

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	:	
	:	
Proposed General Increase	:	
In Rates For Gas Service	:	No. 14-0224
	:	and
	:	No. 14-0225
The Peoples Gas Light and Coke Company	:	Consol.
	:	
Proposed General Increase	:	
In Rates For Gas Service	:	

Rebuttal Testimony of

LISA J. GAST

Manager,
Financial Planning and Analysis
Integrus Business Support, LLC

On Behalf of
North Shore Gas Company and
The Peoples Gas Light and Coke Company

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1 **I. INTRODUCTION AND BACKGROUND**

2 **A. Identification of Witness**

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, Wisconsin 54307-
6 9001.

7 **Q. Are you the same Lisa J. Gast who provided direct testimony on behalf of The**
8 **Peoples Gas Light and Coke Company (“Peoples Gas”) and North Shore Gas**
9 **Company (“North Shore”) (together, “the Utilities”) in these consolidated dockets?**

10 A. Yes.

11 **B. Purpose of Rebuttal Testimony**

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

13 A. The purpose of my rebuttal testimony is to respond to the proposed adjustments to the
14 Utilities’ requested overall rates of return on their proposed rate bases contained in the
15 direct testimony of Illinois Commerce Commission (“Commission”) Staff (“Staff”)
16 witness Janis Freetly (ICC Staff Exhibit 3.0), including her proposed adjustments to the
17 Utilities’ cost of debt components. The Utilities’ witness Paul R. Moul (NS-PGL
18 Ex. 19.0) will respond specifically to Staff’s proposed adjustments to the Utilities’
19 proposed return on equity (“ROE”) component of their rates of return.

20 I will also present updated capital structure and cost of capital schedules for each
21 Utility to reflect financing updates.

22 **C. Summary of Conclusions**

23 **Q. Please summarize the conclusions of your rebuttal testimony.**

24 A. First, Staff’s use of historical spot-day rates for variable rate debt and forecasted new
25 long-term debt issues should be rejected. Using such rates is not consistent with
26 forecasting the Utilities’ costs in a future test year. Furthermore, Staff’s objection to the
27 use of forecasts is misplaced because historical spot-day rates are themselves forecasts of
28 the economic conditions and rates that will prevail and impact rates during the test year.
29 There is no reason to believe that interest rates from a single day in 2014 are a better
30 forecast of interest rates that will prevail in 2015 than the published forecasts from
31 sources that are routinely relied upon by bankers, credit issuers and even Staff for certain
32 purposes.

33 Second, as discussed in the rebuttal testimony of the Utilities’ witness Mr. Moul,
34 the cost of equity proposals made by Staff and CCI¹ significantly understate the Utilities’
35 return for the test year 2015 and for the rate effective period beyond that.

36 As shown in NS-PGL Ex. 18.1N,² North Shore calculates an updated cost of
37 capital and rate of return on rate base for the 2015 test year of 6.89%, which reflects a
38 cost of equity of 10.25%, an embedded cost of long-term debt of 4.13% and an embedded
39 cost of short-term debt of 1.06%.

40 As shown in NS-PGL Ex. 18.1P, Peoples Gas calculates an updated cost of capital
41 and rate of return on rate base for the 2015 test year of 7.27%, which reflects a cost of
42 equity of 10.25%, an embedded cost of long-term debt of 4.44% and an embedded cost of
43 short-term debt of 1.19%.

¹ City of Chicago/Citizens Utility Board/Illinois Industrial Energy Consumers witness Michael P. Gorman.

² An “N” or a “P” at the end of the name of an exhibit means that it applies to North Shore or Peoples Gas, respectively.

