

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

The Peoples Gas Light and Coke Company :
: No. 14-____
Proposed General Increase :
In Rates For Gas Service :

Direct Testimony of

LISA J. GAST

Manager,
Financial Planning and Analysis
Integrus Business Support, LLC

On Behalf of
The Peoples Gas Light and Coke Company

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1 **I. INTRODUCTION AND BACKGROUND**

2 **A. Witness Introduction**

3 **Q. Please state your name and business address.**

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

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

7 A. I am the Manager, Financial Planning and Analysis for Integrys Business Support, LLC
8 (“IBS”), which is a wholly-owned subsidiary of Integrys.

9 **Q. For whom are you providing testimony?**

10 A. I am providing testimony for The Peoples Gas Light and Coke Company (“Peoples Gas”
11 or “PGL”), which is a wholly-owned indirect subsidiary of Integrys.

12 **B. Purpose of Testimony**

13 **Q. What is the purpose of your direct testimony?**

14 A. The purpose of my direct testimony is to present and support Peoples Gas’ forecasted
15 cost of capital – its overall rate of return on its rate base, including its embedded costs of
16 long-term and short-term debt and proposed capital structure for the 2015 test year. The
17 return on equity component of the cost of capital is presented by Peoples Gas witness
18 Mr. Paul Moul in his direct testimony (PGL Exhibit (“Ex.”). 3.0).

19 **C. Summary of Conclusions**

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

23 A. As shown in PGL Ex. 2.1, Peoples Gas calculates a cost of capital and rate of return on
24 rate base for the 2015 test year of 7.36%, which reflects a capital structure consisting of
25 50.31% common equity, 44.88% long-term debt and 4.81% short-term debt, a cost of
26 equity of 10.25%, an embedded cost of long-term debt of 4.72% and an embedded cost of
27 short-term debt of 1.63%.

28 **D. Itemized Attachments to Direct Testimony**

29 **Q. Are you sponsoring any exhibits?**

30 A. Yes, I am sponsoring the following exhibits:

<u>Exhibit No.</u>	<u>Corresponding 83 Ill. Admin. Code Part 285 Schedule</u>
PGL Ex. 2.1	D-1 Cost of Capital Summary
PGL Ex. 2.2	D-2 Cost of Short-Term Debt
PGL Ex. 2.3	D-3 Embedded Cost of Long-Term Debt
PGL Ex. 2.4	D-8 Security Quality Ratings
	<u>Other Exhibits</u>
PGL Ex. 2.5	Delivery Group Quarterly Average Common Equity Ratios

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32 **E. Background and Experience**

33 **Q. Please outline your educational background and business experience.**

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

39 2001 and have since provided financial and accounting services to various Integrys
40 companies including Peoples Gas.

41 **Q. What are your responsibilities in your present position?**

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

46 **II. AUTHORIZED RATE OF RETURN**

47 **Q. Why is it important that Peoples Gas be allowed the opportunity to earn its test year
48 cost of capital through the setting of the authorized return on rate base?**

49 A. This is important because Peoples Gas' obligation to provide safe, adequate and reliable
50 service to its customers at just and reasonable rates requires that it maintain its financial
51 integrity and ability to readily access the capital markets on reasonable terms and
52 conditions. Peoples Gas' proposed capital structure is consistent with the capital
53 structure authorized in its last rate case, Docket Nos. 12-0511/12-0512 (cons.), as well as
54 current market expectations. However, this balanced capital structure, with an equity
55 ratio of approximately 50%, should be considered the minimum required to support
56 Peoples Gas' investment grade credit ratings, and protect itself and its customers from
57 financial shocks, as I discuss further below. Furthermore, it is important that Peoples Gas
58 be allowed an opportunity to earn a fair and reasonable rate of return on its investment
59 that is consistent with the return expected by investors on investments of comparable risk.
60 This in turn necessitates, among other things that the allowed return on rate base be set
61 equal to the utility's test year cost of capital. If Peoples Gas was not permitted an

62 opportunity to earn its full cost of capital, its financial integrity and ability to access
63 capital at reasonable terms may be at risk. Ultimately, compromising Peoples Gas’
64 ability to access capital at a reasonable cost could threaten its ability to meet its service
65 obligations.

