NS Ex. 5.0

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	:	
	:	No. 11-____
Proposed General Increase	:	
In Rates For Gas Service	:	

Direct Testimony of

CHRISTINE M. GREGOR

Director
Operations Accounting
North Shore Gas Company

On Behalf of
North Shore Gas Company

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I. INTRODUCTION AND BACKGROUND

A. Identification of Witness

Q. Please state your name and business address.

A. My name is Christine M. Gregor. My business address is 130 E. Randolph, Chicago, Illinois 60601.

Q. By whom are you employed and in what capacity?

A. I am employed by Integrys Business Support, LLC ("IBS") as Director – Operations Accounting – North Shore Gas Company ("NSG"). I also serve in the same capacity for its affiliate The Peoples Gas Light and Coke Company ("Peoples Gas"). North Shore and Peoples Gas are wholly-owned subsidiaries of Peoples Energy Corporation ("Peoples Energy"), which, in turn, is a wholly-owned subsidiary of Integrys Energy Group, Inc. ("Integrys").

B. Purposes of Testimony

Q. What is the purpose of your direct testimony?

A. North Shore is proposing the use of its forecasted calendar year 2012 as the test year in this proceeding. I will support the prudence and reasonableness of the forecasted costs and expenses for calendar year 2012. More specifically:

(1) I will discuss the preparation of Schedules under Part 285 of the Illinois Commerce Commission's (the "Commission" or "ICC") rules, 83 Illinois Administrative ("Ill. Admin.") Code Part 285 ("Part 285"), based on North Shore's forecasted and historical financials. I will describe the procedures used by North Shore to prepare its Annual Budget for the calendar year ending December 31, 2011, and its financial forecast for the calendar year ending

December 31, 2012. In my testimony, I will discuss the requirements of Section 285.7010 of Part 285 regarding the financial forecast and assumptions being reviewed by an independent Certified Public Accountant. I will present North Shore's projected comparative operating income statement (Schedule-C-4) for the calendar 2012 test year that was developed using its budgeting and financial forecasting processes.

(2) I will discuss operating expense categories for which significant changes are forecasted in calendar year 2012 over the actual amounts incurred in calendar year 2009. For North Shore, I define significant as a change (either an increase or decrease) of 10%, but not less than $100,000.

(3) In particular, I will address North Shore's expenses for depreciation and amortization, taxes other than income taxes, and intercompany services.

C. <u>Summary of Conclusions</u>

Q. Please summarize the conclusions you make in your direct testimony.

A. In brief, the conclusions of my direct testimony are as follows. North Shore's financial statements for the test year, calendar year 2012, fairly state the forecasted results of operations of North Shore and are appropriate as the primary basis for the determination of North Shore's revenue requirement in this proceeding.

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

Q. Are you sponsoring any attachments to your direct testimony?

A. Yes. I sponsor NS Ex. 5.1, which consists of the following Schedules from North Shore's filing under Part 285: Schedule C-4 (Comparative Operating Income Statements for Prior Years and the Test Year), Schedule C-18 (Taxes Other Than Income Taxes, Page 1 of 4), Schedule C-12 (Depreciation Expense), Schedule C-13 (Summary of Affiliated Interest Transactions, Page 1 of 2), and Schedule G-5 (Assumptions Used in the Forecast). I will discuss these exhibits later in my testimony.

Q. Were these exhibits prepared under your supervision and direction?

A. Yes.

E. Background and Experience

Q. What is your educational background?

A. I graduated from the Eastern Illinois University in 1987 and received a Bachelor of Science degree in accounting. I also became a Certified Public Accountant registered in Illinois in 1989. In 1993, I received a Masters of Business Administration degree from DePaul University.

Q. Please describe your business experience.

A. My business experience with the Peoples Energy companies began in 1987. I was directly employed by Peoples Gas from 1987 until 2002, at which time I became an employee of Peoples Energy. My experience generally has involved duties and supervisory positions relating to accounting and decision support/budgeting. In May 2006, I became an employee of Peoples Gas and assumed the position of Assistant Controller – Utility Accounting and Control. I assumed my current position at North Shore and Peoples Gas as Director – Operations Accounting as of February 21, 2007, the date of the merger resulting in Peoples Energy becoming a wholly-owned subsidiary of Integrys. In January 2011, I became employed by IBS retaining my current position.

