Staff responds that it changed how CAPM and DCF were weighted due to the significant increase in beta coefficients for the Proxy Group beginning early 2020. Value Line weekly betas for the Proxy Group skyrocketed from an average of 0.58 to 0.80 in a single week of May of 2020, and the monthly regression beta for the Proxy Group jumped from 0.45 in January 2020 to 0.56 in February 2020. Averaging the 0.58 weekly beta and 0.45 monthly beta produces a pre-jump beta estimate of 0.52 whereas averaging the 0.80 weekly beta and 0.56 monthly beta produces a post-jump beta estimate of 0.68. See Staff Ex. 12.0 (PUBLIC) at 24-25. Therefore, Staff applied more weight to the DCF results than the CAPM results to avoid overstating the ROE estimate due to unusually high current beta estimates.

Although ILAWC claims Staff's approach is arbitrary, Staff notes that it provided a detailed analysis as to why it chose to weigh its DCF and CAPM results differently than it did in ILAWC's last rate case. Staff proposed this alternative weighting approach in the current case because of the significant increase in Value Line betas; this information was not brought to the Commission's attention until it was offered into the record during

Commonwealth Edison Company and Ameren Illinois Company's 2023 multi-year rate plan proceedings. Staff Ex. 12.0 (PUBLIC) at 25-26. Specifically, in those cases, the Commission used only monthly beta estimates to determine ROE while acknowledging that the use of both weekly and monthly beta estimates reduces measurement error from an individual estimate. *Commonwealth Edison Co.*, Docket Nos. 22-0486/23-0055 (Cons.), Order at 467-68 (Dec. 14, 2023); *Ameren Ill. Co.*, Docket Nos. 22-0487/23-0082 (Cons.), Order at 370 (Dec. 14, 2023). Therefore, Staff proposed an alternative adjustment which, consistent with the Commission's recently explained approach to measuring beta, minimizes measurement error by averaging weekly and monthly beta estimates while also addressing the significant increase in beta estimates during 2020 by reducing the weight given to CAPM analysis. *Id.* at 25-26.

Thus, Staff recommends the Commission approve Staff's ROE recommendation, which not only minimizes measurement error by averaging monthly and weekly beta estimates in its CAPM analysis, but also recognizes that current, unusually high, beta estimates may result in CAPM analyses producing inflated ROE estimates and, as such, should be given less weight in this proceeding.

ILAWC argues that Staff's proxy group is flawed because it includes the parent company of ILAWC, AWK. Specifically, ILAWC argues that including AWK in the proxy group is "circular logic" because ILAWC's ROE will contribute to AWK's future ROE.

Staff argues ILAWC is incorrect. It is not necessary to remove AWK from the proxy group if AWK meets the same sample selection criteria as the other proxy group companies.

The Company claims that, "the Commission agreed that the proxy group which excluded AWK was a reasonable sample upon which to apply the various ROE estimation models." ILAWC IB at 98. However, whether AWK should have been included in the proxy group was not a contested issue in Docket No. 22-0210. Furthermore, both the Company and Staff have included AWK in their proxy groups for ILAWC proceedings in the past, with the Company going so far as to criticize Staff for eliminating ILAWC's parent company from its ROE analysis due to lack of necessary market data. Staff Ex. 12.0 (PUBLIC) at 14; Docket No. 11-0767, Order at 90-91, 98-99, 107-08.

Staff contends that the Company's arguments are not persuasive and should be rejected. The Commission must make a decision in this docket based on the record evidence in this proceeding. The record evidence shows that AWK meets ILAWC's sample selection criteria. The Company does not dispute that AWK meets ILAWC's sample selection criteria in this proceeding. See ILAWC Ex. 13.00 at 33. Nevertheless, ILAWC argues that AWK should not be included in the proxy group because (a) a "general practice" of excluding American Water; and (b) because it creates "circular logic." *Id.* However, past Commission decisions demonstrate that (a) there is no "general practice" excluding AWK because AWK has previously been included in proxy groups in multiple past ILAWC rate cases; and (b) "circular logic" did not bar the Company, Staff, or the Commission from including AWK in those past ILAWC rate case proxy groups.

ILAWC argues that Staff's DCF analysis improperly: (1) relies on Value Line's dividends per share ("DPS") growth rates for the Proxy Group companies; and (2) applies

a NCD CF analysis which the Company claims “creates greater opportunity for an analyst to influence the results of the DCF model.” ILAWC IB at 99-100.

ILAWC argues that, “projections of [EPS] growth provide a more robust estimate of total company growth since it is earnings growth that will influence DPS growth.” ILAWC IB at 100-01. Staff states that ILAWC is incorrect. ILAWC’s failure to average Value Line EPS with Value Line DPS growth rates overstates its DCF results and, consequently, its ROE recommendation. Staff demonstrated that incorporating Value Line DPS growth rates in ILAWC’s DCF analysis reduces the Value Line growth estimate by approximately 54 basis points and lowers ILAWC’s average DCF results to 9.72% from 9.99%. *Id.*

Value Line DPS growth estimates should not be ignored in DCF analyses. The Value Line EPS growth rate is higher than the Value Line DPS growth rate. DCF theory holds that dividend growth will equal earnings growth when the payout ratio is constant. See *N. Shore Gas Co.*, Docket No. 14-0224/14-0225 (Cons.), Order at 122 (Jan. 21, 2015). Because the DCF is a dividend discount model rather than an earnings discount model, ignoring the slowing in the growth of dividends that is necessary to increase the earnings retention rate leads to an upwardly biased estimate of the investor-required ROE.

Staff observes that the Commission has repeatedly rejected arguments that Value Line DPS growth rates should not be considered as part of a utility DCF analysis. See, e.g., *N. Shore Gas Co.*, Docket No. 20-0810, Order at 68-69, 73, 75, 86-87 (Sep. 8, 2021); Docket No. 14-0224/14-0225 (Cons.), Order at 132-34. For these reasons, Staff recommends the Commission rely on Staff’s DCF analysis, which averages Value Line’s EPS and DPS growth estimates. *Id.*

ILAWC argues that the use of the NCD CF model increases the number of subjective inputs required to calculate the DCF model and provides greater opportunity for an analyst to influence the results of the DCF model. Staff states that measurement error applies to every ROE model that relies on one or more proxies for unobservable inputs. Staff Ex. 12.0 (PUBLIC) at 18. However, the question should not be whether measurement error exists, but whether it has been minimized through using sound financial models and inputs including current market data and a proxy group comprising companies of comparable investment risk. *Id.*

Before incorporating a NCD CF model into its analysis, Staff compared the analysts’ growth estimates used in the constant growth DCF analysis to the long-term expected growth rate of the economy and concluded the analyst growth estimates were unsustainable. Staff Ex. 12.0 (PUBLIC) at 19. Moreover, Staff’s NCD CF analysis follows the same methodology, and uses stock price, growth estimate, and dividend inputs, that have been accepted multiple times by the Commission in the past. See, e.g., *Commonwealth Edison Co.*, Docket Nos. 22-0486/23-0055 (Cons.), Order at 467, 470 (Dec. 14, 2023); *Ameren Ill. Co.*, Docket Nos. 22-0487/23-0082 (Cons.), Order at 372 (Dec. 14, 2023); Docket No. 11-0767, Order at 107-08, 112.

The Company argues that one potential source of measurement error (using multiple growth estimates in a NCD CF analysis) is worse than another known source of measurement error (using an unsustainable growth estimate in a constant growth DCF

analysis). Staff states the Company's argument should be rejected. Staff demonstrated that the growth estimates ILAWC used in their constant growth DCF analysis are not sustainable. In order to sustain 6.21% growth, as ILAWC's constant growth DCF model assumes, the sample companies would have to indefinitely sustain, on average, a 14.89% return on new common equity investment, which is 38.55% higher than ILAWC's 10.75% cost of common equity recommendation for ILAWC. Staff Ex. 12.0 (PUBLIC) at 19. It is doubtful that the sample companies could sustain an average 14.89% ROE indefinitely. *Id.* Further, a 14.89% return exceeds Value Line's projected 9.68% ROE for the Proxy Group. *Id.*

ILAWC further argues that the relative stability of the financial forecasts for utilities supports the use of a constant growth DCF model to estimate the cost of equity for a mature industry like utilities. Staff asserts the Company's argument should be rejected. For a mature industry like utilities, the average of the Zacks, Market Intelligence, and Value Line growth rates (6.34%) is clearly unsustainable relative to the long-term economic growth rate (4.37%) because a mature industry like utilities cannot grow more than the overall economy in perpetuity. See Staff Ex. 12.0 (PUBLIC) at 18. This ultimately necessitates the use of a NCD CF analysis to estimate the cost of equity.

The Company also argues that Staff's NCD CF result is below any comparable authorized ROE for an electric utility or natural gas utility in the U.S. since at least 1980. ILAWC IB at 101. According to Staff, ILAWC's argument is a red herring. The result obtained from Staff's NCD CF model is not Staff's ROE recommendation; rather, Staff's NCD CF estimate is one of three estimates that Staff relies upon for its ROE recommendation. Staff Ex. 12.0 (PUBLIC) at 17. Staff relied on sound financial models and inputs—models and inputs that have been repeatedly used by the Commission in the past, including NCD CF analysis—to estimate ROE for ILAWC. *Id.* Furthermore, Staff's NCD CF result is less of an outlier than Ms. Bulkley's ECAPM result, a midpoint of 11.225%, which is much higher than the recent average authorized ROEs for water utilities. *Id.* Therefore, the Company's attempt to discredit Staff's NCD CF estimate by comparing it to authorized ROEs for electric and gas utilities is misplaced and should be rejected. *Id.*

c. ICB's Position

ICB request that the Commission adopt ICB witness Walters' recommended 9.35% return on equity ("ROE"), which achieves the careful balance of shareholder and consumer interests that the Act, established Commission practice, and Court precedent require. ICB argue the Commission should reject IAWC's proposed ROE of 10.75%, which drastically overstates the Company's costs of capital and would impose exorbitant costs on ratepayers for no purpose other than to increase the Company's profit margins. ICB maintain Staff's recommended ROE of 9.84% is a more reasonable alternative to the Company's proposal, but the results of Mr. Bista's otherwise well-reasoned analysis are skewed by the inclusion of an inappropriate company in the Proxy Group resulting in overstated cost of equity estimates.

ICB point out the Act charges the Commission with determining the market-required return on common equity for IAWC. U.S. Supreme Court precedent in *Hope* and *Bluefield* governs what constitutes a just and reasonable utility rate of return. ICB assert

that under these precedents, a utility is entitled only to a return sufficient to maintain its financial integrity and to attract capital at reasonable terms. ICB contend the return is to be commensurate with the return investors could earn by investing in other companies of comparable risk. *Bluefield*, 262 U.S. at 692–93; *Hope*, 320 U.S. at 603.

ICB point out Section 9-201(c) of the Act obligates the Commission to set just and reasonable rates. 220 ILCS 5/9-201(c). ICB further note the Act's stated purpose is to "prevent exorbitant rates and unjust discrimination and undue preferences in rates" and to protect consumers. *Springfield Gas & Elec. Co. v. Springfield*, 126 N.E. 739 at 744 (1920). ICB point out the return on equity is to be set no higher than necessary to meet the standards in *Hope* and *Bluefield*. As the *Hope* case noted, "fixing just and reasonable rates involves a balancing of investor and consumer interests." *Hope*, 320 U.S. 591, 603. ICB also point out other jurisdictions have recognized that regulation is not intended to allow a utility a return on equity any higher than necessary to satisfy *Hope* and *Bluefield*. ICB confirm the rate regulation framework places the duty to prevent excessive prices and unfair business practices on the Commission. ICB state the statutes that establish the regulation of utilities reflect the weight of this obligation. See *Pub. Sys. v. Fed. Energy Regulatory Comm'n*, 606 F. 2d 973 at 979 n.27 (D.C. Cir. 1979).

ICB posit that Mr. Walters' recommended ROE is, as U.S. Supreme Court precedent requires, "reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." *Bluefield*, 262 U.S. at 693.

ICB explain that consistent with the Commission's historical practice, ICB witness Walters used several models based on financial theory to estimate the Company's costs of common equity. ICB utilized: 1) a constant growth DCF model using consensus analysts' growth rate projects; 2) a constant growth DCF model using sustainable growth rate estimates; 3) a multi-stage growth DCF model; and 4) a CAPM. ICB applied these models to a group of publicly traded utilities with investment risks similar to the Company's, referred to as the "Proxy Group." ICB Ex. 1.0 at 26-32.

The Proxy Group utilized by ICB is almost the same Proxy Group relied on by the Company's cost of equity witness. *Id.* at 32. ICB note there is one exception to this group, which is the removal of NiSource Inc. ICB chose to remove NiSource due to the fact it was a party to significant merger and acquisition activity, which ICB point out significantly impacted its financial metrics and outlook. *Id.* ICB note the Proxy Group (identified in ICB Ex. 1.02) has an average corporate rating from Moody's of Baa1, which is identical to IAWC's rating from Moody's, and an average corporate rating from S&P of A, which is also identical to the Company's. *Id.* at 34-35.

ICB point out the Proxy Group, as reported in S&P Global Market Intelligence ("MI") and Value Line has an average common equity ratio of 45.3% (including short-term debt) and 51.0% (excluding short-term debt), respectively. *Id.* at 35.

ICB maintain the Company's investment risk is relatively represented by the Proxy Group when taking into consideration the common equity ratios recommended by Staff and ICB. ICB add further, should the Commission adopt the Company's common equity

ratios, a return on equity in the lower end of Mr. Walters' range is warranted. ICB Ex. 1.0 at 31.

ICB's ROE Analysis

ICB witness Walters used several versions of the DCF model in his analysis of the cost of equity for the Company. ICB note the DCF model calculates a stock price by summing the present value of expected future cash flows, discounted at the investors' required rate of return or cost of capital. *Id.* at 35. ICB state the model requires a current stock price, expected dividend, and expected growth rate in dividends, as explained in Mr. Walters' testimony. *Id.* at 36.

ICB point out that for determining the current stock price for the constant growth DCF model, Mr. Walters used the average of the weekly high and low stock prices of the utilities in the proxy group for a 13-week period ending on April 26, 2024. *Id.* ICB chose to use this method because an average price is less susceptible to market variations. *Id.*

ICB note that for the dividend in the constant growth DCF model, Mr. Walters used each proxy utility's most recent quarterly dividend as reported in Value Line, annualized and adjusted for next year's growth. *Id.* at 37.

ICB state that to estimate expected growth in dividends for the constant growth DCF model, Mr. Walters relied on a consensus of estimates of independent securities analysts. *Id.* at 38. In support of this method, ICB witness Walters explained that securities analysts' growth estimates historically have been more accurate than extrapolations based on past growth rates data has been. *Id.* at 37. ICB explain that investors respond to analysts' growth projections, which in turn is captured in observable stock prices. *Id.* To calculate analyst consensus expected growth rate, Mr. Walters calculated the mean of the most recent projections from Zacks, MI, and Yahoo! Finance that were available at the end of the 13-week sample (on April 26, 2024). *Id.* at 38. ICB point out Mr. Walters weighted each of these analyst forecasts equally, as he saw no reason to treat any one of them as more or less credible than the others. *Id.* at 38. ICB indicate this method yielded an average growth rate for the proxy group of 5.91% and a median growth rate of 5.87%. *Id.* at 38.

The ICB constant growth DCF model, using these inputs from a 13-week analysis, produced average and median returns for the proxy group of 9.68% and 9.87%, respectively. *Id.* at 38. However, ICB note the average long-term growth rate of the proxy group of 5.91% is 43% higher than the projected 4.14% long-term growth rate of the United States' GDP. *Id.* at 39. ICB point out, as Mr. Walters explained, a utility's long-term growth rate cannot exceed its economy's long-term GDP growth rate in perpetuity. *Id.* ICB contend this concept is supported by published analyst research and literature, as well as by investment practitioners. *Id.* at 43-45.

Mr. Walters also utilized a Sustainable Growth DCF model. The sustainable growth rate is determined by the percentage of the utility's earnings that is retained and reinvested in its plants and equipment. *Id.* at 40. ICB demonstrate the average and median sustainable growth rates of the proxy group are 4.72% and 4.38% respectively. *Id.* at 41. ICB maintain these growth rates produce average and median DCF results of 8.45% and 8.52% respectively. *Id.*

ICB also utilized a multi-stage DCF model. ICB explain that while the constant growth DCF model produces results that reflect the rational investment expectations in the coming years, it does not account for the reasonable expectation of a shift in the growth rate to a more sustainable growth rate. ICB Ex. 1.0 at 41-42. ICB note a multi-stage DCF model accounts for a growth rate that changes over time. *Id.* at 43. ICB point out the model reflects three growth periods: 1) a short-term growth period consisting of the first five years; 2) a transition period consisting of the next five years (years 6-10); and 3) a long-term growth period starting in year 11 and extending into perpetuity. *Id.*

For the short-term growth period, Mr. Walters relied on the consensus of analysts' growth projections used in his Constant Growth DCF model. *Id.* ICB point out that for the transition period, growth rates were reduced or increased by an equal factor reflecting the difference between the analysts' growth rates and the long-term sustainable growth rate. *Id.* For the long-term period, Mr. Walters assumed each company's growth would converge to the maximum sustainable long-term growth rate. *Id.* Mr. Walters developed his long-term sustainable growth rate based on the consensus of long-term GDP growth rate projections by independent economists. *Id.* at 45. ICB explain that the Blue Chip Economic Indicators publishes the consensus for GDP growth projections twice a year. *Id.* ICB observe that these projections reflect current outlooks for GDP and are likely to have an influence on investor expectations of future growth outlooks. *Id.*

ICB also considered other sources of projected long-term GDP growth. *Id.* These other sources included EIA-Annual Earnings Outlook, Congressional Budget Office, Moody's Analytics, Social Security Administration, and the Economist Intelligence Unit. *Id.* at 46: Table CCW-7. ICB assert the nominal GDP growth and the real GDP growth projections made by these sources supported the use of the consensus for 5-year and 10-year projected GDP growth outlooks as a reasonable estimate of market participants' long-term GDP growth. *Id.* at 46.

ICB explain that for the stock price, dividend, and growth rates in his multi-stage DCF analysis, Mr. Walters relied on the same 13-week average stock prices and most recent quarterly dividend payment data referenced in his constant growth DCF analysis. *Id.* at 47. ICB note that for the first stage of his multi-stage DCF analysis, he used the same consensus of analysts' growth rate projections he used in his Constant Growth DCF model. *Id.* ICB further note that for the second stage (transition stage), he transitioned the growth rate from the first stage to the third stage using a straight linear trend. *Id.* ICB explain that for the third stage the long-term sustainable growth stage is 4% and is based on the consensus of economists' long-term projected nominal GDP growth rate. *Id.*

ICB demonstrate under this multi-stage DCF model, the average and median ROEs of the proxy group over a 13-week period are 8.24% and 7.93% respectively. *Id.* at 47.

The DCF models discussed above are summarized in Mr. Walters' Table CCW-8 from his direct testimony. *Id.* at 48: Tbl. CCW-8. ICB point out that because of his concerns about the long-term growth rates of the Constant Growth Model, Mr. Walters lends more weight to his Sustainable Growth and multi-stage models. *Id.* at 47-48.

ICB's last study was a CAPM. As Mr. Walters explained, the CAPM method of analysis is based upon the theory that the market-required rate of return for a security is

equal to the risk-free rate, plus a risk premium associated with the specific security. ICB Ex. 1.0 at 49. ICB note the beta in the equation represents the stock-specific risk that cannot be reduced through diversification. *Id.* ICB maintain that in a well-diversified portfolio, specific risks related to individual stocks can be reduced by balancing the portfolio with securities that offset the impact of firm-specific factors, such as business cycle, competition, product mix, and production limitations. *Id.*

ICB claim that non-diversifiable risks, on the other hand, are related to market conditions and are referred to as systematic risks. *Id.* ICB argue these risks cannot be reduced through diversification and are considered market risks. *Id.* ICB note, conversely, non-systematic risks, also known as business risks, can be reduced through diversification. *Id.* ICB maintain that according to the CAPM, the market does not compensate investors for taking on risks that can be diversified away. *Id.* Thus, ICB point out investors are only compensated for taking on systematic, or non-diversifiable, risks. *Id.* ICB aver beta is a measure of these systematic risks. *Id.*

ICB state the CAPM requires an estimate of the market risk-free rate, the company's beta, and the market risk premium. Mr. Walters used Blue Chip Financial Forecasts' projected 30-year Treasury bond yield of 4.00% for his CAPM analysis, because long-term Treasury bonds are considered to have negligible credit risk. *Id.* at 50. ICB note for the beta, Mr. Walters used the proxy group's current average Value Line beta of 0.84, the proxy group's historical average Value Line beta of 0.74, and the proxy group's current MI beta of 0.71. *Id.* at 58. For the market risk premium, in addition to considering the normalized market risk premium of 5.50% with the normalized risk-free rate of 4.56% as recommended by Kroll, Mr. Walters also derived estimates using two approaches, a market risk premium approach and a DCF approach. *Id.* at 53. ICB's market risk premium estimate was derived by estimating the expected return on the market using S&P 500 data and adjusting for inflation, resulting in an 11.40% expected return and ultimately an 7.40% risk premium after subtracting the risk-free rate. *Id.* at 54.

For the DCF approach, Mr. Walters employed two versions of the constant growth DCF model. For the first version, ICB employed the FERC method of estimating the expected return on a market by performing a constant growth DCF analysis on each of the dividend paying companies of the S&P 500 index. *Id.* ICB note the growth rate component is based on the average of the growth projections excluding companies with growth rates that were negative or greater than 20%. *Id.* ICB indicate the weighted average growth rate for the remaining companies is 11.00%. *Id.* ICB point out that after reflecting the FERC prescribed method of adjusting the dividend yield, the weighted average expected dividend yield is 1.90%. *Id.* at 54-55. Thus, ICB note the DCF-derived expected return on the market is the sum of those two components, or 12.90%. *Id.* at 55. ICB explain the market risk premium then is the expected market return of 12.90% less the projected risk-free rate of 4.00%, or approximately 8.00%. *Id.*

ICB note the second DCF-based market risk premium estimate was derived by performing the same DCF analysis described above, except using all companies in the S&P 500 index rather than just the dividend paying companies. *Id.* ICB point out the weighted average growth rate for these companies is 11.20%. *Id.* ICB illustrate that after reflecting the FERC prescribed method of adjusting the dividend yield the weighted average expected dividend yield is 1.69%. *Id.* Thus, ICB state the DCF-derived expected

return on the market is the sum of those two components, or 12.89%. *Id.* ICB note the market risk premium then is the expected market return of 12.89% less the projected risk-free rate of 4.00%, or approximately 8.90%. *Id.* at 55. ICB also note the average expected market return based on the DCF model is 12.90%, and the market risk premium averaging the two DCF estimates is 8.90%. *Id.* Mr. Walters also observed that his average expected market return of 11.45% exceeds long-term market expectations of several financial institutions. *Id.* at 55-56. For these reasons, ICB maintain Mr. Walters' expected market returns, and the associated market risk premiums, should be considered reasonable, if not high-end estimates. *Id.* at 56.

Further, Mr. Walters observed that his risk premium estimates are in the range of 5.50% to 8.90%. *Id.* ICB maintain the Kroll analysis indicates a market risk premium falls somewhere in the range of 5.50% to 7.17%. *Id.* ICB note Kroll utilizes multiple methods to determine its estimates, including its own analysis that results in an implied return on the market of 10.06%. *Id.* at 57-58.

ICB suggest that because current beta estimates are being heavily impacted by the market fallout from the 2020 global pandemic, Mr. Walters finds it unreasonable to assume current beta estimates, particularly Blume-adjusted such as those published by Value Line are accurate reflections of investor expectations. ICB Ex. 1.0 at 58-59. ICB contend that using his informed, expert opinion, Mr. Walters gave consideration to the results of his CAPM analyses using the other two betas. *Id.* at 59.

Based on the analyses described above, Mr. Walters estimates the Company's current market cost of equity to be in the reasonable range of 9.00% to 9.70%. *Id.* at 60. ICB assert this range accounts for ICB's concerns about the unreasonable growth rates and inaccurate reflection of investor tendencies in the Value Line beta estimates. *Id.* ICB recommend that the Commission authorize IAWC an ROE of 9.35%, which is the midpoint of his recommended range. *Id.* at 3.

ICB's Response to IAWC's and Staff's ROE Analyses

ICB note Staff witness Bista proposed an ROE of 9.84%. Staff Ex. 3.0 at 3. ICB suggest that while this is still inflated, it is significantly more reasonable than the Company's recommendation. ICB point out that the largest flaw in Mr. Bista's proposal is inclusion of NiSource in the Proxy Group. As ICB noted, NiSource's financial metrics and outlooks are impacted by significant merger and acquisitions activity. ICB argue Mr. Bista's choice to include this company in his Proxy Group impacted his return on equity estimates. ICB Ex. 3.0 at 2-3. ICB note for example, including NiSource increased his constant growth DCF result by 10 basis points and his non-constant growth estimate by 6 basis points. *Id.* ICB believe the Commission should take this inclusion into consideration when evaluating Mr. Bista's analysis, however, his analysis is otherwise sound.

ICB note Company witness Bulkley recommends an ROE of 10.75%. IAWC Ex. 13.0 at 8. ICB assert this recommendation is overstated and unreasonable. ICB importantly point out the fact that ROEs for regulated electric, gas, and water utilities have trended downward and the average remains well below 10.0%. ICB Ex. 1.0 at 4: Figure CCW-1. ICB point out an ROE of 10.75% far surpasses average authorized ROEs, since 2016 the majority of authorized ROEs for natural gas and water utilities have been below

9.7% with many below 9.5%. *Id.* at 5-6. In sum, ICB argue the Company's proposed ROE of 10.75% is well in excess of the current market ROEs for regulated water utilities, for regulated utilities in general, and for the Company in particular. ICB contend the Company's ROE is significantly inflated and, while certainly a benefit to shareholders, creates an unnecessary burden for ratepayers. Mr. Walters' testimony explains that Ms. Bulkley's ROE analyses produced skewed results for several reasons. *Id.* at 63.

The Company's DCF models use unreasonable growth rates and should be rejected. ICB note the Company utilized only one form of DCF model, a single-stage constant growth model. ICB point out the Company utilized three growth rates, the minimum, mean, and maximum for the Proxy Group, or 5.14%, 6.17%, and 7.30%, respectively. ICB Ex. 1.0. at 63. ICB argue, this means Ms. Bulkley relied on growth rates that ranged from 24.1% to 76.3% higher than the expected 4.14% growth rate of the US economy. *Id.* at 64. Unlike Mr. Walters, Ms. Bulkley chose not to adjust for this unrealistic growth rate. *Id.* at 64-65. Therefore, ICB assert that for the same concerns addressed by ICB related to this growth rate, Ms. Bulkley's DCF model produces unreasonable high-end results. *Id.*

ICB suggest further, Ms. Bulkley's puzzling decision to remove a company from her Proxy Group in this model because she believed it to be too low also contributes to this unreasonable result. *Id.* at 63-64. ICB argue that instead of randomly changing the Proxy Group, a proper adjustment would have been to place greater weight on the median results, which mitigates possible high and low outliers. *Id.* ICB aver Ms. Bulkley also should have, given the outrageous growth rates, focused more on the low end DCF results, and most importantly, considered a DCF model. ICB reason that Ms. Bulkley's failure to consider a multi-stage DCF model means the Commission should ignore her results. ICB further contend that the Company's choice to once more claim Mr. Walters' DCF results "... are well below the range of comparable authorized ROEs that have been approved for water utilities since at least 2010" is not true. ILAWC IB at 86 ICB explain that Mr. Walters' multi-stage DCF (7.93%/8.24%) and Constant Growth DCF using the sustainable growth rate (8.45%/8.52%) results are within the range of six separate instances since 2018 of water utility ROE awards ranging from 7.45% to 8.90%. ICB Ex. 3.0 at 5-6.

ICB point out that even though Ms. Bulkley expressed little faith in the use of a DCF model as it applies to her proxy group, it was the only method she utilized to determine her rate of return for her CAPM and ECAPM models. ICB Ex. 1.0. at 70. ICB note Ms. Bulkley's DCF-derived market risk premiums are based on a market return of approximately 12.56%, which consists of a weighted average growth rate component of 10.78% and weighted expected dividend yield of approximately 1.69%. *Id.* at 67. Mr. Walters testified regarding his own DCF model, ICB remind the DCF model requires a long-term sustainable growth rate. *Id.* ICB argue Ms. Bulkley's sustainable market growth rate of 10.78% is far too high to be a rational outlook for sustainable long-term market growth. *Id.* ICB point out this growth rate is over two and a half times the growth rate of the U.S. GDP long-term growth outlook of 4.14%. *Id.* at 68. ICB argue it is completely unreasonable to believe an individual company can sustain growth rates as high as Ms. Bulkley has calculated into perpetuity. ICB further note, Ms. Bulkley's average market risk premium of 8.10% is skewed by companies that fall outside of the

5.00-8.00% range that is supported by empirical evidence. *Id.* at 69. ICB conclude that because of these unreasonable inputs, Ms. Bulkley's CAPM and ECAPM results should be rejected.

ICB note Ms. Bulkley also conducted an ECAPM analysis. ICB point out that the ECAPM analysis modifies the CAPM equation in an attempt to correct supposed deficiencies in the CAPM model. ICB Ex. 1.0. at 70.

ICB assert the significant problem with this choice is that Ms. Bulkley used an adjusted Value Line beta in her analysis, inconsistent with the academic research and literature on ECAPM studies, as Mr. Walters explained in his testimony. *Id.* at 71. ICB point out that the weighting adjustments applied in the ECAPM are mathematically the same as adjusting beta since the inputs are all multiplicative. *Id.* Thus, ICB argue that the end result of using the Value Line adjusted betas in the ECAPM is essentially an expected return line that has been flattened by two duplicative adjustments. *Id.* Moreover, ICB point out that Ms. Bulkley further increases the intercept and flattens the security market line by using projected long-term Treasury yields. *Id.* at 72.

ICB state the ECAPM will raise the intercept point of the security market line and flatten the slope. *Id.* at 72-73. ICB note, this has the effect of increasing CAPM return estimates for companies with betas less than 1 and decreasing the CAPM return estimates for companies with betas greater than 1. *Id.* Mr. Walters modeled the expected return line resulting from the application of the various forms of the CAPM/ECAPM in Figure CCW-6. *Id.* at 73: Fig. CCW-6.

ICB contend Figure CCW-6 shows that the ECAPM adjustment has a very similar impact on the expected return line as a Value Line beta. *Id.* ICB point out that another observation that can be made from the figure is the magnifying effect that the ECAPM using a Value Line beta has on raising the vertical intercept and flattening the slope relative to all other variations. *Id.* 73-74. ICB argue there is simply no legitimate basis to use an adjusted beta within an ECAPM because it unjustifiably alters the security market line and materially inflates a CAPM return for a company with a beta less than 1. *Id.* at 74. ICB note Staff witness Bista echoed the same criticisms as Mr. Walters regarding the ECAPM. Staff Ex. 3.0 at 54-56.

ICB argue that in addition to the obvious and biased flaws inherent in her analysis as being reason enough for this Commission to reject Ms. Bulkley's ECAPM analysis and its results, the Commission should look to its previous Order on the matter. See Docket No. 11-0767 at 109.

ICB declare the unreasonableness of Ms. Bulkley's application of the ECAPM while using adjusted betas is clear when looking at the results of her analysis, with a range from 10.85% to 11.60%. IAWC Ex. 13.0 at 70: Figure 11. ICB point out the average authorized ROE for water utilities has not been at a level of 10.85%, let alone 11.60%, at any time in at least the last 17 years. ICB Ex. 1.0 at 5: Fig. CCW-1. ICB argue that based on the record evidence, the ECAPM, as employed by Ms. Bulkley, should be rejected in its entirety.

ICB maintain that while seeming to finally accept the Commission's repeated rejection of flotation cost adjustments, Ms. Bulkley still refuses to completely reject the

idea. ILAWC Ex. 13.0 at 54. ICB point out that instead of outright including a flotation cost adjustment, she admits to including an “estimated effect” of flotation costs in her overall recommendation. *Id.* ICB argue the Commission should soundly reject this attempt to circumvent the historical rejections of flotation cost adjustments.

d. Commission Analysis and Conclusion

When the Commission evaluates the reasonableness of a utility’s authorized ROE, it must: (1) consider whether the ROE is consistent with other businesses which experience comparable risk; (2) ascertain whether the approved ROE can support credit quality and ensure access to capital; and (3) determine that the end result leads to just and reasonable rates for consumers. See *Bluefield*, 262 U.S. at 679; *Hope*, 320 U.S. at 591. The Commission is charged with approving an ROE that allows the utility to attract equity capital on reasonable terms so that it is able to provide safe, reliable service at just and reasonable rates.

The Company proposes a 10.75% ROE using DCF, CAPM, and ECAPM. Staff proposes a 9.84% ROE using DCF and CAPM models. ICB proposes a 9.34% ROE using DCF, CAPM, and a multi-stage growth DCF model.

The Commission must consider all the competing interests in making an ROE determination. “An authorized ROE that is too low restricts the utility’s access to capital at a reasonable cost. Conversely, an ROE that is too high will result in rates that are neither just nor reasonable.” *N. Shore Gas Co.*, Docket No. 20-0810, Order at 85 (Sept. 8, 2021) (*citing Bluefield*, 262 U.S. at 692; *Hope*, 320 U.S. at 603).

The Commission finds the Company’s proposal is flawed for several reasons. ILAWC’s DCF analysis employs average historical stock prices and does not reflect quarterly dividend payments. As Staff explained, only the most recent stock price reflects the most recently available information, and the Commission has consistently rejected the use of historical data in determining a company’s cost of capital. The Commission has also rejected the use of an annual DCF model because it would unnecessarily introduce measurement error. Further, the Company used unsustainable growth rates in the DCF. The Value Line growth rates used in the Company’s DCF analysis are inflated and should be averaged with the Value Line DPS growth rates for ILAWC’s proxy group. This would decrease ILAWC’s recent Value Line mean growth estimate by approximately 54 basis points and would lower the average constant DCF results from 9.99% to 9.72%. Staff’s DCF analysis incorporates current average stock prices, properly reflects quarterly dividend payments, and used the average of the Value Line DPS and EPS growth rates. The Commission therefore accepts Staff’s DCF analyses.

ILAWC’s CAPM analysis relies exclusively on betas calculated using weekly returns and includes forecasted U.S. Treasury bond yields as a proxy for the risk-free rate. By relying exclusively upon beta calculated using weekly data, the Company has introduced bias into its CAPM analysis that could have been mitigated by including a beta estimate derived from monthly return intervals. Averaging the Company’s weekly Value Line beta (0.84) with a monthly regression beta (0.72) would reduce the Company’s CAPM estimate from 11.28% to 10.85%. The Commission has expressed its preference for using a combination of weekly and monthly beta estimates, as Staff’s CAPM analysis used. Staff’s CAPM also properly relies on current 30-year U.S. Treasury bond yields,

which the Commission has repeatedly endorsed to estimate the risk-free rate because it is impossible to accurately predict future interest rates. Hence, the Commission approves Staff's CAPM analysis.

ILAWC employs an ECAPM analysis that improperly applies adjusted beta estimates, which results in inflated estimates of the proxy group's ROE. The ECAPM has been repeatedly rejected by the Commission and the Company failed to provide adequate evidence to support a change in position.

ICB's DCF analysis is flawed because it uses improper historical stock prices and its CAPM analysis uses projected U.S. Treasury yields as proxy for the risk-free rate and relies exclusively on weekly betas. As explained above, the Commission has repeatedly rejected the use of historical data in determining a company's cost of capital and prefers the using a combination of weekly and monthly beta estimates. The Commission does not agree with ICB that using NiSource skews the results of Staff's ROE recommendation. Therefore, the Commission rejects ICB's DCF and CAPM analyses.

The Commission also adopts Staff's weighting, which applies two-thirds weight to the DCF-derived result and one-third weight to the CAPM result, to address the unusually high weekly and monthly beta estimates. As Staff discussed, current beta estimates are high primarily due to the Covid-19 pandemic. The Commission agrees that the high beta estimates inflated the CAPM results and that the CAPM ROE estimates should be given less weight in this proceeding.

The Commission has consistently approved the use of the DCF and CAPM models in determining the cost of common equity. Staff's ROE analysis, using the DCF and CAPM models, is consistent with the Commission's preferred and accepted methods. The Commission finds Staff's weighted approach to be reasonable given the unusually high beta estimates. The Commission finds Staff's DCF and CAPM models, meet the goals of *Hope* and *Bluefield* in allowing ILAWC to attract capital yet charge reasonable rates. Therefore, the Commission authorizes an ROE of 9.84%.

5. Weighted Average Cost of Capital

For the reasons discussed above, the Commission adopts Staff's proposed overall weighted average cost of capital of 7.10% for ILAWC's water and sewer base, which incorporates Staff's 49.00% common equity ratio and 9.84% rate of return on ILAWC's common equity as shown below:

CAPITAL COMPONENT	PERCENT OF TOTAL CAPITAL	COST	WEIGHTED COST
Short-Term Debt	0.78%	5.55%	0.04%
Long-Term Debt	50.22%	4.46%	2.24%
Common Equity	49.00%	9.84%	4.82%
Total	100.00%		7.10%

D. Cost of Service

1. Peaking Factors

a. ILAWC's Position

The Company explains that peaking factors developed in the Company's class cost of service analysis are the drivers for the class allocations in every cost category where some form of the Base/Extra allocation methodology is used. ILAWC Ex. 22.00 at 46.

The Base/Extra capacity method as explained in detail in the AWWA M1 Manual is generally accepted as a sound method for allocating the cost of water service and was used by the Company in previous cases. The Company states that, in short, the Base/Extra capacity methodology as described in the AWWA M1 Manual relies upon a combination of the average water consumption across the year for each customer class and each class's estimated maximum daily consumption for the year to allocate the fixed costs of the water production and distribution system to customer classes. The Base/Extra capacity allocator is a two-part allocator, the first part being the "Base" component and the second part being the "Extra" component. ILAWC Ex. 8.00 at 38.

The Company explains that the Base component for each class is simply the average daily consumption for the year (total annual sales divided by 365 days). For each class, the "Base" allocation component is each class's average consumption divided by the total sum of average consumption for all classes. The "Extra" component is the difference between the maximum daily consumption for a given class and the average daily consumption for that class. For each class, the "Extra" allocator is each class's extra demand value divided by the total sum of the extra demand values for all customer groups. *Id.*

The Company explains further that for each class, the Base/Extra allocator is calculated as a weighted average of the Base and Extra allocators. The Base component is weighted by the total system load factor expressed as a percentage (average daily system production divided by maximum day production), and the Extra component is weighted by one minus the system load factor. These Base components and Extra components for each class result in maximum day peaking factors and maximum hour peaking factors that are then used in the class cost of service study ("CCOSS") to allocate revenue requirements for various cost categories to customer class. *Id.* at 39.

