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.	:	

AFFIDAVIT OF BRADLEY A. JOHNSON

STATE OF WISCONSIN)
) SS.
COUNTY OF BROWN)

I, Bradley A. Johnson, being first duly sworn, declare under oath as follows:

1. I am Treasurer for The Peoples Gas Light and Coke Company and North Shore Gas Company, the Applicants in this proceeding.

2. I provided direct and rebuttal testimony, identified as Peoples Gas Exs. BAJ-1.0 Rev., BAJ-1.1, BAJ-1.2, BAJ-1.3, BAJ-1.4 and BAJ-1.5; North Shore Exs. BAJ-1.0 Rev., BAJ-1.1, BAJ-1.2, BAJ-1.3, BAJ-1.4 and BAJ-1.5; and North Shore/Peoples Gas Exs. BAJ-2.0, BAJ-2.1N and BAJ-2.1P, respectively, on behalf of the Applicants. Those pieces of testimony, which are attached to this Affidavit, were prepared by me or under my direction and control.

3. I swear and affirm that the testimony provided is true and correct, to the best of my knowledge and ability, and that there are no corrections or revisions to be made to my testimony. If I were asked the same questions today, my answers would be the same. It is my desire that my testimony be considered as evidence by the Administrative Law Judges and by the Illinois Commerce Commission in this Docket.

FURTHER AFFIANT SAYETH NOT.

Bradley A. Johnson

Bradley A. Johnson

SUBSCRIBED AND SWORN to before me this 7th day of September, 2007.

Colleen T. Sipiorski

Notary Public

COLLEEN T. SIPIORSKI NOTARY PUBLIC STATE OF WISCONSIN

CHI2_660018.1

NS/PGL Ex. BAJ-3.0

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

THE PEOPLES GAS LIGHT	:	
AND COKE COMPANY	:	
	:	No. 07-____
	:	
Proposed General Increase	:	
In Rates For Gas Service	:	

Direct Testimony of

BRADLEY A. JOHNSON

Treasurer
The Peoples Gas Light and Coke Company

Peoples Gas Ex. BAJ-1.0 REV

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I. INTRODUCTION AND BACKGROUND

A. Witness Introduction, Background, and Experience

Q. Please state your name and business address.

A. My name is Bradley A. Johnson, and my business address is 130 East Randolph Drive, Chicago, IL 60611.

Q. What is your current position with The Peoples Gas Light and Coke Company ("Peoples Gas" or "Company")?

A. My current position is Treasurer.

Q. Please outline your educational background and business experience.

A. I graduated from the University of Wisconsin – Eau Claire in 1976 with a major in accounting. I received a Masters Degree in Business Administration from the University of Wisconsin – Oshkosh in 1984. I joined Wisconsin Public Service Corporation ("WPSC") as a tax accountant in November of 1979. I held various positions in the Tax Department and the Corporate Planning Department prior to being named Assistant Treasurer of WPS Resources Corporation in April 2001, Treasurer in February 2002, and Vice President and Treasurer in 2004. Upon the recent merger transaction by which Peoples Energy became a wholly-owned subsidiary of WPS Resources Corporation, which was renamed Integrys Energy Group ("Integrys"), I was named Vice President and Treasurer of Integrys and its affiliates, including Peoples Gas.

Q. What are your responsibilities in your present position?

A. My responsibilities include directing the financing, treasury management, financial analysis and forecasting, and oversight of financial risk management activities of Integrys and its affiliates, including Peoples Gas.

B. Purpose of Testimony and Itemized Attachments

Q. What is the purpose of your direct testimony?

A. The purpose of my direct testimony is to identify and support the Company's requested overall rate of return on its proposed rate base ("cost of capital"), including its embedded cost of long-term debt and proposed capital structure for the test year. The proposed return on equity component of the cost of capital is presented by Peoples Gas witness Mr. Moul in his direct testimony (Peoples Gas Exhibit ("Ex.") PRM-1.0.

Q. Are you sponsoring any exhibits?

A. Yes, I am sponsoring the following exhibits:

Exhibit No.	Corresponding 83 Ill. Admin. Code Part 285 Schedule
Peoples Gas Ex. BAJ-1.1	D-1 Cost of Capital Summary
Peoples Gas Ex. BAJ-1.2	D-3 Embedded Cost of Long-Term Debt
Peoples Gas Ex. BAJ-1.3	D-5 Unrecovered Common Equity Issuance Costs
Peoples Gas Ex. BAJ-1.4	D-7 Comparative Financial Data
Peoples Gas Ex. BAJ-1.5	D-8 Security Quality Ratings

Q. What cost of capital is the Company proposing be used to establish the rate of return on rate base in this case?

A. As shown in Peoples Gas Ex. BAJ-1.1, the Company calculates a cost of capital and rate of return on rate base for the fiscal 2006 test year of 8.25%, which reflects a capital structure of 56% common equity and 44% long-term debt, a cost of equity of 11.06%, and an embedded cost of long-term debt of 4.68%.

Q. Is it important that the Company be allowed the opportunity to earn its test year cost of capital through the setting of the authorized return on rate base?

A. Yes. The Company's obligation to provide safe, adequate and reliable service to its customers requires that it maintain its financial integrity and ability to readily access the capital markets on reasonable terms and conditions. This requires that it earn a fair and reasonable rate of return on its investment that is consistent with the return expected by investors on investments of comparable risk. This in turn necessitates, among other things, that the allowed return on rate base be set equal to the utility's actual cost of capital in the historical test year. If the Company is not permitted a reasonable opportunity to earn its full cost of capital, its financial integrity and ability to raise capital on reasonable terms will ultimately be at risk, which in turn will threaten its ability to meet its service obligations.

Q. Have the Company's returns on equity and its key credit ratios declined significantly in recent years, and will they continue to decline absent the requested rate relief?

A. Yes. As shown in Peoples Gas Ex. BAJ -1.4 and summarized in the following table, the Company's equity returns and key credit metrics have declined substantially since 2003, and will continue to do so absent rate relief. The credit metrics associated with the 2006 test year (adjusted to exclude the impacts of the settlement charge associated with its 2000-2004 gas charge proceedings) are insufficient to maintain the Company's current credit ratings or its ability to raise capital on reasonable terms.

	2003	2004	2005	2006(a)
Return on Avg. Common Equity	12.6%	7.2%	7.9%	4.2%
Funds Flow Interest Coverage	7.8x	6.0x	6.0x	2.6x
Funds From Operations/Avg Total Debt	27.7%	19.3%	22.5%	8.4%
Pre-Tax Interest Coverage	6.6x	4.3x	4.2x	2.5x

II. CAPITAL STRUCTURE

Q. Please describe the corporate structure of Peoples Gas and its relationship to Peoples Energy and Integrys.

A. Peoples Gas is an Illinois corporation whose common equity is wholly owned by Peoples Energy, an Illinois corporation and public utility holding company. The common equity of Peoples Energy is wholly owned by Integrys, a Wisconsin corporation and public utility holding company. Shares of Integrys trade on the New York Stock Exchange under the symbol "TEG". Peoples Gas currently has no outstanding authority to, and has no plans to sell common equity to any other entity.

Q. Does Peoples Gas issue debt independently of Peoples Energy and Integrys?

A. Yes. Peoples Gas issues first mortgage bonds to the public independently of Peoples Energy and Integrys for the purpose of funding long-term investment in rate base. The long-term debt of Peoples Gas is owned entirely by the public and not by Peoples Energy or Integrys. Peoples Gas also issues commercial paper to private investors to meet its short-term seasonal cash requirements. The Commission has also granted approval for Peoples Gas to borrow funds on a short-term basis from Peoples Energy and its affiliate, North Shore Gas Company. However, such borrowing authority is used only to supplement the short-term seasonal borrowing capacity of Peoples Gas and is not a source of permanent funding for the Company.

Q. What capital structure does Peoples Gas propose for the purposes of re-setting its rates?

A. Peoples Gas proposes a capital structure consisting of 56% equity and 44% long-term debt, excluding Accumulated Other Comprehensive Income/(Loss) ("AOCI").

Q. Why have you excluded AOCI from the Company's proposed capital structure?

A. AOCI arises at Peoples Gas almost entirely due to pension accounting rules that require a minimum pension liability be recorded on the balance sheet when the present value of projected future pension benefits earned by employees exceeds the market value of trust fund assets. This accounting entry impacts AOCI. Since both the present value of pension benefits earned and asset values are based on market data, the impact on AOCI can be quite volatile as capital market values and interest rates rise and fall. However, there is no cash impact, and these accounting entries have nothing to do with financing the rate base of the Company or its permanent capitalization. Essentially, AOCI represents contingent assets or liabilities that may never be fully recognized. The true impact of these assets and liabilities are realized through time in the form of actual benefits paid, pension expense, and pension contributions.

Q. Is the proposed capital structure reasonable and appropriate for Peoples Gas?

A. Yes. As a public utility with an obligation to serve, Peoples Gas must have ready access to the capital markets when required under all types of market conditions. A strong capital structure helps to provide for such access by allowing the Company to maintain strong credit ratings on its debt. As shown in Peoples Gas Ex. BAJ-1.5, despite recent downgrades by Moodys and Fitch, Peoples Gas still has reasonably strong credit ratings, with ratings on its senior secured debt of A- from Standard & Poors and A1 from Moodys (Fitch no longer provides coverage of Peoples Gas). As shown by Mr. Moul, these ratings are above average among the S&P Public Utilities.

A strong capital structure also helps to insulate the Company from "event-driven" financial shocks. This is particularly important in the current high gas price environment, which may require the Company to issue significant amounts of short-term debt over-and-above its long-term obligations in order to meet its seasonal cash requirements. A strong capital structure also reduces the Company's operating costs by reducing its cost of debt as well as the cost of providing credit in various forms to counter-parties. For all of these reasons, the proposed capital structure is reasonable and appropriate for Peoples Gas.

