NS Ex. 2.0

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

NORTH SHORE GAS COMPANY	:	
	:	No. 12-____
Proposed General Increase	:	
In Rates For Gas Service	:	

Direct Testimony of

LISA J. GAST

Manager
Financial Planning and Analysis
Integrys Business Support, LLC

On Behalf of
North Shore Gas Company

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I. INTRODUCTION AND BACKGROUND

A. Witness Introduction

Q. Please state your name and business address.

A. My name is Lisa J. Gast. My business address is Integrys Energy Group, Inc. ("Integrys"), 700 North Adams Street, P.O. Box 19001, Green Bay, WI 54307-9001.

Q. By whom are you employed and what is your current position?

A. I am the Manager, Financial Planning and Analysis for Integrys Business Support, LLC ("IBS") a wholly owned subsidiary of Integrys.

Q. For whom are you providing testimony?

A. I am providing testimony for North Shore Gas Company ("North Shore"), which is a wholly-owned indirect subsidiary of Integrys.

B. Purpose of Testimony

Q. What is the purpose of your direct testimony?

A. The purpose of my direct testimony is to present and support North Shore's forecasted cost of capital – overall rate of return on its rate base, including its embedded costs of long-term and short-term debt and proposed capital structure for the test year. The return on equity component of the cost of capital is presented by North Shore witness Mr. Moul in his direct testimony (NS Ex. 3.0).

C. Summary of Conclusions

Q. Please summarize your conclusions regarding appropriate capital structure, return on common equity, embedded cost of long-term debt and embedded cost of short-term debt.

A. As shown in NS Ex. 2.1, North Shore calculates a cost of capital and rate of return on rate base for the 2013 test year of 7.65%, which reflects a capital structure consisting of 50.31% common equity, 42.22% long-term debt and 7.47% short-term debt, a cost of equity of 10.75%, an embedded cost of long-term debt of 4.95% and an embedded cost of short-term debt of 2.0%.

D. Itemized Attachments to Direct Testimony

Q. Are you sponsoring any exhibits?

A. Yes, I am sponsoring the following exhibits:

Exhibit No.	Corresponding 83 Ill. Admin. Code Part 285 Schedule
NS Ex. 2.1	D-1 Cost of Capital Summary
NS Ex. 2.2	D-2 Cost of Short-Term Debt
NS Ex. 2.3	D-3 Embedded Cost of Long-Term Debt
NS Ex. 2.4	D-7 Comparative Financial Data
NS Ex. 2.5	D-8 Security Quality Ratings
	Other Exhibits
NS Ex. 2.6	S&P Risk Profile Matrix and Financial Risk Indicative Ratios
NS Ex. 2.7	Delivery Group Quarterly Average Common Equity Ratios

E. Background and Experience

Q. Please outline your educational background and business experience.

A. I graduated from the University of Wisconsin – Green Bay with a Bachelor's Degree in Accounting. I have also received a Masters Degree in Business Administration from the University of Wisconsin - Oshkosh. My professional designations are Certified Public Accountant and Certified Treasury Professional. I joined the Treasury Department at Wisconsin Public Service Corporation, a wholly owned subsidiary of Integrys, in April of 2001.

Q. What are your responsibilities in your present position?

A. As Manager Financial Planning and Analysis, I direct the long-term financial analysis and forecasting, for Integrys and its affiliates, including North Shore. I am also responsible for the capital structure and the cost of debt forecasts for each of Integrys' six regulated electric and natural gas utilities.

II. AUTHORIZED RATE OF RETURN

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

A. This is important because North Shore's obligation to provide safe, adequate and reliable service to its customers at just and reasonable rates requires that it maintain its financial integrity and ability to readily access the capital markets on reasonable terms and conditions. North Shore's proposed capital structure is consistent with the capital structure authorized in its last rate case, as well as current market expectations. However, this balanced capital structure, with an equity ratio of 50.31%, should be considered the minimum required to support North Shore's investment grade credit ratings, and protect itself and its customers from financial shocks, as I discuss further below. Furthermore, it is important that North Shore be allowed an opportunity to 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 test year cost of capital. If North Shore was not permitted an opportunity to earn its full cost of capital, its financial integrity and ability to access capital at reasonable terms may be at risk. Ultimately, compromising North Shore's ability to access capital at reasonable cost could threaten its ability to meet its service obligations.

Q. What is the impact on North Shore's Return on Equity ("ROE") absent the rate relief as requested in this case?

A. North Shore is projecting an ROE of 6.86% in the 2013 test year absent the rate relief requested in this case. This is significantly lower than the ROE of 9.45% authorized by the Commission in North Shore's last rate case and also lower than the 10.21% achieved by North Shore in 2011. Authorizing North Shore's requested rate increase will help North Shore maintain its financial integrity and its ability to raise capital at reasonable rates.

III. COMMON EQUITY

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

A. North Shore is an Illinois corporation, a wholly-owned direct subsidiary of Peoples Energy, LLC ("Peoples Energy"), and a wholly-owned indirect subsidiary of Integrys, a Wisconsin corporation and a public utility holding company. Shares of Integrys trade on the New York Stock Exchange under the symbol "TEG." North Shore has no existing authority to sell common equity to any other entity, and has no plans to seek such authority.

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

A. Yes. North Shore issues first mortgage bonds to public and private investors 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 public and private investors; none is held by Integrys.

