

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	:	
	:	
Proposed General Increase In Rates For Gas Service.	:	No. 07-0241
	:	and
THE PEOPLES GAS LIGHT AND COKE COMPANY	:	No. 07-0242
	:	Consol.
	:	
Proposed General Increase In Rates For Gas Service.	:	

Rebuttal Testimony of
BRADLEY A. JOHNSON
Treasurer
The Peoples Gas Light and Coke Company and
North Shore Gas Company

July 27, 2007

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION AND BACKGROUND	1
A. Witness Identification	1
B. Purposes of Testimony	1
C. Summary of Conclusions	1
D. Itemized Attachments to Rebuttal Testimony	2
II. Capital Structure	2
III. Cost of Long-Term Debt	3
IV. Cost of Equity	5

1 **I. INTRODUCTION AND BACKGROUND**

2 **A. Witness Identification**

3 Q. Please state your name.

4 A. Bradley A. Johnson.

5 Q. Are you the same Bradley A. Johnson who submitted pre-filed Direct Testimony on
6 behalf of The Peoples Gas Light and Coke Company (“Peoples Gas”) and North Shore
7 Gas Company (“North Shore”) (together, “the Utilities”) in this consolidated Docket?

8 A. Yes.

9 **B. Purposes of Testimony**

10 Q. What are the purposes of your Rebuttal Testimony in this proceeding?

11 A. I note that all parties have accepted the Utilities’ proposed capital structure for
12 ratemaking purposes. I respond to Staff witness Janis Freetly’s adjustments to the
13 Utilities’ cost of long-term debt. Finally, I comment on the Staff and intervenors’
14 positions concerting the Utilities’ cost of equity.

15 **C. Summary of Conclusions**

16 Q. Please summarize the conclusions of your Rebuttal Testimony.

17 A. All parties have accepted a capital structure of 56% common equity and 44% long-term
18 debt for the Utilities for ratemaking purposes. Staff’s adjustments to the Utilities’ cost of
19 long-term debt should be adjusted to account for the fact that the Utilities had split credit
20 ratings (AA/A) at the time the debt was issued. The direct testimony by Staff and on
21 behalf of the Citizens Utility Board (“CUB”) and the City of Chicago (“City”) has not
22 caused the Utilities to modify their proposed cost of equity of 11.06%.

23 **D. Itemized Attachments to Rebuttal Testimony**

24 Q. Are there any attachments to your Rebuttal Testimony?

25 A. Yes. I am sponsoring the following exhibits:

26	<u>Exhibit No.</u>	<u>Corresponding 83 Ill. Admin. Code Part 285 Sched.</u>	
27			
28	NS-PGL Ex. BAJ-2.1P	Rev. D-1	Cost of Capital Summary
29	NS-PGL Ex. BAJ-2.1N	Rev. D-1	Cost of Capital Summary

30 **II. Capital Structure**

31 Q. Has Staff or any intervenor proposed changes to the Utilities' proposed capital structure
32 of 56% common equity and 44% long-term debt?

33 A. No. Ms. Freetly of Staff has expressly accepted the Utilities' proposed capital structure.
34 No intervenor discussed the Utilities' proposed capital structure in direct testimony.
35 CUB and the City accepted it without comment and Illinois Attorney General's Office
36 witness David Effron incorporated it into his calculation of the Utilities' revenue
37 requirements.

38 Q. Why is it important to ensure clarity as to this point?

39 A. Because the Utilities' capital structure and capital cost are interrelated. If Staff or an
40 intervenor proposed a change to the Utilities' capital structure for ratemaking purposes,
41 the change could require a reevaluation of the Utilities' cost of capital for ratemaking
42 purposes. The Utilities' positions on cost of capital are based on their proposed capital
43 structure.

44 **III. Cost of Long-Term Debt**

45 Q. What positions have Staff and intervenors taken on the Utilities' forecasted cost of long-
46 term debt, respectively?

47 A. Staff proposes small downward adjustments from 4.68% to 4.64% for Peoples Gas and
48 from 5.42% to 5.37% for North Shore. CUB and the City have accepted the Utilities'
49 proposed costs. No other intervenor addressed the long-term debt cost.

50 Q. Are Staff's adjustments to the Utilities' cost of long-term debt based on an assumed AA
51 rating by S&P appropriate and reasonable?

