BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 080318-GU

In the Matter of:

PETITION FOR RATE INCREASE BY
PEOPLES GAS SYSTEM.
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VOLUME 3

Pages 242 through 430

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PROCEEDINGS:	HEARING
BEFORE:	CHAIRMAN MATTHEW M. CARTER, II COMMISSIONER LISA POLAK EDGAR COMMISSIONER KATRINA J. McMURRIAN COMMISSIONER NANCY ARGENZIANO COMMISSIONER NATHAN A. SKOP
DATE:	Wednesday, March 4, 2009
TIME:	Commenced at 9:30 a.m. Recessed at 5:01 p.m.
PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	MARY ALLEN NEEL, RPR, FPR
APPEARANCES:	(As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

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P R O C E E D I N G S

(Transcript continues in sequence from Volume 2.)

Thereupon,

BRUCE NARZISSENFELD

a witness on behalf of Peoples Gas System, continued his sworn testimony as follows:

DIRECT EXAMINATION

BY MR. REHWINKEL:

Q. Now, just for clarification, you listed these projects. Does that mean they're on hold for both 2008 and 2009?

A. Yes.

Q. Okay. What about Merrill Road? What happened to that project? Did it go to the less than 250 bucket?

A. That's correct. That's what happened. And Merrill Road, when you say what happened to it, we spent 244,000 in 2008, and it will be approximately 50,000 in 2009.

Q. Okay. What is the unknown of 450,000 that I see that's in 2008?

A. The unknown -- the unknown is projects under 250,000 that didn't make it to the list, were not itemized.

Q. I'm sorry. So that's not one project. That is an amalgamation?

A. Correct. It's a catch-all for under 250.

Q. Okay. Now, Flagler County expansion, for 2008 and 2009, there's approximately $6.8 million split between those two years; is that correct?

A. That is correct.

Q. And then for 2008 actual, you only spent 283,000, and for 2009, the new projection, there's 3.051 million; correct?

A. That is correct.

Q. So the total that was originally forecast or budgeted has been cut in half, essentially; is that right?

A. The forecast for 2008 and 2009 stand-alone does represent half. But in its entirety, this project is much bigger than that. This project is an $11 million project in total. But, yes, you are correct, for 2008 and 2009, it is half.

Q. And what was the reason for it? Was there a slowdown related to the economy?

A. Slowdown related to the economy, slowdown in getting permits.

Q. Okay. But that's Palm Coast, which is a very large residential development on the East Coast; correct?

A. Correct.

Q. Okay. And so a big part of this is the economy; is that right?

A. Yes. More specifically, since we used two names, Flagler and Palm Coast, since it is a big one, I'll explain it in two sentences. It's an expansion to serve an area 810 square miles, St. Johns County, Flagler County, Volusia County, and it will ultimately link the south end of our Jacksonville system with the north end of our Daytona system. So it does include more than Palm Coast, but Palm Coast is a significant part of that main extension.

Q. Okay. Now, when I look at this exhibit, Late-filed Exhibit 1 or Hearing Exhibit 94, on the revenue-producing side, it looks to me like for 2009, the revenue-producing budget drops by almost exactly $3 million; is that right?

A. That is correct.

Q. Okay. Now, since you did not change the bottom line capital expenditures that are shown on page 2 of roughly $60 million -- but it's 59,998,964; right?

A. Correct.

Q. What happened is that you took that $3 million and you shifted it over to the maintenance side; is that right?

A. That would be a portion of it. I would say a little broader than that. Some of it went to the maintenance side. But additionally, on the revenue ongoing, where we had other projects under 250,000 itemized, that number was lowered significantly, because we're trying to manage to a number of 60 million and not exceed that amount.

Q. Well, I'm looking over on page 2 of Exhibit 94.

A. Yes.

Q. What is the top section there, say the top quarter of that column? What does that represent? What category of expenditures is that?

A. Maintenance, system improvements, repair and replacement of mains and services.

Q. Okay. It looks to me like these increased 1.2 million.

A. Yes.

Q. Roughly; right?

A. Correct.

Q. And then if I look down here in the next section, municipal, you had originally forecast 3,803,800; correct?

A. Yes.

Q. And now you have projected 5,547,421; right?

A. That is the projection; correct.

Q. So that's about an increase of about 1.7 million.

A. Yes.

Q. The next category, office equipment and computers, et cetera, no change to the bottom line; right?

A. Correct.

Q. But total maintenance, it shows it increased just a shade under $3 million, from 15.043 to 18.001 million.

A. That's correct.

Q. Okay. specifically, on the municipal column, in 2009, the test years, you have $3,803,800 which was entirely composed of projects that would be considered relocations?

A. Yes.

Q. Okay. And that number was a derivative of a historical average, is that correct, the 3,803,000?

A. Substantially. You know, some judgment applied, but substantially, yes.

Q. Okay. Now, that number now in 2009 consists of a bunch of listed projects that total 5.47 million; correct?

A. Correct.

Q. Okay. But the 3,803,000 was not comprised of any specific projects, but basically a historical average added and divided by three, I think, for the prior three years; is that correct?

A. I don't know the specifics, but generally, yes.

Q. Okay. So what has happened is, now all of a sudden when you cut your revenue-producing budget basically due to significant slowdown in the economy, you have 3 million or so dollars freed up, and the budget, to get to $60 million, 1.7 million of that has increased with specific projects identified under the municipal section; is that right?

A. Yes.

Q. Okay. Now, what degree of -- let me ask you this. Road relocations and moves, these are not things that occur overnight, are they?

A. No, sir.

Q. There's a fairly long lead time, A, to get the road project to a position where right-of-way can be taken and the construction work by the contractor for the municipality or the government can proceed; is that correct?

A. That's correct.

Q. And at some point in that process, utilities, including gas companies, are notified of the potential for a move; is that right?

A. That's correct.

Q. Okay. And at some further point in the process, it becomes solidified enough where you can start to take steps on your own to commit to the things you need to do to do your relocations; correct?

A. That's correct.

Q. Engineering, permitting, et cetera; right?

A. That's correct.

Q. Okay. So between the filing of the MFRs in August of 2008, or even back to the preparation of the MFRs in let's say the May time frame, to January 30th, or actually, February 18th, is it your testimony that these relocations went from not knowing what they were to all of a sudden having a list of projects that you could list here as your capital budget commitment?

A. No. When this document was originally prepared, it was a working document for me to keep a handle on where capital was being spent. I was comfortable with the historical averages. As increased scrutiny came to this area and increased activity, I asked for a listing of what made up these projects. And when I had the benefit of the listing, I went ahead and detailed those projects over 250,000 on this list.

Q. Now, can you state with any degree of certainty that each and every one of these projects will occur in the year 2009? I say projects. The relocations themselves.

A. I cannot state with certainty that all of these projects will occur, no.

Q. Okay. And if they don't occur in 2009, they would occur in a period other than 2009, if at all, say 2010 or later?

A. Correct.

Q. Okay. These $5,547,421 of projects, if they are recovered in rates now, in other words, if they are allowed -- they're listed here, and if they're allowed to make up the plant in service or the capital expenditures that the company makes -- let me strike that and ask it a different way.

If these dollars are included in your capital budget that makes up your rate case request, would they become ineligible for recovery under the GSR rider if it were to be approved?

A. I would defer that to witness Binswanger. I'm just not as intimately familiar, and I want to ensure you get the correct answer. I apologize.

MR. REHWINKEL: Mr. Chairman, I would like to pass out one last exhibit for cross-examination purposes and have it identified.

CHAIRMAN CARTER: It will be Exhibit 95.

MR. REHWINKEL: Okay. And this is Response to Staff Interrogatory Number 51. And just so I don't mess up again, I think that this is included in -- it appears to be included in the composite stipulated exhibit under item number 4. So I'm just using this for ease of cross-examination.

CHAIRMAN CARTER: Okay.

(Exhibit 95 was marked for identification.)

BY MR. REHWINKEL:

Q. Mr. Narzissenfeld, are you familiar with this document?

A. Yes.

Q. In fact, your name is here as the respondent on this interrogatory?

A. That is correct.

Q. Okay. In 2003, you had just completed a rate case, and I think the order, if you'll accept -- subject to check, came out or was issued on January 6th of 2003. Will you accept that?

A. Yes.

Q. The Commission made a decision based on your capital expenditures for a projected test year of 2003; is that right?

A. That is correct.

Q. Now, in 2003, though, you actually spent a little more than, but close to half of the capital -- or the maintenance capital budget for 2003; is that correct?

A. That is correct.

Q. But you also spent 30 of the $32 million budgeted for the revenue-producing category in that year; is that correct?

A. I'm sorry. What year?

Q. 2003.

A. I don't know. Subject to check, I don't know.

Q. Well, do you have -- you don't have Exhibit 91 with you, do you, or 90, which is the business plan, 2008 business plan? I think I can hand it to you there.

A. I have it now.

Q. Okay. Can I ask you to look on Bates stamp page 2985?

A. Yes.

Q. Do you have that?

A. Yes, I do.

Q. Okay. This document appears to show that your budget for that year had a total of $50,452,000; is that correct?

A. Yes.

Q. But you spent $41,685,000; is that correct?

A. That is correct.

Q. Now, we show up here on the total revenue-producing capital line 32,664,000 as the budget and 30,525,000 as the actual; is that right?

A. Correct.

Q. On the maintenance capital side, the numbers are close to, but don't exactly look like what's in the 2003 line on Exhibit 95.

A. They're slightly different, but similar. I understand.

MR. REHWINKEL: Okay. Mr. Chairman, those are all the questions I have. Thank you, Mr. Narzissenfeld.

CHAIRMAN CARTER: Thank you, Mr. Rehwinkel.

Staff?

MS. KLANCKE: Staff has no questions for this witness.

CHAIRMAN CARTER: Commissioner Skop, you're recognized.

COMMISSIONER SKOP: Thank you, Mr. Chairman. I don't have a question for the witness, but to Mr. Rehwinkel. I know that you're not a witness, but I'm trying to follow along diligently in terms of looking at all the numbers, and I'm not really -- I think you're losing me. I'm losing -- I mean, I really don't understand the significance, other than -- you know, to distill it, are you trying to suggest that historically capital expenditures have been inflated over what has been spent? I mean, I'm having a hard time following the line of questioning, other than just looking at number A versus number B, number A versus number B. But again, I'm trying to discern what the relevant point may be.

MR. REHWINKEL: Commissioner, to answer your question, I've always tried to adhere to the admonition that attorneys should not testify, and I'll refrain from doing that. But my -- I'm certainly going to represent on the record here that I'm not stating that the company is inflating anything.

As I stated in my opening, projected test year cases are about projections and judgment and exercise of judgment. Certainly I understand conditions change, and what the company does after they budget is a matter of judgment and other factors. My only purpose is to elicit some facts about what has occurred, because history is a lot of times the guide to the future, and I'm just trying to judge that.

COMMISSIONER SKOP: And just one final -- and I appreciate that. With respect to, I guess, Issue 1 in this case, which is whether the test year was appropriate, I saw that OPC took no position in that, but it seems -- the inference here is, it seems to me, that OPC has a problem with the test year.

MR. REHWINKEL: I can --

COMMISSIONER SKOP: Is second-guessing the test year in light of the economic downturn that has happened and corporate reductions in spending as a result of economic conditions.

MR. REHWINKEL: I can certainly represent that we are not taking that position. Selecting a test year and then making appropriate adjustments to the test year to reflect going-forward conditions are the key. So it's not the test year, it's the assumptions that underlie how the test year is representative of going-forward conditions. It's kind of a yin and a yang thing there. We're not contesting the test year. It's really the projection of capital for purposes of setting rates and matching revenues to the costs that the company would incur in the projected period. That is our position.

COMMISSIONER SKOP: Fair enough. I'm just trying to follow along. And like I say, I'm not really sure. That's why I'm having to second-guess what is the relevant point that's trying to be made. Thank you.

CHAIRMAN CARTER: Thank you. Anything further from the bench?

Redirect?

MR. WATSON: Yes, please.

REDIRECT EXAMINATION

BY MR. WATSON:

Q. Mr. Narzissenfeld, I think you said in response to one of Mr. Rehwinkel's questions that your plant in service was about $6.4 million over the estimate that was filed in this case for 2008?

A. That's correct.

Q. If Peoples were to reproject its capital expenditures and the resulting rate base for 2009 based on the known results for 2008, what would be the effect of 2008's known results on that 2009 projection?

A. If we had the opportunity to refile, it would be -- you know, I can tell you it would be $6,365,747 higher.

Q. Okay. Is the $60 million capital expenditure budget for 2009 a number you're going try to get to, or is it something you've been authorized to spend?

A. It's a -- I mean, I'll just tell you straight out, it's a number I've been authorized to spend, and I view my biggest challenge in 2009 to stay within that number. The amount of municipal work, while we had a projection, is significantly more than that. We filed a late-filed exhibit, Binswanger Number 2, where we had over 100 items listed. We were asked to quantify them as best we could, and it adds up to over $8 million, and we still had another 20 or 30 we didn't put dollars to.

I'm not the expert on the stimulus bill, and I'm still trying to learn how it will impact things, but I hear it's going to be roads, bridges, places we have gas. And to the extent that that activity occurs, we're going to have to do more relocations. It's going to be very challenging to stay within the 60 million, but I'm committed to doing that.

MR. WATSON: I think that's all the questions I have.

CHAIRMAN CARTER: Okay. Let's deal with the exhibits. I think we've got -- is it 83? Is that correct?

MR. WATSON: We have 83, and I would move it.

CHAIRMAN CARTER: Any objections? Without objection, show it done.

(Exhibit 83 was admitted into the record.)

CHAIRMAN CARTER: Okay. Mr. Rehwinkel?

MR. REHWINKEL: I would move 90.

CHAIRMAN CARTER: Any objections?

MR. WATSON: None.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit 90 was admitted into the record.)

CHAIRMAN CARTER: Okay. Mr. Rehwinkel, any of the -- did we say we were going to --

MR. REHWINKEL: Ninety-five is already part of the record.

CHAIRMAN CARTER: And 94 is already part of the record?

MR. REHWINKEL: Yes. That was --

CHAIRMAN CARTER: Okay. We were just going to enter that for convenience for Mr. McWhirter, so we'll just show 94 in, and 95.

(Exhibits 94 and 95 were admitted into the record.)

CHAIRMAN CARTER: Okay. Anything further for this witness? We've done rebuttal and direct on this witness; correct?

MR. WATSON: Yes, we have. May he be excused?

CHAIRMAN CARTER: Okay. I'm going to give it a shot. Mr. Narzissenfeld -- great.

THE WITNESS: Good job.

CHAIRMAN CARTER: I'm going home. I'm not doing anything else today. You may be excused. Thank you.

THE WITNESS: Thank you.

CHAIRMAN CARTER: Commissioners, we've been plodding along dutifully here, and I think this is probably an appropriate time for us to take a stretch break. Let's take 10 PSC minutes.

(Short recess.)

CHAIRMAN CARTER: We are back on the record. And when we left, I was just getting ready to talk to staff about some matters here. First and foremost, we just finished with Bruce.

Now, we have already entered into the record the witness. Did we do their -- the stipulated witnesses, did we do them at -- we should probably do them at this time. So this will be Felsenthal; is that correct?

MR. WATSON: Yes, sir.

CHAIRMAN CARTER: All right. Let's see here. Let me get to that page.

Are there any exhibits with Felsenthal?

MR. WATSON: Yes, Mr. Chairman.

CHAIRMAN CARTER: All right. Okay. The prefiled testimony of the witness will be inserted into the record as though read. The Exhibits, 39 and 40, without objection, show it done.

(Exhibits 39 and 40 were admitted into the record.)

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, OCCUPATION AND EMPLOYER.

A. My name is Alan Felsenthal. My business address is 550 West Van Buren Street, Chicago, Illinois 60607. I am employed by Huron Consulting Group ("Huron").

Q. PLEASE PROVIDE A BRIEF OUTLINE OF YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. Upon graduation from the University of Illinois in 1971, I was hired by Arthur Andersen & Co ("Arthur Andersen" or "the Firm"), where I was an auditor, focusing on audits of financial statements of rate regulated entities. I supervised audits, from which the Firm issued audit reports on financial statements that were filed with Securities and Exchange Commission, Federal Communications Commission, Federal Energy Regulatory Commission ("FERC") and various state commissions. Arthur Andersen also consulted in a significant amount of utility rate cases and I helped develop testimony for myself and others on a variety of issues including Construction Work in Progress in rate base, phase-in plans, projected test years, lead-lag studies, cost allocation and income tax normalization. The testimony was filed in Arizona, Illinois, Indiana, Florida, Michigan, Minnesota, New Mexico, Texas, Nevada and Wisconsin. I joined PricewaterhouseCoopers ("PwC") in 2002 and continued performing audits and rate work for regulated entities. I have testified before the Florida Public Service Commission ("FPSC" or "Commission"), the Arizona Corporation Commission and the Illinois Commerce Commission.

Q. HAVE YOU DEALT WITH THE UNIQUE ACCOUNTING, TAX AND FINANCIAL REPORTING ISSUES ENCOUNTERED BY RATE REGULATED ENTERPRISES?

A. Yes. Throughout my career, I have focused on utility accounting, income tax and regulatory issues, primarily as a result of auditing regulated enterprises. The unique accounting standards applicable to rate regulated entities embodied in Financial Accounting Standards Board Statement ("FAS") 71, FAS 90, FAS 92, FAS 101, FAS 109 and various Emerging Issues Task Force issues all need to be understood so that auditors can determine if the accounting has been applied appropriately. During my career, I have seen the issuance of these standards and have consulted with utilities as to how they should be applied. At both Arthur Andersen and PwC, I worked with the technical industry accounting and auditing leadership to communicate and consult on utility accounting and audit and income tax matters.

Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

A. I am a managing director at Huron. Huron provides a variety of accounting, tax and consulting services to various industry sectors. My focus is on the regulated industry sector, primarily electric and gas utilities.

Q. HAVE YOU PROVIDED TRAINING ON THE APPLICATION OF GENERALLY ACCEPTED ACCOUNTING PRINCIPLES ("GAAP") TO RATE REGULATED ENTERPRISES?

A. Yes. At Arthur Andersen, PwC and Huron, I have developed and presented utility accounting seminars focusing on the unique aspects of the regulatory process and the resulting accounting consequences of the process on the application of GAAP. One of the seminars I have presented focuses on the unique accounting and ratemaking impacts applicable to income tax accounting for rate regulated enterprises, including the specific requirements of the Internal Revenue Code ("IRC") applicable to public utilities. I have presented seminars on an open registration basis as well as delivered training on an in-house basis. Seminar participants have included utility company and regulatory commission staff accountants, utility rate departments and internal auditors, tax accountants and others. I also conducted these seminars on an in-house basis for the FERC, several state commissions and have presented at various Edison Electric Institute and American Gas Association ratemaking and accounting seminars. Personnel from various state regulatory commissions have attended the open registration sessions.

TESTIMONY PURPOSE

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony will address several aspects of the income tax calculations submitted by Peoples Gas System ("Peoples" or the "Company") in this proceeding.

I will testify on the computation of income tax expense, accumulated deferred income taxes ("ADIT") and unamortized investment tax credit ("ITC") set forth in the Company's Minimum Filing Requirement ("MFR") schedules. My testimony will address whether such computations for 2007 are in conformity with GAAP, the Uniform System of Accounts, and the requirements of the IRC and Income Tax

Regulations.

