STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	**)**	
Proposed General Increase in Rates	**)**	
for Gas Service	**)**	**DOCKET NO. 11-0280**
	)	
THE PEOPLES GAS LIGHT AND	**)**	**DOCKET NO. 11-0281**
COKE COMPANY	**)**	
Proposed General Increase in Rates	**)**	
for Gas Service	**)**	

DIRECT TESTIMONY OF

LAFAYETTE K. MORGAN, JR.

ON BEHALF OF

THE PEOPLE OF THE STATE OF ILLINOIS,

THE CITIZENS UTILITY BOARD

AND

THE CITY OF CHICAGO

(COLLECTIVELY, GOVERNMENT AND CONSUMER INTERVENORS OR GCI)

PUBLIC

JUNE 15, 2010

EXETER

ASSOCIATES, INC.
10480 Little Patuxent Parkway
Suite 300
Columbia, Maryland 21044

TABLE OF CONTENTS

Introduction and Summary

Q. Would you please state your name and business address?

A. My name is Lafayette K. Morgan, Jr. I am employed as an independent consultant retained by Exeter Associates, Inc. My business address and Exeter Associates' offices are located at 10480 Little Patuxent Parkway, Columbia, Maryland 21044. Exeter is a firm of consulting economists specializing in issues pertaining to public utilities.

Q. Please describe your educational background and qualifications.

A. I received a Master of Business Administration degree from The George Washington University. The major area of concentration for this degree was Finance. I received a Bachelor of Business Administration degree with concentration in Accounting from North Carolina Central University. I was also a Certified Public Accountant licensed in the State of North Carolina.

Q. Would you please describe your professional experience?

A. From May 1984 until June 1990, I was employed by the North Carolina Utilities Commission - Public Staff in Raleigh, North Carolina. I was responsible for analyzing testimony, exhibits, and other data presented by parties before the North Carolina Utilities Commission. I had the additional responsibility of performing the examinations of books and records of utilities involved in rate proceedings and summarizing the results into testimony and exhibits for presentation before that Commission. I was also involved in numerous special projects, including participating in compliance and prudence audits of a major utility and conducting research on several issues affecting natural gas and electric utilities.

From June 1990 until July 1993, I was employed by Potomac Electric Power Company ("Pepco") in Washington, D.C. At Pepco, I was involved in the preparation of the cost of service, rate base and ratemaking adjustments supporting the company's requests for revenue increases in the State of Maryland and the District of Columbia. I also conducted research on several issues affecting the electric utility industry for presentation to management.

From July 1993 to December 2010, I was employed by Exeter Associates, Inc. as a Senior Regulatory Analyst. Since then, and in my role as an independent consultant, I have been involved in the analysis of the operations of public utilities, with particular emphasis on utility rate regulation. I have also been involved in the review and analysis of utility rate filings, focusing primarily on revenue requirements determination. This work has involved natural gas, water, electric and telephone companies.

Q. Have you previously testified in regulatory proceedings on utility rates?

A. Yes. I have previously presented testimony and affidavits on numerous occasions before the North Carolina Utilities Commission, the Pennsylvania Public Utility Commission, the Virginia Corporation Commission, the Louisiana Public Service Commission, the Georgia Public Service Commission, the Maine Public Utilities Commission, the Kentucky Public Service Commission, the Public Utilities Commission of Rhode Island, the Vermont Public Service Board, the Illinois

Commerce Commission, the Maryland Public Service commission and the Federal Energy Regulatory Commission ("FERC").

Q. What is the purpose of your testimony in this proceeding?

A. Exeter Associates has been retained by The Citizens Utility Board ("CUB"), the People of the State of Illinois represented by the Attorney General ("AG"), and the City of Chicago ("City"), (collectively, "Government and Consumer Intervenors" or "GCI") to review the cost of service and rate base claims North Shore Gas Company ("North Shore" or "NS") and the Peoples Gas Light and Coke Company ("Peoples Gas" or "PGL") (together referred to as "the Companies") are requesting in this proceeding. In this testimony, I present my findings on behalf of the GCI regarding certain adjustments to the Companies' test year rate base and net operating income at present rates. In addition, I present a summary spreadsheet which incorporates certain adjustments proposed by GCI witnesses David J. Effron (GCI Ex. 2.0) and Christopher C. Thomas's (GCI Ex. 5.0) adjustments. Mr. Effron proposes additional adjustments to the Companies' test year rate base and operating income, and Mr. Thomas proposes adjustments to the Companies' overall rate of return.