The Company states that the extension of the Base/Extra allocation methodology to individual customer classes is a direct result of the estimates of maximum day use and maximum hour use by customer class. These estimates result in the peaking factors that are used to allocate all of the costs that are subject to the Base/Extra methodology to customer class. ILAWC Ex. 22.00 at 46.

The Company explains that maximum daily and hourly consumption values and peaking factors for the residential, commercial, and public authorities' classes are estimated based on daily and hourly consumption data collected from Missouri-American Water Company's ("Missouri-American") St. Louis County service territory. *Id.* The Company notes that these samples, which are selected by customer class and subgroups within each class, are selected such that the customers in each customer class sample

have monthly usage characteristics that are nearly identical to monthly usage characteristics that ILAWC customers have and are expected to have during the forecast period, thus providing consistency between the usage characteristics of the customers in each sample and the usage characteristics of ILAWC customers in total. Maximum day and maximum hour capacity factors derived from this tailored Advanced Metering Infrastructure (“AMI”) data are used directly in the Company’s water service cost of service analyses. *Id.* at 46-47.

ILAWC states that its affiliates have successfully used this AMI data approach in New Jersey, Virginia, West Virginia, Kentucky, and Indiana, and that in every instance, the base data used was the AMI data from samples of customers in St. Louis County tailored to the specific usage characteristics for customers in each of the affiliated service territories. ILAWC Ex. 8.00 at 51.

The Company notes that the Missouri-American customer base in St. Louis County is a very large and diverse customer base consisting of approximately 350,000 customers. These customers range from low-income customers with relatively flat usage patterns to more affluent customers in more affluent St. Louis suburbs with higher levels of summer seasonal water usage, most if not all of which have AMI metering available on a daily and hourly basis. The Company draws samples of customers from this population whose monthly usage patterns match as closely as possible the monthly usage patterns of ILAWC customers which include the Company’s established service territories in Illinois and the Company’s recently acquired service territories. Matching the monthly usage patterns between AMI St. Louis County customers and ILAWC customers on a forecasted basis removes differences in weather patterns and other socioeconomic drivers and yields as closely as possible an estimated daily and hourly consumption profile that is representative of ILAWC customers. *Id.* at 51-52.

The Company states that in the Company’s last rate case, the Commission ordered the Company to conduct a new demand study specific to the Company’s service territory in Illinois that specifically accounts for recent Company acquisitions. As Company witness O’Neill described in his direct testimony, the development of that study is ongoing and is not yet complete. The Company explains that until such time that the study is complete, the best alternative is to use current data from customers with similar usage characteristics to ILAWC customers in the way described above. ILAWC Ex. 22.00 at 47.

The Company asserts that there is no reason to believe that AMI samples from a neighboring service territory tailored to consumption patterns for ILAWC customers will not provide reasonable and representative results for ILAWC customers similar to what will be developed from an ILAWC-specific capacity study. The Company further states that there is every reason to believe that the results derived from the St. Louis County samples, tailored to ILAWC-specific consumption patterns, will be reflective of current ILAWC customers including customers from newly acquired systems, and will be consistent with results from the ILAWC-specific capacity study currently in progress. *Id.* at 52.

The Company notes that Staff recommends the Commission approve the Company’s approach to peaking factors used for this case. Staff recommends that

ILAWC complete a demand study for its own service territory before it files its next rate case, and that if ILAWC does not complete a demand study for its own service territory before it files its next rate case, the Commission require the Company to provide comparison statistics for Illinois and Missouri demand data that demonstrate Missouri-American's demand is an appropriate proxy for ILAWC's demand. As noted by Company witness Rea, it is the Company's intention going forward to use data from the Illinois-specific demand study when that study is complete and data from that study is available. Staff Ex. 7.00 at 13-14.

The Company explains that IIWC is the only other party to address peaking. IIWC argue that the use of peaking factors developed from AMI data from Missouri-American's St. Louis County service territory results in "significantly different maximum day and maximum hour peaking factors by customer class relative to the last rate case and simply does not reflect the expected relationships between the peaking factors of the various customer classes," and provides example comparisons of the peaking factors used in this case versus the last rate case. While conceding that the peaking factors from the last rate case are outdated, IIWC recommend that the Company be required to use them until a new demand study has been completed. ILAWC Ex. 2.00 at 6.

In response to IIWC, ILAWC witness Rea explained that the immediate question in this case specifically as it relates to peaking factors is whether or not using old capacity study data from the ILAWC service territory is better than using newer capacity study data from a different jurisdiction where the samples of customers used are selected such that their usage characteristics are similar to current ILAWC customers. The Company explains that maximum daily and hourly consumption values and peaking factors for the residential, commercial, and public authorities classes are estimated based on daily and hourly consumption data collected from Missouri-American's St. Louis County service territory. This provides consistency between the usage characteristics of the customers in each sample and the usage characteristics of ILAWC customers in total.

The Company notes that both the Company and Staff believe that the Company's approach in this case of using borrowed AMI data from St. Louis County that is tailored to reflect current usage characteristics for ILAWC customers is a better approach than using the outdated peaking factors used in the last rate case. The Company states that, accordingly, the Commission should reject IIWC's recommendation to use those out-of-date peaking factors.

b. Staff's Position

Staff recommends the Commission approve the Company's use of peaking factors. Peaking factors are a ratio between a daily or hourly maximum rate of usage to the average annual usage for the Company or a service class. Staff Ex. 16.0 at 21-22. Peaking factors help determine cost category allocations for each class in some form where the Base/Extra Capacity method is used. *Id.* at 22; *see also* ILAWC Ex. 22.00 at 46. Under the Base/Extra Capacity Method, the distribution of component costs are determined by allocating costs for each customer class based on the number of equivalent meters, the total quantity of water consumed, and the peak usage demand by the customer class. Staff Ex. 7.0 at 9. These components result in both maximum day and maximum hour peaking factors for each class. *Id.* These peaking factors are then

used in the CCROSS to allocate revenue requirements for various cost categories to each customer class. *Id.* at 9-10.

The Company testified that peaking factors for the residential, commercial, and public authorities classes are based on daily and hourly consumption data collected from a demand study performed by its affiliate, Missouri-American, for Missouri-American's St. Louis County service territory. ILAWC Ex. 8.00 at 49-52. ILAWC argues that there is no reason to believe the usage characteristics for residential and commercial customers in St. Louis County differ from the usage characteristics for residential and commercial customers in ILAWC's service territory. *Id.* at 50.

Staff agrees that the St. Louis County service area has a similar customer base with similar socio-economic and climate characteristics as many of the Company's Illinois service territories. Staff Ex. 7.0 at 12. ILAWC's customer sampling has been derived from Missouri-American's customers and mirrors the usage patterns of the ILAWC customers. *Id.* Therefore, Staff argues that the use of water consumption patterns of residential and commercial customers from Missouri-American's St. Louis County service territory are a reasonable proxy for the water consumption patterns of ILAWC's residential and commercial customers. *Id.*

However, Staff recommends that ILAWC complete a demand study for its own service territory before it files its next rate case. Staff Ex. 16.0 at 23; Section IV.D.1. If ILAWC does not complete a demand study for its own service territory before it files its next rate case, Staff recommends the Commission require the Company to provide comparison statistics for Illinois and Missouri demand data that demonstrate Missouri-American's demand is an appropriate proxy for ILAWC's demand. Staff Ex. 7.0 at 12-13; Section IV.D.1.

For these reasons, Staff recommends the Commission approve ILAWC's proposed peaking factors.

c. IIWC's Position

IIWC note the class base, maximum day, and maximum hour rates of water usage for customer classes serve as the basis for allocating base, maximum day, and maximum hour capacity costs between the Company's customer classes. *Id.* at 5. IIWC point out maximum rates of water usage are expressed in terms of peak demand ratios, or peaking factors. IIWC note the maximum rate of usage, regardless of whether it is daily or hourly, can be expressed as a percent of average annual usage, or base usage. This percentage relationship to base usage is the peaking factor. *Id.* IIWC testify that weather-sensitive customers whose water consumption increases during the summer due to discretionary outdoor water use have higher peak demand ratios than customer whose water use is steady year-round. *Id.* at 6.

IIWC note in this proceeding the Company used maximum day and maximum hour peaking factors developed using AMI data from Missouri-American's St. Louis County service territory. ILAWC Ex. 8.00 at 49. IIWC also note that the Company is currently in the process of conducting a demand study, which will include data acquisition beginning in 2024, and continuing for a period of not less than three years. ILAWC Ex. 3.00 at 46.

In ILAWC's last rate case, ILAWC testified it had acquired over sixty thousand additional customers through water system purchases and the cost of serving those customers was included in the consolidated Central Zone CCROSS. Docket No. 22-0210, IAWC Ex. 1.00 at 6; Docket No. 22-0210, IAWC Ex. 7.00 at 8. IIWC point out in that proceeding the Company acknowledged that the acquired systems consisted primarily of residential customers. Docket No. 22-0210, Ex. IIWC/FEA Ex. 1.1.

IIWC note in this proceeding the Company confirms that since its last rate case it has acquired three water and five wastewater systems, totaling over 36,000 additional direct and indirect customer connections. ILAWC Ex. 1.00 at 9. IIWC testify that again, just as in the preceding ILAWC rate case, these 36,000 additional customers are made up of primarily residential customers. ILAWC Sch. E-5 at 54. IIWC declares this fact is important considering that compared to non-residential customers, residential customers typically have larger extra-capacity demands which exceed their base consumption. IIWC Ex. 1.0 at 7. IIWC contend the Company ignored this difference and chose not to examine the maximum day or maximum hour demand ratios of the newly acquired systems and instead proposed to rely on data from a different jurisdiction with different customers in a different state. *Id.* at 7.

IIWC point out that the Company bases the estimates for the maximum daily and hourly consumption values and peaking factors for the residential, commercial and public authorities on daily and hourly consumption data collected from Missouri-American's St. Louis County service territory. ILAWC Ex. 22.00 at 46. IIWC note the Company claims the samples are selected such that the customers in each customer class sample have monthly usage characteristics that are nearly identical to monthly usage characteristics that ILAWC customers have and are expected to have during the forecast period. *Id.* at 46. IIWC point out that the Staff supports the Company's position while at the same time admitting that it would be preferable to use actual ILAWC smart meter data to compile hourly and daily peaking factors for the Company's CCROSS. Staff Ex. 16.0 at 22. IIWC claim Staff is willing to accept the Company's position despite not having the most factual, appropriate information. IIWC suggest Staff's support of the Company does not inspire conviction. IIWC note Staff states it would be preferable to use actual ILAWC smart meter data to compile hourly and daily peaking factors and suggests the Company's "attempt to use up to date data, albeit sampling data" seems to be reasonable. *Id.* at 22. IIWC provided information illustrating the fact, and supporting their position, that the Company's approach results in significantly different maximum day and maximum hour peaking factors by customer class relative to the last rate case, failing to reflect the expected relationships between the peaking factors of the various customers classes.

IIWC provided a comparison of the maximum day and maximum hour peaking factors used in the Company's CCROSS in this case to the peaking factors used in the Company's last rate case, for each customer class. IIWC Ex. 1.0 at 8.

IIWC assert the Company's CCROSS for the Central Water Division in this case reflects a residential maximum day peaking factor that is now lower than both the commercial and industrial class maximum day peaking factors. IIWC point out the residential maximum hour peaking factor is less than the commercial maximum hour peaking factor. IIWC contend that this illustrates the relationship between the Company's peaking factors for the residential, commercial and industrial classes do not align with the

expected load profiles of residential customers relative to commercial and industrial customers. IIWC argue that this raises the concern that the peaking factors used by the Company in this case may not result in an accurate measure of the Company's cost of providing service to each customer class. IIWC note residential customers typically exhibit weather-sensitive usage patterns, with peak usage in the summer months, while industrial customers use water at a more consistent rate year-round for processes. *Id.* at 9. IIWC state that based on this information, one would expect the most weather-sensitive class to have a higher maximum day peaking factor than a less weather-sensitive class like commercial customers, or a non-weather-sensitive class with a flatter load profile that uses water for processes. *Id.*

IIWC also illustrated the peaking factors used in the Company's CCOS for the Pekin District exhibit a similar problem. *Id.* IIWC argue that the suggestion by both the Company and Staff that peaking factors across the states should be comparable is factually inconsistent with the customer class load characteristics implied by the peaking factors used by the Company in the CCOS. IIWC assert that "should be compatible" should not be the benchmark for the Commission.

IIWC compared both the St. Louis, Missouri and Illinois customer peaking factors for residential and industrial customers. IIWC contend the results reveal, the peaking factors used in the CCOS for Illinois districts are not consistent with the notion that residential customer water consumption is more weather-sensitive than industrial water consumption. *Id.* at 15. IIWC hold that residential class peaking factors should be higher than industrial class peaking factors due to the nature of residential water consumption as compared to industrial class customers who use water on a more consistent basis year-round for process purposes. As shown in IIWC Table 1-RT, ILAWC's CCOS relies on maximum day and maximum hour peaking factors for residential customers which are lower than the maximum day and maximum hour peaking factors for the industrial class customers. IIWC point out that while the Missouri-American peaking factors do in fact reflect this logical pattern, their application to Illinois customers does not result in the same logical outcome.

IIWC recommend the Company be required to use the same peaking factors that were used in its last rate case until such time as the new demand study has been completed. IIWC stated it understands and concedes that the peaking factors from the Company's last rate case will be outdated now given the Company's recent acquisitions, but argue they will indeed continue to reflect the expected relationships between the residential, commercial and industrial classes.

d. Commission Analysis and Conclusion

The Commission agrees with Staff and the Company that, while the peaking factors used by the Company rely on a different service territory, the usage patterns are reasonably representative of the Illinois service territory. The St. Louis County service area has a similar customer base with similar socio-economic and climate characteristics as the Company's service territory. Thus, the Commission finds the Company's approach in this case of using data from St. Louis County that is tailored to reflect current usage characteristics for ILAWC customers is a better approach than using the outdated peaking factors used in the last rate case as IIWC recommend. The Commission notes that IIWC

admit that the recommended peaking factors from the last rate case are outdated since ILAWC has acquired additional water systems and added additional customers since the last rate case. IIWC's preferred method relies on outdated peaking factors that are no longer representative of current customer demand.

Therefore, the Commission agrees with the Company's approach to peaking factors used for this case and it is approved. The Commission also agrees with Staff that if ILAWC has not completed a demand study for its own service territory before it files its next rate case, then the Company will be required to provide comparison statistics for Illinois and Missouri demand data that demonstrate Missouri-American's demand is an appropriate proxy for ILAWC's demand.

2. Purchased Power Costs

a. ILAWC's Position

The Company explains that in its CCOSS, it allocates its fuel and purchase power costs to customer class based on total water sales. ILAWC Ex. 8.00 at 51. The Company notes that Staff recommends the Commission approve the Company's use of Factor 1, which allocates purchased power costs between customer classes based on each class's annual (or average daily) consumption, to allocate purchased power costs between customer classes.

The Company explains that IIWC is the only other party to address purchased power costs. The Company notes that IIWC argue that the use of Factor 1 does not recognize how ILAWC incurs purchased power expense. IIWC also assert that the use of Factor 1 reflects an assumption that Fuel and Purchase Power expenses are base costs, which tend to vary with the quantity of water used, plus costs associated with supplying, treating, pumping, and distributing water to customers under average load conditions, without the elements necessary to meet peak demands. The Company states that IIWC argue that using Factor 2 would be consistent with the allocation of other Source of Supply and Water Treatment expenses that have been classified as serving both base and maximum day extra-capacity requirements, and using Factor 4 would be consistent with the allocation of other Power and Pumping expenses that have been classified as serving both base and maximum day extra-capacity requirements. IIWC also assert that Factor 2 and Factor 4 more accurately allocate purchased power expense between customer classes, because they allocate costs between customer classes based on average flow, and peak day demand.

The Company disagrees with IIWC. The Company maintains that while it is true that the Company incurs more costs to pump water at times when demands are higher than at times when demands are lower, the important question is whether the cost per kilowatt-hour ("kWh") that the Company incurs is significantly higher during periods of high demand than during periods of low demand, IIWC have not provided any evidence to suggest that is the case. If the cost per kWh is roughly the same regardless of when the Company uses electricity, then there is no reason to allocate costs disproportionately to certain customer classes. The Company states that given that there has been no demonstration that the cost per kWh is different during different times of the year, allocating purchase power costs based on total consumption (Factor 1) is appropriate. The Company notes that additionally, while it is true that more power is used to pump

water during peak periods, and more cost is incurred, but if that water is primarily for residential customers, the cost during those periods would also be primarily allocated to residential customers because their volumes would count more toward total annual usage than other classes. The Company explains that because pumping equipment pumps a variable commodity and not the capacity itself, it is not logical to use a capacity allocator to allocate the variable cost of pumping. Pumps simply deliver water, making the cost of pumping a variable cost. The Company states that accordingly, it is logical to use a variable cost allocator to allocate the variable cost of pumping, which is what the Company has done.

The Company notes that Staff agrees, concluding that “until it is established that there are different kWh charges incurred by the Company during peak demand periods (both hourly and daily), the Company’s use of Factor 1 to allocate these costs is appropriate.” Staff Ex. 16.0 at 25.

b. Staff’s Position

Staff recommends the Commission approve the Company’s use of Factor 1 to allocate purchased power costs between customer classes. Staff Ex. 16.0 at 25.

The Company claims that while it does incur more costs to pump water at times when demand is higher, the “more important question” is whether the cost per kWh the Company incurs is significantly higher during periods of high demand. ILAWC Ex. 22.00 at 49. The Company argues that there is no evidence that the Company incurs significantly higher kWh costs during periods of high demand than during periods of low demand. *Id.*

Until it is established that there are different kWh charges incurred by the Company during peak demand periods (both hourly and daily), Staff state that the Company’s use of Factor 1 to allocate these costs is appropriate. Staff Ex. 16.0 at 25. For this reason, Staff recommends the Commission approve the Company’s use of Factor 1 to allocate purchased power costs between customer classes. *Id.*

IIRC argue that Factor 2, rather than Factor 1, should be used to allocate purchased power costs between customer classes. Specifically, IIRC argue that: (a) water consumption varies by month; (b) the Company incurs more costs to pump water at times when demands are higher than at time when demands are lower; and (c) using Factor 2 would be consistent with the allocation of other Source of Supply and Water Treatment expenses that have been classified as serving both base and maximum day extra-capacity requirements, and (d) Factor 4 would be consistent with the allocation of other Power and Pumping expenses that have been classified as serving both base and maximum day extra-capacity requirements. *Id.* at 10-12.

However, as explained by the Company, while it is true that more power is used to pump water during peak periods, which incurs more costs, if that water is primarily used for residential customers, the cost during those periods would also be primarily allocated to residential customers because their volumes would count more toward total annual usage than other classes. Because pumping equipment pumps a variable commodity and not the capacity itself, it is not logical to use a capacity allocator to allocate the variable cost of pumping. *Id.*

Staff states the key question is whether the cost per kWh the Company incurs is significantly higher during periods of high demand than during periods of low demand. If the cost per kWh is roughly the same regardless of when the Company uses electricity, then there is no reason to allocate costs disproportionately to certain customer classes. *Id.*

For these reasons, Staff recommends the Commission approve the Company's use of Factor 1 to allocate purchased power costs between customer classes.

c. IWC's Position

IWC note that for Source of Supply, Power and Pumping and Water Treatment, the Company used Factor 1 to allocate purchased power costs between customer classes. IWC Ex. 1.0 at 10. IWC also note Factor 1 allocates purchased power costs between customer classes based on each class's annual (or average daily) consumption. *Id.* at 10. IWC point out the use of Factor 1 reflects an assumption that Fuel and Purchase Power expenses are base costs, which tend to vary with the quantity of water used, plus costs associated with supplying, treating, pumping and distributing water to customers under average load conditions, without the elements necessary to meet peak demands.

IWC contend the use of Factor 1 does not recognize how ILAWC incurs purchased power expense. IWC note that if Purchased Power expense is based on both demand and energy consumption and demand costs are based on the highest power demand in a billing period then the demand component of purchased power expense does not vary with the amount of water consumed, it instead varies with the peak day and peak hour power consumption. IWC Ex. 1.0 at 11.

IWC argue the use of Factor 2 would be consistent with the allocation of other Source of Supply and Water Treatment expenses that have been classified as serving both base and maximum day extra-capacity requirements.

IWC point out that the Company, as well as Staff for the same reasons, reject the IWC proposal stating there has been no demonstration that the cost per kWh is any different during times of high demand than during periods of lower demand. ILAWC Ex. 22.00 at 49. IWC claim this argument misses the point. In response, IWC first note water consumption varies by month. IWC Ex. 2.0 at 7. Second, IWC point out, the Company incurs more costs to pump water at times when demands are higher than at times when demands are lower. IWC note for example, the highest period of consumption occurs during the summer months of June through August, and the higher sales result in the need for extra-capacity to deliver the above-average water demands to those customers. IWC note that as a result, the Company must procure greater amounts of power (kWh) to operate pumps to deliver the extra water capacity to customers during the extra-capacity demand periods. IWC Ex. 2.0 at 7. IWC argue that the bottom line is, delivering greater amounts of water requires procuring greater amounts of power to operate the delivery system and this should be reflected in the classification and allocation of purchased power costs in the Company's CCOS. IWC point out that the Company acknowledges that it incurs more costs to pump water at times when demands are higher than at times when demands are lower. ILAWC Ex. 22.00 at 49. Therefore, the Company incurs more power costs to deliver water when demands are

higher and uses less power to deliver lower water volumes at times when demand is lower. IIWC Ex. 2.0 at 7-8.

IIWC maintain, the use of Factor 2 would be consistent with the allocation of other Source of Supply and Water Treatment expenses that have been classified as serving both base and maximum day extra-capacity requirements. IIWC Ex. 2.0 at 11. IIWC argue similarly, Factor 4 would be consistent with the allocation of other Power and Pumping expenses that have been classified as serving both base and maximum day extra-capacity requirements. *Id.* at 11. IIWC argue Factor 2 and Factor 4 more accurately allocate purchased power expense between customer classes, because they allocate costs between customer classes based on average flow, and peak day demand. *Id.* at 11. IIWC assert average daily usage reasonably allocates a portion of the energy component of purchased power, and peak day factors correspond to the demand component of the Company's purchased power expense, which is established during peak water consumption periods.

IIWC argue that the fact that the cost per kWh may or may not vary during various demand periods does not change the reality that a portion of purchased power costs is incurred to meet extra-capacity demand, and the allocation factor used in the CCROSS should reflect that reality. IIWC continue to assert Factor 2 and Factor 4 more accurately allocate purchased power expense between customer classes based on how the Company incurs purchased power expense to meet the seasonal, monthly, and daily water demands of its customers.

d. Commission Analysis and Conclusion

The Company provided a CCROSS in which it allocated its fuel and purchase power cost to customer class based on total water sales. The Company used Factor 1, which allocates purchased power costs between customer classes based on each class's annual (or average daily) consumption, to allocate purchased power costs between customer classes. Staff supports the Company's use of Factor 1.

IIWC state that the use of Factor 1 reflects an assumption that Fuel and Purchase Power expenses are base costs, which tend to vary with the quantity of water used, plus costs associated with supplying, treating, pumping and distributing water to customers under average load conditions, without the elements necessary to meet peak demands. IIWC argue Factor 2 and Factor 4 more accurately allocate purchased power expense between customer classes, because they allocate costs between customer classes based on average flow, and peak day demand. The Commission does not agree.

The Company claims that while it is true that more power is used to pump water during peak periods, which incurs more costs, if that water is primarily used for residential customers, the cost during those periods would also be primarily allocated to residential customers because their volumes would count more toward total annual usage than other classes. The Commission agrees with ILAWC that because pumping equipment pumps a variable commodity and not the capacity itself, it is not logical to use a capacity allocator to allocate the variable cost of pumping.

The Commission is not convinced that the IIWC's claims warrant the changes IIWC propose in this proceeding. The evidence does not show that the peaking marginal costs

per hour have a significant increase due to high demand versus low demand of power purchase change. The Commission does not find that the use of a capacity allocator would be appropriate to allocate the variable cost of pumping. The Commission approves the Company's use of Factor 1 to allocate purchased power costs between customer classes.

3. Industrial Distribution Multiplier

The Company explains that the use of distribution multipliers in the Company's CCOSS is important in the allocation of distribution mains costs to customer classes. The Company notes that it is often the case that for large customers, service is taken directly from the transmission system (10" and above); therefore, it would not be appropriate to allocate costs related to the smaller diameter distribution system to these customers. The Company explains that for each customer class, a distribution multiplier is applied that estimates the percentage of water sales served to that class directly from the distribution system. A distribution multiplier for a customer class of 1.00 means that all of the water supplied to that class is served from distribution mains, and that particular class should get a full allocation of distribution mains costs. A distribution multiplier of 0.00 means that none of the water supplied to that class is served by distribution mains and that particular class should not get any allocation of distribution mains costs. A distribution multiplier of 0.50 means that 50% of the water supply to that class is served from distribution mains, and therefore 50% of the water used by that class is used in the calculation of the distribution allocation factor. The Company notes that the higher the distribution multiplier is for a customer class; the more distribution costs will be allocated to that class.

The Company notes that IIRC propose to use a distribution multiplier of 0.50 for the industrial class. The Company agrees. The Company also agrees with IIRC that it is appropriate to calculate a specific distribution multiplier for industrial customers in Illinois, and that it is appropriate in the CCOSS in the next rate case to develop a specific calculation of these multipliers for the industrial class.

Staff also agrees with the Company's use of a 0.50 distribution multiplier for the industrial class and does not object to the IIRC's recommendation regarding the calculations for the CCOSS in the next rate case. Staff Ex. 16.0 at 26. Thus, this issue is uncontested, IIRC's recommendations are reasonable, and they are approved.

4. One-Step vs. Two-Step Cost of Service Methodology

a. ILAWC's Position

The Company explains that in this proceeding, as in the Company's last rate case, the Company proposed a two-step cost of service allocation methodology. This methodology represents a change from the one-step methodology used in previous ILAWC rate cases where individual account balances were allocated directly to customer class. The Company notes that it made a similar proposal in its last rate case which the Commission declined to adopt. The Commission stated that while the Commission is not averse to trying new allocation factors, the Commission found that the Company did not fully support its proposed changes and rejected the Company's new allocation factor methodology. ILAWC Ex. 8.00 at 47.

The Company explains that Staff is the only party to address the Company's proposal to use a two-step cost of service allocation methodology. The Company states that Staff argues that the Commission should reject the Company's use of a two-step allocation factor method. The Commission has endorsed the one-step method many times in the past and Staff asserts that information concerning residential rate design is more obscured using the two-step method. According to Staff, ComEd notes, the one-step method allows for more flexibility and transparency because account balances are allocated directly to customer classes, rather than utilizing cost categories and cost category revenue requirements. Staff Ex. 7.00 at 13-14.

The Company continues to support the use of a two-step approach. The Company explains that part of the advantage of the two-step approach is that it becomes much easier to set meter charges on a cost basis using the revenue requirements associated with the metering, service line, and customer service functions which is provided directly by the two-step class cost of service approach. ILAWC Ex. 8.00 at 46. The Company states that as demonstrated by Company witness Rea, and as acknowledged by Staff, the results by customer class are virtually identical between the one-step and two-step methodologies when those methodologies are applied consistently.

The Company states that given that the results between the two approaches are nearly identical, the Company does not oppose keeping the one-step approach to cost of service as the preferred approach but recommends that revenue requirements by business function continue to be calculated and provided in the cost-of-service results. This can continue to inform aspects of rate design such as the determination of meter charges, and potentially provide the basis for different rate designs going forward as they are needed.

b. Staff's Position

Staff recommends the Commission approve a CCROSS that utilizes the one-step method to promote flexibility and transparency, like it has done many times in the past.

The Company provided two different cost of service models in this proceeding: a two-step allocation method and a one-step allocation method. In the two-step method, the Company first allocates the revenue requirement and account balances to cost categories. ILAWC Ex. 8.00 at 46; Staff Ex. 7.0 at 13. After the Company determines a revenue requirement for each cost category, the Company then allocates the cost category revenue requirement to each customer class using a single allocation methodology for each cost category. *Id.*

However, in each of the Company's last four rate cases, the Commission-approved CCROSS uses the one-step allocation factor method, where account balances are allocated directly to customer classes using the appropriate class allocation methodology. Staff Ex. 7.0 at 13; *see also* Docket No. 22-0210, Order at 137. Notably, the Commission endorsed the one-step method many times in the past and information concerning residential rate design is more obscured using the two-step method. Staff Ex. 7.0 at 15-17.

In ILAWC's last rate case, the Commission Order states that, while the Commission is not averse to trying new allocation factors, ILAWC had not fully supported

its use of the two-step method. Docket No. 22-0210, Order at 137. This is consistent with decisions the Commission has made in both *Aqua Illinois, Inc.* and *Prairie Path Water Company* (now *Utility Services of Illinois, Inc.*) rate cases in the recent past. See *Aqua Ill. Inc.*, Docket No. 17-0259, Order at 43 (Mar. 7, 2018); *Aqua Ill. Inc.*, Docket No. 11-0436, Order at 40 (Feb. 16, 2012); Docket No. 21-0198, Order at 100.

Furthermore, the two-step method does not offer a significant advantage or improvement to the one-step method. The one-step method allows for more flexibility and transparency because account balances are allocated directly to customer classes, rather than utilizing cost categories and cost category revenue requirements. The results from using the two-step method and the one-step method in this docket are negligible. Staff Ex. 7.0 at 14-15.

The Company argues this two-step CCROSS allocation methodology is the appropriate method to allocate revenue requirements to customers classes because it simplifies the cost-of-service analysis and makes the resulting allocation to customer classes more intuitive. ILAWC states that the one-step method “lacks the transparency and additional functionality of reporting revenue requirements by business function and customer class afforded with the two-step methodology proposed by the Company.” ILAWC IB at 118. However, this statement is patently false. In this docket, and in the Company’s last rate case, Staff’s primary argument against the Company’s two-step method is that it is less transparent than the Company’s one-step method.

In Staff’s view, ILAWC has failed to explain why utilizing cost categories and cost category revenue requirements is more transparent than simply allocating account balances directly to customer classes. There is no reason to over-complicate the CCROSS allocation methodology and change this methodology that has been approved many times for many utilities in the recent past.

For these reasons, Staff recommends the Commission approve the one-step cost allocation methodology and reject the Company’s proposed two-step cost allocation methodology, consistent with the Commission’s past rulings on this identical issue.

c. Commission Analysis and Conclusion

The Commission notes that the Company also proposed a two-step cost of service allocation methodology in its last rate case. The Company argues that part of the advantage of the two-step approach is that it becomes much easier to set meter charges on a cost basis using the revenue requirements associated with the metering, service line, and customer service functions which is provided directly by the two-step class cost of service approach. The Company states that there is not much of a difference between the one-step and two-step methodologies when the methods are applied consistently. ILAWC prefers the two-step approach but does not oppose the one-step approach to cost of service as the preferred approach. However, the Company recommends that revenue requirements by business function continue to be calculated and provided in the cost-of-service results.

Staff disputes the Company’s proposed two-step method claiming it does not offer a significant advantage or improvement to the one-step method. The one-step method allows for more flexibility and transparency because account balances are allocated

directly to customer classes, rather than utilizing cost categories and cost category revenue requirements. Staff points out that the results from using the two-step method and the one-step method in this docket are negligible.

The Commission notes that the parties have indicated that there is not much difference between the one-step and two-step method. The Commission therefore agrees with Staff and approves the CCOSS that utilizes the one-step method to promote flexibility and transparency and rejects the Company's two-step method.

E. Rate Design

1. Wastewater Revenue Requirement Reallocation

a. ILAWC's Position

In this proceeding, the Company is proposing to reallocate approximately \$15.8 million of revenue requirements from Central Zone wastewater customers to Central Zone water customers in Step One and \$16.6 million in Step Two. This represents 20% of the total Step One Central Zone proposed wastewater revenue requirement and 20% of the Company's Step Two Central Zone proposed wastewater revenue requirement. This amount represents a 4% increase in both Step One and Step Two water service proposed revenue requirement. ILAWC Ex. 8.00 at 69, 71; ILAWC Ex. 1.00 at 26.

The Company states that the benefit impact to Central Zone wastewater customers of this proposal is significant and the impact on water service customers will be negligible: The average wastewater bill for Central Zone wastewater customers with 4000 gallons of monthly usage will decrease from \$102.26 to \$81.52 which is a reduction of 20%. The corresponding increase to residential water customers in the Central Zone will be negligible. The overall average water bill for Central Zone water customers will increase from \$76.79 to \$80.48, which is an increase of 5%. The overall Bill-to-Income ("BTI") ratio at median household income for water and wastewater customers under the Company's proposed rates is expected to be 0.99% and 1.00% respectively in Step One. Absent the Company's proposal, the overall BTI ratio at median household income for water and wastewater customers under the Company's proposed rates is expected to be 0.94% and 1.13% respectively. ILAWC Ex. 8.00 at 80-81.

The Company recognizes it made a similar proposal in its last rate case, Docket No. 22-0210, where the Company proposed to reallocate approximately \$14.3 million of revenue requirements from Central Zone wastewater customers to the Company's water service customers. The Company notes that the Commission rejected the Company's proposal to reallocate a portion of wastewater revenue requirement to water customers in Docket No. 22-0210, stating that allowing the Company to reallocate approximately \$11.8 million of the Company's Central Zone wastewater revenue requirement to be recovered from water customers would violate the standard principle of cost causation. *Id.* at 69-70.

As ILAWC explains, the Commission did approve a reallocation of Central Zone wastewater revenue requirements to Chicago Metro wastewater revenue requirements. The reallocation amount ordered by the Commission was approximately \$11.8 million. The Commission also ordered a six-year phase in plan for wastewater rates whereby this

\$11.8 million reallocation would be reduced to zero over six years such that at the end of the six-year period, Chicago Metro rates would be based on the Chicago Metro approved revenue requirement and the Central Zone rate design for wastewater would be based on the Central Zone approved revenue requirement. *Id.* at 70-71. The Company notes that its proposed wastewater rate design is including the reallocation of wastewater revenue requirements from Central Zone to Chicago Metro customers based on the Commission's schedule for Year 3 and Year 4 in its Order in Docket No. 22-0210.

The Company states it is proposing again a reallocation of a portion of wastewater revenue requirements to water customers because the Company firmly believes that it is in the long-term best interest of its customers. The Company explains that there are numerous public policy reasons for approving a reallocation of wastewater revenue requirements to water customers, and it is well within the realm of rate design to incorporate public policy considerations. While cost causation is an important concept in rate design, cost causation is not and will never be the only consideration that should be considered in designing rates.

The guiding principle behind the Company's reallocation proposal, ILAWC maintains, is affordability. It is an important goal of rate design to make bills for water and wastewater service as affordable as possible for as many customers as possible, and as previously explained, affordability is an important principle in rate design. The Company explains that approximately 85% of Illinois' residents are served by more than 800 wastewater treatment facilities and 690 wastewater collection systems. ILAWC Ex. 15.02 at 104. By comparison, only eight gas utilities and three investor-owned electric utilities serve most of the residents in the state. The Company notes that unfortunately, fragmentation in water and wastewater infrastructure creates undesirable variability in water and wastewater quality across communities. Adequate prioritization of Illinois' wastewater infrastructure is vital to protecting our abundant water resources and providing a safe and clean resource for all users.

The Company explains that unfortunately, deficiencies in Illinois' wastewater infrastructure not only result in dire wastewater conditions, but they also pose a threat to our water resources. The Company notes that in 2022, the Illinois Section of the American Society of Civil Engineers released its Report Card that gave the state's drinking water infrastructure a grade of a D+ and wastewater infrastructure a grade of C, and quotes the Report Card as follows:

The Report Card was created to help every citizen, stakeholder and decision-maker in Illinois understand the state of our infrastructure and where we can collectively work to improve it. There is still significant underinvestment in several categories that threaten our competitive advantage and the health, safety, and welfare of our citizens. We need to continue the momentum of investing in the infrastructure engine that drives our lives and economy.

ILAWC Ex. 15.00 at 4.

ILAWC explains that there are two important policy considerations that support the Company's proposal. The first is affordability, which is an important principle of rate design. The Company's proposal is designed to help maximize the affordability of wastewater service for Central Zone wastewater customers. The median household income ("MHI") for wastewater customers in the Company's Central Zone is approximately \$72,200 per year, which is 37% lower than the Chicago Metro Zone (\$114,500 MHI), 12% lower than Central Zone water customers (\$82,000 MHI), and 14% below the statewide MHI for Illinois (\$83,500 MHI). *Id.* at 74.

The Company states that the second important public policy consideration is investment in wastewater and water systems in communities where investment is badly needed, especially in lower income communities. The ability to maintain affordable wastewater service, especially in lower income communities, is a key to enabling investment in those communities. If communities that need significant investment in infrastructure were required to pay for the entire cost of those infrastructure improvements, the hardships on homes and businesses in those communities would be significant. The Company notes that the concept of single tariff pricing, which the Company's reallocation proposal is very much related to, allows those costs to be spread over a large base of customers thus easing the burden on any particular group of customers. *Id.* at 74-75.

Accordingly, the Company states that its proposal is also supported by principles of environmental justice. The Company maintains that the ability of ILAWC to assist residents of distressed communities, some of whom are experiencing truly awful wastewater conditions, will in many cases be restricted if the Company's proposal is not adopted. With the reallocation of a portion of the Company's wastewater revenue requirement, ILAWC will have the regulatory treatment needed to continue acquiring and investing in these systems and be a source of safe, reliable, and affordable wastewater service to distressed communities. ILAWC Ex. 15.00 at 5. The Company explains that these principles of environmental justice have been articulated in the resolutions passed by the Board of Directors ("Board") of the National Association of Regulatory Utility Commissioners ("NARUC") at the 2022 Winter Policy Summit on February 16, 2022 ("NARUC Resolutions"). The NARUC Resolutions are presented in the record as ILAWC Exhibit 15.01. *Id.* at 6.

The Company explains that it recognizes that the Water Equity Resolution is not binding on the Commission, but ILAWC believes it represents an important perspective on what utility regulators consider worthwhile strategies to address affordability.