I will also testify on the calculation of income tax expense, ADIT and unamortized ITC included in the MFRs for the projected year 2009, the test year for this proceeding. My testimony on the 2009 projected information will address whether the projected income tax expense, ADIT and unamortized ITC have been determined using a methodology consistent with the actual 2007 income tax calculations and consistent with the projected test year cost of service and the specific IRC and Income Tax Regulations covering projected test years.

Q. WHAT PRINCIPLES GUIDED YOUR TESTIMONY?

A. My testimony has been guided by the recognition that in the ordinary operation of a public utility such as Peoples, both the accrual of revenue based on delivery of gas service and the accrual of expenses generate income tax consequences. To the extent that those revenues and expenses are included in the cost of service of the utility, so should the related income tax expense. To do otherwise would deny Peoples the opportunity to recover a necessary cost of providing service. The amount of income tax expense should be consistent with the requirements of GAAP and the IRC.

Q. HAVE YOU PREPARED ANY EXHIBITS TO BE INTRODUCED IN THIS PROCEEDING?

A. Yes, I am sponsoring or co-sponsoring the schedules of the MFRs listed in Exhibit ___(ADF-1), which were prepared under my direction and supervision. Each schedule contains a general explanation of what is called for and shown on the schedule. In addition, I have prepared or caused to be prepared Exhibit ___(ADF-2), entitled Calculation of IRC Required Deferred Income Tax Adjustment. Both of these exhibits are attached to my testimony.

ACCOUNTING FOR INCOME TAXES

Q. CAN YOU PLEASE DESCRIBE THE COMPUTATION OF INCOME TAX EXPENSE?

A. Yes. FAS 109, Accounting for Income Taxes, provides guidance on accounting for income taxes. There are several components to the calculation. The first component is "current" income tax expense, representing the estimated amount of current year income taxes payable based on current year taxable income. Taxable income for the year is determined in accordance with the IRC and is the amount reflected on the income tax return for the year. The IRC contains procedures for determining if and when an item is "taxable" or "deductible." The IRC rules for determining what is taxable or deductible (and therefore what is included in the tax return for the year) may differ from what is reportable as "revenue" or "expense" under GAAP. For instance, certain expenses recorded on the financial statements under GAAP in one year may be deductible on the tax return in a different period. There are also instances where the amounts shown as deductions on the tax return in one year are not reflected on the financial statements until a later year. Differences between the book treatment and the tax return treatment of revenues and expenses result in different balances of book and tax assets and liabilities on the respective book and tax balance sheets. These differences are referred to as temporary differences.

Q. CAN YOU PROVIDE AN EXAMPLE OF A BOOK/TAX TEMPORARY DIFFERENCE?

A. Yes. When a company acquires a fixed asset, that asset is depreciated for book purposes over its estimated useful life in a systematic and rational manner. Most utilities use the straight line depreciation method to determine book depreciation expense. For income tax purposes, that same asset may be depreciated for determining taxable income on the income tax return using an accelerated method permitted under the IRC. When the annual depreciation charge for book and income tax purposes is compared each year, there will likely be differences between annual book and tax depreciation. However, given the same capitalized asset cost, over the life of the asset total depreciation will be the same. This is because depreciation charges under both the accounting rules and the IRC are meant to "recover" the capitalized asset cost.

Another example of a temporary book/tax difference is the accrual recorded on the books for other post employment benefit costs which is not deductible for income tax return purposes until it is settled. In this example, the book accrual/expense occurs in advance of the tax deduction.

A third example is contributions in aid of construction, which are generally considered taxable when received for income tax purposes. However, for book purposes they are recorded as a reduction of property, plant and equipment.

Q. HOW ARE DIFFERENCES BETWEEN THE BOOK TREATMENT AND INCOME TAX TREATMENT OF THESE TYPES OF TRANSACTIONS ACCOUNTED FOR UNDER FAS 109?

A. In addition to the calculation of current tax expense (the estimated amount of income taxes included on the tax return for a particular year) FAS 109 requires a calculation of the tax expense on temporary differences. The income tax component resulting from applying the income tax rate to temporary differences is known as "deferred tax expense." Because the financial statements reflect accrual accounting, the income tax expense calculation must reflect the liability for income taxes payable in the future as a result of transactions recorded in the financial statements currently. Thus, income tax expense under GAAP includes both a currently payable component as well as a deferred income tax component. In the regulated environment, the process of recording deferred income taxes on temporary differences is often referred to as "comprehensive interperiod income tax allocation" or "normalization".

Q. DOES THE ADIT BALANCE REPRESENT AN OBLIGATION FOR FUTURE INCOME TAXES AT THE BALANCE SHEET DATE?

A. Yes. ADIT amounts are taxes that are expected to be paid in the future based on transactions recorded in the financial statements today. The purpose of deferred income tax accounting is to reflect in the financial statements the tax effects (both current and deferred) of assets, liabilities, revenues and expenses recorded on the financial statements.

ADIT balances are sometimes referred to as an "interest free loan" from the U.S. Treasury. This was the result intended by Congress when it changed the IRC to permit the use of accelerated depreciation. Congress felt that by being allowed to accelerate depreciation deductions (and thereby reduce current income tax payments), companies would lower the financing costs of their investment in capital assets more quickly and thus would be incented to incur such expenditures. For accounting purposes, using up the tax basis of capital assets is both a cost to be recognized in the financial statements when claimed (deferred tax expense) and a liability for future taxes due when the turnaround occurs and book depreciation exceeds tax depreciation (ADIT).

Q. ARE ALL BOOK/TAX DIFFERENCES "TEMPORARY DIFFERENCES" AND SIMPLY A MATTER OF WHEN THE ITEM IS INCLUDED ON THE TAX RETURN VERSUS WHEN THE ITEM IS SHOWN ON THE FINANCIAL STATEMENTS?

A. No. Certain items of revenue and expense are treated differently for financial reporting purposes than for income tax purposes. These are referred to as permanent differences.

An example of a permanent difference is the cost of meals and entertainment which are reported as expenses in the financial statements but, based on the IRC, are not completely deductible in determining taxable income on the income tax return.

Q. IS THE DISTINCTION BETWEEN PERMANENT AND TEMPORARY DIFFERENCES IMPORTANT IN THE INCOME TAX CALCULATION?

A. Yes. Deferred income taxes are not required on permanent differences as such differences will never be included on income tax returns.

RATEMAKING TREATMENT OF INCOME TAXES

Q. IS DEFERRED INCOME TAX ACCOUNTING APPROPRIATE

FOR RATEMAKING PURPOSES?

A. Yes. Income tax expense in a given year is the result of that year's economic activity. In determining the revenue requirement, it is important for regulatory commissions to consider the recovery of all appropriate costs of providing service, including the associated income tax effects of the costs.

During the ratemaking process, the regulator considers all items of revenues and expenses and makes a finding as to whether the individual revenues and expenses should be allowed in the determination of revenue requirements. Once the regulator determines the allowable costs excluding income taxes, the income tax consequences, both current and deferred can be calculated. This is because income taxes have no independent existence of their own. They result from an independent determination of revenues and expenses. The revenues and expenses are generally determined on an accrual basis and the tax consequences of revenues and expenses must be determined on that same accrual basis (current and deferred income taxes).

As I discussed earlier, the accelerated depreciation (the major component of deferred taxes) of assets was meant to lower the cost of financing assets by providing the company an interest free loan. The ADIT balance (the interest free loan from the U.S. Treasury) is a zero cost source of capital in the cost of capital computation thereby giving the benefit of the reduced financing costs to ratepayers.

Q. IS THERE ANOTHER METHODOLOGY USED TO COMPUTE INCOME TAX EXPENSE FOR UTILITIES?

A. Yes. Some regulatory commissions have utilized a "flow through" methodology. This methodology is not GAAP for enterprises in general. Under flow-through, the tax reducing effects of book/tax temporary differences are flowed through to ratepayers by only permitting the utility to recover **current** income tax expense in the cost of service. The **deferred** income tax expense is not included as a recoverable test year expense. Under flow-through, the "interest free loan" from the U.S. Treasury is not retained by the company to pay the taxes in the future when they become payable. Instead, these interest free funds go to the ratepayers when the temporary difference arises and are paid back by the ratepayer when the taxes become payable.

Because temporary differences, by definition, will reverse in the future, under a flow-through methodology ratepayers receive the benefit of accelerated deductions in the periods where current income tax expense is reduced for such deductions but pay the higher current income tax expense when the temporary difference reverses. No deferred income tax expense is recorded.

Mechanically, a temporary difference that is flowed through has the same effect as a permanent difference in that no deferred income tax expense is recorded on the flow through temporary difference. Utility companies whose regulators have determined income tax expense using the flow through methodology are the only entities that can use this approach for determining income tax expense.

Q. IS FLOW THROUGH AN APPROPRIATE METHODOLOGY?

A. No. The flow through method has a number of flaws including:

- The stimulus incentives of accelerated income tax deductions are not available to the utility as such benefits are given to ratepayers when the temporary difference arises via a reduction in income tax expense.
- There is a significant potential for intergenerational inequity. Ratepayers who are customers of the company when the flowed through temporary differences arise, will receive the lower income tax expense and may not be the same ratepayers that will be responsible for the higher income tax expense deemed necessary to pay the higher income tax expense when the temporary differences reverse.
- FERC and others have demonstrated that in the long-term, ratepayers are better off with permitting recovery of deferred income tax expense. This is mainly due to the increased risk associated with the flow-through methodology, among which is the need for additional rate cases to get back the interest free loan that is in the hands of the ratepayer to be able to pay the increased taxes at the time the temporary difference reverses.

Q. HAS THE FERC TAKEN A POSITION ON THE APPROPRIATENESS OF DEFERRED INCOME TAX ACCOUNTING?

A. Yes. The FERC concluded in Orders 144 and 144A that deferred tax accounting was appropriate. FERC has required deferred tax accounting since the issuance of those orders in the 1980's.

Q. HAS THE FPSC TAKEN A POSITION ON THE

APPROPRIATENESS OF DEFERRED INCOME TAX ACCOUNTING?

A. Yes. The FPSC has long acknowledged that normalization is appropriate for revenues and expenses that are recognized at different times for book and tax purposes.

Q. DOES THE IRC CONTAIN REQUIREMENTS ADDRESSING DEFERRED INCOME TAX ACCOUNTING?

A. Yes. The IRC contains specific requirements that are applicable to public utility property. These requirements, in effect, mandate that in order for a public utility to be eligible to claim accelerated depreciation for income tax purposes, the regulator must permit recovery of deferred income taxes on the difference resulting from using accelerated depreciation for income tax purposes and straight line depreciation for book purposes. In other words, the use of the flow-through accounting method for the book/tax depreciation difference would cause a "normalization violation."

The penalty for violating the normalization requirements is the loss of the ability to claim accelerated depreciation for income tax purposes on all assets as of the violation date and on subsequent additions. It is a severe penalty.

Q. IS THERE ANOTHER COMPONENT OF THE INCOME TAX CALCULATION?

A. Yes. In addition to current and deferred income taxes, a third element of the tax computation is the ITC.

Q. CAN YOU PLEASE SUMMARIZE WHAT THE ITC IS AND HOW IT IS TREATED FOR ACCOUNTING/RATE MAKING

PURPOSES?

A. The ITC, which has gone in and out of existence over the years, lowers income tax expense permanently if certain qualifying investments are made. The intent of the ITC is to reduce the net cost of acquiring depreciable property, thereby providing taxpayers an incentive to invest in qualifying assets. To make sure that its objectives are met for investments in qualifying utility property, the IRC prescribes methods of sharing the benefit between the ratepayers and the shareholders.

The ITC is a direct reduction of income taxes payable in a given year. Unlike accelerated depreciation and other book/tax differences that will eventually reverse or turn around, the ITC is akin to a grant or rebate. The ITC provides an incentive to capital investment by granting a tax credit (a direct dollar for dollar offset to current taxes payable) based on a percentage applied to investment in tangible personal property (most gas distribution assets).

The accounting for the ITC is contained in Accounting Principles Board Opinions 2 and 4, <u>Accounting for the Investment Credit</u>. Most utilities account for the ITC by reducing current income taxes for the amount of the ITC realized in a particular year, with an offsetting "unamortized ITC." The unamortized amount is then amortized to reduce income tax expense over the life of the property giving rise to the ITC. Under this approach, the ITC is reflected in net income over the productive life of the acquired property.

The ITC was repealed as a result of the Tax Reform Act of 1986. However, prior to that date, Peoples had made an election to share the ITC by treating the unamortized balance as a rate base reduction (zero cost capital in the cost of capital calculation) and amortizing the ITC below the line. Peoples realized ITC on tax returns prior to its repeal and continues to treat the unamortized balance as zero cost capital in the 2009 test year.

HURON PROCEDURES

Q. WHAT PROCEDURES DID HURON PERFORM WITH RESPECT TO THE COMPANY'S INCOME TAX CALCULATIONS?

A. The following procedures were performed by me or under my direct supervision:

1. We read the Company's portion of TECO Energy, Inc.'s 2006 income tax return to identify the differences between book and taxable income. As previously described, these book/tax differences result because certain items of revenue and expense are recognized in different periods for income tax purposes and financial reporting purposes. Schedule M of the tax return lists the book/tax differences. We did not review the 2007 tax return as it is currently being prepared and is not expected to be finalized and filed until September 15, 2008.
2. We obtained the supporting documentation for significant book/tax differences, noting that the book/tax differences were treated appropriately in the calculation of both current and deferred income tax expense and the related current and deferred balance sheet accounts for 2007 and the 2009 test year.
3. We reviewed the calculation of projected 2009 income tax expense and the methodology used to determine such amounts. During this

process, we focused on amounts treated as permanent differences, as these items impact the total income tax expense calculation.

4. We analyzed the roll-forward of ADIT from December 31, 2007 to December 31, 2009 based upon projected 2008 and 2009 activity.
5. We reviewed the documentation supporting the ITC amortization.
6. We read the relevant sections of prior FPSC Orders pertaining to income taxes.
7. We read the MFR schedules identified in Exhibit ___(ADF-1).
8. We compared the projected 2009 ADIT amounts included in the MFR income tax schedules to the IRC requirements for how such amounts are to be computed when a forecast test period is used in a rate proceeding.

INCOME TAX MFRs

Q. IS THE INCOME TAX EXPENSE REFLECTED IN THE HISTORICAL 2007 AND FORECAST 2009 MFRS COMPUTED APPROPRIATELY?

A. Yes. Federal and state income tax expense has been correctly computed in the income statement in accordance with GAAP and the requirements of the FPSC. In addition, the computed income tax expense for 2007 and 2009 conforms with the requirements of the IRC, including the special provisions applicable to utilities.

Peoples' income tax provision has been determined using comprehensive interperiod income tax allocation. Each dollar of revenue and each dollar of expense have inherent tax consequences. The company's tax computation is based on the revenues and expenses associated with the provision of its regulated utility service to its Florida ratepayers. In this manner the tax expense included in the revenue requirement calculation is the appropriate tax expense reflecting the tax consequences of the costs and revenues included in the establishment of the revenue requirement.

The ITC claimed in previous years by Peoples is being appropriately amortized and the unamortized balance is included as zero cost capital in the 2009 projected test year.

Q. HAVE ANY RECENT CHANGES IN FEDERAL TAX POLICY BEEN CONSIDERED IN THIS PROCEEDING?

A. Yes. On February 13, 2008, the President of the United States signed the Economic Stimulus Act of 2008 (the "Act"). The Act allows an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of qualified property for the 2008 and 2009 calendar years. This results in a larger book/tax difference for accelerated depreciation used for income tax depreciation versus straight line depreciation used for financial reporting. Peoples has reflected the impact of this provision in the 2009 MFRs.

IRC REQUIREMENTS FOR PROJECTED TEST PERIODS

Q. IN ADDITION TO THE MFR SCHEDULES RELATING TO INCOME TAX EXPENSE, ARE YOU TESTIFYING ON ANY OTHER ISSUES?

A. Yes. My testimony addresses one further adjustment that needs to be made to comply with the normalization requirements of the IRC when a projected or forecast test period is used.

The ADIT balances on MFR Schedule G-1, page 8 are based on a 13-month average of projected balances. However, the IRC requirements in this situation require a specific computation to determine the maximum amount of ADIT to be treated as zero cost capital in the cost of capital calculation. The specific computation is shown on Exhibit ___(ADF-2), summarized on Paul Higgins' Exhibit ___(JPH-5), and is included in the specific adjustments as a reduction to deferred taxes (of $205,000) on MFR Schedule G-3 page 2. This adjustment is only required for accumulated deferred income taxes recorded in Account 282, net of the FAS 109 component, because this account includes the deferred taxes governed by the IRS normalization rules.

Q. CAN YOU PLEASE DESCRIBE THE PROJECTED TEST YEAR REQUIREMENTS OF THE IRC?

A. Yes. The IRC rules are set forth in Treasury Regulation Section 1.167(l)–1(h)(6) which address forecast test periods and the appropriate amount of ADIT used to reduce rate base (or to be treated as zero cost capital in the determination of cost of capital) for a forecast test period. Specifically, these regulations require that:

> for the purposes of determining the maximum amount of the reserve to be excluded from the rate base (or to be included as no-cost capital) under subdivision (I) of this subparagraph), if solely an historical period is used to determine depreciation for Federal income tax expense for ratemaking purposes, then the amount of the reserve account for the period is the amount of the reserve (determined under subparagraph (2) of this paragraph) at the end of

the historical period. If solely a future period is used for such determination, the amount of the reserve at the beginning of the period and a pro rata portion of the amount of any projected increase to be credited or decrease to be charged during a future period (or the future portion of a part-historical and part-future period) shall be determined by multiplying any such increase or decrease by a fraction, the numerator of which is the number of days remaining in the period at the time such increase or decrease is to be accrued, and the denominator of which is the total number of days in the period (or future portion).

Q. PEOPLES HAS USED A 2009 FORECAST TEST YEAR IN THIS PROCEEDING. IT EXPECTS NEW RATES TO BE EFFECTIVE IN MAY 2009. ARE THE ABOVE RULES RELEVANT TO THIS SITUATION?

A. Yes. Peoples' revenue requirements are based on the 2009 13-month average balances of plant, accumulated depreciation and other rate base items. The 13-month average is developed based on the monthly rate base balances from December 2008 through December 2009. Similarly, capital structure amounts including the ADIT balances treated as a source of cost free capital are also based on a 13-month average. Operating expenses, including depreciation expense and federal income tax expense, are based on the year ending December 31, 2009. This timing situation, where rates go into effect before the end of the test period, is the situation wherein these IRC rules are applicable.

Q. CAN YOU CITE SPECIFIC IRC GUIDANCE OR

A. Yes. There have been several private letter rulings ("PLRs") issued in instances with fact patterns similar to Peoples. The specific PLRs are PLR 9029040, PLR 9202029, PLR 9224040 and PLR 9313008. Although private letter rulings issued to specific taxpayers are not to be cited as precedent, they reflect IRS thinking on an issue and are consistently followed by the IRS. PLR 9029040 states:

> If rates go into effect before the end of the test period, and the rate base reduction is not prorated, the utility commission is denying a current return for accelerated depreciation benefits the utility is only projected to have. This procedure is a form of flow-through, for current rates are reduced to reflect the capital cost savings of accelerated depreciation deductions not yet claimed or accrued by the utility. Yet projected data is often necessary in determining rates, since historical data by itself is rarely an accurate indication of future utility operating results. Thus, the regulations provide that as long as the portion of the deferred tax reserve based on truly projected (future estimated) data is prorated according to the formula in section 1.167(l)-1(h)(6)(ii), a regulator may deduct this reserve from rate base in determining a utility's allowable return. In other words, a utility regulator using projected data in computing ratemaking tax expense and rate base exclusion must account for the passage of time if it is to avoid flow-through.

