

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

THE PEOPLES GAS LIGHT	:	
AND COKE COMPANY	:	
	:	No. 09-_____
Proposed General Increase	:	
In Rates For Gas Service	:	

Direct Testimony of
BRADLEY A. JOHNSON
Treasurer
The Peoples Gas Light and Coke Company
February 13, 2009

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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 Bradley A. Johnson, and my business address is 130 East Randolph Drive,
5 Chicago, IL 60601.

6 Q. What is your current position with The Peoples Gas Light and Coke Company (“Peoples
7 Gas” or the “Company”)?

8 A. My current position is Treasurer.

9 **B. Purpose of Testimony**

10 Q. What is the purpose of your direct testimony?

11 A. The purpose of my direct testimony is to identify and support the Company’s requested
12 overall rate of return on its proposed rate base (“cost of capital”), including its embedded
13 cost of long-term debt and proposed capital structure for the test year. The proposed
14 return on equity component of the cost of capital is presented by Peoples Gas witness
15 Mr. Moul in his direct testimony (Peoples Gas Exhibit (“Ex.”) PRM-1.0).

16 **C. Summary of Conclusions**

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

19 A. As shown in Peoples Gas Ex. BAJ-1.1, the Company calculates a cost of capital and rate
20 of return on rate base for the fiscal 2010 test year of 9.34%, which reflects a capital
21 structure of 56% common equity and 44% long-term debt, a cost of equity of 12.00%,
22 and an embedded cost of long-term debt of 5.96%.

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

24 Q. Are you sponsoring any exhibits?

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

<u>Exhibit No.</u>	<u>Corresponding 83 Ill. Admin. Code Part 285 Schedule</u>
Peoples Gas Ex. D-1 BAJ-1.1	Cost of Capital Summary
Peoples Gas Ex. D-3 BAJ-1.2	Embedded Cost of Long-Term Debt
Peoples Gas Ex. D-7 BAJ-1.3	Comparative Financial Data
Peoples Gas Ex. D-8 BAJ-1.4	Security Quality Ratings

26 **E. Background and Experience**

27 Q. Please outline your educational background and business experience.

28 A. I graduated from the University of Wisconsin – Eau Claire in 1976 with a major in
29 accounting. I received a Masters Degree in Business Administration from the University
30 of Wisconsin – Oshkosh in 1984. I joined Wisconsin Public Service Corporation as a
31 tax accountant in November of 1979. I held various positions in the Tax Department and
32 the Corporate Planning Department prior to being named Assistant Treasurer of WPS
33 Resources Corporation in April 2001, Treasurer in February 2002, and Vice President
34 and Treasurer in 2004. Upon the recent merger transaction by which Peoples Energy
35 Corporation (“Peoples Energy”) became a wholly-owned subsidiary of WPS Resources
36 Corporation, which was renamed Integrys Energy Group (“Integrys”), I was named Vice
37 President and Treasurer of Integrys and its affiliates, including Peoples Gas.

38 Q. What are your responsibilities in your present position?

39 A. As Treasurer, I direct the financing, treasury management, financial analysis and
40 forecasting, and oversight of financial risk management activities of Integrys and its
41 affiliates, including Peoples Gas. I also oversee these companies' financial risk
42 management activities.

43 **II. AUTHORIZED RATE OF RETURN**

44 Q. Is it important that the Company be allowed the opportunity to earn its test year cost of
45 capital through the setting of the authorized return on rate base?

46 A. Yes. The Company's obligation to provide safe, adequate and reliable service to its
47 customers at just and reasonable rates requires that it maintain its financial integrity and
48 ability to readily access the capital markets on reasonable terms and conditions. A strong
49 capital structure, like that proposed by the Company, is consistent with the capital
50 structure authorized by the Illinois Commerce Commission (the "Commission" or "ICC")
51 for the Company in ICC Docket No. 07-0242 last year, as well as current market
52 expectations. A strong capital structure is also important in maintaining the Company's
53 investment grade credit ratings, and protecting the Company and its customers from
54 financial shocks, as I discuss further below. A strong capital structure is especially
55 important in this time of financial market turmoil. Along with a strong capital structure,
56 it is important that the Company be allowed an opportunity to earn a fair and reasonable
57 rate of return on its investment that is consistent with the return expected by investors on
58 investments of comparable risk. This in turn necessitates, among other things, that the
59 allowed return on rate base be set equal to the utility's actual cost of capital in the test
60 year. If the Company is not permitted an opportunity to earn its full cost of capital, its

61 financial integrity and ability to raise capital on reasonable terms will ultimately be at
 62 risk, which in turn will threaten its ability to meet its service obligations.