44 **D. Itemized Attachments to Rebuttal Testimony**

45 **Q. Are there any attachments to your rebuttal testimony?**

46 A. Yes. I am sponsoring the following attachments:

- 47 • NS-PGL Ex. 18.1N – North Shore Revised Schedule D-1
- 48 • NS-PGL Ex. 18.2N – North Shore Revised Schedule D-2
- 49 • NS-PGL Ex. 18.1P – Peoples Gas Revised Schedule D-1
- 50 • NS-PGL Ex. 18.2P – Peoples Gas Revised Schedule D-2
- 51 • NS-PGL Ex. 18.3P – Peoples Gas Revised Schedule D-3

52 **II. COST OF DEBT**

53 **A. Cost of Short-Term Debt**

54 **Q. Do you agree with the cost of short-term debt proposed by Ms. Freetly for each of**
55 **the companies?**

56 A. No. Ms. Freetly relied on a historical spot day rate as of June 12, 2014 to set a forecasted
57 2015 test year rate. There is no reason to believe that a single interest rate from a single
58 day in 2014 is a better forecast of the interest rates that will prevail in 2015 than the
59 published forecasts from sources that are routinely relied upon by bankers, credit issuers
60 and even Staff for certain purposes.

61 **Q. How was the Utilities' updated short-term debt rates developed?**

62 A. The Utilities' updated short-term debt rates were developed as described in my direct
63 testimony, using the current forecast from Moody's DataBuffet.com. A credit spread
64 adjustment of 20 basis points for A2/P2 commercial paper was calculated using the most
65 recent 12 month data, which is down from 27 basis points in our initial filing.

66 **Q. What is the updated cost of short-term debt for each Company?**

67 A. The updated cost of short term debt is 1.06% for North Shore and 1.19% for Peoples Gas.
 68 Please see NS-PGL Ex. 18.2N and NS-PGL Ex. 18.2P. A summary of the test year
 69 information is provided in the table below:

	North Shore		Peoples Gas	
	Direct Filing	Rebuttal Update	Direct Filing	Rebuttal Update
12-month average of monthly average balances	\$17,615,000	\$21,678,000	\$95,233,000	\$58,805,000
Amortization of Upfront Credit Facility Fees	\$108,000	\$108,000	\$396,000	\$396,000
% of Amortization of Upfront Credit Facility	0.61%	0.50%	0.42%	0.67%
Total Short-Term Interest Expense	\$230,000	\$121,000	\$1,156,000	\$304,000
% Short-Term Interest	1.31%	0.56%	1.21%	0.52%
Total Cost of Short Term Debt	\$338,000	\$229,000	\$1,552,000	\$700,000
% Total Short Term Debt	1.92%	1.06%	1.63%	1.19%

70
 71 **B. Cost of Long-Term Debt**

72 **Q. Do you agree with the adjustments Ms. Freetly made to the forecasted long-term**
 73 **debt cost for Peoples Gas?**

74 A. No. Ms. Freetly adjusted the interest rates associated with forecasted debt issues at
 75 Peoples Gas to currently observed rates (historical in respect to the 2015 test year).
 76 Ms. Freetly’s proposal to base the cost of forecasted debt issues on historical observed
 77 rates should be rejected.

78 **Q. What should the rate be for Peoples Gas’ Series VV tax-exempt remarketing**
 79 **forecasted to occur in July 2014?**

80 A. Since the filing of this case, the Series VV remarketing has been completed. The actual
81 rate is 3.90%. NS-PGL Ex. 18.3P, an updated version of Schedule D-3, reflects this rate.

82 **Q. What should the rate be for Peoples Gas' Series WW remarketing that will occur in**
83 **the third quarter of 2015?**

84 A. Peoples Gas proposes to use a forecasted rate of 5.05%. NS-PGL Ex. 18.3P, an updated
85 version of Schedule D-3, reflects this rate.