Q. HAS THE IRS DEFINED "HISTORICAL" VERSUS "FUTURE" TEST PERIODS AS IT RELATES TO THE PRO RATA ADIT

CALCULATION?

A. Yes. In PLR 9202029, the following guidance was provided by the IRS.

> Critical to the interpretation of section 1.167(l)-1(h)(6)(ii) of the regulation is the meaning of the terms "historical" and "future" in relation to the period for determining depreciation for ratemaking tax expense (this test period might not be consistent with the taxpayer's test year; see, e.g. section 1.167(l)-1(h)(6)(iv) Example (2)). The meaning of these terms does not depend on the type or quality of the data used in the ratemaking process--whether the data used is actual or estimated--but on when the utility's rates become effective. The historical period is that portion of the test period before rates go into effect, while the portion of the test period after the effective date of the rate order is the future period.
>
> These date-based definitions of the terms "historical" and "future" are consistent with the purpose of normalization, which is to preserve for regulated utilities the benefit of accelerated depreciation as a source of cost-free capital. This cost-free capital is made available by prohibiting flowthrough. But whether or not flowthrough can be accomplished by means of a rate base exclusion depends primarily on whether, at the time rates become effective, the amounts originally projected to accrue to the deferred tax reserve have actually accrued.

In Peoples' filing, the future portion of the test period subject to the pro rata guidance is the period from May 2009 (the expected effective date of the rate change) to December 31, 2009 (the end of the projected test period).

Q. HOW DID PEOPLES ADDRESS THIS REQUIREMENT IN DETERMINING THE PROPER LEVEL OF ACCUMULATED DEFERRED TAXES TO BE TREATED AS COST FREE CAPITAL IN THE FORECAST TEST PERIOD ENDED DECEMBER 31, 2009?

A. Peoples first determined the monthly projected balances for accumulated deferred income taxes for the year 2009. The monthly changes to accumulated deferred income taxes were based on the specific forecast of book and tax depreciation throughout the 2009 projected test period. These amounts were used to populate the 2009 MFRs related to monthly ADIT in accordance with the FPSC rules. Month-end ADIT balances from December 2008 through December 2009 are shown on MFR Schedule G-1, pages 7 and 8, and a 13-month average is computed. The 13-month average ADIT balance is then summarized on MFR Schedule G-3, page 2.

As explained previously, the average ADIT balance determined in this manner does not comply with the pro rata Treasury Regulations. The Treasury Regulations require that a pro rata calculation be used to determine the maximum amount of ADIT to be treated as cost free capital in the cost of capital computation.

My Exhibit ___(ADF-2) contains the required calculation. The monthly changes to ADIT were identified based on the specific forecast of book and tax depreciation throughout the 2009 projected test period. The January to April 2009 changes to ADIT were not prorated because they occur prior to the estimated May 2009 effective date of the rate increase (the "historical" portion of the test period as defined by the IRS). The projected changes to ADIT after the effective date of the rate increase are subject to the pro rata rules (the "future" portion of the test period). Thus, the forecast May 2009 increase in ADIT was pro rated using a numerator of 215 days and a denominator of 245 days (the number of days from the effective date of the rate change to the end of the forecast test period). The projected ADIT change in December 2009 was pro rated using a numerator of one day and a denominator of 245 days.

Next, a 13-month average of the prorated monthly change in the ADIT balances for the test period was computed. This amount was compared to the 13 month average non-prorated 2009 monthly changes in the ADIT balance reflected on MFR Schedule G-1 pages 7 and 8 and MFR Schedule G-3 page 2 and an adjustment of $205,000 was computed. This adjustment is reflected on Paul Higgins' Exhibit ___(JPH-5) and is necessary to state the projected 2009 ADIT balance to be treated as zero cost capital at the level required to comply with the forecast test period requirements set forth in Treasury Regulation Section 1.167(1)–1(h)(6).

Q. ONCE THE ADIT FOR EACH MONTH IN THE TEST PERIOD IS DETERMINED USING THE PRO RATA METHODOLOGY, WHY IS IT NECESSARY TO AVERAGE THE PRO RATA MONTHLY ADIT BALANCES?

A. When an average rate base is used, the pro rata monthly ADIT balances must also be averaged to comply with the consistency portion of the normalization requirements. In PLR 9224040, the IRS was requested to rule on the following issue:

> Where an average rate base is used and where the test period is part historical and part future under section 1.167(l)-1(h)(6)(ii) of the regulations, whether the consistency rules of section 168(i)(9)(B) of the Code require the average rate base to be reduced by the average of (i) the estimated deferred taxes at the beginning of the test period and (ii) the prorated estimated deferred taxes at the end of the test period?

The conclusion in that PLR is clear:

> 2. Where an average rate base is used and where the test period is part historical and part future for purposes of section 1.167(l)-1(h)(6)(ii) of the regulations, failure to reduce the average rate base by the average of (i) the estimated deferred taxes at the beginning of the test period and (ii) the estimated deferred taxes at the end of the test period as prorated under section 1.167(l)-1(h)(6)(ii), will violate the consistency rules of section 168(i)(9)(B) of the Code.

Q. WHAT ARE THE CONSEQUENCES IF PEOPLES DOES NOT FOLLOW THE PRO RATA RULES OF THE INTERNAL REVENUE SERVICE WITH RESPECT TO FORECAST TEST PERIOD ADIT?

A. Based on the Treasury Regulations and the PLRs I referenced, noncompliance with the Treasury Regulations would result in a form of flow through that violates the normalization requirements of the IRC. As I explained previously, the penalty for violating the normalization requirements is the loss of the ability to claim accelerated depreciation on public utility property.

Q. WHY IS THIS PRO RATA AVERAGING ADJUSTMENT ONLY REQUIRED FOR THE ADIT BALANCES RECORDED IN ACCOUNT 282, NET OF THE RELATED FAS 109 COMPONENT?

A. The ADIT recorded in Account 282, net of the related FAS 109 component represent the deferred taxes subject to the IRS normalization rules. The remainder of the ADIT balances (Accounts 190, 281 and 283) included as zero cost capital in the capital structure are not subject to the same requirements.

FIN 48

Q. WERE ANY NEW INCOME TAX FASB'S CONSIDERED?

A. Yes. In June 2006, the FASB issued FASB Interpretation Number 48, <u>Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No 109, Accounting for Income Taxes (FIN 48).</u>

FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, a company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the position will be sustained on examination by the taxing authorities, based on the technical merit of the position.

Q. PLEASE DESCRIBE HOW THIS AFFECTS PEOPLES.

A. The Company adopted the provisions of FIN 48 effective January 1, 2007 with no impact. Peoples does not have any uncertain tax positions at December 31, 2007 and has not projected any such positions in the 2009 MFRs.

SUMMARY

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. Peoples has presented income tax schedules in accordance with the requirements of the Commission's MFRs. The income tax MFRs have been prepared on the basis of comprehensive interperiod income tax allocation in accordance with GAAP.

The unamortized ITC balance is appropriately treated as zero cost capital in the cost of capital computation.

The 2007 income tax MFRs present fairly the information required to be set forth therein in accordance with GAAP and the requirements for preparation of such schedules. The projected 2009 MFR income tax schedules have been presented on a basis consistent with the historical schedules and consistent with other projected information for the test period. Further, the projected 2009 MFR income tax amounts have been properly stated in accordance with GAAP and, with the adjustment included on Exhibit ___(ADF-2), have been calculated in accordance with the requirements of the IRC and Regulations applicable to projected test periods.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

CHAIRMAN CARTER: Okay. That's witness Felsenthal.

Next is witness Wall. The prefiled testimony of the witness will be inserted into the record as though read. Exhibit 41, without objection, show it done, entered into the record.

(Exhibit 41 was admitted into the record.)

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Richard F. Wall and my business address is 5101 Northwest 21st Avenue, Suite 460, Fort Lauderdale, Florida 33309.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Peoples Gas System ("Peoples" or the "Company") as General Manager of the South Region, having held that position since May 2005.

Q. PLEASE PROVIDE A BRIEF OUTLINE OF YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. My career in the natural gas industry began in 1979, and I was employed by two Florida natural gas local distribution companies before becoming employed by Peoples. At the time I accepted employment with Peoples, I was the Director of Utility Operations of NUI Utilities, Inc., then the parent company of City Gas Company of Florida.

I began my employment with Peoples in May 2005 as the General Manager of the Company's South Region.

My education in the natural gas business includes specialized courses conducted by the ASME & Institute of Gas Technology, the Southern Natural Gas Association, the American Gas Association and other professional industry groups in areas such as Distribution, Regulation, Corrosion Control, Natural Gas Distribution Systems, and Measurement and Engineering. I am a former Gas Research Institute Technical Advisor and a past President of the Florida Natural Gas Association. I am a former member of the Licensing and Examination Board of Miami-Dade County. I hold Master Gas licenses in Miami-Dade and Broward Counties, and serve as one of the Company's qualifiers in these operating areas.

Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

A. As General Manager of Peoples' South Region, I am responsible for all aspects of the daily operations of the Region, and the six operating divisions within the South Region's business structure. These divisions include Orlando, Eustis, Daytona Beach, Palm Beach, Southwest Florida, and the Dade-Broward division. My responsibilities include developing annual operating budgets, and directing and planning the operation and maintenance of the distribution system to ensure maximum efficiency and safety of gas delivery to Peoples' natural gas customers. I assist in developing marketing and sales strategies and am responsible for the direction of employee training and evaluation, employee safety, organizational and employee development, and compensation for all Region employees.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony addresses the miscellaneous service charges in the Company's tariff, such as the charges for connecting and reconnecting service to a customer or changing the customer's name and/or address, and how the amounts of those charges were developed.

Q. HAVE YOU PREPARED OR CAUSED TO BE PREPARED ANY EXHIBITS TO BE INTRODUCED IN THIS PROCEEDING?

A. Yes. The schedules of the minimum filing requirements ("MFRs") (Composite Exhibit __(PGS-1)) listed in Exhibit ___(RFW-1) were prepared by me or under my supervision. Each schedule contains a general explanation of what is called for and shown on the schedule.

Q. **PLEASE DESCRIBE THE METHODOLOGY THAT WAS USED IN DETERMINING THE COSTS TO PERFORM EACH OF THE TASKS REFLECTED IN MFR SCHEDULE E-3.**

A. We performed a comprehensive time and motion study for each of the identified tasks. The studies involved capturing all relevant order and activity-based statistical data for each aspect of our process and service to the customer, beginning with order origination and continuing through completion of the last processing step required to finalize the customer-requested activity, or required utility service.

Q. **WHAT LABOR AND MATERIAL COSTS WERE USED IN DEVELOPING THE COST OF EACH IDENTIFIED TASK?**

A. While all associated tasks and processes studied were based on current performance and operating conditions required to complete each task identified in MFR Schedule E-3, the labor and material rates used to determine the cost of each task were adjusted to reflect the projected test year assumptions. In short, if a task took X number of minutes to complete, the labor rate applied to that time was the rate projected to exist in the projected test year.

Q. **WHERE DID YOU OBTAIN THE ASSUMPTIONS USED TO DETERMINE THE PROJECTED TEST YEAR RATES AND COSTS?**

A. The labor rates were adjusted to reflect the Company's assumptions listed in MFR Schedule G-2, page 10, supported by the testimony of Paul Higgins. By way of example, those assumptions reflect a labor increase of

4% for 2009. The costs of materials were adjusted by applying the Company's inflationary assumptions for material costs for periods 2008 and 2009 shown in MFR Schedule G-2, page 10.

Q. IS PEOPLES PROPOSING ANY CHANGES IN THE MISCELLANEOUS SERVICE CHARGES IN THIS PROCEEDING?

A. Yes. Based on the cost of the activities involved, as developed in the time and motion studies we performed, Peoples is proposing various increases and decreases in the miscellaneous service charges in the tariff. These proposed changes are shown on Sheets 5.101 and 5.101-1 of the legislative versions of the revised tariff sheets contained in MFR Schedule E-9.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. I was responsible for performing the time and motion studies used to determine Peoples' cost of performing the activities for which miscellaneous service charges are provided in the Company's tariff. These charges cover activities such as providing the initial service connection for a customer, reconnecting a previously disconnected customer, and providing final notice of termination. Peoples is proposing to increase several miscellaneous service charges as shown on MFR Schedule E-1, page 3.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

CHAIRMAN CARTER: Next we have witness Richards; is that correct, staff?

MS. KLANCKE: That is correct.

CHAIRMAN CARTER: Okay. Richards, the prefiled testimony of the witness will be inserted into the record as though read. For the record, Exhibits 42 through 47, without objection, show it done, entered into the record.

(Exhibits 42 through 47 were admitted into the record.)

Q. **PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A. My name is Susan C. Richards and my business address is 702 N. Franklin Street, Tampa, Florida 33602.

Q. **BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

A. I am employed by Peoples Gas System ("Peoples" or the "Company") as Manager - Budget and Finance, and have held that position since August 2006.

Q. **PLEASE PROVIDE A BRIEF OUTLINE OF YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.**

A. I hold a degree in accounting from the University of South Florida, and have been employed by Peoples for 16 years. From August 1992 until September 1996, I worked in marketing in the Company's St. Petersburg Division. In 1996, I began working as a financial analyst in the budget department, and became Supervisor, Budget & Finance in 2003, after which I assumed my current position with the Company.

Q. **WHAT ARE YOUR CURRENT RESPONSIBILITIES?**

A. As Manager, Budget and Finance, I am responsible for Peoples' annual budget and multi-year forecast, analysis of capital expenditures, analytical work on customer consumption of natural gas, trends in that consumption, and weather tracking.

Q. **WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

A. My testimony presents the numbers and classes of customers in the projected test year, as well as the projected consumption by those customers. I will explain the development of the historical portion of the cost of service study, excluding the costs associated with miscellaneous service charges, and the base revenue budget for the projected test year in this proceeding.

Q. **HAVE YOU PREPARED OR CAUSED TO BE PREPARED ANY EXHIBITS TO BE INTRODUCED IN THIS PROCEEDING?**

A. Yes. The schedules of the MFRs listed in Exhibit ___(SCR-1) were prepared by me or under my supervision. Each schedule contains a general explanation of what is called for and shown on the schedule. In addition, I prepared or caused to be prepared Exhibits ___(SCR-2) through ___(SCR-6).

Q. **HOW DID YOU DEVELOP THE PROJECTED NUMBER OF CUSTOMERS IN THE PROJECTED TEST YEAR?**

A. The projected number of customers was derived from analysis of our customers as of the end of the 2007 historic base year plus the forecasted customer additions, minus losses and seasonal activity for 2008. This became the beginning base for projecting the same information for the projected test year.

Q. **HOW DO YOU FORECAST CUSTOMER ADDITIONS?**

A. Peoples' annual budget for revenue-producing capital expenditures is developed based on the specific capital projects for which the expenditures will be made. Each project is associated with a projected number of customer additions by rate class and by year. For 2008, I included forecasted customer additions by rate class, adjusted these gross additions based on the historical losses of customers and historical seasonal customer data to arrive at the projected number of customers as of the end of 2008.

The process described above was repeated in order to forecast the number of customers for the 2009 projected test year. In addition to any new capital projects, gross additions are included from existing on-going revenue-producing projects and on-main saturation projects.

Q. **YOU MENTIONED CUSTOMER LOSSES. DOES PEOPLES ACTUALLY LOSE CUSTOMERS EACH YEAR?**

A. Yes. The Company loses customers each year as a result of, among other things, competition from alternative energy sources, single-appliance customers' replacing the gas appliance with an electric appliance when the gas appliance reaches the end of its useful life, inner city renewal projects, demolition and replacement of single family homes, and mortgage foreclosures.

Q. **HOW DID YOU PROJECT OR FORECAST THE CUSTOMER LOSSES FOR 2008 AND THE PROJECTED TEST YEAR?**

A. I used a historical average of customer losses which was developed for and applied to each customer rate class. This average was adjusted slightly to reflect more recent history resulting from current economic conditions.

Q. **WHAT IS THE "SEASONAL ACTIVITY" YOU MENTIONED, AND HOW DID IT AFFECT THE PROJECTED NUMBER OF CUSTOMERS FOR 2008 AND THE PROJECTED TEST YEAR?**

A. Peoples has about 3,000 customers who are part time, seasonal customers. They are generally in Florida only for the winter months or a portion of the winter months. I reviewed the historical activity of these customers to adjust monthly the number of customers for both 2008 and the 2009 projected test year.

Q. **WHAT ARE THE NUMBERS OF CUSTOMERS YOU HAVE PROJECTED FOR PEOPLES IN THE PROJECTED TEST YEAR?**

A. For 2009, the Company projects to have an average of 338,795 customers. The numbers of customers by rate class for the projected test year are shown on Schedules H-2, pages 2 and 3, and G-2, page 8, of the MFRs.

Q. **HOW WAS THE CONSUMPTION OF EACH CUSTOMER CLASS DETERMINED FOR THE PROJECTED TEST YEAR? PLEASE BEGIN WITH THE RESIDENTIAL CUSTOMER CLASS.**

A. After a lengthy study of historical residential customer consumption over a 10-year period, I identified a continuing trend of declining use per residential customer. Rather than just accept the linear trend of lower usage per customer, a regression model was developed to forecast the future consumption of these customers. The model took into account 10 years of weather history, 10 years of the residential delivered cost of gas, and the 10-year linear trend of declining use per customer I previously mentioned. As shown on my Exhibit ___(SCR-2), although the trend of declining use was still evident, it was not as severe as that shown by the linear model alone after the consumption had been weather normalized.

Q. **WHAT IS A REGRESSION MODEL?**

A. It is a technique used for modeling numerical data consisting of values of a dependent variable (in this case, customer therm consumption) and one or more independent, or explanatory variables (in this case, weather, gas price, and the historical linear decline in usage). In simpler terms, it uses known past customer information to predict what the future customer information will be in terms of the dependent variable, customer therm consumption. The regression model is developed in Microsoft Excel using its regression analysis tool. The tool performs linear regression analysis by using the "least squares" or "best-fit" method to fit a line through a set of observations. The regression analysis estimates the relationship between variables so that a given result can be predicted with the use of one or more other variables.

Q. **DID THE RESULTS DEVELOPED BY THE REGRESSION MODEL CORRELATE WITH ACTUAL RESIDENTIAL CUSTOMER USE?**

A. Yes. The model was able to replicate the customer usage with a high degree of correlation for each of the Company's divisions based on 10 years of weather-normalized consumption history. On a consolidated basis the correlation was greater than 98%.

Q. **DID YOU USE THE SAME REGRESSION MODEL TO PROJECT THE CONSUMPTION OF THE COMPANY'S COMMERCIAL CUSTOMER CLASSES?**

A. Yes, but as explained later in my testimony, I used the same regression model only for the smaller commercial rate classes GS-1 through GS-3. Peoples' commercial classes were expanded from three rate classes to five rate classes as a result of the Company's last base rate proceeding, and this change made tracking commercial trends somewhat more difficult. However, I was able to obtain 10 years of consumption history for existing customers that had been on the Company's system for that period, and assumed they had been on their current rate schedule during that time. I then used this data to simulate the regression model using the same variables used for the residential rate class – the delivered price of gas, weather and a 10-year linear trend. Again, I identified a growing trend of declining use per customer greater than would be caused by weather alone.

