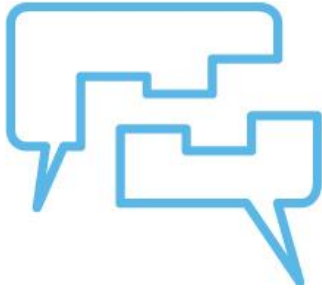


Rochelle Municipal Utilities – Rochelle, IL

Proposal for Electric Revenue Requirement, Cost of Service and Rate Design

June 15, 2011



Let's talk about an opportunity.

Russell A. Hissom, CPA, Partner

Baker Tilly Virchow Krause, LLP

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Candor. Insight. Results.

June 15, 2011

Rochelle Municipal Utilities
Mr. Ray Schwartz
333 Lincoln Highway
Rochelle, IL 61068

Dear Mr. Schwartz:

Thank you very much for this opportunity. Baker Tilly Virchow Krause, LLP (Baker Tilly) is pleased to submit this proposal to provide an electric revenue requirement, cost of service study, and rate design consulting services for Rochelle Municipal Utilities (RMU). Baker Tilly has performed these services for clients throughout the United States, and we have developed a reputation for efficiency and skillful creativity.

Our proposal is based on our experience providing these services to public power entities nationwide. Our goal is to serve as your most valued advisor. We understand that the initial reason for this analysis was to develop rates for RMU's flat load profile customers. As you and I discussed, it would be appropriate to first do a cost of service study and then develop rates for all customers classes based on the cost of service analysis.

Your project is perfectly aligned with our team strengths, and we are confident you will be pleased with the results we provide. We are eager to get started. Our response to your request for proposals details our approach to partnering with you to accomplish your objectives. We recognize the trust you place in us as your service provider and look forward to a successful partnership.

Sincerely,

BAKER TILLY VIRCHOW KRAUSE, LLP



Russell A. Hissom, CPA, Partner

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Executive Summary

Working with Rochelle Municipal Utilities

We will provide RMU with needs-based consulting services to help you address your specific business needs and challenges. This approach ensures our financial, technical, and industry specialists can tailor our methodologies to develop real-world solutions for you.

We would like to highlight several factors which distinguish a relationship with Baker Tilly.

- > **Our Familiarity with the Needs of Public Power.** Baker Tilly currently provides consulting and attest services to 272 utilities nationwide. Our project team will be able to efficiently orient itself to the needs and issues of RMU.
- > **Public Power Industry Knowledge.** We know the issues faced by public power in its desire to provide economical rates to its ratepayers and in the challenges it faces in today's operating environment. We regularly teach courses for the American Public Power Association on utility rates, advanced accounting, and governance. We will use this industry knowledge to effectively serve RMU.
- > **Dedicated Resources.** We have over thirty employees who do consulting work exclusively for utilities. The members of the project team have extensive prior experience in providing the services desired in your request for proposal. Our Energy and Utilities Group consists of dedicated experts with experiences in all areas of utility operations.
- > **Independence.** We offer a completely independent view for the utility to rely upon. We are able to bring this fresh, independent perspective to the project which will allow us to produce an unbiased, honest and understandable report.

Our Core Values Guide our Work

Throughout our relationship with RMU, we will be guided by our firm's core values - ***Integrity, Passion, and Stewardship*** - a set of principles that guide our behaviors and choices and help us strive for excellence in everything we do.

Firm Qualifications

Baker Tilly was founded in 1931 and today is ranked the 13th largest certified public accounting and consulting firm in the United States with a staff of over 160 partners and 1,400 staff located in fourteen offices.

You will be served by Baker Tilly's Energy and Utilities Group based in our Madison, WI office which consists of over thirty professionals dedicated entirely to serving only users and providers of utility services across the country. We provide services to nearly 300 utilities in thirty-seven states. The specialized focus of our Energy and Utilities Group gives our staff the understanding of the issues your organization faces and the experience to find effective solutions. All staff assigned to your engagement are full-time Baker Tilly staff specializing in the utility industry.

Baker Tilly has performed similar studies for many other public power utilities, including past audits and rate studies for RMU. We teach cost of service and rate design principles for the American Public Power Association. We have the staff size and commitment to this project to meet your timeline requirements. Our staff practices their craft with the knowledge, experience, skills, integrity, and reputation to deliver what you ask and meet your satisfaction.