63 Q. Have the Company’s returns on equity and its key credit ratios declined significantly in
 64 recent years, and will they continue to decline absent the requested rate relief?

65 A. Yes. As shown in Peoples Gas Ex. BAJ-1.3 and summarized in the following table, the
 66 Company’s equity returns and key credit metrics have declined substantially since 2003,
 67 and the 2008 rate increase was not adequate to fully restore the Company’s required
 68 returns and credit metrics. Indeed, absent rate relief, the credit metrics associated with
 69 the 2010 test year are insufficient to maintain the Company’s current credit ratings or its
 70 ability to raise capital on reasonable terms.

	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008*</u>	<u>2009</u>	<u>2010</u>
Return on Avg. Common Equity	12.0%	6.3%	1.3%	1.3%	-2.1%	6.6%	3.2%	0.3%
Funds Flow Interest Coverage	7.4x	6.0x	2.9x	2.0x	2.4x	5.4x	4.1x	3.9x
Funds From Operations/Avg Total Debt	25.0%	20.6%	9.1%	5.9%	8.9%	20.1%	16.0%	18.1%
Pre-Tax Interest Coverage	6.5x	3.8x	1.3x	1.4x	0.2x	3.4x	2.1x	1.0x

*Based on 6 months actuals and 6 months forecast

71 **III. COMMON EQUITY RATIO**

72 Q. Please describe the corporate structure of Peoples Gas and its relationship to Peoples
 73 Energy and Integrys.

74 A. Peoples Gas is an Illinois corporation whose common equity is wholly owned by Peoples
 75 Energy, an Illinois corporation and public utility holding company. The common equity
 76 of Peoples Energy is wholly owned by Integrys, a Wisconsin corporation and public
 77 utility holding company. Shares of Integrys trade on the New York Stock Exchange
 78 under the symbol “TEG”. Peoples Gas currently has no outstanding authority, and has no
 79 plans to seek such authority, to sell common equity to any other entity.

80 Q. Does Peoples Gas issue debt independently of Peoples Energy and Integrys?
81 A. Yes. Peoples Gas issues first mortgage bonds to the public independently of Peoples
82 Energy and Integrys for the purpose of funding long-term investment in rate base. The
83 long-term debt of Peoples Gas is owned entirely by the public and not by Peoples Energy
84 or Integrys. Peoples Gas also issues commercial paper to private investors to meet its
85 short-term seasonal cash requirements. The Commission has also granted approval for
86 Peoples Gas to borrow funds on a short-term basis from Peoples Energy and its affiliate,
87 North Shore Gas Company. However, such borrowing authority is used only to
88 supplement the short-term seasonal borrowing capacity of Peoples Gas and is not a
89 source of permanent funding for the Company.

90 **IV. CAPITAL STRUCTURE OBJECTIVES**

91 Q. What capital structure does Peoples Gas propose for the purposes of re-setting its rates?

92 A. Peoples Gas proposes a capital structure consisting of 56% common equity and 44%
93 long-term debt.

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

95 A. Yes. As a public utility with an obligation to serve, Peoples Gas must have ready access
96 to the capital markets when required under all types of market conditions. A strong
97 capital structure helps to provide for such access by allowing the Company to maintain
98 strong credit ratings on its debt. As shown in Peoples Gas Ex. BAJ-1.4, Peoples Gas still
99 has reasonably strong credit ratings, with ratings on its senior secured debt of A- from
100 Standard & Poors and A1 from Moody's. As shown by Mr. Moul, these ratings are
101 above average among the S&P Public Utilities.

125 between 2023 and 2030, contained mandatory tender provisions that provided investors
126 the right to tender such bonds at par prior to each weekly interest rate reset point.
127 Peoples Gas was obligated to purchase any such bonds tendered if they could not be re-
128 marketed. Therefore, the Company was required to classify them for accounting
129 purposes as short-term debt on its balance sheet. However, from a practical standpoint,
130 the re-marketing risk for these bonds was very small, they had extended principal
131 maturity dates, and the Company has since refinanced all such debt to eliminate the put
132 feature. Peoples Gas Ex. BAJ-1.3 reflects this tax-exempt adjustable rate debt for the
133 2003 period as long-term debt.