Q. DID THE RESULTS DEVELOPED BY THE REGRESSION MODEL CORRELATE WITH ACTUAL CUSTOMER USE FOR THE GS-1 THROUGH GS-3 CUSTOMER CLASSES?

A. The GS-1 through -3 classes fit the model very well and the predictions were within an acceptable error rate of less than plus or minus 5% in the last few years. The models have a high degree of correlation but do vary by rate class and operating location. A summary of the regression statistics is contained in my Exhibit ___(SCR–3), and graphs showing the correlation between the actual therms per bill and projected therms per bill are contained in Exhibit ___(SCR-4).

Q. HOW DID YOU FORECAST PROJECTED TEST YEAR CONSUMPTION FOR THE OTHER RATE CLASSES?

A. The large commercial and industrial classes (GS-4, GS-5, SIS, IS and ISLV) were individually forecasted based on input from the customers as to their plans for the projected year, and this input was used to determine projected test year consumption for these classes of customers.

Consumption of customers in the Small General Service ("SGS") rate class is very volatile, with movement in and out of the class by new customers that are unable to predict what their consumption will be. Due to this volatility, the regression model was not able to produce an estimated average annual therm consumption with a high degree of correlation. To effectively forecast this rate class a five-year linear trend was calculated for the period ending April 2008. I believe using a linear trend not only accounts for the impact of weather but also predicts the declining use per customer.

Q YOU'VE MENTIONED THAT YOU WEATHER-NORMALIZED THE HISTORIC CONSUMPTION. HOW WAS THIS ACCOMPLISHED?

A. Peoples' receives actual degree day data from Accuweather for each operating division. The heating and cooling degree days are weighted over a 60-day billing period to arrive at an average monthly number of degree days. These degree days have been tracked for the past 10 years and used in the regression model described above. The 10-year weighted average was used to project weather for the 2009 test year. Exhibit ___(SCR-5) summarizes the 60-day billing period weighted heating and cooling degree days by location for 10 years ending April 2008.

Q. YOU'VE MENTIONED A TREND OF DECLINING USE PER CUSTOMER. WHAT IS OCCURING?

A. I conducted a thorough study of each of the Company's operating divisions, tracking the consumption of each customer class and analyzing the usage patterns of the class. As appliances are updated and replaced, they are being replaced with electronic ignition appliances such as ranges, furnaces and pool heaters, which no longer have the constant flame and flow of gas associated with older appliances with a standing pilot. Water heaters are much more efficient today than they were even a few years ago. In addition, Peoples has been promoting instantaneous (tankless) water heaters, which reduce gas consumption as they have no pilot light and no need to maintain hot water within the tank. Water heaters are one of the major base load appliances in each household.

Q. IS THIS TREND PECULIAR TO PEOPLES, OR IS IT SOMETHING BEING EXPERIENCED BY OTHER LOCAL DISRIBUTION COMPANIES?

A. Peoples is not alone in experiencing this trend. A declining use per customer is being experienced all over the United States. The American Gas Association ("AGA") conducted a detailed study documenting the efficiencies of appliances and customer trends in different areas of the country. The South Atlantic region has experienced a 12.8% decline over the past six years. Our findings came to the same conclusions that were confirmed by the research provided by AGA. A copy of the Executive Summary from the study is attached to my testimony as Exhibit ___(SCR-6).

Q. HAVE YOU IDENTIFIED ANY CAUSES FOR THE DECLINING-USE-PER-CUSTOMER TREND YOU HAVE IDENTIFIED?

A. Yes. The declining use can be attributed to improved appliance efficiencies, as well as conservation efforts over the past decade. This is driven by the historical forces related to the turnover of old appliances to the more energy-efficient appliances that become available on the market each year. For example, since our last rate proceeding, Peoples' aggressive energy conservation programs have assisted customers in replacing over 17,000 water heaters, furnaces, ranges and dryers with new energy-efficient appliances. In addition, changes in customer usage trends as a result of higher fuel costs than those which existed a few years ago also contribute to the trend. Customer habits changed when natural gas prices increased, and some gas appliances, such as pool heaters and fire logs, are now often used only sparingly.

Q. DID THIS TREND AFFECT YOUR PROJECTIONS OF THE THERM CONSUMPTION BY CUSTOMER CLASS FOR THE PROJECTED TEST YEAR AND, IF SO, HOW?

A. Yes. Each of the Company's divisions was analyzed and the estimated annual therms were calculated using the regression model. With two exceptions, the Southwest Florida and Dade-Broward divisions, estimated annual therms are trending downward. The upward trend for the Dade-Broward division can be attributed to the loss of single appliance (range only) customers and the addition of multi-appliance homes. The Southwest Florida division is relatively new and its usage is trending slightly upward as we continue to add customers and the customer base becomes more stable.

Q. DID YOUR ANALYSES INDICATE WHETHER THIS DECLINING USE TREND COULD BE EXPECTED TO CONTINUE IN THE FUTURE?

A. Yes. The average annual therms per customer are expected to continue to decline beyond the projected test year. I believe past performance is a good indicator of increasing appliance efficiencies, and do not believe we will see gas prices return to the lows of the 1990s.

Q. WHAT IS THE PROJECTED RATE USED FOR THE PURCHASED GAS ADJUSTMENT (PGA)?

A. Residential gas was projected at an average of $1.17955 per therm. Commercial customers pay a slightly lower rate, an average of $1.11710 and the wholesale customers would pay an estimated $1.08584 per therm. As I stated earlier, customer usage will vary depending on the price of gas and the weather. For example, if the price of gas in the regression model is increased by 26% (from $1.18 to $1.48), the residential consumption would drop from 221 estimated annual therms to 213 estimated annual therms. The impact of such a decrease in consumption would result in a reduction in revenue of approximately $1 million. As gas prices fluctuate daily, the impact on projected revenues could have a material impact on earnings.

Q. ARE COMMERCIAL CLASSES ALSO IMPACTED BY THE COST OF GAS?

A. Yes. All customers are affected by the cost of gas. For the smaller commercial classes whose volumes have been predicted using the regression model, the impact of such an increase can be forecasted. Using the same projected increase in gas costs noted above, the impact to Peoples could exceed a $2 million reduction in revenue for the GS-1, GS-2, and GS-3 rate classes.

Q. WHAT WAS THE PROJECTED AVERAGE ANNUAL CONSUMPTION OF A RESIDENTIAL CUSTOMER IN THE 2003 PROJECTED TEST YEAR IN PEOPLES' LAST RATE CASE?

A. The average annual consumption was projected to be 249 therms per year.

Q. WHAT IS THE AVERAGE ANNUAL CONSUMPTION OF A RESIDENTIAL CUSTOMER IN THE 2009 PROJECTED TEST

YEAR IN THIS CASE?

A. The average annual consumption is projected to be 221 therms per year. This represents a decline of greater than 11% since 2003, and is consistent with the AGA study decline of 12.8% noted earlier.

Q. WHAT IS THE PROJECTED THERM CONSUMPTION OF EACH RATE CLASS FOR THE 2009 PROJECTED TEST YEAR?

A. The therm consumption by rate class is shown on MFR Schedules H-2 and G-2, page 8.

Q. WERE YOU RESPONSIBLE FOR THE COST OF SERVICE STUDY INCLUDED IN THE MINIMUM FILING REQUIREMENTS SUBMITTED BY PEOPLES IN THIS CASE?

A. The full cost of service study is covered by both the "E" schedules and the "H" schedules of the MFRs. Certain information developed in the "E" schedules flows into certain of the "H" schedules, and vice versa. I was responsible for the preparation of the "E" schedules listed on Exhibit ___(SCR-1), Richard Wall was responsible for preparation of Schedule E-3, and Daniel Yardley was responsible for preparation of the "H" schedules.

Q. PLEASE EXPLAIN WHAT IS SHOWN ON THE "E" SCHEDULES FOR WHICH YOU WERE RESPONSIBLE.

A. Schedule E-1 details customer bills, therms and revenue by rate class under the current rate structure, under the current rate structure adjusted for therms and bills in the projected test year without any rate increase, and under the proposed rate structure for the projected test year. Schedule E-2 uses information from Schedules E-1 and H-1 to show revenues calculated at present rates, present rates adjusted for growth in bills and therms only, and proposed rates for the projected test year. Again, this information is shown for each customer class.

Schedule E-4 shows, for the historic base year, the system peak month sales by rate class.

Schedule E-5 consists of monthly bill comparisons under present and proposed rates for each rate class. Bill comparisons are shown both with and without fuel.

Schedule E-6 details for each of the five years ending with the historic base year, and for the projected test year, the derivation of the components (rate base, accumulated depreciation, operation and maintenance expense, taxes other than income, required return and income taxes) of the overall cost of service. This cost and the supporting information is used on Schedule H-3 to begin the classification of costs based on whether they are driven by the numbers of customers, the capacity of the Company's system, commodity (system throughput) or revenue. Whether various costs are customer, capacity, commodity or revenue related in terms of cost causation is discussed in more detail by Mr. Yardley.

Q. WHAT IS A COST OF SERVICE STUDY?

A. A cost of service study is a method of determining, based on responsibility for the incurrence of costs, our costs of initiating and maintaining service to each customer class. Once the cost to serve each rate class has been determined, the cost of service study permits rates to be designed for each rate class in a manner that will, to the extent consistent with other considerations in the rate design process, permit recovery of the Company's cost to serve each class.

Q. HOW DID YOU DETERMINE THE BASE RATE REVENUE BUDGET FOR THE PROJECTED TEST YEAR?

A. As described earlier, once I have determined the number of customers by month, rate class, and division, this is multiplied by the estimated annual therms by rate class and division. The numbers of bills are multiplied by the average customer charge and the tariff per therm rate. For off-system sales revenues, I used $500,000, which is an appropriate level as described in more detail in Paul Higgins' testimony. This $500,000 amount was netted against the projected 2009 revenue requirements. For miscellaneous revenues, I have trended the number of transactions or units and multiplied by the Commission-approved charges.

Q. WHAT IS THE TOTAL BASE RATE REVENUE FOR THE PROJECTED TEST YEAR AT THE CURRENTLY AUTHORIZED BASE RATES?

A. As shown on MFR Schedule G-2, page 8, total base rate revenue at the currently authorized rates is $521,577,680, including purchased gas adjustment, or PGA, revenues of $351,671,555.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. As more fully explained in my testimony, Peoples is projected to have an average of 338,795 total customers in the projected test year. Those total customers, by rate class, are detailed on Schedules H-2 and G-2, page 8, of the MFRs. Those MFR schedules also show the therm consumption by rate class, which I developed based on analyses of 10 years of consumption history. Those analyses also confirmed a trend of declining usage per customer, a trend other natural gas local distribution companies in the United States are also experiencing due to increased appliance efficiencies, rising natural gas commodity cost, and customer conservation efforts. The projected average annual consumption per residential customer for the 2003 projected test year in the Company's last base rate proceeding was 249 therms. The average annual consumption of a residential customer in the 2009 projected test year is projected to be 221 therms.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

CHAIRMAN CARTER: Okay. That brings us to witness Higgins. You're recognized.

MR. WATSON: You gave me -- you saved me a lot of words. Paul Higgins.

Thereupon,

J. PAUL HIGGINS

was called as a witness on behalf of Peoples Gas System and, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. WATSON:

Q. Could you state for the record your name and business address?

A. My name is J. Paul Higgins. My business address is 702 North Franklin Street, Tampa, Florida, 33602.

Q. And by whom are you employed and in what capacity?

A. I'm the assistant controller for TECO Peoples Gas.

Q. Did you prepare and cause to be prefiled in this proceeding direct testimony consisting of 43 pages?

A. Yes, I did.

Q. Do you have any corrections or changes to that testimony?

A. Yes. Technically, in the portion regarding the storm damage reserve, we do. While it was correct when prepared, I subsequently learned that certain costs are not chargeable against the reserve pursuant to Rule 25-6.0143. As a result, my analysis, which my Exhibit JPH-3 shows, would have some changed numbers, and that would also change some of my testimony.

While I do not want to correct my prefiled testimony, because it has, in essence, been modified by the deposition, I would note that the annual accrual to the proposed reserve Peoples is seeking authority to establish would be $75,000 rather than $100,000, and this is shown on my Late-filed Deposition Exhibit Number 1.

Q. Do you have any corrections or changes to your Exhibit JPH-3?

A. Yes. As noted in the case of my direct testimony, some of those numbers would change on the analysis, but the bottom line is that the requested annual accrual would be 75,000 rather than 100,000.

Q. Do you have changes in any of your other exhibits that were submitted with your prefiled direct testimony?

A. No, I do not.

Q. If I were to ask you the questions in your direct testimony today, would your answers be the same?

A. Yes, other than as just noted.

MR. WATSON: We would ask that Mr. Higgins' direct testimony be inserted into the record as though read.

CHAIRMAN CARTER: The prefiled testimony of the witness will be inserted into the record as though read.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is J. Paul Higgins and my business address is 702 North Franklin Street, Tampa, Florida 33602.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Peoples Gas System ("Peoples" or the "Company") as Assistant Controller, a position I have held since August 1, 2006.

Q. PLEASE PROVIDE A BRIEF OUTLINE OF YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. I received a B.B.A. (with high honors) in Accounting from the University of Notre Dame in May 1985, and became a Certified Public Accountant in November of that year. I worked in public accounting for seven years at two of the "Big Four" CPA firms, and I became employed by Peoples in July 1993 as a budget analyst. I was appointed Manager, Finance & Budget, in 1998, and in September 2000 was promoted to Director, Finance & Budget, a position I held until being appointed to my present position.

Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

A. As Assistant Controller, I am responsible for the determination and implementation of accounting policies and practices for Peoples. I am responsible for maintaining the financial books and records of the Company. Included in my areas of responsibility are General Accounting, Plant (Property) Accounting, Gas Accounting, Sarbanes-Oxley compliance, Accounts Payable, Payroll, and certain cash and treasury functions. I am responsible for all external financial reporting aspects for the Company including periodic surveillance reports filed with the

Commission.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will present a general overview of Peoples' case, present the O&M benchmark calculations, explain the Company's historic base year and projected test year rate base and operating and maintenance ("O&M") expenses, and describe the budgeting process used to assist in developing those projections. I will also explain how we arrived at the Company's cost of capital for the projected test year, as well as factors and assumptions used in projecting rate base, O&M expenses and cost of capital in the 2009 projected test year. My testimony will also address the calculation of, and foundation for, the revenue requirements of the Company. These and other matters are covered – at least in part – by schedules included in the minimum filing requirements ("MFRs") (Composite Exhibit __(PGS-1)) required by Rule 25-7.039, *Florida Administrative Code* that I sponsor.

Q. ARE THERE ANY OTHER SUBJECTS ON WHICH YOU WILL TESTIFY?

A. Yes. I will also testify in support and explanation of the storm damage reserve for which Peoples seeks Commission approval, as well as our proposal to change the method of recovering the fuel portion of bad debt expense. Finally, I will present the Company's proposed position regarding the treatment of off-system sales for purposes of this proceeding.

Q. HAVE YOU PREPARED OR CAUSED TO BE PREPARED ANY EXHIBITS TO BE INTRODUCED IN THIS PROCEEDING?

A. Yes. The schedules of the MFRs listed in Exhibit ___(JPH-1) were prepared by me or under my supervision. Each schedule contains a general explanation of what is called for and shown on the schedule. In addition, I prepared or caused to be prepared Exhibits ___(JPH-2) through ___(JPH-6). All of these exhibits are attached to my testimony.

Q. **WHAT IS THE HISTORIC BASE YEAR PEOPLES IS USING IN THIS PROCEEDING?**

A. The historic base year is the 12 months ended December 31, 2007. All data related to this base year is historical data taken from the books and records of the Company, which are kept in the regular course of the Company's business in accordance with Generally Accepted Accounting Principles ("GAAP") and provisions of the Uniform System of Accounts prescribed by the Commission. The Company's books and records are audited annually by Pricewaterhouse Coopers, TECO Energy's independent auditors, and other audits are made regularly by the Commission and the Internal Revenue Service.

Q. **WHAT IS THE PROJECTED TEST YEAR FOR PURPOSES OF THIS PROCEEDING?**

A. Peoples has selected the 2009 calendar year as the projected test year in this proceeding. Calendar year 2009 is appropriate for use as the test year since it is representative of Peoples' projected revenues and projected cost of service, capital structure and rate base required to provide reliable, cost-effective service to customers during the period when the Company's new rates will be in effect.

Q. **WHAT IS THE AMOUNT OF THE RATE BASE FOR THE 2007**

HISTORIC BASE YEAR?

A. The calculation of the 13-month average rate base for the historic base year is contained on MFR Schedule B-2. As adjusted, Peoples' average rate base as of December 31, 2007 was $513,778,483. This compares to the average rate base for the 2001 historic base year in Peoples' last rate case of $461,554,070, an increase of 11.3%.

Q. WHAT ARE SOME OF THE FACTORS THAT HAVE CONTRIBUTED TO THE GROWTH IN RATE BASE OVER THIS SIX YEAR PERIOD?

A. There are several factors that have contributed to growth in rate base over this six-year period. Notably, the Company has continued to add a significant number of new customers to its system, adding about 100,000 new residential and commercial customers during this period. To support this growth, the Company has added over 1,500 miles of main to its distribution system. The Company has also faced continuing and increasing requirements for maintenance capital expenditures, including significant amounts for relocation of facilities due to rapid expansion of highways and roads throughout the State of Florida.

Q. WHAT ADJUSTMENTS HAVE BEEN MADE TO THE RATE BASE FOR THE HISTORIC BASE YEAR?

A. Adjustments were made to remove non-utility and non-jurisdictional items from the average per-books rate base. We have also removed items that are recovered through cost recovery mechanisms, such as the purchased gas adjustment ("PGA") and conservation cost recovery clauses. The adjustments made are contained on MFR Schedules B-3 and B-13.

Q. WHAT IS THE AMOUNT OF THE COMPANY'S NET OPERATING INCOME ("NOI") FOR THE HISTORIC BASE YEAR?

A. The calculation of NOI for the historic base year is found in MFR Schedule C-1. The adjusted NOI was $41,045,483.

Q. WHAT ADJUSTMENTS WERE MADE TO THE HISTORIC BASE YEAR NOI?

A. Items recovered through cost recovery mechanisms such as the PGA and energy conservation cost recovery clauses were removed from the calculation of net operating income. Depreciation and amortization expenses were also adjusted for the effect of the rate base adjustments I have described previously. In addition, certain adjustments to NOI were made to be reflective of previous Commission directives and policies as well as to be consistent with those determined in prior rate proceedings.

Q. YOU REFERRED EARLIER TO THE "O&M BENCHMARK." PLEASE EXPLAIN THAT REFERENCE.

A. The O&M benchmark is one high level approach that the Commission uses to analyze the growth of certain costs. The Commission has a long-standing process of comparing O&M expenses from one rate case to the next. The idea is that controllable O&M expenses should in general grow at a rate similar to that of customer growth and inflation. There are often valid reasons why certain expenses or categories of expense could be expected to increase or decrease at a different rate than this benchmark, and therefore it would be necessary to explain the circumstances.