86 **Q. How was the 5.05% rate for the Peoples Gas' Series WW remarketing determined?**

87 A. Having observed that Moody's second quarter of 2014 rate for Aaa Municipal 20 year
88 bonds of 4.16% reduced by .28% for 16 year vs. 20 year maturity matched the achieved
89 rate for Series VV, Peoples Gas realized that no credit spread adjustment was needed to
90 the Moody's forecasted rate. Thus, the 5.05% rate for Series WW remarketing was
91 developed using Moody's DataBuffet.com current third quarter of 2015 forecast for Aaa
92 Municipal 20 year bonds of 5.18% reduced by .13% for the 18 year vs. 20 year maturity.
93 The .28% and .13% term adjustments were observed differences at July 31, 2013, in the
94 AAA Municipal Yield Curve.

95 **Q. What rates should be used for the planned 30 year bond issuances for 2014 Series**
96 **BBB and 2015 Series CCC for Peoples Gas?**

97 A. The rate for the forecasted 2014 Series BBB should be 4.70%. The rate for the 2015
98 Series CCC should be 5.50%. These rates reflect the current 30 year Treasury forecast
99 from Moody's DataBuffet.com for the third quarter of the forecasted year of issuance
100 rounded to the nearest 5 basis points, (3.75% and 4.55% respectively) reflecting that
101 Peoples Gas anticipates an earlier pricing followed by a delayed draw of funds as done

102 with the most recent Peoples Gas private placement debt issuances. A credit spread of 95
103 basis points reflecting current market information is added to the 30 year Treasury
104 forecast to arrive at the forecasted rates. This compares to a 105 basis point credit spread
105 assumed in our initial filing.

106 **Q. Are there any other updates to Peoples Gas forecasted long-term debt?**

107 A. Yes. Peoples Gas is forecasting to refinance Series QQ \$75 million 4.875% tax exempt
108 debt in 2014. The expectation is that the financing needed to call this issuance in full will
109 be raised with Series BBB. Series BBB was originally forecasted as a \$150 million
110 issuance. However, with the refinancing of Series QQ, Series BBB is now forecasted as
111 a \$200 million issuance. This update along with Peoples Gas' updated forecasted rates is
112 shown in NS-PGL Ex 18.3P.

113 **Q. When does Peoples Gas expect to know the actual Series BBB rate?**

114 A. Peoples Gas expects to know the actual rate for Series BBB in the third quarter 2014.
115 Peoples Gas requests that the forecasted rate be updated with the actual rate when it
116 becomes known.

117 **Q. What is Peoples Gas's embedded cost of long-term debt reflecting these updates?**

118 A. As shown on NS-PGL Ex 18.3P, Peoples Gas's embedded cost of long-term debt for
119 2015 equals 4.44%. This is down from 4.72% in our initial filing.

120 **III. SUMMARY**

121 **Q. In summary, what are your conclusions regarding the proposals by Staff concerning**
122 **the Utilities' overall rate of return on rate base in this case?**

123 A. My conclusions are as follows:

- 124 • Based on (a) the Utilities’ revised capital structure, (b) their cost of equity, (c) their
125 updated cost of short-term debt, and (d) their updated cost of long-term debt, the
126 allowed overall rate of return on rate base should be 6.89% for North Shore and
127 7.27% for Peoples Gas. The rates compare to the current authorized return for North
128 Shore of 6.72% and Peoples Gas of 6.67%.
- 129 • Using current interest rates is not consistent with forecasting the Utilities’ costs in a
130 forecasted test year. Current interest rates reflect only the current economic
131 environment. They are inconsistent with a forecasted test year and assume that
132 current interest rates will continue to be available through the 2015 test year.
133 Forecasted interest rates allow for forecasted changes in the economic environment.
- 134 • As discussed in the rebuttal testimony of the Utilities’ witness Mr. Moul, the cost of
135 equity proposals made by Staff and CCI are inadequate and inconsistent with market
136 expectations as measured by the proxy group of companies used in Mr. Moul’s return
137 on equity study. An ROE that is out of line with current market expectations would
138 have a harmful effect on the Utilities’ ability to raise sufficient capital at a reasonable
139 cost.

140 **Q. Does this conclude your rebuttal testimony?**

141 A. Yes.