Q. In connection with this case, have you performed an examination and review of the companies' testimony and exhibits?

A. Yes. I have reviewed NS and PGL's testimony and exhibits, their rate filing, as well as their responses to CUB, the AG and other intervenors' data requests.

Q. Would you please summarize what is presented on the attached schedules?

A. Yes. I have prepared a set of schedules that present my findings and recommendations regarding PGL's and NS's respective rate base and net operating income. In addition to my own adjustments and findings, I have incorporated the recommendations of Mr. Effron and Mr. Thomas. The adjustments recommended by Mr. Effron, which I have included in my exhibit, include Plant in Service; Accumulated Depreciation; Retirement Benefits; Accumulated Deferred Income Taxes; Employee Payroll and Benefits: Incentive Compensation IBS Benefits Charges: and Office Supplies Expense. Mr. Thomas has made recommendations regarding the Companies' allowed rate of return which I have reflected in the cost of service. The exhibits attached to my testimony contain two separate sets of schedules – one set for each utility. The two sets are similar in presentation. However, a company abbreviation is used to designate each company. For example, "Schedule LKM-1NS" (GCI Ex. 1.1NS) refers to North Shore, while "Schedule LKM-1PGL" (GCI Ex. 1.1PG) refers to Peoples Gas.

Schedule LKM-1 summarizes the overall findings regarding net operating income of my and Mr. Effron's adjustments. Schedule LKM-2 presents a summary of rate base and my and Mr. Effron's adjustments thereto. Schedule LKM-3 summarizes each of the adjustments to the Companies' net income. The total of those adjustments are carried forward to Schedule LKM-1 (GCI Ex. 1.1) and used in the determination of the revenue requirement. The remaining schedules are supporting schedules that show the derivation of each of my adjustments to the Companies' rate base and net operating income. GCI Ex. 1.1NS and GCI Ex. 1.1PGL include each of the schedules referenced herein for each respective utility.

Q. Please summarize your findings.

A. As shown on Schedule LKM-1 (GCI Ex. 1.1), I have determined the appropriate change in NS' revenues to be an increase of $2,431,267, and the appropriate change in PGL's revenues to be $52,343,730. When these increases are compared to the Companies' requests of $8,728,000 and $123,652,000 for NS and PGL, respectively, they result in reductions in the Companies' requested revenue increase of $6,296,733 (NS) and $71,308,270 (PGL). The GCI recommended distribution revenue increase would result in a 3.1 percent increase for NS and 10.3 percent increase for PGL in distribution revenue instead of the 11.5 percent (NS) and 25.2 percent (PGL) proposed by the Companies.

Q. What time period did you use in your analysis of the companies' operating results?

A. The Companies' filings include their revenue requirement analyses based upon the future test year ending December 31, 2012. The future test year is based on the Companies' 2012 operating and capital budgets, adjusted as deemed necessary by the Companies. I have based my analysis of the Companies' operating results on the same period used by the Companies in their rate filing, direct testimony and exhibits.

Q. How is the remainder of your testimony organized?

A. The remainder of this testimony addresses each of the adjustments that I am recommending and is presented in the order identified in the table of contents to this testimony. For each issue, I will document and explain why it was necessary to make the adjustment.

Rate Base Adjustments

Allowance for Cash Working Capital

Q. How is cash working capital defined?

A. For ratemaking purposes, cash working capital is the investment that a utility needs to have on hand to fund its day-to-day operations, and that is how the Commission has viewed it in the past. Positive cash working capital represents funds provided by investors that should be included in rate base so that the utility earns a return on it. Negative cash working capital represents funds supplied by ratepayers that should be recognized as a rate base offset.

Q. How did the companies reflect cash working capital in their filings?

A. The Companies' cash working capital allowance is calculated based upon the results of a lead/lag study (the Companies performed individual lead/lag studies). A lead/lag study is an in-depth analysis that measures the difference between the lapse of time when a company receives revenue for the provision of service and the lapse of time when a company pays for the costs of providing service. This difference, expressed as a number of days, is used to calculate the level of investor-supplied funds advanced for operations or the level of funds advanced by customers.