Q. What are your responsibilities as Director – Operations Accounting for North Shore and Peoples Gas?

A. My responsibilities include providing financial management analysis and direction for North Shore and Peoples Gas. I perform many controller-like functions for this utility. I am responsible for reviewing and signing off on the monthly financial statements, including the analysis of margin and unbilled revenues. I coordinate and/or participate in the preparation of the North Shore's operating budget (the "Annual Operating Budget") and the capital expenditure budget (the Annual Capital Budget), which together comprise the Annual Budget, and provide analysis of variances between actual results and forecasted amounts for the entity.

II. FINANCIAL STATEMENTS AND PART 285 SCHEDULES

A. Preparation of Part 285 Schedules

Q. NS Ex. 5.1 sets forth certain of the Schedules required to be filed pursuant to 83 Ill. Admin. Code Part 285. Are those the only Part 285 Schedules in North Shore's filing that were prepared under your supervision and direction?

A. No, I am responsible for a large number of the Part 285 Schedules. I am responsible for the Schedules attached hereto as part of NS Ex. 5.1 plus the other Schedules attached to other North Shore witnesses' testimony or included in the Part 285 filing to the extent that those Schedules were derived from North Shore's forecasted financials.

Q. Is the information contained in the Part 285 Schedules that is drawn from North Shore's forecasted financials appropriate and reasonable?

A. Yes. North Shore's forecasted financials for the test year, calendar year 2012, were prepared in accordance with U.S. Generally Accepted Accounting Principles and they record its forecasted revenues, costs, and expenses for calendar year 2012. The data in the Part 285 Schedules was drawn from North Shore's forecasting processes and systems for calendar year 2012 that I will describe later in my testimony. The data in the Part 285 Schedules that is drawn from North Shore's books and records for prior periods is also appropriate and reasonable.

B. <u>Forecasting Methodology</u>

Q. What is the basis for the projected calendar 2012 financial data presented by North Shore in this filing?

A. North Shore's forecast for calendar year 2010, updated for actual results through June 2010 ("6&6" Forecast), and its calendar 2011 Annual Budget were the basic building blocks for the financial projections for the 2012 presented in this filing. The Annual Budget, as I noted earlier, is composed of the Annual Operating Budget and the Annual Capital Budget.

The Annual Operating Budget reflects expected operation and maintenance expenses for each "home center" as well as estimates for revenue, gas costs, depreciation, taxes, interest income and interest expense. A home center is usually a company department but may be related to a specific cost or activity, such as benefits expenses.

The Annual Capital Budget details all capital projects, mainly construction and retirement expenditures, for each home center, by major capital category and general charges. General charges include such items as overhead expenses (*e.g.*, pensions and employee welfare benefits) and redistribution expenses (*e.g.*, loadings for absent time allowed, stores expense, capitalized depreciation, tools and work equipment expenses, and self-constructed assets).

Q. Please describe North Shore's methodology for developing the financial projections presented in this case.

A. For the Calendar 2011 Annual Budget and the 2012 test year forecast, a set of assumptions and guidelines were developed by subject matter experts and were reviewed and approved prior to being entered into the system. All home centers and other participants providing input for the financial projections were then required to utilize these assumptions and guidelines.

Integrys and its subsidiaries, including North Shore, utilize a forecasting software application called Cognos. Revenue and gas cost information is developed using in-house models and transferred into the Cognos model. North Shore witness Kevin Kuse discusses the development of revenues and gas costs in his testimony (NS Ex. 4.0). Individual home centers enter planned headcount, overtime hours, material costs, outside services costs, other departmental expenses, and corporate expenses. Additionally, each home center determines the allocation of its costs to applicable projects or activities (*e.g.*, maintenance of mains, service additions, and retirement of mains). Based on the input of the latest labor rates from North Shore's payroll system and projected increases for bargaining unit and non-bargaining unit employees, labor costs are calculated and, along with other costs, are allocated to the appropriate expense/capital categories based on project identification.