Q. How does the proposed capital structure for the fiscal 2006 test year compare to the Company's actual capital structure?

A. The proposed capital structure is the Company's actual fiscal 2006 year-end capital structure and also closely approximates the average capital structure employed by the Company during fiscal year 2006 as well as the past several years. As shown in Peoples Gas Ex. BAJ-1.4, People's Gas' fiscal 2006 year-end capital structure excluding AOCI was 56.0% common equity and 44.0% long-term debt. The fiscal 2006 13-month average capital structure was 55.4% common equity and 44.6% long-term debt. Over the five year period 2002-2006, the Company's year-end capital structure excluding AOCI averaged 56.5% common equity and 43.5% long-term debt.

It should be noted that during fiscal years 2002-2003, the Company had varying amounts of tax-exempt adjustable rate debt outstanding which, although not maturing until between 2023 and 2030, contained mandatory tender provisions that provided investors the right to tender such bonds at par prior to each weekly interest rate reset point. Peoples Gas was obligated to purchase any such bonds tendered if they could not be re-marketed. Therefore, the Company was required to classify them for accounting purposes as short-term debt on its balance sheet. However, from a practical standpoint, the re-marketing risk for these bonds was very small, they had extended principal maturity dates, and the Company has since refinanced all such debt to eliminate the put feature. Peoples Gas Ex. BAJ-1.4 reflects this tax-exempt adjustable rate debt for the period 2002-2003 as long-term debt.

Q. What impact did the Company's fiscal 2006 charges related to the settlement of its 2000 through 2004 gas charge proceedings ("the settlement charges") have on the 2006 year-end capital structure?

A. The settlement charges reduced common equity by $62 million at the time the charges were recorded. However, Peoples Gas omitted dividend payments to Peoples Energy for the third and fourth quarters of Fiscal 2006 to help restore the Company's balance sheet equity. In addition, Peoples Gas issued common stock to Peoples Energy, its parent company, over the May-September 2006 timeframe in an aggregate dollar amount that, when combined with retained earnings during the last two quarters of fiscal 2006, restored the common equity balance at fiscal year-end to approximately what it would have been absent the settlement charges. Peoples Gas will continue to manage its capital structure to remain consistent with the proposed capital structure.

Q. How does the proposed capital structure compare to the capital structures approved by the Commission in other recent rate case decisions for gas utilities in Illinois?

A. The Company's proposed capital structure, which reflects a debt to total capital ratio of 44%, is consistent with the capital structures used in other recent gas utility rate orders.

For example, summarized below are the ratios of debt to total capital reflected in the capital structures approved by the Commission in recent utility gas rate orders.

Company	Docket Number	% Debt/ Total Capital
Nicor Gas	Docket 04-0779	43.5%
Illinois Power (Gas)	Docket 04-0476	44.9%
AmerenCILCO (Gas)	Dockets 02-O798,03-008,03-009	45.7%
AmerenUE (Gas)	Dockets 02-O798,03-008,03-009	45.0%
AmerenCIPS (Gas)	Dockets 02-O798,03-008,03-009	49.1%

Q. Is the proposed capital structure reasonable when compared with the proxy group of companies ("the Gas Group") used by Company witness Mr. Moul to develop his return on equity recommendation?

A. Yes, as discussed in Mr. Moul's testimony, the Company's proposed common equity percentage reflected in its test year capital structure falls within the range of common equity percentages of the Gas Group and is comparable to the forecasted 2006 and 2007 averages for those companies of 54.5% and 54.9%, respectively.

Q. Would it be appropriate to include a short-term borrowing component in the Company's test year capital structure?

A. No. Peoples Gas uses short-term debt only to finance seasonal cash needs, particularly for purchased gas costs and short-term construction work in progress, not as a permanent source of financing rate base investments. The Company's practice is to finance its long-lived, permanent assets with permanent capital consisting of long-term debt and common equity. In fact, during many months of the year the Company has no short-term debt outstanding. For example, during fiscal year 2006, no short-term debt was outstanding on 238 days throughout the year, including consecutively from March 28, 2006 to

September 30, 2006. During fiscal year 2005 no short-term debt was outstanding on 209 days throughout the year, including consecutively from March 8, 2005 to September 25, 2005. During fiscal 2004, no short-term debt was outstanding on 191 days throughout the year, including consecutively from March 30, 2004 to August 23, 2004.

III. COST OF COMMON EQUITY

Q. What cost of common equity does the Company propose?

A. As recommended in the testimony of Company Witness Mr. Moul, the Company is proposing a cost of common equity of 11.06%.

Q. What information is shown on Peoples Gas Ex. BAJ-1.3?

A. Peoples Gas Ex. BAJ-1.3 shows the Company's unrecovered common equity issuance costs since 1973. As indicated on the Exhibit, the Company's parent Peoples Energy most recently has raised equity capital from the public through a continuous share distribution program managed by Cantor Fitzgerald as underwriter at an average issuance cost of 2.35%. This program was run by Peoples Energy prior to its merger into the Integrys organization. Previous equity issuances by Peoples Energy have cost between 2.64% and 3.84%. Mr. Moul's testimony discusses and supports the inclusion of a 0.2% component for equity issuance costs, or flotation costs, in the proposed return on common equity.

IV. EMBEDDED COST OF LONG-TERM DEBT

Q. What is the embedded cost of long-term debt included in the proposed test year cost of capital for Peoples Gas?

A. The embedded cost of long-term debt included in the proposed test year cost of capital is 4.68%, which is the Company's actual embedded cost of debt for fiscal year 2006 as shown in Peoples Gas Ex. BAJ-1.2.

Q. What efforts has the Company made to reduce its embedded cost of debt since its last rate case in 1995?

A. The Company has refinanced its entire long-term debt portfolio since 1995 to take advantage of a lower interest rate environment and provide for a more laddered maturity structure, which reduces interest rate and refinancing risk. As a result of these efforts, the Company has reduced its embedded cost of long-term debt from 7.19% as allowed by the Commission in Docket 95-0032 to 4.68% for fiscal 2006.

Q. Does this complete your direct testimony?

A. Yes.

The Peoples Gas Light and Coke Company

Cost of Capital Summary (1)

Line No.	Class of Capital	Historical Test Year Ended September 30, 2006					Line No.
		Amount (2)	Percent of Total	Percent Cost	Cost Reference	Weighted Cost	
	(A)	(B)	(C)	(D)	(E)	(F) = (C X D)	
1	Long-term Debt (3)	$ 478,998,000	42.90%	4.68% (4)	D-3	2.01%	1
2	Common Equity	637,533,000	57.10%	11.06% (5)		6.32%	2
3	Total Capital	$ 1,116,531,000				8.33%	3

	Class of Capital	Proforma Test Year Ending September 30, 2006					
		Amount	Percent of Total	Percent Cost	Cost Reference	Weighted Cost	
	(A)	(B)	(C)	(D)	(E)	(F) = (C X D)	
4	Long-term Debt (3)		44.00%	4.68% (4)	D-3	2.06%	4
5	Common Equity		56.00%	11.06% (5)		6.19%	5
6	Total Capital					8.25%	6

Notes: (1) The weights and costs of the components of the capital structure do not differ from total company data.
(2) Long Term Debt balances at year end current proceeds. Common Equity balances based at year-end excluding Accumulated Other Comprehensive Income.
(3) No redeemable long-term debt due within one year.
(4) Long Term Debt percent cost is based on year-end current proceeds.
(5) Cost of common equity requested in this filing.