The Company notes that the resolution states explicitly that utilities and regulators should explore "whether consolidated pricing and/or consolidated water and wastewater revenue requirements assist utilities in leveraging economies of scale to achieve price stability by spreading costs across a broader customer base...." The Company explains that its reallocation proposal would result in more affordable rates for wastewater customers, while not impinging on the affordability of water service—a win/win for water and wastewater equity. The Company states that this is a clear endorsement of precisely the consolidated water and wastewater revenue requirement proposal that ILAWC is making in this case, and the Company believes this is a prime example of regulators'

capacity to implement policies that help customers obtain safe, reliable, and affordable water and wastewater service.

The Company notes that, generally speaking, the arguments raised by interveners against the Company's proposed reallocation of wastewater revenue requirements to water customers in Docket No. 22-0210, and those raised in testimony in this proceeding, center around cost causation, namely, that because water customers do not cause costs to be incurred in a wastewater system, water customers should not have to pay for the wastewater system. Arguments were also made that it was not appropriate for water customers in a specific geographic location to have to pay for costs in a wastewater system in a different area that they were not connected to and did not use when they may be paying for wastewater service separately in their own community.

The Company explains that while on the surface the Company's proposal does not strictly comply with cost causation standards, the Commission is not prohibited from making an allocation of wastewater revenue requirements to water customers when designing rates. *Willowbrook Util. Co.*, Docket No. 80-0519, 1981 WL 639546 (Ill.C.C.) (June 17, 1981)

ILAWC states that its proposed partial reallocation of wastewater revenue requirements to water customers asks the Commission to exercise its rate design discretion to further important policy goals for the water and wastewater industry, including the need to address water sector fragmentation, distressed and deteriorating systems, bill affordability, and water equity. The Company maintains that this is consistent with the intent of the Act: "that the health, welfare and prosperity of all Illinois citizens require the provision of adequate, efficient, reliable, environmentally safe and least-cost public utility services at prices which accurately reflect the long-term cost of such services and which are equitable to all citizens." 220 ILCS 5/1-102.

The Company asserts that these goals cannot be achieved through a strict reliance on cost-causation principles alone, as NARUC acknowledged in its 2022 Winter Policy Summit, "helping struggling customers pay their water and wastewater bills takes the combined efforts of utilities, regulators, policy leaders, and communities." ILAWC Ex. 15.01 at 2.

ILAWC explains that its proposed wastewater service rate design does just that. It calculates rates based on reasonable and well-supported cost of service studies that incorporate cost-causation principles (as discussed further below) and relies on other principles of rate design—including but not limited to gradualism and affordability—to re-allocate a portion of the Central Zone wastewater revenue requirement to the Company's water customers. The Company notes that this proposal enables the Company to make continued and prudent investment in deteriorating systems while also ensuring that rates remain affordable for all of the Company's customers.

The Company further explains that, additionally, a cost causation argument can be made that supports the Company's proposal. ILAWC Exhibit 8.08 provides an analysis of wastewater treatment flows for 2023 in the Company's various wastewater systems

and compares those flows to water consumption for customers connected to those wastewater systems. The analysis shows that in total, 15.3 million gallons of wastewater per day entered the Company's various wastewater treatment systems (collection mains and treatment plant) compared to a total level of water consumption of 5.1 million gallons per day by customers connected to those systems. ILAWC Ex. 8.00 at 77-78.

The Company notes that approximately two-thirds of the wastewater that enters the Company's wastewater treatment systems does not come directly from water used by retail customers connected to those systems. This wastewater flow is Inflow & Infiltration, which is primarily groundwater and stormwater that enters a sewer system. The Company explains that because only one-third of the water that enters these wastewater treatment systems is actually wastewater that comes from customers connected to the systems, it can be argued that for certain components of the system an allocation of costs to someone other than customers directly connected to the system would be appropriate because cost causation can be attributed to someone other than directly connected customers. *Id.* at 78.

Regarding concerns that the Company's proposal may require customers to pay for a service that they do not use, ILAWC notes that it is an integrated water and wastewater service utility. The Company explains that rate design for individual services offered by a multi-service utility like ILAWC necessarily involves an allocation of costs between the two services. Customers of the utility that take one service but not the other are naturally incited to argue that allocated costs should be pushed toward the service they do not use. Rate design for water and wastewater service necessarily involves allocation of costs between the two across the entire ILAWC system of which all customers, including water-only customers, are a part of. *Id.* at 78-79.

The Company maintains that while water-only customers in Peoria and Champaign may not immediately benefit from supporting wastewater investments in Alton and Granite City, all customers on the system at one point will benefit from the ability to spread investment costs in individual communities across a large statewide customer base through single tariff pricing. Water customers in Champaign helping to support wastewater investments in Alton is not fundamentally different than water customers in Champaign helping to support water investments in Alton, and vice versa. This arrangement is ultimately in the long-term best interest of all customers, especially when it can be shown that the temporary reallocation of a portion of wastewater revenue requirements to water customers is in the public interest as it helps improve the affordability of service across the state. *Id.* at 79.

The Company notes that, consistent with their testimony, Staff and several Intervenor (the AG, ILWC, and the Municipalities) oppose the Company's wastewater revenue requirement reallocation proposal. The Company explains that absent from each initial brief filed by Staff and Intervenor in this proceeding is any acknowledgement of the reality of distressed water and wastewater systems in Illinois, or the investment necessary to rehabilitate those systems and provide this State's citizens with safe, efficient, and reliable water and wastewater service. Instead, these parties oppose the Company's proposal on the same cost causation grounds they discussed in testimony.

The Company maintains that the Commission should reject these cost causation arguments for all the reasons discussed above.

Regarding arguments focused on the lack of enabling legislation that would authorize the reallocation proposal, and the general idea that this issue is one that should be addressed by the General Assembly (AG IB at 49-50; Municipalities IB at 8-9), the Company notes that Section 1-102 of the Act states that the goals and objectives of utility regulation in Illinois are efficiency, environmental quality, reliability, and equity. See 220 ILCS 5/1-102. While Section 1-102(d)(iii) states that the cost of supplying public utility services should be allocated to those who caused the cost to be incurred, Section 1-102(d)(iv) clearly allows for other factors to be considered in regulatory decisions as long as the rationale for these other considerations is set forth, which the Company has done. *Id.* Section 1-102(d)(v) states that regulation should allow for orderly transition periods to accommodate changes in public utility service markets, which the Company's proposal clearly supports, and Section 1-102(d)(viii) makes direct reference to affordability of service and the preservation of the availability of services to all citizens, which the Company's proposal is designed to do. *Id.*

In sum, the Company does not believe that cost causation is a more important rate design principle than affordability. The Company would not agree that any particular rate design principle is fundamentally more important than any other particular rate design principle, and that in the development of revenue allocations and rate design, all of the rate design principles that apply to the development of rates should be considered as a package. ILAWC is an integrated water and wastewater service utility, and rate design for individual services offered by a multi-service utility like ILAWC necessarily involves an allocation of costs between the two services.

b. Staff's Position

Staff recommends the Commission reject the Company's proposal to reallocate approximately \$15.8 million of ILAWC's wastewater revenue requirement to ILAWC's Central Water customers. Staff Ex. 7.0 at 39-40.

One of the fundamental goals of equitable ratemaking is that the costs of supplying public utility services are allocated to those who cause the costs to be incurred. 220 ILCS 5/1-102(d)(iii). In fact, the Act indicates that if factors other than cost of service are considered in regulatory decisions, the rationale for these actions should be set forth. 220 ILCS 5/1-102(d)(iv). Thus, cost of service and cost causation should be primary considerations for the Commission.

The Company argues that the guiding principle behind its reallocation proposal is affordability. ILAWC Ex. 8.00 at 73. The Company indicates its proposal seeks to maximize the number of customers for whom Basic Water and Wastewater Service is expected to be less than 2% of household income. *Id.* at 74.

While Staff admits affordability is a consideration in rate design, the Company's proposal to reallocate costs from one utility service to another utility service would violate basic cost causation principles. Staff Ex. 7.0 at 39. Specifically, requiring water customers to pay wastewater costs when they do not receive wastewater service is a violation of Section 1-102(d)(iii) and is not cost-based. *Id.* at 40.

The Commission rejected the Company's proposal to reallocate \$11.8 million of wastewater revenues to water customers in ILAWC's last rate case. Docket No. 22-0210, Order at 104-30. In that docket, the AG testified that only about 25% of ILAWC's customers receive both water and wastewater service. *Id.* at 124. This means that, if the Commission approved this proposal, customers may be paying both for their own provider's wastewater costs and ILAWC's wastewater costs (of which they receive no benefit or service). *Id.* at 122. Furthermore, Illinois courts have held that it is unjust and unreasonable for a utility to charge individuals for a service they do not receive. *Citizens Util. Bd. v. Ill. Com. Comm'n*, 157 Ill. App. 3d 201 at 206-07 (1st Dist. 1987) ("[I]t would be difficult to envision a more unjust and unreasonable charge than for a service never rendered by a utility.")

Staff states that the circumstances have hardly changed since ILAWC's last rate case. The Company once again proposes to allocate wastewater costs to customers who do not receive wastewater services. Notably, other parties also object to ILAWC's proposal. Champaign Ex. 1.0 at 6; South Beloit Ex. 1.0 at 2-3; AG Ex. 2.00 REV at 17. The Commission has heard ILAWC's same arguments before; the Company has failed to offer any new evidence to support this proposal; and the Commission should once again reject reallocating millions of dollars of the wastewater revenue requirement to water customers who do not receive wastewater service from the Company.

The Company tries to explain that wastewater reallocation follows cost causation principles because a majority of the wastewater that enters the Company's treatment systems comes primarily from groundwater and stormwater that enters a sewer system, but a water-only customer in Champaign does not cause the costs to move stormwater that falls in Jerseyville, nor do those Champaign customers receive any benefits. Paying for wastewater service twice: from both their own wastewater provider(s) and from ILAWC who does not provide wastewater services to them, does not make water-only bills more affordable for water-only customers.

Regardless of the Company's attempts to argue otherwise, wastewater reallocation directly violates the principles of cost causation. While the Company complains that cost causation is a fundamental goal of equitable ratemaking, it cannot sidestep the fact that the Act makes cost causation a primary consideration for the Commission. See 220 ILCS 5/1-102(d)(iii)-(iv).)

Finally, the Company argues that its proposal should be approved as it moves the Company closer to single-tariff pricing. Staff notes that the Company does not propose single-tariff pricing in this docket, and thus, as it is not a proposal in this docket, Staff recommends that the Commission does not address single-tariff pricing for ILAWC. Regardless, moving towards single-tariff pricing is not a valid reason to allow for wastewater reallocation. First, single-tariff pricing often refers to offering the same tariffed rate for all of a utility's customers regardless of whether they are on interconnected systems; it does not typically refer to what NARUC calls "consolidated pricing", where a utility establishes a combined water and wastewater requirement for customers who receive both of those services. Despite ILAWC's claim that its reallocation proposal is "very much related to" the concept of single-tariff pricing (ILAWC IB at 124), ILAWC is clearly mistaken. Single-tariff pricing is not about charging customers receiving one type of utility service for a different type of utility service they do not receive, it is about charging

customers who receive the same type of utility service under the same tariffs whether those systems are interconnected or not.

Second, the Company cites two Commission dockets from over forty years ago, to support its claim that past Commission decisions permit the Commission to approve wastewater reallocation because it approved “single-tariff pricing,” *Willowbrook Util. Co.*, Docket No. 80-0519 (“Willowbrook”) and *Countryside Utils. Corp.*, Docket No. 82-0373 (“Countryside”). *Willowbrook*, Docket No. 80-0519, 1981 Ill. PUC Lexis 20 (June 17, 1981); *Countryside Utilities Corp.*, Docket No. 82-0373, 1983 WL 822646 (Ill.C.C.) (Mar. 22, 1983). While these two dockets approved a combined water and sewer rate base, further details are scarce. First, we do not know how many water-only or sewer-only customers each of these utilities had at the time; the vast majority of customers may have been combined water and sewer customers. Second, it is unclear, especially in *Countryside*, whether the rate base associated with sewer operations was significantly lower than the rate base associated with water operations. Third, it is unclear whether combining water and wastewater revenue requirements resulted in benefits, such as paying less for operating costs, for water- or sewer-only customers. For example, in *Willowbrook*, joint operating costs were allocated solely to sewer customers.

Furthermore, while the Commission may have approved a combined water and sewer rate bases two times over forty years ago, that is not what the Company is asking the Commission to do in the current case. In this case, Staff notes that the Company requests a one-time increase for the revenue requirement for water customers and a resulting, one-time decrease for the revenue requirement for sewer customers. While the Company correctly argues that sewer customers will significantly benefit from this, because this is a one-time revenue requirement reallocation proposal and not a consolidated water and sewer tariff, there is no guarantee that water-only customers will similarly benefit from economies-of-scale by sewer customers paying for improvements to their water systems in the future. In other words, ILAWC’s proposal does not result in water-only customers experiencing economies-of-scale, it results in water-only customers paying an unjust and unreasonable charge.

For these reasons, Staff recommends the Commission reject the Company’s wastewater reallocation proposal.

c. AG’s Position

The AG asks that the Commission not allow ILAWC to recover the costs of providing service to wastewater customers from water customers who, in most cases, do not and cannot receive such service from the Company. The Commission rejected a similar proposal by ILAWC in the Company’s last rate case, finding that the proposal would violate the principle of cost-causation. Docket No. 22-0210, Order at 128-129. The AG requests that the Commission similarly reject ILAWC’s proposal in this case so that water customers are not required to pay the costs of a service they do not receive from ILAWC.

The AG points out that ILAWC argues “the benefit impact to Central Zone wastewater customers of this proposal is significant and the [negative] impact on water service customers will be negligible.” ILAWC IB at 120. ILAWC states that this will decrease the average monthly bill for Central Zone wastewater customers from \$102.26

to \$81.52 (or 20%) and increase bills for Central Zone water customers from \$76.79 to \$80.48 (or 5%). *Id.* at 121. The AG points out that ILAWC brushes over the fact that it is asking water customers to pay an additional \$44.28 per year for services that they do not receive. The AG explains that the reason that ILAWC's monthly bills are so high in the first instance is because the Company has failed to prudently manage its costs and has undertaken a massive spending spree in recent years—acquiring small systems throughout the state without conducting adequate due diligence into system conditions, and then spending \$25 million on unanticipated repairs and system improvements. The AG iterates that ILAWC's proposal to shift costs from one group of customers to another blatantly violates principles of cost causation and while the Company claims cost causation “is not the be-all and end-all of rate design,” ILAWC IB at 120, Staff points out that “cost of service and cost causation should be primary considerations for the Commission.” Staff IB at 83. The AG emphasizes that ILAWC has not and cannot provide any evidence to show that it is reasonable to ask water customers to pay an additional \$44 per year for services they do not receive simply because the Company repeatedly increases its rate base with new system acquisitions and associated investments.

According to ILAWC witness Rea, the Company is re-asserting this previously rejected proposal because it “firmly believes that it is in the long-term best interest of [its] customers.” ILAWC Ex. 8.00 at 72. However, the AG points out that the Company has provided no additional information that should cause the Commission to deviate from its well-founded conclusion in Docket No. 22-0210. The Act requires that all rates or other charges “be just and reasonable,” and “[e]very unjust or unreasonable charge . . . is hereby prohibited and declared unlawful.” 220 ILCS 5/9-101. The Act further specifies that utility regulation should be designed to promote fair and equitable treatment of consumers and investors, meaning, in part, that “the cost of supplying public utility services is allocated to those who cause the costs to be incurred.” 220 ILCS 5/1-102(d)(iii). Accordingly, the principle of cost causation—that the cost of service should be paid by those who cause it—is well-established in the Act and in Commission practice. *See, e.g., Util. Servs. of Ill., Inc.*, Docket No. 17-1106, Order at 61 (Sep. 24, 2018). The AG asks the Commission to reject ILAWC's proposal because it violates cost-causation principles and would require water customers to pay for wastewater services that they do not receive from ILAWC.

The Company claims its proposal is “supported by principles of environmental justice” because reallocating these costs will grant ILAWC “the regulatory treatment needed to support continuing to acquire and invest in these systems and be source of safe, reliable, and affordable wastewater service in distressed communities.” ILAWC IB at 124. To support this claim, ILAWC cites to the NARUC Resolutions. These resolutions propose that all utilities “regardless of ownership type” be required “to meet the same high quality [environmental] standards, disclose whether they are meeting those standards, and face appropriate consequences if they do not.” ILAWC Ex. 15.01 at 1. The AG notes that ILAWC is fully aware that it will be required to meet these standards under new regulations from the Environmental Protection Agency and the AG expects the Company to take reasonable and prudent steps to comply with these regulations. Indeed, the resolutions suggest “reliable wastewater service can be realized through advanced planning” and “prudent, incremental, and consistent investment in water and wastewater infrastructure.” ILAWC Ex. 15.01 at 1–2. The AG points out that these are basic

requirements of the Act that ILAWC must comply with through its normal operations. The AG asks that ILAWC not be given special ratemaking or rate design treatment to meet its basic public utility obligations.

As to water sector fragmentation, the resolutions state “small and struggling utilities” could be encouraged and incentivized “to voluntarily partner with more experienced regulated water utilit[ies]” to “obtain the resources necessary to provide customers with safe and reliable water service at stable prices.” ILAWC Ex. 15.01 at 2. While the phrase “voluntarily partner” is ambiguous, the AG iterates that it does not necessarily mean that small utilities must or should sell their systems to large companies like ILAWC. Instead, the AG notes, a preferable option could be for small systems to apply for the ample state and federal funding discussed in Section III.A.2.h., above. This is particularly true where, as Bolingbrook points out, “many ILAWC customers spend a monthly average of over \$200 on water and sewer service alone. Generally, a family’s water bill should be on the low-end, or least costly monthly utility bill they pay; however, in Bolingbrook, families are paying substantially more for water than any other monthly utility and, as a result, are forced to alter their daily lives merely to afford a water bill.” Bolingbrook IB at 12–13. The AG concludes that adding charges for wastewater services that these customers do not receive unfairly adds further burdens to these customers.

The AG asks that the Commission reject the Company’s special rate design treatment because it violates cost causation principles and cannot be approved based on ILAWC’s blanket and unsupported statements that its proposal is “supported by principles of environmental justice.”

The AG maintains that the Company’s proposal to disregard cost-causation principles is not only contrary to the Act, but also is an attempt to circumvent the law after multiple unsuccessful attempts to amend the Act to permit this exact type of reallocation. Legislative archives show that multiple bills have been introduced in the General Assembly that would change the language of the Act to expressly allow water and wastewater utilities to allocate costs across services. See, e.g., Bill Status of HB0415, 102nd General Assembly, ILLINOIS GENERAL ASSEMBLY (last action, Jan. 10, 2023). In each case, the Company actively supported these bills by filing witness slips in support and in each case, the bills failed to become law. Having failed to secure the necessary legislation, the Company is now asking the Commission to exercise authority it has, to date, not claimed. The AG explains that, at the very least, this demonstrates that the Company’s proposed reallocation is unprecedented and imprudent, if not beyond the Commission’s authority entirely. See *W. Va. v. EPA*, 597 U.S. 697, 731 (2022) (finding the US EPA exceeded its statutory authority when it attempted to promulgate a regulatory scheme similar to one that Congress has “considered and rejected multiple times”). The AG asks that the Commission deny the Company’s attempt at an end run around the legislative process and continue to apply fundamental ratemaking principles that are consistent with the Act and fundamental fairness.

The AG states, “It was the decision of the previous service provider, the Company, and its shareholders to pursue these acquisitions, and existing water customers should not be unquestionably expected to bear the risk and cost burden of the acquisitions and the plant investment in service areas that may have been subject to under-investment or

neglect.” AG Ex. 2.00 REV at 16-17. ILAWC has acquired thirteen new water and sewer systems in the two years since its last rate case. The AG asserts that these acquisitions, along with investments in those acquisitions, will unreasonably increase ratepayers’ bills both in the acquired systems and across ILAWC’s entire service territory. ILAWC’s proposal would further burden water customers who would be asked to not only pay for the new water acquisitions—but also be required to cover costs of new sewer systems, from which they do not receive any benefit. The AG concludes this is not only unfair, but blatantly violates cost-causation principles.

Like Mr. Larkin-Connolly, witnesses for Staff, IIRC, Champaign, and South Beloit also asked the Commission to reject ILAWC’s proposal because it violates cost-causation principles and would be fundamentally unfair and unreasonable to water customers. The AG suggests that if the Company is concerned that its acquisitions and related investments will result in rate shock for its new and existing customers, then it should adjust its acquisition strategy to ensure that rates are not driven up to unreasonable levels for existing and acquired customers alike. It should not violate the Act and basic cost-causation principles to cover the costs of its own imprudence. The AG concludes that captive ratepayers should not be forced to cover the costs of the Company’s excessive and costly acquisitions when it is the Company and its shareholders—not water customers—who benefit and doing so violates basic cost-causation principles.

In the Company’s last rate case, the Commission directed ILAWC to reallocate a portion of its Central Zone wastewater revenue requirement to Chicago Metro wastewater customers for a six-year period. Docket No. 22-0210, Order at 128–129. While the AG maintains this is still unfair to Chicago Metro customers, this approach would at least result in the costs being reassigned to customers who receive the same (wastewater) service, rather than a different (water) service. Over this six-year period, Chicago Metro wastewater rates would gradually be reduced as revenue was transferred back into the Central Zone wastewater revenue requirement. At the end of the period, Chicago Metro wastewater rates would reflect Chicago Metro’s revenue requirement and Central Zone wastewater rates would reflect the Central Zone’s revenue requirement.

In light of the Commission’s ruling in Docket No. 22-0210, and to prevent ILAWC from turning this reallocation into a reoccurring practice, the AG recommends that any reallocation from the Central wastewater district to the Chicago wastewater district in this case be limited to the same six-year period and incorporated into the timeline provided by the Commission in ILAWC’s last rate case.

For these reasons, the AG concludes that the Commission should deny the Company’s request to reallocate a portion of its wastewater revenue requirement to water customers.

d. Municipalities’ Position

In this case, the Municipalities note that ILAWC renews its previously rejected request to reallocate wastewater costs to water customers who do not receive wastewater service from the Company—a proposal that this Commission found in the last ILAWC rate case to be “in direct violation” of the standard rate-making principle of cost causation. Consistent with established law, rate-making principles, and the Commission’s Order in

Docket No. 22-0210 at 128, the Municipalities urge that the Commission again should reject ILAWC's request.

The Municipalities observe that ILAWC seeks to inappropriately allocate wastewater revenue requirements to water customers in the Central Zone using a two-step phase-in. The cost-shifting amounts to 20 percent of the Company's total proposed wastewater revenue requirement, adding an additional four percent increase to those water customers' bills. ILAWC Ex. 8.00 at 71.

The Municipalities contend that the facts pertaining to this improper cost shifting proposal are not in dispute. Simply, ILAWC wants water customers who do not receive wastewater service from ILAWC to pay for 20 percent of the Company's wastewater revenue requirements because, if ILAWC's wastewater customers paid the full revenue requirements for their service, the resulting wastewater rates would increase by some 46 percent. Staff Ex. 7.0 at 36. Rather than controlling and reducing costs to provide wastewater service to those wastewater customers, the Municipalities opine that the Company wants to transfer the burden caused by ILAWC's inability to control wastewater costs and mismanagement to water customers who do not receive wastewater service from the Company.

The Municipalities further note that under ILAWC's cost-shifting proposal, the Company's Central Zone wastewater customers would see their wastewater rates decrease by 20 percent per month from current rates, (ILAWC Ex. 8.00 at 80), while Central Zone water customers to whom ILAWC does not provide wastewater service would see a five percent surcharge on their bills to subsidize ILAWC's inefficiencies. In short, contrary to the law, ILAWC wants to charge water customers for a service they do not receive and will not receive while these rates are in effect (and probably never will receive because the water customers are serviced by their own, or other municipal wastewater systems), while simultaneously reducing by 20 percent from current rates the charges to customers who use ILAWC wastewater services. If the cost-shifting were approved, Central Zone water customers who do not receive wastewater services from ILAWC would pay twice for wastewater service—once to the actual provider of the service and a second time to ILAWC.

The Municipalities argue that ILAWC's witnesses admit that there has been no change in state law or regulations or ratemaking principles to justify the Commission now granting ILAWC's request—a request previously denied. The only change is that ILAWC is seeking to shift millions of dollars more than it proposed to do in 2022.

Utility customers should not be required to pay more than what the service provided to them is reasonably worth, nor should they pay for costs not legitimately incurred for their benefit. *United Cities Gas Co. v. Ill. Com. Comm'n*, 163 Ill.2d 1 at 24 (1994). The service provided by ILAWC to the targeted Central Zone water customers is water, not wastewater, and these customers should not pay for wastewater service in their rates. This difference is determinative. In *Cent. Ill. Pub. Serv. Co. v. Ill. Com. Comm'n*, 243 Ill. App. 3d, 421, 428, (4th Dist. 1993), the court found one of the goals and objectives of utility regulation "is to ensure that 'the cost of supplying public utility services is allocated to those who cause the costs to be incurred.'" In *Citizens Util. Co. v. Ill. Com. Comm'n*, 157 Ill. App. 3d 201 (1st Dist. 1987), the water utility provided no wastewater

service but charged customers for the service. The court agreed with the Commission's ordering a refund of the wastewater charges because "it would be difficult to envision 'a more unjust and unreasonable charge than for a service never rendered by a utility.'" *Id.* at 207. ILAWC's proposal in this docket to burden Central Zone water customers who do not receive ILAWC wastewater service with wastewater costs likewise is unjust and unreasonable because no ILAWC-owned or operated wastewater system provides wastewater service to the Central Zone customers who would be improperly charged the \$16.6 million in reallocated wastewater costs. In other words, the Company's proposal would impose charges to ratepayers for a service not rendered by the Company—wastewater—which is clearly inappropriate and contrary to Illinois law and sound ratemaking practices.

ILAWC witness Losli argues that, because the IEPA apparently transferred \$95 million of wastewater loan funds to a drinking water loan program solely for lead pipe remediation work, the IEPA shows cross-subsidization is allowed in Illinois. ILAWC Ex. 15.00 at 4. She offered no details or support for her conclusion. When asked to provide the specific Federal Register citation to support Losli's claim, the Company responded to a data request by stating that it did not have any citation to support her testimony. Champaign Cross Ex. 1.00.

The Company apparently was referring to 65 FR 60940 (October 13, 2000) that addresses the limited ability for a state to shift federal funds from one fund to another. The provision authorizes states to transfer designated funds between the Drinking Water State Revolving Fund and the Clean Water State Revolving Fund under certain circumstances. The regulations require that any transfer be "consistent with State law." 65 FR 60940, 60943. As noted above, Illinois does not provide for cost-shifting from one utility service to another at the customer level.

ILAWC also attempts to justify its position by citations to cases where combined water and wastewater utilities separately allocated costs between the two operations and did not, as ILAWC requests in this docket, shift inappropriate costs between water and wastewater operations. Rather than supporting the Company's position, the dockets are distinguishable.

In *Willowbrook*, the utility sought a rate increase for the 390 customers served by its combined water and wastewater system, consisting of one well and a wastewater treatment plant. Docket No. 80-0519, 1981 WL 639546. Willowbrook filed as a combined utility and did not separate its costs between water and sewer rates. In other words, contrary to ILAWC's assertion, the Commission did not make any allocation of wastewater revenue requirements when it designed the rates in that docket.

In *Countryside*, Docket No. 82-0373 (Mar. 22, 1983), the utility presented separate income and expense statements for the water and the wastewater operations, and the Commission set rates for each operation separately based upon the separate pro formas. More importantly, there was no subsidy between the water and wastewater operations, which is contrary to what would occur in the instant case if wastewater revenue requirements were shifted to water customers.

The Municipalities provided undisputed evidence that Champaign, South Beloit, Urbana, Philo, Savoy, and Saint Joseph, all Central Zone customers, do not use any

wastewater system provided by ILAWC. Instead, service is provided to residents of these municipalities either by a wastewater district or by the municipality itself. If ILAWC's improper proposal were adopted, then these water customers would have to pay not only for the wastewater service from their providers but also for phantom wastewater service not provided by ILAWC. Adding to the inequity, ILAWC's proposal would reduce charges to its own wastewater customers by over 20 percent while increasing water customers' bills by over five percent for the inappropriate surcharge.

The Municipalities conclude that ILAWC's proposed improper cost shifting of wastewater costs to water customers who do not receive wastewater service from the Company should be rejected again by the Commission. It is against sound ratemaking principles that require rates to be cost based, is not based on the law, and is contrary to sound public policy.

e. IIWC's Position

IIWC propose the approximate \$16 million revenue requirement be allocated by spreading it across all wastewater service customer classes in the state. IIWC Ex. 1.0 at 19. IIWC believe this approach better reflects cost-causation. In addition, the spread is consistent with how water customer rates have been transitioning to consolidated tariff pricing over the years. *Id.* at 19. IIWC note, traditionally the entire water revenue requirement has remained with the water customers across the state and therefore the entire wastewater revenue requirement should remain the responsibility of wastewater customers across the state.

IIWC argue it is clear wastewater revenue requirement should be recovered from wastewater customers as it unquestionably best reflects cost-causation. IIWC point out that a similar cost shifting proposal was rejected in the Company's last rate case and for all the reasons stated by IIWC, Staff, the AG, and the Municipalities, it should again be rejected in this proceeding.

f. Commission Analysis and Conclusion

The Commission notes that IIWC propose that the \$15.8 million revenue requirement be allocated by spreading it across all wastewater service customer classes in the State. No other party commented on this proposal. While the Commission finds that this is closer to cost causation for wastewater customers, it could still lead to cost subsidies. The Commission finds that IIWC's proposal is not developed enough in the record for the Commission to make a determination and it is rejected.

The Commission agrees with Staff and Intervenors that allowing the Company to reallocate approximately \$15.8 million of ILAWC's Central Zone wastewater revenue requirement to be recovered from ILAWC's water customers would violate the principle of cost causation. A regulatory objective in Illinois is that "the cost of supplying public utility services is allocated to those who cause the cost to be incurred." 220 ILCS 5/1-102(d)(iii). ILAWC's proposal would be a direct violation of this principle and it is rejected.

2. Meter Charges

a. ILAWC's Position

The Company notes that Staff supports the Company's methodology for calculating meter charges, but recommends the charges be modified to be consistent with their recommendation that the Commission not approve the Company's wastewater revenue requirement reallocation proposal.

The Company states that IIRC is the only other party to address meter charges in their Initial Brief, discussing them together with volumetric charges. The Company explains that IIRC assert that "it is a fact that the costs of providing water utility service are primarily fixed in nature and do not vary with the volume of water used by customers," and argue that it is more appropriate to recover a larger portion of any approved revenue increase through fixed monthly meter charges. IIRC note that in the Company's last rate case, the Company proposed to leave its then-current meter charges unchanged, but the Commission set meter charges according to Staff's recommended methodology. IIRC recommend returning the meter charges to the level they were at the beginning of the Company's last rate case, with a corresponding change to volumetric charges.

ILAWC explains that the Company and Staff both oppose IIRC's recommendation regarding meter and volumetric charges. The Company notes that, as Company witness Rea explained in response to IIRC witness York, meter charges that were in place at the beginning of the last rate case were not developed using the methodology the Company has described in this proceeding, and the Company does not believe that the setting of specific meter charges that resulted from final rates two rate cases ago, when revenue requirements and billing determinants were significantly different than they are today, should have any bearing on the determination of meter charges in this case. The Company states that the determination of meter charges in this case is based on sound rate design and cost of service principles, and importantly is based on revenue requirement and billing determinant information projected forward in this case and should be approved by the Commission.

The Company observes that Staff agrees, explaining that reverting customer charges to what was appropriate two years ago does not ensure that costs are recovered by those who cause those costs now. Fixed customer costs should be recovered through the customer charge, and all other costs should be recovered through the usage charge. The customer charges approved in the Company's last rate case were cost-based and appropriately adjusted to recover only the cost of metering, service line, and customer service functions. The rates recommended by Staff in this proceeding are also cost based and recover the fixed customer costs from each meter size larger than 5/8" without exceeding recovery of the fixed customer costs reflected in the Company's COS Study. In contrast, IIRC's proposal would allow the Company to recover more guaranteed revenue through the fixed customer charge than the fixed costs it incurs. Non-fixed costs are appropriately recovered by the declining block rate structure and should not be adjusted to reduce the amount of non-fixed costs recovered.

b. Staff's Position

Staff recommends the Commission approve a Central Water (including South Beloit and Villa Grove customers) customer charge of \$26.12, which represents a 100% fixed customer cost recovery through the customer charge and the remainder of the revenue requirement through the usage charge. Staff's rate design proposals are based upon the Company's proposed revenue requirements to allow a comparison between the Company and Staff proposals. Staff notes the final approved rates should follow Staff's recommended rate design methodology and be adjusted according to the revenue requirements approved by the Commission in this case. Staff Ex. 7.0 at 4.

Water rates utilize two different types of charges to recover revenues from each customer class. The first type are meter charges" or customer charges, which recover the fixed customer costs for providing water service based on the meter size installed at a ratepayer's premises. Staff Ex. 7.0 at 18. The second type are volumetric charges or usage charges, which recover the variable costs for providing water service based on the volume of water a customer uses. *Id.* at 18, 24.

Generally, Staff agrees that the Company's proposed customer charges are cost based. Staff Ex. 7.0 at 20. However, because Staff disagrees with ILAWC's wastewater revenue requirement reallocation proposal, the Central Water rates must be recalculated to remove that reallocation. *Id.* Staff removed the approximately \$15.8 million of reallocated wastewater revenues and reduced the customer and usage charges for numerous customer classes by the same percentages that each class was targeted to contribute to the wastewater reallocation. *Id.* at 21.

Staff recommends the Commission approve a Central Water (including South Beloit and Villa Grove customers) customer charge of \$26.12, which represents a 100% fixed customer cost recovery through the customer charge. Staff Ex. 7.0 at 24. For meter sizes larger than 5/8", Staff recommends the Company use the AWWA M1 Manual approved equivalent flow increase factors that correspond to the appropriate meter size as closely as possible to recover 100% of fixed costs through the customer charge. *Id.* Customer charge revenues collected from all meter sizes should not exceed the threshold of fixed customer cost recovery from water customers the Commission approves in this proceeding. *Id.*

ILAWC argues that the service line component should be assigned to meter size based on a separate weighting factor for service lines, which is different than the AWWA equivalencies for meter flow which Staff recommends the Company use. ILAWC IB at 131. ILAWC also claims that customer-related costs should be assigned based on a flat amount per customer that applies equally to all meter sizes. *Id.*

Staff does not object to the Company's method, so long as the revenue collected through the customer charge does not exceed the fixed customer costs needed to provide water service to all its water customers. Staff Ex. 16.0 at 6. This is the same method that was approved in the Company's last rate case. Docket No. 22-0210, Order on Reh'g at 16-17.

IIWC propose to adjust customer charges for meters 3/4" and larger back to levels prior to those approved in the Company's last rate case. IIWC Ex. 1.0 at 21. IIWC

propose this because “it would be more appropriate to recover a larger portion of any approved revenue increase through the fixed monthly meter charges, with an offsetting reduction in volumetric rate blocks” and because ILAWC had “initially proposed to maintain” those rates. *Id.* IIWC argues that water utility service costs are “primarily fixed in nature[] and do not vary with the volume of water used by customers.” *Id.* at 20.

Staff recommends the Commission reject IIWC’s proposal. Reverting customer charges to what was appropriate two years ago does not ensure that costs are recovered by those who cause those costs now. Staff Ex. 16.0 at 27. Fixed customer costs should be recovered through the customer charge, and all other costs should be recovered through the usage charge. *Id.* at 27-28. The customer charges approved in the Company’s last rate case were cost-based and appropriately adjusted to recover only the cost of metering, service line, and customer service functions. *Id.* at 28. The rates recommended by Staff in this proceeding are also cost based and recover the fixed customer costs from each meter size larger than 5/8” without exceeding recovery of the fixed customer costs reflected in the Company’s COS Study. *Id.* In contrast, IIWC’s proposal would allow the Company to recover more guaranteed revenue through the fixed customer charge than the fixed customer costs it incurs. *Id.* Non-fixed costs are appropriately recovered by the declining block rate structure and should not be adjusted to reduce the amount of non-fixed costs recovered. *Id.* at 28-29.

For these reasons, the Commission should reject IIWC’s proposal and instead approve a customer charge based on the COS Study in this proceeding.

c. IIWC’s Position

IIWC note the Company is opposed to IIWC’s proposal to return monthly meter charges to what they were at the beginning of the last rate case. IIWC point out that the Company notes that the meter charges that were in place at the beginning of the last rate case were actually lower than the Company has proposed in this case for 5/8” meters and significantly higher than those proposed in this case for meter sizes above 1” meters. *Id.* IIWC note both the Company and Staff argue utilizing the meter charges in place at the beginning of the Company’s last rate case would result in rates that would not be structured in a way that reflects an appropriate assignment of cost responsibilities of metering, service line, and customer related costs. IIWC point out Staff indicated it generally agrees that the Company’s proposed customer charges are cost based. IIWC disagree.

IIWC argue it is the Company’s proposal that fails to reflect the appropriate assignment of costs. To begin, it should be noted that IIWC’s proposal only affects meters sized 3/4” and larger. IIWC Ex. 2.0 at 12. IIWC point out that its proposal leaves the 5/8” meter charge at the level proposed by the Company and Staff and will not affect a majority (90%) of the residential customers. IIWC Ex. 2.0 at 12.

IIWC note the Company’s meter charges are composed of metering revenue requirement, service line revenue requirement, and customer related revenue requirements. However, IIWC assert it is important to note that these are only a fraction of the fixed costs included in the Company’s COSS. IIWC point out that the Company’s COSS shows that the cost of service associated with meters, service and customers represents only approximately 26.5% of the Company’s claimed fixed costs. ILAWC Ex.

