

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
MICHAEL A. SMALL

Assistant Controller
Financial and Accounting Services
Integrays Business Support, LLC

On Behalf of
The Peoples Gas Light and Coke Company

February 13, 2009

TABLE OF CONTENTS

	<u>Page</u>
I. INTRODUCTION AND BACKGROUND	1
A. Identification of Witness	1
B. Purposes of Testimony	1
C. Summary of Conclusions	3
D. Background and Experience	3
II. INTEGRYS BUSINESS SUPPORT	4
A. Creation and Background of IBS and the Regulated AIA	4
B. Purpose, Goals, Allocation Methodologies, and Reporting Requirements of IBS	5
III. ALLOCATION OF IBS COSTS	8
IV. ALLOCATION OF NON-IBS AFFILIATED INTEREST COSTS	10

1 **I. INTRODUCTION AND BACKGROUND**

2 **A. Identification of Witness**

3 Q. Please state your name and business address.

4 A. My name is Michael A. Small. My business address is Integrys Energy Group, Inc.
5 (“Integrys”), 130 East Randolph Drive, Chicago, Illinois 60601.

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

7 A. I am the Assistant Controller of Financial and Accounting Services of Integrys Business
8 Support, LLC (“IBS”), which is a first tier wholly-owned subsidiary of Integrys.

9 **B. Purposes of Testimony**

10 Q. On whose behalf are you offering this testimony?

11 A. I am offering this testimony on behalf of The Peoples Gas Light and Coke Company
12 (“Peoples Gas”), which is a first tier wholly-owned subsidiary of Peoples Energy
13 Corporation (“PEC”), which in turn is a first tier wholly-owned subsidiary of Integrys.

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

15 A. In my direct testimony I will focus on the effects of various affiliated interest agreements
16 on Peoples Gas’ revenue requirement. The Illinois Commerce Commission (the
17 “Commission” or “ICC”) has recently addressed various affiliated interest arrangements
18 among Integrys and its regulated subsidiaries in other dockets.

19 The Commission approved the most recent version of the Master Regulated
20 Affiliated Interest Agreement (the “Regulated Agreement”) among Integrys and its
21 regulated utility affiliates, including Peoples Gas and its sister Illinois utility North Shore
22 Gas Company (“North Shore”), in ICC Docket No. 06-0540, on February 7, 2007. In that

23 same order, the Commission approved an updated version of the Services and Transfers
24 Agreement (the “STA”) among PEC and its various direct and indirect subsidiaries,
25 including Peoples Gas and North Shore. The ICC approved an amendment to the STA in
26 ICC Docket No. 07-0492, on December 19, 2007.

27 The Commission later approved a Master Regulated Affiliated Interest Agreement
28 (the “Regulated AIA”), pursuant to which IBS provides services to all of the regulated
29 operating companies in the Integrys holding company system, as part of its order
30 approving the formation of IBS as Peoples Gas’ and North Shore’s affiliated centralized
31 service company in ICC Docket No. 07-0361, on December 5, 2007. That approval
32 expressly included approval of the cost allocation methodology in the Regulated AIA.¹

33 In my direct testimony, I note that the fourteen services provided by IBS under
34 the Regulated AIA were described at length in the record in ICC Docket No. 07-0361,
35 and I describe how costs are allocated to regulated utility affiliates under the Regulated
36 AIA, and the accounting, reporting, and recordkeeping methodologies that IBS follows as
37 approved by the Commission in ICC Docket No. 07-0361.

38 I also address the services provided and received by Peoples Gas under the STA
39 and the Regulated Agreement, and the extent of costs allocated to Peoples Gas under
40 these two additional agreements. As noted in my testimony, since IBS became
41 operational on January 1, 2008, the provision of services by and to Peoples Gas under the
42 STA and the Regulated Agreement has been very limited in scope.

¹ Exhibits B and C to the Regulated AIA have been slightly modified, as was reported in a November 3, 2008, compliance filing with the ICC.

43 **C. Summary of Conclusions**

44 Q. Please summarize the conclusions of your direct testimony.

45 A. In brief, the conclusions of my direct testimony are as follows. The amounts allocated by
46 IBS to Peoples Gas under the Regulated AIA reflect necessary and prudent costs of
47 Peoples Gas' utility business and are reasonable in amount. The amounts allocated to
48 Peoples Gas under the STA and the Regulated Agreement also are necessary and prudent
49 costs of Peoples Gas' utility business and are reasonable in amount.

50 **D. Background and Experience**

51 Q. Please describe your educational background and business experience.

52 A. I graduated from Loyola University in 1981 and received a Bachelor of Business
53 Administration degree in Accounting. I became a Certified Public Accountant registered
54 in Illinois in 1983. In 1992, I received a Masters of Business Administration degree from
55 DePaul University.