The Peoples Gas Light and Coke Company

Embedded Cost of Long-Term Debt

Net Proceeds Method

Line No.	Debt Issue Type, Coupon Rate		Date Issued	Maturity Date	Date Reacquired	Principal Amount	Face Amount Outstanding	Unamortized Discount or (Premium)	Unamortized Debt Expense (Gain)	Carrying Value	Annual Coupon Interest	Annualized Amort. Of Discount or (Premium)	Annualized Amort. Of Debt Expense	Annualized Interest Expense	Line No.
	[A]		[B]	[C]	[D]	[E]	[F]	[G]	[H]	[I]=[F-G-H]	[J]=[A*F]	[K]	[L]	[M]=[J+K+L]	
	Test Year Ended September 30, 2006														
1	First and Refunding Mortgage Bonds:														1
2	Series HH - 4.75%	(1)	03/01/00	03/01/30	-	$ 50,000,000	$ 50,000,000	$ -	$ 1,676,000	$ 48,324,000	$ 2,375,000	$ -	$ 72,000	$ 2,447,000	2
3	Series KK - 5	(1)	02/06/03	02/01/33	-	50,000,000	50,000,000	605,000	1,734,000	47,661,000	2,500,000	23,000	66,000	2,589,000	3
4	Series LL - 3.05	(1)	02/20/03	02/01/33	-	50,000,000	50,000,000	-	828,000	49,172,000	1,525,000	-	31,000	1,556,000	4
5	Series MM-2 - 4		02/27/03	03/01/10	-	50,000,000	50,000,000	167,000	291,000	49,542,000	2,000,000	49,000	85,000	2,134,000	5
6	Series NN-2 - 4.625		04/29/03	05/01/13	-	75,000,000	75,000,000	40,000	997,000	73,963,000	3,469,000	6,000	152,000	3,627,000	6
7	Series OO - 3.6 Auction Rate	(1)	10/09/03	10/01/37	-	51,000,000	51,000,000	-	1,054,000	49,946,000	1,836,000 (2)	-	34,000	1,870,000	7
8	Series PP - 3.55 Auction Rate	(1)	10/09/03	10/01/37	-	51,000,000	51,000,000	-	1,039,000	49,961,000	1,811,000 (2)	-	34,000	1,845,000	8
9	Series QQ - 4.875	(1)	11/25/03	11/01/38	-	75,000,000	75,000,000	-	1,823,000	73,177,000	3,656,000	-	57,000	3,713,000	9
10	Series RR - 4.3	(1)	06/01/05	06/01/35	-	50,000,000	50,000,000	-	993,000	49,007,000	2,150,000	-	35,000	2,185,000	10
11	Sub-Total					$ 502,000,000	$ 502,000,000	$ 812,000	$10,435,000	$ 490,753,000	$ 21,322,000	$ 78,000	$ 566,000	$ 21,966,000	11
12	Less: Amortization of Losses on Reacquired Bonds														12
13	Series X - 6.875%	(1)	03/01/85	02/01/33	03/14/03	$ -	$ -	$ -	$ 1,527,000	$ (1,527,000)	$ -	$ -	$ 58,000	$ 58,000	13
14	Series Y - 7.5	(1)	03/01/85	02/01/33	04/03/00	-	-	-	692,000	(692,000)	-	-	26,000	26,000	14
15	Series Z - 7.5	(1)	03/01/85	03/01/15	04/03/00	-	-	-	554,000	(554,000)	-	-	66,000	66,000	15
16	Series AA - 10.25	(1)	03/01/85	06/01/35	08/01/95	-	-	-	1,481,000	(1,481,000)	-	-	52,000	52,000	16
17	Series BB - 8.1	(1)	05/01/90	10/01/37	05/01/00	-	-	-	706,000	(706,000)	-	-	22,000	22,000	17
18	Series DD - 5.-3/4	(1)	12/01/93	11/01/38	12/01/03	-	-	-	2,239,000	(2,239,000)	-	-	70,000	70,000	18
19	Series EE - Variable Rate	(1)	12/01/93	10/01/37	10/14/03	-	-	-	232,000	(232,000)	-	-	7,000	7,000	19
20	Series FF - 6.1	(1)	06/01/95	06/01/35	06/02/05	-	-	-	1,426,000	(1,426,000)	-	-	50,000	50,000	20
21	Series GG - Variable Rate	(1)	03/01/00	02/01/33	03/27/03	-	-	-	1,305,000	(1,305,000)	-	-	50,000	50,000	21
22	Series II - Variable Rate	(1)	03/01/00	10/01/37	11/12/03	-	-	-	797,000	(797,000)	-	-	26,000	26,000	22
23	Series JJ - Variable Rate	(1)	03/01/00	10/01/37	10/14/03	-	-	-	797,000	(797,000)	-	-	25,000	25,000	23
24	Sub-Total					$ -	$ -	$ -	$11,756,000	$ (11,756,000)	$ -	$ -	$ 452,000	$ 452,000	24
25	Total					$ 502,000,000	$ 502,000,000	$ 812,000	$22,191,000	$ 478,997,000	$ 21,322,000	$ 78,000	$ 1,018,000	$ 22,418,000	25
26	Embedded Cost of Long-Term Debt (M / I)													4.68%	26

Notes: (1) Tax-exempt bonds.
(2) Based on auction rate in effect at September 30, 2006.

The Peoples Gas Light and Coke Company

Unrecovered Common Equity Issuance Costs (1) (2)

Year Ended September 30, 2006

Line No.	Type	Date Issued	Shares	Per Share Offering Price	Gross Proceeds	Underwriting Discounts & Commissions	Net Proceeds	Company Issuance Expense	Selling & Issuance Costs
	[A]	[B]	[C]	[D]	[E]=C*D	[F]	[G]=E-F	[H]	[I]=(F+H)/E
1	Public	01-16-73	1,350,000 (3)	38.75	52,312,000	1,323,000	50,989,000	59,000	2.64%
2	Public	07-19-77	1,000,000 (3)	53.00	53,000,000	1,450,000	51,550,000	142,000	3.00%
3	Public	01-09-92	1,950,000 (4)	26.50	51,675,000	1,872,000	49,803,000	113,000 (5)	3.84%
4	Public	Various (6)	1,235,700 (4)	39.56 (7)	48,883,000	980,000	47,903,000	171,000	2.35%

Notes:
(1) When issuing Common Stock the Company records the Net Proceeds as an increase to Common Stockholders Equity. Issuance Expenses are charged directly to Common Stockholders Equity.
(2) Commission orders in Docket Nos. 57573, 76-0004, 78-0076, 79-0073, 80-0090, 82-0082, 83-0580, 90-0007, 91-0586 and 95-0032.
(3) Shares of Peoples Energy Corporation Common Stock sold under its former name Peoples Gas Company.
(4) Shares of Peoples Energy Corporation Common Stock.
(5) Included in this number is an estimate. Actual invoice for printing could not be found, therefore original estimate from printer of $25,000 was included.
(6) Peoples Energy entered into a sale agreement with Cantor Fitzgerald & Co on December 17, 2002 to sell up to 1,500,000 shares of common stock through a continuous share distribution program, at a commission rate of 2%. The numbers represent shares sold through September 30, 2006.
(7) Average price of shares issued under the continuous share distribution program.

Section 285.4070
Schedule D-7
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The Peoples Gas Light and Coke Company

Comparative Financial Data
(000s) except per share data

Line No.	Description	Source	Test Year Ended 9/30/2006	Historical Year Ended September 30, 2005	2004	2003	2002
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
1	Funds from Operations						
2	Net Income	FERC - Income Statement	$ (35,611)	$ 49,309	$ 45,265	$ 79,582	$ 77,301
3	Depreciation and Amortization	SEC Annual Report - Cash Flow	61,323	60,652	66,599	64,897	66,105
4	Deferred Income Tax and Investment Tax Credits - Net	SEC Annual Report - Cash Flow	(37,540)	(3,271)	2,917	17,126	34,503
5	AFUDC	N/A	-	-	-	-	-
6	Other Internal Sources:						
7	Pension Funding (Greater) Less Than Expense	SEC Annual Report - Cash Flow	(4,700)	(4,016)	2,977	(4,402)	(31,285)
8	Other Adjustments	SEC Annual Report - Cash Flow	(4,888)	17,197	(10,911)	(895)	25,090
9	Total Funds from Operations	Line 2 + 3 + 4 - 5 + 7 + 8	$ (21,416)	$ 119,871	$ 106,847	$ 156,308	$ 171,714
10	Capital Structure						
11	Short-term Debt (1)	FERC - Balance Sheet [231, 233]	$ -	$ 360	$ 30,999	$ 80,340	$ 98,146
12	Long-term Debt (2)	FERC - Balance Sheet [221, 226]	501,188	501,111	501,033	500,955	451,971
13	Preferred Stock	N/A	-	-	-	-	-
14	Common Equity:						
15	Common Equity Excluding AOCI	N/A	637,533	634,754	636,600	647,535	636,377
16	Accumulated Other Comprehensive Income (3)	FERC - Balance Sheet [219]	(1,428)	(21,482)	(7,080)	(21,052)	(491)
17	Common Equity Including AOCI	FERC - Balance Sheet	$ 636,105	$ 613,272	$ 629,520	$ 626,483	$ 635,886
18	Total Capital Including AOCI	Line 11 + 12 + 13 + 17	$ 1,137,293	$ 1,114,743	$ 1,161,552	$ 1,207,778	$ 1,186,003
19	Total Capital Excluding AOCI	Line 11 + 12 + 13 + 15	$ 1,138,721	$ 1,136,225	$ 1,168,632	$ 1,228,830	$ 1,186,494
20	Capital Structure Ratios - Including AOCI						
21	Short-term Debt Ratio	Line 11 / Line 18	0.00%	0.03%	2.67%	6.65%	8.28%
22	Long-term Debt Ratio	Line 12 / Line 18	44.07%	44.95%	43.13%	41.48%	38.11%
23	Preferred Stock Ratio	Line 13 / Line 18	0.00%	0.00%	0.00%	0.00%	0.00%
24	Common Equity Ratio	Line 17 / Line 18	55.93%	55.01%	54.20%	51.87%	53.62%
25	Capital Structure Ratios - Excluding AOCI						
26	Short-term Debt Ratio	Line 11 / Line 19	0.00%	0.03%	2.65%	6.54%	8.27%
27	Long-term Debt Ratio	Line 12 / Line 19	44.01%	44.10%	42.87%	40.77%	38.09%
28	Preferred Stock Ratio	Line 13 / Line 19	0.00%	0.00%	0.00%	0.00%	0.00%
29	Common Equity Ratio	Line 15 / Line 19	55.99%	55.87%	54.47%	52.70%	53.64%
30	Capital Structure Ratios - Excluding Short Term Debt and AOCI						
31	Long-term Debt Ratio	Line 12 / (Line 19 - Line 11)	44.01%	44.12%	44.04%	43.62%	41.53%
32	Preferred Stock Ratio	Line 13 /(Line 19 - Line 11)	0.00%	0.00%	0.00%	0.00%	0.00%
33	Common Equity Ratio	Line 15 / (Line 19 - Line 11)	55.99%	55.88%	55.96%	56.38%	58.47%

Notes:
(1) Excludes adjustable rate bonds that are classified as short-term debt for SEC reporting purposes.
(2) Includes long-term debt due within one year, adjustable rate bonds classified as short-term for SEC reporting purposes and unamortized discount on long-term debt.
(3) Prior to 2004, Accumulated Other Comprehensive Income activity was recorded in account 211.