66 **Q. What would Peoples Gas’ Return on Equity (“ROE”) be absent the rate relief**
67 **requested in this case?**

68 A. Peoples Gas is projecting an ROE of 5.04% in the 2015 test year absent the rate relief
69 requested in this case. This is significantly lower than the ROE of 9.28% authorized by
70 the Commission in Peoples Gas’ last rate case. Authorizing Peoples Gas’ requested rate
71 increase will help Peoples Gas maintain its financial integrity and its ability to raise
72 capital at reasonable rates.

73 **III. COMMON EQUITY**

74 **Q. Please describe the corporate structure of Peoples Gas and its relationship to**
75 **Integrys.**

76 A. Peoples Gas is an Illinois corporation and a wholly-owned indirect subsidiary of Integrys,
77 a Wisconsin corporation and a public utility holding company. Shares of Integrys trade
78 on the New York Stock Exchange under the symbol “TEG”. Peoples Gas has no existing
79 authority to sell common equity to any other entity, and has no plans to seek such
80 authority.

81 **Q. Does Peoples Gas issue debt independently of Integrys?**

82 A. Yes. Peoples Gas issues its own first mortgage bonds to public and private investors for
83 the purpose of funding long-term investment in rate base. The long-term debt of Peoples

84 Gas is owned entirely by public and private investors. Peoples Gas also issues
85 commercial paper to private investors to meet its short-term seasonal cash requirements.

86 **Q. Does Peoples Gas also borrow from its affiliates?**

87 A. Yes, the Commission has granted approval for Peoples Gas to borrow funds on a short-
88 term basis from Integrys, and from its affiliate, North Shore Gas Company.

89 **IV. CAPITAL STRUCTURE OBJECTIVES**

90 **Q. What capital structure does Peoples Gas propose for the purposes of its 2015**
91 **revenue requirement?**

92 A. Peoples Gas proposes an average annual capital structure consisting of 50.31% common
93 equity, 44.88% long-term debt and 4.81% short-term debt.

94 **Q. How does Peoples Gas' proposed capital structure for the 2015 test year compare to**
95 **its currently authorized capital structure?**

96 A. It is similar. In its Order dated June 18, 2013 (at 182) in Peoples Gas' last rate case,
97 Docket Nos. 12-0511/12-0512 (cons.), the Commission authorized a capital structure
98 comprised of 50.43% common equity, 43.61% long-term debt and 5.96% short-term debt.
99 Authorized capital structure was not an issue on rehearing and thus was not changed in
100 the Order on Rehearing dated December 18, 2013.

101 **Q. Is Peoples Gas' capital structure impacted or affected by the presence of any**
102 **unregulated or nonutility affiliation?**

103 A. No. Peoples Gas' capital structure is designed and managed to support its regulated
104 utility operations, allowing it to access the capital markets at reasonable cost. Peoples

105 Gas' credit rating decisions and recent capital market transactions indicate no incremental
106 risk or cost imposed upon Peoples Gas by virtue of any affiliate.

107 **Q. Is this proposed capital structure reasonable and appropriate for Peoples Gas?**

108 A. Yes, the proposed capital structure supports Peoples Gas' current credit ratings. As a
109 public utility with an obligation to serve, Peoples Gas must have ready access to the
110 capital markets when required under all types of market conditions. Peoples Gas'
111 proposed equity ratio of approximately 50% supports Peoples Gas' investment grade
112 credit ratings and provides for such access. As discussed by Peoples Gas witness Mr.
113 Moul in PGL Ex. 3.0, Peoples Gas currently maintains a corporate credit rating of A-
114 from S&P and an issuer rating of A2 from Moody's. These ratings are the same as the
115 average ratings of the peer group of companies (the "Delivery Group") used by Mr. Moul
116 to develop his return on equity recommendation (PGL Ex. 3.3).

