

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	:	

Surrebuttal 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

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION AND BACKGROUND	1
A. Identification of Witness.....	1
B. Purpose of Surrebuttal Testimony	1
C. Summary of Conclusions.....	2
D. Itemized Attachments to Surrebuttal Testimony	2
II. COST OF DEBT.....	3
A. Cost of Short-Term Debt	3
B. Cost of Long-Term Debt.....	3
III. SUMMARY	4

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 and rebuttal testimony**
8 **on behalf of The Peoples Gas Light and Coke Company (“Peoples Gas”) and North**
9 **Shore Gas Company (“North Shore”) (together, “the Utilities”) in these**
10 **consolidated dockets?**

11 A. Yes.

12 **B. Purpose of Surrebuttal Testimony**

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

14 A. The purpose of my surrebuttal testimony is to respond to the proposed adjustments to the
15 Utilities’ requested overall rates of return on their proposed rate bases contained in the
16 direct testimony of Illinois Commerce Commission (“Commission”) Staff (“Staff”)
17 witness Janis Freetly (Staff Exhibit (“Ex.”) 8.0), including her proposed adjustments to
18 the Utilities’ cost of debt components. The Utilities’ surrebuttal witness Paul R. Moul
19 (NS-PGL Ex. 35.0) will respond specifically to proposed adjustments to the Utilities’
20 proposed return on equity (“ROE”) component of their rates of return.

21 I also present an updated cost of capital schedule for Peoples Gas to reflect
22 financing updates. North Shore does not have any updates from my rebuttal testimony.

23 **C. Summary of Conclusions**

24 **Q. Please summarize the conclusions of your surrebuttal testimony.**

25 A. Staff's use of historical spot-day rates for variable rate debt and forecasted new long-term
26 debt issues should be rejected. Using actual rates to project a forecasted rate in the test
27 year is not a superior indicator of what the future rate will be.

28 As discussed in the surrebuttal testimony of the Utilities' witness Mr. Moul, the
29 cost of equity proposals made by Staff and CCI¹ significantly understate the Utilities'
30 return for the test year 2015 and for the rate effective period beyond that.

31 As shown in my rebuttal testimony, NS-PGL Ex. 18.1N², North Shore calculated
32 a cost of capital and rate of return on rate base for the 2015 test year of 6.89%, which
33 reflects a cost of equity of 10.25%, an embedded cost of long-term debt of 4.13% and an
34 embedded cost of short-term debt of 1.06%.

35 As shown in NS-PGL Ex. 34.1P, Peoples Gas calculates an updated cost of capital
36 and rate of return on rate base for the 2015 test year of 7.21%, which reflects a cost of
37 equity of 10.25%, an embedded cost of long-term debt of 4.32% and an embedded cost of
38 short-term debt of 1.19%.

39 **D. Itemized Attachments to Surrebuttal Testimony**

40 **Q. Are there any attachments to your surrebuttal testimony?**

41 A. Yes. I am sponsoring NS-PGL Ex. 34.1P, Peoples Gas Revised Schedule D-1 and
42 NS-PGL Ex. 34.2P, Peoples Gas Revised Schedule D-3.

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.

43 **II. COST OF DEBT**

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

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

47 A. No. The Utilities reject Ms. Freetly's reliance on a historical spot day rate as of June 12,
48 2014 to set a forecasted 2015 test year rate. There is no reason to believe that a single
49 interest rate from a single day in 2014 is a better forecast of the interest rates that will
50 prevail in 2015 than the published forecasts from sources that are routinely relied upon by
51 bankers, credit issuers and even Staff for certain purposes.

52 **B. Cost of Long-Term Debt**

53 **Q. Does Peoples Gas know the actual rate for the planned 2014 Series BBB 30-year**
54 **bond issuance?**

55 A. Yes. Peoples Gas completed the pricing for Series BBB on August 20, 2014, and the
56 actual rate is 4.21%.

57 **Q. When does Peoples Gas expect to complete the Series BBB transaction?**

58 A. Peoples Gas expects to complete the Series BBB transaction on November 3, 2014.

59 **Q. How does the actual Series BBB rate compare to the rate Peoples Gas used in**
60 **rebuttal testimony and the rate that Ms. Freetly used in her direct testimony?**

61 A. The actual rate for Peoples Gas Series BBB is lower than both the Peoples Gas estimate
62 and Ms. Freetly's. In Peoples Gas rebuttal testimony, Peoples Gas used a forecasted rate
63 from Moody's DataBuffet.com to arrive at a forecasted rate of 4.70%. Ms. Freetly used
64 an actual rate as of June 11, 2014 to arrive at a rate of 4.66%.

65 **Q. What does this show?**

66 A. This shows that using an actual interest rate from a particular date to set a future interest
67 rate is not an accurate tool to use for forecasting future interest rates. Financial
68 professionals, such as bankers, credit issuers and even Staff for certain purposes routinely
69 rely on forecasts developed by experts. Doing so is also appropriate in setting rates for a
70 future test year for Peoples Gas and North Shore Gas.

71 **Q. Does Peoples Gas have an alternative?**

72 A. Yes. Peoples Gas proposes to provide, in a delayed exhibit, updated forecasted interest
73 rates prior to the final hearing to allow for the most current forecast to set the interest
74 rates of both Series WW and Series CCC in the test year.

75 **Q. What is Peoples Gas' embedded cost of long-term debt?**

76 A. As shown on NS-PGL Ex 34.2P, Peoples Gas' embedded cost of long-term debt for the
77 2015 test year equals 4.32%. This is slightly down from our rebuttal testimony estimate
78 of 4.44%.

79 **III. SUMMARY**

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

82 A. My conclusions are as follows:

83 • Based on (a) the Utilities' capital structure, (b) their cost of equity, (c) cost of short-
84 term debt, and (d) their updated cost of long-term debt, the allowed overall rate of
85 return on rate base should be 6.89% for North Shore and 7.21% for Peoples Gas. The

86 rates compare to the current authorized return for North Shore of 6.72% and Peoples
87 Gas of 6.67%.

88 • Using current interest rates is not consistent with forecasting the Utilities' costs in a
89 future test year. Forecasted interest rates allow for forecasted changes in the
90 economic environment. The Commission should allow Peoples Gas to provide a
91 delayed exhibit to update the forecasted interest rates prior to the final hearing to
92 allow the most current forecast to set the interest rates for both Series WW and Series
93 CCC in the test year.

94 • As discussed in the rebuttal testimony of the Utilities' witness Mr. Moul, the cost of
95 equity proposals made by Staff and CCI are inadequate and inconsistent with market
96 expectations as measured by the proxy group of companies used in Mr. Moul's return
97 on equity study. An ROE that is out of line with current market expectations would
98 have a harmful effect on the Utilities' ability to raise sufficient capital at a reasonable
99 cost.

100 **Q. Does this conclude your surrebuttal testimony?**

101 A. Yes.