Overhead costs and costs that are redistributed to projects are also entered by the responsible home centers. These costs are then allocated to projects based on percentages developed from the previous year's actual experience or projected if there is a known significant change in overhead costs or project costs. Income taxes are based on statutory rates and estimated amortizations.

NS Ex. 5.1 (Schedule G-5) is a summary of the principal significant assumptions used to prepare the financial forecast for the test year.

Q. Please describe the approval process for the Annual Budget.

A. The Cognos system generates a variety of reports including comparisons to the prior year. These reports are analyzed to ensure that the system algorithms and allocation factors were inputted correctly and the results are in line with expectations and prior results, and that any deviations can be explained. A detailed review of the output is performed by the Director of Accounting and other personnel within the financial services division of Integrys Business Support, LLC ("IBS"). Once the Annual Budget is thoroughly reviewed, it is presented to the senior management of Integrys for review and approval. Based on that review, the Annual Budget is deemed final or revisions are made as required. Once the Annual Budget is approved by senior management, it is presented in summary form to the Integrys Board of Directors. The Board reviews and approves both the Annual Operating and Annual Capital Budgets. The 2011 Annual Budget was presented to (and approved by) the Integrys Board of Directors in December 2010.

Q. Please describe the process for the preparation of the financial forecast for the test year, calendar year 2012.

A. The test year financial forecast being presented in this case was developed following essentially the same process that is used for the Annual Budget, including review and approval by senior staff of North Shore. However, the test year forecast was not presented to Integrys' Board of Directors prior to the filing in this case because that is not a regular or required business process.

Q. Are the same assumptions and methodologies used in the test year as for forecasts that are prepared for management or other entities such as the Securities and Exchange Commission?

A. There is one difference. It is assumed that the regulatory accounting treatment of the re-measurement of deferred tax balances related to post-retirement medical obligations caused by recent changes in tax law that North Shore witness John Stabile explains in detail in his testimony (NS Ex. 10.0) is recorded in 2010. In addition, after the forecast was prepared, there have been three tax related changes that will impact the forecast. These include the bonus depreciation in connection with the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, the increase in the Illinois state corporate income tax rate, and the tax accounting method change related to overhead capitalization. Due to the positive impact on cash related to the change for bonus depreciation, senior management is reviewing various options in response to this. These changes will be reflected in rebuttal.

Q. Was the financial forecast – the Statement of Income, Balance Sheet, Statement of Cash Flows and Statement of Retained Earnings (Part 285, Schedules G-15, G-16, G-17, and G-18) – and the related notes, including North Shore's summary of the underlying assumptions, examined by an independent Certified Public Accountant?

A. Yes. The financial forecast - the Statement of Income, Balance Sheet, Statement of Cash Flows and Statement of Retained Earnings (Part 285, Schedules G-15, G-16, G-17, and G-18) – and the related notes, including North Shore's summary of the assumptions underlying its forecast (Part 285, Schedule G-5) were examined by an independent Certified Public Accountant, Deloitte & Touche LLP. The examination was performed in accordance with standards established by the American Institute of Certified Public Accountants ("AICPA"), including AICPA Audit and Accounting Guide: Guide for Prospective Financial Information dated March 1, 2008. Deloitte & Touche LLP has supplied to North Shore the report of an independent accountant required by Section 285.7010 of Part 285, and North Shore has submitted that report as part of its submissions under Part 285 to the ICC. North Shore is seeking a waiver to permit use of the 2009 AICPA Guide rather than the 1999 Guide referenced in Section 285.7010.

C. Financial Statements

Q. Please describe Schedule C-4, page 1, which is part of NS Ex. 5.1.

A. Schedule C-4 shows North Shore's Operating Income Statements for the calendar 2012 test year and the three preceding years by the Uniform System of Accounts ("USOA") as established by the Federal Energy Regulatory Commission and modified by the ICC for Gas Utilities. Page 1 provides aggregate figures for the categories of items within Operating Revenues, Operating Expenses, and Operating Income. Column A identifies account numbers. Column B identifies account names or categories. Columns C, D, and E set forth figures based on North Shore's forecasted financials for calendar years 2012, 2011, and 2010 respectively. Column F sets forth figures based on North Shore's books and records for calendar year 2009.