56 My business experience with the Peoples Energy Corporation companies began in
57 1981. I was hired as an internal auditor in the Internal Audit Department where I worked
58 from 1981 to 1984. From 1984 to 1998, I worked in the Accounting Department in a
59 variety of capacities including Supervisor of General Ledger, Accounts Payable, and Fuel
60 Accounting. From 1999 to 2003, I held the position of Manager of Corporate
61 Accounting. My responsibilities included managing accounting for PEC non-regulated
62 businesses, utility fuel accounting, and risk management back office operations. From
63 2003 to 2004, I held the position of Manager of Financial Reporting. My primary
64 responsibilities included external reporting to the Securities and Exchange Commission,
65 in addition to providing support for earning releases, and shareholder activities. From

66 2004 to 2007, I held the position of Manager of General Accounting. My responsibilities
67 included maintaining the general ledger, plant accounting records, and accounts payable
68 processing. From 2007 to the present, I have held the position of Assistant Controller.

69 Q. Please describe your current duties and responsibilities.

70 A. As Assistant Controller of Financial and Accounting Services, my responsibilities include
71 oversight of accounting activities of the regulated utilities owned by Integrys, specifically
72 the General Ledger, Property Accounting, and Accounts Payable activities.

73 **II. INTEGRYS BUSINESS SUPPORT**

74 **A. Creation and Background of IBS and the Regulated AIA**

75 Q. Why did Integrys form IBS?

76 A. The ICC and the Public Service Commission of Wisconsin (“PSCW”) both required that
77 Integrys and the other applicants in ICC Docket No. 06-0540 propose the formation of a
78 service company within 120 days after closing of the transaction between Integrys (then
79 known as WPS Resources Corporation) and PEC pursuant to which Integrys became the
80 ultimate parent company of the Integrys family of companies that now includes PEC,
81 Peoples Gas, and North Shore. (See ICC Docket No. 06-0540, Order of February 7,
82 2007, at Appendix, Condition No. 10). IBS became operational on January 1, 2008. IBS
83 is a “centralized service company” within the meaning of the Federal Energy Regulatory
84 Commission’s (“FERC”) regulations.

85 Q. Please provide some background on the Regulated AIA.

86 A. As part of the IBS formation process, an affiliated interest agreement (the Regulated AIA
87 mentioned above) was entered into among IBS and the six regulated utility operating

88 companies in the Integrys holding company system, including Peoples Gas and North
89 Shore. The Regulated AIA was approved by or appropriate waivers were granted by the
90 four state public service commissions in which the Integrys utilities operate, including
91 approval by the ICC in ICC Docket No. 07-0361.

92 **B. Purpose, Goals, Allocation Methodologies,**
93 **and Reporting Requirements of IBS**

94 Q. Please describe the purpose of IBS.

95 A. As a centralized service company, IBS is the primary intercompany service provider to
96 regulated and non-regulated affiliates within the Integrys holding company system. The
97 provision of services to the non-regulated affiliates is governed by a separate
98 “Non-Regulated AIA” to which all non-regulated Integrys subsidiaries are parties. The
99 ICC did not approve the Non-Regulated AIA, because neither Peoples Gas nor North
100 Shore are parties to it. However, the Non-Regulated AIA is substantially identical in all
101 material respects to the Regulated AIA, except that the Regulated AIA contains
102 additional reporting requirements and the Non-Regulated AIA does not contemplate the
103 provision of certain services by IBS that are only appropriate for the regulated affiliates.

104 Q. What services are provided by IBS to its regulated affiliates?

105 A. IBS provides fourteen categories of services to its regulated affiliates such as Peoples Gas
106 under the Regulated AIA. Those categories were described at length, and supported by
107 testimony, in the record in ICC Docket No. 07-0361, and are listed in Exhibit B to the
108 Regulated AIA (as modified as reported in the November 3, 2008, compliance filing with
109 the ICC).

110 Q. Please describe in general the methodology that IBS follows in allocating costs.

111 A. Pursuant to the Regulated AIA, and as required by FERC regulations of all jurisdictional
112 centralized service companies, IBS renders services “at cost.” Because IBS exists only to
113 serve its affiliates, its goal each month is to “zero-out” its costs by charging them to its
114 customers in an appropriate cost-causal fashion (in other words, in a manner that follows
115 the causation of the costs) that was submitted to the four state commissions for approval
116 or waiver. That also is consistent with FERC regulations. As I indicated earlier, the IBS
117 cost allocation methodology was built into the Regulated AIA and both the agreement
118 and the methodology itself was expressly approved by the ICC in ICC Docket
119 No. 07-0361. (Certain specific allocation factors appear in Exhibit C to the Regulated
120 AIA. As noted earlier, Exhibit C has been slightly modified, as reported in the
121 November 3, 2008, compliance filing with the ICC.)