8.04. IIWC note Company Exhibit 8.04 shows that the Company's total fixed costs are \$359.8 million and of that total only \$99.1 million is for Meters, Services, and Customers. *Id.* IIWC state that the Company noted that over 90% of the Company's revenue requirement are fixed costs and less than 10% are variable costs. IIWC argue that despite this fact, Staff claims the IIWC proposal will allow the Company to collect more in fixed costs than the Company actually incurs in fixed costs. IIWC argue this is not accurate. IIWC assert that the Company's proposed meter charges in this case will only recover 30% for the Central Water Division and 43% for the Pekin districts, of the claimed revenue deficiency. *Id.* at 18. IIWC note this means that approximately 72% of the Company's fixed costs (at its claimed revenue deficiency) would be recovered through volumetric charges using the Company and Staff proposed rate designs. IIWC argue that therein lies the problem, despite the fact that the Company's cost of service is increasing, under the Company's proposed rates, less of the fixed costs are being recovered through meter charges, and an increasing percentage of fixed costs are being recovered through volumetric charges. *Id.*

IIWC also assert that the meter charges effectively represent a minimum bill since they would be applicable even if no water was consumed during the billing period. *Id.* IIWC contend it does not make any sense for there to be a decrease in meter charge while at the same time the Company's cost of service has increased since the last rate case.

IIWC point out that both the Company and Staff justify their positions by stating that their proposed meter charges rely on AWWA equivalency factors. IIWC note however, the AWWA Manual M1 indicates that ratios should be developed that are applicable to an individual utility's particular circumstances and facilities. AWWA Manual M1, Seventh Edition, at 385. IIWC assert neither the Company nor Staff have provided any analysis to show that the equivalent meter ratios from the AWWA Manual M1 are appropriate for the Company's particular circumstances. IIWC note in addition, the AWWA equivalency factors are not absolute mandates for rate design, hence the AWWA Manual M1 noting the development of the ratios according to a particular utility's particular circumstances and facilities. IIWC argue the Company and Staff proposed meter charges simply overlook the practical differences in the way the system is designed and how the infrastructure is used to provide service to the different types of customers.

IIWC argue the Company and Staff are wrong, and their proposals should be rejected. IIWC point out the Company's costs of service are increasing, yet the portion of fixed costs recovered through fixed monthly meter charges are decreasing. IIWC continue to recommend returning the meter charges for meters sized 3/4" and larger to levels that were current at the time of the filing of the Company's last rate case. IIWC claim this would restore the recovery of a greater percentage of fixed cost in meter charges or minimum monthly bills as has been done in past rate structures. IIWC contend its recommendation better aligns with cost of service in this case, and importantly leaves a majority of residential customers unaffected.

d. Commission Analysis and Conclusion

The Commission disagrees with IIWC's proposal that the Company should return the meter charge to the same rates as the beginning of the last ILAWC rate case. IIWC

argue that much of the costs of providing water service are primarily fixed in nature and do not vary much with the volume of water used by customers. ILWC is recommending that the Commission set meter charges to the level they were at the start of the prior rate case, with a corresponding change to volumetric charges. The Commission adopted Staff's recommended methodology in the last rate case and the Company set rates based on this methodology. Since the last rate case, ILAWC has acquired additional water and wastewater systems and added additional customers, thus the revenue requirements and billing determinants are significantly different than they are today. The Commission agrees with Staff and the Company that utilizing the meter charges in place at the beginning of the Company's last rate case would result in rates that would not be structured in a way that reflects an appropriate assignment of cost responsibilities of metering, service line, and customer related costs.

ILAWC argues that fixed customer related costs should be recovered through the customer charges. Staff does not object to this proposal as long as the revenue collected through the customer charge does not exceed the fixed costs needed to provide water service to all of the water customers. This is the same method that was approved in the Company's last rate case. Docket No. 22-0210, Order on Reh'g at 16-17. The Commission is not convinced by ILWC's arguments that the methodology should be changed. The Commission agrees with Staff that the fixed customer charge should represent 100% of the customer fixed costs and the remainder should be recovered from the volumetric charge. Accordingly, the Commission rejects ILWC's proposal and approves Staff's meter charge recommendations.

3. Volumetric Charges

a. ILAWC's Position

The Company notes that the Company and Staff are generally in agreement regarding volumetric charges, other than Staff's recommendation to adjust them to account for Staff's recommendation that the Commission reject the Company's wastewater revenue requirement reallocation proposal. Staff Ex. 7.00 at 26. The Company disagrees with that recommendation, see Section III.E.1. of this Order. The Company notes that in the alternative to Staff's recommended modification to the Company's proposed wastewater charges that removes the reallocation, Staff proposes gradually increasing the Central Wastewater rates to achieve full cost of service. ILAWC Ex. 35.00 at 29. The Company states that Staff notes that after rejecting the Company's proposal in its last rate case, the Commission instituted small, annual increases for Central Wastewater rates until rates are adequate to generate full cost of service revenue recovery. Staff states that the Commission could implement a similar approach here, explaining that it is likely that when the Company requests another rate increase, the starting point for calculating revenue deficiencies for Central Wastewater should be a rate design that recovers the full cost of service. Staff explains that this alternative benefits customers by reducing rate shock and embracing gradualism, and it provides a path towards a rate design that recovers the full cost of service. The Company states that the Commission should reject this alternative, and instead approve the Company's wastewater revenue reallocation proposal.

The Company notes that IIRC was the only other party that addressed volumetric charges, together with meter charges. The Company states that IIRC's recommended modification to volumetric charges should be rejected for the reasons discussed immediately above in Section III.E.2.

b. Staff's Position

Because Staff recommends the Commission reject ILAWC's wastewater revenue requirement reallocation proposal, the Central Water rates must be recalculated to remove that reallocation. Staff Ex. 7.0 at 25. Staff recommends that the Commission adopt the water usage charges, based on the Company's proposed revenue requirement as shown in Attachment A of Staff Exhibit 7.0.

Wastewater or sewer rates utilize two different types of charges to recover revenues from each customer class. The first type of charges are labeled meter charges or customer charges, which recover the fixed customer costs for providing sewer service and includes the first 1,000 gallons of wastewater usage per month. Staff Ex. 7.0 at 31. The second type of charges are labeled volumetric charges or usage charges, which recover the variable costs for providing wastewater service based on the volume of wastewater a customer uses. *Id.* at 31-32. There is a flat usage charge for residential customers and a declining block rate for non-residential customers. *Id.* at 32. Chicago Metro Collection-Only customers are also charged a Purchased Sewer Treatment Adjustment Clause rate. *Id.* The Company's Central Wastewater tariff includes Collection and Treatment rates only. *Id.* There are additional customer charges for Godfrey, which includes rates for multi-unit facilities and a rate for non-residential customers, a flat usage charge for all residential usage above 1,000 gallons, and a declining block usage rate for non-residential customers. *Id.* Alton customers pay contract rates. *Id.* Finally, recent Company acquisitions have their own tariffed rates as outlined in their respective Asset Purchase Agreements. *Id.*

The Company proposes to increase Chicago Metro Wastewater rates by approximately \$7.3 million in Step One of the proposed two-step increase to recover the full revenue requirement. ILAWC Ex. 8.00 at 67-68. For Collection Only customers, the Company proposes no increase to the customer charge and to increase the usage charge from \$0.13200 per 100 gallons to \$0.78105 per 100 gallons. Staff Ex. 7.0 at 33. For Collection and Treatment customers, the Company proposes no increase to the customer charge and to increase the usage charge from \$0.67500 per 100 gallons to \$0.78105 per 100 gallons. *Id.*

Staff does not object to the Company's Chicago Metro Wastewater rates, as those rates cover the increase in the cost to serve those customers. Staff Ex. 7.0 at 33-34.

The Company proposes to (1) create a Collection Only rate; (2) consolidate all acquired systems that take service under individual tariffs into the Central Wastewater rates; and (3) re-allocate approximately \$15.8 million of the Central Wastewater revenue requirement to the Central Water revenue requirement. See Staff Ex. 7.0 at 34.

Staff does not object to consolidating the Company's recent wastewater acquisitions into the Central Wastewater rates. *Id.* Consolidation allows the Company to

spread capital costs over a larger base of customers and mitigate rate shock when infrastructure improvements are necessary. *Id.*

However, since Staff disagrees with reallocating the wastewater revenue requirement to water customers, the Central Wastewater rates must be recalculated. Staff and the Company generally agree how Central Wastewater rates should be designed, the only issue at dispute between Staff and the Company is the reallocated wastewater revenue requirement. See Staff Ex. 16.0 at 8-9.

Staff recommends the Commission approve a Central Wastewater rate design that recovers 100% of the costs to serve from Central Wastewater customers. Staff Ex. 7.0 at 49. This results in a 46% increase for Central Wastewater customers. *Id.* This is no more drastic than the Company's proposed increase for Pekin Water customers at 44%. *Id.*

In the alternative, Staff recommends gradually increasing the Central Wastewater rates to achieve full cost of service. After rejecting the Company's proposal in its last rate case, the Commission instituted small, annual increases for Central Wastewater rates until rates are adequate to generate full cost of service revenue recovery. Docket No. 22-0210, Order at 129. Staff states that the Commission could implement a similar approach here. It is likely that when the Company requests another rate increase, the starting point for calculating revenue deficiencies for Central Wastewater should be a rate design that recovers the full cost of service. Staff Ex. 7.0 at 47. This alternative benefits customers by reducing rate shock and embracing gradualism, and it provides a path towards a rate design that recovers the full cost of service. *Id.* at 47-48.

c. IWC's Position

IWC argue, given the concerns of instability and continuous need to modify rates, it believes it is appropriate to recover a larger portion of any approved revenue increase through the fixed monthly meter charges, with an offsetting reduction in volumetric rate blocks.

IWC note the Company and the Staff are in general agreement on how volumetric rates should be set. IWC make clear the Company does not agree with the IWC proposal. *Id.* IWC note the Company argues that the determination of volumetric rates that would result from any reduction in volumetric rates should apply to all rate steps. *Id.* at 134.

IWC argue that consistent with typical volumetric recovery, the first volumetric rate block of the Modified Gross Lease rate structure should primarily recover the utility's fixed costs of providing service to small volume users, such as residential and commercial customers. IWC Ex. 1.0 at 22. As such, the tail blocks should be less expensive. IWC note the Company will also recover some fixed costs, but such recovery will better reflect the economies of scale associated with serving higher load factor customers. *Id.*

IWC argue that despite the protests of the Company and Staff, IWC's recommendation will improve revenue stability for the utility by mitigating the impact of fluctuations in sales volumes on cost recovery. IWC argue its approach recognizes the economies of scale and the operational efficiencies the large users bring to the system. IWC requests the Commission approve its recommendation.

d. Commission Analysis and Conclusion

The Commission agrees with Staff and rejects ILAWC's wastewater reallocation proposal; the Central Water rates should be recalculated to remove the Company's proposed wastewater allocation. The Commission adopts Staff's recommended gradual increase of the Central Wastewater rates to achieve full cost of service.

In its last rate case, the Commission instituted small, annual increases for Central Wastewater rates set to continue until rates are adequate to generate full cost of service revenue recovery. Docket No. 22-0210, Order at 129. The Commission will implement a similar approach here. It is likely that when the Company requests another rate increase, the starting point for calculating revenue deficiencies for Central Wastewater will be a rate design that recovers the full cost of service. Staff's alternative benefits customers by reducing rate shock and embracing gradualism, and it provides a path towards a rate design that recovers the full cost of service and it is approved. The Commission agrees that this alternative will not involve a reallocation of wastewater costs to serve a different utility service customer base (i.e., water service), which the Commission concluded in Docket No. 22-0210 would violate ratemaking principles.

4. Bill Impacts

a. ILAWC's Position

The Company states that Bolingbrook addresses ILAWC's proposed changes in rates in a manner that is dramatic and relies heavily on the citations to various portions of the Act that refer to just and reasonable rates. The Company notes that although Bolingbrook places less emphasis on this, those sections of the Act also refer to the "provision of adequate, efficient, reliable, environmentally safe" public utility services and that the "public health, safety and welfare shall be protected," i.e., to the need for utility service to provide for and protect the health and welfare of ILAWC's customers. The Company maintains that this points to a significant omission from their discussion, namely, the need for investment in plant and facilities to ensure that "safety, health and welfare." Bolingbrook does not cite, for example, to Section 8-401 of the Act, requiring that the utility "provide service and facilities which are in all respects adequate, efficient, reliable and environmentally safe and which, consistent with these obligations, constitute the least-cost means of meeting the utility's service obligations." 220 ILCS 5/8-401. This is one of many other requirements in the Act that must be considered when evaluating the impact of ILAWC's rate requests and proposals on affordability. The Company explains that, as discussed in the testimony of Mr. O'Neill, among others, the Company needs to undertake significant investments to comply with regulatory requirements for clean drinking water and safe wastewater disposal. The Company states that Bolingbrook ignores the need for this investment, in a one-sided attack on the Company's proposed rates.

The Company maintains that Bolingbrook also ignores the affordability analysis that ILAWC provided—an analysis which demonstrates the affordability of its rates—and ignores as well as the various proposals the Company has made in this case to enhance the affordability of rates over time. The Company notes that ILAWC's affordability analysis demonstrates that the Company's water and wastewater service has been, is,

and is expected to continue to be affordable for the majority of its residential customers, including under the rates proposed in this case.

The Company further states that in making its arguments, Bolingbrook relies heavily on comments made by customers in this proceeding. The Company explains that those comments are not evidence and cannot be the basis for any determination of fact by the Commission. *Apple Canyon Lake Prop. Owners' Ass'n v. Ill. Com. Comm'n*, 2013 IL App (3d) 100832, ¶ 42, 985 N.E.2d 695, 708.

The Company explains that Bolingbrook's reference to numerous high bills from customers in Bolingbrook is misleading. ILAWC notes that the 136 bills cited by Bolingbrook do not represent a representative sample of bills issued by the Company to customers in Bolingbrook, as the Company issues approximately 22,000 bills in Bolingbrook per month. See Bolingbrook Cross Ex. 1 Conf. The Company states that additionally, the amount and charges shown on the bill may reflect a variety of customer-specific conditions, including, but not limited to, use of water for landscape irrigation, operation of swimming pools, leaks, past due balances, or amounts for prior billing periods, and may have been the subject of customer inquiry to ILAWC's customer service center or the resolution of any such inquiries. The Company also notes that the charges on these bills include charges from Bolingbrook which are included on ILAWC's bills and passed through to Bolingbrook customers. A high-level review of the 136 bills provided shows that 17 are for accounts that are past due or delinquent. Additionally, 26 bills (19% of bills provided) showed water usage above 10,000 gallons per month. Of those 26 bills, 11 bills showed water usage above 20,000 gallons per month with one customer using over 32,000 gallons per month. The average ILAWC residential customer utilizes 3,800 gallons per month.

Finally, Bolingbrook refers to the Company's rising rates. However, the Company notes it has only filed for three rate increases in the last 13 years. ILAWC explains that if Bolingbrook truly believes in its concerns, as expressed in its brief, about rising rates, and the need to ensure that rates are affordable, one would expect Bolingbrook to embrace ILAWC's low-income discount tariff, as well as the various proposals which as a package, as the Company has explained, are intended to enhance the affordability of rates, part by potentially reducing the number of cases that need to be filed over time. The Company notes that Bolingbrook does not come out in support of any of these measures, which suggest the brief represents nothing more than a series of complaints, without endorsement of any proposed solutions.

b. Staff's Position

Staff conducted a water bill impact analysis by examining a monthly bill for a residential customer with a 5/8" meter using 4,130 gallons of water per month in each of the Company's rate zones. Staff Ex. 7.0 at 29-30. At Company-proposed rates, most typical use residential water customers will have a water bill increase between approximately 34% and 37%. *Id.* at 30. Under Staff's proposal, most typical use residential customers will have a water bill increase between 30% and 49%. *Id.*

Staff also considered Central Water rate design proposals that recover different levels of fixed customer costs through the customer charge. *Id.* at 22. Although one of the fundamental goals of rate design is cost causation (assigning costs to the customers

that create those costs), affordability is another factor to consider in rate design. *Id.* at 23. Lowering the percentage of fixed charges collected through the customer charge results in slightly lower bills. *Id.*

Staff's recommended rate design would recover 100% of fixed customer costs through the customer charge and the remainder of the revenue requirement through the usage charge. *Id.* at 30-31. The difference in monthly bills between recovering 50% of the Company's fixed customer costs through the customer charge and recovering 100% of the Company's fixed customer costs through the customer charge is approximately \$3.21 for a 4,500 gallon per month user. *Id.* at 23, 31. Because the bill impact is small (and smaller for customers who use less than 4,500 gallons per month), Staff recommends the Commission approve Staff's water rate design which follows the principles of cost causation and recovers 100% of fixed costs through the customer charge. *Id.* at 31.

In its Initial Brief, Bolingbrook discusses the public forum hosted in Bolingbrook, Illinois on July 22, 2024, and includes some quoted comments from attendees. Bolingbrook also summarizes some of the public comments posted on the Commission's eDocket system. *Id.* at 8-9.

Public comments are "relevant to ratemaking proceedings." *Apple Canyon Lake Prop. Owners' Ass'n v. Ill. Com. Comm'n*, 2013 IL App (3d) 100832, ¶ 42. However, public comments "may not be treated as evidence or relied upon to resolve contested issues of fact." *Id.* Thus, while the Commission may consider the quoted comments in its decision, the Commission may not consider the quoted comments as evidence or testimony in this matter; further, pursuant to *Apple Canyon*, the Commission may not rely on these comments to resolve contested issues of fact.

Staff conducted a wastewater bill impact analysis by examining a monthly bill for a residential customer using 4,500 gallons per month. Staff Ex. 7.0 at 51. Chicago Metro customers see the same bill impacts for both the Company and Staff's identical rate design proposals. *Id.* at 51-52. For Central Wastewater customers, average use residential customers would see a 29.55% increase under Staff's proposal and a 0.092% increase under the Company's proposal. *Id.* at 52. This is because Staff's proposal removes the reallocated wastewater revenues. *Id.* at 52-53.

c. Bolingbrook's Position

Bolingbrook argues ILAWC's proposed rate increase will certainly impose further financial hardships on Bolingbrook customers who depend upon the utility's water service in order to survive. Pursuant to the Act and court precedent, the Commission must ensure that the public health, safety and welfare are protected, that rates are affordable, that rates preserve the availability of water services to all citizens, and that rates are equitable to all citizens. As it relates to Bolingbrook, the unaffordable, inaccessible, and inequitable rates proposed by ILAWC will have a detrimental impact on the health, safety and welfare of Bolingbrook citizens, who respectfully request that the Commission reject the proposed rate increase.

In making this argument, Bolingbrook notes the General Assembly, in passing and subsequently amending the Act, shared the same purpose and intention of the framers

of the Illinois Constitution of 1970: "...to provide for the health, safety and welfare of the people; maintain a representative and orderly government; eliminate poverty and inequality; assure legal, social and economic justice..." Ill. Const. 1970, preamble. The stated goals and objectives of the Act are efficiency, environmental quality, reliability, and equity. With respect to "equity," the General Assembly states that it is the public policy of the State that public utilities shall be regulated effectively and comprehensively to ensure:

(d) Equity: the fair treatment of consumers and investors in order that (i) the public health, safety and welfare shall be protected;... (viii) the rates for utility services are affordable and therefore preserve the availability of such services to all citizens.

220 ILCS 5/1-102(d)(i), (viii).

Bolingbrook emphasizes that, pursuant to the Act (220 ILCS 5/8-101), ILAWC has a duty to furnish, provide, and maintain service instrumentalities, equipment, and facilities to promote the safety, health, comfort, and convenience of its patrons, employees, and public, and shall be in all respects adequate, efficient, just, and reasonable. The Commission must also ensure that the rates requested by ILAWC for utility services are affordable and therefore preserve the availability of such services to all citizens. 220 ILCS 5/1-102(d)(viii); *Apple Canyon Lake Prop. Owners' Ass'n.*, 2013 IL App (3d) 100832, ¶ 41.

Bolingbrook's residents are currently spending substantially more on their monthly water bill compared to what the average American and Illinoisan pays. As such, for many, many customers, the rates are not affordable and do not preserve the availability of such services to all citizens of Bolingbrook. Rates for Bolingbrook customers are amongst the highest in the State of Illinois—before any increase is added to their monthly bills. The Act places upon the Commission the duty "to see that the provisions of the Constitution and statutes of this State affecting public utilities...are enforced and obeyed[.]" 220 ILCS 5/4-201. The Act thus grants the Commission the power of ratemaking over any public utility in accordance with equitable principles and must determine whether a public utility's requested rate is just and reasonable based upon those principles.

Generally, a family's household water bill should be the least costly monthly utility bill, or on the low-end of all monthly utility bills paid. The water rate dilemma in Bolingbrook is appalling, considering what the average American and Illinoisian spends on water and other utilities per month. Applying Bolingbrook customers' dilemma on a national and statewide scale, Bolingbrook notes that Americans spend a monthly average of \$429.33 per month for their utility bills (e.g., water service; energy; gas; internet). Ana Durani & Samantha Allen, "*Monthly Utility Costs in the U.S. By State*," *Forbes*, July 26, 2024. In Illinois, residents spend a monthly average of \$248.86 on those utilities, including: \$97 for natural gas bills, \$95.86 for energy bills, \$30 for internet bills, and \$26 for water service bills. *Id.* By extension, according to 2023 data provided by the Bureau of Economic Analysis of the U.S. Department of Commerce, the average Illinois resident spends \$288 in grocery and non-restaurant foods costs per month, \$620.75 in health care costs per month, and \$917-\$1,182 or more in child care costs per month. "*Cost of Living in Illinois*," SoFi, SoFi Technologies, Inc., April 2023. In Bolingbrook, many ILAWC

customers spend a monthly average of over \$150 on water and sewer service alone. While other Illinois families enjoy a relatively inexpensive monthly water bill, Bolingbrook families are forced to spend substantially more for water than any other monthly utility, and, as a result, must alter their daily lives merely to afford water.

In accordance with their sworn duties to protect the health, safety and welfare of the constituents they serve, the corporate authorities for Bolingbrook collected a sampling of approximately 136 water billing statements issued to Bolingbrook customers between January and August 2024. Bolingbrook Cross Ex. A Conf.; Bolingbrook Cross Ex. A Conf. (Supp.). This sampling only represents a sliver of the unaffordable water billing statements issued to customers, as the municipality is home to approximately 74,000 residents. Bolingbrook provided this sampling as part of this proceeding in order to illustrate the financial hardships faced by many Bolingbrook customers. The billing statements contained therein range from approximately \$91.49 per month to \$728.60 per month, with the average billing statement being approximately \$203 per month. *Id.*

On July 22, 2024, a public forum was held in Bolingbrook, Illinois for the purpose of receiving public comment concerning the rate increase proposed by the Company in accordance with Section 8-306(n) of the Act, 220 ILCS 5/8-306(n). See Notice of Public Forum (June 6, 2024). The public forum in Bolingbrook was attended by well over 300 people and numerous elected officials. The majority of the attendees were against the rate increase sought by ILAWC. Bolingbrook residents loudly voiced their concerns about how the proposed rate increase will exacerbate the financial hardships placed upon them by the current, unaffordable water rate.

Bolingbrook notes that affordability concerns for those on fixed incomes is the reason AARP Illinois became involved in this case, requesting public forums such as the forum in Champaign, because ILAWC's proposed increase to fixed monthly charges—the portion of the water bill charged irrespective of the amount of water used—"makes controlling your water bill more difficult." Andrew Adams, "*In the Suburbs, Proposed Water Rate Hikes Spark Outrage*," Crain's Chicago Business (Credit: Capitol News Illinois), July 25, 2024.

Despite the public's overwhelming opposition to the rate proposal, ILAWC minimizes the local impact of their rate increase in Bolingbrook. In response, Bolingbrook points to the direct testimony of AG witness Selvaggio, who indicates the Company's step two rate increase is unprecedented and unsupported by any stated authorization. AG Ex. 1.00 at 5.

In addition to the concerns voiced at the Bolingbrook public forum, Bolingbrook notes the hundreds of public comments posted to the Commission website that echo the sentiments expressed at the public forum. As of August 23, 2024, there were approximately 746 related comments posted to the Commission website.

The billing figures provided in the sampling data corroborate the significant concerns voiced by many Bolingbrook customers—that ILAWC's rising rates have unnecessarily resulted in elderly residents on fixed incomes and working-class families altering their daily lives to boost the Company's revenue and appease its executives and shareholders. Moreover, the sampling data, together with the large variety of concerns expressed at the public forum and posted to the Commission website, paints a grim reality

that cannot be ignored by the Commission. Bolingbrook argues that many customers in Bolingbrook and other service areas cannot afford the Company's water rates as is, and any increase to those rates, let alone the proposed rate increase, would exacerbate their financial struggles in contradiction of the utility's obligation to make rates affordable in order to preserve the availability of those services to its patrons.

For all of these reasons, Bolingbrook contends the rate increase requested by ILAWC is neither just, reasonable, nor affordable. Instead, it promises to harm the health, safety and welfare of Bolingbrook citizens. Therefore, Bolingbrook recommends that any increase to the current rates paid by Bolingbrook customers should be rejected by the Commission in accordance with the Act, case law and basic fairness to allow people access to water.

d. Commission Analysis and Conclusion

The Commission notes and takes into account Bolingbrook's input as well as all of the customers who commented about the proposed rate increase. While the Commission can consider these comments, it is noted that they cannot be relied on to make a determination of facts.

The Commission agrees with Staff that the water only customers should not be charged for sewer service they do not receive. Staff conducted both a water and a wastewater bill impact analysis to determine the average rate increase. Staff's recommended rate design would recover 100% of fixed customer costs through the customer charge and the remainder of the revenue requirement through the usage charge. The difference in monthly bills between recovering 50% of the Company's fixed customer costs through the customer charge and recovering 100% of the Company's fixed customer costs through the customer charge is approximately \$3.21 for a 4,500 gallon per month user.

Under Staff's rate design, the typical residential use customer will see an increase between 30%-49%. Staff recommends the Commission approve Staff's water rate design which recovers 100% of fixed costs through the customer charge. The Commission notes that Staff's bill impact analysis is nearly identical for both the Company's and Staff's rate design. Since Staff removed ILAWC's reallocation proposal for the wastewater revenues, the Central zone wastewater customers would see a larger increase under Staff's rate design than the Company's proposed rate design. Staff's rate design recovers the cost of service for the ratepayers. The Commission will continue to follow cost causation principles and adopt Staff's position.

F. Riders

1. Rider VBA Modification

a. ILAWC's Position

ILAWC is proposing to modify the production and treatment cost component of its VBA mechanism to fully reconcile authorized production cost expense with actual production cost expense incurred. ILAWC Ex. 4.00 at 25.

The Company explains that its current VBA mechanism was approved in Docket No. 16-0093 for all residential and non-residential service customers, exclusive of

customers on a competitive service tariff. The purpose of the VBA is to allow ILAWC to recover its authorized annual volumetric revenues, net of production costs. The VBA is impacted by volumetric sales, resulting in a credit when sales are higher than authorized and a surcharge when sales are lower, net of the adjustment for production costs.

ILAWC states that the production cost component of the VBA, the Unit Production Cost ("UPC") for water service and Unit Treatment Cost ("UTC") for wastewater service, is calculated as the authorized level of production/treatment costs divided by rate case sales to determine a cost per 100 gallons. Thus, the only variability accounted for in the current VBA methodology is associated with increases and/or decreases in volumetric sales. *Id.* at 26. As a result, the current Production/Treatment cost component of the VBA does not account for the external pricing and market factors that place production costs outside of the Company's, and in many cases, the Company's suppliers' control. Production and Treatment expenses are a significant operating expense, that ILAWC must incur to continue to provide safe and reliable service to its customers. The Company claims that Production and Treatment expenses are difficult to predict and can demonstrate significant fluctuation and volatility. ILAWC's proposed modification of the VBA mechanism would allow ILAWC to credit customers if Production and Treatment expenses fluctuate downward and recover ILAWC's actual Production and Treatment expenses if the expenses fluctuate upward.

ILAWC notes that production costs account for approximately 24% of the Company's O&M expense. This means that one of every four dollars spent on O&M expense is related to cost categories that are outside of the Company's control. ILAWC Ex. 31 at 21. The proposed VBA modification would benefit customers by ensuring that customers only pay for actual Production/Treatment expenses incurred, no more and no less. Any reductions in Production/Treatment expenses would be flowed back to customers more expeditiously through the annual mechanism filings. ILAWC Ex. 4.00 at 27; 18.00 at 24. Moreover, in the event that Rider ATCR is not approved, the Company is requesting to use the modified VBA mechanism to flow litigation proceeds related to environmental regulations, including PFAS regulations, back to customers. ILAWC Ex. 4.00 at 27.

ILAWC explains that the Company's proposed VBA modification will continue to allow ILAWC to control costs. The Company's proposal only adjusts for production and treatment costs and is not applicable to all of ILAWC's operating costs. *Id.* The Company will continue to actively find ways to mitigate its exposure to volatility in these expenses (e.g., by leveraging the buying power and expertise of the Service Company), as the Company is committed to providing safe and reliable water service to its customers at affordable rates. This request does not change that; it simply ensures that customers only pay for the production costs incurred, while allowing the Company to collect the proper revenues to cover those production costs incurred which the Company cannot avoid.

The Company's proposal is similar in nature to other adjustment mechanisms employed in the state of Illinois. ILAWC Ex. 31.00 at 20. First, the Company states its proposal aligns with the Act, which allows water utilities to implement surcharges for costs that fluctuate for reasons beyond the utility's control or are difficult to predict. See 220

ILCS 5/9-220.2. Here, the Company is proposing is to address costs that are outside of its control and have demonstrated volatility.

The Company explains its proposed mechanism is very similar to mechanisms in place for Illinois natural gas utilities. ILAWC Ex. 31.00 at 20. These utilities have the ability to recover the commodity cost of natural gas through automatic rate adjustment clauses. The pass through and reconcilable nature of these costs acknowledges that there is an inherent deviation in expense that is outside of the Company's primary control, yet required to provide service to customers, which, as shown above can fluctuate dramatically between periods. In addition, electric utilities in Illinois are afforded the opportunity to adjust rates for variations in purchased power, transmission service, and fuel costs. The same ratemaking principles that justify these natural gas and electric utility mechanisms apply to ILAWC's recovery of production expenses.

The Company notes that Staff and other intervenors do not agree with ILAWC's proposed modification. Staff Ex. 18.00 at 24. They contend that ILAWC should not be allowed to adjust the production cost component of Rider VBA to reflect actual production costs above or below authorized. They assert that ILAWC's proposal does not meet the legal requirements for a VBA mechanism, represents a shifting of risk to customers, is single-issue ratemaking, production costs are not material in amount, and the proposed VBA modification would reduce the incentive ILAWC has to manage expenses.

As ILAWC explains, however, utility's production costs are variable and outside of the utility's, and often its suppliers', control. ILAWC Ex. 18.00 at 24. Therefore, it would be appropriate to recover the actual costs, which, could be to customers' benefit if costs decline from current levels.

Staff argues that ILAWC's proposal does not meet the legal requirements for a volumetric balancing adjustment rider because the proposal would reconcile actual costs, and volumetric balancing adjustment riders can have "no impact on the revenue requirement." *Id.* at 25. While according to ILAWC it is true that reconciling actual production costs implicates an element of the revenue requirement, the Act permits water utilities to file a surcharge which adjusts rates to provide for recovery of costs which fluctuate for reasons beyond the utility's control or are difficult to predict. ILAWC maintains its proposed modification aligns with this authorization as production expenses remain outside of ILAWC's control and are difficult to predict. ILAWC Ex. 31.00 at 17. The modification of Rider VBA bundles such a surcharge into the existing VBA mechanism, a more administratively efficient approach than proposing the creation of a separate mechanism for production costs. ILAWC Ex. 18.00 at 25.

The Company notes that Staff also contends that the Company has not shown that its production costs are volatile. However, ILAWC states this is not the case. The Company's suppliers are still experiencing pressure and increased costs in areas such as labor and continue to express concerns around input costs such as energy. In the past, the Company was able to secure long-term contracts for production items such as chemicals. These long-term contracts were used to lock in favorable pricing and limit exposure to market fluctuations. Over half of ILAWC's chemical supply contracts are presently revisited more than annually. One fourth of the contracts are revisited quarterly. This unwillingness to engage in longer-term contracts is a reflection of suppliers' concern

around markets shifting rapidly. These costs are necessary to continue to provide safe and reliable service and outside of ILAWC's control, and the Company's proposal to modify the VBA is designed to protect customers and the Company against this market volatility.

Staff contends that ILAWC's average cost per unit of sales is not volatile, and there were no observable decreases in these costs that cannot be accounted for by decreasing sales volumes. Staff Ex. 18.00 at 26. However, ILAWC explains that Staff's own workpapers demonstrate the volatility in pricing. ILAWC states there are instances where reconciling the VBA based on actual production costs would have benefited customers. The Company claims that while prices have risen sharply in the last few years, there is no guarantee that they will continue to rise. There is still great uncertainty in general of where price trends may move. ILAWC maintains conditions that created this recent volatility have not abated as ILAWC's suppliers are weary to engage in long term contracts due to concerns that volatility continues. The Company's proposal to reconcile rider VBA on actual production costs is designed to protect the Company and customers against this potential market volatility.

Additionally, ILAWC explains its proposal does not represent single-issue ratemaking, as the Act has already authorized water utilities to propose and implement adjustments like the one ILAWC is proposing. This authorization is a recognition that there is a need to protect both customers and the company from certain expenses that are out of the utility's control and difficult to predict. ILAWC's proposed mechanism ensures that customers only pay for the actual costs incurred by the Company, no more and no less. ILAWC has proposed modifying the VBA because the mechanism already contains a production cost component. This mechanism is well known by the parties auditing ILAWC's VBA filings and the Company's proposal is simply a modification to this existing calculation.

The Company notes that, Staff and AG both to continue to oppose ILAWC's proposed modification to Rider VBA, contending that ILAWC's proposal shifts costs to ratepayers. ILAWC claims that the proposed VBA modification would benefit customers by ensuring that customers only pay for actual Production/Treatment expenses incurred. The Company states that it is clear that production costs may decrease as well as increase—ILAWC's update in this case reduced production costs by \$1.3 million. Any reductions in Production/Treatment expenses would be flowed back to customers more expeditiously through the annual mechanism filings. Moreover, in the event that Rider ATCR is not approved, the Company is requesting to use the modified VBA mechanism to flow litigation proceeds related to environmental regulations, including PFAS regulations, back to customers.

ILAWC explains that one of the benefits of the Company's proposal is that it would work in a symmetrical manner and would provide a mechanism for customers to receive the benefit of decreased production costs sooner than under the current VBA construct. This would ensure that ILAWC's customers pay only the costs the Company incurs for production expenses.

The Company states that the AG contends production costs are neither unpredictable nor beyond the Company's control because the Company has the power

to make decisions on how it operates its system, the chemicals and treatment processes it uses, how and when it procures energy and materials, and how it manages its facilities. The Company states that this is not accurate. The Company may be able to select the chemicals and treatment processes it uses (as long as they allow the Company to meet the applicable health and safety requirements), but it cannot control the prices of those chemicals and treatment processes. Nor, in the case of electricity, can the Company dictate the price it pays. The Company explains that, as the Commission found in ILAWC's last rate case, production costs can change due to "significant, impactful, yet unpredictable events" (in that case, events like the Russian invasion of Ukraine and the MISO capacity auction). Docket No. 22-0210, Order at 18.

Nevertheless, the Company states that its proposed VBA modification will continue to allow ILAWC to control costs. The Company's proposal only adjusts for production and treatment costs and is not applicable to all of ILAWC's operating costs. The Company notes that Staff contends that ILAWC's production costs are not sufficiently volatile, because volatility requires costs to go up and down, and that any change in production costs are driven by inflationary price increases only. The Company asserts that the data do not bear this out. During the course of ILAWC's last case, Docket No. 22-0210, production costs increased by millions of dollars. Docket No. 22-0210, Order at 10. During the course of this case, they decreased by \$1.3 million.

Lastly, ILAWC explains the proposed modifications to Rider VBA are part of the various programs and proposals ILAWC is proposing to address specific areas of cost recovery, including the volatility and fluctuating nature of certain costs. Along with the Company's proposed expansion of its low-income discount tariff, this group of proposals, including modification of Rider VBA, support and enhance the continued affordability of ILAWC's rates over the long term. The Company states that going forward, these proposals would not only smooth out rate increases for customers over time, but they could also (all else being equal) reduce the frequency of ILAWC's rate cases over time (and thus reduce the level of rate case expense that would be charged to customers). The Company maintains that this supports customer affordability.

b. Staff's Position

Staff recommends the Commission reject ILAWC's proposal to modify its Rider VBA. Staff states that the Commission should reject the Company's proposal because: (1) ILAWC's proposal does not meet the legal requirement for VBA riders because reconciling actual costs would impact the revenue requirement; (2) ILAWC's proposal is not necessary because costs per unit of sales is not volatile; and (3) ILAWC's proposal would shift virtually all of Rider VBA's risk onto ratepayers. See *generally* Staff Ex. 5.0; Staff Ex. 14.0.

Instead, Staff recommends that the Commission maintain the current form of ILAWC's Rider VBA, where test-year average production and treatment costs are adjusted based on actual sales. Staff Ex. 14.0 at 1.

Staff explains that Rider VBA reconciles the difference between rate case forecasted sales and actual sales. See ILAWC Ex. 4.00 25-26. Rider VBA uses a UTC/UPC component to account for when actual sales volumes differ from forecasted sales volumes. Staff Ex. 5.0 at 3-4. Specifically, the UTC/UPC component is an average

forecasted treatment or production cost based on test year predictions of costs and test year predictions of sales. *Id.* If forecasted sales are higher than actual sales, then the Company's rates will be reduced with an upward adjustment due the higher sales requiring more water to be treated. *Id.* Likewise, if forecasted sales are lower than actual sales, then the Company's rates will be increased with a downward adjustment due to lower sales requiring less water to be treated. *Id.*

The Company's proposal would replace the current UTC/UPC component with a reconciliation of actual costs. Staff Ex. 5.0 at 4. In other words, instead of adjusting rates solely based on differences between forecasted and actual sales, ILAWC's proposal would allow for corrections for both (a) differences between forecasted and actual sales; and (b) differences between forecasted and actual treatment and production costs while ignoring all other costs that may vary as well. *See id.*

Staff states there are a multitude of concerns with ILAWC's proposal. First, ILAWC's proposal does not meet the legal requirements for a volume balancing adjustment rider. The Illinois Supreme Court affirmed the legality of volume balancing adjustment riders in *People ex rel. Madigan v. Ill. Com. Comm'n*, 25 N.E.3d 587 (2015) ("Madigan"). In Madigan, the Court considered numerous arguments against the Commission's approval of a volume balancing adjustment rider for natural gas companies. *Id.* at ¶ 1-2.

The petitioners in Madigan argued that VBA riders violate traditional rate-of-return principles because the riders include "an assumed profit level", thereby removing any incentive for a utility to operate efficiently. *Id.* at ¶ 28. The Court rejected this argument. *Id.* at ¶ 29. Specifically, the Court noted that "a rate design that allows a utility company to recover its revenue requirement does not guarantee a profit any more than the revenue requirement itself does." *Id.* at ¶ 30.