“Our **commitment** to the public sector is second to none.”

Project Methodology

We view the rate study as having five distinct phases to achieve RMU's objectives and goals:

- > Establish project management responsibilities and communication protocols
- > Develop revenue requirement, conduct the cost of service study and review with RMU
- > Complete rate design
- > Provide draft report
- > Deliver and present final report

“ We strive for **excellence**
in everything we do. ”

Workplan

Phase 1 – Establish Project Management and Communication

Baker Tilly’s project management philosophy relies heavily on communication and client/project team involvement. As a firm we follow the strong project management principles and practices of the Project Management Institute.

Kickoff Meeting

The kickoff meeting will set the tone for the project and establish benchmarks for completion of project segments. During the meeting, we will discuss project issues, cost of service and rate design philosophies, and specific project requirements. Points of responsibility will be established within the Baker Tilly project team and RMU management to help the project run smoothly and provide maximum value.

Project Workplan Approval

This proposal includes a preliminary project plan that we have developed based on the request for proposals and our experience in performing electric cost-of-service and rate design studies with public power entities across the country. As part of the project kickoff, we will discuss our proposed workplan with management, revise as needed and obtain management’s concurrence with the final draft prior to initiating project fieldwork.

The detailed project steps include:

Task	Project Steps - Project Management and Communication
1	Attend project kick-off meeting with management and other stakeholders
2	Establish points of contact and responsibility for team members
3	Agree on project milestones
4	Establish communication protocols and frequency
5	Discuss project logistics
6	Initiate web-based project tool protocols
7	Finalize project workplan with management’s approval
8	Discuss the initial data request for information needed to complete the study

Phase 2 – Conduct the Revenue Requirement and Cost of Service Study

A revenue requirement will be developed for the test period. The revenue requirement will include these considerations:

- > Impact of existing and future capital improvements
- > Analysis of RMU's operating budget and a comparison with previous years actual requirements
- > Analysis and discussions regarding other costs/income that may be applicable
- > Debt service and bond coverage requirements

Our work is done according to generally accepted cost of service study principles and rate design study techniques.

After discussions with staff and management, we will review overall cost allocations and cost allocators from previous cost of service studies. We will determine whether the previous allocations are still valid or update them as appropriate based on changing customer characteristics.

In order to assign and match revenue recovery to cost responsibility, we will analyze statistical load data to identify cost drivers by customer classes. For customers in demand charge rate schedules, this will involve analyzing interval data from RMU's meter reading system to determine customer demand. Ideally we will be working with five minute load data.

For non-demand classes, we will aggregate and analyze customer data by customer class. For example, we will look at dedicated and primarily residential facilities to determine the residential class's contribution to the overall system peak demand. This information will be valuable when it comes time to develop overall rate design recommendations.

Expenses and cost will be categorized and clearly tied back to financial data and forecasts. This will make the cost of service study transparent for RMU and will ensure all applicable revenue requirement elements are included in the cost of service and subsequent rate design. Our work is done according to generally accepted cost of service study principles and rate design study techniques.

Cost of Service Cost Allocation Philosophy

We have developed unbundling of costs as a standard output of the Baker Tilly electric cost of service rate model. Costs are allocated to the following main areas:

1) Power Supply - Purchased Power

These include demand-related, energy-related, and transmission-related costs for purchased power

2) Transmission Related Costs

The costs for construction, operation, and maintenance of the transmission system (if present) are unbundled and allocated to each customer class. These costs consist of the following components: *cost of transmission facilities, operation and maintenance costs, scheduling system control, and dispatch services*

3) Distribution Costs

The distribution costs of the utility are unbundled into *substation costs, distribution system costs, transformer costs, services, meter operation and maintenance, and street lighting operation and maintenance*

4) Customer Service

Costs are calculated for providing the following services to customers: *meter installation, meter reading, billing, collection etc.*

5) Administrative and General

Costs are allocated based on the overall costs in the power supply, transmission, distribution, and customer service areas.