The Peoples Gas Light and Coke Company

Comparative Financial Data
(000s) except per share data

Line No.	Description	Historical Source	Test Year Ended 9/30/2006	Historical Year Ended September 30, 2005	2004	2003	2002
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
34	Cost of Capital						
35	Embedded Cost of Long-term Debt	Sch. D-3, State Reg. Quarterly Filings	4.68%	4.37%	4.36%	5.19%	6.61%
36	Embedded Cost of Preferred Stock	N/A	-	-	-	-	-
37	Earnings Ratios						
38	Operating Income	FERC - Income Statement	$ (10,412)	$ 70,372	$ 64,889	$ 99,521	$ 96,875
39	Earnings Available for Common Equity (EACE)	Line 2 - Line 57	$ (35,611)	$ 49,309	$ 45,265	$ 79,582	$ 77,301
40	Net Original Cost Rate Base	Sch. B-1, State Reg. Quarterly Filings	$ 1,308,007	$ 1,120,530	$ 1,092,309	$ 1,073,036	$ 1,059,639
41	AFUDC as a percentage of EACE	Line 5 / Line 35	0.00%	0.00%	0.00%	0.00%	0.00%
42	Return on Net Original Cost Rate Base	Line 34 / Line 36	-0.80%	6.28%	5.94%	9.27%	9.14%
43	Return on Average Common Equity Including AOCI	Line 35 / 2-Yr. Avg. Line 17	-5.70%	7.94%	7.21%	12.61%	12.30%
44	Return on Average Common Equity Excluding AOCI	Line 35 / 2-Yr. Avg. Line 15	-5.60%	7.76%	7.05%	12.40%	12.27%
45	Fixed Charge Coverage						
46	Pre-Tax Interest Coverage:						
47	Total Operating Income	FERC - Income Statement	$ (10,412)	$ 70,372	$ 64,889	$ 99,521	$ 96,875
48	Income From Gas Plant Leased to Others	FERC - Income Statement [412, 413]	253	258	271	287	120
49	Other Income and Deductions, net	FERC - Income Statement [408.2 - 426.5]	1,591	2,509	1,231	2,256	4,229
50	Federal and State Income Taxes	FERC - Income Statement [409.1 - 411.4]	(25,960)	26,227	24,783	46,515	47,754
51	AFUDC Equity Funds Portion	N/A	-	-	-	-	-
52	Pre-tax Income Before Interest Charges	Line 43 + 44 + 45 + 46 - 47	$ (34,528)	$ 99,366	$ 91,174	$ 148,579	$ 148,978
53	Total Interest Charges	FERC - Income Statement [427 - 431]	$ 27,043	$ 23,830	$ 21,126	$ 22,482	$ 23,922
54	Pre-tax Interest Coverage	Line 48 / Line 49	(1.3)	4.2	4.3	6.6	6.2
55	After-tax Fixed Charge Coverage:						
56	Total Operating Income	FERC - Income Statement	$ (10,412)	$ 70,372	$ 64,889	$ 99,521	$ 96,875
57	Income From Gas Plant Leased to Others	FERC - Income Statement [412, 413]	253	258	271	287	120
58	Other Income and Deductions, net_	FERC - Income Statement [408.2 - 426.5]	1,591	2,509	1,231	2,256	4,229
59	Income Before Interest Charges	Line 52 + 53 + 54	$ (8,568)	$ 73,139	$ 66,391	$ 102,064	$ 101,224
60	Total Interest Charges	FERC - Income Statement [427 - 431]	$ 27,043	$ 23,830	$ 21,126	$ 22,482	$ 23,922
61	Preferred Dividends	N/A	-	-	-	-	-
62	After-tax Fixed Charge Coverage	Line 55 / (Line 56 + 57)	(0.3)	3.1	3.1	4.5	4.2
63	Cash Flow Ratios						
64	Funds from Operations	Line 9	$ (21,416)	$ 119,871	$ 106,847	$ 156,308	$ 171,714
65	Cash Interest Paid	SEC Annual Report - Cash Flow	23,797	22,391	19,572	19,897	22,987
66	Funds from Operation plus Cash Interest Paid	Line 60 + 61	$ 2,381	$ 142,262	$ 126,419	$ 176,205	$ 194,701
67	Total Interest Incurred	Line 49	$ 27,043	$ 23,830	$ 21,126	$ 22,482	$ 23,922
68	Funds Flow Interest Coverage	Line 62 / Line 63	0.1	6.0	6.0	7.8	8.1

The Peoples Gas Light and Coke Company

Comparative Financial Data
(000s) except per share data

Line No.	Description	Historical Source	Test Year Ended 9/30/2006	Historical Year Ended September 30, 2005	2004	2003	2002
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
69	Average Short-term Debt (1)	12 Month Average [231, 233]	$ 35,062	$ 31,490	$ 42,630	$ 65,036	$ 93,445
70	Average Long-term Debt (2)	12 Month Average [221, 226]	$ 501,153	$ 501,075	$ 510,206	$ 499,290	$ 451,949
71	Funds Flow as % of Average Total Debt	Line 60 / (Line 65 + 66)	-3.99%	22.51%	19.33%	27.70%	31.48%
72	Common Dividends	SEC Annual Report - Cash Flow	$ 15,400	$ 51,300	$ 56,200	$ 80,337	$ 52,862
73	Preferred Dividends	N/A	-	-	-	-	-
74	Cash Coverage of Common Dividends	(Line 60 - 69) / Line 68	(1.4)	2.3	1.9	1.9	3.2
75	Gross Construction Expenditures	SEC Annual Report - Cash Flow	$ 92,202	$ 73,021	$ 67,750	$ 73,007	$ 81,343
76	Net Cash Flow as % of Construction Expenditures	(Line 60 - 68 - 69) / (Line 71 - 5)	-40%	94%	75%	104%	146%
77	Common Stock Related Data						
78	Shares Outstanding - Fiscal Year End	SEC Annual Report	25,357,566	24,817,566	24,817,566	24,817,566	24,817,566
79	Shares Outstanding - Monthly Weighted Average	SEC Annual Report	24,952,566	24,817,566	24,817,566	24,817,566	24,817,566
80	Earnings Per Share - Weighted Average	(Line 35 * 1,000) / Line 75	($1.43)	$1.99	$1.82	$3.21	$ 3.11
81	Dividend Paid Per Share - Weighted Average	(Line 68 * 1,000) / Line 75	$0.62	$2.07	$2.26	$3.24	2.13
82	Dividend Payout Ratio (Declared Basis)	Line 68 / Line 35	-43%	104%	124%	101%	68%

Notes: (1) Excludes adjustable rate bonds that are classified as short-term debt for SEC reporting purposes.
(2) Includes long-term debt due within one year, adjustable rate bonds classified as short-term for SEC reporting purposes and unamortized discount on long-term debt.

The Peoples Gas Light and Coke Company

Comparative Financial Data
(000s) except per share data

Line	Description	Source	Test Year Ended 9/30/2006	Historical Year Ended September 30, 2005	2004	2003	2002
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
	Amounts Attributable to Non-Utility Subsidiaries						
1	Funds from Operations						
2	Net Income	FERC - Income Statement [418.10]	$ 18	$ (733)	$ 143	$ 344	$ 51
3	Depreciation and Amortization	N/A	-	-	-	-	-
4	Deferred Income Tax and Investment Tax Credits - Net	SEC Annual Report - Cash Flow	-	808	-	-	-
5	AFUDC	N/A	-	-	-	-	-
6	Other Internal Sources:						
7	Pension Funding (Greater) Less Than Expense	N/A	-	-	-	-	-
8	Other Adjustments	SEC Annual Report - Cash Flow	(18)	192	69	16	69
9	Total Funds from Operations	Line 2 + 3 + 4 - 5 + 7 + 8	$ -	$ 267	$ 212	$ 360	$ 120
10	Capital Structure						
11	Short-term Debt	N/A	$ -	$ -	$ -	$ -	$ -
12	Long-term Debt	N/A	-	-	-	-	-
13	Preferred Stock	N/A	-	-	-	-	-
14	Common Equity:						
15	Common Equity Excluding AOCI	N/A	5,329	6,360	7,093	6,950	6,606
16	Accumulated Other Comprehensive Income	N/A	-	-	-	-	-
17	Common Equity Including AOCI	FERC - Balance Sheet [123.10]	$ 5,329	$ 6,360	$ 7,093	$ 6,950	$ 6,606
18	Total Capital Including AOCI	Line 11 + 12 + 13 + 17	$ 5,329	$ 6,360	$ 7,093	$ 6,950	$ 6,606
19	Total Capital Excluding AOCI	Line 11 + 12 + 13 + 15	$ 5,329	$ 6,360	$ 7,093	$ 6,950	$ 6,606
20	Earnings Ratios						
21	Operating Income	N/A	-	-	-	-	-
22	Earnings Available for Common Equity (EACE)	Line 2 - Line 39	$ 18	$ (733)	$ 143	$ 344	$ 51
23	Net Original Cost Rate Base	N/A	-	-	-	-	-
24	Fixed Charge Coverage						
25	Pre-Tax Interest Coverage:						
26	Total Operating Income	N/A	$ -	$ -	$ -	$ -	$ -
27	Income From Gas Plant Leased to Others	N/A	-	-	-	-	-
28	Other Income and Deductions, net	FERC - Income Statement [418.10]	18	(733)	143	344	51
29	Federal and State Income Taxes	N/A	-	-	-	-	-
30	AFUDC Equity Funds Portion	N/A	-	-	-	-	-
31	Pre-tax Income Before Interest Charges	Line 26 + 27 + 28 + 29 - 30	$ 18	$ (733)	$ 143	$ 344	$ 51
32	Total Interest Charges	N/A	-	-	-	-	-