Test year Other Operation and Maintenance Expenses of $62,765,000, shown on page 1, Column C, line 8, reflects all expenses recorded in Accounts 401 and 402 (detail O&M accounts 700-932) other than the Cost of Gas, which is shown on page 1, Column C, line 7. The test year amount shown for Other Operation and Maintenance Expenses, $62,765,000, is the same as that shown on NS Ex. 6.1 at Schedule C-1, page 1 of 1, line 24, Column C, sponsored by North Shore witness Ms. Moy (NS Ex. 6.0).

Other than Depreciation and Amortization Expense totaling $10,102,000, (shown on Schedule C-4, page 1, lines 9 and 10, Column C), the remaining operating expenses (shown on Schedule C-4, page 1, lines 11 through 15, Column C) essentially represent taxes imposed by federal, state, and local governments. The test year amounts shown for Depreciation Expense, Amortization Expense and taxes are the same as those shown on NS Ex. 6.1 at Schedule C-1, page 1 of 1, lines 25-27, Column C, lines 29 through 32, Column C, sponsored by Ms. Moy.

The test year amount shown for Operating Income, $11,345,000, on Schedule C-4, page 1, line 17, Column C, is the same as that shown on NS Ex. 6.1 at Schedule C-1, page 1 of 1, line 34, Column C, sponsored by Ms. Moy.

The total operating revenues figure, $240,608,000, on Schedule C-4, page 1, line 5, Column C, is the same as that shown on NS Ex. 6.1 at Schedule C-1, page 1 of 1, line 11, Column C, sponsored by Ms. Moy.

The Cost of Gas figure, $148,869,000, on Schedule C-4, page 1, line 7, Column C, is the same as that shown on NS Ex. 6.1 at Schedule C-1, page 1 of 1, line 13, Column C, sponsored by Ms. Moy.

Q. Please describe pages 2 and 3 of Schedule C-4.

A. Pages 2 and 3 show in more detail North Shore's Operation and Maintenance Expense for the test year and the three preceding years by Account, including Cost of Gas. Total Operation and Maintenance Expense for the test year, shown on page 3, Column C, line 43, is $211,634,000. This amount is equal to the sum of the Cost of Gas on page 2, Column C, line 8, and Total Operation and Maintenance, Excluding Cost of Gas on page 3, Column C, line 42. Total Operation and Maintenance, Excluding Cost of Gas, for the test year is $62,765,000, as also noted above. (Also page 1, line 8, Column C.)

Q. Is it your position that all of the expenses reflected on Schedule C-4 that are incorporated in North Shore's proposed revenue requirement are prudent and reasonable in amount?

A. Yes, based on the information in my testimony and its attachments and that provided by North Shore's other witnesses.

III. ACCOUNT VARIANCES

Q. Have you undertaken an analysis to determine if there were significant variances in the operating expense Accounts from calendar year 2009 to the test year, calendar year 2012?

A. Yes.

Q. Please explain the variations.

A. For purposes of this analysis, I looked at major groupings of accounts and I defined "significant" to be a change, whether an increase or decrease, of at least 10% but not less than $100,000. For example, the fifth grouping of accounts on Schedule C-4 is labeled "Distribution Expenses - Operation". The total for these accounts for calendar year 2009 was $7,211,000 as shown on Schedule C-4, page 2, Column F, line 30. The total for these same accounts for calendar year 2012 was $8,909,000 (as shown on Schedule C-4, page 2, Column C, line 30), a difference of over 23% and $1,698,000. Therefore, I will present an explanation of the variance. However, the second grouping of accounts on Schedule C-4 is labeled "Production-Operation". The total for these accounts for calendar year 2009 was $122,000, as shown on Schedule C-4, page 2, column F, line 13. The total for these same accounts for calendar year 2012 was $123,000 (Schedule C-4, page 2, column C, line 13). Because the difference was only $1,000, less than $100,000, I am not offering an explanation of this variance.

Q. Please explain the $1,698,000 increase in expenses for the category Total Distribution Expenses-Operation shown on Schedule C-4, page 2, Columns F and C, line 30.

