

The Peoples Gas Light and Coke Company

Assumptions Used in the Forecast

PRESENTATION BASIS

The financial forecast has been prepared by The Peoples Gas Light and Coke Company ("the Company") and presented in accordance with the guidelines established in the May 1, 2007 AICPA Guide for Prospective Financial Information. The forecasted financial statements contained herein present, to the best of management's knowledge and belief at the time this forecast was prepared using information that was reasonably available at the time, the Company's expected financial position, results of operations and cash flows as of and for the year ending December 31, 2010, assuming that current tariffed rates remain in effect through December 31, 2010 and assuming that natural gas commodity market prices in 2009 and 2010 are equal to the New York Mercantile Exchange ("NYMEX") future prices as reported on June 25, 2008. In compliance with the information requirements set forth in Part 285 of Chapter 1, Title 83 of the Illinois Administrative Code, existing rates are used to develop fiscal 2010 operating results for the purpose of determining the Company's revenue deficiency. Other than the two assumptions discussed above, this forecast also reflects management's judgment as of December 18, 2008, the date of preparation of this forecast, of expected conditions and the Company's expected course of action. The assumptions disclosed herein are those that management believes are significant to the forecast. There will be differences between the forecast and actual results because events and circumstances do not occur as expected and those differences may be material, which would cause these forecasted results not to be achieved.

ACCOUNTING POLICIES

The accounting policies used in preparing the forecast are the same as those used in the Company's audited financial statements.

SUMMARY OF SIGNIFICANT ASSUMPTIONS/ITEMS

I. Operating Revenues

1. Forecasted revenues were primarily determined by applying the Company's current rates and rate structure to forecasted deliveries of gas to customers, plus the cost of gas delivered, environmental recovery charges, Enhanced Efficiency Program charges, the volume balancing adjustment and other miscellaneous charges.
2. Forecasted deliveries, including changes due to customer growth and conservation, were determined using internally developed models that consider various factors, including historical, trend and regression analysis. The models also consider economic and market variables.

3. Forecasted deliveries assumed 6,096 normal heating degree-days. This represents the average of actual weather at O'Hare International Airport for the 12-year period from 1996 through 2007.
4. Based on the above volume assumptions, forecasted deliveries to customers are 173.2 Bcf, including 99.1 Bcf delivered to sales customers and 74.1 Bcf delivered to transportation customers.
5. Revenues not associated with delivery volumes were determined primarily from historical factors or the number of customers. Revenues for large customers with special contracts were based on a combination of historical and projected data.
6. Late payment charges were forecasted to be \$11.6 million. This estimate reflects the Company's recent history of such charges.
7. Revenue attributable to the recovery of environmental clean-up costs (Rider 11 revenue) is forecast at \$23.1 million. There is a corresponding charge to expense, and thus these revenues have no direct impact on forecasted income.
8. Revenue attributable to the Enhanced Efficiency Program (Rider EEP) is forecast at \$6.4 million. There is a corresponding charge to expense, and thus these revenues have no direct impact on forecasted income.
9. Revenue attributable to the volume balancing adjustment (Rider VBA) is forecast at \$5.6 million based on forecasted declining use per customer compared to the rate case margin allowed in the Rider.
10. There are no significant changes to the customer base. The forecast has not been adjusted for any impact of the current economic slowdown.

## II. Cost of Gas

1. The cost of gas purchased for sales to customers is passed on directly to customers without mark-up. Therefore, while a change in the forecast of gas costs may have a significant effect on revenue and the cost of gas, it would not have a direct impact on the Company's forecast of income. Indirectly, changes in the cost of gas impacts customer deliveries and the forecast of other costs, especially bad debt expense.
2. The forecasted cost of gas purchased for sales to customers includes natural gas commodity costs and non-commodity costs, along with changes in inventory and adjustments for prior and forecasted over/under collections of gas costs from customers. At the end of 2010, the forecasted over collection from customers is \$16.3 million. This is based on forecasted monthly differences between actual gas costs and billed gas costs due in part to timing differences amortized over a 12 month period.