Q. HAVE YOU MADE A COMPARISON OF O&M EXPENSES FOR

THE 2007 HISTORIC BASE YEAR VERSUS THE BENCHMARK OF THE O&M EXPENSES IN THE 2001 HISTORIC BASE YEAR IN PEOPLES' LAST RATE CASE?

A. Yes. The O&M expense for the historic base year is $65,728,617 compared to a calculated benchmark of $76,766,623 using the Commission methodology of increasing controllable O&M expenses by the rate of inflation plus customer growth. The historic base year O&M expense is less than the benchmark by $11,038,006, or 14.4%. These amounts are detailed on MFR Schedule C-34. The fact that the 2007 historic base year O&M expense is 14.4% less than the O&M expense benchmark using 2001 historic base year costs adjusted for customer growth and inflation suggests strongly that the increase during that six-year period has been reasonable.

Q. **WHAT ARE THE VARIOUS FUNCTIONS COMPRISING O&M EXPENSE?**

A. The functions are Distribution, Customer Accounts, General and Administrative ("G&A"), and Sales.

Q. **ARE ALL THE FUNCTIONAL AREAS OF THE O&M BENCHMARK CALCULATED USING THE SAME COMPOUND MULTIPLIERS?**

A. Yes, all the functional areas of the O&M benchmark were calculated using the same compound multiplier as developed on MFR Schedule C-37.

Q. **WHAT IS THE BENCHMARK COMPARISON FOR DISTRIBUTION EXPENSE?**

A. As shown on MFR Schedule C-34, Distribution Expense for the 2007 historic base year is $3,177,964, or 15.8%, less than the benchmark. Reasons for this better-than-benchmark performance include the reorganization of Peoples' operations from four to three regions, resulting in a reduction in workforce, as well as the leveraging of technologies in the operations area where feasible. An example of the employment of technology is the Company's implementation of its new mapping software. This implementation has allowed the Company to be more precise in its management of requests to locate facilities, resulting in a reduction in the number of locate tickets required to be physically cleared by Company personnel.

Q. WHAT IS THE BENCHMARK COMPARISON FOR CUSTOMER ACCOUNTS EXPENSE?

A. As shown on MFR Schedule C-34, Customer Accounts Expense for the 2007 historic base year is $1,925,177, or 18.0%, less than the benchmark. The primary reason for this better-than-benchmark performance is Peoples' restructuring of its call center operations from four regional units into a single virtual call center with two physical locations. In addition, the Company continues to leverage cost-effective technologies in this area including the use of interactive voice response (IVR) technology as well as the use of increasing customer self-service capabilities via the internet.

Q. WHAT IS THE BENCHMARK COMPARISON FOR G&A EXPENSE?

A. As shown on MFR Schedule C-34, General & Administrative Expense for the 2007 historic base year is $1,431,312 higher than the benchmark, representing 4.3% above the benchmark calculation. While several expense items included in this category experienced increases above inflation and customer growth, two significant drivers are pension expense (account 926) and industry dues (account 930). In the 2001 base year, the Company's recorded pension cost was a pension benefit ("income") of approximately $508,000 as actuarially determined. The same item in 2007, again actuarially determined in accordance with applicable GAAP, was a pension expense of approximately $2.1 million. Also, in the Company's last rate case, the Commission approved an additional $500,000 for industry research that had previously been recorded in Cost of Gas. This reclassification into O&M expense resulted in a one-for-one increase in O&M and corresponding decrease in Cost of Gas. As shown on MFR Schedule C-38, after adjusting for these two items alone, the Company is below the calculated adjusted benchmark comparison for G&A Expense by $1,755,654, or 4.8%, for the year ended December 31, 2007.

Q. ARE THERE OTHER G&A EXPENSE ITEMS THAT HAVE SHOWN SIGNIFICANT INCREASES SINCE THE 2001 BASE YEAR?

A. Yes. One particularly noteworthy item is the expense for the Company's medical plan. Health care cost increases have been well-publicized for many years now, and Peoples' experience in this area is no different from that of most companies. Since the 2001 base year, the Company's medical expense has more than doubled. In fact, the 2007 historic base year saw an unprecedented level of health care expense of over $4 million compared to less than $1.8 million in the 2001 base year.

Q. **HAS THE COMPANY EMPLOYED INITIATIVES TO CONTROL HEALTH CARE COSTS?**

A. Yes. Like all benefit plans of Peoples, the medical plan is managed by the Human Resource professionals at Tampa Electric. The Company has employed a variety of initiatives to control its health care costs, including the following:

- Price strategy to encourage cost-effective plan selections;
- Annual adjustments to employee contributions;
- Annual indexing of deductibles and out-of-pocket amounts;
- Emphasis on employee and retiree awareness and consumer responsibility;
- Comprehensive disease management program to facilitate the effective medical treatment of plan participants with specific diseases that, if not properly managed, can generate expensive claim costs;
- Aggressive vendor management; and
- Restructuring of prescription drug programs to encourage increased utilization of generic medication and Retail Refill Allowance programs.

Q. **WHAT IS THE BENCHMARK COMPARISON FOR SALES EXPENSE?**

A. As shown on MFR Schedule C-34, Sales Expense for the 2007 historic base year is $7,366,177, or 57.6%, less than the benchmark. The Company's marketing services are provided by its affiliate, TECO

Partners, Inc. ("TPI"), and the cost of the services received under this contract has declined significantly since the Company's last rate case.

Q. **HAS AN ADJUSTMENT BEEN MADE TO ALLOCATE PEOPLES' G&A EXPENSES BETWEEN THE UTILITY AND ANY NON-UTILITY AFFILIATES?**

A. Yes. All applicable Peoples corporate G&A expenses are allocated between the Company and its non-utility affiliates. The allocations are recorded on the books based on budgeted expense for the year using an operating methodology based on the Modified Massachusetts Formula and employing the drivers of net revenues, payroll, and gross plant in service in order to calculate a weighted average allocation factor for each entity. Because the allocations are included in the actual per-books expenses, no further adjustment is required. MFR Schedule C-6 shows the amount of G&A (and other) expenses that have been allocated.

Q. **DOES PEOPLES' HISTORIC BASE YEAR O&M EXPENSE INCLUDE CHARGES FROM TAMPA ELECTRIC?**

A. Yes. The historic base year includes charges for various goods and services provided by Tampa Electric. The goods and services received are primarily corporate shared services consisting of information technology, telecommunications, payroll processing, human resources, regulatory, facility services, mail room services, bank charges and rent. The Company also contracts with Tampa Electric for meter reading services in areas where there is overlapping service territory. Expenses are determined based on direct charges for services received or resources consumed. These items are charged to Peoples at cost.

Q. DOES PEOPLES' INTEREST EXPENSE INCLUDE INTERCOMPANY EXPENSE PAID TO TAMPA ELECTRIC?

A. Yes, when applicable. Short-term debt for both Peoples and Tampa Electric is typically obtained from either the companies' bank credit facility or their accounts-receivable-backed credit facility. However, in instances when Peoples requires short-term funding and Tampa Electric has excess cash available, short-term debt is provided to Peoples by Tampa Electric. In these cases, Peoples pays a short-term investment interest rate to Tampa Electric as interest expense to Peoples. This policy holds Tampa Electric neutral in that it receives the short-term investment rate it would have earned had it invested that cash, and it benefits Peoples somewhat in that the short-term investment rate is slightly lower than the short-term borrowing rate. In the event that the roles were reversed (e.g., Peoples had cash and Tampa Electric required short-term debt), the reverse treatment would be applied.

Q. DOES PEOPLES' HISTORIC BASE YEAR O&M EXPENSE INCLUDE CHARGES FROM TECO ENERGY?

A. Yes. The historic base year includes charges for various services received from TECO Energy. Some of the services received include corporate governance, treasury, general accounting, tax support, legal services, and risk management as well as general corporate overhead. Expenses are based on direct charges where appropriate and an allocation. Allocated items are charged using an operating methodology based on the Modified Massachusetts Formula. This allocation methodology consists of developing weighted average allocation percentages of all TECO Energy affiliates, both regulated and non-regulated, based on revenues, net income and operating assets. This method has been consistently applied since Peoples became part of TECO Energy in 1997 and is consistent with the methodology employed during the Company's last rate proceeding. The goal of this approach is to take advantage of economies of scope and scale inherent in a shared services organization.

Q. HOW DID YOU DEVELOP THE RATE BASE FOR THE PROJECTED TEST YEAR?

A. Rate base was projected using a combination of trending based on historical data as well as specific adjustments based on known or reasonably foreseeable events that are expected to occur during the projected test year.

The main item affecting the rate base calculation is the projected capital expenditures that are incorporated into Plant in Service. In order to develop Plant in Service for the projected test year, capital expenditures were estimated for both 2008 and 2009. The testimony of Peoples witness Bruce Narzissenfeld describes more fully the approach taken in preparing these estimates. In addition to capital expenditures, plant retirements and removal costs were considered. The testimony of Peoples witness Donna Hobkirk, as well as Mr. Narzissenfeld, describes the procedures used in calculating these items.

The other major component of rate base is working capital. Projecting working capital for the 2009 projected test year began with developing projected balances for the various balance sheet line items, described more fully below.

Q. IN FORECASTING THE 2008 "BASE YEAR + 1" BALANCE SHEET, DID YOU USE THE COMPANY'S 2008 BUDGETED BALANCE SHEET ASSUMPTIONS?

A. Yes, with a few exceptions. First, Accumulated Deferred Income Taxes ("ADIT") was changed to reflect the creation of bonus depreciation as a result of the passage of the Economic Stimulus Act of 2008. Second, the Company's 2008 budget included an estimate of interim rate relief in its revenue for 2008. For purposes of the forecasted surveillance report and preparation of the MFRs for this rate case, the Company excluded this amount from its 2008 revenue projections, and the related net income and income tax amounts were adjusted in the Company's equity and accrued income tax accounts. Also, during preparation of the detailed MFRs for the 2008 Plant in Service accounts, a budget discrepancy was discovered with respect to the treatment of a large contribution in aid of construction related to the pipeline extension to serve Tampa Electric's Bayside Power Station. This discrepancy was corrected in preparing the detailed 2008 projections in the MFRs, and as a result there were shifts between Plant in Service and construction work in progress ("CWIP") balances as well as a reduction of about $400,000 in depreciation expense for 2008 which impacted the projected balance in Accumulated Depreciation as of December 31, 2008. In addition, a long-term debt issue that was originally planned for June 2008 was actually issued in May 2008. The Company's balance sheet and related interest expense accounts were adjusted to reflect the actual event that occurred in May. Finally, during 2008 the Company has recorded Other Comprehensive Income ("OCI") as a result of Statement of Financial Accounting Standard ("FAS") No. 133 accounting for an interest rate swap related to the aforementioned long-term debt issuance. This accounting treatment was not contemplated in the original 2008 budgeted balance sheet. In order to ensure that year-end balances for 2008 appropriately reflect this treatment, the related balance sheet line items (OCI and Deferred Tax Asset accounts) were adjusted to reflect the results of the actual debt issuance.

Q. HOW DID YOU DEVELOP THE BALANCE SHEET FOR THE PROJECTED TEST YEAR?

A. In developing projections for the balance sheet accounts for the projected test year, the Company employed the same process used in developing its annual budgeted balance sheet. These methods are described on an account by account basis in MFR Schedule G-6. The ending balances as of December 31, 2008 were used as the beginning balances for the 2009 balance sheet, and activity for each line item was forecasted for the projected test year. Plant in Service balances were forecasted based on the Company's 2009 capital budget by account, estimated retirements, and expenditures for removal costs. An analysis was used to project certain balance sheet accounts, including Accounts Receivable, Accounts Payable, and Unbilled Revenues. Certain accounts were trended for known patterns of activity that occur in the normal course of business. Finally, for the regulatory clause accounts -- Unrecovered Gas Costs and Conservation Cost Recovery -- the Company forecasted 13-month average balances at or near zero reflecting the Company's intention to not be significantly over or under-recovered during the projected test year.

Q. WHAT AMOUNT OF WORKING CAPITAL HAS THE COMPANY INCLUDED IN RATE BASE FOR THE PROJECTED TEST YEAR?

A. As shown on MFR Schedule G-1, Pages 2 and 3, the Company is requesting a negative $11,494,371 in working capital for the 2009 projected test year. This means that rate base will be reduced by this amount.

Q. WHAT METHODOLOGY DID THE COMPANY USE TO CALCULATE THIS LEVEL OF WORKING CAPITAL?

A. Working capital was developed using the balance sheet method which has been accepted for many years by the Commission. The various components that make up working capital were projected using a variety of methods described in MFR Schedule G-6, pages 2 and 3.

Q. WERE ANY EQUITY INFUSIONS TO PEOPLES FROM TECO ENERGY INCLUDED IN THE BALANCE SHEET FOR THE PROJECTED TEST YEAR?

A. Yes. The equity infusions budgeted for 2009 total $25 million. This infusion is the result of the Company's planned capital structure needs based on its expenditures and business requirements. The balance between debt and equity continues to be maintained in a manner that ensures financial integrity for the Company now and into the future. As described more fully in Gordon Gillette's testimony, the Company has targeted an equity ratio of 55%.

Q. HOW DOES PEOPLES DEVELOP ITS BUDGET FOR OPERATING AND MAINTENANCE EXPENSES?

A. The Company prepares a detailed annual budget for O&M expense, revenue, and capital expenditures. The O&M expense budget is built primarily by resource type (payroll, materials and supplies, outside services, etc.) and is prepared in great detail covering all operating divisions/regions, as well as Peoples corporate departments and intercompany O&M charges from Tampa Electric and TECO Energy. For payroll, the Company's largest expense type, budgeted amounts are calculated on an individual employee basis. Operating divisions/regions budget payroll expenses by person, including an estimate for merit increases and an allocation of payroll costs to capital expenditures or clearing accounts if applicable. Similarly, corporate departments budget payroll expense for each individual, including an estimate for merit increases. Any requests for new employees would be added to these detailed budget inputs. Other resource types are budgeted at the local level by managers closest to the specific areas and functions based on historical expense levels and expected activities and cost increases for the upcoming year. The individual division/region O&M expense budgets are then rolled up for the total company and included in overall analyses of need and reasonableness for the upcoming year before the total O&M expense budget is approved. Generally, this process occurs from August through December of any particular year and is the typical O&M expense budget process for the Company on an annual basis. Variances from budget are monitored and explained on a monthly, quarterly, and annual basis.

Q. WHAT OTHER FACTORS SHOULD THE COMMISSION

CONSIDER IN RELYING ON THE COMPANY'S BUDGET PROCESS?

A. Peoples employs a budget process that incorporates the American Institute of Certified Public Accountants ("AICPA") guidelines for preparing prospective financial information. The Company's process reflects all of the guidelines, including those related to quality, consistency, documentation, the use of appropriate accounting principles and assumptions, the adequacy of review and approval, and the regular comparison of financial forecasts with actual results.

Q. HOW WAS THE O&M EXPENSE BUDGET FOR 2008, THE HISTORIC BASE YEAR + 1, DEVELOPED?

A. The Company's 2008 budget for O&M expense was prepared as described in my answer to your previous question. In the MFRs (Schedule G-2, pages 10-19), a calculation has been made of O&M expense for the base year + 1 using the trending methodology prescribed by the Commission, adjusting for certain specific items where trend factors do not represent the future expected expense level.

Q. HOW DOES THE 2008 BUDGET COMPARE WITH THE DATA INCLUDED IN THE MFRs FOR THE HISTORIC BASE YEAR + 1?

A. The amount of O&M expense shown on Schedule G-2, page 19, for 2008 is higher than the Company's O&M expense budget for 2008 by about $155,000, a difference of less than one-quarter of one percent.

Q. HOW DID YOU DEVELOP THE O&M EXPENSE PROJECTIONS FOR THE PROJECTED TEST YEAR?

A. For the 2009 projected test year, Peoples prepared O&M expense projections using two distinct methodologies and reconciled the total O&M expense calculated using the two methods. In the first methodology, the Company prepared a detailed 2009 O&M expense budget much as described above for the Company's annual budget process. Input was sought from field operation managers and corporate department heads regarding expected 2009 O&M expense levels, including any changes other than inflationary increases and planned increases or decreases to existing 2008 staffing levels. Detailed budget information was provided by Tampa Electric and TECO Energy departments for direct and allocated expenses for 2009. This data was incorporated in a detailed O&M expense budget such as the Company would have produced during its annual budget process.

In the second methodology, the Company calculated O&M expense for the projected test year using the trending methodology prescribed by the Commission, adjusting for certain specific items where trend factors do not represent the expected 2009 expense level. These calculations are shown on MFR Schedule G-2, pages 10-19.

Q. HOW DOES THE 2009 BUDGET COMPARE WITH THE DATA INCLUDED IN THE MFRs FOR THE PROJECTED TEST YEAR?

A. The amount of O&M expense as shown on Schedule G-2, page 19 for 2009 is lower than the Company's O&M expense budget for 2009 by about $72,000, a difference of 0.1%. Based on this comparison of both the 2008 and 2009 O&M expense budgets to the amounts calculated in the MFRs, the O&M expense in the MFRs appears reasonable for each of those years.

Q. HAS THE COMPANY CONDUCTED ANY ANALYSES TO DETERMINE WHETHER THE PROJECTED O&M EXPENSES ARE REASONABLE?

A. Yes. We have performed several analyses that confirm the reasonableness of O&M expenses for the projected test year. First, as noted above and shown on Exhibit ___(JPH-2), it is compelling that the O&M expense amounts for 2008 and 2009, built by two separate and distinct methods, differ only immaterially from each other. Second, after excluding certain one-time or unusual changes in either 2008 or 2009 expense levels, the percentage increase for each of those years was less than 4%, which again appears reasonable. Third, the Company's performance with respect to the Commission's benchmark as shown on MFR Schedule C-34, and as I have previously more fully described, is an indication of the reasonableness of base O&M expense levels. Finally, the Company periodically compares itself to industry data available from sources such as the American Gas Association, and these comparisons show that based on various metrics Peoples' O&M expense levels are reasonable. In addition, the assumptions used in preparing our O&M forecasts were developed in a manner consistent with the aforementioned AICPA guidelines for prospective financial information. Accordingly, I believe the projected O&M expense amount included in the MFRs for the projected test year is reasonable and justified.

Q. WHAT TRENDING FACTORS WERE USED IN THE MFRS TO DEVELOP THE 2008 AND 2009 O&M EXPENSE AMOUNTS DISCUSSED ABOVE?

A. As prescribed by the Commission, Peoples considered the trending factors of payroll only, customer growth plus payroll, customer growth plus inflation, and inflation only. For inflation, the Company used the Consumer Price Index – All Urban ("CPI-U") forecasts for 2008 and 2009 provided by Moody's Economy.com service. These estimates of inflation for 2008 and 2009 were 2.9% and 2.1%, respectively. Payroll increases were based on actual merit increases for 2008 of 3.5% overall and a projected increase of 4.0% for 2009 provided by compensation professionals in the Tampa Electric Human Resources department.

Q. YOU MENTIONED THAT CERTAIN EXPENSE ITEMS WERE NOT PROJECTED USING TRENDING FACTORS. PLEASE DESCRIBE THESE.

A. That is correct. In several instances, we have specific knowledge of expense items that will not follow those trend factors for 2008 or 2009. In those cases, the Company used the "Other Not Trended" lines on MFR Schedule G-2, pages 10-19 to project these items.