Q. What changes have you made to the allowance for cash working capital?

A. I have made two adjustments to the cash working capital allowance. The first adjustment is a change in the revenue collection lag. The second adjustment is the incorporation of the operations and maintenance ("O&M") adjustments proposed by Mr. Effron and me in the lead/lag study.

Q. Please explain your adjustment to the revenue collection lag.

A. NS and PGL have calculated the revenue collection lag based upon a matrix that separates the revenue collected during each 30-day period after the bills are submitted. The percentage of total revenue collected in each 30-day block is multiplied by the mid-point of the period to derive the weighted collection lag days. Most of the Companies' revenues are collected in arrears, except for a small portion of the revenues that is recognized as prepaid. The prepaid revenues are included in the revenues that were collected up to 30 days after billing. As a result, the revenues billed in advance are reflected with 11.53 weighted lag days as though they were billed in arrears. I disagree with this approach. Prepayments, by definition, are collected in advance. Therefore, I have calculated the collections lag with prepayments separated from the revenues collected during the first 30 days. As a result, the prepayments are included in a separate category in the calculation of the collection lag at zero days.

On Schedule LKM-4, I present the calculation of the revenue lag by applying a mid-point of zero to the prepayments. This approach is actually a conservative approach because, depending on the circumstances, the use of the actual prepayment date could result in lead or a negative lag which could shorten the revenue lag further. Given the absence of the data measuring the action collection date of these revenues, this conservative approach is a reasonable approximation of the lag.

Q. Please explain the second adjustment to the cash working capital allowance.

A. The second adjustment involves the incorporation of the adjustment to O&M expenses that Mr. Effron has proposed. For instance, if Mr. Effron has considered an expense to be inappropriate for ratemaking, that expense should be removed from the lead/lag study because it would be inappropriate to allow a working capital allowance on funds advanced to pay an expense that is not recognized for ratemaking purposes. The incorporation of those adjustments is presented on Schedule LKM 4, Page1.

Q. Please summarize your adjustment to the cash working capital allowance.

A. On Schedule LKM-4, page 1, I present my adjustment to cash working capital allowance of a decrease of $7,432 for NS and an increase of $1,152,946 for PGL. These adjustments reflect the combination of the change in the collection lag days and the incorporation of the O&M expense adjustments.

<u>Materials and Supplies</u>

Q. What adjustment are you recommending to the level of materials and supplies in rate base?

A. The Accounts Payable related to Materials and Supplies represents the portion of Materials and Supplies the Companies have received but not yet paid for. The accounts payable are properly excluded from rate base because even though they are recorded, the Companies have not spent the cash in payment of the costs. As a result, it would be improper for the Companies to earn a return on those costs. The Companies have included the 13-month average of Materials and Supplies in rate base less the accounts payable related to Material and Supplies purchases. The monthly accounts payable amount was derived by comparing the Materials and Supplies balance for each month to the previous month's balance. If there were an increase occurred in the current month over the previous month, the Companies assumed that the increase represented the accounts payable in that month. In months where the Materials and Supplies balance declined from the prior month, the Companies assumed that there were no accounts payable related to Materials and Supplies.

Q. Do you agree with the Companies' evaluation of accounts payable related to materials and supplies?

A. No. The notion that there are no accounts payable related to Materials and Supplies in months where the Materials and Supplies balance decreased from the prior month is erroneous. Materials and Supplies are added to inventory virtually every month. However, there are some months where the amount taken out of Materials and Supplies inventory exceeds the amount related to the new inventory that is added. Nevertheless, there would still be accounts payable related to the amount added to inventory during that month despite the net balance.

Q. How have you adjusted materials and supplies to reflect the accounts payable?

A. In the response to Staff data request TEE 6.02, the Companies provided the monthly debits to Materials and Supplies that represent the increases in the account due to purchases. Also, in the response to Staff data request TEE 6.04, the Companies indicated that the payment lag for Materials and Supplies is 42.44 days. Hence, the Materials and Supplies received in a given month are not paid for until more than a month later. In my calculation of the accounts payable related to the Materials and Supplies, I used the monthly debits as the accounts payable related to Materials and Supplies. Since, the future test year is projected, it is necessary to estimate the projected accounts payable related to the monthly Materials and Supplies balance. I derived that projection by calculating the average accounts payable as a percentage of Materials and Supplies. Once I derived that percentage, I applied it to the future test year Materials and Supplies to obtain the accounts payable amount used to reduce the Materials and Supplies. On Schedule LKM-5, I present this adjustment which reduces rate base by $220,642 for NS and $1,651,710 for PGL .Gas in Storage.