3. Non-commodity costs, primarily pipeline transportation and storage demand charges, were generally based on contractual volumes and rates in place at July 2008. No material changes are expected in these contracts for the forecast period.
4. Forecasted commodity costs were based on the product of forecasted purchase volumes and forecasted gas purchase costs.
5. Forecasted purchase volumes include lost and unaccounted-for gas. The Company forecasted an unaccounted-for loss rate of 2.0% of forecasted retail deliveries, which is consistent with the actual loss rate experienced in recent years.
6. Forecasted gas purchase costs were determined by applying the 1-day forward NYMEX gas price as of June 25, 2008 (\$10.95 per MMBtu, unweighted), adjusted for applicable basis differentials and existing hedge positions.

Natural gas prices are volatile. Because of the large volume of forecasted natural gas purchases, the assumptions used for gas purchase costs could have a significant impact on the amount of forecasted bad debt expense.

At January 30, 2009, the 1-day forward NYMEX gas price was \$6.52. This change in price would decrease bad debt expense by approximately \$8.0 million pre-tax.

7. Hub revenues, which are credited to (reduce) gas costs, were forecasted at \$4.9 million based on available storage capacity and management's expectations regarding specific contract renewals.

### III. Operations and Maintenance Costs

#### A. Labor

1. The number of employees is projected to remain constant in calendar year 2010 at 1,139 compared to calendar 2009.
2. Union employee wage increases were based on existing union contracts, which cover the forecast period. The contract stipulates a 3.25% increase in May 2010.
3. Non-union wages were forecast to increase 4.2% in calendar 2009 and 2010.

#### B. Bad Debt

The provision for bad debt was forecast at 2.54% of revenue. This rate is consistent with prior experience.

C. Pension and Post Retirement Expense

Pension and post retirement expense was developed with the assistance of the Company's actuaries. The discount rate assumption for pension expense was forecast at 6.40%, which was the discount rate at December 31, 2007. The discount rate assumption for post retirement expense was forecast at 6.25%, which was the discount rate at December 31, 2007. The forecast also used the market value of plan assets at June 30, 2008 and a \$10.2 million pension and post retirement fund contribution in calendar 2009 and a \$0.3 million pension and post retirement fund contribution in calendar 2010.

The discount rate has increased slightly since the Company prepared its forecast. At December 31, 2008, the discount rate was 6.45% for both pension and post retirement expense which would not have material impact on the forecast. However, since the company prepared the forecast, the value of plan assets used to determine expense have decreased. This decrease in assets would increase pension expense by approximately \$2.8 million and increase post retirement expense by less than \$0.2 million compared to the amounts reflected in the forecast. Forecasted contributions would also change to \$16.7 million in 2009 and \$15.8 million in 2010.

D. Environmental Costs

Costs related to the investigation and removal of manufactured gas residues are initially recorded in a regulatory asset account. As these costs are billed to customers, a corresponding amount of the deferred charge is expensed and therefore does not directly impact forecasted income. \$23.1 million is forecasted to be billed and expensed in the year ending 12/31/10. Liabilities were developed based on engineering costs estimates and probable outcomes, and were based on a review and judgment by the Company's management and outside consultants.

E. Enhanced Efficiency Program Costs

Costs related to the Enhanced Efficiency Program are expensed as incurred. The difference between the budgeted monthly expenditure billed to customers and the actual expenses is recorded as a reconciliation expense. The amount billed to customers, with an offsetting expense in operating and maintenance expenses is \$1.1 million in calendar 2010, and therefore does not directly impact forecasted income.

F. Inter-company Billing Charges

Various services are performed by affiliates of PGL and those costs are billed to PGL on a monthly basis. These costs are billed to the Company and paid by the Company in accordance with the Master Regulated Affiliated Interest Agreement approved by the Illinois Commerce Commission in Docket No. 07-0361 and any subsequent updates to the Agreement.

G. Other Costs

The Company forecasted operating and maintenance costs through a detailed bottoms-up budgeting process. Unless specifically determined otherwise, this process assumed, as a default, a 2.0% and 1.8% annual rate of inflation for 2009 and 2010 respectively except for materials and supplies, including pipe, copper, steel, etc which assumed a 5% inflation rate in 2009 and 2010. The cost of natural gas purchased for the Company's internal use was forecasted in a similar manner as gas purchased for sales to customers.