A. Most of this increase is due to a shift of labor from distribution maintenance to distribution – operations. This is due to the budget and test year forecast inadvertently not taking into account the allocation of travel time from Account 880 to the various other operations and maintenance accounts.

Q. Please explain the $1,205,000 decrease in expenses for the category Total Distribution Expenses-Maintenance shown on Schedule C-4, page 3, Columns F and C, line 10.

A. Most of this decrease is the result of the shift of labor from distribution maintenance to distribution - operations. This is due to the budget and test year forecast inadvertently not taking into account the allocation of travel time from Account 880 to the various other operations and maintenance accounts. This decrease is offset by the increase in Total Distribution Expenses-Operation explained above.

Q. Please explain the $1,142,000 decrease in expenses for the category Total Customer Accounts Expense - Operation shown on Schedule C-4, page 3, Columns F and C, line 17.

A. Most of this decrease relates to lower costs due to the outsourcing of the customer call center.

Q. Please explain the $13,057,000 increase in the category Total Administrative and General Expenses-Operation shown on Schedule C-4, page 3, Columns F and C, line 38.

A. There are several reasons for this increase. First, the amortization of environmental costs increased $7,825,000 due to higher expenditures related to manufactured gas plant sites. These costs are recovered through Rider 11 and therefore have no impact on the revenue requirement. Second, costs associated with the Enhanced Efficiency Program ("EEP") increased $218,000. These costs are recovered through Rider EEP and have no impact on the revenue requirement. Similarly, amortization of rate case costs increased $623,000 with no impact on the revenue requirement. Third, benefits increased $1,318,000 largely due to increased group insurance costs including FAS 106 retirement costs, which North Shore witness Christine Phillips will explain in detail in her testimony (NS Ex. 11.0). Fourth, there are increased costs related to depreciation and cost of capital billed from IBS of $2,532,000. This is due to several new software projects being implemented in 2010, including the Work Asset Management System and a PeopleSoft upgrade. The remaining variance of $541,000 is the result of other general and administrative increases.

IV. DEPRECIATION

Q. Please explain the main driver(s) causing the increase of $3,877,000 in Depreciation expense from calendar year 2009 to the test year as shown on Schedule C-12, page 1, Column L, line 9 vs. Schedule C-12, page 4, Column L, line 9.

A. There are two main drivers of this increase. One is the increased capital expenditures since 2009 and second, included are the new depreciation rates and change to net dismantling accrual basis approved in ICC Docket Nos. 09-0166/09-0167 consolidated.

V. TAXES OTHER THAN INCOME TAXES

Q. Please describe Schedule C-18, included as part of NS Ex. 5.1.

A. Schedule C-18, page 1 of 4, details North Shore's Taxes Other Than Income Taxes (federal, state, and local) for the test year. The total of these taxes for the test year, shown on line 19, column F is $4,315,000. The amount charged to expense as reflected in line 19, column B, $3,308,000, ties to (agrees with) Schedule C-4, page 1, line 11, column C and Schedule C-1, line 27, column C sponsored by Ms. Moy.

VI. INTERCOMPANY SERVICES

Q. Please describe Schedule C-13, included as part of NS Ex. 5.1.

A. Schedule C-13, page 1 summarizes North Shore's transactions with affiliated interests for calendar years 2012 and 2011. The exhibit shows amounts billed to North Shore by IBS pursuant to the Master Regulated Affiliated Interest Agreement (the "Regulated AIA") approved by the Commission in ICC Docket No. 07-0361 and amounts billed to North Shore by the other affiliated companies through the Intercompany Loan Arrangements approved by the Commission in ICC Docket Nos. 04-0602 and 04-0603 and the Affiliated Interest Agreement approved by the Commission in ICC Docket No 06-0540. The forecasted total amounts billed to North Shore for the test year are $34,294,000. The exhibit also shows the amounts billed by North Shore to Peoples Gas and Peoples Energy Home Services pursuant to the Services and Transfers Agreement ("STA") and the Affiliated Interest Agreement, totaling $144,000 for the forecasted test year.

Q. Does this conclude your direct testimony?

A. Yes.