The Peoples Gas Light and Coke Company

Comparative Financial Data
(000s) except per share data

Line	Description	Source	Test Year Ended 9/30/2006	Historical Year Ended September 30, 2005	2004	2003	2002
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
33	After-tax Fixed Charge Coverage:						
34	Total Operating Income	N/A	$ -	$ -	$ -	$ -	$ -
35	Income From Gas Plant Leased to Others	N/A	-	-	-	-	-
36	Other Income and Deductions, net_	FERC - Income Statement [418.10]	18	(733)	143	344	51
37	Income Before Interest Charges	Line 34 + 35 + 36	$ 18	$ (733)	$ 143	$ 344	$ 51
38	Total Interest Charges	N/A	-	-	-	-	-
39	Preferred Dividends	N/A	-	-	-	-	-
40	Cash Flow Ratios						
41	Funds from Operations	Line 9	$ -	$ 267	$ 212	$ 360	$ 120
42	Cash Interest Paid	N/A	-	-	-	-	-
43	Funds from Operation plus Cash Interest Paid	Line 41 + 42	$ -	$ 267	$ 212	$ 360	$ 120
44	Total Interest Incurred	N/A	-	-	-	-	-
45	Average Short-term Debt	N/A	-	-	-	-	-
46	Average Long-term Debt	N/A	-	-	-	-	-
47	Common Dividends	N/A	-	-	-	-	-
48	Preferred Dividends	N/A	-	-	-	-	-
49	Gross Construction Expenditures	N/A	-	-	-	-	-
50	Common Stock Related Data						
51	Shares Outstanding - Fiscal Year End	N/A	-	-	-	-	-
52	Shares Outstanding - Monthly Weighted Average	N/A	-	-	-	-	-

The Peoples Gas Light and Coke Company

Security Quality Rating Changes

		Moodys		Standard & Poors		Fitch (1)	
Line No.	Debt	Rating	Date Assigned	Rating	Date Assigned	Rating	Date Assigned
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
1	Senior Secured Debt	A1	04/21/06	A-	No change in	A+	05/05/06
2	(First Mortgage Bonds)				last 5 years.	AA-	07/29/03
3	Short-Term Debt	P-1	No change in	A-2	No change in	F1	07/29/03
4	(Commercial Paper)		last 5 years.		last 5 years.		

Note: (1) The Fitch rating relationship was not renewed past the October 8, 2006 expiration date.

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	:	
	:	
	:	No. 07-____
Proposed General Increase	:	
In Rates For Gas Service	:	

Direct Testimony of

BRADLEY A. JOHNSON

Treasurer
North Shore Gas Company

TABLE OF CONTENTS

I. INTRODUCTION AND BACKGROUND

A. Witness Introduction, Background and Experience

Q. Please state your name and business address.

A. My name is Bradley A. Johnson, and my business address is 130 East Randolph Drive, Chicago, IL 60611.

Q. What is your current position with North Shore Gas Company ("North Shore" or "Company")?

A. My current position is Treasurer.

Q. Please outline your educational background and business experience.

A. I graduated from the University of Wisconsin – Eau Claire in 1976 with a major in accounting. I received a Masters Degree in Business Administration from the University of Wisconsin – Oshkosh in 1984. I joined Wisconsin Public Service Corporation ("WPSC") as a tax accountant in November of 1979. I held various positions in the Tax Department and the Corporate Planning Department prior to being named Assistant Treasurer of WPS Resources Corporation in April 2001, Treasurer in February 2002, and Vice President and Treasurer in 2004. Upon the recent merger transaction by which Peoples Energy became a wholly-owned subsidiary of WPS Resources Corporation, which was renamed Integrys Energy Group ("Integrys"), I was named Vice President and Treasurer of Integrys and its affiliates, including North Shore Gas Company.

Q. What are your responsibilities in your present position?

A. My responsibilities include directing the financing, treasury management, financial analysis and forecasting, and oversight of financial risk management activities of Integrys and its affiliates, including North Shore Gas Company.

B. Purpose of Testimony and Itemized Attachments

Q. What is the purpose of your direct testimony?

A. The purpose of my direct testimony is to identify and support the Company's requested overall rate of return on its proposed rate base ("cost of capital"), including its embedded cost of long-term debt and proposed capital structure for the test year. The proposed return on equity component of the cost of capital is presented by North Shore witness Mr. Moul in his direct testimony (North Shore Exhibit ("Ex.") PRM-1.0).

Q. Are you sponsoring any exhibits?

A. Yes, I am sponsoring the following exhibits:

Exhibit No.		Corresponding 83 Ill. Admin. Code Part 285 Schedule
North Shore Ex. BAJ-1.1	D-1	Cost of Capital Summary
North Shore Ex. BAJ-1.2	D-3	Embedded Cost of Long-Term Debt
North Shore Ex. BAJ-1.3	D-5	Unrecovered Common Equity Issuance Costs
North Shore Ex. BAJ-1.4	D-7	Comparative Financial Data
North Shore Ex. BAJ-1.5	D-8	Security Quality Ratings

Q. What cost of capital is the Company proposing be used to establish the rate of return on rate base in this case?

A. As shown in North Shore Ex. BAJ-1.1, the Company calculates a cost of capital and rate of return on rate base for the fiscal 2006 test year of 8.57%, which reflects a capital structure of 56% common equity and 44% long-term debt, a cost of equity of 11.06%, and an embedded cost of long-term debt of 5.42%.

Q. Is it important that the Company be allowed the opportunity to earn its test year cost of capital through the setting of the authorized return on rate base?

A. Yes. The Company's obligation to provide safe, adequate and reliable service to its customers requires that it maintain its financial integrity and ability to readily access the capital markets on reasonable terms and conditions. This requires that it earn a fair and reasonable rate of return on investment that is consistent with the return expected by investors on investments of comparable risk. This in turn necessitates, among other things, that the allowed return on rate base be set equal to the utility's actual cost of capital in the historical test year. If the Company is not permitted a reasonable opportunity to earn its full cost of capital, its financial integrity and ability to raise capital on reasonable terms will be at risk, which in turn will threaten its ability to meet its service obligations.

Q. Have the Company's returns on equity and its key credit ratios declined in recent years, and will they continue to decline absent the requested rate relief?

A. As shown in North Shore Ex. BAJ-1.4 and summarized in the following table, the Company's equity returns have declined substantially since 2003, and will continue to do so absent rate relief. In addition, the Company's pre-tax interest coverage ratio has declined, while its cash flow coverage ratios have remained strong. Absent the requested rate relief, these key credit ratios will deteriorate to levels that are insufficient to maintain the Company's current ratings or its ability to raise capital on reasonable terms.

	2003	2004	2005	2006(a)
Return on Average Common Equity	14.1%	10.7%	11.0%	9.1%
Funds Flow Interest Coverage	6.9x	7.3x	4.9x	7.4x
Funds From Operations/Avg Total Debt	32.6%	35.6%	21.7%	37.1%
Pre-Tax Interest Coverage	7.0x	5.6x	5.7x	4.6x

II. CAPITAL STRUCTURE

Q. Please describe the corporate structure of North Shore and its relationship to Peoples Energy and Integrys..

A. North Shore is an Illinois corporation whose common equity is wholly owned by Peoples Energy, an Illinois corporation and public utility holding company. The common equity of Peoples Energy is wholly owned by Integrys, a Wisconsin corporation and public utility holding company. Shares of Integrys trade on the New York Stock Exchange under the symbol "TEG." North Shore currently has no outstanding authority to, and has no plans to, sell common equity to any other entity.

Q. Does North Shore issue debt independently of Peoples Energy and Integrys?

A. Yes. North Shore issues first mortgage bonds to the public independently of Peoples Energy and Integrys for the purpose of funding long-term investment in rate base. The long-term debt of North Shore is owned entirely by the public and not by Peoples Energy or Integrys. The Commission has also granted approval for North Shore to borrow funds on a short-term basis from Peoples Energy and its affiliate, The Peoples Gas Light and Coke Company. However, such borrowing authority is used only to finance the Company's short-term seasonal borrowing needs and is not a source of permanent funding for the Company.

Q. What capital structure does North Shore propose for the purposes of re-setting its rates?

A. North Shore proposes a capital structure consisting of 56% equity and 44% long-term debt, excluding Accumulated Other Comprehensive Income/(Loss) ("AOCI").

Q. Why have you excluded AOCI from the Company's proposed capital structure?

A. AOCI arises at North Shore almost entirely due to pension accounting rules that require a minimum pension liability be recorded on the balance sheet when the present value of projected future pension benefits earned by employees exceeds the market value of trust fund assets. This accounting entry impacts AOCI. Since both the present value of pension benefits earned and asset values are based on market data, the impact on AOCI can be quite volatile as capital market values and interest rates rise and fall. However, there is no cash impact, and these accounting entries have nothing to do with financing the rate base of the Company or its permanent capitalization. Essentially, AOCI represents contingent assets or liabilities that may never be fully recognized. The true impact of these assets and liabilities are realized through time in the form of actual benefits paid, pension expense, and pension contributions.

Q. Is the proposed capital structure reasonable and appropriate for North Shore?

A. Yes. As a public utility with an obligation to serve, North Shore must have ready access to the capital markets when required under all types of market conditions. A strong capital structure helps to provide for such access by allowing the Company to maintain strong credit ratings on its debt. As shown in North Shore Ex. BAJ-1.5, despite recent downgrades by Moody's and Fitch, North Shore still has reasonably strong credit ratings, with an A- rating from Standard & Poor's and an A1 rating from Moodys (Fitch no longer provides coverage of North Shore). As shown by Mr. Moul, these ratings are above average among the S&P Public Utilities.

A strong capital structure also helps to insulate the Company from "event-driven" financial shocks. This is particularly important in the current high gas price environment, which may require the Company to issue significant amounts of short-term debt over-and-above its long-term obligations in order to meet its seasonal cash requirements. A strong capital structure also reduces the Company's operating costs by reducing its cost of debt as well as the cost of providing credit in various forms to counter-parties. For all of these reasons, the proposed capital structure is reasonable and appropriate for North Shore.

Q. How does the proposed capital structure for the fiscal 2006 test year compare to the Company's actual capital structure?