122 Q. What accounting, reporting, and recordkeeping requirements must IBS follow as a
123 centralized service company?

124 A. As a “centralized service company” subject to FERC regulation and regulatory
125 requirements, IBS is required to follow the uniform system of accounts (“USOA”)
126 promulgated by FERC for such entities. This exhaustive USOA, modeled after that used
127 by utilities, is found in 18 CFR Part 367. IBS must also follow the detailed record
128 retention requirements promulgated by FERC at 18 CFR Part 368. Finally, IBS must file
129 a detailed annual report with FERC, the FERC “Form 60,” (18 CFR Part 369), which is
130 the annual report required of all centralized service companies and that contains billing,
131 cost, and financial reporting tied to USOA accounts, as well as reporting various other
132 matters and transactions. This lengthy report to FERC is due on May 1 of each year with
133 respect to the previous calendar year.

134 Q. Does the Commission have access to these various books, records, and reports of IBS?

135 A. Yes, it does. With respect to access generally, Illinois law, the federal Public Utility
136 Holding Company Act of 2005, and other applicable law provide the Commission with
137 ample authority and access in this regard. The Commission also required access to IBS
138 books and records in Condition of Approval No. 37 of its Order in ICC Docket
139 No. 06-0540.

140 Q. Will the Commission receive records and reports from IBS other than those specifically
141 required by FERC regulations?

142 A. Yes, it will. In addition to requiring that IBS follow all applicable FERC regulations and
143 requirements, Article 4 of the Regulated AIA requires that IBS: (1) provide the
144 Commission with a copy of its annual Form 60 report; (2) make a detailed annual filing
145 with the Commission (as supplemental schedules to Form 21) regarding costs incurred
146 and allocated by IBS, which was a condition of the Commission's approval in ICC
147 Docket No. 07-0361; (3) perform a triennial cost/market and compliance study, to be
148 updated annually, with copies of the study to be filed with the Commission; (4) perform
149 an annual audit of transactions occurring under the Regulated AIA, with a copy of the
150 results to be filed with the Commission; and (5) provide Peoples Gas (and North Shore)
151 sufficient information such that they can file an annual report with the Commission
152 regarding all of their transactions under the Regulated AIA during each calendar year.
153 This information will either be filed with, or made available to, the Commission, in most
154 cases in an electronic format (and in some cases under a request for confidential
155 protection).

156 **III. ALLOCATION OF IBS COSTS**

157 Q. Please describe more specifically the methods IBS uses to allocate and collect its costs.

158 A. As contemplated by the Regulated AIA, IBS bills Peoples Gas and the other regulated
159 utilities each month for the respective costs attributable to services provided by IBS to
160 each utility, following a process that is consistent with the Regulated AIA and its
161 allocation methodology approved by the ICC in its Docket No. 07-0361.

162 As specifically set forth in the Regulated AIA, and as described in testimony in
163 the record in ICC Docket No. 07-0361, IBS uses a three-tier allocation methodology.

164 Q. What is the first tier of the allocation methodology?

165 A. The first tier is to bill a service recipient on a direct charge basis for a service that is
166 specifically performed for that single affiliate, when possible. Because this approach
167 most directly matches a cost to its cause, this method is used whenever reasonably
168 practical. A good example of this approach is the billing for services provided by the
169 General Ledger accounting group. Peoples Gas does not have a general ledger
170 accounting group. Consequently, IBS performs these functions for Peoples Gas and bills
171 Peoples Gas on a direct charge basis for the costs of these services. Each accountant that
172 performs work related to monthly closings and account analysis specifically for Peoples
173 Gas records her or his time performing these tasks, and IBS bills Peoples Gas for that
174 effort directly. Costs incurred for a service that are directly charged are not among the
175 costs allocated by the other two methods described below.

176 Q. What is the second tier of the allocation methodology?

177 A. The second tier is another cost-causal approach. This method looks at the specific
178 service provided and allocates the total cost of the service based on the affiliates' use of

179 this service by applying the appropriate allocation factor to the total cost of the service.
180 Accounts payable processing is an example of a service that would use the second tier
181 cost causal allocation method. This method is more appropriate and practical for
182 accounts payable processing than the direct billed method because invoices are processed
183 in a random fashion. More specifically, invoices are aggregated centrally in the Accounts
184 Payable system and assigned to a particular work queue based on the characteristics of
185 the invoice (invoices with a purchase order, without a purchase order, etc). Each work
186 queue will typically contain invoices of all the affiliated companies. The invoice
187 processors will work the items in his/her assigned queue. Once the processor has
188 finished working invoices in his/her queue, he/she will begin processing invoices
189 contained in another queue. The direct billed method would require processors to incur
190 significant additional effort to track time resulting in higher service costs. When the
191 second tier allocation methodology is in use, one or more of the “Allocation Factors”
192 from Exhibit C of the Regulated AIA is used, depending on which IBS service is the
193 subject of the cost allocation.