Q. What adjustment are you recommending to the level of gas in storage in rate base?

A. The Companies have included the average gas in storage balance in rate base based upon the data available at the time this rate case was filed. The Companies also reduced the average balance of gas in storage inventory to reflect the associated accounts payable in a manner consistent with the accounts payable related to Materials and Supplies. I am recommending two adjustments to gas in storage to better reflect the amount on which the Companies should earn a return.

First, in the response to AG Data Requests No. 4.07 and 4.40, the Companies provided an update of the gas in storage balance based upon the most recent pricing information. I have used the data provided by the Companies in those responses to project the future year gas in storage balance.

Second, as I explained in my discussion of Materials and Supplies, I disagree with the means by which the Companies derived the accounts payable balances. Instead of using only the monthly increase in the gas in storage from the previous month as the accounts payable related to the gas in storage, I used the monthly projected gas storage injections for the future test year as presented in the response to Staff Data Request NS ENG 5.01, Attachment 2. According to the Companies' lead/lag analyses, there is a 35.08 lag day period for the payment of the gas injected into storage. Therefore, the gas injected into storage in the current month is not paid for until the following month. As a result, the companies should not earn a return on expenditures they have not incurred. On Schedule, LKM-6, I present this combined adjustment which reduces rate base by $3,086,481 for NS and $16,200,362 for PGL.

<u>Accumulated Deferred Income Taxes Related to the Tax Accounting Change</u>

Q. Please explain the adjustment to the accumulated deferred income taxes relating to the tax accounting change.

A. In 2006, the United States Department of Treasury proposed changes that affect Section 1.263(a)-0 through Section 1.263 (a)-3(h)(2) of Treasury Regulations relating to the capitalization of certain repairs and replacements of plant property. Essentially, the proposed regulations change the "unit of property" concept in such a way as to make it possible to expense certain costs for tax purposes that would have to be capitalized under current regulations. The determining factor for whether project expenditures are capitalized or expensed is whether it is considered a "unit of property," as that concept is used for plant construction expenditures.

In determining income taxes, costs that are capitalized are deducted in increments, as depreciation expense, over the service life of the asset. However, expensing a cost will allow deduction of the entire cost, in determining taxes for the year in which the cost was incurred. Thus, the proposed change in tax regulations changes the timing of the deductibility of the cost, rather than creating new tax deductions. As a result, the total tax expense would not change. However, the amount of taxes that are payable for that year would change because of the current deductibility of costs that were previously capitalized.

The Internal Revenue Service requires that tax returns be reported on a consistent basis. When there is a change in accounting methods, such as the proposed change in tax regulations, the IRS requires a calculation of taxes as if the new method of accounting had always been used, to determine the accumulated effect of the change on the Company adopting the change. The result of that calculation of the accumulated effect of the tax accounting change may require a "catch up" adjustment, which is recorded as a deferred tax liability that decreases rate base and yields savings to ratepayers.

Q. Have the Companies adopted the tax accounting changes?

A. Yes. The Companies have adopted the tax accounting changes and have also recognized an accumulated deferred income tax liability.

Q. What adjustment are you proposing to the Companies' proposed accumulated deferred income taxes amount?

A. The Companies have adopted the tax accounting change, but rather than recognize the full Accumulated Deferred Income Taxes liability in their determination of rate base, the Companies have proposed to include only 50 percent of that amount. I am proposing an adjustment to recognize the full amount of the Accumulated Deferred Income Tax in Rate Base.

Q. What is the basis of the Companies' 50 percent reduction?

A. The Companies cite the sharing of risks as the reason for reducing the Accumulated Deferred Income Tax liability. The Company cites audit risks as one of the risks it is attempting to mitigate. In other words, the Companies are concerned that an IRS audit might reveal that the Companies should have recorded an amount different from the amount they have recorded.

Q. Is this a valid reason to reduce the tax benefits to ratepayers?

A. No, for several reasons, any one of which is adequate basis for rejecting the Companies' proposal. First, everyday tax expenses recorded by the Companies are also subject to tax audit. However, I have not seen a utility propose to include only a portion of its tax expense in the cost of service because of the risk that an audit would uncover a utility calculation error. Second, any such calculation is a part of prudent business management and would therefore be a management responsibility. Third, there is no rational basis for allocating a portion of this risk to ratepayers, since they have no ability to affect the election of accounting options or to alter the Companies' calculations.