The ratemaking process includes two distinct steps: (1) the Commission determines a utility's revenue requirement, which includes fixed costs and a reasonable return on equity; then (2) the Commission designs a rate that allows the Company to recover that revenue from its customers as accurately as possible. Madigan at ¶ 31.

The Company's current Rider VBA is solely a rate design mechanism. It does not impact the revenue requirement; it is simply a mechanism that helps ensure the recovery of the revenue requirement. *See id.* at ¶ 32. As it currently operates, the Company's Rider VBA does not ensure net profits or even net revenue; it ensures recovery of the revenue requirement as determined by the Commission. *See id.*

Staff explains that the Court in Madigan emphasized that the VBA rider the Commission approved in that circumstance "accepts the revenue requirement and offers a way for the companies to recover it – no more or less – via the annual true-up calculation", and that the rider caps the amount of revenue the Company can recover regardless of its actual costs. *Id.* at ¶ 32. If these costs increase beyond the amounts used to calculate the revenue requirement, the utility's profits would decrease. *Id.* In other words, those riders do not allow utilities to earn more than they are already entitled through the revenue requirement. *Id.*

Contrary to Madigan, the Company's proposal to reconcile actual costs transforms ILAWC's Rider VBA from solely a rate design mechanism to a rider that changes the revenue requirement. Staff Ex. 14.0 at 2. Even the Company's own witness admits this is true. ILAWC Ex. 18.00 at 25. ("[I]t is true that reconciling actual production costs implicates an element of the revenue requirement."). If the Company seeks to reconcile actual rather than forecasted costs through Rider VBA, then the Company's proposal is vastly different from the riders discussed in Madigan and ILAWC must prove that the costs it seeks to reconcile are "unexpected, volatile, or fluctuating." Madigan at ¶ 16; *Commonwealth Edison Co. v. Ill. Com. Comm'n*, 405 Ill. App. 3d 389, 411 (2nd Dist. 2010).

Second, the Company's actual costs are not sufficiently volatile to justify using a rider. Riders are useful in alleviating the burden imposed upon a utility in meeting unexpected, volatile, or fluctuating expenses outside the control of the company. *A. Finkl & Sons Co. v. Ill. Com. Comm'n*, 250 Ill. App. 3d 317, 326 (1st Dist. 1993). However, riders are not allowed absent a showing of exceptional circumstances. *Commonwealth Edison Co. v. Ill. Com. Comm'n*, 405 Ill. App. 3d 389, 411 (2nd Dist. 2010).

The Company's actual costs are not volatile and do not justify the extraordinary remedy of rider treatment. The Company provided data regarding actual production and treatment costs. Staff Ex. 5.0 at Attach. A. When that cost data is combined with actual sales data provided by the Company in its Rider VBA reconciliations for 2017-2022, the average cost per unit increased from about \$0.04 per unit in 2017 to about \$0.07 per unit of sales in 2022, which can be explained by inflation. Staff Ex. 5.0 at 5. However, volatility typically means that prices go up and down. *Id.*; see also *Cent. Ill. Light Co. v. Ill. Com. Comm'n*, 255 Ill. App. 3d 876 (1st Dist. 1993). According to the Company, these costs are volatile because labor and energy costs are increasing. ILAWC Ex. 18.00 at 25-26. However, these costs are not volatile—they are increasing due to inflation. Staff Ex. 14.0 at 3-4.

Third, the Company's proposal would shift virtually all of Rider VBA's risk onto ratepayers. VBA riders are intended to benefit both the companies and their customers. Madigan at ¶ 33. They help bridge the increasingly problematic disconnect between a utility's fixed costs and their revenue losses due to a diminishing customer base and energy efficiency programs which reduce usage. *Id.* VBA riders stabilize both utility revenues and customer bills. *Id.*

The trend in costs is clearly increasing. Staff Ex. 5.0 at 5. Based on the data provided by the Company, reconciling Rider VBA based on actual costs benefits the Company but would have provided little benefit to its customers between 2017 and 2022. *Id.* Furthermore, because the stated reasons for actual cost increases: labor and energy cost increases, are inflationary rather than volatile, it is much more likely that costs will continue to increase rather than decrease. Staff Ex. 14.0 at 4.

Staff argues that allowing the Company to recover these increasing, inflationary costs primarily benefits the Company and shifts these risks to ratepayers. This is because, in a reconciliation proceeding, there would be no opportunity to review if other costs may have declined over the same period. Furthermore, by allowing a reconciliation of actual costs, the Company has less of an incentive to control costs and increase efficiency.

For these reasons, Staff recommends the Commission reject the Company's proposal to reconcile actual, rather than forecasted, production costs.

c. AG's Position

The AG requests that the Commission reject the Company's proposed changes to Rider VBA because these changes would unfairly and without justification shift additional risk to ratepayers. Rider VBA is a decoupling mechanism that separates the Company's revenue from its sales, allowing ILAWC to recover volumetric revenues, net production costs without regard to sales. ILAWC Ex. 4.00 at 26. The purpose of this rider is to incentivize ILAWC to promote water conservation and efficiency, while reducing the Company's financial risk. AG Ex. 2.00 REV. at 34–35. ILAWC is asking the Commission to approve a modification to the Rider VBA to include additional production and treatment operating costs, including fuel, power, chemical, and waste disposal expenses. AG Ex. 2.00 REV. at 35. In its current form, the Company's Rider VBA "is solely a rate design mechanism. It does not impact the revenue requirement; it is simply a mechanism that helps ensure the recovery of the revenue requirement." Staff IB at 100. In contrast, the AG states that the Company's proposal would transform Rider VBA into an improper cost recovery rider similar to Rider ATCR.

The AG maintains that the VBA modification "would reduce the transparency of the Company's rates and shift operating risks to customers that should be borne by the Company and its investors" by "hid[ing] the creation of a new operating cost rider by embedding it in the Rider VBA." AG Ex. 2.00 REV at 37. The AG asserts that like Rider ATCR, these costs are neither unpredictable nor beyond the Company's control because the Company has the power to make decisions on how it operates its system, the chemicals and treatment processes it uses, how and when it procures energy and materials, and how it manages its facilities. *Id.* at 38. "In stark contrast, customers have absolutely no control over ILAWC's production and treatment costs" but "are entirely dependent on ILAWC to manage these costs prudently and efficiently." *Id.* at 38. The AG contends that like Rider ATCR, this modification was not only contested by Mr. Larkin-Connolly, but also witnesses for Staff and ILWC who argued that these costs are not eligible for rider VBA recovery, that the costs are not as "unpredictable and volatile" as the Company claims, and that the rider is unnecessary because the associated costs represent a small fraction of ILAWC's overall expenses. Staff Ex. 5.0 at 4–5, ILWC Ex. 1.0 at 25.

The AG states that if the Commission were to approve ILAWC's proposal, it would unfairly shift additional risk to captive ratepayers despite the Company's failure to demonstrate that such ordinary costs can or should be recovered through a rider. ILAWC claims its proposal is consistent with Section 9-220.2 of the Act which permits utilities to recover the costs of reasonable and prudent QIP investments and "implement surcharges for costs that fluctuate for reasons beyond the utility's control." ILAWC IB at 147, *citing* 220 ILCS 5/9-220.2. The AG points out that the recovery of QIP costs is expressly authorized by statute—ILAWC's proposal is not. Further, the AG notes that the costs that the Company seeks to recover through its revised Rider VBA are not unpredictable nor do they fluctuate for reasons beyond the utility's control.

The AG observes that ILAWC also argues that its proposal “is very similar to mechanisms in place for Illinois natural gas utilities (and gas utilities in numerous other states).” ILAWC IB at 147. However, the Company does not provide any examples to support this claim but cites to the surrebuttal testimony of ILAWC witness Selinger, who likewise did not provide a single example to support his claim, but only said “[t]hese utilities have the ability to recover the commodity cost of natural gas through automatic rate adjustment clauses.” ILAWC Ex. 31.00 at 20. The AG contends that the Company cannot support its proposal by vague references to the riders of unidentified natural gas utilities in Illinois and “numerous other states.” The AG requests that the Commission reject the Company’s proposed revised Rider VBA because it is not supported by the record evidence in this proceeding.

Accordingly, the AG requests that the Commission reject ILAWC’s proposed Rider VBA modification because these costs are ineligible for rider recovery and including them in the Rider VBA would unfairly shift risk to ratepayers that should be borne by the Company and its shareholders.

d. IWC’s Position

IWC continue to oppose the Company’s attempt to reconcile production costs through Rider VBA. IWC note the Company claims its modification to Rider VBA will attempt to reconcile actual production and treatment costs with the authorized amount included in rate base. The Company argues that the current production/treatment cost component of the VBA does not account for the external pricing and market factors that place production costs outside of the Company’s control. The Company argues Production and Treatment expenses are difficult to predict and can demonstrate significant volatility. The Company asserts that the production costs are material when compared to its total O&M expenses. Specifically, the Company states that the production costs account for 24% of the Company’s O&M expense. IWC argue the costs are but a small fraction of the Company’s total revenue requirement. IWC note the Company contends that such a comparison does not represent an appropriate basis to assess the relative magnitude of production costs, as the revenue requirement includes components such as rate of return and taxes. IWC point out that the Company suggests that a better comparison would be to look at the total costs relative to the total O&M expense. IWC state however, as Staff argues, the Company’s adjustment transforms Rider VBA from solely a rate design mechanism to a rider that changes the revenue requirement. IWC argue that such a comparison to the total revenue requirement by IWC is not off base and illustrates the costs are relatively minor and do not necessitate use of a rider which should be reserved for significant unpredictable costs.

IWC argue that in addition, allowing the reconciliation of these costs through Rider VBA reduces the Company’s incentive to effectively manage these costs, shifting the risk of operational efficiencies from the Company to the customers. IWC note, that VBA riders are intended to benefit both the companies and their customers. IWC argue that allowing the Company to recover these costs shifts the risk to the ratepayers. IWC agree with Staff that there is no opportunity in a reconciliation proceeding to review whether other costs may have declined over the same period. IWC argue there is little incentive for the Company to control costs. IWC claim that the Company has chosen a projected test year, as such it bears the burden of developing a reliable projection of reasonable

and prudent production costs to recover from ratepayers, which should take into consideration its knowledge of the price pressures faced by its suppliers. IIRC note that IIRC, Staff, and the AG all opposed the modification proposed by the Company and urge the Commission to reject the Company's proposal.

e. Commission Analysis and Conclusion

Rider VBA reconciles the difference between rate case forecasted sales and actual sales. Rider VBA uses a UTC/UPC component to account for when actual sales volumes differ from forecasted sales volumes. Specifically, the UTC/UPC component is an average of forecasted treatment or production cost based on test year predictions of costs and test year predictions of sales. The purpose of this rider is to incentivize ILAWC to promote water conservation and efficiency, while reducing the Company's financial risk.

Staff, the AG, and IIRC all recommend that the Commission reject the Company's proposed change to Rider VBA, stating that the proposal is not necessary because costs are not volatile, it does not meet the requirements for Rider VBA because reconciling actual costs would impact the revenue requirement, and this proposal would shift virtually all of the Rider VBA risk to ratepayers.

The Commission notes that the Company's proposal would replace the forecasted costs with a reconciliation of actual costs. The Commission agrees that there is no opportunity in a reconciliation proceeding to review whether other costs may have declined over the same period. The Commission does not agree with the Company that this would be in the best interest of ratepayers. This would appear to remove the incentive for ILAWC to save money and would change the rider from a rate design mechanism to a rider that changes the revenue requirement. The Commission finds that as is, Rider VBA stabilizes both utility revenues and customers' bills. Therefore, the Company's proposal to modify Rider VBA is rejected.

2. Rider ATCR

a. ILAWC's Position

The Company proposed a new environmental rider in this proceeding: the Advanced Treatment and Compliance Rider ("ATCR"). ILAWC states that this rider is designed to recover the costs associated with "new investment in qualifying, non-QIP eligible utility plant required to comply with any statutes, regulations, orders, or legal mandates relating to protection of the environment, public health and safety, or natural resources." ILAWC Ex. 4.05 at 1.

ILAWC explains that Rider ATCR was motivated by new and emerging PFAS regulations and standards with which the Company will need to comply. PFAS is the acronym for per- and polyfluoroalkyl substances. PFAS are manufactured chemicals that have been used in industry and consumer products since the 1940s. There are thousands of different PFAS, and due to their widespread production and use, as well as their ability to move and persist in the environment, they can be present in both surface water and groundwater. While its proposed rider is focused on PFAS in the short term, ILAWC states it could also be used to recover costs associated with similar regulations, for example, regulations concerning other emerging contaminants. Costs associated with compliance with regulations like these fluctuate for reasons beyond the utility's control,

and therefore, a rider is an appropriate mechanism to recover those costs. Rider ATCR will allow the Company to make prudent investments to address new regulations and standards that better serve the long-term interests of the customers, while smoothing future rate increases more efficiently and effectively.

ILAWC states that Section 9-220.2(a) of the Act provides that “[t]he Commission may authorize a water or sewer utility to file a surcharge which adjusts rates and charges to provide for recovery of” purchased water, purchased sewage treatment service, qualifying infrastructure plant, and “(iii) other costs which fluctuate for reasons beyond the utility’s control or are difficult to predict.” 220 ILCS 5/9-220.2(a). Subsection (c) provides that “[o]n a periodic basis, the Commission shall initiate hearings to reconcile amounts collected under each surcharge authorized pursuant to this Section with the actual prudently incurred costs recoverable for each annual period during which the surcharge was in effect.” 220 ILCS 5/9-220.2(c); see also *Citizens Util. Bd. v. Ill. Com. Comm’n*, 166 Ill. 2d 111, 138, 651 N.E.2d 1089, 1102 (1995) (“[A] rider mechanism is effective and appropriate for cost recovery when a utility is faced with unexpected, volatile, or fluctuating expenses.”).

According to ILAWC, the costs that ILAWC proposes to recover through Rider ATCR are precisely the kinds of costs that Section 9-220.2(a)(iii) of the Act was intended to address, as they both “fluctuate for reasons beyond the utility’s control” and “are difficult to predict.” 220 ILCS 5/9-220.2(a)(iii). Notably, Section 9-220.2(a) does not establish any additional limitations on the kinds of costs recoverable under this subsection. For example, ILAWC states, it does not establish, require, or even discuss a minimum dollar threshold that would be used to determine if a proposed surcharge is lawful or appropriate. Nor does it limit eligible riders to addressing specific issues such as fluctuations in market or commodity prices. No such limitations have been imposed by the Commission’s implementing regulations, which only address purchased water and sewage treatment surcharges (Part 655), and qualifying infrastructure plant surcharges (Part 656), 83 Ill. Admin. Code Parts 655, 656.

ILAWC notes that Illinois has statutorily authorized cost recovery mechanisms associated with qualifying infrastructure (see 220 ILCS 5/9-220.2(a)(iv); 220 ILCS 5/9-220.3), renewable energy mandates (220 ILCS 5/16-107.6(h)), energy efficiency (220 ILCS 5/8-103), and zero carbon electricity generation (220 ILCS 5/16-108(k)). ILAWC maintains that the Commission has recognized the need to utilize cost recovery mechanisms related to environmental compliance as well, having authorized recovery of expenses associated with manufactured gas plant remediation through cost recovery riders. See, e.g., *In re Commonwealth Edison Co.* Docket No. 05-0597, Opinion and Order at 212-213 (July 25, 2006). More recently, in Docket No. 20-0722, ILAWC notes the Commission approved modified extension policies for Nicor Gas Company to facilitate the connection of renewable natural gas facilities to the Company’s distribution system. *N. Ill. Gas Co.*, Docket No. 20-0722, Order (July 8, 2021). ILAWC explains that this type of action demonstrates the Commission’s ability to advance state environmental policy goals, while enhancing operational efficiency. The Company believes it is important to address environmental compliance in a way that maximizes its ability to provide safe, reliable water to its customers. The Company states Rider ATCR would allow it to do just that.

ILAWC points out that water supply utilities are subject to a complex array of regulations at the federal, state, and local levels with respect to water quantity, water quality, and other environmental aspects of their facilities and operations. Drinking water quality is addressed by a combination of federal regulations under the Safe Drinking Water Act of 1973 and state regulation under Title 415 of the Illinois Compiled Statutes Chapter 40 and Title 35 of the Illinois Administrative Code. ILAWC explains that Federal law established the US EPA as the federal regulatory body governing drinking water. Pursuant to that authority, the US EPA has established standards for contaminant levels in drinking water, mandatory treatment methods, monitoring and reporting requirements, and public notification mandates in the event of contaminant level or treatment method noncompliance. See 40 C.F.R. Parts 141-143. The US EPA has granted “primacy” to the IEPA to administer the federal regulatory standards.

Over the years, ILAWC explains, regulatory protection has been extended through the establishment of maximum contaminant levels (“MCLs”) or by treatment requirements that target additional contaminants. MCLs determine the maximum level of each covered substance within the drinking water that is deemed safe for the customer. They also include requirements for monitoring, remediation, and public notice when standards are exceeded. There are now MCLs for over 90 individual organic and inorganic chemicals, including groups like trihalomethanes (“THMs”), haloacetic acids, and *E. coli* bacteria indicator microorganisms. In addition, treatment technology requirements include specifications that surface water filtration and groundwater disinfection cover protozoa, viruses, and other bacteria.

ILAWC states that there also has recently been an increase in public concern over water quality standards and regulation. This increase has led to growth and increased stringency in US EPA and state drinking water regulation, including the regulations surrounding PFAS that Rider ATCR will target.

ILAWC notes that the US EPA finalized the National Primary Drinking Water Regulation in April 2024, which imposes an MCL to regulate two specific types of PFAS, perfluorooctanoic acid (“PFOA”) and perfluorooctanesulfonic acid (“PFOS”) at a level of 4 parts per trillion (4.0 nanograms/Liter). The regulation also includes an enforceable limit on a combination of PFNA, PFHxS, PFBS, and GenX Chemicals. Along with those enforceable MCLs, the regulation includes monitoring requirements for the six PFAS covered and requirements to notify the public if monitoring detects them at levels that exceed the proposed regulatory standards. It also requires water systems to take actions to reduce the levels of these PFAS in drinking water if they exceed the proposed regulatory standards by removing these chemicals through various types of treatment or switching to an alternative water supply that meets the standard. The regulation establishes a compressed timeframe for compliance. Additionally, during the pendency of this proceeding, Illinois proposed rules addressing PFAS, which similarly set a limit of 4 parts per trillion.

In addition to PFAS regulations, ILAWC explains that the US EPA has proposed significant changes to the Lead and Copper Rule, namely, lowering the lead action level to 0.010 mg/L, eliminating the lead trigger level to require water systems to act earlier, updating the tap sampling practice, and enhancing outreach activities regarding lead in drinking water. If passed, this regulation would ultimately compress the current timeline

for compliance with similar Illinois regulations and increase the number of resources being dedicated to administrative communication and outreach, while at the same time requiring a shift from replacing aging infrastructure to full replacement of Company and customer lead and galvanized service lines.

According to ILAWC, the increased stringency of regulations like these heightens the risk associated with furnishing safe and adequate water quality and water quantity because the investment and effort that will be required to comply with the new level of regulation will increase and require changes in current treatment process and practices. ILAWC states Rider ATCR will allow the Company to address regulations such as these efficiently and effectively.

As technology continues to advance, ILAWC maintains it is likely that additional emerging contaminants will be discovered, studied, and ultimately regulated. According to ILAWC, Rider ATCR allows the Company to more effectively address and comply with those future regulations.

The Company anticipates that a significant amount of investment will need to be made to comply with new environmental regulations. ILAWC witness O'Neill estimates the cost of compliance with the new PFAS regulations at approximately \$80 to \$300 million over the course of three years, from 2024 through 2026. The higher end of this range assumes an MCL of 2 parts per trillion, and the lower end assumes an MCL of 4 parts per trillion. Since this testimony was filed, ILAWC states that Illinois proposed its limit of 4 parts per trillion, however, that is still subject to change, as the rule is not yet final. Regardless, either number represents a significant portion of the Company's projected capital expenditures. The amount will only increase if, as the Company expects, additional rules and regulations surrounding emerging contaminants are proposed and finalized. Further, ILAWC explains, these numbers are just estimates, and the actual investment could be higher once the Company is able to fully assess the current capabilities of its facilities and the upgrades necessary for compliance.

In addition to PFAS-related expenses, the Company must also make investments to comply with other regulatory and compliance directives, including phosphorus removal requirements at WWTP, Lead and Copper Rule requirements, reduction of Combined Sewer Overflows and Sanitary Sewer Overflows, and relocation of pipe due to State and Municipal infrastructure improvement projects. ILAWC states the total anticipated investment in non-PFAS related compliance over the next five years is \$108 million.

According to ILAWC, there are several factors that contribute to the unpredictability of the costs associated with regulatory compliance. While Staff witness Au argues that compliance with environmental standards is par for the course and not a unique business challenge for the Company, these factors establish that is not the case.

ILAWC explains that there have been a host of new and emerging regulations and standards governing both water supply and wastewater treatment. Even proposed regulations and standards can and do change and evolve up until rules are finalized. This gives companies little certainty about the scope and extent, or the timing, of necessary investments. The regulatory and rulemaking processes for developing the new regulations provides the Company with an understanding of what limits may be forthcoming, but the lengthy regulatory processes often result in changes, updates, and

modifications to the science, the proposed standards, and the guidance. The proposed methods of determining the health impact level of various contaminants, for example, can and do change before regulations are complete, and it is difficult for the Company to determine the level of investments, techniques, or treatments that will be needed until regulations are finalized and the maximum contaminant level is established.

Related to PFAS investments specifically, there is still some uncertainty regarding the MCL set by the Illinois' regulation. It is currently a proposed regulation and is not yet final. ILAWC states if it did change, this could alter the level of investment the Company would need to make to comply.

Further, as noted by the Company, federal or state regulatory authorities may decide to regulate additional PFAS compounds or other emerging contaminants. According to ILAWC, that would likely result in additional, significant investment on the part of the Company and would be the type of expense that could be recovered under Rider ATCR.

Finally, given the compressed timeframe for compliance with new PFAS standards, ILAWC states there is uncertainty surrounding the availability of the necessary equipment and services. Demand on equipment, material, and contractors (the extent and timing of which are outside the utility's control) will affect the schedule and cost to install the new facilities and equipment. This is especially so because every facility that has to meet the new standards will be attempting to install the same equipment within very similar timeframes. Equipment manufacturers and contractors may not have the resources to meet the expected demand for the specialized equipment and installation under a short timeframe. Each of these factors is beyond the ability of the Company to control and causes unpredictable outcomes.

The Company notes that Staff, the AG, and ILWC assert that the Company has not established that Rider ATCR meets the statutory requirement that it recover costs that fluctuate for reasons beyond the utility's control or are difficult to predict. Staff asserts that all utilities must be responsive to statutory environmental standards; this is not a unique business challenge that only ILAWC must address. Similarly, the AG argues that there is nothing new or exceptional about ILAWC's need to comply with environmental and safety regulations; indeed, it is a core responsibility of any utility. The Company acknowledges that it has been required to comply with environmental regulations in the past and that other utilities must do so as well. However, that is not the question Section 9-220.2(a) asks. It asks whether costs fluctuate for reasons beyond the utility's control or are otherwise hard to predict, which the Company states it has provided evidence to support in its testimony and briefing.

The Company explains that it has little certainty about the scope and extent, or the timing, or necessary investments to comply with new environmental regulations because of the nature of those regulations. The Company observes that neither Staff nor the AG nor ILWC meaningfully engages with the Company's evidence to support this assertion; they only argue that complying with environmental regulations is expected and necessary, and therefore, predictable. The Company states that Staff and intervenors' failure to address the specific evidence the Company provided leaves that evidence unrebutted.

The Company notes that Staff also contends that because the Company is able to estimate the amount of investment that could be required to comply with PFAS regulations, that also means the associated costs cannot be volatile, unexpected, or fluctuating. The Company explains that this number is just an estimate and could change. The Company states that the actual investments could change once the Company is able to assess the current capabilities of its facilities and the upgrades necessary for compliance.

The Company explains that Staff and the AG further argue that adoption of Rider ATCR would be harmful to customers because it would shift unnecessary risk to them. The Company states, however, that Rider ATCR would actually be beneficial to customers because it would mitigate future rate increases and facilitate smaller, more gradual increases to customers' bills. Recovery would occur over a period of time and be more spread out. The Company observes that while Staff suggests that the Company should simply file a new rate case whenever it believes existing rates are insufficient, this is not necessarily more beneficial for customers, especially considering that rate cases involve significant expense that is then passed on to customers.

The Company adds that customers would further benefit from Rider ATCR's treatment of litigation proceeds, as they would receive expected settlement or litigation proceeds more quickly than if the rider did not exist. The Company states that for those reasons, customers would benefit from the adoption of Rider ATCR.

The Company notes that Staff and the AG argue that Rider ATCR's scope is too broad. They compare the language of the Company's Rider ESR, proposed in the last rate case, to the language of Rider ATCR, which it proposes in this rate case. The Company observes that both parties contend that the language is similar, and therefore, because the Commission rejected Rider ESR, it should reject Rider ATCR. The Company asserts, however, that there is an important distinction between Rider ESR and Rider ATCR. The Company explains that it has made clear its intention to use Rider ATCR initially and primarily for the recovery of costs associated with PFAS regulations. The Company's testimony has focused on PFAS regulations, the unique challenges that they present, and the various investments the Company will need to make to comply. It has indicated that these regulations are the primary driver for proposing Rider ATCR and are the focus of the Company's attention. Therefore, Rider ATCR does, in fact, have a narrower scope based on these commitments the Company has made in this proceeding.

b. Staff's Position

Staff recommends that ILAWC's proposed Rider ATCR be rejected. Notably, the AG and IIWC also argue that Rider ATCR should be rejected. See AG Ex. 2.00 REV; IIWC Ex. 1.0.

Staff explains that non-QIP eligible capital investments would otherwise generally be included in ILAWC's rate base upon a filing a rate proceeding and only recovered if the Commission approves new rates. Staff Ex. 1.0 at 23. The Commission would determine whether the capital additions are prudent and reasonable and, if approved, the non-QIP eligible capital investments are included in the revenue requirement used to set base rates, which are recovered from ILAWC customers. *Id.*

Conversely, Rider ATCR would allow ILAWC to recover non-QIP capital investments prospectively prior to the Commission's review of prudence and reasonableness, including a return on the investment, net of accumulated depreciation and accumulated deferred income taxes, depreciation expense, and property taxes associated with Rider ATCR eligible plant. *Id.* at 24. ILAWC would prepare a reconciliation filing on or before March 15, 2027 to reconcile the estimated costs and actual costs incurred from the Rider ATCR effective period from January 1, 2026 through December 31, 2026. *Id.* at 25.

Staff argues that Rider ATCR should be rejected because: (1) it is unlawful; (2) it is not necessary; and (3) it would subject ratepayers to unnecessary risk.

ILAWC claims that Section 9-220.2(a) authorizes Rider ATCR. ILAWC Ex. 18.00 at 16; 220 ILCS 5/9-220.2(a). Staff notes that ILAWC implies that subsection (a)(iii) allows for Rider ATCR. Staff Ex. 18.00 at 16-17. However, subsection (a)(iii) does not apply to capital investments and thus should not apply to a surcharge such as Rider ATCR; this is because the language in the statute referencing "other costs" refers to expenses rather than capital investments of new infrastructure, equipment, and technologies.

This is evident when looking to the plain language of the statute in the next subsection. Specifically, subsection (a)(iv) refers to "costs associated with an investment in [QIP]...". This is significant because if the General Assembly intended to reference infrastructure in subsection (a)(iii), it would have explicitly done so as it did in subsection (a)(iv).

The primary purpose of statutory interpretation is to ascertain and give effect to the intent of the legislature. *Skaperdas v. Cnty Cas. Ins. Co.*, 2015 IL 117021, ¶15. Legislative intent should be sought primarily from the language of the statute, since the language of the statute is the best evidence of legislative intent and provides the best means of deciphering it. *Bruso v. Alexian Brothers Hospital*, 178 Ill. 2d 445 at 451-52 (1997). Thus, in looking at the plain language of the statute, it does not anticipate recovery of capital investments. Hence, the Company's reliance on Section 9-220.2(a) for the implementation of Rider ATCR is unpersuasive and is not applicable to the costs in question.

Staff is unaware of the Commission approving any rider pursuant to Section 220.2(a)(iii), much less a rider recovering capital investment costs, and ILAWC has not provided any examples of such a rider. Further, Section 9-220.2(a) states only that the Commission "may" approve such surcharges. Even if the capital investments under the proposed Rider ATCR were contemplated by Section 9-220.2(a), which they were not, the Commission is not required to approve such a surcharge and should not do so.

Outside of explicit statutory authority, the Commission may approve a rider mechanism "to approve direct recovery of unique costs through a rider when circumstances warrant such treatment." *Citizens Util. Bd. v. Ill. Com. Comm'n*, 166 Ill. 2d 111 at 138 (1995). A rider mechanism is only "effective and appropriate for cost recovery when a utility is faced with unexpected, volatile, or fluctuating expenses." *Id.* However, Staff states ILAWC has not provided evidence that costs associated with environmental compliance are unexpected, volatile, or fluctuating. The Company itself recognizes that it anticipates an investment of \$80-\$300 million over the next three years to comply with

PFAS regulations. ILAWC Ex. 3.00 at 39-40. Given that ILAWC can provide a specific range, it is not volatile, unexpected, or fluctuating.

Further, because “a rider is a method of single-issue ratemaking, by nature, it is not allowed absent a showing of exceptional circumstances. . . . The risk of single-issue ratemaking requires that all riders be closely scrutinized to prevent understatement or overstatement of the overall revenue requirement.” *Commonwealth Edison Co. v. Ill. Com. Comm’n*, 405 Ill. App. 3d 389 at 411 (2010). Thus, Staff argues if the Commission were to approve Rider ATCR, which it should not, Rider ATCR would distort the ratemaking process given that the Company is choosing rider recovery for single cost elements related to certain capital investments outside of its approved revenue requirement and is ignoring all the other costs elements going into that revenue requirement which also are not fixed and can vary as well. This would constitute single-issue ratemaking because increases in one element of the revenue requirement may result in decreases in another element of the revenue requirement.

Staff argues that Rider ATCR is not necessary because the Company may include the relevant costs when filing a new rate case. Staff Ex. 1.0 at 23. ILAWC may file a rate case whenever ILAWC believes its existing rates are insufficient. *Id.* at 26. ILAWC is requesting amortization of its rate case expense over a three-year period, indicating that ILAWC may file a request for another rate case increase in a few years. *Id.* Further, ILAWC already has a rider to recover QIP costs and has not shown that another rider is necessary for other capital investments. *Id.*

If and when changes to environmental mandates are enacted, there would likely be ample time for water and wastewater utilities to comply with the final regulations. *Id.* Finally, Staff states, all utilities must be responsive to statutory environmental standards; this is not a unique business challenge that only ILAWC must address. Staff Ex. 1.0 at 27. Staff is unaware of the Commission approving a similar rider, and ILAWC has failed to provide any examples of such an approved rider.

Staff notes that in ILAWC’s last rate case, the Commission rejected a similar rider, Rider ESR, because if ILAWC should “find in the future that its existing rates are insufficient to comply with any environmental rules or regulations, the Company may elect to file a rate case.” Docket No. 22-0210, Order at 173. ILAWC claims that Rider ATCR is narrower in scope than the Rider ESR; however, Rider ATCR is essentially the same as Rider ESR. Staff Ex. 1.0 at 28. Rider ESR was “designed to recover the costs associated with new investment in qualifying, non-QIP eligible utility plant required to comply with new or emerging federal and state environmental and safety requirements or to satisfy other state or federal environmental policy objectives.” Docket No. 22-0210, IAWC Ex. 6.02 (Feb. 10, 2022). Similarly, the Company claims that Rider ATCR “is designed to recover the costs associated with new investment in qualifying, non-QIP eligible utility plant required to comply with any statutes, regulations, orders, or legal mandates relating to protection of the environment, public health and safety, or natural resources.” ILAWC Ex. 4.05 at 1. Thus, although Rider ATCR omits “state or federal environmental policy objectives” from the former Rider ESR, the intent of Rider ATCR is almost identical to the rejected Rider ESR. Additionally, while Rider ATCR lists some specific statutes and governmental entities in its definition of qualifying plant, it also includes any other law, order, or regulation. Importantly, the rider’s definition does not

specify that the law must be one related to protection of the environment, public health and safety, or natural resources. Therefore, due to the similarity to the already-rejected Rider ESR, and because Rider ATCR is broad, vague, and speculative, the Commission should also reject Rider ATCR.

Staff mentions that another problem with Rider ATCR is that it would allow ILAWC to recover costs prior to the Commission determining whether such investments are prudent and reasonable. Staff Ex. 1.0 at 25. Further, Rider ATCR would recover from ratepayers a return on the cost of the capital investments, cost of depreciation expense, and property taxes. *Id.* Without the benefit of Commission review of costs prior to their recovery, ratepayers are subject to risk. This is especially true because the language of Rider ATCR is broad, vague, and speculative and without limit on how much ILAWC could invest in a given operating period. Staff Ex. 1.0 at 29. Also, Rider ATCR could encourage unnecessary capital spending that would increase customer bills. *Id.*

Staff asserts that the Commission agreed in ILAWC's last rate case that the similar Rider ESR "would arguably place greater risk on the ratepayer for the benefit of stakeholders because ILAWC would be able to immediately recover costs, including a return to investors, under the rider subject to a reconciliation." Docket No. 22-0210, Order at 173. Staff argues that the Commission should once again find that Ride ATCR places unnecessary risk on ratepayers.

Staff argues the Company's reliance on Section 9-220.2(a)(iii) is misplaced. Staff argues that the Act does not contemplate costs related to capital investments. Even if the Act did contemplate such costs, the Commission "may" authorize rider recovery; it is not required to authorize rider recovery under the Act. *Id.* at 93-94.

The Company also fails to provide any example of the Commission authorizing a rider pursuant to Section 9-220.2(a)(iii). Staff is aware of only one Commission case in which subsection (a)(iii) was even at issue. In *Consumers III. Water Co.*, the Commission denied a rider under subsection (a)(iii) and found that "the more (or less) a cost has the attributes of the costs specifically identified in subsections 9.220.2(a)(i) and (ii), the more (or less) likely it is to qualify for a Rider under the fluctuation/prediction standards in subsection 9.220.2(a)(iii)." *Consumers III. Water Co.*, Docket No. 02-0155, Order at 23-24 fn. 43 (Mar. 12, 2003).

Here, ILAWC has made no argument that the costs to be recovered under Rider ATCR are similar in any way to the costs expressly recoverable in subsections 9-220.2(a)(i) and (ii); i.e., purchased water and purchased sewage treatment service. Approving Rider ATCR pursuant to subsection 9-220.2(a)(iii) would be a departure from past Commission practice, and Staff recommends the Commission deny Rider ATCR.

The Company cites to two past Commission cases where it claims that the Commission approved mechanisms similar to the proposed Rider ATCR. Staff argues neither docket is persuasive. In Docket No. 05-0597, the Commission approved a rider to recover manufactured gas plant remediation costs. *Commonwealth Edison Co.*, Docket No. 05-0597, Order at 212-213 (July 26, 2006). However, this rider was unlike the proposed Rider ATCR. First, in Docket No. 05-0597, the Commission had previously found that such riders were preferred for manufactured gas plant remediation costs, or "coal tar" costs (*id.* at 212), unlike here where the Commission has stated no such

preference. Second, no party had disputed that those environmental costs, presumably due to unexpected site conditions, were volatile and fluctuating (*id.*), unlike here where several parties dispute the volatility and fluctuation. Third, ComEd was using the rider to recover costs related remediation and not capital investments. Thus, although the ComEd rider was related to an environmental compliance issue, it otherwise bears no similarities to the proposed Rider ATCR. ILAWC's other example, a citation to Docket No. 20-0722, which approved a renewable natural gas pilot program, is irrelevant.

Staff asserts that the Company's claim that utility commissions in 30 states have approved environmental compliance riders or similar alternative ratemaking mechanisms is likewise unpersuasive. ILAWC has provided no further details which would allow the Commission to assess whether such riders or "alternative mechanisms" are indeed similar to Rider ATCR. Notably, ILAWC admits that a rider such as Rider ATCR seems to be more prevalent for energy utilities, not water. *Id.* The Company also states, without further details, that Indiana-American Water Company ("Indiana-American") has a "System Improvement Charge." *Id.* Staff maintains this is unpersuasive and irrelevant. Indiana-American is not governed by the Act and the same statutes and regulations do not apply to Indiana utilities.

The Company notes the rules including regulations surrounding PFAS that it must comply with in its attempt to argue that such regulation is outside of its control and causes unpredictable outcomes. However, Staff argues that what ILAWC fails to address is the Company's current duty and obligation to comply with environmental standards, which the Company is currently doing without a rider like Rider ATCR.

Staff observes that the Company also fails to acknowledge that any safety and reliability benefits due to its proposed investments would still be realized if the costs were recovered by the traditional ratemaking process; the rider recovery mechanism itself does not benefit customers. ILAWC also argues that Rider ATCR would smooth out rate increases for customers over time or result in smaller, more gradual increases. ILAWC notably stops short of suggesting that the proposed rider would actually reduce customers' ultimate cost from the investments. However, the Company's explanation fails to quantify any potential difference that could benefit customers.

Finally, the Company argues that customers would benefit from Rider ATCR's treatment of litigation proceeds, arguing that customers could receive benefits from one South Carolina district court case faster than they would otherwise, because proceeds would be reflected as a credit in the Rider ATCR revenue requirement. Staff points out that these proposed settlements are only that—proposed. ILAWC admits that the settlements have not been approved, have no deadline, and are only expected to result in some recovery for ILAWC, net of litigation costs. This highly unspecific and speculative benefit should not be given any weight by the Commission, and it does not overcome Staff's argument that riders such as Rider ATCR would primarily benefit shareholders, not ratepayers. Therefore, Rider ATCR should be rejected because it would subject ratepayers to unnecessary risk. *Id.*

Staff concludes stating that for all of the reasons stated above, Rider ATCR should be rejected. However, if the Commission approves Rider ATCR, Staff recommends the following:

- Change the operation year from a prospective to a historical period to limit the speculative aspect of how much will be invested and when the assets are expected to be placed in service; this could also reduce the amount of the reconciliation adjustment (i.e., limit the impact to variances in volume and revenues, and thereby exclude the impact of capital investment amounts and timing);
- Impose a dollar limit on the amount of capital investments for an operation year and the corresponding impact on customer bills; and
- Remove language from the rider that permits the Company to include capital investment projects to comply with any other law whether federal, State of Illinois, or municipal, because it is broad, vague, and could encourage unnecessary capital spending that would unreasonably increase customer bills.