IV. Depreciation

The provision for depreciation and amortization, expressed as an annual percentage of the original cost of depreciable property, was 2.4% for calendar year 2010. Depreciation expense in calendar year 2010 is based on the average estimated life of depreciable property and the new estimated lives based on the depreciation study being filed as part of the rate case. The Company is required to file a new depreciation study every 5 years and its current depreciation study was approved by the Illinois Commerce Commission in 2005. Consistent with the Company's current accounting for removal costs, forecasted depreciation expense also includes dismantling costs, net of salvage, as incurred at the time of the dismantling activity.

V. Income Taxes

1. Income taxes were forecast by applying the current federal and state statutory income tax rates of 35% and 7.3%, respectively to forecasted pre-tax income, after adjusting for forecasted permanent items.
2. Reversals of property-related deferred income taxes are based on the weighted average tax rate method.

VI. Interest Income and Expense

1. Interest expense includes a) interest on long-term debt, b) amortization of debt issuance costs, c) interest and fees associated with short-term borrowings and lines of credit, and d) interest expense related to customer deposits, budget plan customers, employee deferred compensation balances, and over-collected gas costs.
2. For fixed rate long-term debt, interest expense was forecast by applying the stated interest rate to the principal amount of each series of currently outstanding first-mortgage bonds.
3. For floating rate long-term debt, interest expense was calculated using the Economy.com forecasted 3 month LIBOR rate rounded to the nearest 5 basis points at 7/08/08 x 175% for Series OO – this is the maximum rate paid in the event of a failed auction and reflects the current bond pricing. Series PP was based on 75% of the 3 month LIBOR rate at July 8, 2008 + an additional 87 basis points for letter of credit and remarketing fees – this anticipates reissuing the bonds in weekly auction rate mode.

4. For variable rate short-term debt, interest expense was forecasted at an average of 4.50% for 2010 with rates ranging from 3.87% in January to 5.38% in December based on the economy.com forecast for 1 month non-financial commercial paper as of July 8, 2008.

VII. Long-Term Debt

The forecast includes the issuance of \$50 million in long-term debt on November 1, 2008 at an annual interest rate of 7.15%, the reissuance of Series PP in weekly auction rate mode in November 2008 at rates described in VI #3 above, the issuance of \$50 million of long-term debt on October 1, 2009 at 7.75%, and the issuance of \$50 million of long-term debt on March 1, 2010 at an annual interest rate of 7.9%. Each of the new issuances includes \$.45 million of debt issuance costs amortized over 10 years. The March 1, 2010 issue replaces 4.0% Series MM-2 that matures on that date. The forecasted rates were estimated using the 10-Year Treasury rate forecasted for the quarter, rounded to the nearest 5 basis points plus a basis point spread of 300 for the 2008 issue, 200 for the 2009 and 2010 issues. The Treasury forecasted rates were per the Economy.com September 12, 2008 forecast.

On November 3, 2008 PGL issued \$45 million of 5 year debt at 7% and \$5 million of 10 year debt at 8%.

VIII. Dividends

There are no dividend declarations forecasted for PGL in 2010.

IX. Capital Expenditures

Capital expenditures were forecasted as follows for calendar 2010 (\$ in millions):

	<u>Construction</u>	<u>Net Dismantling</u>	<u>Total</u>
Distribution system	\$134.5	\$13.9	\$148.4
Underground storage	27.8	.7	28.5
Information technology	2.7		2.7
Other	<u>18.0</u>	<u>(.3)</u>	<u>17.7</u>
Total	\$183.0	\$14.3	\$197.3

Net dismantling is a component of 2010 depreciation expense. Dismantling activity was forecasted primarily based on historical trends of such activity related to new capital additions.

The Company will likely reduce its 2009 operation and maintenance and capital expenditures in response to the current economic slowdown, and may make reductions in 2010 if the current economic environment does not significantly improve. No changes have been made to the forecast as a result of any of those

possible reductions. The impact on the December 31, 2010 forecasted balance sheet of the likely reduction in 2009 capital expenditure is a reduction in property, plant and equipment of up to approximately \$60 million.