Moreover, the risk does not appear to be as significant as the Companies suggest. The Companies acknowledge that this tax accounting change has become more common in the utility industry. The Companies have access to the best practices of the industry and accounting guidance from industry groups regarding this tax accounting change. Given that the Company is not on the forefront on this issue, its risk of errors is diminished. Prudent management, including utilizing the resources of such trade organizations, will allow the Companies to minimize risks. Conversely, reducing the amount returned to ratepayers does not minimize those risks. Instead, it withholds the benefit that is due to the ratepayers. On Schedule LKM-6, I have presented my adjustment to Accumulated Deferred Income Taxes, which reduces rate base by $464,000 for NS and $5,224,000 for PGL.

Q. **Mr. Effron has made several adjustments to the accumulated deferred income taxes. How does your adjustment differ from his adjustments**?

A. The adjustment I made is unrelated to those made by Mr. Effron. My adjustment captures accumulated deferred taxes that are related to changes in tax accounting rules that the Companies excluded from the cost of service. Mr. Effron's adjustments relate to the accumulated deferred income taxes related to temporary differences that are routinely recorded, but were not reflected in the cost of service in this proceeding. Also, since Mr. Effron adjusted certain plant in service items, it is necessary to adjust the related accumulated deferred income taxes.

<u>Change in State Income Tax Rate</u>

Q. **What adjustment have you made to state income tax expense?**

A. Recently, the Illinois state legislators passed a bill increasing the corporate and personal income tax rates effective this year, 2011. For businesses, the income tax rate increased from 7.3 percent to 9.5 percent. For the Companies, the increased income tax rate will be basis of the income tax they pay during the rate effective period. However, at the time the Companies' prepared this case, the higher rate was not in effect and the Companies used the old tax rate of 7.3 percent in the cost of service as the basis of the state income tax expense. In order to reflect the actual costs that the Companies will incur, Mr. Effron and I have used the new income tax rates in the preparation of our adjustments to the cost of service.

Q. How did you calculate the adjustment to reflect the increase in the state income tax rate?

A. I calculated the adjustment to reflect the increase in the state income tax rate by backing into the taxable income and operating income elements used to calculate the total state income tax expense. First, I divided the projected state income tax expense, prior to the ratemaking adjustments, by the old state tax rate to derive the taxable income. Once the taxable income was derived, I applied the change in the tax rate to derive the portion of the adjustment relating to applying the increased tax rate to the taxable income. For the tax effect of the Companies' operating income adjustments, I divided the state income tax expense effect of the operating income adjustments by the old state tax rate to derive the taxable operating income adjustment. Once the operating income adjustment was derived, I applied the change in the tax rate to derive the portion of the adjustment relating to applying the increased tax rate to the operating income adjustments. The combination of the two components totals the adjustment to reflect the change in the state income tax rate. On Schedule LKM-8, I present this adjustment which increase state income tax expense by $240,453 for NS and $539,128 for PGL.

Rate Case Expense Adjustment

Q. Have you reviewed PGL and NS Schedules C-10?

A. Yes. Schedule C-10 shows the Companies requested rate case expense. Although the Companies have claimed that the specific expenses associated with each outside consultant, witness, and attorney are confidential, the total amounts claimed by PGL and NS are $4,086,000 and $2,721,000 respectively. This totals $6,807,000.

Q. How does this compare with the amounts PGL and NS requested as their rate case expense in their last rate case, Docket 09-0166/0167?

A. In their last rate case, PGL and NS requested $4,788,000 and $2,597,000 respectively, totaling $7,385,000. See Sch. C-10.1; Docket 09-0166/0167, Order at 43. The total amount allowed in that case is more than the amount requested in this case.

Q. Does that cause you to conclude that the amounts requested in this case are reasonable?

A. No. In 2009 the Public Utilities Act was amended to add Section 9-229, which provides that the Commission "shall specifically assess the justness and reasonableness of any amount expended by a public utility to compensate attorneys or technical experts to prepare and litigate a general rate case filing. This issue shall be expressly addressed in the Commission's final order." Although the effective date of this amendment was July 10, 2009, the Order in Docket 09-0166/0167 did not contain an assessment of the amounts expended by the utilities for attorneys or technical experts.