Staff Ex. 1.0 at 28.

c. AG's Position

The AG asks that the Commission reject the Company's proposed Rider ATCR because this rider would unnecessarily burden ratepayers with costs that are not unpredictable or outside of the Company's control. The AG asks the Commission to carefully consider the risks to ratepayers before approving any new rider.

The Company asks the Commission to authorize Rider ATCR under Section 9-220.2(a) of the Act, which provides that the Commission can "authorize a water or sewer utility to file a surcharge which adjusts rates and charges to provide for recovery of . . . other costs which fluctuate for reasons beyond the utility's control or are difficult to predict." 220 ILCS 5/9-220.2(a)(iii). Staff points out that ILAWC's proposal violates Section 9-220.2(a) because subsection 9-220.2(a)(iii) does not apply to capital investments and thus should not apply to a surcharge such as Rider ATCR. The AG agrees.

Further, even if the statute did authorize recovery of capital investments (which the AG maintains it does not), the AG asserts that the costs that the Company proposes to recover under ATCR are neither unpredictable nor beyond the Company's control. Echoing the statutory language, riders are traditionally meant to recover "unexpected, volatile, or fluctuating expenses." *A. Finkl & Sons Co. v. Ill. Com. Comm'n*, 250 Ill. App. 3d 317 at 327 (1st Dist. 1993). Thus, the Commission should only approve a rider "if the utility cannot influence the cost" and "the expense is a pass-through item that does not change other expenses or increase income." *Commonwealth Edison Co. v. Ill. Com. Comm'n*, 405 Ill. App. 3d 389, 414 (2d Dist. 2010) (citing *Citizens Util. Bd. V. Ill. Com. Comm'n*, 166 Ill. 2d 111, 138 (1995)).

With respect to compliance-related costs, the AG explains there is nothing new or exceptional about ILAWC's need to comply with environmental and safety regulations; indeed, it is a core responsibility of any utility. See 220 ILCS 5/8-401. While the Company claims these regulations are "subject to factors outside of [its] control," the AG states that the EPA has consistently provided companies with flexibility on how to achieve compliance, which investments to make, and when to make those investments. AG Ex.

2.00 REV. at 32. In stark contrast, ratepayers have no control over the Company's compliance methods or investments, yet the Company expects ratepayers—not the Company and its shareholders—to bear the risk associated with the Company's compliance with existing and any new water quality regulations.

The AG notes that in ILAWC's last rate case, the Commission rejected ILAWC's proposed Rider ESR. Docket No. 22-0210, Order at 150–151. In doing so, the Commission acknowledged this risk imbalance in ILAWC's last rate case by finding that the Rider ESR “would arguably place greater risk on the ratepayer for the benefit of stakeholders because I[L]AWC would be able to immediately recover costs, including a return to investors, under the rider subject to a reconciliation” *Id.* The AG argues that Rider ATCR is just like Rider ESR, which the Commission has already denied, in that it would permit the Company to recover certain compliance costs between rate cases. ILAWC's witnesses claim that the scope of Rider ATCR is narrower than the Rider ESR and that the primary purpose of Rider ATCR is to allow the Company to recover the costs associated with new US EPA Per- and PFAS regulations. *E.g.* ILAWC Ex. 3.00 at 40. However, the AG argues that the two riders are substantially similar and Rider ATCR would allow the Company to recover a broad scope of investments connected to any statutes, regulations, or legal mandates relating to protection of the environment, public health and safety, or natural resources, well-beyond new EPA PFAS regulations. The AG asserts that such an all-encompassing description cannot reasonably be considered “narrow” in scope.

Next, the AG turns to ILAWC's argument that similar mechanisms have been approved for Illinois energy utilities. The AG notes that to support this claim, ILAWC primarily cites to statutorily created riders, including “cost recovery mechanisms associated with qualifying infrastructure (see 220 ILCS 4/9-220.2(a)(iv); 220 ILCS 5/9-220.3), renewable energy mandates (220 ILCS 5/16-107.6(h)), energy efficiency (220 ILCS 5/8-103), and zero carbon electricity generation (220 ILCS 5/16-108(k)). The AG points out that all these examples were authorized by the Illinois General Assembly; they were not approved by the Commission as riders to recover “costs which fluctuate for reasons beyond the utility's control” under Section 9-220.2, as the Company proposes here. The AG asks that the Commission not deviate from its recent, 2022 decision simply because the General Assembly authorized riders for other—unrelated—costs in the past.

ILAWC also claims that its proposal is supported by the Commission's decisions to authorize Commonwealth Edison's “rider to recover manufactured gas plant remediation costs” in 2006 and Nicor Gas' renewable natural gas rider in 2021. *In re Commonwealth Edison Co.*, Docket No. 05-0597, Order at 212–213 (July 26, 2006). *N. Ill. Gas Co.*, Docket No. 20-0722, Order (July 8, 2021). The AG explains that ILAWC ignores that Commonwealth Edison's rider was for the limited purpose of recovering specific MGP or “coal tar” costs that were related to Superfund remediation. *In re Commonwealth Edison Co.*, Docket No. 05-0597, Order at 212–213 (July 26, 2006); see also *Citizens Util. Bd. v. Ill. Com. Comm'n*, 166 Ill.2d 111 (1995) (upholding coal tar rider and establishing standards for rider recovery). In the instant case, ILAWC asks for rider recovery of all investments connected to “any statutes, regulations, or legal mandates relating to protection of the environment, public health and safety, or natural resources.” ILAWC Ex. 4.05 at 1. The AG contends that this request goes well beyond the coal tar

remediation rider that the Commission authorized for ComEd. Indeed, these are the same types of costs that the Commission found were not sufficiently volatile for rider recovery in ILAWC's last rate case less than two years ago. The AG requests that the Commission follow its past practice and reject ILAWC's proposed Rider ATCR.

The AG explains that the Nicor Gas decision is also distinguishable from ILAWC's proposal in this proceeding. First, Nicor's rider was authorized under Section 9-244, which permits the Commission to approve alternative recovery riders in limited circumstances where the proposed program is "likely to result in rates lower than would have been in effect under traditional rate of return regulation;" "likely to result in other substantial and identifiable benefits" to ratepayers; is in compliance with Commission's standards and will not adversely affect service and reliability, the Company's financial condition, or competitive markets; includes annual reporting requirements; and "includes provisions for an equitable sharing of any net economic benefits between the utility and its customers." 220 ILCS 5/9-244(b). In other words, Section 9-244 allows for innovative approaches to rate recovery in limited circumstances, so long as the utility can show that its proposal will benefit ratepayers. Section 9-220.2(a)(iii), upon which ILAWC's proposal is based, allows for rider surcharges to recover "costs which fluctuate for reasons beyond the utility's control or are difficult to predict." 220 ILCS 5/9-220.2(a)(iii). Nicor's proposal was a pilot program with a spending cap of \$20 million, for which Nicor was required to demonstrate tangible benefits to both the Company and ratepayers. *N. Ill. Gas Co.*, Docket No. 20-0722, Order (July 8, 2021). The AG iterates that ILAWC's proposal is based on vague assertions of "environmental compliance" with no budget cap and no identified benefit to ratepayers. The AG asks that the Commission not be persuaded by ILAWC's attempt to conflate vastly different riders but instead reject Rider ATCR, like it rejected ILAWC's previous environmental compliance rider in 2022.

The AG asserts that ILAWC has failed to demonstrate that it is reasonable and prudent for the Company to recover the costs of environmental compliance through a rider, rather than through traditional ratemaking. The AG explains that the fact that the "Company anticipates that a significant amount of investment will need to be made to comply with new environmental regulations," further supports that these costs should be managed consistent with the applicable rules, thoroughly reviewed and either approved or denied in traditional rate proceedings, so that the Commission can ensure that the Company only recovers from ratepayers the reasonable and prudent costs of its investments. ILAWC IB at 140. In short, the AG asserts that the Company does not need Rider ATCR to recover the environmental costs it is seeking and that allowing the Company to recover the proposed expenses through this proposed rider would shift all the Company's risk to ratepayers, burden the Commission and stakeholders with reconciliation proceedings in addition to its many other rider reconciliations (e.g. QIP, VBA, purchased water and sewer rider reconciliations, BDE (bad debt expense), and VIT (variable tax rider)) and undermine traditional ratemaking and the regulatory bargain. For the reasons set forth above and in the AG's testimony and briefs, the AG asks that the Commission reject the Company's proposed Rider ATCR.

d. Municipalities' Position

The Municipalities urge the Commission to reject ILAWC proposed Rider ATCR to recover capital investments related to non-replacement required [for safety and

environmental] compliance. The Company states Rider ATCR is new, but it is really just a repackaging of its rejected Rider ESR from Docket No. 22-0210. While the Commission may authorize a water or sewer utility surcharge for “costs which fluctuate beyond the utility’s control or are difficult to predict,” 220 ILCS 5/9-220.2(a)(iii), ILAWC’s Rider ATCR fails to meet this basic requirement. As a result, it should be rejected just as Rider ESR was rejected in ILAWC’s previous rate case.

In Docket No. 22-0210, ILAWC described Rider ESR as a mechanism to recover unpredictable capital costs it might incur to comply with changes in environmental regulations and standards. The Company’s description was found to be inadequate and the Commission rejected the proposed rider. The Municipalities state that just as in the last rate case, the facts do not support adoption of Rider ATCR in this docket.

AG witness Larkin-Connolly analyzed the proposed rider and found that ILAWC’s argument that it is narrower than the rejected ESR to be inaccurate. “While the definitions of eligible investments in Rider ATCR may appear to have more specificity because explicit laws and administrative institutions are identified, the language still uses terms like ‘any’ that, based on my plain reading, would allow for a generous interpretation that could be used to support a wide swath of investments.” AG Ex. 2.00 at 27.

The Company asserts that Rider ATCR is necessary because it would help mitigate the need for more frequent rate cases because ILAWC needs to comply in the future with new regulations relating to PFAS and the Company does not know what the cost of compliance may be. ILAWC Ex. 4.00 at 20. However, the Municipalities argue the Company admits that once the rule is finalized, “public water systems will be required to modify their facilities to comply with the PFAS Rule within three years.” *Id.* To reach his conclusion, Mr. Selinger ignores testimony by Mr. O’Neill that reports the company “anticipates investing approximately \$80 million to \$300 million over the next three years to address new regulations and standards regarding PFAS, through the construction of new facilities and equipment.” ILAWC Ex. 3.0 at 39. The Municipalities believe this demonstrates that the Company does not know the cost of compliance. They point to Staff witness Au’s statement that “I have an overarching concern that the Company has not demonstrated that Rider ATCR is necessary.” Staff Ex. 1.0 at 22.

The Municipalities note the AG’s statement that ILAWC’s argument that Rider ATCR is needed because the emerging PFAS regulations cannot be predicted “is far from the reality.” AG Ex. 2.00 at 29.

They argue the Commission’s findings in Docket No. 22-0210 rejecting ILAWC’s Rider ESR are still true in this docket and are applicable to the proposed Rider ATCR. Accordingly, the Municipalities contend the Company’s Rider ATCR proposal should be rejected.

e. IIWC’s Position

IIWC continue to oppose the Company’s proposal with regard to Rider ATCR. IIWC point out the Company notes Rider ATCR is designed to recover the costs associated with new investment, non-QIP eligible utility plant required to comply with various statutes, regulations, orders or legal mandates relating to the environment, public health and safety or natural resources. IIWC note the Company argues the costs

associated with these potential mandates fluctuate for reasons beyond the Company's control and are therefore appropriate for rider recovery. IIWC point out the Company argues a rider in this instance is appropriate since the costs fluctuate for reasons beyond the utilities control and are difficult to predict. IIWC also note the Company argues Illinois statute allows the Company's proposed rider. IIWC concede it is true the Commission may authorize a water or sewer utility to file a surcharge which adjusts rates and charges to provide for recovery of the cost of purchased water, the cost of purchased sewage treatment service or other costs which fluctuate for reasons beyond the utilities control or are difficult to predict. 220 ILCS 5/9-220.2(a). However, IIWC agrees with Staff that the statute does not apply to capital investments and therefore is not intended for the purposes the Company advances.

IIWC point out that without specific statutory authority, a rider mechanism is only effective and appropriate for cost recovery when the utility is faced with unexpected, volatile, or fluctuating expenses. *Citizens Util. Bd. v. Ill. Com. Comm'n*, 166 Ill. 2d 111 at 138 (1995). IIWC, Staff, and the AG all argue these costs are not unexpected, volatile, or fluctuating. IIWC note that the Company contends that the first investment it anticipates recovering through Rider ATCR would be for PFAS regulations. IIWC point out that the Company notes the initial proposed surcharge would recover \$4.79 million which represents approximately 1% of the Company's claimed \$407.99 million water revenue requirement in this proceeding. IIWC assert that clearly this cost is not unexpected, volatile or fluctuating. IIWC note in a similar attempt, the Company estimates the cost of compliance with new PFAS regulations will require the Company to spend \$80 million over a 3-year period. IIWC note that the Company qualifies this number suggesting that the \$80 million is subject to change. IIWC argue that again, the Company has failed to illustrate how this amount is unexpected, volatile or fluctuating.

IIWC state the Company can include the relevant costs in its next rate case. IIWC argue the Company has failed to demonstrate Rider ATCR is necessary and therefore it should be rejected by the Commission.

f. Commission Analysis and Conclusion

Similar to the last rate case, the Company is asking the Commission to approve a new environmental rider in this proceeding that will address costs associated with non-QIP eligible utility plant required to comply with any statutes, regulations, orders, or legal mandates relating to protection of the environment, public health and safety, or natural resources. Staff, the AG, IIWC, and the Municipalities all recommend that the Commission reject this proposal as unnecessary.

In reviewing the costs that the Company is seeking to recover, the Commission determines that all utilities are faced with these types of costs that ILAWC attempts to collect through Rider ATCR. The Company relies on Section 9-220.2(a) of the Act to support its position. Riders should be reserved for cost recovery when the utility is faced with unexpected, volatile, or fluctuating expenses and the Company has not proven this is the case.

The Commission finds that the record does not support ILAWC's assertion that these costs are volatile, fluctuate beyond the utility's control or are difficult to predict. Rider ATCR would allow ILAWC to recover non-QIP capital investments prospectively

prior to the Commission's review of prudence and reasonableness, including a return on the investment, net of accumulated depreciation and accumulated deferred income taxes, depreciation expense, and property taxes associated with Rider ATCR eligible plant. These non-QIP eligible capital investments would otherwise generally be included in ILAWC's rate base upon filing a rate proceeding and only recovered if the Commission approves new rates. The Commission does not find much difference from the Company's last rate case with Rider ESR. Accordingly, the Commission rejects ILAWC's proposed Rider ATCR.

G. Low-Income Tariff

1. Affordability Analysis

a. ILAWC's Position

ILAWC states that the concept of affordability for water and wastewater service is based on the idea that everyone should have access to drinking water and wastewater service that is (1) safe, meaning it complies with the U.S. Safe Drinking Water Act and regulations promulgated by the U.S. EPA; (2) reliable, so that it is resilient in the face of floods, droughts, and other climate risks; and (3) affordable. ILAWC Ex. 8.00 at 5.

The Company states that it knows that its water and wastewater service is essential and that it must make necessary investments to continue to provide safe and reliable water and wastewater service. The Company further states that it also knows how important it is for that service to remain affordable. ILAWC contends that maintaining affordability of service is an important objective for ILAWC. ILAWC Ex. 8.00 at 6; ILAWC Ex. 1.00.

The Company explains that it assesses the affordability of its water and wastewater service by comparing annual bills for water and wastewater service to household income in the communities that it serves and conducts two different types of affordability analysis for its water and wastewater service. ILAWC details that the first analysis is an Enterprise-Level analysis of affordability, which considers affordability of service at a high level over a multi-year period. ILAWC states that the second analysis is a Community-Level analysis of affordability, which takes a deep dive into the affordability of service at the individual customer level under current or proposed rates and current economic conditions. The Company states that its affordability study for water service is provided in ILAWC Exhibit 8.01 and the affordability study for wastewater service is provided in ILAWC Exhibit 8.02. The Company states that each exhibit contains both the Enterprise-Level Analysis and a Community-Level Analysis for the applicable service.

The Company contends that there are three conclusions that can be drawn from its affordability study:

- The affordability of the Company's water and wastewater service from 2012 through the forecast test period indicates that the way the Company has invested in and managed its water and wastewater systems has indeed been for the long-term benefit of its customers.

- The Company's water and wastewater service has been, is, and is expected to continue to be affordable for the majority of its residential customers, including under the rates proposed in this case.
- There are, however, groups of customers for whom affordability of water and wastewater service may be challenging.

ILAWC Ex. 8.00 at 7.

The Company states that its affordability assessment requires at least two data points—the average monthly or annual bill for water service and some measure of household income for the customer population. The Company explains that for the broader residential customer base, commonly available household income measures are measures of income at different percentiles. ILAWC details that Median Household Income (“MHI”), which is household income at a 50th percentile level (50% of households in a given population have incomes greater than the median and 50% of households have incomes lower than the median), can be measured at a statewide or community level and can be paired with a data set that provides the number of customers served in each community to arrive at a weighted number that represents MHI for the Company's entire service territory. *Id.* at 7-8.

ILAWC explains that at a more detailed level, individual household income is considered, and affordability can then be assessed, across a full range of households, based on their various income levels and bills for water and/or wastewater service. ILAWC states that a variety of household income data is readily and publicly available from the U.S. Census Bureau through the American Community Survey (“ACS”) at the state, county, and community levels. *Id.* at 8.

The Company points out that it provided water and wastewater affordability analyses in its last rate case, Docket No. 22-0210. ILAWC Exs. 7.03; 7.04. The Company details that those analyses, which presented the Commission with an approach for evaluating the affordability of utility services that, to Mr. Rea's knowledge, had not been previously employed in Illinois rate cases, examined the long-term view of affordability of water and wastewater service to customers and took a deep dive view of the demographics of the Company's customers at the community level and the impacts of utility bills on its customers at a very detailed level.

The Company states that it has made two significant enhancements to its affordability analysis provided in the last rate case:

- The Company has developed a metric called the Affordability Index. This index, which is a simple and easy to understand metric, allows for easy comparisons of the affordability of water and wastewater service across the entire service territory, among communities within the Company's service territory, and among different demographic groups of customers.
- The Company has developed real-time rate modeling capabilities that allow for instant analysis of the impact on affordability of service from changes in rate design.

Id. at 9.

The Company states that the Enterprise-Level Analysis of affordability for water and wastewater service is a historical comparison of average monthly bills for ILAWC residential customers to household income for the Company's residential customers. The Company details that the metric used to describe affordability is the BTI Ratio, which is defined as annual water bills divided by estimated annual household income. ILAWC states that this view looks at average residential monthly bills for all customers over time compared to MHI for the Company's residential customer base. *Id.* at 9-10.

ILAWC states that the MHI for the Company's service territory is a weighted average of the number of customers the Company serves in each community in the service territory and the median household income in each of those communities for owner-occupied and single-unit, renter-occupied homes as reported by data in the ACS based on the most recent year's available data (2022 in this proceeding). The Company points out that the relationship between this service territory-specific figure and the MHI for the State of Illinois for 2022 (also provided at the community level through the ACS) is then applied to historical MHI data for the State of Illinois to arrive at historical MHI data for the ILAWC service territory. *Id.* at 10-11.

ILAWC explains that the charts it provided in ILAWC Exhibit 8.00, compare historical average monthly water bills to MHI for ILAWC Water customers from 2012 through 2023 stated in absolute terms and stated in terms of BTI Ratio, along with estimated average monthly bills under the Company's proposed rates in this case and estimated MHI for ILAWC Water customers during the forecasted test years. The Company details that the data shows that the BTI Ratios for water service for ILAWC Water customers have dropped from 1.06% in 2012 to 0.87% in 2023. The Company states that the BTI Ratio at the median income level is expected to be 0.99% under the ILAWC's proposed rates in this case for Step One rates and 0.98% for Step Two proposed rates. *Id.* at 11-12.

The Company explains that for wastewater service, the charts it provided in ILAWC Exhibit 8.00, compare historical average monthly water bills to MHI for ILAWC from 2012 through 2023 stated in absolute terms and stated in terms of BTI Ratio, along with estimated average monthly bills under the Company's proposed rates in this case and estimated MHI for ILAWC customers during the forecasted test years. The data shows that the BTI Ratios for wastewater service for ILAWC customers have consistently been between 0.6% and 0.8% of MHI from 2012 to 2023. The BTI Ratio at the median income level is expected to be 1.00% under the Company's proposed rates in this case for Step One rates and 0.99% for Step Two proposed rates. *Id.* at 13-14.

The Company maintains that there is no definitive standard for affordability as a percentage of MHI. Benchmarks for affordability expressed as a total bill's percentage of MHI is a policy decision. However, bills that are less than 2.0% or 2.5% of MHI for water and 4.0% to 4.5% of MHI for combined water/wastewater are considered "affordable" by some. Teodoro, Manuel P., "Measuring Household Affordability for Water and Sewer Utilities," Journal AWWA (2018), doi:10.5942/jawwa.2018.110.0002.

The Company explains that the assessment of affordability of service cannot be reduced to a yes or no question—it will never be that simple. One can generally measure

average water bills against any given benchmark and come up with a yes or no answer, but affordability of service is a continuum, and that is what the Company's Community-Level analysis, described below, shows. The Company states that there will always be customers for whom water service is more affordable than for others depending on demographics and income levels. This is true across all of the communities that ILAWC serves, including even the wealthiest communities that the Company serves. *Id.* at 14-15.

The Company explains that the Community-Level Analysis takes a deeper dive into the affordability of water and wastewater service at a local level across different customer demographics and proposed rates for each community that the Company serves. For larger communities, the analysis is done at a zip-code level. *Id.* at 15.

The Company states that the purpose of the Community-Level Analysis is to identify, at an individual customer level, the percentages of household income that bills for water and wastewater service are expected to take up under the Company's proposed rates, and to identify demographic trends either by geographic location or by income level for customers where affordability of service may be an issue based on BTI Ratios measured at the individual customer level. *Id.*

ILAWC explains that the Enterprise-Level Analysis and the Community-Level Analysis are two different but complementary views of affordability. As previously stated, the purpose of the Enterprise-Level analysis is to provide a high-level historical perspective on how the affordability of service has been trending over time and how it is expected to continue to trend under proposed rates. The Community-Level analysis takes a deep dive into the affordability of service at the individual customer level under current or proposed rates and current economic conditions. *Id.* at 16.

The Company notes that there is academic research that supports the Company's approach to assessing affordability of service at this detailed level. Cardoso and Wichman outline a framework for assessing affordability of water service that uses the full distribution of household income at the local level rather than MHI or some other static representative level of income and uses varying levels of water usage at the individual household level instead of a static representative level of water usage. The Company explains that while the Company's methodology differs from Cardoso and Wichman in certain areas, the goal remains the same, which is to analyze affordability at the individual customer level and identify customer groups where affordability of service may be an issue.

The Company states that the following information is used to assess affordability of service at the community and individual customer level:

- The number of customers served in each community.
- The distribution of owner-occupied households and renter-occupied households by income level in each community.
- The percentage of occupied housing units that are owner-occupied households or renter-occupied households that are not in multi-dwelling buildings in each community.

- The average number of persons per household in each community for both owner-occupied and renter-occupied households.
- The distribution of the size of households (one-person, two-person, etc.) for households of different income levels.
- The standard definition of Basic Water Service.
- Current or proposed rate structures.

Id. at 17.

The Company explains that Basic Water Service is a water usage level that reflects the level of water consumption for basic human services (cooking, cleaning, sanitation, and general health requirements), which is then assumed to be constant from month-to-month and not subject to significant seasonality or weather conditions. This standard can be expressed in terms of gallons per resident per day. This service is different from discretionary seasonal water usage for filling swimming pools, lawn irrigation, etc. This definition of Basic Water Service can be used to customize a level of usage that accurately reflects water service for different sizes of households. *Id.* at 17-18.

For the purpose of the Company's affordability analyses, Basic Water Service is defined to be 40 gallons of water per household member per day. This figure is based on the review of relevant literature on the subject and a review of Company billing data for residential customers in months with minimum levels of discretionary water usage, all of which supports the definition of 40 gallons of water per household member per day. *Id.* at 18.

The Company explains that the definition of Basic Water Service at 40 gallons per household member per day is also suitable for wastewater analysis because wastewater billings, especially in light of the Company's proposal for winter averaging, are based on the same type of service that Basic Water Service is meant to represent, namely water consumption for basic human services (e.g., cooking, cleaning, sanitation, and general health requirements). All of this service effectively is returned through the wastewater collection system and, therefore, the definition of Basic Water Service serves as an appropriate benchmark for analysis of affordability for wastewater service. *Id.* at 18-19.

The Company's Community-Level Analysis provides a complete set of demographic information for the Company's customer base in each community and a set of affordability data for its service territory in total and for various cross sections of the Company's customers. *Id.* at 19.

ILAWC explains that the demographic information provided by this analysis is primarily economic in nature, although the analysis can be expanded to provide information on various identifiers such as race, languages spoken, etc. The primary demographic (economic) information provided by the analysis is the estimated number of customers at different levels of Federal Poverty Level ("FPL") and at different levels of household income. FPL is a measurement set by the U.S. Department of Health and Human Services of the minimum amount of annual income that is needed for individuals and families to pay for essentials, such as room and board, clothes, and transportation. The FPL takes into account the number of people in a household, their income, and the

state in which they live. For Illinois, the FPL guidelines for 2024 are set at \$14,850 for a household size of one and \$5,140 per year for each additional household member. *Id.*

The Company states that the charts in ILAWC Exhibit 8.00 at page 20, for both water and wastewater service, shows the relationship between residential customers' bills for Basic Water Service under the Company's proposed rates and level of household income. The Company explains that these charts show that under the Company's proposed rate structure, the Affordability Index metric (discussed below) for the Company's service territory in total is 74% under proposed rates for water service and 82% under proposed rates for wastewater service, meaning that 74% of the Company's residential water customers and 82% of the Company's residential wastewater customers can expect to see bills for Basic Water Service to be less than 2% of their household income. The Company estimates that there are approximately 70,000 residential water customers and 12,900 wastewater customers that will see bills for Basic Water Service above 2% of their household income, which is approximately 25% and 17% of the total customer population for water and wastewater service, respectively. *Id.* at 21.

The Company further explains that the Affordability Index ("AI") is a metric that reflects the percentage of a group of customers for whom Basic Water Service is expected to be less than a given percentage of annual household income. Consistent with the discussion above regarding standards for affordability, the Company uses 2% of household income as the benchmark for this metric, which is at the conservative end of the range of affordability often cited.

ILAWC states that the AI metric is designed to reflect the percentage of residential customers in a state, community, or demographic group for whom Basic Water Service is expected to cost 2% or less of annual household income. An AI value of 100% means that all customers within a selected group can expect Basic Water Service at less than 2% of annual household income. An AI value of 70% means that approximately 70% of customers within a selected group can expect Basic Water Service at less than 2% of annual household income, and 30% of customers in that group can expect Basic Water Service to cost more than 2% of annual household income. The AI value is calculated based on modeling of proposed rates and community-level demographic information discussed above, which assesses affordability across the entire range of customer demographics in each community the Company serves. *Id.*

The Company notes that the 2% benchmark is generally consistent with industry standards for affordability at the individual household level and is slightly lower than the 4.5% benchmark for combined water and wastewater service used by Cardoso and Wichman. Cardoso, Diego S. and Wichman, Casey J., "Water Affordability in the United States," Water Resources Research, vol. 58, issue 12 (2020).

However, the Company explains that affordability is not uniform across the Company's entire service territory. While the Company's water rates (and therefore bills) are the same for the vast majority of the Company's customers with the Company's water service territory and are generally consistent within the Central Zone wastewater service territory and within the Chicago Metro wastewater service territory, household income can vary significantly across the Company's service territory. ILAWC has a very diverse service territory and serves customers in urban, suburban, and rural communities with

household incomes that range from well over \$100,000 MHI in many Chicago suburban areas to as low as \$40,000 in East St. Louis and Cairo. The Company's affordability analyses provide information on the number of customers served in each community, the MHI for each community, and the BTI Ratios for Basic Water Service in each community. *Id.* at 23.

The Company states that the large majority of customers with annual household incomes under \$20,000 will see bills for Basic Water/Wastewater Service that are higher than 2% of their household income. Customers with incomes above \$100,000 a year will see bills for Basic Water/Wastewater Service below 2% of household income. Customers with household income between \$20,000 and \$100,000 may see bills higher than 2% of household income for Basic Water/Wastewater Service depending on their specific income level, household size, and location. *Id.*

The Company notes that Staff and LAC were the only parties to address the Company's affordability study. The Company states that Staff is generally supportive of the Company's approach to assessing affordability, and agrees with the Company position, based on industry literature, that 2.0-2.5% of MHI for water and 4.0-4.5% of MHI for combined water/wastewater can be considered affordable. Staff performed an analysis of affordability that found that only average residential users in two counties, Alexander and Pulaski, with incomes at or below the MHI for the county, would have a monthly water bill that exceeds 2.0% MHI (but not 2.5% MHI).

The Company states that LAC raises a number of issues relating to the Company's affordability analysis, arguing that the approach to affordability analysis proposed by LAC witness Colton is superior. LAC asserts that there at least five major flaws with the Company's methodological approach.

The Company explains that first, LAC criticizes the use of MHI as part of the Company's Enterprise Analysis. The Company states that LAC argues that the Company's Enterprise-Wide Level analysis is irrelevant both in terms of scope and purpose and in terms of execution, but the Company and Staff disagree.

The Company states that second, LAC claims that the Company improperly focuses on the incomes of homeowners without considering renters. However, as Mr. Rea explained, it is impossible to know definitively what these households pay in rent for water or wastewater service. Presumably, building owners that receive water and/or wastewater service from ILAWC are recovering those costs through rents, but there is no way to know if owners are overcharging or undercharging renters or if they are also charging renters for building water or wastewater service that renters are themselves not actually using. The Company states that all of this suggests that the overall cost impact to a typical rental household in a multi-family building would be lower than for the residential population in total, and the impact on affordability of service for what households in multifamily buildings might not be significantly different than for the Company's total residential group.

The Company states that third, LAC claims that the Company's Enterprise Analysis and Community Analysis do not adequately or accurately address the breadth or depth of water service unaffordability in the Company's service area, asserting that under the Company's proposed rates, not a single group under 200% FPL would have affordable

water service absent access to a discount. The Company maintains that here, the key is the assumption absent access to a discount. The Company notes that as discussed in the following section, the Company has proposed an expansion of its low-income discount tariff program to use four tiers, including customers with incomes at 150-300% of FPL. The Company states that if anything, LAC's comments serve to justify the Company's low-income discount proposal, rather than reflecting any flaw in the Company's affordability analysis.

The Company states that fourth, LAC claims that the Company's Community Level analysis relies on an "unjustified assumption about ILAWC customers' water usage," namely the Company's definition of Basic Water Service as 40 gallons per person per day. The Company observes that here, the Company would note that Staff does not object to the Company's 40 gallons per person per day estimate in its affordability analysis. In testimony, Staff witness Boggs explained that the Company's analysis came from actual ILAWC residential customer data from 2023 and that the Company adequately documented its reasoning for using 40 gallons per person per day with real data. Additionally, Company witness Rea explained that LAC's analysis of this issue is complicated and somewhat convoluted. Mr. Rea noted that it can be easy to manage data in a way that appears to prove or disprove a certain assumption, but most often the simplest approach is the best. The Company explains that the analysis that Mr. Rea presented in his rebuttal testimony that supports ILAWC's definition of 40 gallons per household member per day is simple and straightforward and demonstrates that the Company's definition of Basic Water Service is consistent with usage levels used to develop proposed rates in this proceeding.

The Company observes that finally, LAC asserts that the Company's Community analysis supposedly relies on a questionable set of data and assumptions regarding household income and an affordability metric that further understates the extent to which customers struggle to pay their water bills, and that the analysis does not reveal how unaffordable the Company's water service for those who cannot afford it, as opposed to the sheer number of customers for whom it is unaffordable. The Company notes, however, that as Mr. Rea explained, this assertion is simply false. The Company states that ILAWC Exhibits 8.01 and 8.02 provide enormous levels of detail on the affordability of water and wastewater service across all income groups and also provide data on BTI Ratio for customers at different levels of household income by increments of the FPL. The Company explains that while the Affordability Index is a simple summary metric that describes the estimated percentage of customers with bills less than 2% of annual household income and can be used to easily compare affordability of service across a variety of demographics (community, income level, household size, etc.), the data needed to fully analyze the depth and breadth of affordability is completely contained within the affordability analyses provided by the Company. The Company notes that as with other criticisms, LAC did not acknowledge, much less engage with or rebut, this evidence.

The Company states that, in summary, the Commission should reject LAC's arguments regarding the Company's affordability analysis. As Mr. Rea explained when summarizing his assessment of LAC's positions, much of LAC's position has been around semantics, and the words that the Company used to describe the Company's affordability analysis. Much of the testimony has focused on labels (Basic Water Service) and

descriptions (individual customer level and American Community Survey data). LAC also has leveled criticisms of how Mr. Rea summarized the results of the Community-Level analysis through use of the Company's Affordability index, but with the exception of the use of MHI in the Enterprise-Wide analysis and the specific use of 40 gallons per household member per day in the Community-Level analysis, he has not leveled significant criticisms of the Company's general framework for analyzing affordability and has not suggested significant improvements.

The Company notes that the Company, LAC, and the AG are in agreement on the levels of discounts in a low-income discount tariff that would be needed to achieve broader affordability. The Company maintains that, accordingly, the real issue regarding the Company's affordability analysis is whether the Company's approach to analyzing affordability through its companion Enterprise-Level and Community-Level analyses are appropriate. The Company states that the Company's two-pronged approach to its affordability analysis is a robust and groundbreaking approach to the analysis of affordability of utility service, and provides a significant level of detail regarding the affordability of service at the individual customer level while also providing a higher level multi-year general view of affordability across the Company's service territory.

b. Staff's Position

Staff asserts that everyone should have access to water and wastewater service that is safe, reliable, and affordable. According to the Company, while there is no standard for affordability, it considers bills less than 2.0-2.5% of MHI for water and 4.0-4.5% of MHI for combined water/wastewater to be affordable. *Id.* at 14.

As part of Staff's analysis of the Company's rate design proposals, Staff reviewed the affordability of the Company's proposed water and wastewater bills. Staff Ex. 7.0 at 53-60. Staff agrees with the Company's claim that 2% of MHI for water and 4.5% of MHI for combined water/wastewater are affordable energy bills. *Id.* at 54-55. Staff compared proposed water and combined water/wastewater rates with MHIs in the counties ILAWC serves, using an assumed monthly usage of 4,500 gallons for both water and wastewater. *Id.* at 55-58. For the Company's proposal, this results in bills of \$73.68 for Central Water, \$51.18 for Pekin Water, \$56.34 for Chicago Metro Collection Only, \$113.44 for Chicago Metro Collection and Treatment, and \$89.56 for Central wastewater. *Id.* at 58-59. For Staff's proposal, this results in bills of \$70.46 for Central Water, \$51.18 for Pekin Water, \$56.34 for Chicago Metro Collection-Only, \$113.44 for Chicago Metro Collection and Treatment, \$114.96 for Central Wastewater Collection and Treatment, and \$31.50 for Central Wastewater Collection Only. *Id.* at 59. Thus, only average residential users in two counties, Alexander and Pulaski, with incomes at or below the MHI for the county, would have a monthly water bill that exceeds 2.0% MHI (but not 2.5% MHI). *Id.* Given Staff's proposed Central Water rates are only \$3.22 lower than the Company's proposed Central Water rates; adopting one over the other likely will not have a significant effect on affordability. Staff's proposed Central Wastewater rates are \$25.40 per month more for an average residential use customer than the Company's proposed Central Wastewater rates; however, this is because of Staff's recommendation to reject ILAWC's wastewater reallocation proposal.

Staff contends that the Company provided evidence in support of its affordability analyses. ILAWC IB at 152-68. The Company states that 2% of MHI for water and 4.5% of MHI for combined water and wastewater are affordable energy bills and Staff's own analysis determined rates for ILAWC customers in all service territories, with the exception of customers in Alexander and Pulaski counties, are affordable.

Staff also agrees with the use of MHI as a reasonable measurement tool for water and wastewater bill affordability. Staff Ex. 16.0 at 12. ILAWC's use of MHI in its Enterprise-Level analysis shows the long-term impact of changes in rates and usage on the general affordability of water and wastewater, and ILAWC used data from ILAWC's own service territory, like income, socioeconomic factors, and actual proposed customer bills. *Id.* Furthermore, MHI is easily accessible and county specific. *Id.* Thus, there is value in comparing MHI to the Company's actual income data and bill impacts. *Id.*

Additionally, Staff does not share LAC's concerns about the use of MHI for homeowners in an affordability analysis. The majority of the Company's residential customers are homeowners. Staff Ex. 16.0 at 14-15. MHI for renters increased more than MHI for homeowners over the past ten years. *Id.* at 14. Changes in homeowner percentage over the past ten years is not solely based on an individual's MHI; it could be due to any number of socioeconomic factors. *Id.*

Furthermore, Staff identified concerns with LAC's affordability analysis. First, it is unclear what level of monthly usage LAC assumed for water or wastewater customers. Staff Ex. 16.0 at 16. Second, it is unclear whether LAC assumed the FPL would stay the same or change over LAC's chosen six-year period. *Id.* If neither incomes nor assumed bill amounts are known measures, it is impossible to know if LAC's affordability analysis is reliable. *Id.* Meanwhile, Staff uses a known level of proposed billing rates and published MHI, which are publicly available and generally reliable as a measure of affordability. *Id.*

Related to Community-Level analysis, Staff does not object to ILAWC's use of 40 gallons per person per day as an estimate of basic water service. Staff Ex. 16.0 at 18. ILAWC's choice of 40 gallons per person per day is based on actual ILAWC residential customer data from 2023. *Id.*; see also ILAWC Ex. 22.00 at 17-18, Table 2. It is important to use accurate levels of consumption when analyzing water and wastewater bill affordability so rates can beset as close as possible to recover its revenue requirement. Staff Ex. 16.0 at 18-19.