134 The Company's tax-exempt adjustable rate Series PP bonds were brought in
135 house from the auction rate market in the Spring of 2008 due to market conditions for
136 auction rate securities. Current financial statements reflect these bonds as retired. The
137 Company intends to reissue these bonds when market conditions improve. Peoples Gas
138 Ex. BAJ-1.3 reflects this tax-exempt adjustable rate debt for the 2009 and 2010 period as
139 long-term debt. This was the same treatment accorded these bonds in the Company's last
140 rate case, Docket 07-0242.

141 Q. How does the proposed capital structure compare to the capital structures approved by
142 the Commission in other recent rate case decisions for gas utilities in Illinois?

143 A. The Company's proposed capital structure is consistent with the capital structures used in
144 other recent gas utility rate orders. For example, summarized below are the ratios of debt
145 to permanent capital reflected in the capital structures approved by the Commission in
146 recent utility gas rate orders.

<u>Company</u>	<u>ICC Docket Number</u>	<u>% LT Debt/ Permanent Capital</u>
Nicor Gas	Docket 04-0779	43.5%
AmerenIP (Gas)	Dockets 07-0590,07-0589,07-0588,07-0587,07-0586,07-0585 (Consolidated)	39.7%
AmerenCILCO (Gas)	Dockets 07-0590,07-0589,07-0588,07-0587,07-0586,07-0585 (Consolidated)	39.3%
AmerenCIPS (Gas)	Dockets 07-0590,07-0589,07-0588,07-0587,07-0586,07-0585 (Consolidated)	46.9%

147 Q. Is the proposed capital structure reasonable when compared with the proxy group of
148 companies (“the Gas Group”) used by Company witness Mr. Moul to develop his return
149 on equity recommendation?

150 A. Yes, as discussed in Mr. Moul’s testimony, the Company’s proposed common equity
151 ratio falls within the range of common equity percentages of the Gas Group and is within
152 one percentage point of the forecasted 2008 and 2009 averages for those companies of
153 56.8%.

154 Q. Would it be appropriate to include a short-term borrowing component in the Company’s
155 test year capital structure?

156 A. No. Peoples Gas uses short-term debt only to finance seasonal cash needs, particularly
157 for purchased gas costs and short-term construction work in progress, and not as a
158 permanent source of financing rate base investments. The Company’s practice is to
159 finance its long-lived, permanent assets with permanent capital consisting of long-term
160 debt and common equity. In fact, during many months of the year the Company has no
161 short-term debt outstanding. For example, during fiscal year 2007, the Company had no
162 short-term debt outstanding on 58 days throughout the year, including consecutively from
163 April 10, 2007 to May 24, 2007. During fiscal year 2006, no short-term debt was
164 outstanding on 238 days throughout the year, including consecutively from March 28,

165 2006 to September 30, 2006. During fiscal year 2005 no short-term debt was outstanding
166 on 209 days throughout the year, including consecutively from March 8, 2005 to
167 September 25, 2005. During fiscal 2004, no short-term debt was outstanding on 191 days
168 throughout the year, including consecutively from March 30, 2004 to August 23, 2004.
169 This practice has not changed since the Commission used a capital structure with no
170 short-term debt component in the Company's last rate case.

171 **V. COST OF COMMON EQUITY**

172 Q. What cost of common equity does the Company propose?

173 A. As recommended by Mr. Moul, the Company is proposing a cost of common equity of
174 12.0%.

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

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

178 A. The embedded cost of long-term debt included in the proposed test year cost of capital is
179 5.96%, as shown in Peoples Gas Ex. BAJ-1.2.

180 Q. How has the Company's pro forma embedded cost of long-term debt changed since its
181 last rate case, Docket 07-242?

182 A. The pro forma embedded cost of long-term debt reflects changes since 2006, the test year
183 in the last rate case, outstanding indebtedness, both actual and planned, as summarized
184 below.

		Forecasted <u>Rate</u>	Effective <u>Date</u>	Maturity <u>Date</u>	<u>Amount</u>	Rate in <u>2006</u>	Rate <u>Change</u>
Auction	Series OO	7.73			51,000,000	3.60	4.13
Auction	Series PP	4.18			51,000,000	3.55	0.63
	New - 10 Year	7.15	11/1/2008	11/1/2018	50,000,000		
	New - 10 Year	7.75	10/1/2009	10/1/2019	50,000,000		
(a)	New - 10 Year	7.90	3/1/2010	3/1/2020	50,000,000	4.00	3.90
(a)	Replaces 4.0% Series MM-2 that matures on 3/1/2010						

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The forecasted rates reflect current volatile financial market conditions.

187 Q. Does this complete your direct testimony?

188 A. Yes.