Q. In addition, the PGL and NS Schedules C-10.1 show that neither company had spent the full amount requested by April 30, 2011.[1] Can you describe the major components of the PGL and NS rate case expenses?

A. Yes. The major expenses claimed by the Companies are the following:

Item of Expense	PGL	NS	Total
Stafflogix	$ XXXXXX	$ XXXXXX	$XXXXXX
Outside legal	$XXXXXX	$XXXXXX	$XXXXXX
InterCompany – Affiliate billing	$XXXXXX	$XXXXXX	$XXXXXX

Q. Did the Companies describe the bases for these amounts, or any other specific amounts, in their testimony?

A. PGL and NS witness Sharon Moy sponsored Schedule C-10. She testified that the Companies "sought to incur only prudent and reasonable" costs, and described certain factors that she stated are relevant. PGL Ex. 6.0 at 16-17; NS Ex. 6.0 at 16-17. However, she did not address any specific expense.

[1] Confidential Schedules C-10.1 show that the PG and NS spent $XXXXXXXXXXXXX as of April 30, 2011, including the cost of appeal, totaling $XXXXXX.

Q. Have you had the opportunity to specifically review any of the claimed rate case expenses?

A. Yes, to some extent. PGL and NS produced various invoices for the above three categories of expense in response to Staff data requests. In most cases, the invoices were for the period through April 30, 2011, so they are necessarily incomplete.

Nevertheless, they raise some concerns about whether the Companies have provided the information necessary so that the reasonableness of the costs can be specifically assessed.

Q. Did the Stafflogix invoices produced by the Companies raise any concerns?

A. Yes. PGL and NS Response to Staff data request JMO 10.01, Attachment 01 shows that Stafflogix has billed $XXXXXXXX and yet only one witness, John Hengtgen, is identified as associated with Stafflogix. PGL and NS Ex. 7.0. The invoice for Stafflogix services does not contain a description of the work performed by the various people it identifies and covers the time period from April 1, 2010 to May 1, 2011. PGL and NS Response to Staff data request JMO 10.01, Attachment 2 Confidential. It is not possible to assess the reasonableness of this charge without more specificity in the invoices or other company materials.

Q. Is there anything else about the Stafflogix charge that causes you concern?

A. Yes. In the PGL and NS Response to Staff data request JMO 9.06, Attachment 1, the Companies provided estimates by five subject matter categories of the Stafflogix and SFIO charges. A footnote explains that charges totaling $XXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX

XXXXXXXXXXXXXXXXXXXXXXXXXXXXXX”[2] This is more than XXX of the total amount the Companies claim for Stafflogix. More detail showing how this amount was spent is necessary in order to specifically assess whether the $XXXXXX charge is just and reasonable.

Q. **Did the Companies produce any invoices for the Inter-Company Affiliate billing expense?**

A. Yes. The Companies produced Inter-Company Affiliate billing for the period February, 2010 through April 30, 2011. The totals for PGL and NS were shown as $XXXX and $XXXXX respectively.[3] The invoices included several categories of information, but did not contain the name of the witness or consultant or associate the category of work performed with a rate case witness or function. Further explanation for the billing entries is necessary in order to specifically assess whether these charges are just and reasonable.

Q. Do you have any other concerns in regard to the Inter-Company Affiliate billing?

A. Yes. The total amount of Inter-Company Affiliate billing for direct testimony and discovery through April 30, 2011 is $XXXXXX compared to a total charge of $XXX XXXX. In addition to the lack of detail about the expenses incurred, it does not appear that the Companies are on track to spend the full amount requested. Although the production of the Companies' direct testimony, exhibits and schedules, as well as substantial discovery, have already taken place, the invoices account for less than

[2] The amount for PG is $XXXXX and the amount for NS is $XXXXX. See PGL JMO 9.06, Attach 01, detail, note (1).

XXX of the total amount claimed. Further production of invoices should be monitored to assess how close the Companies' estimate is to actual costs incurred. The Companies have included $XXXX for "rebuttal witnesses" in Schedule C-10, further increasing the amount consumers are being asked to pay for this expense and requiring scrutiny to assure that this expense is not over-stated.