Fixed, Departmental and Variable Costs

To assist management with information for decision-making, each cost category identified above is further broken down into the following sub-groups:

- > **Fixed costs** — Fixed costs do not change if the utility changes its operations. Examples of these costs are interest expense on debt, depreciation expense, and return on investment in facilities
- > **Department costs** — These are the costs of labor and supplies directly assignable to a utility department.
- > **Variable costs** — These costs depend on the utility's operations. For example, the cost of purchased power depends on the amount of power demanded by customers.

This more detailed cost information can be used by management to determine the cost impact of a change in utility operations.

The detailed project steps include:

Task	Project Steps – Revenue Requirement and Cost of Service Study
1	Discuss cost allocation methodologies with RMU management and operations staff; review cost allocations used in latest cost-of-service study.
2	Review line item operation and maintenance expense items for the electric revenue requirement for allocation into electric cost parameters including: <ul style="list-style-type: none"> > Demand > Transmission components > Energy components > Distribution components > Customer coincident peak demand > Customer non-coincident peak demand > System and customer load factors > Line losses > Customer Costs > Street lighting > Administrative and general
3	Allocate capital additions and the associated rate of return component to the electric cost parameters shown above
4	Review electric demand and energy sales by customer class and determine the system demand for each customer class. For large customers subject to demand rate schedules, the same analysis will be performed on a customer-by-customer basis.
5	Review cost-of-service allocated to each customer class based on system demand and other industry factors

Phase 3 – Design Rates

The cost of service study calculates the revenue that should be recovered from each customer class. The next task is to develop rates that equitably recover the amounts identified for each class and accomplish other important management objectives. Alternative rate design options will be discussed with management during the kickoff meeting and prior to finalizing the rate design.

The rate design will include:

- > Appropriate energy, demand charges and other requirements for all rate schedules
- > Appropriate energy, demand, and other charges for all rate schedules
- > Recommendations on alternative rate structures such as time-of-use, “Green Tariffs” (for the integration of sustainable energy resources), and interruptible rates.

The rate design study will also address these issues:

- > Consistency and simplicity in rate structures
- > Impacts of rate design on consumption and revenue elasticity
- > Adequate and equitable usage, demand, and basic charges
- > Economic development encouragement the city may want to provide to businesses
- > Reasonableness of fee structures and utility repair and replacement funding methodologies
- > Rates for RMU’s flat load customers that take into account their operations

Typically, rates will be designed to ensure that each customer class will cover their costs of service. However, we know from experience that many factors play into a functioning community and often rates are set that move towards the cost of service or reflect issues of public interest. These issues will be discussed with RMU management prior to the design phase of the rate study. New rate schedules may be developed based on our recommendations if deemed appropriate by management.

Task	Project Steps – Rate Design
1	Discuss rate design methodologies with utility management and operations staff
2	Design rates based on above
3	Issue draft of comments and recommendations to utility management for review; discuss with management and revise as needed

Phase 4 - Draft Report & Quality Assurance Practices

To summarize the results of the above phases, we will prepare the draft report for management review. Management can then ask questions, offer comments, and request changes for inclusion in the final report and recommendations.

Quality Control Practices

From Day 1 of their careers at Baker Tilly, our associates focus on presenting exceptional quality services to our clients. The quality mindset is taught and practiced for each project that we perform.

To ensure this occurs, we have developed various processes and review practices that become part of each engagement. You can be assured that completing your project in a timely manner and within the scope parameters will remain our top priority.

We are members of the Securities and Exchange Commission Practice Section (SECPS) and Private Companies Practice Section (PCPS) of the American Institute of Certified Public Accountants. As members of the SECPS and PCPS, we have agreed to subject our policies and procedures to an independent outside review. The peer review has been successfully completed since 1982 with the most recent review being in 2006, at which time we received the highest level of assurance obtainable regarding our practices as part of this outside review process.

In addition to the external peer review, our Baker Tilly technical experts perform in-house inspections regularly. This maintains our quality at the highest possible standards. To assure quality, the preliminary report goes through a three stage review process. After preparation of the report by staff and managers, the project manager reviews the report and makes revisions as necessary. Finally, the project partner reviews and comments on the report before it is issued to RMU management. This process ensures the final document and recommendations will be of the highest and most accurate quality.