194 Q. What is the third tier of the allocation methodology?

195 A. Last, a General/Corporate allocator is used when neither of the two previous methods is
196 appropriate. This comes into play for the services provided by IBS that are of a general
197 nature. The General/Corporate allocator also appears in Exhibit C of the Regulated AIA
198 (the same allocator appears in the Non-Regulated AIA). Certain corporate secretary,
199 executive management, and financial services fit into this category, as they benefit all of
200 the subsidiaries of a publicly-traded entity.

201 Q. Is the IBS model prudent?

202 A. Yes, the IBS model, including the allocation methodology, is prudent. The formation of
203 IBS was directed and then approved by the ICC, and the Regulated AIA, including its
204 allocation methodology, was also expressly approved by the ICC.

205 **IV. ALLOCATION OF NON-IBS AFFILIATED INTEREST COSTS**

206 Q. Do the services provided by IBS complement services provided under any other
207 intercompany service agreement?

208 A. Yes. While IBS is now the primary provider of inter-company services within the
209 Integrys holding company system, other affiliates still provide certain shared services to
210 Peoples Gas. These services are provided under the terms of the STA or the separate
211 “Regulated Agreement” to which Peoples Gas and North Shore were added with the
212 ICC’s approval.

213 Q. To what extent does Peoples Gas receive services under these non-IBS affiliate interest
214 arrangements now that IBS is operational?

215 A. As I indicated earlier, since IBS became operational, the provision of service to Peoples
216 Gas under the Regulated Agreement has been limited. Using six month actual data and
217 six month forecasted data for 2008, Peoples Gas was billed \$13.3 million in 2008. The
218 majority of this amount (\$11.7 million) was billed by Integrys for environmental
219 remediation work charged as a pass-through (invoices paid by Integrys but billed at cost,
220 without any mark-up or profit to Integrys). Although environmental services are
221 centrally managed by IBS, a purchase order was inadvertently created on Integrys’ books
222 during the conversion of the company’s enterprise resource planning (“ERP”) system.
223 Because Peoples Gas received the benefit of this service and the charges were
224 appropriately recorded on Peoples Gas’ books, the company decided simply to pay this

225 charge and to correct this procedure prospectively. Subsequent purchase orders for
226 remediation work will be recorded and managed by IBS. The balance of the billing
227 (\$1.6 million) was for other pass-through and miscellaneous services rendered under the
228 Regulated Agreement. Similarly, during that same time period and using the same data,
229 billings to Peoples Gas under the STA by PEC and North Shore are estimated to be
230 \$1.3 million. These costs for services provided to Peoples Gas by affiliates other than
231 IBS reflect a small pool of services for which it remains most cost effective for the
232 service to be provided by a sister utility or affiliate other than IBS. Detailed billing
233 amounts to Peoples Gas and by Peoples Gas to other affiliates can be found in
234 Schedule C-13, discussed by Peoples Gas witness Christine Gregor (Peoples Gas
235 Ex. CMG-1.0) and included in Peoples Gas Ex. CMG-1.1.

236 Q. Are any changes anticipated with respect to the cost of these non-IBS services that are
237 provided to Peoples Gas?

238 A. No, although I do want to note that Peoples Gas and North Shore proposed in a
239 December 19, 2008, filing with the ICC that the Regulated Agreement and STA be
240 combined into a single new non-IBS affiliated interest agreement in an effort to minimize
241 contract administration and to reflect the narrow scope of non-IBS services that are now
242 provided by and among affiliates. I understand that this proposed agreement is currently
243 pending for approval in ICC Docket No. 08-0682. This new agreement will not affect the
244 manner in which Peoples Gas and its affiliates bill each other for services provided, and it
245 was stated in the application filed in ICC Docket No. 08-0682 that the pricing rules from
246 the Regulated Agreement will still be followed in the new one. The new agreement,
247 which was filed for approval within one year after the IBS operational start-up date at the

248 direction of the PSCW, is in large part intended to be a clarification of the scope of
249 services provided among non-IBS affiliates in light of IBS' role as the primary provider
250 of inter-company services within the Integrys family.

251 Q. Does this conclude your direct testimony?

252 A. Yes.