Q. PLEASE DESCRIBE THESE "OTHER NOT TRENDED" EXPENSE ITEMS IN MORE DETAIL.

A. Certainly. I will take these one at a time, by the applicable account number.

<u>Account 871 – Distribution Load Dispatching</u> – In late 2007, the Company established a full-time gas control department at the Company's corporate headquarters. Peoples currently has one full-time employee engaged in this activity and plans to hire one additional gas control analyst in 2008 and three additional analysts in 2009 in order to provide a robust

gas control function on a 24-hour, 7-days a week basis. The Company's distribution system has become more complex in recent years as a result of an increase in the number of interstate pipelines supplying gas to the system and an increase in the number of power generation customers placed behind the Company's system. In order to provide "24/7" functionality, the Company needs a department of five analysts engaged in this activity. The 2009 projected test year includes expenses for this effort.

Account 878 – Meter and House Regulator Expenses – In 2008, the Company is scheduled to complete a three-year program to replace approximately 62,600 residential meters necessitated by the discovery of a manufacturing defect. In a settlement with the manufacturer, Peoples received amounts over the three-year period to fund the replacement of these meters. As a result of various efficiencies during the replacement process, the Company has been able to replace the meters at a cost substantially below the reimbursement amount, thereby generating offsets to O&M expense during these three years. In 2008, the Company is projecting an offset, net of the related expenses for replacement, to O&M expense in account 878. As this program is expected to be completed in 2008 and no further settlement funds will be received in future years, there will be no expense offsets in the 2009 projected test year.

Account 880 – Other Expenses – This account has been used to record the Company's requested amount for a storm damage reserve, as described more fully later in my testimony.

Account 887 – Maintenance of Mains – The large increase in this account represents expected expenses related to the new distribution pipeline integrity costs as well as for additional required system reliability. This item is also described more fully later in my testimony.

Account 904 – Uncollectible Accounts – Bad debt expense was based on the four-year average factor developed during the rate case as part of the expansion factor calculation. This approach is consistent with that used by the Commission in the Company's last rate proceeding as well as in other rate proceedings.

Account 912 – Demonstrating and Selling Expenses – Sales expense was based on the new contract for marketing services between Peoples and its marketing services provider TPI. In 2008 a new contract was negotiated to reflect new or expanded services which Peoples requested to be provided by TPI. Also, the Company is placing an increased focus on saturation efforts on existing mains, and this endeavor requires more labor intensive one-on-one marketing to potential customers than has been done in the past. The 2008 expense was grown at inflation for 2009 as called for in the contract. Even after this increase, the remaining sales and marketing expenses are more than $6 million below the benchmark expense described earlier.

Account 920 – Administrative and General Salaries – The Company has a variable incentive pay mechanism for all employees based on the achievements of individuals as well as the Company against pre-established goals. These goals include factors for safety, customer favorability, operational unit financial goals, and individually-determined goals. In addition, there is both an upside and a downside to the incentive payout based on Peoples' net income performance. During 2007, as a result of revenues that were substantially below plan, which drove lower than planned net income, Peoples' incentive payout to all employees was significantly reduced. For the 2008 and 2009 projections for this proceeding, the incentive payout has been included at the targeted payout amounts. It is important to note that the Company's Human Resource professionals routinely evaluate salary levels for all jobs in the Company using data from outside salary experts, and this compensation review includes consideration of targeted incentives for each position's market valuation. In order to evaluate market compensation comparisons, the Company uses data from various outside expert resources including Towers Perrin, World at Work, Mercer Inc., Hewitt Associates, Watson Wyatt Worldwide, and Gartner, Inc. Compensation levels, including targeted incentive compensation, reflect a market-based level necessary to attract and retain qualified employees.

Account 921 – Office Supplies and Expenses – This account contains a variety of expenses including intercompany items from both Tampa Electric and TECO Energy as described more fully elsewhere in my testimony. For purposes of projecting the 2009 projected test year expense levels, both Tampa Electric and TECO Energy provided detailed budget amounts for 2009. In several cases, these items did not reflect trend increases over 2007 historic base year levels and therefore the items were included as "other not trended" in determining 2009 expense levels. Information Technology expense, a shared service provided to Peoples by Tampa Electric, was flat from 2007 to 2008 and was reduced by over

$90,000 from 2008 to 2009. The G&A expense allocation from TECO Energy was reduced by nearly $550,000 from 2007 to 2008, so this item was also included in "other not trended" expenses. Two other items included in "other not trended" expense for this account were credit card fee expense (eliminated during 2007 due to a change in this program) and airplane related expenses, which experienced higher than normal trends due largely to fuel expense increases above inflation and certain maintenance and pilot training costs that did not follow inflationary patterns.

Account 925 – Injuries and Damages – This account (sub account 925-02) includes costs for Injuries and Damages expense, a significant expense item for the Company which includes the cost of insurance premiums as well as claims incurred and legal expense in defending these claims. To project this expense for the 2008 budget and 2009 projected test year, the Company prepared an analysis of the past five years' activity in account 925-02, including increases and decreases in the related liability account on the balance sheet (Injuries and Damages Reserve). Over this period, claims incurred and the reserve account levels have fluctuated significantly, so an average over the five-year period was developed. In addition, the Company's Risk Management department (a shared service provided by TECO Energy), in conjunction with its outside actuarial firm, prepared an analysis of premiums expended and actual claims losses incurred over the past eight years. I reviewed data from both of these sources and developed an expense level for 2009 that was appropriate based on this data.

Account 926 – Employee Pensions and Benefits – This account includes all employee benefits expenses. As noted in my earlier testimony on the benchmarking test, several of the items in this account have experienced significant increases since our last rate case, including pension, medical, and other post employment benefits expenses. For purposes of projecting expense levels for the 2009 projected test year for Pension and FAS 106 expense (Other Post-Employment Benefits), the Company employed its outside actuarial firm (Towers Perrin) to provide detailed expense projections for 2009. Medical and dental expenses were projected for 2009 to increase 9% over 2008 levels. This projected increase represents a weighted average of medical and dental expense increases expected for 2009 as estimated by outside advisors Mercer Health and Benefits LLC. It should be noted that the 2008 budget for medical expense was not trended off the record expense level the Company experienced in 2007, when several unusually large medical claims occurred. The 2008 budgeted medical expense was lower than 2007 actual by nearly $740,000, and that expense reduction has been reflected in the Company's O&M expense projections included for purposes of this rate proceeding.

Account 928 – Regulatory Commission Expenses – This account represents the Company's provision for the amortization of expenses incurred in preparing and prosecuting this rate filing with the Commission. The amount included for the 2009 projected test year was based on the estimated total rate case expenses incurred as shown on MFR Schedule C-13 amortized over a three-year period.

Q. PLEASE EXPLAIN PEOPLES' PROPOSAL TO ESTABLISH A STORM DAMAGE RESERVE IN THIS PROCEEDING.

A. As noted earlier, Peoples has included an additional $100,000 annually in its O&M expense projection for the 2009 projected test year to begin establishing an unfunded storm damage reserve (liability) on its books. This concept is well-established with the Commission for electric utilities, who admittedly bear most of the brunt of expenditures related to storm damages. In Florida, there is one gas distribution company, Florida Public Utilities Company, which has received approval to set up an unfunded storm damage reserve liability. In this case, Peoples is seeking Commission approval to establish a reserve so the Company is not forced to incur large, unusual and unpredictable costs in any particular year. Rather, these costs would be spread out more evenly over a long period, which would provide rate stability from a customer perspective and greater financial stability from the Company's standpoint.

Q. WHAT STUDIES, IF ANY, WERE CONDUCTED TO DETERMINE THE APPROPRIATE AMOUNT OF THE RESERVE YOU SEEK AUTHORITY TO ESTABLISH?

A. In order to estimate the amount of storm damage reserve required on an annual basis, Peoples examined its historical books and records for the ten-year period from 1998 to 2007. While the bulk of expenditures occurred during the well-publicized years of 2004 (when five named hurricanes impacted the Company's system) and 2005 (during which there were three named hurricanes), there were other smaller amounts expended related to hurricanes, tropical storms, and tornadoes during this ten-year period. In 2004, Peoples spent over $740,000 as a result of the five named hurricanes that affected its distribution system, over $600,000 of which was expensed in O&M that year. In 2005, the Company incurred an additional $200,000 of O&M expense related to that year's three named storms. Over the 10-year period studied, the Company incurred a total of over $1,056,000 of expenditures, of which nearly $900,000 was classified as O&M expense in the applicable year.

Q. DO THE AMOUNTS NOTED ABOVE INCLUDE ANY EXPENSES FOR "BASE PAY" (OR STRAIGHT-TIME PAYROLL)?

A. Yes, the Company accumulated all costs related to these storms, including base payroll. The total amount of base pay included over the 10-year period was approximately $200,000. This amount of "base pay" has been excluded when determining the storm damage accrual, in keeping with established Commission practices, such as those contained in Rule 25-6.0143.

Q. HOW DID YOU CALCULATE THE AMOUNT OF RESERVE REQUESTED?

A. Based on the data noted above, on a simple average basis, the Company incurred about $70,000 of O&M expense annually over these 10 years excluding base pay. However, the vast majority (97%) of these costs were incurred in the past five years. Accordingly, we also calculated a five-year average of O&M expenses related to these storms. The five-year average was approximately $133,000. Taking into consideration these two averages, Peoples determined that an accrual of $100,000 per year was a reasonable amount with which to establish the new storm damage reserve account. The results of the study we conducted, and the determination of the accrual are contained in Exhibit ___(JPH-3).

Q. **WOULD THERE BE A "CAP" ON THIS LIABILITY ACCOUNT IN THE EVENT THE COMPANY DOESN'T ACTUALLY INCUR THE REQUESTED LEVEL OF ACCRUED EXPENSES IN THE FUTURE?**

A. Yes. Peoples proposes to accrue this amount annually in its financial statements, reducing the liability account in instances when a storm or other significant weather event occurs requiring the expenditure of funds consistent with established Commission guidelines. In the event storms or other significant disasters do not occur in the future, Peoples proposes to limit the amount of the related storm damage reserve liability to $1 million. If the account balance were to reach this level, Peoples would stop accruing the annual expense amount requested in this rate proceeding.

Q. **WHAT IS THE COMPANY'S PROPOSAL WITH RESPECT TO BAD DEBT EXPENSE?**

A. In this proceeding, Peoples is proposing to recover the gas cost portion of the Company's uncollectible accounts through the PGA. This is a change in cost recovery for this expense item, moving the recovery from base rates to the PGA. This change in recovery policy would, of course, result in an offsetting increase in cost of gas expense and a reduction to O&M expense in the same amount.

Q. **WHY IS PEOPLES PROPOSING THIS CHANGE?**

A. The Company believes this request is consistent with the Commission's intent in establishing the PGA mechanism, which is designed to permit natural gas utilities to recover, on a timely basis, the total cost of natural gas purchased for delivery to its customers, and to assure that such cost is not over- or under-collected. There should be no dispute with respect to the nature of these expenses in this circumstance – the funds were spent to obtain gas that was sold to and used by customers, and the Company has been unable to collect the cost of this gas. Therefore, it is appropriate to include this in the PGA for recovery.

Q. HOW DID THE COMPANY REFLECT THIS PROPOSAL IN THE REVENUE REQUIREMENTS CALCULATION IN THIS CASE?

A. In order to reflect this appropriately in the MFRs and revenue requirements calculation for the projected test year, Peoples first calculated an estimate of the total annual uncollectible account expense for the 2009 projected test year. As noted earlier, the total expense was based on the four-year average factor developed during the rate case as part of the expansion factor calculation. Then, the Company removed a portion of the total calculated expense from O&M expense in the projected test year via a pro forma adjustment as shown on MFR Schedule G-2, page 2 – an estimate of the percentage of total uncollectible expenses that are attributable to the cost of gas.

Q. HOW DID YOU DETERMINE THE PERCENTAGE OF UNCOLLECTIBLE ACCOUNTS ATTRIBUTABLE TO THE COST OF GAS?

A. In order to calculate an estimate to apply to the projected test year total uncollectible expense, Peoples performed a detailed analysis of historical write-offs for 2005, 2006 and 2007. During these three years, the fuel portions of total bad debt expense were 40%, 49%, and 47%, respectively, and the weighted average percentage for the three-year period was 46%. The Company applied this weighted average percentage to total calculated bad debt expense for the projected test year of $1,573,000, and the resulting amount ($723,580) was reduced from O&M expense via a pro forma adjustment as previously described.

Q. WHAT DOES THE COMPANY'S TOTAL ANNUAL BAD DEBT EXPENSE REPRESENT AS A PERCENTAGE OF ITS TOTAL ANNUAL REVENUES?

A. Total bad debt expense for the projected test year represents less than one-half of one percent of projected total revenues in the projected test year.

Q. HOW AND WHEN WOULD THIS PROPOSED CHANGE BE IMPLEMENTED GOING FORWARD IF IT IS APPROVED BY THE COMMISSION?

A. While the calculation of the percentage noted above was performed using historical data, uncollectible fuel expense to be charged to the PGA on a going forward basis will be determined using actual fuel expense included in the individual customer's bills that is deemed uncollectible, calculated using a methodology similar to that used in studying the historical periods noted. Additionally, the fuel proportion of write-offs (as calculated) will be applied to recoveries and account adjustments. The change would be implemented upon Commission approval and issuance of a final order in this proceeding.

Q. IF THE COMMISSION DOESN'T APPROVE THE COMPANY'S REQUESTED TREATMENT OF BAD DEBT EXPENSE, WILL AN

ADJUSTMENT TO O&M EXPENSE IN THE PROJECTED TEST YEAR BE REQUIRED?

A. Yes, it will. The Company included total projected bad debt expense in its calculation of base O&M expense for the projected test year and then removed the estimated portion of bad debt related to the PGA from projected test year O&M expense request by making a pro forma adjustment. If the Commission doesn't approve the Company's request, then the pro forma adjustment, a reduction to expense, should be eliminated. The resulting bad debt expense included for rate-making purposes would then be included as stated on MFR Schedule G-2, page 14.

Q. WHAT TREATMENT WAS ACCORDED OFF-SYSTEM SALES IN THE COMPANY'S LAST RATE PROCEEDING?

A. In Order No. PSC-03-0038-FOF-GU (Docket No. 020384-GU), the Commission ruled that "*for purposes of setting rates* in this docket, operating revenues should be increased by $500,000 in the projected test year" for off-system sales ("OSS") (emphasis added). Since the Company's original revenue projections for that filing included no amount of OSS, this level of $500,000 annually was set as a base level of OSS for purposes of setting rates. Additionally, the Commission changed the sharing mechanism whereby the Company would retain 25% of all "net revenues" from OSS from that time forward, while 75% of the net revenues were to be used to reduce the Company's cost of gas recovered through the PGA clause.

Q. WHAT AMOUNT OF OFF-SYSTEM SALES HAS BEEN

INCLUDED IN THE PROJECTED TEST YEAR REVENUES FOR RATE MAKING PURPOSES?

A. For purposes of this proceeding, the Company has included a base level of $500,000 of OSS net revenues to Peoples, consistent with the Commission's treatment of these revenues in our prior proceeding. The Company also proposes to retain the sharing mechanism in place since its last rate proceeding, with 25% of net revenues being retained by the Company and 75% going to offset expenses recovered through the PGA clause.

Q. HAS THE COMPANY BEEN SUCCESSFUL IN REALIZING A LARGER AMOUNT OF OFF-SYSTEM SALES THAN THIS REQUEST IN PRIOR YEARS? IF SO, WHY DOES THE COMPANY REQUEST THE SAME LEVEL AS IN THE PRIOR PROCEEDING?

A. Yes, Peoples has been successful in its OSS efforts, generating net revenues to the Company in excess of $500,000 annually. There are several reasons, however, why the Company is requesting the same treatment in this case.

The Commission was clear in its last order that the selected base level of sales was "for purposes of setting rates." This was not presented as the Company's expected level of future OSS revenues. This $500,000 amount, while less than the Company has been able to generate in recent years, represents a significant reduction to revenue requirements in the rate proceeding while at the same time not excessively burdening the Company with an unreasonably high "hurdle" in future years.

In contemplating this issue, it is important to remember that these sales are sporadic, opportunistic transactions that are highly dependent on market conditions. Sales agreements are short-term, spot market type transactions that are non-recurring in nature. Market conditions drive these opportunities and will dictate the Company's opportunity to make future off-system sales. In fact, the Company has already started to see a decline in this market, with 2007 sales below the 2006 level. While the future direction of market conditions is difficult to predict, the Company expects continuing decline in this market.

Q. EARLIER IN YOUR TESTIMONY ABOUT "OTHER NOT TRENDED" O&M EXPENSE, YOU MENTIONED A LARGE INCREASE FOR PIPELINE INTEGRITY AND SYSTEM RELIABILITY COSTS. PLEASE EXPLAIN THOSE IN MORE DETAIL.

A. Yes, this increased expense level is included in account number 887 (Maintenance of Mains). In the historic base year, Peoples incurred expenses of approximately $250,000 for transmission pipeline integrity activities, and its budget for 2008 anticipated a similar level. A new rule is expected to be adopted, however, which will require a significantly larger level of expenses in 2009 and beyond related to distribution pipeline integrity activities. This has been factored into the Company's 2009 O&M expense budget. In total, costs included in account 887 for pipeline integrity management and system reliability requirements represent over $750,000 in the projected test year as compared to the $250,000 expended in the historic base year.

Q. PLEASE PROVIDE SOME BACKGROUND INFORMATION ON DISTRIBUTION PIPELINE INTEGRITY ACTIVITIES.

A. The federal Pipeline Safety Act of 2002 ushered in significant new requirements for transmission pipelines. While this new legislation had an impact on local distribution companies such as Peoples, the impact was limited by the relatively small proportion of pipelines within the LDC's system that are classified as "transmission" pipelines. Since that time, however, the U.S. Department of Transportation's Pipeline and Hazardous Materials Safety Administration ("PHMSA") has been studying the issue of distribution integrity management programs ("DIMP") with the intention of promulgating new regulatory requirements in this area as well. This review process has been long and deliberate, and during the deliberations, the Pipeline Inspection, Protection, Enforcement, and Safety Act of 2006 was passed by Congress and signed into law by President Bush (Public Law 109-468, the "PIPES Act"). The PIPES Act included a mandate that PHMSA require distribution system operators such as Peoples to implement integrity management programs and install excess flow valves ("EFVs") in all new or replaced residential gas service lines where operating conditions are suitable for available valves, beginning June 1, 2008.

PHMSA issued a notice of proposed rulemaking ("NOPR") with respect to DIMP requirements which was published in the *Federal Register* for June 25, 2008 (73 FR 36015). The proposed rule is expected to be finalized in about a year.

Based on input from various stakeholders – including representatives of the natural gas industry, state regulatory agencies, and the public – PHMSA's proposed rule for distribution integrity outlines seven steps that distribution companies must take. These steps are as follows:

1. Develop and implement a written integrity management plan.
2. Know your infrastructure.
3. Identify threats, both existing and of potential future importance.
4. Assess and prioritize risks.
5. Identify and implement appropriate measures to mitigate the risks.
6. Measure performance, monitor results and evaluate effectiveness of programs while making changes where needed.
7. Periodically report a limited set of performance measures to regulators.

The rules proposed by the NOPR also address the EFV installation requirement of the PIPES Act.