Finally, while LAC argues that ILAWC's data and assumptions are unreasonable, accounting for data across the entire residential population for income and housing size is a reasonable way to analyze affordability of water and wastewater service for the Company's customers. Staff Ex. 16.0 at 20. ILAWC considers the volume of water consumption and the relationship between household income and household size. *Id.* Furthermore, although LAC argues that without the Company's low-income discount, rates would be unaffordable (LAC IB (Corr.) at 15), the fact is that the Company does offer a low-income discount which makes its rates affordable for low-income ratepayers, and Staff recommends considering the Company's low-income discount when analyzing affordability. Staff Ex. 16.0 at 21.

For these reasons, Staff does not object to the Company's affordability analyses and, while Staff recommends rejecting the Company's expanded Low-Income Discount

Tariff Proposal, ILAWC's affordability analyses should be used to support the approval of a low-income discount rate.

c. LAC's Position

While ILAWC and LAC agree on a low-income discount proposal, they disagree about the affordability analysis to support that proposal. LAC IB (Corr.) at 10. LAC argues that while this is less important given most of the parties' agreement on a proposal, because this proceeding may serve as a model for future rate cases, LAC argues that it is important for the Commission to consider the parties' competing methods of analysis.

In preparing competing low-income discount proposals, LAC and the Company relied on different assumptions and analytical methods. LAC argues that the assumptions and methodology utilized by LAC witness Colton were superior, and more in-line with those methods used in his testimony in the 2023 gas rate cases in which the Commission adopted gas low-income discount programs proposed by Mr. Colton through LAC. The competing methodologies and assumptions are as follows:

- Company: Company witness Rea provided a two-part analysis to support the Company's proposal: an "enterprise level" analysis focused on the "affordability of service at a high level over a multi-year period," as well as a "community level" analysis of affordability that analyzes local customer "income levels and bills for water and/or wastewater service." IAWC Ex. 8.00 at 6, 15-16.
- Enterprise Level Analysis: Mr. Rea calculates an average water and wastewater bill by year for each year 2011 through 2026 and compares those bills to median household income (MHI) for the same years. *Id.* at 10-11. Mr. Rea then takes these figures to generate a "Bill to Income ('BTI') ratio, which is defined as annual water bills divided by estimated annual household income." *Id.* at 9-10.
- Community Level Analysis: "The Community-Level analysis takes a deep dive into the affordability of service at the individual customer level." *Id.* at 16. Mr. Rea examines the percentage of customers for whom Basic Water Service—defined as 40 gallons of water per person per day ("GPPD")—is expected to be less than 2% of household income. *Id.* at 22.
- LAC: LAC witness Roger Colton conducted several analyses to measure the affordability of the Company's water and wastewater service for its lowest-income customers, up to 150% FPL. (He did not analyze those with incomes above 150% FPL because he initially agreed with the Company's proposal in that regard. LAC Ex. 1.0 (CORR) at 7. First, Mr. Colton analyzed the average bill-to-income ratio for customers at the Company's proposed rates, less the value of its initially-proposed discount.

LAC Ex. 1.0 at 36. Mr. Colton adjusted the assumed water usage from 40 to 50 GPPD. *Id.* at 38. Mr. Colton also broke down this affordability measurement by zip code for those incomes. In Table 4 in LAC Exhibit 1.0, Mr. Colton found "that some customers will be

just over 2% of household income while other customers will be anywhere from two to four times over that measure of affordability.” *Id.* at 39. He then modified the Company’s proposed discount rates to produce figures that would result in affordable bills for virtually all customers enrolled in the LIDR program by increasing the size of the discount for the lower income tiers. *Id.* at 40. *Id.* at 41. Mr. Colton determined that under his proposal, low-income customers’ water burdens would be substantially closer to true affordability, with only 2 zip codes exceeding 3% of monthly household income. LAC states that by comparison, not one zip code in the Company’s service territories would see water burdens exceeding 4%. *Id.* at 41-42.

LAC takes issue with Staff’s claim that it is “unclear what level of monthly usage LAC assumed for water or wastewater customers,” (Staff Reply Br. at 73), noting that Mr. Colton’s testimony reflects that LAC was assuming a 50 gallon per person per household member per day usage level. LAC Ex. 1.0 (CORR) at 38. Additionally, LAC mentions that it provided supporting work papers confirming the same. Thus, Staff’s claim has no basis in the record.

Staff also argued that it is “unclear whether LAC assumed the federal poverty level ... would stay the same or change over LAC’s chosen six-year period.” Staff Reply Br. at 73. LAC states Staff’s own Cross-Exhibit 4 is a response to a Data Request in which LAC plainly stated that “LAC’s anticipated eligibility levels are drawn from ILAWC Ex. 8.01, which provides estimates of customers at different income and water usage levels. 112,955 customers are anticipated to be potentially eligible, based on the total number of customers listed in ILAWC Ex. 8.01 at or below 300% FPL. This number is not expected to shift meaningfully between now and the end of 2026.” LAC Ex. 1.0 (CORR.) at 45. LAC points out that Staff does not explain how hypothetical changes in the poverty level will affect enrollment, which is what matters in terms of projecting program costs, but LAC has plainly produced evidence via this exhibit about projected enrollment and thus program costs. LAC urges the Commission to reject Staff’s undeveloped arguments about its affordability analysis, raised on reply for the first time and which are directly contradicted by the evidentiary record.

LAC argues that it is clear that Mr. Colton’s methodological approach is superior. LAC argues this is the case because his approach is based on empirical and well-accepted research related to actual water usage and relies on a more reasonable interpretation of company usage and billing records. LAC also argues Mr. Colton’s approach is more consistent with the affordability analysis already approved by the Commission in 2023’s gas rate proceedings and is equally well-suited to this case. Therefore, LAC contends it should be approved in this proceeding.

LAC asserts that there are at least five major flaws with the Company’s methodological approach to assessing the affordability of its services.

First, LAC claims that Mr. Rea’s Enterprise Analysis relies on MHI to assess incomes in the Company’s service territory, an approach that has been almost universally criticized by scholars, governmental organizations, and advocacy groups as the basis for an affordability analysis. LAC Ex. 1.0 (CORR) at 11-13.

Second, LAC states that Mr. Rea’s Enterprise Analysis compounds the problem of relying on MHI by only focusing on the incomes of homeowners. Given rising housing

costs in the Company's service territory, Mr. Rea's approach "leads to the erroneous conclusion that there is a direct relationship between rising housing costs and affordable utility rates." LAC Ex. 1.0 (CORR) at 18.

Third, LAC says Mr. Rea's Enterprise Analysis and Community Analysis do not adequately or accurately address the breadth or depth of water service unaffordability in the Company's service area. The parties appear to agree that a 4% of household income burden for combined water and wastewater service is an appropriate target for affordability. See, e.g., IAWC Ex. 8.00 at 22; Staff Ex. 7.0 at 54-60. However, LAC argues that under the Company's proposed rates, not a single group under 200% FPL would have affordable water service absent access to a discount. LAC Ex. 1.0 (CORR) at 21. This represents a problem for more than one-quarter of all IAWC water customers and one-fifth of wastewater customers, LAC points out. LAC Ex. 1.0 (CORR), at 21 *citing* IAWC Ex. 8.01-8.02.

Fourth, LAC argues that Mr. Rea's Community Level analysis relies on an unjustified assumption about IAWC customers' water usage. To conduct his analysis, Mr. Rea assessed "the percentage of a group of customers for whom Basic Water Service is expected to be less than a given percentage of annual household income" based on a purported review of customer bills. IAWC Ex. 8.00, at 22. He defines "Basic Water Service" to represent what is necessary for basic human activity, assigning it a value of 40 GPPD. *Id.* at 17-18. However, LAC contends that this definition is not consistent with either generally-accepted usage estimates or Company billing data. LAC claims that most water use analyses tend to rely on much larger daily water use estimates and for this reason Mr. Colton more reasonably used a 50 GPPD standard. LAC Ex. 1.0 (CORR) at 28-29. LAC argues that a review of the Company's billing data shows that the Company's actual water usage varies dramatically across its customer base: a "mean" usage of 3,653 gallons per month with a standard deviation of 2,482 is not instructive for purposes of conducting an affordability analysis. LAC Ex. 2.0 (CORR) at 17-18. It is also not instructive, LAC claims, since this "mean" appears to rely on a faulty set of assumptions about the number of household members using at or below this amount of water. *Id.* at 20-24.

Finally, LAC claims that Mr. Rea's Community analysis relies on a questionable set of data and assumptions regarding household income and an affordability metric that further understates the extent to which customers struggle to pay their water bills. LAC Ex. 1.0 (CORR) at 29-33. It also does not acknowledge how unaffordable the Company's water service for those who cannot afford it, as opposed to the sheer number of customers for whom it is unaffordable. LAC Ex. 1.0 (CORR) at 35. Additionally, LAC argues that it does not actually rely on "community-level demographic information," but instead relies on income and household size data from the Census Bureau's HINC-01 dataset, which is not available at the "community level" at sufficient granularity. LAC Ex. 2.0 (CORR) at 27-29.

d. Commission Analysis and Conclusion

The Company provided affordability analysis for both water and wastewater. As an essential service, the Commission must balance the cost of service for ILAWC to provide safe water and wastewater services. ILAWC performed an analysis in an

Enterprise-Level and a Community-Level analysis of affordability. Enterprise reviews affordability of service at a high level over a multi-year period. Community-Level analysis of affordability review the affordability of service at the individual customer level under current or proposed rates and current economic conditions.

The Commission notes that Staff performed an analysis of affordability and generally agreed with the Company's finding. Staff determined that two counties, Alexander and Pulaski, with incomes at or below the MHI for the county, would have a monthly water bill that exceeds 2.0% MHI. Staff generally agreed with the Company's finding that most of the customers fall into the 2.0-2.5% of MHI for water and 4.0-4.4% for combined water/wastewater.

While LAC disputes the method that the Company used to determine the low-income class and maintains that its method is superior, LAC agrees with the Company's low-income discount program. LAC also argues that its method is more consistent with the affordability analysis already approved by the Commission in 2023's gas rate proceedings and is equally well-suited to this case.

The Commission adopts the Company's proposal for this proceeding. The Company's analysis allows for affordability of water and sewer service to be assessed across the entire service territory. The Commission finds that the Company and Staff provide details regarding the affordability of service at the individual customer level while also providing a higher-level multi-year general view of affordability across the Company's service territory.

The Commission directs the Company to continue to refine the affordability analysis as additional information becomes available following implementation of the low-income discount program. The Commission notes that it will review affordability studies on a case-by-case basis and no precedent is set by adopting this method. As part of the ILAWC's next rate case, the Commission encourages the Company to incorporate aspects of LAC witness Colton's affordability analysis, including, for example, increased water usage assumptions and consideration of how unaffordable rates are prior to applying a discount.

2. Low-Income Discount Program

a. ILAWC's Position

The Company states that it has a low-income discount tariff for water and wastewater service. This tariff was approved by the Commission in Docket No. 22-0210. The Company states that this tariff offers a 70% discount on the volumetric charges on water and wastewater bills for participating customers. ILAWC explains that all customers with household incomes less than 150% of FPL are eligible for the tariff. The Company states that the cost of the discounts offered to customers are recovered through the Company's Rider VBA. ILAWC Ex. 8.00 at 28-29.

The Company states that it is proposing in this proceeding to modify the current low-income discount tariff to incorporate a tiered approach to discounts such that customers at different levels of household income would see different levels of discounts in the program that adds additional tiers of household income to the program. The Company asserts that it is also proposing to include discounts on fixed charges in addition

to the current discounts on volumetric charges. The Company states that it originally proposed three tiers for a modified low-income discount program. The Company has agreed to modify this proposal to use four tiers, with discounts as recommended by the AG, as summarized in the table on page 61 of the AG's Initial Brief. AG's IB at 61.

The Company notes that Staff recommends the Commission reject the Company's expanded low-income discount tariff proposal, arguing that there "has not been adequate time to assess whether the Company's current program has reached enough customers or whether it has reduced the utility burden of targeted customers." Staff IB at 105. The Company notes that Staff explains that water and wastewater operations are different than natural gas operations and that Staff asserted that the administrative burdens of an expanded program may be more costly than estimated given that the Company does not have a LIHEAP-equivalent to verify eligibility and expedite the application process, and recommends that the Company focus on increasing the number of customers on its current tariff. *Id.* at 105-106.

The Company recommends that the Commission reject Staff's arguments against expansion of the low-income program, and notes that the AG, the Company, and LAC are all in agreement that the Commission should adopt the Company's surrebuttal proposal, which the AG characterizes as consistent with the "gold standard" discount rates that the Commission approved in the gas rate cases in 2023 and would ensure affordable rates for low-income customers without overburdening other ratepayers.

b. Staff's Position

Staff recommends the Commission reject ILAWC's expanded low-income discount tariff proposal. Staff Ex. 7.0 at 61.

Staff notes that the AG states that the Company, the AG, and LAC all agree on a low-income discount tariff rate proposal (the "Expanded Proposal"). However, Staff continues to recommend the Commission reject the Expanded Proposal and instead continue the current, existing low-income discount program (the "Existing Program"). First, the Existing Program already provides a significant discount—70% of all applicable base rate volumetric charges for customers—for all customers below 150% the FPL. Docket No. 22-0210, Order at 183. In other words, just like the Expanded Proposal, the Existing Program also ensures that bills are more affordable.

Second, there has not been an adequate amount of time to assess whether the existing program has been effective, reached consumers, or reduced the utility burden of low-income customers. Abandoning the Existing Program this soon will render the current data meaningless and delay the Commission's ability to evaluate low-income discount proposals. ILAWC's Existing Program has only reached 3.2% of estimated eligible water customers and 5% of estimated eligible sewer customers. *Id.* Staff contends that ILAWC should focus on increasing the number of customers on the existing program before expanding the program. *Id.* at 106.

Third, water and wastewater operations do not mirror the natural gas operations that the Expanded Program is based on. Most notably, ILAWC does not have a LIHEAP-equivalent organization in water or wastewater to verify eligibility, promote the discount, or expedite the application process. *Id.* The Existing Program only has one tier: 0-150%

FPL. See *id.* Adding three additional tiers will make the application and income verification process more complicated.

Moreover, with only 3.2% participation in the water low-income discount rate program, it is obvious that improvements must be made to the Company's marketing and enrollment procedures. Customers cannot receive the benefits of either proposal if they are not enrolled in the program.

Staff urges the Commission to reject the Expanded Program, which makes the enrollment process more complicated, and leave the Existing Program, a simpler low-income discount rate program, in place. Further, Staff asserts that the Company should increase its marketing of the Existing Program, increase the enrollment rate of the Existing Program, and provide data to allow parties to evaluate the Existing Program and determine, based on actual evidence, what needs to be done to improve the Company's processes and procedures and help ILAWC's lowest-income customers make their bills more affordable.

ILAWC, the AG, and LAC ask the Commission to approve an Expanded Program because of what the Commission approved in different dockets involving different types of utilities with different customer characteristics all based on an entirely different record. However, Staff states, adjusting the tiers and discount amounts will not result in more affordable bills if an insignificant number of eligible customers are enrolled in the program. The choice of tiers and discount amounts in a new program will not fix the underlying issue: ILAWC's 3.2% participation rate.

Additionally, Staff asserts that more evidence is necessary to determine how to address ILAWC's low-income discount participation rate. Maintaining the Existing Program will provide the parties actual data to make informed recommendations, while approving a new program will make the data already available irrelevant. Staff's recommendation is not that the Existing Program should exist into perpetuity; rather, Staff's recommendation is that the Commission allow the Existing Program to continue until enough record evidence can be submitted to make informed decisions about how to improve it.

For these reasons, Staff recommends the Commission reject the Expanded Program and instead direct the Company to continue to improve the participation rate in the Existing Program.

c. AG's Position

The AG, ILAWC, and LAC are all in agreement that the Commission should adopt the Company's surrebuttal proposal, as shown in Table 8 on page 52 of ILAWC's Amended Position Statement. Staff is the only party that recommends that the Commission reject this agreed proposal. According to Staff, "there has not been adequate time to assess whether the Company's current program has reached enough customers or whether it has reduced the utility burden of targeted customers." Staff IB at 105. Mr. Rea points out, while "the Company's current program is still young," that does not mean that the Company should "hold off on improving the discount schedules under the current program if it can be shown that changes to those schedules can further enhance affordability." ILAWC Ex. 22.00 at 34. The AG agrees with Mr. Rea's

assessment and find that the Company's proposed four-tiered discount program is a significant improvement to its current program and will likely lower the bill burdens on ILAWC's low-income ratepayers.

Staff also argues that "water and wastewater operations do not mirror the natural gas operations that ILAWC's proposal derives from because ILAWC does not have a LIHEAP-equivalent in water or wastewater to verify eligibility or expedite the application process. The AG asserts that Staff ignores that ILAWC will be required to verify the incomes of participating customers, regardless of which discount program it adopts, and already uses a third-party to verify customers' incomes for its current discount program. Incomes for federal poverty levels are publicly available online. Further, ILAWC does not share Staff's concerns, despite it being the Company's burden—not Staff's—to verify customer eligibility. The AG asks that the Commission not reject this vast improvement to ILAWC's discount program based on Staff's unfounded concerns about income verification.

The AG requests that the Commission reject Staff's recommendation to maintain ILAWC's current discount because the surrebuttal modifications are consistent with the "gold standard" discount rates that the Commission approved in the gas rate cases in 2023 and would ensure affordable rates for low-income customers without overburdening other ratepayers.

d. LAC's Position

Regardless of the methodology and assumptions ultimately approved by the Commission, LAC agrees with the compromise proposal put forward by AG witness Larkin-Connolly and adopted via Company witness Rea's surrebuttal testimony, since it is almost identical to LAC's own methodologically.

This proposal by the AG which was endorsed by the Company is virtually identical to what LAC originally proposed in this case and would cost approximately \$3.549 million for water and \$3.098 million for wastewater prior to net cost savings, assuming a 35% participation rate. LAC Ex. 1.0 (CORR) at 45; LAC Ex. 2.0 (CORR) at 4-6. Although it is lacking in one regard—the discount for the 150-250% FPL tier—LAC concedes that it represents a significant improvement over the Company's original proposal and a reasonable compromise that, if adopted, will help address the Company's current low-income customer affordability crisis. AG Ex. 4.00 at 27. Furthermore, LAC argues that it will cost non-participating customers just 40 cents per month to ensure that their neighbors can afford water to drink, cook, and clean with. LAC Ex. 2.0 (CORR) at 5.

LAC argues that the Expanded Program, if approved, would have other benefits, including the reduction of shutoffs and uncollectible accounts. LAC Ex. 1.0 (CORR) at 46-48. These problems create additional costs for the Company and other customers, LAC argues, but providing sufficiently large discounts can reduce them. *See also id.* at 48-56.

Still, LAC argues that more will need to be done to ensure that, if this proposal is adopted, it is implemented effectively and used by eligible customers. It is true that current uptake rates of the Company's current discount program are low—in part because current discounts are not especially impactful and have not been widely promoted. The

Company has taken some steps to promote the program by email, social media, and other steps, but far more could be done, including affirmative outreach to local officials and community organizations along the lines currently being discussed for the gas utility discounts going into effect on October 1, 2024. LAC Cross Ex. 3.0 at 1. The Company needs not (and apparently will not, per LAC Cross Ex. 3.0 at 2) spend more money to do this, other than the marginal cost of annual notices Staff agrees would be worthwhile, (LAC Cross Ex. 2 at 2), but the Company is ready to partner with many organizations to increase public awareness of the program, including the Illinois Department of Commerce and Economic Opportunity, non-profits within its service territory, community action agencies, LAC, and of course, the Commission. *Id.*; see also LAC Ex. 2.0 (CORR) at 7-8.

Staff is the only party to these proceedings that objects to this proposal, having already previously objected to the Company adopting any type of discount program in its prior rate case. The Company, LAC, and the AG are all in agreement that Mr. Larkin-Connolly's surrebuttal proposal for a low-income discount program modeled on LAC's original proposal in these proceedings should be adopted in full.

However, LAC points out that Staff also adopts the Company's flawed conclusion that only average residential customers in two counties—Alexander and Pulaski—will have unaffordable bills. Staff's adoption of the Company's affordability analysis without conducting an independent analysis, and without reference to the substantial evidence of unaffordability LAC has placed into the record—and which shows that the Company's current and proposed rates are far less affordable than claimed—is a serious problem and in error, LAC claims.

LAC argues that neither Staff's expert testimony nor briefing offer support for Staff's apparent view that ILAWC's poorest customers do not need discounts and can realistically afford their water service, and Staff provides little reason for opposing expansion. Staff argues that the Existing Program is sufficient, even though Staff also opposed adopting a discount rate for those above the poverty line as part of the Company's prior rate case. Docket No. 22-0210, Order at 181. LAC argues that Staff has ignored evidence in the record that the Company's current and proposed rates are unaffordable. Likewise, Staff's suggestion that this expanded low-income discount program may cost more to implement than the Company estimates is speculation, according to LAC, and relies on an observation in its expert's testimony that is not supported by other evidence or analysis. Staff Ex. 16.0, at 37.

Staff also argues that the low uptake rate of the current low-income discount program shows that more time is needed to assess the Company's current program, which began in the past couple of years. LAC concedes that it is true that participation rates in the current program remain low, at no more than 5% of eligible customers, but argues in response that there are at least three flaws with Staff's argument that low enrollment justifies rejecting a proposed expansion of the Existing Program.

First, LAC points out that Staff relies on the Company's faulty affordability analysis to conclude that its current rates—with and without a low-income discount program—are generally affordable for almost all of the Company's customers. If the Company's affordability analysis is not reasonable (and it is not) then so is Staff's reliance on it.

Second, LAC argues that Staff's argument relies on the assumption that a low uptake rate for the Existing Program justifies keeping it the same as a matter of public policy. However, it is the Commission's duty to ensure that it approves only those rates that are just and reasonable. If an expanded low-income discount program would help to keep rates just and reasonable for the Company's most vulnerable customers, such as those identified by Bolingbrook, an expansion is justified. There is simply no reason, LAC argues, why the Company cannot focus on increasing the number of customers on its Existing Program and implement the Expanded Program that achieves genuine affordability at the same time. LAC argues that Staff's position presents a false choice.

Third, LAC argues that Staff does not present any alternative proposal for increasing participation in the Existing Program in order to improve affordability for those who are currently eligible but have not yet applied. It instead recommends the Company focus on increasing participation without suggesting a plan that is reasonably calculated to meet this goal. Staff ignores the fact that a more generous low-income discount program would itself serve as an incentive for eligible customers to sign up if they know doing so could actually result in a meaningful reduction of their bills.

In response to a Data Request asking what percentage of customers would need to be enrolled in ILAWC's current discount rate program to indicate sufficient interest to justify expansion, Staff stated without explanation that a 35% participation rate would be sufficient. LAC Cross Ex. 2 at 4; Staff Ex. 16.0 at 38. LAC argues that this liberal target participation rate is taken from the 2023 gas discount rates, LAC Ex. 1.0 (CORR) at 45, and is a goal. Notably, LAC points out that 35% enrollment is a higher uptake rate than even Illinois' LIHEAP program sees in a given year (22%), not to mention TANF (13%), the Child Care and Development Fund (31%), or public or subsidized housing programs (33%). *Linda Giannarelli, Urban Institute, What Portion of Illinois Residents Eligible for Safety Net Benefits Receive Those Benefits*, at xi (Jan. 2023). LAC also states that while "the Company's current program is still young," this alone does not mean ILAWC, nor the Commission should bury its head in the sand and "hold off on improving the discount schedules . . . if it can be shown that changes to those schedules can further enhance affordability." ILAWC Ex. 22.00 at 34.

e. Commission Analysis and Conclusion

Based on careful consideration of the record evidence, the Commission adopts the Expanded Proposal, which is the Company's proposal, as modified by the AG, to expand its low-income discount tariff for water and wastewater service previously approved in Docket No. 22-0210, the Company's last rate case.

The Commission notes that the Company, the AG, and LAC all agree on the Expanded Proposal and urge the Commission to adopt it. The record shows that the Expanded Proposal will offer deeper discounts to customers with lower incomes which will potentially improve affordability of service for those customers, including ILAWC's most vulnerable customers. The Commission finds that the proposed eligibility thresholds and discount levels are reasonable, supported by the record, and they are approved.

The Commission notes that the discount rates in the Expanded Proposal are consistent with the discount rates that the Commission approved in the gas rate cases in 2023 and would ensure affordable rates for low-income customers without burdening

other ratepayers. The Commission is not convinced by Staff's arguments that the Commission should reject the Expanded Proposal and instead continue the Existing Program as this Expanded Program will help more ratepayers. The Commission notes Staff's concern about the low participation in the program. With the expanded program more customers will be eligible for a discounted rate and the Company is encouraged to work with the communities and local organizations, and get more customers enrolled in the program. The Commission encourages ILAWC to make all reasonable efforts to ensure eligible customers are aware of and able to make use of the Company's low-income tariff. In its next rate case filing, the Company shall present adequate information for the Commission to determine whether the Company's low-income tariff reduces eligible customers' utility burdens.

The Commission hereby directs the Company to implement the low-income tariff by July 1, 2025. The Company shall have 60 days after the date of this final Order to develop and submit a final estimated implementation timeline consistent with the July 1, 2025 deadline ("Initial Status Report"). The Initial Status Report must include, but shall not be limited to: 1) identification of specific system changes necessary to implement the discount program; 2) any logistical, IT, or system barriers to implementing the program; and 3) how the system changes to accommodate the program are prioritized among other existing IT and/or system upgrades and changes.

The Commission further directs the Company to submit implementation status reports to the Commission every two months after the Initial Status Report until the low-income tariff is fully implemented. These status reports shall be filed as compliance filings in this docket. In the implementation reporting requirements described below, ILAWC must explain the progress toward meeting the July 1, 2025 deadline. The Commission finds that implementing the program by July 1, 2025 is imperative to ensure that ILAWC's most financially vulnerable customers receive assistance as the 2025 summer high water usage season begins. The implementation status reports should summarize the following data:

- A summary of actions taken by the Company to implement the low-income tariff;
- An itemized list of implementation costs;
- A summary of the Company's progress towards 100% implementation (may be expressed in percentages); and
- Projected completion date for implementation of the low-income tariff.

ILAWC should provide the following information (to the extent possible) within 12 months from the date the low-income tariff goes into effect:

- The number of customers enrolling in this tariff for each month of the preceding year by zip code;
- The number of customers that were denied for not meeting eligibility requirements and the reasons for the denial;
- The billed usage for each month of the preceding year by zip code;
- An itemized list of administrative costs incurred to implement and operate each year;

- Description of education and outreach materials (copies of those materials, where applicable) and the mode and how often they are distributed each year; and
- Data on processing time for eligibility from initial request to approval and the discount appearing on the customer's monthly bill.

While the Commission expects the Expanded Proposal to increase affordability across eligible customers, the Commission also anticipates the Company could realize system benefits associated with reduced collections and customer service-related costs. The low-income program could also reduce uncollectibles and related disconnections tied to arrearages. To capture these various savings that could benefit all customers, ILAWC will need to track the low-income program's utility system impacts. ILAWC, Staff, and stakeholders shall use system savings information when evaluating and estimating the value of the low-income program provides for the Company. The Company is directed to track the following information (to the extent possible) if it intends to include system savings in future Company filings:

- The dollar amount of uncollectibles costs that have been reduced on an annual basis subsequent to the implementation of the low-income program;
- The dollar amount of credit and collections costs, and any other Company costs that have been reduced on an annual basis subsequent to the implementation of the low-income program;
- The aggregated Tier 1 (0%-50% FPL) and Tier 2 (51%-100% FPL) customer billing and arrearage data from the two years prior to the low-income program implementation to assess how the low-income program impacts the customer and utility system benefit analysis (prioritizing past data from only Tier 1 and Tier 2 now, but eventually tracking this information for all tiers as the discount program matures);
- How ILAWC has marketed the availability of the low-income program to populations who might qualify for the discount;
- What improvements can be made in those marketing efforts to reach more eligible customers; and
- Other information Staff identifies as needed for incorporating system savings into the low-income program.

ILAWC is also directed to present a report with the above information to the Commission within twelve months from the date the low-income program goes into effect and every year thereafter. The report shall clearly document the level of reduced uncollectibles, credit, and collections costs, and any other reduced Company costs attributed to the low-income program. After the initial report, Staff will review and make a recommendation to the Commission as to whether the low-income discount program is achieving its goals.

H. Other Issues

1. Pension/OPEB Deferral Accounting

a. ILAWC's Position

The Company states that it is requesting an accounting order in this proceeding, for regulatory accounting treatment for pension expenses and OPEB expenses. Specifically, the Company states that it requests that through the conclusion of the Company's next rate proceeding, the Company be permitted to record any amounts above or below the authorized level of the expenses approved in this case for pension and OPEB into separate regulatory asset or liability accounts. ILAWC explains that at the time of the next rate proceeding, the Company will address the recovery of the balances and any request to continue regulatory asset or liability treatment beyond that next base rate proceeding. ILAWC Ex. 6.00 at 11.

The Company elaborates that it would maintain two separate regulatory asset or liability accounts for both pension and OPEB expenses. ILAWC details that at the beginning the first month after rates proposed in this proceeding are in effect, the Company will record the difference between the expense authorized in this case, and the actual expense incurred in accordance with ASC 715 guidelines. ILAWC states that the annual number approved divided by 12 will result in a monthly authorized amount which will be compared to the actual expense for the month. The Company contends that if the authorized number that is in rates is higher than the actual expense, a regulatory liability will be set up to record the difference. ILAWC states that if the actual expense is higher than the authorized amount in rates, a regulatory asset will be recorded. The Company notes that at the time of the next rate case, the Company will present the net amount in these accounts for return to the customers (in the case of a net Regulatory Liability) or for collection in rates (in the case of a net Regulatory Asset) over a to-be-defined period of time. *Id.* at 13.

The Company states that it is not proposing to recover carrying costs on any balances, but is only proposing to record any variance between the base level established in this case and the actual level incurred to an asset or liability account. ILAWC states that any balances will be addressed in the Company's next general rate case where the Commission may determine an appropriate amortization period. The Company notes that at that time, if approved by the Commission, the annual amortization expense will be included. *Id.* at 11.

The Company states that it is making this proposal because the pension and OPEB expenses included in the test year in this case are based upon the actuary report provided by the Company's actuary, WTW, for calendar year 2023, calculated in accordance with Accounting Standards Codification Topic 715 ("ASC 715"). The Company details that the actual amount of the expenses going forward are expected to vary from the test year level based on a number of factors. ILAWC explains that the pension and OPEB expenses are a complex calculation based upon actuarial reports that consider a number of variables. *Id.* at 12. The Company further explains, as shown in the tables on ILAWC Exhibit 6 on page 12, that the level of fluctuation in these expenses from year to year is significant and the expenses can change drastically based on market fluctuations and the factors used to calculate the expenses.

The Company notes, that, pension costs increase 153% from 2022 to 2023 but decreased 222% from 2020 to 2021. OPEB costs increased 101% from 2014 to 2015 and decreased 666% from 2017 to 2018. Thus, the Company states that the expenses are clearly volatile.

ILAWC asserts that its proposed accounting treatment would allow recovery to be addressed in a future case, and if inclusion of the regulatory asset/liability in rates was approved, would ensure that customers only pay for the pension and OPEB expenses incurred, nothing more and nothing less, while allowing the Company to collect the proper revenues to cover a portion of the Company's labor related expenses already experiencing volatility. The Company states that the fluctuation and volatility are outside of the Company's control and results in a significant expense for the Company. ILAWC makes clear that the purpose of the Company's request is to both protect the Company's customers if the expense were to decrease in the future, as well as to allow the Company the opportunity to claim in a future proceeding the increased levels of cost. *Id.* at 13.

ILAWC explains that Staff and the AG oppose the proposal, generally on the grounds that pension and OPEB expenses do not represent a material portion of the Company's revenue requirement for water and wastewater operations, that the Company can control any volatility, and that the volatility in the expenses is not significant enough to warrant treating these expenses in isolation from other expenses. The Company states that Staff also claims that approving the Company's request for regulatory accounting deferral treatment for pension and OPEB expenses could be viewed as single-issue ratemaking. ILAWC Ex. 20.00 at 2.

Regarding the materiality of the pension and OPEB expenses, ILAWC states that the issue here is not the amount of pension and OPEB expenses, the issue here is volatility: the degree to which pension and OPEB expenses fluctuate year over year, and that there is material variance from year to year in these expenses. The Company points out that Staff gives an example, stating that between 2018 and 2019, the pension expense change was \$492,452 or 21.8%, and stating that this is below the Company's materiality threshold of \$500,000. The Company further points out, however, that what was actually stated in the Company's rebuttal testimony was a threshold variance of 5% or \$500,000 as a benchmark for materiality. ILAWC Ex. 18.00 at 4. Therefore 21.8% is material. ILAWC Ex. 20.00 at 5.

Regarding the ability to control volatility, the Company states that it can and has taken cost control actions. *Id.* at 4. ILAWC states that the measures the Company has taken may impact the amount of pension and OPEB expense but they do not remove the volatility. The Company details that pension and OPEB expenses are determined by actuarial analysis. ILAWC points out that some of the assumptions used in the analysis are items such as current interest rates, salary increases, inflation, investments markets, life expectancy. ILAWC states that these can create considerable volatility outside the Company's control. *Id.* at 12.

ILAWC states that regarding single-issue ratemaking, the Company is not proposing that the regulatory asset or liability be used to raise or lower rates in this case, or that the costs be considered outside the context of a full rate case. The Company states that its pension and OPEB expenses will still be subject to detailed ratemaking

review in the Company's next base rate case, where it can be considered in the context of all other costs. The Company states that the Commission will decide what level will be allowed or disallowed in future rate cases on a case-by-case basis. ILAWC contends that therefore, the single-issue ratemaking concern is not warranted.

b. Staff's Position

Staff recommends that the Commission reject the Company's proposal to establish a regulatory asset or liability account for pension and OPEB expense. Staff Ex. 2.0 at 11-12. Specifically, Staff disagrees with the Company that these expenses are volatile enough to justify the extraordinary remedy of a regulatory asset. *Id.* Furthermore, Staff argues that the Commission has rejected similar proposals and similar claims of volatility in the past. *Id.* at 13-15.

Staff disagrees with the Company's proposal. First, the Company's proposal for a regulatory asset or liability treatment lacks specific recommendations for how the Commission should treat the regulatory asset or liability in the next rate case if the Commission were to approve such a regulatory treatment. Essentially, the Company is asking the Commission to blindly approve the regulatory treatment for pension and OPEB expenses. The only detail the Company provides is that the Company does not want carrying costs between this rate case and the next. *Id.* 6.00 at 11. When Staff asked the Company to provide specific details about its proposal, the Company objected on the grounds that it called for speculation. Staff Cross Ex. 1.0 at 1. The responses ILAWC did provide all indicate that these specifics will need to be determined in the Company's next rate case. *Id.* at 2. If the Company has to speculate about the details of its own proposal, then the proposal is not sufficiently detailed enough for the Company to meet its burden of proof and the Commission to approve it.

Second, the Company's proposal would not allow for savings to be preserved and passed back to customers. The Company argues that if "the regulatory accounting treatment which the Company seeks in this case [had] been in place in 2013 and continued through 2023[,] a net of \$30,724,666 savings would have been preserved for pass back to customers." ILAWC Ex. 20.00 at 9. However, the Company later claimed in discovery that "[t]he Company will continue to support the deferral whether the result is an asset or liability position." Staff Cross Ex. 1.0 at 1. This deferral treatment would not allow for any of those amounts to be refunded to customers; instead these amounts will be held continuously into future rate cases. The Company even "reserves the right to contest the treatment of OPEB and pension liability balances in rate base in future cases." *Id.*; see also ILAWC Ex. 32.00 at 3. Staff states that the Company fails to propose an amortization period or a specific refund policy. Staff Cross Ex. 1.0 at 2. Taken together, this evidence demonstrates that the Company's proposal will not allow for any savings to be preserved and passed back to customers.

Third, these costs are not sufficiently volatile enough to justify the extraordinary remedy of a regulatory asset. The Company contends that the pension and OPEB costs are volatile even though the 10-year average fluctuations of these costs are only (\$262,903) for pension and (\$334,600) for OPEB. Staff Cross Ex. 1.0 at 10. Furthermore, pension and OPEB expense represent an insignificant portion of the Company's overall revenue requirement. In each of the last three ILAWC rate cases, pension and OPEB

expense equals less than 2% of the authorized revenue requirement. Staff Ex. 2.0 at 10. For a cost to be volatile, the fluctuations have to be material. *See, e.g., Cent. Ill. Light Co.*, Order on Reh'g, Docket No. 90-0127 at 28 (Aug. 2, 1991). Because of the insignificance of these costs as a part of the total revenue requirement, they cannot fluctuate enough to justify the use of a regulatory asset. *Id.* at 11.

Fourth, the Act does not explicitly permit the use of a regulatory asset for similar overhead costs. The Company and Staff agree that, in general, pension and OPEB expenses are overhead costs of its eligible employees. Staff Cross Ex. 1.0 at 7. In accounting, overhead costs are not directly linked to a specific operating cost and are allocated to the Company's operating expenses. Based on a review of the Act, there are no overhead expenses that are expressly permitted to receive regulatory asset treatment. The Company did not substantiate the pension and OPEB costs are material but instead stated that the expenses are unusual and the costs are prudent and reasonable. Staff Cross Ex. 1.0 at 8. Staff does not claim that the pension and OPEB costs are not reasonable and prudent; all costs approved in a revenue requirement must be determined to be prudent and reasonable. Simply being reasonable and prudent does not imply that the pension and OPEB costs should receive this kind of regulatory treatment, nor does being "unusual" rise to the level of volatile, unpredictable, or fluctuating required to receive rider treatment.

Fifth, pension and OPEB expense are within the control of the Company. As an initial matter, the Company itself offered these benefits to its employees. Even if the Company argues that it cannot now revoke those benefits, the Company had control of those costs when it offered those benefits. This is very different than other instances where the Commission has found that costs are truly outside the Company's control, such as environmental cleanup costs or expenses arising from storms. Docket No. 90-0127, Order on Reh'g at 51; *Commonwealth Edison Co.*, Docket No. 13-0639, Order at 14-15 (Apr. 26, 2012).

Furthermore, the Company has itself demonstrated that it is able to control costs by implementing cost savings measures. ILAWC Ex. 20.00 at 4-5. Staff questions whether the Company would have implemented these important cost savings measures if the Commission had approved ILAWC's request for a pension rider when it proposed one eight years ago. Staff Ex. 2.0 at 12-13.