The detailed project steps include:

Task	Project Steps – Quality Assurance
1	Perform quality assurance procedures
2	Issue draft report to utility management and stakeholders
3	Discuss draft report with management
4	Make requested revisions

Phase 5 – Final Report Delivery and Presentation

Upon review and discussion of the preliminary report with RMU management, we will prepare a final report and recommendations to be presented to utility management and other interested parties.

Team Qualifications

Baker Tilly is proposing the following team to meet the objectives detailed in the workplan.

In developing our Project Team to serve you, we have matched the capabilities of our personnel with your requirements.

- > **Russell Hissom, Partner on the Energy and Utilities Team**, has been with Baker Tilly since 1983. He specializes in serving the financial and operational needs of the utility industry. He has extensive experience in developing cost-of-service and rate design studies for electric, water, wastewater, and communications utilities; analyzing the input and performance of parties under jointly owned facilities contracts; and performing operational reviews of utilities.
- > **Mike Johnson, Manager on the Energy and Utilities Team** has been with Baker Tilly since 2001. He specializes in working with utilities and rate studies. He has experience in electric utility operations, power supply, automation, and rate making and will serve as project manager for this engagement. Mike has managed projects of comparable size and scope for the following utilities in recent years:
- > **Andrew Behm, Consultant on the Energy and Utilities Team**, joined Baker Tilly in 2011 after three years at the Wisconsin Public Service Commission. He specializes in utility cost of service analysis and rate design.

Client:	Muscatine Power & Water
Project Description	Electric Cost of Service and Rate Design Study
Date:	2010/2011
Contact:	Ms. Laurie Birch, Manager of Accounting & Finance
Phone:	563 262 3410
Email	Lbirch@mpw.org

Client:	City of Colton Electric Utility
Project Description	Electric Cost of Service and Rate Design Study
Date:	2011
Contact:	Ms. Peggy Kiegler, Senior Utilities Financial Analyst
Phone:	909 370 6177
Email	pkeigler@ci.colton.ca.us

Client:	Brainerd Public Utilities
Project Description	Electric Cost of Service and Rate Design Study
Date:	2009
Contact:	Mr. Todd Wicklund, Finance Director
Phone:	218 825 3220
Email	TWicklund@bpu.org

Client:	Reading Municipal Light Department
Project Description	Electric Cost of Service and Rate Design Study
Date:	2008
Contact:	Mr. Vincent Cameron, General Manager
Phone:	781 942 6415
Email	vcameron@rml.com

Client:	Columbia, MO
Project Description	Electric, Water, and Wastewater Cost of Service and Rate Design Study
Date:	2006 - 2007
Contact:	Mr. Jim Windsor, Manager of Rates and Fiscal Planning
Phone:	573 874 6306
Email	jrw@gocolumbiamo.com

Client:	Popular Bluff, MO
Project Description	Electric Cost of Service and Rate Design Study
Date:	2006 - 2007
Contact:	Mr. Bill Bach, Utility Manager
Phone:	573 686 8003
Email	bbach@pbutilities.com

**Russell A. Hissom, CPA***Partner***608 240 2361****russ.hissom@bakertilly.com**

Russell Hissom, Partner in the Energy and Utilities Group, has been with Baker Tilly Virchow Krause, LLP since 1983. Russ specializes in serving the financial and operational needs of the utility industry. He has extensive experience with financial and compliance audits of utilities and joint action agencies, work order asset management and FERC accounting implementation projects, construction audits, management audits, contract compliance audits under jointly owned electric generation contracts, overhead cost allocation studies, NERC Audit Readiness projects for Registered Entities, and specialized accounting training for utilities. He has spoken nationally on a variety of utility topics for organizations such as APPA and NERC Regional Audit Organizations.

Specific experience

- > Partner in-charge of financial audits for electric, water, wastewater, gas and communications utilities.
- > Performs work order asset management and FERC accounting implementation projects.
- > Performs contract performance management audits for utilities and State Public Utility Commissions.
- > Performs compliance audits that analyze the impact and performance of utilities under jointly owned electric generation contracts.
- > Performs management audits that analyze utility operations in key business processes to determine efficiencies in operations.
- > Performs benchmarking analysis, overhead cost allocation studies and utility financial performance projects.
- > Performs business process consulting projects to assist utilities in readiness for Regulatory audits, such as NERC compliance.
- > Regular instructor for industry associations on work order and industry accounting topics
- > Analyzes revenue requirement, cost of service studies, and rate design for electric, water, wastewater, gas and communications utilities.
- > Serves as an expert witness before regulatory bodies in utility rate proceedings.
- > Authors various articles related to the utility industry.