Q. Did the Companies produce invoices for legal services?

A. Yes. The Companies produced invoices for both Foley & Lardner and Rooney Rippie and Ratnaswamy. The invoices for each firm contained a single monthly charge, and Foley & Lardner included XXXXXXXXXX the monthly charge.[4] The invoices do not show the number of hours billed, the hourly charge, or the service provided. The retainer agreements for each firm XXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX XXXXXXXXXXXXXXXXXXXXXXXXXXXX[5] An analysis of whether the billing at each phase matches the estimated or budgets amounts will be necessary as time progresses, but at present it appears that the firms are XXXXXXXXXXX budget indicating that the legal services estimates might be too XXX. Further invoices along with an explanation for the billing entries are necessary in order to specifically assess whether these charges are just and reasonable.

Q. Did you review any other invoices from outside consultants included in the rate case expense?

[3] PG and NS responses to JMO 10.01 Attach 3, confidential.
[4] PG JMO 10.01 APT ATTACH 01; NS PG JMO 10.01 APT ATTACH 01.
[5] NS/PG JMO 4.01, ATTACH 05 and 06.

A. Yes. The invoices for the months September and December 2010 and January, February and March 2011 for SFIO were provided in discovery. It is unclear whether there were billings for other months. The invoices that were produced showed that of the fixed monthly amount paid to this consultant, approximately XXX was for non-rate case expenses.[6] This expense should be reduced by the same percentage so that only rate case expenses are included in the charge to consumers. The billing for the missing months as well as continued review of this billing are necessary in order to specifically assess whether these charges are reasonable.

Q. Do you recommend a rate case adjustment?

A. At this point, I cannot recommend a specific dollar value adjustment. In addition to the need to review additional invoices as the case progresses, as specified above, the invoices produced by the Companies fail to provide sufficient detail to allow me to assess what services are being performed as part of the rate case expense. The invoices for the three major expense items (Stafflogix, InterCompany Affiliate Billing, and Legal Services) lack detail showing the services provided, the issue addressed, the relevant witness, the hours spent, or the hourly charges associated with specific services. Similarly, the Companies' direct testimony did not explain or describe any specific rate case expense item. Although the information produced to date raises significant questions, it is impossible to specifically assess or conclude that these charges are reasonable or just in the absence of this information.

[6] The Response to Staff data request JMO 10.01, Attachment 2, shows that for these five months, XXXXX XXXX were for non-rate case services for PG and NS respectively. The total billed for both companies for these months was XXXXXXXXXX per the retainer agreement. I assume the companies were also billed for October and November, but those billings were not available in discovery.

Q. Do you have any other concerns with the rate case expense amount requested by the Companies?

A. Consistent with the CUB and the AG's position in the ComEd rate case, I recommend that the Commission commence treating the annual allowance for rate case expense as a normalized amount, rather than an amortization, for several reasons, including the following. Although the amortization treatment afforded rate case expense previously effectively treats the rate case expense as an asset that is deferred and amortized, rate case costs should be treated as a normalized O&M expense and should not be afforded regulatory asset treatment. The ratemaking treatment of such costs should provide for a normalized expense allowance (similar to other O&M expenses) for reasonable rate case expenses, rather than the establishment of a regulatory asset that is amortized prospectively.

The purpose of the rate case allowance should be to include in rates a representative and normal annual level of reasonably and prudently incurred regulatory expense, rather than to provide the utility with guaranteed dollar-for dollar cost recovery. Consistent with such normalization treatment of this expense, PGL and NS should not establish an asset for deferral of the current rate case cost and should not record amortization. Under a normalization approach, any remaining amortization of prior case balances would be replaced by a new representative, normalized rate case expense in each company's next rate case.

Interest Synchronization

Q. Please explain your interest synchronization adjustment.

A. To determine the tax-deductible interest for ratemaking, I have multiplied the adjusted rate base by the weighted cost of debt included in the capital structure. This procedure synchronizes the interest deduction for tax purposes with the interest component of the return on rate base to be recovered from ratepayers. This adjustment simply recognizes the adjustments that GCI have proposed to rate base. As shown in Schedules LKM-9, this adjustment decreases the interest deduction by $324,822 for NS and $5,300,418 for PGL as compared to the interest deduction recognized by the Companies in their filings. For NS, this increases state and federal income taxes by $30,858 and $104,006, respectively. For PGL, this increases state and federal income taxes by $503,540 and $1,678,907, respectively.

Q. Does this conclude your testimony?

A. Yes, it does.