Sixth, the Commission has rejected similar proposals in the past. In Docket No. 20-0810, North Shore proposed to amortize prior pension settlement expenses and for the prior period pension expenses to be included in the revenue requirement, with the amortization period based on the average remaining service life of the underlying pension plan. Docket No. 20-0810 at 22-24. North Shore then proposed to use prior period expenses to establish five new regulatory assets, each with its own ten-year amortization period, and to include the unamortized balances in rate base. *Id.* Staff recommended this proposal be rejected because, among other reasons, it was single-issue ratemaking; specifically, deferring and amortizing an operating expense causes revenue and expenses to be improperly matched as one year's expenses is netted against a different year's revenue. *Id.* at 27. The Commission agreed with Staff because North Shore's proposal would improperly include expenses incurred outside the test year. *Id.*

Staff submits that the same result would occur if the Commission approved the Company's proposal in this docket. By creating a regulatory asset, the Commission would create a liability against ratepayers to be paid back to the Company later. The use of a regulatory asset does not allow parties an opportunity to examine other Company costs and expenses and determine whether an increase in pension and OPEB expense results in a decrease in some other cost or expense. In effect, it allows pension and OPEB expense to increase, and nets that against a different year's revenue.

Seventh, the Commission has rejected similar claims that costs like these are volatile. In the Company's last rate case, the Commission cautioned against approving mechanisms that "would arguably place a greater risk on the ratepayer for the benefit of stakeholders because ILAWC would be able to immediately recover costs, including a return to investors, under the rider subject to a reconciliation. ... [If] existing rates are insufficient ... the Company may elect to file a rate case." Docket No. 22-0210, Order at 173, 178-79; see also Docket No. 23-0066, Order at 215. Sound ratemaking policy does not consider a single ratemaking component alone; rather, it analyzes all costs, expenses, and capital structure to set rates for an appropriate test year. Staff Ex. 2.0 at 15.

Eighth, the Company's proposal would result in difficulties determining reasonable amounts to be included in future revenue requirements. Staff Ex. 11.0 at 14. All the cumulative pension and OPEB transactions between rate cases would need to be analyzed and verified by the Commission, and such analysis is incredibly complex. Not only would this process take a lot of time, but errors are likely to occur, much like they did in this docket. *Id.*

Finally, the Company's proposal improperly shifts all risk from the Company to its ratepayers. Staff Ex. 11.0 at 14. The Company claims it will assume the risk that pension and OPEB expense are less than authorized. Staff Cross Ex. 1.0 at 14. However, the proposed regulatory asset treatment would alleviate the risk from the Company and pass all risk to the ratepayer. The Company does not allow new employees to receive pension benefits and has shifted to a 401(k), which alleviates the Company of all risk and passes the volatility risk to its employees. Staff Cross Ex. 1.0 at 15. This proposal could result in multiple years' worth of pension and OPEB expense being recovered in one future test year, which is exactly why the Commission rejected North Shore's proposal in Docket No. 20-0810.

For these reasons, Staff recommends the Commission reject ILAWC's proposal to establish a regulatory asset for pension and OPEB costs.

c. AG's Position

The AG asks the Commission to reject the Company's proposal concerning creation of a regulatory asset for pension and OPEB expenses. AG Ex. 3.00 at 31–33. The AG points out that the deferral and amortization the Company requests (1) removes the Company's incentive to manage expenses while increasing consumer costs, and (2) violates both the test year rule by adding costs from prior years to test year expenses and rate base and the rule against single-issue ratemaking by adding costs for one expense item from several years to the test year without regard to the aggregate costs and revenues of the utility. The AG asserts that ILAWC asks the Commission for special treatment of its pension and OPEB expenses so that ILAWC can recover its total pension

and OPEB expenses from its customers, even when those costs exceed the expense level allowed as part of ILAWC's revenue requirement. ILAWC Ex. 6.00 at 12–14. The Company requests that it be permitted to record amounts above or below the authorized level of expenses into separate regulatory asset or liability to be addressed at the time of the next base rate proceeding. ILAWC IB at 171–172.

The Company describes this as requesting the variance between the base level and the actual level. ILAWC IB at 172. The AG explains that in reality, the Company's request is to account for increases in costs and would allow it "the opportunity to claim in a future proceeding the increased level of costs." ILAWC Ex. 6.00 at 13. The Company also asserts that this would "protect customers if the expense were to decrease in the future ..." *Id.* at 13. The AG contends that ratepayers, however, will not necessarily benefit. Instead, they will be paying for both the pension and OPEB expense from the current rate case and the amount of pension and OPEB expense that exceeds the authorized amount every year, deferred and amortized monthly. ILAWC Ex. 6.00 at 13–14. As a result, the risk of cost increases is shifted entirely from the Company to ratepayers. The AG argues that the Company's proposal likewise wrongly obliterates any incentive for it to control costs between rate cases.

The AG notes that isolating pension and OPEB expenses for deferral and amortization removes those costs from the ratemaking formula, which aggregates costs in a single test year and sets a revenue requirement based on total annual cost. *BPI II*, 146 Ill. 2d at 244–245; *Citizens Util. Co. v. Ill. Com. Comm'n*, 124 Ill. 2d 195, 200–201 (1988). According to the AG, if the deferral and amortization requested in this docket is allowed by the Commission, then Company management would lose the incentive to control these costs between rate cases because it would be assured that ratepayers would pay whatever cost was incurred, regardless how high those costs go and regardless whether, in the aggregate, ILAWC managed its other costs so that these costs were covered in rates. The AG notes that allowing for the Company's request would also wrongly skew the ratemaking bargain because the Company could isolate one set of costs without regard to total revenues and profit. Thus, ratepayers will lose both the benefit of ILAWC's efforts to control these particular costs and the benefit that would arise if the Company achieved other efficiencies to offset increased pension and OPEB costs.

The AG maintains that under ILAWC's proposal, if ILAWC requests another rate increase in the near future and pension and OPEB expenses decrease, then the test year expense would be reduced but rates would include a credit for amortization for past pension and OPEB decreases. Ordinarily, a cost reduction would be one cost input among thousands that would affect whether the Company seeks a rate increase and not isolated from the Company's aggregate financial position, providing a benefit to its customers between rate cases. If the pension and OPEB costs exceed the amount requested in any year before the next test year, then the excess amounts would be added to customers' rates, thus increasing the cost beyond the test year amount. If deferrals and amortizations accumulate in the future, then ILAWC's captive ratepayers will face paying current and past costs which will drive up future rates.

The AG notes that utility rates are established on the basis of a test year. In Part 285 of the Commission's rules, a utility seeking to increase rates must present extensive data showing its costs for a 12-month period. 83 Ill. Adm. Code 285.1000. The utility has

the option of choosing a future or a historical test year. 83 Ill. Adm. Code 287.20. The test year is used to accurately determine the utility's revenue requirement and to prevent a utility from overstating its revenue requirement by mismatching low revenue data from one year with high expense data from a different year. *BPI I*, 136 Ill. 2d 192, 219; *BPI II*, 146 Ill. 2d at 238.

The AG notes that the prohibition against single-issue ratemaking is related to the test year rule. As the Illinois Supreme Court explained in *BPI II*:

The rule against single-issue ratemaking recognizes that the revenue formula is designed to determine the revenue requirement based on the aggregate costs and demand of the utility. Therefore, it would be improper to consider changes to components of the revenue requirement in isolation. Often times a change in one item of the revenue formula is offset by a corresponding change in another component of the formula. For example, an increase in depreciation expense attributable to a new plant may be offset by a decrease in the cost of labor due to increased productivity, or by increased demand for electricity. ... In such a case, the revenue requirement would be overstated if rates were increased based solely on the higher depreciation expense without first considering changes to other elements of the revenue formula. Conversely the revenue requirement would be understated if rates were reduced based on the higher demand data without considering the effects of higher expenses.

BPI II, 146 Ill. 2d at 244-245.

ILAWC continues to argue the volatility of the expenses and its lack of control despite measures it has taken to control cost. ILAWC IB at 174–175. According to the AG, whether the expenses fluctuate should not exclude them from the ratemaking formula. ILAWC asks the Commission to isolate its pension and OPEB expenses, and to add the higher costs from former years to the revenue requirement in future years to assure cost recovery of these isolated expenses. The revenue requirement is based on total costs. Savings or changes in other aspects of ILAWC's operations can be expected to affect both the pension and OPEB expense and the overall profitability of the enterprise, whether they are a material expense.

The AG contend that the deferral and amortization that ILAWC requests would isolate these costs so that they are recovered from future ratepayers even if the Company's revenues in the prior years were, in the aggregate, sufficient. The Company argues that this is not single-issue ratemaking because the expenses will be reviewed in the next full rate case. The AG explains that this argument misunderstands single-issue ratemaking. The expenses may be reviewed, but the AG argues that such expenses will still be mismatched by the Company outside of rate case test year without regard to aggregate costs, which is single-issue ratemaking and a violation of the test year rule. As the *BPI II* court stated, "Depreciation recognizes the cost of that portion of the asset which is expended in a given year, regardless of the time period in which the construction costs

were actually paid.” *BPI II*, 146 Ill. 2d at 239. The AG iterates that the purpose of the test year is to match the utility’s costs with the benefits produced by those costs in a single year snapshot.

The AG maintains that the deferral and amortization of pension and OPEB costs requested by ILAWC violates the test year rule and is single-issue ratemaking, which violates Illinois law. Further, it removes the Company’s incentive to manage expenses while increasing consumer costs. For these reasons, the AG encourages the Commission to reject the Company’s request to create a regulatory asset for pension and OPEB expenses.

d. Commission Analysis and Conclusion

The Company requests that through the conclusion of the Company’s next rate proceeding, the Company be permitted to record any amounts above or below the authorized level of the expenses approved in this case for pension and OPEB into separate regulatory asset or liability accounts. ILAWC explains that in the next rate case proceeding, the Company will address the recovery of the balances and any request to continue regulatory asset or liability treatment beyond that next rate case proceeding.

Staff argues that these costs represent an insignificant portion of the Company’s overall revenue requirement, the Company has control over these costs, a regulatory asset would discourage further cost control measures, the 10-year average fluctuations of these costs are not sufficiently volatile to justify a regulatory asset.

The AG states that under the Company’s proposal, not only would ratepayers pay for both the Pension and OPEB expense from the current rate case, customers will pay for the amount of Pension and OPEB expense that exceeds the authorized amount every year, deferred and amortized monthly.

The Commission agrees with Staff and the AG that the Company’s proposal is not in the best interest of ratepayers. The Commission does not agree that the expenses are volatile enough to be a regulatory asset. A regulatory asset is a future debt of the ratepayer that can be passed on together with interest to ratepayers. The Commission notes that the Company failed to provide the specific details about its proposal. Maintaining the current review in a rate case allows the Commission to determine whether the costs are just and reasonable. The Company’s proposal would remove incentives for it to minimize the pension and OPEB costs through changes to the plans or other cost mitigation measures, since this proposal would accommodate any cost increases. This would not lead to savings for ratepayers. This could also remove the Company’s incentive to manage expenses while increasing consumer costs. Therefore, the Company’s proposal is rejected.

IV. UNCONTESTED ISSUES

A. Rate Base

1. Adjustment for 2023 Actuals

ILAWC states it updated rate base to include a full 12 months of actuals through September 2023. ILAWC Ex. 18.00 at 6. The Company notes that its original filing used only a 9-month period as the starting year for its forecast of Service Company expense.

This correction accounts for \$9 million of ILAWC's revenue requirement update and is undisputed among the parties in this proceeding. Therefore, the Commission finds that ILAWC's adjustment to rate base for 2023 actuals is reasonable, uncontested, and it is approved.

2. Pension/OPEB Liability

ILAWC explains that Staff proposed adjustments to the rate base, net of accumulated deferred income taxes, including the Company's pension and OPEB liabilities as a reduction to rate base stating that, "the pension and OPEB funds have liability balances that represent cost-free sources of capital." Staff Ex. 11.0 at 4. To limit the issues in this proceeding, the Company states that it has accepted Staff's proposed adjustments which are presented in Staff Schedule 11.02. ILAWC 32.00 at 3. The Commission finds that this adjustment is reasonable, uncontested, and it is approved.

3. Adjustment for Property to be Sold

ILAWC states that Staff witness Siebert proposed an adjustment to remove assets the Company has requested Commission approval to sell in Docket Nos. 24-0095 and 24-0096 from rate base. ILAWC Ex. 32.0 at 7. The Company explains that its proposal to sell land assets in Docket Nos. 24-0095 and 24-0096 was recently approved, although there are no contracts or agreement to sell these assets. ILAWC Ex. 19.00 at 7-8. ILAWC further explains that since the assets in Docket No. 24-0095 are still being used by ILAWC employees to provide service to its customers, the Company does not agree that these assets should be removed from rate base. However, in the interest of limiting the issues in this proceeding, the Company states that it is willing to agree to remove the assets listed in Docket Nos. 24-0095 and 24-0096 from rate base. ILAWC Ex. 32.00 at 8. The adjustments are presented on ILAWC Exhibit 32.02. The AG agreed with Staff's proposed adjustments. AG Ex. 3.00 at 29-30. The Commission understands this issue to be uncontested and finds this is reasonable and it is approved.

4. 2012-2020 Capitalized Incentive Compensation Previously Disallowed

ILAWC states that the AG proposed an adjustment, Schedule A-3, which removes capitalized performance compensation based on financial metrics from the years of 2012 through 2020 that had been removed in the Company's prior rate cases. The Company explains that while it continues to believe it is appropriate to capitalize a portion of its performance compensation, the Company agrees to the adjustment presented on Staff Schedule A-3 to limit the contested issues in this proceeding. Thus, the Company states it has removed the amounts from rate base, shown on Schedule B-2.4, contained within ILAWC Exhibit 32.03. The Commission understand that no parties object. The Commission finds that this is reasonable and it is approved.

5. Corrections to Accumulated Deferred Income Taxes ("ADIT")

ILAWC states that both Staff and the AG proposed adjustment to reduce rate base for accumulated deferred income taxes ("ADIT") related to net utility plant acquisition adjustments ("UPAA"), net goodwill, and deferred rate case expense. Staff Ex. 2, Attach. B; AG Ex. 1.00 REV. PUBLIC at 18. ILAWC further states that the Company has agreed

to this adjustment. The Commission understands that no parties object. The Commission finds that this adjustment is reasonable and it is approved.

6. Deferred Charges Corrections

ILAWC states that Staff proposed adjustment to the rate base for deferred charges corrections which are presented on Staff Schedule 2.03. Staff Ex. 2.0 at 5. ILAWC agrees with Staff's proposal. ILAWC Ex. 19.00 at 3. The Company notes that no other party objects. The Commission finds that this adjustment is reasonable and it is approved.

7. Reclassification of Upgrades to Plant Accounting Software

ILAWC states that Staff proposed an adjustment to the reclassification of the upgrades to the Company's plant accounting software costs from deferred charges to plant in service. The adjustment is presented on Staff Schedule 2.04. Staff Ex. 2.0 at 5. The Company has accepted this adjustment. ILAWC Ex. 19.00 at 3. ILAWC notes that this is uncontested among the parties. The Commission finds that this adjustment is reasonable and it is approved.

8. Construction Work in Progress

The Company states that it has accepted the AG's adjustment to construction work in progress ("CWIP"), as reflected in the Company's Part 285 Schedule. The Company further states that no other party objects to this adjustment. This Commission finds this is reasonable and it is approved.

9. Mounds Acquisition Adjustment

The Company states that it no longer needs the adjustment to the rate base presented on ILAWC Exhibit 31.04 which relates to the Mounds acquisition, valued at \$634,890, following the City of Mounds' termination of the acquisition agreement on July 8, 2024. ILAWC Ex. 31.00 Rev. at 27. The Company provided a separate cost of service study and rate design with Staff Data Request CB 11.02 reflecting the removal of Mounds. The Commission finds that this is reasonable and it is approved.

10. AFUDC on Post-Acquisition Improvements

The Company states that it has accepted the AG's adjustment to depreciate post-in-service allowance for funds used during construction ("AFUDC") on post-acquisition improvements on acquired systems at the overall effective book depreciation rate of 2.86% for water and 2.89% for wastewater. AG Ex. 1.00 REV PUBLIC at 33-34; ILAWC Ex. 19.00 at 10. The Commission understands that no other party objects. The Commission finds that this is reasonable and it is approved.

11. ADIT Proration

ILAWC states that Staff agrees to the Company's ADIT proration as presented in the Revised Schedule B-9, which eliminates the effect of averaging the beginning and ending balance after the proration, so that the amount included in the ending balance is simply the prorated 2025 activity of \$2,708,614. ILAWC Ex. 32.00 at 5. The Commission finds that this is reasonable and it is approved.

12. Corporate Alternative Minimum Tax

ILAWC states that the Corporate Alternative Minimum Tax (“CAMT”) imposes a 15% tax on adjusted financial statement income (“AFSI”), for which applicable corporations will be required to pay the greater of the 15% of AFSI or their calculated regular federal tax liability. ILAWC explains that based on the current interim Internal Revenue Service guidance and forecasted projections, American Water and its subsidiaries, including ILAWC, will be subject to CAMT. The Company’s approach to CAMT is set out in its Direct Testimony, ILAWC Exhibit 5.00 at 8-11. The Company notes that no party in this proceeding addressed CAMT. The Commission finds that the Company’s proposed approach is reasonable and it is approved.

13. Investment Tax Credits (“ITC”)

ILAWC explains that because the Company had a net operating loss carryforward since 2008, the state ITC credit each year accumulated but did not start amortizing since the Company was not realizing the benefit of the credit and could not pass back the benefit to customers until that net operating loss carryforward was exhausted. ILAWC Ex. 5.00 at 8-9. ILAWC states that this was done with the 2021 income tax return filing. ILAWC Ex. 5.00 at 8-9. The Company further states that the cumulative credits are now able to be amortized and passed back to customers in rates. ILAWC Ex. 5.00 at 8-9. Accordingly, the Company notes that it increased the annual state ITC amortization from \$100,715 to \$180,350. ILAWC Ex. 5.00 at 12. The Commission understands that no party objects. The Commission finds this to be reasonable and it is approved.

B. Operating Expenses and Revenues

1. Employee Benefits Expense

The Company states that it proposed Employee Benefits for the annual periods ending each December, from 2022 through 2025. ILAWC Ex. 7.00 at 12. Staff recommended an adjustment for the Employee Benefits Expense in Staff Exhibit 2.0, Staff Schedule 2.01 for the expense and rate base for the capitalized amount. Staff Ex. 2.0 at 4. Staff proposed a similar adjustment on Staff Exhibit 11.0, Schedule 11.01. Staff Ex. 11.0 at 3. The Company accepted the adjustment and revised its Schedule C-11.3. ILAWC Ex. 21.00 Rev. at 2. The Commission understands this issue is uncontested among the parties in this proceeding. The Commission finds the proposal to be reasonable and it is approved.

2. Mounds Acquisition Adjustment

The Company states that it has removed \$634,890 related to the Mounds acquisition from the revenue requirement, following the City of Mounds’ termination of the acquisition agreement on July 8, 2024. ILAWC Ex. 31.00 Rev. at 27; ILAWC Ex. 31.04 The Company notes that it has provided a separate cost of service study and rate design with Staff Data Request CB 11.02 reflecting the removal of Mounds. The Commission finds that this is reasonable and it is approved.

3. Depreciation Rates

ILAWC states that Staff agrees with the Company’s proposed depreciation rates and has recommended that the depreciation rate tables be included as appendices to the

Commission's Final Order in this proceeding. ILAWC Ex. 31.00 Rev. at 28. The Company states that it accepts Staff's recommendation. The Commission finds Staff's recommendation to be reasonable and it is approved.

4. Lobbying Expenses

ILAWC states that Staff proposed an adjustment to remove \$5,051 in lobbying expenses. ILAWC Ex. 31.00 Rev. at 24; Staff Ex. 4.0 at 2; Staff Sch. 4.01. The Company explains that although the Company interprets these expenses under Section 9-224 of the Act as not qualifying as lobbying expenses, in the interest of narrowing the issues in this proceeding, the Company accepts Staff's adjustment. ILAWC Ex. 31.00 Rev. at 24. The Commission finds that this is reasonable and it is approved.

5. Charitable Expenses

ILAWC states that several Illinois-based charities and programs have received support from the American Water Charitable Foundation, including park restoration, canoe and kayak trail creation, food pantries and water splash parks. ILAWC notes that charitable expenses are uncontested among the parties. ILAWC Ex. 1.00 at 29. The Commission finds the Company's charitable expenses reasonable and they are approved.

6. Advertising Expenses

The Company states that Staff proposed an adjustment to remove \$4,463 in advertising expenses. Staff Ex. 4.0 at 4-5, 80-132. The Company accepts Staff's proposal. ILAWC notes that no other party objects. ILAWC Ex. 18.00 at 8. The Commission finds this adjustment reasonable and it is approved.

7. Condemnation Costs

ILAWC states that the AG proposed an adjustment to remove \$500,000 in condemnation costs from Miscellaneous expense. AG Ex. 3.00 at 3. The Company explains that it expects these costs to be recoverable if incurred during a rate case test period and reserves the right to seek recovery of such costs in future proceedings. ILAWC Ex. 18.00 at 8. Therefore, the Company agrees with the AG's proposal. The Commission finds the AG's proposal reasonable and it is approved.

8. Service Company Charges

ILAWC states that Staff recommends that the Commission find that AWWSC's service charges to ILAWC are just and reasonable. ILAWC Ex. 18.00 at 8. Additionally, ILAWC states that Staff withdrew its recommendation related to a third-party audit of AWWSC and withdrew recommendation to remove the CAS expense forecast to be charged to ILAWC. ILAWC Ex. 18.00 at 8; Staff Ex. 15.0 at 2. The Company explains that these were based on concerns AWR related costs were being allocated to ILAWC and were reflected in the test year that have now been resolved. ILAWC notes that there are no objections from the parties. The Commission finds this to be reasonable and the service charges are approved.

9. Rate Case Expense (Baryenbruch)

ILAWC stated that Staff proposed an adjustment to remove the fees for ILAWC witness Baryenbruch from rate case expense but withdrew its proposed adjustment on rebuttal. The Company notes that Staff now finds the Company's rate case costs of \$3,296,632 to be just and reasonable. Staff Ex. 15.0 at 7. Thus, and as also explained in Section III.B.2 above, the Commission finds the Company's rate case expense is reasonable and it is approved.

C. Cost of Capital

See Section III.C above.

D. Cost of Service

1. Demand Study

ILAWC states that the Commission's Order in Docket No. 22-0210 directed the Company to "conduct a new demand study that includes load characteristics of the fifteen newly acquired water systems and fourteen wastewater system in this case, and any additional systems the Company acquires before the next rate case...." Docket No. 22-0210, Order at 195. The Company explains that it is currently in the process of completing that updated demand study as directed. ILAWC Ex. 3.00 at 46.

ILAWC states that to complete the updated study, the Company is using a similar methodology as the one used for the demand study that the Company proposed, and the Commission approved, in Docket No. 11-0058. The Company notes that the demand study is a direct measurement study to develop capacity factors by customer class that are determined for each sampled district based on maximum day and maximum hour demands actually experienced by the sampled customers within each respective customer class. ILAWC states that it has undertaken a statistical analysis of each zone and customer class to determine the sample size that can be considered representative of each customer class within each sampled district and selected approximately 1,600 representative customers. ILAWC Ex. 3.00 at 46.

Similar to the demand study carried out in Docket No. 11-0058, the Company states that it is utilizing smart meter technology to record the consumption information from the sampled customers. For this demand study, the Company notes it will utilize its existing smart meters or deploy smart meters to allow for a more efficient collection of data during the multi-year collection period. ILAWC Ex. 3.00 at 46-47.

The Company further states that the demand study will also include customer representation from previously acquired systems and any system acquired before this case. ILAWC explains that representative customers from seventeen systems will be included within the Residential and Commercial Classes samples groups for the demand study.

Similar to the previous demand study, the Company states that it has proposed to collect customer consumption data over a period of not less than three years to determine the peak maximum day and peak maximum hour for each rate zone and customer class. The Company points out that a longer study allows for a better understanding of

consumption and allows for an averaging of environmental conditions that may affect the customers' usage over a short period.

Given that the demand study has not yet been completed; and given that the peaking factors used in the last rate case are out of date, the Company states that it developed maximum day and maximum hour capacity factors based on AMI data from ILAWC's affiliate in Missouri, using AMI data from Missouri-American Water Company's St. Louis County service territory. ILAWC states that this issue is discussed in more detail above in Section III.D.1. ILAWC Ex. 8.00 at 49. The Commission finds the Company's approach to determining demand factors for this case is uncontested, reasonable and it is approved. The Commission also finds the Company's approach to the ongoing demand study for this case is uncontested, reasonable and it is approved.

2. Billing Determinants

In this proceeding, the Company states that it is proposing billing determinants for the 12-month period ending December 31, 2025, that necessarily must consider long-term trends in use per customer for residential and commercial customer groups, the impacts of weather on customer usage, and the impact of the COVID-19 public health emergency on water consumption for ILAWC's water customers. The Company explains that these considerations require the Company to analyze water consumption and determine (1) if there is a significant and pervasive rate of decline in water use per customer over time; (2) if there are significant relationships between water consumption and weather conditions in the Company's service territory and there was different from normal in the twelve month period ended September 30, 2023, which the Company is using as the base year for revenue requirement calculations; and (3) if the COVID-19 public health emergency has had a significant impact on water consumption for ILAWC's customers, again to determine if a COVID-related adjustment to usage is appropriate for the Test Year. ILAWC Ex. 8.00 at 81-82.

ILAWC states that the parameters and relationships necessary to analyze the impact of declining use, weather, and COVID-19 on water consumption for ILAWC's customers are estimated through the use of statistical linear regression modeling. The Company explains that a detailed description of the methodology employed for that analysis is provided in the direct testimony of Company witness Rea. ILAWC Ex. 8.00 at 83-100.

ILAWC explains that the statistical analysis of usage for the residential and commercial classes shows that once weather effects and the one-time effects of COVID-19 have been accounted for, there is a significant downward trend in usage for these customer classes. ILAWC further explains that the charts set forth on page 101 of ILAWC Exhibit 8.00 show use per customer for each class for the 10 years ending September 2023, adjusted for weather impacts and COVID-19 impacts. ILAWC Ex. 8.00 at 100.

ILAWC points out that these charts and the supporting analysis demonstrate that there has been a significant and pervasive decline in normalized use per customer for residential and commercial in the ILAWC service territory. The Company notes that its modeling normalizes for weather and COVID-19 and shows that there has been a pervasive decline in usage for these classes over the past 10 years. The historical trends

in adjusted monthly use per customer for the residential and commercial will continue through the relevant periods going forward. ILAWC Ex. 8.00 at 101-102.

The Company notes that it provided an updated revenue requirement on rebuttal that included certain changes to billing determinants. Specifically, for water service, the Company states that it corrected some formula errors in its present rate revenue calculations that resulted in changes to billing determinant steps for Villa Grove and Jerseyville water rates. ILAWC explains that this resulted in both changes to billing determinants and changes in present rates for water service, again associated with revenues for Villa Grove and Jerseyville. Additionally, the Company states it made updates to contract rates for large Interurban customers that affect present rate revenues for those customers. For wastewater service, the Company states it made updates to present rates for revenues in Piasa, Shiloh, and Tolono. The Company points out that these changes do not affect billing determinants but do affect present rate revenues. With the exception of the changes in billing determinants for Villa Grove water service to accommodate the update in billing determinant steps, the Company states that none of these changes affected proposed rates. ILAWC Ex. 22.00 at 60.

The Commission finds the Company's development of billing determinants is uncontested, reasonable, and its use of linear regression models to establish billing determinants in this docket is approved.

E. Rate Design

1. Removal of Riders from Sales for Resale Class

In its initial filing, the Company states it proposed various revisions to its existing tariffs, including one that makes Riders QIP, VBA, and BDE inapplicable to Sales for Resale Service Class customers. ILAWC Ex. 4.00 at 28-29; ILAWC Ex. 4.07. The Commission understands that no party contested the Company's proposed revision to its riders removing Sale for Resale customers. The Commission finds this revision reasonable and it is approved.

2. Public Fire Charges

ILAWC states that Staff agrees with the Company's proposal for an increase of 38% for public fire rates for Central Zone customers and an increase of 44% for Pekin district customers which moves Pekin public fire charges closer to cost of service for those charges. ILAWC Ex. 8.00, 65; ILAWC Ex. 8.06, 3-5; Staff Ex. 7.0 at 4, 26-28. The Company notes that no party to this proceeding objects to the Company's proposed public fire charges. The Commission finds that this is reasonable and it is approved.

F. Low-Income Tariff

1. Reporting Requirements

As discussed in the rebuttal testimony of Staff witness Boggs, the Company states it has agreed to provide the following annual reporting requirements through an Information Sheet related to its proposed low-income program:

- The number of participants enrolling in each Tier for each month of the preceding year by zip code;

- The billed usage in each Tier for each month of the preceding year by zip code
- Itemized list of administrative costs incurred to implement and operate the Low-Income Discount Program for each year since approval of the program
- Description of educational and outreach materials (plus copies of those materials where applicable); and
- Data on processing time for each Tier, from initial request to approval, under each of the options available to customers requesting the low income credit (online, by phone, or by mail).

Staff Ex. 16.0 at 34-35, 38. The Commission understands this issue to be uncontested. The Commission finds the reporting requirements are reasonable and they are approved.

G. Other

1. Depreciation Study

The Company states it conducted a depreciation study used in this proceeding, which was calculated as of December 31, 2022. ILAWC Ex. 11.00 at 2. ILAWC explains that this study has been accepted by the parties. Staff recommends that Staff Exhibit 2.0, Attachments F and G be attached as appendices to the Final Order enter in this proceeding with any changes based on the final Commission decisions, if any. Staff Ex. 2.0 at 18-19. The Company did not object to this recommendation. Thus, the Commission finds the Company's proposed depreciation rates presented in the depreciation study prepared for this proceeding are reasonable and they are adopted. The Commission also finds Staff's recommendation is reasonable and it is adopted.

2. Original Cost Determination

The Company states it has accepted Staff's recommendation that the Commission conclude and make a finding in the Final Order of this proceeding concerning an original cost determination. Staff Ex. 2.0 at 20. Additionally, the Company states it proposes to update the original cost determination from \$2,855,112,407, which represents the Company's plant balance as of September 30, 2023, to \$3,021,495,669, which represents the Company's plant balance as of December 31, 2023. *Id.*; ILAWC Ex. 19.00 at 11. The Commission adopts the Company's updated original cost determination.

3. Gross Revenue Conversion Factor

The Company in its rebuttal testimony did not object to a zone-specific gross revenue conversion factor proposed by the AG and Staff. AG Ex. 1.00 REV at 4; Staff Ex. 1.0 at 6-7. Thus, the Commission finds the zone-specific gross revenue conversion factor to be reasonable and it is adopted.

4. Qualified Infrastructure Plant

ILAWC states that it supports Staff's recommendation to include amounts for NetQIP and NetDep by rate zone in a Findings and Orderings paragraph in the Final Order in this proceeding to document the QIP costs included in this proceeding and agrees with Staff's recommended language. Staff Ex. 2.0 at 16-18.

ILAWC further states that it also supports Staff's recommendation to include a Findings and Orderings paragraph in the Final Order of this proceeding concerning the future review of QIP costs and agrees with Staff's recommended language. ILAWC Ex. 19.00 at 10-11; Staff Ex. 2.0 at 16-17. The Commission finds that the recommended language is uncontested, reasonable, and it is adopted below.

V. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) Illinois-American Water Company is in the business of furnishing water and sewer service to the public in various areas in the State of Illinois and is a public utility as defined in the Act;
- (2) the Commission has jurisdiction over the parties hereto and of the subject matter herein;
- (3) the findings and conclusions stated in the prefatory portion of this Order are supported by the evidence of record and are hereby adopted as findings of fact; Appendices A through D and Schedules 9 through 14 attached hereto provide supporting calculations for various conclusions in this Order;
- (4) the test year in this proceeding is a future test year consisting of the 12 months ending December 31, 2025; this test year is appropriate for purposes of this proceeding;
- (5) for purposes of this proceeding, Illinois-American Water Company's net original cost rate bases are set forth in Appendices A through D attached hereto;
- (6) the \$3,021,495,669 original cost of plant for Illinois-American Water Company at December 31, 2023 should be approved as the original cost of plant;
- (7) the projected 2024 and 2025 QIP amounts for Central Water included in base rates are comprised of Utility Plant in Service of \$40,477,879 and \$149,607,677, respectively; related accumulated depreciation of \$233,669 and \$2,767,151, respectively; related accumulated deferred income tax of \$1,918,483 and \$9,973,505, respectively, for a NetQIP – Rate base of \$38,325,727 for 2024 and \$136,867,021 for 2025; and \$767,085 and \$4,355,876 in annualized depreciation expense, respectively;
- (8) the projected 2024 and 2025 QIP amounts for Pekin Water included in base rates are comprised of Utility Plant in Service of 2,830,395 and \$9,357,888, respectively; related accumulated depreciation of \$13,075 and \$143,921, respectively; related accumulated deferred income tax of \$180,699 and \$892,198, respectively, for NetQIP – Rate base of \$2,636,621 for 2024 and \$8,321,769 for 2025; and \$43,085 and \$223,738 in annualized depreciation expense, respectively;
- (9) the projected 2024 and 2025 QIP amounts for Central Wastewater included in base rates are comprised of Utility Plant in Service of \$6,371,899 and

\$29,780,136, respectively; related accumulated depreciation of \$24,997 and \$426,487, respectively; related accumulated deferred income tax of \$88,692 and \$1,568,361, respectively, for NetQIP – Rate base of \$6,258,210 for 2024 and \$27,785,288 for 2025; and \$84,916 and \$717,091 in annualized depreciation expense, respectively;

- (10) the projected 2024 and 2025 QIP amounts for Chicago Metro Wastewater included in base rates are comprised of Utility Plant in Service of \$3,625,704 and \$12,057,365, respectively; related accumulated depreciation of \$18,760 and \$172,245, respectively; related accumulated deferred income tax of \$67,451 and \$847,004, respectively, for NetQIP – Rate base of \$3,539,492 for 2024 and \$11,038,116 for 2025; and \$55,722 and \$254,365 in annualized depreciation expense, respectively;
- (11) the Commission finds that Illinois-American Water Company's 2024 and 2025 QIP costs included in rate base in this proceeding for each rate zone are subject to review in the Company's annual QIP reconciliation proceedings and the costs related to such QIP are subject to adjustments for prudence and reasonableness in the annual QIP reconciliation and future base rate proceedings;
- (12) the Commission has considered the estimated costs to be expended by Illinois-American Water Company to compensate attorneys and technical experts to prepare and litigate rate case proceedings and assess that the amount included in the total revenue requirement of \$3,296,632 as rate case expense, which is inclusive of the total required \$500,000 Consumer Intervenor Compensation Fund Payment and amortized over a three-year period, is just and reasonable pursuant to Section 9-229 of the Act;
- (13) Illinois-American Water Company's approach to the Corporate Alternative Minimum Tax, which is consistent with the approved approach in Docket No. 23-0055, is reasonable and should be approved;
- (14) a just and reasonable rate of return which Illinois-American Water Company should be allowed an opportunity to earn on its net original cost rate base is 7.10%; this rate of return incorporates an ROE of 9.84%;
- (15) the rates of return set forth in Finding (14) above result in operating revenues and net annual operating income as shown in Appendices A through D based on the test year herein approved;
- (16) the cost of service, interclass revenue allocation, rate design, and tariff terms and conditions found appropriate in the prefatory portion of this Order are just and reasonable for purposes of this proceeding and should be adopted;
- (17) Illinois-American Water Company's rates which are presently in effect for water service and sewer service are insufficient to generate the operating income necessary to permit it the opportunity to earn a fair and reasonable return on net original cost rate base; the currently effective rates should be permanently canceled and annulled;

- (18) the rates proposed by Illinois-American Water Company, having been modified by this Order, should be permanently canceled and annulled;
- (19) Illinois-American Water Company should be authorized to place into effect tariff sheets designed to produce annual operating revenues as contained in Appendices A through D, such tariff sheets to be applicable to service furnished on and after their effective date; the terms and conditions in these tariff sheets should be consistent with Findings (17), (21) and (22);
- (20) Illinois-American Water Company's proposed Rider ATCR is not reasonable and it is not approved;
- (21) Illinois-American Water Company's proposed changes to Rider VBA are not reasonable and they are not approved;
- (22) Illinois-American Water Company's proposed pension and OPEB accounting treatment is not reasonable and Illinois-American Water Company is not authorized to implement the accounting treatment as described in the prefatory portion of this Order; and
- (23) the new tariff sheets authorized to be filed by this Order shall reflect an effective date not less than five working days after the date of filing, with the tariff sheets to be corrected within that time period if necessary, except as is otherwise required by Section 9-201(b) of the Act as amended.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the Proposed Tariffs proposing a general increase in rates, filed by Illinois-American Water Company on January 25, 2024, are hereby permanently canceled and annulled.

IT IS FURTHER ORDERED that Illinois-American Water Company is hereby authorized to place into effect tariff sheets designed to produce annual operating revenues contained in Appendices A through D, such tariff sheets to be applicable to service furnished on and after their effective date.

IT IS FURTHER ORDERED that upon the effective date of the new tariff sheets to be filed pursuant to this Order, the tariff sheets presently in effect for water and sewer service rendered by Illinois-American Water Company which are replaced thereby are hereby permanently canceled and annulled.

IT IS FURTHER ORDERED the \$3,021,496,669 original cost of plant for Illinois-American Water Company at December 31, 2023 is unconditionally approved as the original cost of plant.

IT IS FURTHER ORDERED that Illinois-American Water Company's 2024 and 2025 QIP costs included in rate base in this proceeding for each rate zone are subject to review in the Company's annual QIP reconciliation proceedings and the costs related to such QIP are subject to adjustments for prudence and reasonableness in the annual QIP reconciliation and future base rate proceedings.

IT IS FURTHER ORDERED that Illinois-American Water Company comply with the requirements in Findings (7)-(12), (14), and (17) above.

IT IS FURTHER ORDERED that all motions, petitions, and objections which have not been disposed of are hereby deemed to be disposed of in a manner consistent with the conclusions herein.

IT IS FURTHER ORDERED that pursuant to Section 10-113(a) of the Public Utilities Act and 83 Ill. Adm. Code 200.880, any application for rehearing shall be filed within 30 days after service of the Order on the party.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this 5th day of December, 2024.

(SIGNED) DOUGLAS P. SCOTT

Acting Chairman