Q. Does North Shore also borrow from its affiliates?

A. Yes, the Commission has granted approval for North Shore to borrow funds on a short-term basis from its corporate parent, and from its affiliate, The Peoples Gas Light and Coke Company.

IV. CAPITAL STRUCTURE OBJECTIVES

Q. What capital structure does North Shore propose for the purposes of its 2013 revenue requirement?

A. North Shore proposes an average annual capital structure consisting of 50.31% common equity, 42.22% long-term debt and 7.47% short-term debt.

Q. How does North Shore's proposed capital structure for the 2013 test year compare to its currently authorized capital structure?

A. It is similar. In its January 10, 2012 order in Docket Nos. 11-0280 and 11-0281 (cons.) (at p. 141), the Commission authorized a capital structure comprised of 50.00% common equity, 46.10% long-term debt and 3.90% short-term debt.

Q. Does North Shore's proposed capital structure meet the requirements of Section 9-230 of the Public Utilities Act?

A. Yes. The statute states:

> In determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges, the

> Commission shall not include any (i) incremental risk, (ii) increased cost of capital, or (iii) after May 31, 2003, revenue or expense attributed to telephone directory operations, which is the direct or indirect result of the public utility's affiliation with unregulated or nonutility companies.

North Shore’s currently authorized equity ratio of 50% and its proposed equity ratio of 50.31% imply a “significant” financial risk level in S&P’s financial risk matrix. This “significant” financial risk coupled with the “excellent” business risk profile that S&P assigns to North Shore imply a corporate credit rating of A- as shown on NS Ex. 2.6, which is the current rating published by S&P for North Shore. The fact that North Shore’s proposed capital structure implies a corporate credit rating of A-, the same rating currently published by S&P for North Shore, which is based on North Shore’s “excellent” business risk profile and Integrys’ “significant” financial risk profile, demonstrates that North Shore’s financial risk and related cost of capital, based on its proposed capital structure, is not adversely affected by its affiliation with non-regulated affiliates.

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

A. Yes, the proposed capital structure supports North Shore’s current credit ratings. 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. North Shore’s proposed capital structure with an equity ratio of approximately 50% supports and is consistent with North Shore’s investment grade credit ratings and provides for such access. As discussed by North Shore witness Mr. Moul in NS Ex. 3.0, North Shore currently maintains a corporate credit rating of A- from S&P and an issuer rating of A3 from Moody's. These ratings are the same as the average ratings of the peer group of companies (the "Delivery Group") used by Mr. Moul to develop his return on equity recommendation (NS Ex. 3.3).

Q. Why is it important for a company to maintain a strong capital structure?

A. A strong capital structure helps to insulate a company from "event-driven" financial shocks. This is particularly important during periods of financial market volatility and provides flexibility when gas prices fluctuate to extreme levels as we saw in the summer of 2008. A strong capital structure also reduces a company's costs by reducing its cost of debt as well as the cost of receiving credit in various forms from counter-parties. North Shore's proposed capital structure with an equity ratio of approximately 50% should be considered the minimum acceptable equity ratio for North Shore to support its current credit ratings and access to capital at reasonable cost.

Q. How does the proposed common equity ratio compare with the Delivery Group?

A. North Shore's proposed common equity ratio is similar to the 2011 quarterly average equity ratio of 49.9% and the 5-year quarterly average equity ratio of 48.0% for the Delivery Group. These Delivery Group equity ratios are shown on NS Ex. 2.7.

V. COST OF COMMON EQUITY

Q. What is North Shore's forecasted cost of common equity for 2013?

A. As calculated by Mr. Moul, North Shore's forecasted cost of common equity in 2013 is 10.75%.

VI. 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 4.95%, as shown in NS Ex. 2.3.

Q. How has North Shore's pro forma embedded cost of long-term debt changed since its last rate order?

A. The pro forma embedded cost of long-term debt reflects changes in North Shore's outstanding indebtedness, both actual and planned, since its 2012 rate order in Docket Nos. 11-0280/11-0281 (cons.) as summarized below.

	Forecasted Rate	Effective Date	Maturity Date	Amount	Rate in 2012 order	Rate Change
New - 15 Year	3.430	4/3/2012	4/1/2027	28,000,000	5.000	(1.570)
New - 10 Year	4.950	5/1/2013	5/1/2023	55,000,000		

New 2012 issue was used to refinance Series M

VII. EMBEDDED COST OF SHORT-TERM DEBT

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

A. The cost of short-term debt included in the proposed test year cost of capital is 2.00%, as shown in NS Ex. 2.2.

Q. How were interest rates on short-term debt forecasted?

A. The monthly short-term interest rates are based on forecasted 1-month commercial paper rates from DataBuffet.com as of March 13, 2012. North Shore has determined that the rates forecasted by Moody's DataBuffet.com closely represent rates on AA rated commercial paper; therefore, North Shore has added 35 basis points to the interest rate forecast from Moody's DataBuffet.com to approximate the spread between AA and A2/P2 rated commercial paper**.**

Q. How did you determine the 35 basis point spread between AA and A2/P2 rated commercial paper?

A. The 35 basis point spread is the difference between 30-Day AA and A2/P2 commercial paper rates from March 26, 2012, as published by the Federal Reserve.

Q. Does this complete your direct testimony?

A. Yes.