Q. HOW WILL THE NEW RULE IMPACT PEOPLES' O&M EXPENSES?

A. While the full impact of costs is not known with certainty, the Company has estimated various costs related to compliance with the new rule. Peoples anticipates that the costs of developing the Company's plan, preparing required documentation, and performing required risk assessments will represent approximately $250,000 in the 2009 projected test year. This estimate was based on industry data included in a study completed by the American Gas Association. It is anticipated that most or all of this work will be accomplished by the employment of outside contractors.

Q. IS THE TOTAL AMOUNT OF "OTHER NOT TRENDED" O&M EXPENSE FOR ACCOUNT 887 SPECIFICALLY RELATED TO THE NEW DIMP RULE NOTED ABOVE?

A. No, it is not. A portion of the expenses identified in the Company's projections represent costs required for system reliability purposes, and some of the costs are related to transmission pipeline integrity activities. Such costs, while not a result of the DIMP rule itself, are related in kind to the new DIMP costs and, as such, were combined with those costs for projecting O&M expenses for the 2009 projected test year. Included for additional system reliability is $50,000 for the assessment of voltage drops in the system. As requested by the Commission, the Company is separating its distribution systems into electrically-isolated sections in order to be able to be able to test for voltage drops on an ongoing basis.

In addition, approximately $450,000 of expense will be incurred in 2009 related to ongoing transmission pipeline integrity management activities. Specifically, Peoples is completing its final phase of compliance with the transmission integrity requirements by completing an examination of encased pipelines subject to the transmission rules.

Q. IS EVERY ITEM INCLUDED IN THIS OVER $750,000 IN O&M EXPENSE GOING TO RECUR ON AN ANNUAL BASIS?

A. No, not every item. Expenditures for certain of these items are required to be made every so many years. The Company has projected the costs related to these items on an ongoing annual basis through 2016. Using this analysis, the Company will incur an average O&M expense of nearly $720,000 every year related to these activities included in account 887. There are, of course, significant uncertainties in these cost projections for the future. Accordingly, Peoples feels that its request for approximately $750,000 for the 2009 projected test year is reasonable and warranted for rate-making purposes as this expense is expected to remain a significant issue on an ongoing basis. A summary of our analysis of these compliance expenses is attached to my testimony as Exhibit ___(JPH-4).

Q. HOW DID YOU DETERMINE PEOPLES' COST OF CAPITAL FOR THE PROJECTED TEST YEAR?

A. Schedule G-3, Page 2 shows a calculation of Peoples' cost of capital for the projected test year. Capital structure components were forecasted for 2009, and 13-month averages were developed for each item. To these amounts, certain adjustments were made in order to reconcile capital structure to rate base, and an overall cost of capital was derived. As shown on that schedule, the embedded cost of long-term debt for 2009 is 7.20%; the cost of short-term debt is 4.50%; and the costs of residential and commercial customer deposits are 6.00% and 7.00%, respectively. Deferred taxes and tax credits are shown at zero cost. Common equity is shown at a cost of 11.50% as provided for in the testimony of Dr. Donald Murry, the Company's external cost of capital witness. As shown on that schedule, when factoring in the above noted capital structure items at the appropriate proportions, the overall cost of capital for 2009 is projected to be 8.88%.

Q. HOW HAVE YOU TREATED OTHER COMPREHENSIVE INCOME ("OCI") AND THE RELATED DEFERRED TAX ASSET ("DTA") IN THE CALCULATION OF THE EMBEDDED COST OF LONG-TERM DEBT NOTED ABOVE?

A. As noted above and summarized on MFR Schedule G-3, Page 3, the Company's embedded cost of long-term debt is 7.20% for the projected test year. On this schedule, the Company has appropriately adjusted long-term debt balances for the amount of any unamortized debt issuing expenses as well as any unamortized debt discounts or premiums, which is standard practice for this Commission.

In addition, the Company has reflected unamortized OCI and related DTA as an adjustment to the long-term debt balances in calculating the embedded cost of long-term debt. These balances arose from the settlement of interest rate swaps ("hedges") placed in advance of a debt issuance that occurred in May 2008. The remaining balances in OCI and DTA related to these hedges will be amortized into interest expense over the life of the related debt. Accordingly, for purposes of calculating the embedded cost of long-term debt, the unamortized portion of OCI and DTA related to these hedges was treated as an adjustment to long-term debt in the same manner as would occur for debt issuing expenses, discounts, or premiums.

Q. HOW DID YOU RECONCILE CAPITAL STRUCTURE TO RATE BASE?

A. As required by the Commission, the Company reconciled its rate base to capital structure. In doing so, several adjustments were required in order to keep these two items in balance.

Initially, certain items are adjusted to specific capital structure items to which they are specifically related. These "specific adjustments" include unamortized debt discount and expense ("DD&E", an adjustment to long-term debt), dividends declared (an adjustment to equity), and property held for future use and non-utility adjustments to rate base (each a specific adjustment to equity). Also, there are two "reclassification" adjustments among capital structure items, including investment tax credits moving from equity to "tax credits" and OCI and the related DTA on settled hedges moving from equity to long-term debt. Since the OCI and related DTA are related to interest rate swaps on long-term debt issuances, it is appropriately reflected in long-term debt for capital structure purposes.

Two items required special treatment in the process of reconciling capital structure to rate base as they have an impact on accumulated deferred income taxes. Those items are the competitive rate adjustment receivable and unamortized rate case expense. In the case of these two adjustments, the Company first calculated an adjustment to deferred income taxes at the Company's effective tax rate, then applied the balance of the adjustment to capital structure on a pro rata basis.

Finally, the remaining items were adjusted to capital structure on a pro rata basis.

Q. WAS ANY CAPITAL STRUCTURE ADJUSTMENT TO DEFERRED TAXES NEEDED TO COMPLY WITH SPECIFIC

RULES UNDER THE INTERNAL REVENUE CODE?

A. Yes, there was a small adjustment made to deferred income taxes in the capital structure related to the fact that the Company is employing a projected test year in this rate proceeding. This adjustment was a reduction to accumulated deferred income taxes, and the offset to this amount was applied to investor sources of capital on a pro rata basis. The justification for this adjustment is described in detail in the testimony of Alan Felsenthal.

Q. IN MAKING PRO RATA ADJUSTMENTS TO THE CAPITAL STRUCTURE, DID YOU TREAT THE VARIOUS ADJUSTMENTS IN A MANNER CONSISTENT WITH THE TREATMENT RECEIVED IN THE COMPANY'S LAST RATE CASE?

A. Yes, except in the case of two adjustments. The two items for which different treatment was applied were acquisition adjustment and other accounts receivable.

Both of these capital structure adjustments were previously removed 100% from equity, which in our view is not appropriate. Peoples is aware that the Commission has typically removed "non-utility" items 100% from equity, and it has retained this treatment for true "non-utility" adjustments as previously noted. It is the Company's view, however, that these two items are *related to utility business* although they are not being booked "above the line" in the utility. Other accounts receivable represents primarily TECO Partners accounts receivable for things like gas appliance sales contracts. Clearly, these sales are ultimately made to increase gas usage or to assist in customer retention efforts. Similarly, the acquisition adjustment acquired in the purchase of West Florida Natural Gas that has been excluded from rate base represents an investment which is clearly related to the Company's core utility business. As such, these adjustments are more appropriately made on a pro rata basis over investor sources of capital.

In the Company's last rate order, the Commission required pro rata adjustments to be made over investor sources of capital, including common equity, preferred stock, short-term debt and long-term debt. In reconciling capital structure to rate base, Peoples has continued to apply this methodology, applying pro rata adjustments to investor sources of capital as noted (after identifying components of deferred taxes when appropriate). The reconciliation of the projected test year rate base to the projected test year capital structure is shown on Exhibit ___(JPH-5).

Q. WHAT ARE THE REVENUE REQUIREMENTS FOR THE PROJECTED TEST YEAR, AND WHAT DO THOSE REQUIREMENTS MEAN FOR PEOPLES' RATE OF RETURN ON EQUITY WITHOUT A GRANT OF THE RATE RELIEF SOUGHT IN THIS PROCEEDING?

A. The Company is seeking to adjust its rates in order to recover an overall cost of service of $196,394,217, which represents total revenue requirements. Absent the rate relief sought, projections for the 2009 projected test year show an overall rate of return of 6.02%, equating to a return on common equity ("ROE") of 5.61%. This ROE of 5.61% can be compared to the 11.25% midpoint ROE currently authorized by the Commission, and to the 11.50% midpoint ROE supported by Dr. Murry, and is not adequate to maintain the financial integrity of the Company. The calculation of the 5.61% ROE is shown on Exhibit ____(JPH-6).

Q. WHAT IS THE REVENUE DEFICIENCY PEOPLES' IS SEEKING TO RECOVER THROUGH THE ADJUSTED RATES FOR WHICH IT SEEKS THE COMMISSION'S APPROVAL?

A. As shown in MFR Schedule G-5, the Company's adjusted net operating income ("NOI") at current rates is projected to be $33,944,697 for the 2009 projected test year. When compared to the NOI requirements as filed in this proceeding for the same period, a NOI deficiency of $16,115,558 is calculated. Applying the expansion factor to this NOI deficiency amount results in a revenue deficiency of $26,488,091 for the projected test year.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. In my testimony, I presented a general overview of Peoples' case, and demonstrated that the O&M expense for the historic base year in this case is less than the applicable Commission benchmark for those expenses by $11,038,006, or 14.4%. I explained the Company's historic and projected test year rate base and O&M expenses, and described the budgeting and MFR processes used to develop those projections. I also explained the calculation of the Company's cost of capital for the projected test year, as well as factors and assumptions used in projecting rate base, O&M expenses and cost of capital in the 2009 projected test year.

I also offered testimony regarding the storm damage reserve for which Peoples seeks the Commission's approval, our proposal to change the accounting treatment of bad debt expense to record the fuel portion of uncollectible expense in the PGA rather than as a part of base rates, and the Company's position regarding the treatment of off-system sales for rate-making purposes.

Finally, I testified to the calculation of the revenue requirements of the Company, and the $26,488,091 revenue deficiency Peoples is seeking authority to recover through the new base rates proposed in this proceeding.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BY MR. WATSON:

Q. Mr. Higgins, did you also prepare and cause to be filed in this docket rebuttal testimony consisting of 31 pages?

A. Yes, I did.

Q. If I were to ask you the questions in your rebuttal testimony today, would your answers be the same?

A. Yes.

MR. WATSON: We would ask that Mr. Higgins' rebuttal testimony be inserted into the record as though read.

CHAIRMAN CARTER: Pursuant to the agreement during the preliminary statements, preliminary matters, the prefiled testimony of the witness will be inserted into the record as though read.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is J. Paul Higgins and my business address is 702 North Franklin Street, Tampa, Florida 33602.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Peoples Gas System ("Peoples" or the "Company") as Assistant Controller.

Q. ARE YOU THE SAME J. PAUL HIGGINS WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my rebuttal testimony is to address serious errors, shortcomings and improper conclusions reached in the prepared direct testimonies of Mr. Helmuth W. Schultz, III and Dr. J. Randall Woolridge, hired by the Office of Public Counsel ("OPC") and testifying on behalf of the Citizens of the State of Florida.

Q. PLEASE SUMMARIZE THE AREAS OF KEY CONCERN AND DISAGREEMENT YOU HAVE REGARDING THE SUBSTANCE OF THE TESTIMONIES OF MR. SCHULTZ AND DR. WOOLRIDGE.

A. Most of my areas of concern and disagreement relate to Mr. Schultz's testimony. However, I do take exception to Dr. Woolridge's testimony regarding the Company's short-term debt rate. Overall, my key concerns and disagreements relate to the following areas:

- Uncollectible Accounts Recovery Mechanism
- Incentive Compensation

- Stock Compensation
- Directors and Officers Insurance
- TECO Energy Allocated Expenses
- Marketing Expense
- Rate Case Expense
- Payroll Expense
- Storm Damage Reserve
- Employee Benefits Expense
- Short-Term Debt Rate
- Interest Synchronization and Income Taxes

Uncollectible Accounts Recovery Mechanism

Q. **MR. SCHULTZ CLAIMS THAT ALLOWING THE COMPANY'S REQUEST TO MOVE RECOVERY OF THE FUEL PORTION OF BAD DEBT EXPENSE TO THE PURCHASED GAS ADJUSTMENT ("PGA") WOULD RESULT IN A SOFTENING OF THE COMPANY'S EFFORTS TO COLLECT BAD DEBT. DOES THIS CLAIM HAVE ANY MERIT?**

A. No. Mr. Schultz's conclusion is incorrect and inconsistent with sound regulatory principles. Regardless of whether Peoples recovers the fuel portion of bad debt through base rates or through the PGA, the Company will continue as it always has to use all appropriate resources to recover the full amount of outstanding accounts receivable. As noted in my direct testimony, the Company's proposed pro forma adjustment to remove the fuel portion of bad debt expense from the O&M expense reflected in base rates represents 46% of total bad debt expense. For the projected test year, the adjustment to reflect the fuel portion of bad debt expense is $723,580. This leaves a remaining balance of $849,420 of the Company's O&M expense in base rates, or 54% of the total calculated expense. In my opinion, 54% of the expense represents a material expense to the Company for which ample motivation still remains to maintain its excellent history of collections.

Q. DO YOU AGREE WITH MR. SCHULTZ'S STATEMENT THAT THE PGA IS VIRTUALLY AN AUTOMATIC PASS THROUGH?

A. No. Florida has no automatic pass through clauses. The PGA mechanism is thoroughly audited every year by Commission staff. As such, all charges to the PGA are reviewed each year by the Commission, which has the authority to disallow expenses.

Q. HAS THE COMMISSION'S POLICY BEEN TO RECOVER ALL PRUDENTLY INCURRED GAS RELATED EXPENSES THROUGH THE PGA?

A. Yes, but the Commission has never addressed the recovery of the fuel cost portion of bad debt expense through the clause. Peoples believes recovery of the fuel cost portion of bad debt expense through the PGA would be consistent with the Commission's policy with respect to all other gas related costs. Mr. Schultz appears to never consider this policy.

Incentive Compensation

Q. MR. SCHULTZ COMPLAINS THAT THE COMPANY DID NOT PROVIDE SUFFICIENT INFORMATION IN THE DISCOVERY PROCESS IN ORDER TO EVALUATE THE INCENTIVE GOALS AND RELATED INCENTIVE COMPENSATION. HOW DO YOU

RESPOND TO THIS COMPLAINT?

A. I don't believe this is true. To date, of the more than 100,000 pages of documents the Company has produced as part of the discovery process, more than 41,000 pages have been copied for OPC and Commission Staff. Included in this production were a significant number of documents related to incentive compensation, especially those produced in response to OPC's First and Second Sets of Requests for Production of Documents (Nos. 35, 59, and 60) and OPC's First and Second Sets of Interrogatories (Nos. 22, 28, 41, 42, 43, 61 and 79). If this data was not sufficient for Mr. Schultz's needs, he could have and should have asked for additional detail. Despite having as much as two and a half months between the date of the Company's responses to discovery and the date of Mr. Schultz's testimony, the first I learned of this alleged incompleteness was in reading his filed testimony.

Q. **WHAT ADJUSTMENT IS MR. SCHULTZ PROPOSING REGARDING INCENTIVE COMPENSATION?**

A. In the face of what he claims was incomplete information with respect to the Company's incentive goals, Mr. Schultz has proposed to eliminate 100% of the Company's targeted 2009 incentive compensation.

Q. **DO YOU AGREE WITH MR. SCHULTZ'S PROPOSED ADJUSTMENT?**

A. No. Mr. Schultz does not adequately support this conclusion and his proposed adjustment is not appropriate.

Q. **PLEASE DESCRIBE PEOPLES' COMPENSATION PLAN.**

A. The Company targets total compensation at the market average when comparing external market data to similar Company positions. For all employees of Peoples, there are two parts of compensation – base salary, which is the fixed portion of total compensation, and short-term incentive, which is the cash portion of compensation that is "at risk". For officers and key employees, there is a third component of compensation, long-term incentive, which is the equity portion of total compensation.

The Company considers these multiple components to be key elements of its total rewards plan, which also includes other benefits such as health care and life insurance benefits. Each of these components plays an important role in enabling Peoples to remain competitive with other companies seeking to attract similarly qualified employees.

Q. PLEASE DESCRIBE HOW THE COMPANY'S SHORT-TERM INCENTIVE PROGRAMS WORK.

A. As I said, Peoples has three types of short-term incentive plans – an officer short-term incentive plan, a key employee short-term incentive plan, and a general employee short-term incentive plan known as "RSVP", or "Rewarding Service, Valuing Performance".

The officers' short-term incentive plan provides a consistent framework for applying annual incentive pay to officers of Peoples. Each participant is assigned a target award amount, expressed as a percentage of annual base salary. The target award levels are established at a level that, when combined with each participant's base salary, provides a competitive total cash compensation opportunity. The incentive portion reflects compensation "at risk" which is directly related to performance and results achieved. Performance is measured, in part, against a combination of quantifiable financial and operational goals. Each participant has a "business plan" goal which reflects the participant's contribution to achieving initiatives in support of the business plan and overcoming any business changes by mitigating the impact of unexpected adverse business developments or enhancing profitability through effective management initiatives beyond the business plan.

The key employee short-term incentive plan works virtually identically to the incentive plan for officers. As with officers, key employees have both financial and operational goals.

The general employee short-term incentive RSVP plan is available to all other employees working at least 20 hours per week. For 2008, the plan is comprised of customer service, safety, financial and individual performance goals. The target payout percentage is applied to the higher of the employee's total earnings or job market value for the calendar year.

The incentive plans put a portion of employees' compensation "at risk". This means that if performance goals are not met, the payout is not made. If certain performance results are achieved, a predictable award will be earned based upon objective criteria. The actual amount of the award depends upon the achieved results.

All of the incentive plans are designed to emphasize key operational and financial goals, link pay with business performance and personal contributions to results, motivate participants to achieve high levels of performance, and reinforce desired business behaviors and results. Incentive plans such as these encourage cost control and resource optimization, both of which benefit customers. While there is no empirical evidence to support it, the Company attributes its incentive plans to helping it manage costs for an extended period of time with only one base rate increase request and to its favorable performance under the Commission's O&M expense benchmark test.

Q. IS INCENTIVE PAY A KEY COMPONENT OF TOTAL COMPENSATION?

A. Yes, it is. The Company uses market data and benchmarking results to measure the competitiveness of its compensation. In a time when utilities are facing workforce challenges requiring numerous industry-wide initiatives, it is critical for Peoples to attract and retain talented individuals. Its total compensation plan, including incentive compensation, is designed to cost-effectively do so.

Q. HOW DOES THE COMPANY DETERMINE REASONABLE AND APPROPRIATE COMPENSATION LEVELS?

A. The Company uses market data and benchmarking results to measure the competitiveness of its compensation. For each Company position, it matches essential job functions to those found in external market surveys. These same surveys show that incentive compensation programs like Peoples' are common. Based on the *World at Work 2008/2009 Annual Salary Budget Survey*, over 80% of the 2,375 companies surveyed use an incentive pay program.

Incentive compensation plans are not new. In fact, Peoples' RSVP program has been in place for many years, and its appropriateness was not challenged by the Commission in the Company's last rate case in 2002. In the most recent Gulf Power Company ("Gulf") base rate proceeding

(Docket No. 010949-EI), Mr. Schultz filed testimony that recommended the removal of portions of incentive pay from O&M expense. The Commission disagreed and made no adjustment, noting that Gulf offers a plan consisting of base salary and incentive compensation and that only receiving a base salary would mean Gulf employees would be compensated below employees at other companies. While I am not familiar with the details of Gulf's plan, its utilization of market data appears to be similar to Peoples'. One apparent difference is that Gulf's philosophy is to pay employees at the 75th percentile while Peoples' is to target the market average.