Russell A. Hissom, page 2

Industry involvement

- > American Institute of Certified Public Accountants (AICPA)
- > American Public Power Association (APPA)
- > Society of Corporate Compliance and Ethics
- > Various state institutes of Certified Public Accountants
- > Various state utility organizations.

Education

University of Wisconsin - Milwaukee
Bachelor of Business Administration in Accounting

Relevant continuing education

- > Annual Accounting and Auditing Update
- > AICPA Ethics Training
- > Lean Six Sigma Methodologies
- > Utility Training Seminars
- > Utility Rates and Governance Training Course
- > Advanced Utility Accounting
- > Enterprise Leadership Training
- > Strategic Planning for Utilities
- > GASB 34 Implementation

**Mike A. Johnson***Manager***608 240 2623****Mike.Johnson@bakertilly.com**

Mike Johnson, Manager with Baker Tilly Virchow Krause, LLP, has been with the firm since 2001. Mike is a member of the Energy and Utility Team; specializing in working with utilities. He has experience in electric utility operations, power supply, automation, and rate making.

Specific Experience

- > Develops utility cost analysis models.
- > Models and evaluates power market bidding and settlement processes.
- > Establishes utility cost of services and identifies utility revenues.
- > Reviews utility transmission service agreements and analyzes upgrade costs.
- > Provides analysis of benefits associated with utility system automation.
- > Evaluates data and system integration issues.
- > Models cost functionalization and allocation systems for designing and managing “what if?” scenarios.
- > Facilitates technology focus groups.
- > Worked as a program manager for automation projects at electric utilities prior to joining Baker Tilly.
- > Provides energy procurement/settlement and asset evaluation/reclassification expertise to multiple projects.

Industry Involvement

- > Presents seminars on automation and internet for electric utilities at national conferences.
- > Designs and presents internet courses at national conferences.

Education

St. Helens College, England
Mechatronics/Higher National Diploma (combined electrical and mechanical engineering equivalent to Bachelor of Science)

**Andrew J. Behm***Consultant***608 240 2364****andrew.behm@bakertilly.com**

Andrew Behm, Consultant with Baker Tilly Virchow Krause, LLP, joined the firm in 2011 after three years with the Wisconsin Public Service Commission (PSC) performing cost of service analysis and developing water and wastewater rates, including conservation rates. Andrew also prepared and offered testimony in hearings before the Public Service Commission. Andrew specializes in providing process improvement and compliance-based consulting services to Baker Tilly's electric, water and wastewater utilities.

Specific experience

- > Analyzing utility cost of service and proposing rate designs.
- > Making recommendations for and preparing alternative rate designs, including conservation based rates.
- > Preparing and presenting testimony based on data analysis for rate hearings before public utility commissions.
- > Assisting clients to identify and mitigate risks.
- > Auditing contract compliance and evaluating financial and operational controls.

Education

University of Wisconsin – Madison, WI
Bachelor of Science in Economics

Project Timeline

The following details our proposed timeline to achieve the objectives identified in the workplan. The timeline will fluctuate based on availability of RMU staff to respond to information requests.

Rochelle Municipal Utilities, IL - Electric Cost of Service and Rate Design Study																
Milestone	Week from Contract															
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Contract Award																
Initial Information Request																
RMU Completes Information Request																
Kick Off Meeting/Field Work																
Develop Revenue Requirement																
Cost of Service Allocation																
Baker Tilly/RMU Team Review																
Rate Design																
Draft Report (RMU Review/Updates)																
Final Report/Presentation																

Fees

Our “not to exceed” fee for this project is \$27,590. Additional work will be charged at the rate of \$190/hr, at the option of management.

Not To Exceed Cost	
Total Labor Investment	\$ 26,840
Estimated out-of-pocket expenses (charged at cost)	750
Total Not To Exceed Cost	\$ 27,590