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

118 A. A strong capital structure helps to insulate a company from "event-driven" financial
119 shocks. This is particularly important during periods of financial market volatility and
120 provides flexibility when gas prices fluctuate to extreme levels as we saw in the summer
121 of 2008. A strong capital structure also reduces a company's costs by reducing its cost of
122 debt as well as the cost of receiving credit in various forms from counter-parties. Peoples
123 Gas' proposed capital structure with an equity ratio of approximately 50% should be
124 considered the minimum acceptable equity ratio for Peoples Gas to support its current
125 credit ratings and access to capital at a reasonable cost (PGL Ex. 2.4). A strong capital
126 structure is particularly important at present as Peoples Gas is currently engaged in its

127 extremely capital intensive accelerated main replacement program and access to capital
128 markets will be required frequently over the period of the program.

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

130 A. Peoples Gas' proposed common equity ratio is similar to the 2012 quarterly average
131 equity ratio of 48.9% and the 5-year quarterly average equity ratio of 48.5% for the
132 Delivery Group. These Delivery Group equity ratios are shown on PGL Ex. 2.5.

133 **Q. Is the capital structure adjusted to exclude capital associated with amounts that
134 Peoples Gas will recover under Rider QIP, Qualifying Infrastructure Plant ("Rider
135 QIP"), which is described by Peoples Gas witness Mr. Dennis Derricks?**

136 A. The capital structure is not adjusted for Rider QIP because the capital structure has to
137 support Peoples Gas' total capital requirements including funding for the accelerated
138 main replacement project and other qualifying infrastructure plant expenditures. The rate
139 of return for Rider QIP is the rate of return approved in the most recent rate case
140 proceeding. Thus, this case will set the rate of return for Rider QIP beginning in 2015.

141 **V. COST OF COMMON EQUITY**

142 **Q. What is Peoples Gas' forecasted cost of common equity for 2015?**

143 A. As calculated by Mr. Moul, Peoples Gas' forecasted cost of common equity for 2015 is
144 10.25%.

145 **VI. EMBEDDED COST OF LONG-TERM DEBT**

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

148 A. The embedded cost of long-term debt included in the proposed test year cost of capital is
149 4.72%, as shown in PGL Ex. 2.3.

150 **Q. How has Peoples Gas’ pro forma embedded cost of long-term debt changed since its**
151 **last rate order?**

152 A. The pro forma embedded cost of long-term debt reflects forecasted changes in Peoples
153 Gas’ outstanding indebtedness, since the Commission’s Order dated June 18, 2013 in
154 Docket Nos. 12-0511/12-0512 (cons.) as summarized below.

	<u>Forecasted Rate</u>	<u>Effective Date</u>	<u>Maturity Date</u>	<u>Amount</u>
Series VV Reset	5.05%	7/1/2014	3/1/2030	\$50,000,000
New 30 Year	5.50%	10/1/2014	10/1/2044	\$150,000,000
Series WW Reset	5.85%	8/1/2015	2/1/2033	\$50,000,000
New 30 Year	6.40%	10/1/2015	10/1/2045	\$150,000,000

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156 **Q. How were the forecasted rates determined?**

157 A. The forecasted rates for the tax-exempt rate resets were calculated based on the
158 forecasted 20-year Aaa Municipal bond yield, adjusted for difference in years to maturity
159 and the applicable credit spread. The rates for the new 30 year issues use the forecasted
160 30-year Treasury rate for the quarter of issuance plus a credit spread of 105 basis points.

161 **VII. EMBEDDED COST OF SHORT-TERM DEBT**

162 **Q. What is the cost of short-term debt included in the proposed test year cost of capital**
163 **for Peoples Gas?**

164 A. The cost of short-term debt included in the proposed test year cost of capital is 1.63%, as
165 shown in PGL Ex. 2.2.

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

167 A. The monthly short-term interest rates are based on forecasted 1-month commercial paper
168 rates from Moody's DataBuffet.com as of August 5, 2013. Peoples Gas has determined
169 that the rates forecasted by DataBuffet.com closely represent rates on AA rated
170 commercial paper; therefore, Peoples Gas has added 27 basis points to the interest rate
171 forecast from DataBuffet.com to approximate the spread between AA and A2/P2 rated
172 commercial paper.

173 **Q. How did you determine the 27 basis point spread between AA and A2/P2 rated
174 commercial paper?**

175 A. The 27 basis point spread is the 12 month average difference between 30-Day AA and
176 A2/P2 commercial paper rates, as published by the Federal Reserve from August 2012 to
177 July 2013.

178 **Q. Does this complete your direct testimony?**

179 A. Yes.