A. The proposed capital structure reflects a lower percentage of equity than the fiscal 2006 year-end and average capital structures as well as the average capital structure employed by the Company over the past several years. As shown in North Shore Ex. BAJ-1.4, the Company's fiscal 2006 year-end capital structure excluding AOCI was 59.3% common equity and 40.7% long-term debt. The fiscal 2006 13-month average capital structure was 59.1% common equity and 40.9% long-term debt. Over the five year period 2001-2005, the Company's year-end capital structure excluding AOCI averaged 60.0% common equity and 40.0% long-term debt. However, the Company believes that a capital structure comprised of 56% equity and 44% long-term debt is sufficient to achieve the objectives discussed earlier in my testimony.

Q. What impact did the Company's fiscal 2006 charges related to the settlement of its 2000 through 2004 gas charge proceedings ("the settlement charges") have on the 2006 year-end capital structure?

A. The settlement charges reduced common equity by $2.6 million at the time the charges were recorded. However, North Shore omitted dividend payments to Peoples Energy, its parent company, for the third and fourth quarters of fiscal 2006, which restored the common equity balance at fiscal year-end to approximately what it would have been absent the settlement charges. North Shore will continue to manage its capital structure to remain consistent with the proposed capital structure.

Q. How does the proposed capital structure compare to the capital structures approved by the Commission in other recent rate case decisions for gas utilities in Illinois?

A. The Company's proposed capital structure, which reflects a debt to total capital ratio of 44%, is consistent with the capital structures used in other recent gas utility rate orders. For example, summarized below are the ratios of debt to total capital reflected in the capital structures approved by the Commission in recent utility gas rate orders.

Company	Docket Number	% Debt/ Total Capital
NICOR GAS	DOCKET 04-0779	43.5%
ILLINOIS POWER (GAS)	DOCKET 04-0476	44.9%
AMEREN CILCO (GAS)	DOCKETS 02-O798,03-008,03-009	45.7%
Ameren Union Elec (Gas)	Dockets 02-O798,03-008,03-009	45.0%
Ameren CIPS (Gas)	Dockets 02-O798,03-008,03-009	49.1%

Q. Is the proposed capital structure reasonable when compared with the peer companies ("the Gas Group") used by Company witness Mr. Moul to develop his return on equity recommendation?

A. Yes, as discussed in Mr. Moul's testimony, the Company's proposed common equity percentage reflected in its test year capital structure falls within the range of common equity percentages of the Gas Group and is comparable to the forecasted 2006 and 2007 averages for those companies of 54.5% and 54.9%, respectively.

Q. Would it be appropriate to include a short-term borrowing component in the Company's test year capital structure?

A. No. North Shore uses short-term debt only to finance seasonal cash needs, particularly for purchased gas costs and short-term construction work in progress, not as a permanent source of financing rate base investments. The Company's practice is to finance its long-lived, permanent assets with permanent capital consisting of long-term debt and common equity. In fact, during many months of the year the Company has no short-term debt outstanding. For example, during fiscal year 2006 no short-term debt was outstanding for 302 days throughout the year, including consecutively from February 6 to September 30, 2006. During fiscal year 2005, no short-term debt was outstanding on 290 days throughout the year, including consecutively from February 1, 2005 to September 30, 2005. During fiscal 2004, no short-term debt was outstanding on 319 days throughout the year, including consecutively from January 28, 2004 to September 27, 2004.

III. COST OF COMMON EQUITY

Q. What cost of common equity does the Company propose?

A. As discussed and supported in the testimony of Company witness Mr. Moul, the Company is proposing a cost of common equity of 11.06%.

Q. What information is shown on Respondent's North Shore Ex. BAJ-1.3?

A. North Shore Ex. BAJ-1.3 shows the Company's unrecovered common equity issuance costs since 1973. As indicated on the Exhibit, the Company's parent Peoples Energy most recently has raised equity capital from the public through a continuous share distribution program managed by Cantor Fitzgerald as underwriter, at an average issuance cost of 2.35%. This program was run by Peoples Energy prior to its merger into the Integrys organization. Previous equity issuances by Peoples Energy have cost between 2.64% and 3.84%. Mr. Moul's testimony discusses and supports the inclusion of a 0.2% component for equity issuance costs, or flotation costs, in the proposed return on common equity.

IV. EMBEDDED COST OF LONG-TERM DEBT

Q. What is the embedded cost of long-term debt included in the proposed test year cost of capital for North Shore?

A. The embedded cost of long-term debt included in the proposed test year cost of capital is 5.42%, which is the Company's actual embedded cost of debt for fiscal year 2006 as shown in North Shore Ex. BAJ-1.2.

Q. What efforts has the Company made to reduce its embedded cost of debt since its last rate case in 1995?

A. The Company has refinanced its entire long-term debt portfolio since 1995 to take advantage of a lower interest rate environment. As a result of these efforts, the Company has reduced its embedded cost of long-term debt from 7.70% as allowed by the Commission in Docket 95-0031 to 5.42% for fiscal 2006.

Q. Does this complete your direct testimony?

A. Yes.

North Shore Gas Company

Cost of Capital Summary (1)

Line No.	Class of Capital	Historical Test Year Ended September 30, 2006: Amount (2)	Percent of Total	Percent Cost	Cost Reference	Weighted Cost	Line No.
	(A)	(B)	(C)	(D)	(E)	(F) = (C X D)	
1	Long-term Debt (3)	$ 65,616,000	39.38%	5.42% (4)	D-3	2.13%	1
2	Common Equity	101,019,000	60.62%	11.06% (5)		6.70%	2
3	Total Capital	$ 166,635,000				8.83%	3

	Class of Capital	Proforma Test Year Ending September 30, 2006: Amount	Percent of Total	Percent Cost	Cost Reference	Weighted Cost	
	(A)	(B)	(C)	(D)	(E)	(F) = (C X D)	
4	Long-term Debt (3)		44.00%	5.42% (4)	D-3	2.38%	4
5	Common Equity		56.00%	11.06% (5)		6.19%	5
6	Total Capital					8.57%	6

Notes: (1) The weights and costs of the components of the capital structure do not differ from total company data.
(2) Long Term Debt balances at year end current proceeds. Common Equity balances based at year-end excluding Accumulated Other Comprehensive Income.
(3) No redeemable long-term debt due within one year.
(4) Long Term Debt percent cost is based on year-end current proceeds.
(5) Cost of common equity requested in this filing.

North Shore Gas Company

Embedded Cost of Long-Term Debt

Net Proceeds Method

Line No.	Debt Issue Type, Coupon Rate		Date Issued	Maturity Date	Date Reacquired	Principal Amount	Face Amount Outstanding	Unamortized Discount or (Premium)	Unamortized Debt Expense (Gain)	Carrying Value	Annual Coupon Interest	Annualized Amort. of Discount or (Premium)	Annualized Amort. of Debt Expense	Annualized Interest Expense	Line No.
	[A]		[B]	[C]	[D]	[E]	[F]	[G]	[H]	[I]=[F-G-H]	[J]=[A*F]	[K]	[L]	[M]=[J+K+L]	
	Test Year Ended September 30, 2006														
1	First Mortgage Bonds:														1
2	Series M - 5.00%	(1)	12/18/98	12/01/28		$ 30,035,000	$ 29,250,000	$ -	$ 1,046,000	$ 28,204,000	$ 1,463,000	$ -	$ 47,000	$ 1,510,000	2
3	Series N-2 - 4.625		04/29/03	05/01/13		40,000,000	40,000,000	21,000	528,000	39,451,000	1,850,000	3,000	80,000	1,933,000	3
4	Sub-Total					$ 70,035,000	$ 69,250,000	$ 21,000	$ 1,574,000	$ 67,655,000	$ 3,313,000	$ 3,000	$ 127,000	$ 3,443,000	4
5	Less: Amortization of Losses on Reacquired Bonds														5
6	Series J - 8%		11/01/90	11/01/20	12/05/02	$ -	$ -	$ -	$ 760,000	$ (760,000)	$ -	$ -	$ 54,000	$ 54,000	6
7	Series K - 6-3/8	(1)	10/01/92	12/01/28	01/19/99	-	-	-	1,265,000	(1,265,000)	-	-	57,000	57,000	7
8	Series M - 5.00	(1)	12/18/98	12/01/28	Various	-	-	-	14,000	(14,000)	-	-	1,000	1,000	8
9	Sub-Total					$ -	$ -	$ -	$ 2,039,000	$ (2,039,000)	$ -	$ -	$ 112,000	$ 112,000	9
10	Total					$ 70,035,000	$ 69,250,000	$ 21,000	$ 3,613,000	$ 65,616,000	$ 3,313,000	$ 3,000	$ 239,000	$ 3,555,000	10
11	Embedded Cost of Long-Term Debt (M / I)													5.42%	11

Note: (1) Tax-exempt bond.

North Shore Gas Company

Unrecovered Common Equity Issuance Costs (1) (2)

Year Ended September 30, 2006

Line No.	Type	Date Issued	Shares	Per Share Offering Price	Gross Proceeds	Underwriting Discounts & Commissions	Net Proceeds	Company Issuance Expense	Selling & Issuance Costs
	[A]	[B]	[C]	[D]	[E]=C*D	[F]	[G]=E-F	[H]	[I]=(F+H)/E
1	Public	01-16-73	1,350,000 (3)	38.75	52,312,000	1,323,000	50,989,000	59,000	2.64%
2	Public	07-19-77	1,000,000 (3)	53.00	53,000,000	1,450,000	51,550,000	142,000	3.00%
3	Public	01-09-92	1,950,000 (4)	26.50	51,675,000	1,872,000	49,803,000	113,000 (5)	3.84%
4	Public	Various (6)	1,235,700 (4)	39.56 (7)	48,883,000	980,000	47,903,000	171,000	2.35%

Notes:
(1) When issuing Common Stock the Company records the Net Proceeds as an increase to Common Stockholders Equity. Issuance Expenses are charged directly to Common Stockholders Equity.
(2) The Illinois Commerce Commission has not previously approved rate treatment of these costs. See Illinois Commerce Commission orders in Docket Nos. 58534, 77-0376, 79-0072, 80-0089, 82-0189, 83-0630, 91-0010 and 95-0031.
(3) Shares of Peoples Energy Corporation Common Stock sold under its former name Peoples Gas Company.
(4) Shares of Peoples Energy Corporation Common Stock.
(5) Included in this number is an estimate. Actual invoice for printing could not be found, therefore original estimate from printer of $25,000 was included.
(6) Peoples Energy entered into a sale agreement with Cantor Fitzgerald & Co on December 17, 2002 to sell up to 1,500,000 shares of common stock through a continuous share distribution program, at a commission rate of 2%. The numbers represent shares sold through September 30, 2006.
(7) Average price of shares issued under the continuous share distribution program.