52 A. We agree that it is reasonable to adjust the Utilities' cost of long-term debt to reflect their
53 respective stand-alone financial strength, if and to the extent that it differs from the
54 financial strength of Integrys Energy Group, Inc. We also agree with Ms. Freetly's point
55 in footnote 4 of page 5 of her direct testimony that, while these adjustments are small in
56 this case, it is important to reflect the Utilities' stand-alone financial strength in their
57 rates. But we believe that Staff's proposed adjustments to the Utilities' long-term debt
58 cost are excessive in this case.

59 Q. Please explain.

60 A. Ms. Freetly bases her adjustment on the spread between AA-rated long-term utility bonds
61 and similar bonds rated A when the Utilities issued their long-term debt in 2003.
62 However, at that time the Utilities had a split rating by the credit rating agencies. While
63 Standard & Poors ("S&P") had downgraded the Utilities from AA- to A- in 2002,
64 Moodys downgrade was from Aa2 to Aa3. In other words, the Utilities were rated single
65 "A" by one agency and "AA" by another agency. This split rating should be taken into
66 account in the "stand-alone" adjustment of the Utilities' long-term debt cost.

67 Q. What impact should the Utilities' split rating have on the stand-alone adjustment?

68 A. Because of the small adjustments and associated revenue requirements involved, we
69 propose a simple approach. We propose that the split rating be reflected by taking only
70 half of the spread between AA-rated bonds and A-rated bonds in 2003 that Ms. Freetly
71 calculated. Thus, for the North Shore Series N bonds and the Peoples Gas Series NN
72 bonds issued in April 2003, the stand-alone adjustment should be 0.043% instead of
73 0.085%, resulting in an interest rate of 4.582%. For the Peoples Gas Series MM bonds
74 issued in February 2003, the stand-alone adjustment should be 0.0675% instead of
75 0.135%, resulting in an interest rate of 3.933%.

76 Q. Is Ms. Freetly's adjustment to the cost of the insured tax-exempt Peoples Gas Series KK,
77 LL, OO, PP and RR bonds to reflect reduced cost of the insurance premiums if Peoples
78 Gas' S&P rating had remained at AA- appropriate and reasonable?

79 A. As with the cost of the 2003 bond issuances, we agree with the concept of this
80 adjustment, but do not agree with the size of the adjustment. Again, the adjustment
81 should take into account the fact that Peoples Gas had a split rating, single A by S&P and
82 double A by Moodys, at the time these bonds were issued. Consistent with our simplified
83 approach on the taxable bonds, we propose that one half of Ms. Freetly's adjustment be
84 made to the cost of the non-taxable bonds.

85 Q. Are your proposed adjustments to the Utilities' long-term debt costs reflected in the
86 Utilities' updated revenue requirement estimates provided by Mr. Fiorella?

87 A. Yes, they are. Our proposed adjustments to Staff's adjusted figures (which include an
88 update to the auction rates for the Peoples Gas Series OO and PP bonds) result in a long-
89 term debt cost for Peoples Gas of 4.67% and 5.39% for North Shore. This calculation is

90 provided in my revised D-1 schedules, NS-PGL Exs. BAJ-2.1P and BAJ-2.1N. The
91 adjusted long-term debt costs are reflected in Mr. Fiorella's revised C-1 Schedules,
92 NS-PGL Exs. SF-2.5P and N.

93 **IV. Cost of Equity**

94 Q. What positions have the Staff and intervenors taken on the Utilities' cost of common
95 equity?

96 A. Compared to the Utilities proposed return on equity of 11.06%, Staff recommends 9.70%
97 for Peoples Gas and 9.50% for North Shore if the Utilities' proposed Riders UBA and
98 VBA are approved, and unspecified reductions if the riders are not approved. CUB and
99 the City argue for 8.11% if the riders are not approved, and 7.42% if the riders are
100 approved. No other intervenor addressed the Utilities' cost of equity, although Illinois
101 Attorney General's Office witness David Efron incorporated the CUB/City position into
102 his calculation of the Utilities' revenue requirements.

103 Q. Has the testimony by Staff witness Kight-Garlich or CUB/City witness Thomas caused
104 the Utilities to change their proposed cost of equity?

105 A. No. Mr. Moul's rebuttal testimony provides additional support for the Utilities' proposed
106 11.06% cost of equity assuming the Utilities' proposed Riders UBA and VBA are
107 approved.

108 Q. Does this complete your rebuttal testimony?

109 A. Yes.