North Shore Gas Company

Comparative Financial Data
(000s) except per share data

Line	Description	Source	Test Year Ended 9/30/2006	Historical Year Ended September 30, 2005	2004	2003	2002
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
1	Funds from Operations						
2	Net Income	FERC - Income Statement	$ 6,707	$ 11,397	$ 11,076	$ 14,545	$ 12,921
3	Depreciation and Amortization	SEC Annual Report - Cash Flow	6,594	6,548	8,403	7,631	7,120
4	Deferred Income Tax and Investment Tax Credits - Net	SEC Annual Report - Cash Flow	3,420	6,015	3,095	1,452	3,993
5	AFUDC	N/A	-	-	-	-	-
6	Other Internal Sources:						
7	Pension Funding (Greater) Less Than Expensed	SEC Annual Report - Cash Flow	1,495	(6,949)	2,801	1,675	801
8	Other Adjustments	SEC Annual Report - Cash Flow	5,815	(1,671)	(270)	(2,199)	1,933
9	Total Funds from Operations	Line 2 + 3 + 4 - 5 + 7 + 8	$ 24,031	$ 15,340	$ 25,105	$ 23,104	$ 26,768
10	Capital Structure						
11	Short-term Debt	FERC - Balance Sheet [231, 233]	$ -	$ -	$ 3,810	$ -	$ 2,210
12	Long-term Debt (1)	FERC - Balance Sheet [221, 226]	69,229	69,226	69,303	69,314	69,008
13	Preferred Stock	N/A	-	-	-	-	-
14	Common Equity:						
15	Common Equity Excluding AOCI	N/A	101,019	105,312	105,015	105,639	102,483
16	Accumulated Other Comprehensive Income	FERC - Balance Sheet [219]	(150)	(2,376)	(1,336)	(2,278)	-
17	Common Equity Including AOCI	FERC - Balance Sheet	$ 100,869	$ 102,936	$ 103,679	$ 103,361	$ 102,483
18	Total Capital Including AOCI	Line 11 + 12 + 13 + 17	$ 170,098	$ 172,162	$ 176,792	$ 172,675	$ 173,701
19	Total Capital Excluding AOCI	Line 11 + 12 + 13 + 15	$ 170,248	$ 174,538	$ 178,128	$ 174,953	$ 173,701
20	Capital Structure Ratios - Including AOCI						
21	Short-term Debt Ratio	Line 11 / Line 18	0.00%	0.00%	2.16%	0.00%	1.27%
22	Long-term Debt Ratio	Line 12 / Line 18	40.70%	40.21%	39.20%	40.14%	39.73%
23	Preferred Stock Ratio	Line 13 / Line 18	0.00%	0.00%	0.00%	0.00%	0.00%
24	Common Equity Ratio	Line 17 / Line 18	59.30%	59.79%	58.64%	59.86%	59.00%
25	Capital Structure Ratios - Excluding AOCI						
26	Short-term Debt Ratio	Line 11 / Line 19	0.00%	0.00%	2.14%	0.00%	1.27%
27	Long-term Debt Ratio	Line 12 / Line 19	40.66%	39.66%	38.91%	39.62%	39.73%
28	Preferred Stock Ratio	Line 13 / Line 19	0.00%	0.00%	0.00%	0.00%	0.00%
29	Common Equity Ratio	Line 15 / Line 19	59.34%	60.34%	58.95%	60.38%	59.00%
30	Capital Structure Ratios - Excluding Short Term Debt and AOCI						
31	Long-term Debt Ratio	Line 12 / (Line 19 - Line 11)	40.66%	39.66%	39.76%	39.62%	40.24%
32	Preferred Stock Ratio	Line 13 / (Line 19 - Line 11)	0.00%	0.00%	0.00%	0.00%	0.00%
33	Common Equity Ratio	Line 15 / (Line 19 - Line 11)	59.34%	60.34%	60.24%	60.38%	59.76%

Note: (1) Includes long-term debt due within one year and unamortized discount on long-term debt.

North Shore Gas Company

Comparative Financial Data
(000s) except per share data

Line	Description	Historical Source	Test Year Ended 9/30/2006	Historical Year Ended September 30, 2005	2004	2003	2002
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
34	Cost of Capital						
35	Embedded Cost of Long-term Debt	Sch. D-3, State Reg. Quarterly Filings	5.42%	5.30%	5.31%	5.31%	6.99%
36	Embedded Cost of Preferred Stock	N/A	-	-	-	-	-
37	Earnings Ratios						
38	Operating Income	FERC - Income Statement	$ 10,093	$ 14,791	$ 14,289	$ 18,199	$ 16,455
39	Earnings Available for Common Equity (EACE)	Line 2 - Line 57	$ 6,707	$ 11,397	$ 11,076	$ 14,545	$ 12,921
40	Net Original Cost Rate Base	Sch. B-1, State Reg. Quarterly Filings	$ 197,107	$ 185,808	$ 187,165	$ 187,237	$ 188,641
41	AFUDC as a percentage of EACE	Line 5 / Line 35	0.00%	0.00%	0.00%	0.00%	0.00%
42	Return on Net Original Cost Rate Base	Line 34 / Line 36	5.12%	7.96%	7.63%	9.72%	8.72%
43	Return on Average Common Equity Including AOCI	Line 35 / 2-Yr. Avg. Line 17	6.58%	11.03%	10.70%	14.13%	12.72%
44	Return on Average Common Equity Excluding AOCI	Line 35 / 2-Yr. Avg. Line 15	6.50%	10.84%	10.52%	13.98%	12.72%
45	Fixed Charge Coverage						
46	Pre-Tax Interest Coverage:						
47	Total Operating Income	FERC - Income Statement	$ 10,093	$ 14,791	$ 14,289	$ 18,199	$ 16,455
48	Income From Gas Plant Leased to Others	FERC - Income Statement [412, 413]	-	-	-	-	-
49	Other Income and Deductions, net	FERC - Income Statement [408.2 - 426.5]	701	425	692	233	1,602
50	Federal and State Income Taxes	FERC - Income Statement [409.1 - 411.4]	3,797	6,656	6,743	8,712	7,916
51	AFUDC Equity Funds Portion	N/A	-	-	-	-	-
52	Pre-tax Income Before Interest Charges	Line 43 + 44 + 45 + 46 - 47	$ 14,591	$ 21,872	$ 21,724	$ 27,144	$ 25,973
53	Total Interest Charges	FERC - Income Statement [427 - 431]	$ 4,087	$ 3,818	$ 3,905	$ 3,887	$ 5,137
54	Pre-tax Interest Coverage	Line 48 / Line 49	3.6	5.7	5.6	7.0	5.1
55	After-tax Fixed Charge Coverage:						
56	Total Operating Income	FERC - Income Statement	$ 10,093	$ 14,791	$ 14,289	$ 18,199	$ 16,455
57	Income From Gas Plant Leased to Others	FERC - Income Statement [412, 413]	-	-	-	-	-
58	Other Income and Deductions, net	FERC - Income Statement [408.2 - 426.5]	701	425	692	233	1,602
59	Income Before Interest Charges	Line 52 + 53 + 54	$ 10,794	$ 15,216	$ 14,981	$ 18,432	$ 18,057
60	Total Interest Charges	FERC - Income Statement [427 - 431]	$ 4,087	$ 3,818	$ 3,905	$ 3,887	$ 5,137
61	Preferred Dividends	N/A	-	-	-	-	-
62	After-tax Fixed Charge Coverage	Line 55 / (Line 56 + 57)	2.6	4.0	3.8	4.7	3.5

North Shore Gas Company

Comparative Financial Data
(000s) except per share data

Line	Description	Historical Source	Test Year Ended 9/30/2006	Historical Year Ended September 30, 2005	2004	2003	2002
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
63	Cash Flow Ratios						
64	Funds from Operations	Line 9	$ 24,031	$ 15,340	$ 25,105	$ 23,104	$ 26,768
65	Cash Interest Paid	SEC Annual Report - Cash Flow	3,621	3,531	3,456	3,753	4,549
66	Funds from Operation plus Cash Interest Paid	Line 60 + 61	$ 27,652	$ 18,871	$ 28,561	$ 26,857	$ 31,317
67	Total Interest Incurred	Line 49	$ 4,087	$ 3,818	$ 3,905	$ 3,887	$ 5,137
68	Funds Flow Interest Coverage	Line 62 / Line 63	6.8	4.9	7.3	6.9	6.1
69	Average Short-term Debt	12 Month Average [231, 233]	$ 2,560	$ 1,497	$ 1,198	$ 8,821	$ 1,436
70	Average Long-term Debt	12 Month Average [221, 226]	$ 69,227	$ 69,238	$ 69,304	$ 62,168	$ 69,059
71	Funds Flow as % of Average Total Debt	Line 60 / (Line 65 + 66)	33.48%	21.69%	35.61%	32.55%	37.97%
72	Common Dividends	SEC Annual Report - Cash Flow	$ 11,000	$ 11,100	$ 11,700	$ 11,389	$ 11,132
73	Preferred Dividends	N/A	-	-	-	-	-
74	Cash Coverage of Common Dividends	(Line 60 - 69) / Line 68	2.2	1.4	2.1	2.0	2.4
75	Gross Construction Expenditures	SEC Annual Report - Cash Flow	$ 9,418	$ 9,815	$ 10,592	$ 8,992	$ 11,334
76	Net Cash Flow as % of Construction Expenditures	(Line 60 - 68 - 69) / (Line 71 - 5)	138%	43%	127%	130%	138%
77	Common Stock Related Data						
78	Shares Outstanding - Fiscal Year End	SEC Annual Report	3,625,887	3,625,887	3,625,887	3,625,887	3,625,887
79	Shares Outstanding - Monthly Weighted Average	SEC Annual Report	3,625,887	3,625,887	3,625,887	3,625,887	3,625,887
80	Earnings Per Share - Weighted Average	(Line 35 * 1,000) / Line 75	$1.85	$3.14	$3.05	$4.01	$3.56
81	Dividend Paid Per Share - Weighted Average	(Line 68 * 1,000) / Line 75	$3.03	$3.06	$3.23	$3.14	$3.07
82	Dividend Payout Ratio (Declared Basis)	Line 68 / Line 35	164%	97%	106%	78%	86%

North Shore Gas Company

Comparative Financial Data
(000s) except per share data

Line	Description	Source	Test Year Ended 9/30/2006	Historical Year Ended September 30, 2005	2004	2003	2002
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
	Amounts Attributable to Non-Utility Subsidiaries						
1	Funds from Operations						
2	Net Income	FERC - Income Statement [418.10]	$ -	$ -	$ -	$ -	$ 6
3	Depreciation and Amortization	N/A	-	-	-	-	-
4	Deferred Income Tax and Investment Tax Credits - Net	N/A	-	-	-	-	-
5	AFUDC	N/A	-	-	-	-	-
6	Other Internal Sources:						
7	Pension Funding (Greater) Less Than Expense	N/A	-	-	-	-	-
8	Other Adjustments	SEC Annual Report - Cash Flow	-	-	-	-	3
9	Total Funds from Operations		$ -	$ -	$ -	$ -	$ 9
10	Capital Structure						
11	Short-term Debt	N/A	$ -	$ -	$ -	$ -	$ -
12	Long-term Debt	N/A	-	-	-	-	-
13	Preferred Stock	N/A	-	-	-	-	-
14	Common Equity:						
15	Common Equity Excluding AOCI	N/A	-	153	153	153	153
16	Accumulated Other Comprehensive Income	N/A	-	-	-	-	-
17	Common Equity Including AOCI	FERC - Balance Sheet [123.10]	$ -	$ 153	$ 153	$ 153	$ 153
18	Total Capital Including AOCI	Line 11 + 12 + 13 + 17	$ -	$ 153	$ 153	$ 153	$ 153
19	Total Capital Excluding AOCI	Line 11 + 12 + 13 + 15	$ -	$ 153	$ 153	$ 153	$ 153
20	Earnings Ratios						
21	Operating Income	N/A	-	-	-	-	-
22	Earnings Available for Common Equity (EACE)	Line 2 - Line 39	$ -	$ -	$ -	$ -	$ 6
23	Net Original Cost Rate Base	N/A	-	-	-	-	-
24	Fixed Charge Coverage						
25	Pre-Tax Interest Coverage:						
26	Total Operating Income	N/A	$ -	$ -	$ -	$ -	$ -
27	Income From Gas Plant Leased to Others	N/A	-	-	-	-	-
28	Other Income and Deductions, net	FERC - Income Statement [418.10]	-	-	-	-	6
29	Federal and State Income Taxes	N/A	-	-	-	-	-
30	AFUDC Equity Funds Portion	N/A	-	-	-	-	-
31	Pre-tax Income Before Interest Charges	Line 26 + 27 + 28 + 29 - 30	$ -	$ -	$ -	$ -	$ 6
32	Total Interest Charges		-	-	-	-	-

Section 285.4070
Schedule D-7
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North Shore Gas Company

Comparative Financial Data
(000s) except per share data

Line	Description	Source	Test Year Ended 9/30/2006	Historical Year Ended September 30, 2005	2004	2003	2002
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
33	After-tax Fixed Charge Coverage:						
34	Total Operating Income	N/A	$ -	$ -	$ -	$ -	$ -
35	Income From Gas Plant Leased to Others	N/A	-	-	-	-	-
36	Other Income and Deductions, net_	FERC - Income Statement [418.10]	-	-	-	-	6
37	Income Before Interest Charges	Line 34 + 35 + 36	$ -	$ -	$ -	$ -	$ 6
38	Total Interest Charges	N/A	-	-	-	-	-
39	Preferred Dividends	N/A	-	-	-	-	-
40	Cash Flow Ratios						
41	Funds from Operations	Line 9	$ -	$ -	$ -	$ -	$ 9
42	Cash Interest Paid	N/A	-	-	-	-	-
43	Funds from Operation plus Cash Interest Paid	Line 41 + 42	$ -	$ -	$ -	$ -	$ 9
44	Total Interest Incurred		-	-	-	-	-
45	Average Short-term Debt	N/A	-	-	-	-	-
46	Average Long-term Debt	N/A	-	-	-	-	-
47	Common Dividends	N/A	-	-	-	-	-
48	Preferred Dividends	N/A	-	-	-	-	-
49	Gross Construction Expenditures	N/A	-	-	-	-	-
50	Common Stock Related Data						
51	Shares Outstanding - Fiscal Year End	N/A	-	-	-	-	-
52	Shares Outstanding - Monthly Weighted Average	N/A	-	-	-	-	-

North Shore Gas Company

Security Quality Rating Changes

		Moodys		Standard & Poors		Fitch (1)	
Line No.	Debt	Rating	Date Assigned	Rating	Date Assigned	Rating	Date Assigned
	[A]	[B]	[C]	[D]	[E]	[F]	[G]
1	Senior Secured Debt	A1	04/21/06	A-	No change in	A+	05/05/06
2	(First Mortgage Bonds)				last 5 years.	AA-	07/29/03
3	Short-Term Debt (2)	P-1	No change in	A-2	No change in	F1	07/29/03
4	(Commercial Paper)		last 5 years.		last 5 years.		

Notes: (1) The Fitch rating relationship was not renewed past the October 8, 2006 expiration date.
(2) North Shore Gas' credit facilities were allowed to expire in July 2004 and the short-term debt ratings were not renewed.

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	:	No. 07-0242
COMPANY	:	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

I. INTRODUCTION AND BACKGROUND

A. Witness Identification

Q. Please state your name.

A. Bradley A. Johnson.

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

A. Yes.

B. Purposes of Testimony

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

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

C. Summary of Conclusions

Q. Please summarize the conclusions of your Rebuttal Testimony.

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

D. <u>Itemized Attachments to Rebuttal Testimony</u>

Q. Are there any attachments to your Rebuttal Testimony?

A. Yes. I am sponsoring the following exhibits:

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

II. <u>Capital Structure</u>

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

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

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

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

III. Cost of Long-Term Debt

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

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

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

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

Q. Please explain.

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

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

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

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

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

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

A. Yes, they are. Our proposed adjustments to Staff's adjusted figures (which include an update to the auction rates for the Peoples Gas Series OO and PP bonds) result in a long-term debt cost for Peoples Gas of 4.67% and 5.39% for North Shore. This calculation is provided in my revised D-1 schedules, NS-PGL Exs. BAJ-2.1P and BAJ-2.1N. The adjusted long-term debt costs are reflected in Mr. Fiorella's revised C-1 Schedules, NS-PGL Exs. SF-2.5P and N.

IV. Cost of Equity

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

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

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

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

Q. Does this complete your rebuttal testimony?

A. Yes.

North Shore Gas Company

Revised Schedule D-1: Cost of Capital Summary (1)

		Company Filed: Proforma Test Year Ended September 30, 2006					
Line No.	Class of Capital	Amount (2)	Percent of Total	Percent Cost	Cost Reference	Weighted Cost	Line No.
	(A)	(B)	(C)	(D)	(E)	(F) = (C X D)	
1	Long-term Debt (3)		44.00%	5.39% (4)		2.37%	1
2	Common Equity		56.00%	11.06% (5)		6.19%	2
3	Total Capital					8.56%	3

Notes: (1) The weights and costs of the components of the capital structure do not differ from total company data.
(2) Long Term Debt balances at year end current proceeds. Common Equity balances based at year-end excluding Accumulated Other Comprehensive Income.
(3) No redeemable long-term debt due within one year.
(4) Long Term Debt percent cost is based on year-end current proceeds.
(5) Cost of common equity requested in this filing.

The Peoples Gas Light and Coke Company

Revised Schedule D-1: Cost of Capital Summary (1)

		Proforma Test Year Ended September 30, 2006					
Line No.	Class of Capital	Amount (2)	Percent of Total	Percent Cost	Cost Reference	Weighted Cost	Line No.
	(A)	(B)	(C)	(D)	(E)	(F) = (C X D)	
1	Long-term Debt (3)		44.00%	4.67% (4)		2.05%	1
2	Common Equity		56.00%	11.06% (5)		6.19%	2
3	Total Capital					8.24%	3

Notes: (1) The weights and costs of the components of the capital structure do not differ from total company data.
(2) Long Term Debt balances at year end current proceeds. Common Equity balances based at year-end excluding Accumulated Other Comprehensive Income.
(3) No redeemable long-term debt due within one year.
(4) Long Term Debt percent cost is based on year-end current proceeds.
(5) Cost of common equity requested in this filing.