Q. WOULD PEOPLES NEED TO CONSIDER RESTRUCTURING ITS TOTAL COMPENSATION PACKAGE IF ANY INCENTIVE COMPENSATION EXPENSES WERE EXCLUDED?

A. Yes. Peoples would consider redesigning its total compensation package, focused on decreasing or eliminating the "at risk" incentive compensation component. It is inappropriate to single out the incentive component of employees' total compensation just because it is called "incentive" compensation. Peoples' total compensation packages, including the portion that is contingent on achieving incentive goals, is set near the average level, which is the relevant level of cost that should be considered for ratemaking purposes. Accepting Mr. Schultz's recommendation to disallow incentive compensation would adversely affect the Company's ability to compete in attracting and retaining a high quality and skilled workforce. Otherwise, total compensation would be below the average for comparable jobs putting it at a competitive disadvantage.

It's also worth noting that using incentive compensation programs is less costly than increasing base salaries because incentive compensation is "at risk" and, by definition, not guaranteed. The "at risk" component motivates employees to perform at high levels and results in more efficiency, which translates to direct benefits for the Company's customers.

Q. **MR. SCHULTZ CLAIMS THAT THE COMPANY HAS FAILED TO SHOW THAT THE GOALS SET ARE REALISTIC GOALS. CAN YOU EXPLAIN THE GOAL SETTING PROCESS?**

A. Yes. But I must begin by saying Mr. Schultz completely misunderstands the term "incentive compensation." Goals are established each year to focus the organization on customer service, safety, financial and individual performance priorities. The goals are designed to be measurable and attainable but still represent a challenge to achieve. The goal-setting process includes a review of historical results and achievements, the challenges of the goal, and the applicability to the upcoming year's operational and financial objectives. The goals are set to have a reasonable chance of achievement while requiring efforts that challenge the organization's employees and balance the cost to provide targeted levels of service. The goals have been appropriately set and have helped Peoples accomplish overall operational and financial successes over the years. The goal-setting process is not taken lightly by the Company and there are numerous factors that go into setting goals and targets each year, including consideration of past achievements, organizational changes, and system enhancements.

Q. WHAT DID YOU MEAN WHEN YOU SAID MR. SCHULTZ "COMPLETELY MISUNDERSTANDS" THE TERM "INCENTIVE COMPENSATION"?

A. My statement might best be explained by an example, since the total compensation of each Peoples employee is established at the market average for similar positions in order for Peoples to be competitive in acquiring capable employees.

Assume the total market-based annual compensation for a particular position is $100. For non-key and non-officer employees, this $100 might be broken down into a base salary of $95 and an "incentive" component of $5. In order to be paid the $5, the employee must achieve certain goals. If the goals are not achieved to the extent required, the Company doesn't pay the full $5 to the employee, and the employee is therefore compensated for the year at less than the market average for his or her position. If the goals (whatever they may be) are achieved, the employee is paid the $5 "incentive" and is compensated at the market average for his or her position.

Peoples could just as easily change its compensation program and pay the employee in the example a base salary of $100, establish no goals beneficial to the Company's business plans or customer satisfaction, and "go its merry way." There would therefore be no "incentive" compensation, and nothing for Mr. Schultz to question. It should "go without saying" that an employee who failed to perform – whether under an "incentive" plan or a market-based program in which his or her total compensation was all base salary – would be terminated.

Q. **PLEASE PROVIDE ADDITIONAL DETAIL REGARDING GOALS FOR OFFICERS AND KEY EMPLOYEES.**

A. While much of what I have just described is applicable to all employees, including officers and key employees, there are some differences with respect to these latter groups of employees. For 2008, Peoples' officers' short-term incentive plan consisted of 40% operational goals, 40% financial goals focused on Peoples Gas' net income and 20% focused on TECO Energy financial results. For key employees, 50% of their goals were operational, 35% tied to Peoples Gas' net income, and the remaining 15% focused on TECO Energy's financial results.

Q. **IS INCENTIVE COMPENSATION APPROPRIATE TO INCLUDE IN THE COMPANY'S O&M EXPENSE FOR PURPOSES OF THIS PROCEEDING?**

A. Yes. The overall focus of both the officer and key employee programs is on Peoples' operational and financial results. Participants in these plans help ensure the Company's goal of providing customers with safe and reliable service is achieved. The participants also focus on ensuring an adequate return to shareholders. Both of these objectives benefit ratepayers. The first directly benefits ratepayers who rely on natural gas service to meet their energy needs, and the second indirectly benefits ratepayers by having a Company that is able to attract needed capital at a reasonable cost to provide safe and reliable service.

Q. **MR. SCHULTZ SUGGESTS DENYING THE ENTIRE AMOUNT OF INCENTIVE COMPENSATION FOR PURPOSES OF THIS PROCEEDING. IS THAT RECOMMENDATION APPROPRIATE?**

A. Absolutely not. There is no basis for any adjustment to "incentive" compensation, and Mr. Schultz has provided no study, assertion, guess or any other evidence to even suggest that the Company's paying its employees total compensation at the market average for comparable positions is either imprudent or unreasonable. Certainly, he suggests no alternative method of determining how they should be paid for the work they perform for the Company, or how the prudency or reasonableness of their compensation should be judged.

"Incentive" compensation is simply a portion of Peoples' employees' total market-based compensation that may or may not be paid, depending on whether or not certain goals are, or are not, achieved. As described in detail above and as documented in the Company's answers to interrogatories and requests for production of documents throughout the discovery process, the Company's short-term incentive compensation program is part of an overall total compensation package and is heavily weighted toward providing benefits to customers. The goals promote safety, reliable service, cost containment and the financial soundness of Peoples. The entire expense should be allowed because it is designed to achieve favorable customer results. Whatever the goals to be achieved may be, Peoples believes – as do numerous other companies – that making a portion of its employees' total market-based compensation contingent on meeting such goals is beneficial not only to the Company, but to its customers.

Stock Compensation

Q. MR. SCHULTZ CHARACTERIZES RESTRICTED STOCK

GRANTS AND STOCK OPTIONS AS "EXCESSIVE COMPENSATION THAT SHOULD NOT BE PAID FOR WITH RATEPAYER FUNDS". DO YOU AGREE WITH THIS CHARACTERIZATION?

A. No, I do not, and his proposal to remove 100% of this expense from the Company's request is not appropriate. Mr. Schultz has provided no analysis, market benchmarks, or other data to support his recommended adjustment. Simply characterizing these elements of compensation as "excessive" and making a few inflammatory statements about them is not sufficient evidence to warrant excluding the entire amount from the Company's O&M expense, which is already below the Commission's benchmark.

Q. PLEASE DESCRIBE THE COMPANY'S LONG-TERM INCENTIVE COMPENSATION PLAN.

A. The Company's long-term incentive plan is another component of officers' and key employees' total compensation package. Through stock awards, the Company's plan is designed to reward long-term Company and individual successes and, as such, it is used as a retention tool. For eligible employees, the Company awards a mix of 70% performance and 30% time-vested restricted shares based on an annual market review conducted by outside consultants that compares the value of the grants to salary levels to determine the appropriate award amounts. The Company's performance must be strong and employees must remain employed by the Company for the duration of the vesting period to be eligible for any payout.

For performance restricted shares, the Company's performance is measured against a set of peer companies. The performance measurement period is three years and the award (ranging from zero to 150% of the grant amount) depends on the Company's total return as compared to other peer companies.

Unlike performance restricted shares, time-vested restricted shares are not measured against TECO Energy total shareholder return but are used solely as a retention tool. The eligible employee must be employed at the end of a three-year vesting period in order to receive payment of these shares.

Like the incentive plans discussed at length earlier in my testimony, the long-term incentive program is part of Peoples' total compensation package and it specifically allows the Company to retain some of its key talent. All aspects of these plans are market-based and benefit ratepayers and shareholders alike. Accordingly, the associated costs are appropriately included in the Company's cost of service. Mr. Schultz has offered no evidence to suggest that any portion of these costs is unreasonable, imprudently incurred, or not in the best interests of either the Company or its customers.

Q. MR. SCHULTZ ALSO INDICATES THAT EQUITY COMPENSATION INCREASES THE DISPARITY BETWEEN THE GENERAL EMPLOYEE POPULATION AND MANAGEMENT, AND THAT THIS BENEFIT IS ESPECIALLY EXCESSIVE GIVEN THE CURRENT ECONOMY. HE ALSO NOTES THAT VERY FEW OF THE COMPANY'S RATEPAYERS

HAVE THESE BENEFITS AVAILABLE TO THEM. HOW DO YOU RESPOND TO THESE STATEMENTS?

A. Mr. Schultz's comments, besides being unsupported, are not relevant in determining whether these expenses are appropriate for the particular level of employee and his or her role in the Company's management. What is relevant are the points I have previously made with respect to the benefits required to attract and retain high-quality individuals who are motivated to make good decisions for both the Company and its ratepayers. Finally, while the current economy might eventually impact comparable job market values, it would have no impact on the "at-risk" payment rationale for the Company's incentive compensation plan.

Directors and Officers Insurance

Q. **WHAT ARE MR. SCHULTZ'S COMPLAINTS WITH RESPECT TO DIRECTORS AND OFFICERS ("D&O") INSURANCE EXPENSE?**

A. Mr. Schultz argues, in a somewhat circular manner, that D&O insurance should be the responsibility of shareholders and that the expense should not be borne by the ratepayers. Without any market studies or information supporting his claim, he also states that compensation and benefit packages provided to officers and directors are sufficient to provide remuneration for their services, and that D&O insurance represents an incremental expense that is, therefore, not required to attract and retain qualified individuals to serve in these valuable roles. Finally, Mr. Schultz states that if the Commission finds justification for the ratepayers to share in this expense, it should arbitrarily base it on the 2003 expense level rather than the 2009 expected expense level.

Q. SHOULD D&O INSURANCE BE TREATED ANY DIFFERENTLY THAN OTHER INSURANCE?

A. No. D&O insurance is a cost of doing business that is every bit as essential as traditional property and casualty insurance. D&O insurance is clearly a necessary part of conducting business for any large corporation. In light of the growing risk exposures related to corporate governance, it would be impossible to attract and retain highly qualified directors and officers without the protections afforded by a D&O insurance program. Corporate surveys indicate that virtually all publicly traded entities maintain D&O insurance. It is a necessary and prudent cost of providing gas service to customers and is appropriately included in the Company's determination of revenue requirements in this case.

Q. DO YOU AGREE WITH MR. SCHULTZ'S ASSERTION THAT D&O INSURANCE PROVIDES NO BENEFIT TO RATEPAYERS?

A. No. To the contrary, it is highly unlikely that Peoples and its affiliated companies would be able to obtain capable directors and officers if it did not maintain D&O liability coverage. D&O insurance enables the Company to assemble a highly qualified team of directors and officers to manage and oversee the conduct of its business. Furthermore, it provides a significant source of balance sheet protection from losses from lawsuits, thereby safeguarding the utility from financial stress and preserving capital for uses that ensure the efficient and continuing delivery of gas service to customers. In my opinion, it would be imprudent for Peoples not to have D&O coverage, and I am not personally aware that this

Commission has ever disallowed D&O insurance premiums as an expense for ratemaking purposes.

Q. WHAT HAS HAPPENED IN THE D&O INSURANCE MARKET IN THE PAST FEW YEARS THAT HAS IMPACTED COSTS?

A. D&O insurance premiums fluctuate as a result of some of the same market forces that impact the premiums for property, liability, workers' compensation, and other insurance policies. The D&O insurance market rapidly shifted from a very "soft" pricing environment in the late 1990's into a difficult or "hard" market in the early 2000's. The primary drivers for the significant change in market conditions included the negative claims experience of D&O insurance underwriters resulting from the "dot com" stock market bubble, the negative influence of the September 11th terrorist attacks on the entire insurance market, increasing and significant claim activity related to companies such as Enron, and a general increase in attention and scrutiny surrounding corporate governance, including the passage of Sarbanes-Oxley legislation. A significant contraction in the availability of, and an increase in the pricing for, D&O insurance is directly attributable to these factors.

Since 2007, Peoples' premiums have stabilized to a point that represents the current "market" pricing level for D&O insurance but the Company anticipates that it will be challenging to sustain the pricing included in its 2009 budget forecast due to the negative insurance market influences that are expected given the current financial market distress.

Q. PLEASE COMMENT ON MR. SCHULTZ'S STATEMENT THAT IF THE COMMISSION DETERMINES THERE IS SOME

RATEPAYER BENEFIT TO D&O INSURANCE, IT SHOULD LIMIT THE EXPENSE LEVEL TO THE 2003 EXPENSE AMOUNT.

A. This position is arbitrary and totally inappropriate. Mr. Schultz has arbitrarily chosen a year simply because it reflects an expense level lower than the amount requested. Interestingly, he ignores the fact that the test year expense is actually less than the Company's 2007 and 2008 amounts. The 2009 projected expense is reasonable and prudent, not because of its relationship to historical levels that happen to be favorable, but because it is a well-supported projection of the cost of this type of insurance based on expected market conditions.

Q. WHAT OTHER DIFFICULTY EXISTS WITH RESPECT TO MR. SCHULTZ'S PROPOSED ELIMINATION OF $342,000 OF EXPENSE RELATED TO D&O INSURANCE?

A. In addition to the previously mentioned reasons Mr. Schultz's adjustment is not appropriate, he has mistakenly proposed to eliminate D&O insurance expense twice. That is, he has "double dipped" in his attempt to reduce the Company's projected expenses.

Q. PLEASE EXPLAIN MR. SCHULTZ'S "DOUBLE DIP" ERROR.

A. In the Company's books and records, the full amount of D&O insurance expense is included in the TECO Energy allocation of its general and administrative ("G&A") expenses; that is, the Company incurs no direct expense for D&O insurance. Mr. Schultz proposed elimination of this expense based on the Company's response to an interrogatory, not based on a review of its books and records, and apparently assumed the expense was one incurred directly by Peoples, rather than indirectly via the TECO Energy G&A expense allocation. Separately, as discussed below and as shown on Schedule C-8 of his Exhibit HWS-1, Mr. Schultz proposed an adjustment of $1.26 million to eliminate three specific items included in TECO Energy's G&A allocation, including approximately $337,000 for D&O insurance. As I have previously testified, the Company does not agree that any adjustment to remove D&O insurance expense is appropriate. Additionally, in proposing two separate adjustments, Mr. Schultz would have the Commission remove the Company's D&O insurance expense twice.

TECO Energy Allocated Expenses

Q. DO YOU AGREE WITH MR. SCHULTZ'S PROPOSED $1.26 MILLION ADJUSTMENT TO TECO ENERGY ALLOCATED EXPENSES?

A. No. Mr. Schultz has recommended exclusion of TECO Energy's allocated expenses for incentive compensation, restricted stock grants and stock options, and D&O insurance for the same reasons he is recommending a disallowance for Peoples. To his credit, Mr. Schultz recognizes that the expense levels allocated from TECO Energy included in the projected test year are lower than in the historic base year, and he reduces his proposed adjustment on a pro rata basis. As stated earlier, however, there is no basis for his recommended adjustments and they are not appropriate.

Marketing Expense

Q. WHAT DOES MR. SCHULTZ PROPOSE REGARDING THE COMPANY'S MARKETING EXPENSE?

A. Mr. Schultz proposes reducing the Company's expense level by $2 million. His adjustment, however, is based on a misunderstanding of the targets and related variable payment mechanism contained in the contract between Peoples and TECO Partners, Inc. ("TECO Partners"). He also displays a general lack of understanding of Peoples' natural gas business in proposing this adjustment. Mr. Schultz's recommended adjustment is arbitrary and without merit.

Q. PLEASE EXPLAIN MR. SCHULTZ'S MISUNDERSTANDING OF THE TECO PARTNERS CONTRACT.

A. Mr. Schultz bases his proposed adjustment on the difference between the contractual target of 12,000 new "signings" for 2009 and the net number of customer additions. He confuses gross customer additions with net customer additions. This accounts for most of the difference. Second, Mr. Schultz misunderstands the difference between "signings" and customer additions. Signings do not necessarily result in customer additions in the same year as the signing; a customer addition can lag the date of the signing for various reasons.

Q. CAN YOU GIVE EXAMPLES OF HOW ACTUAL CUSTOMER ADDITIONS CAN LAG THE DATE OF A SIGNING?

A. Yes. A development with 336 homes in Orlando was signed in March 2008 for gas service. Customers will begin receiving service over a period of years as the development builds out. However, no homes in the "signed" development began receiving service in 2008. Under the contract with TECO Partners, 336 customers would have been classified as "signings", but would not be deemed "new customers" until the year they begin taking natural gas service.

Another example is a restaurant signed in December 2007. The restaurant's construction was not scheduled to be completed for twelve to eighteen months and it was not deemed a customer until one or two years after the signing.

Q. **MR. SCHULTZ SEEMS CONCERNED THAT TECO PARTNERS COULD BE COMPENSATED BY PEOPLES EVEN IF CUSTOMER LEVELS WERE DECLINING. IS THIS CONCERN WARRANTED?**

A. No. Mr. Schultz's concern is apparently based on a misunderstanding of the depth and breadth of services provided by TECO Partners to Peoples under the contract. The contract is not simply one that reflects new sales efforts that add customers. While this is clearly one aspect of the services provided, there are many other areas of marketing and sales support services, including customer retention efforts, that are provided under the contract.

The marketing services provided by TECO Partners to Peoples have cost the Company less than when Peoples had its own marketing resources. As noted in my direct testimony, the Company's marketing costs compared to the Commission's benchmark amount for marketing expenses is a direct result of this contract. In fact, the projected expense for 2009 is significantly lower than the expense allowed by the Commission in the Company's last rate proceeding in 2002. Both the contract and the charges for which it provides are appropriate, and have provided Peoples' ratepayers with millions of dollars of savings over the years. No amount of adjustment is warranted with respect to the Company's marketing contract with TECO Partners.

Rate Case Expense

Q. **MR. SCHULTZ ASSERTS THAT PEOPLES' RATE CASE EXPENSE IS EXCESSIVE. HE ARGUES THAT THE COMPANY'S EXISTING ACCOUNTING STAFF SHOULD HAVE BEEN ABLE TO HANDLE MORE TASKS INTERNALLY, AND THAT RATE CASE COSTS SHOULD BE LIMITED TO STATED CONTRACT AMOUNTS. DO YOU AGREE?**

A. No. Mr. Schultz makes a number of inaccurate assertions related to rate case expense. At this stage in this proceeding, I doubt any interested party would disagree that assembling the filing made by the Company requires resources that are incremental to Peoples' day-to-day business operations. Just as the intervenors have hired outside resources to assist in preparing their cases, Peoples has hired consultants to assist in case preparation and to serve as expert witnesses. The Company is staffed to handle ongoing, day-to-day responsibilities, and the additional workload of this rate filing required supplementing the existing team. For Peoples to do otherwise would result in increased cost to customers.

Q. **WHAT ADJUSTMENTS DOES MR. SCHULTZ PROPOSE REGARDING THE COMPANY'S RATE CASE EXPENSE AMOUNTS AND ARE THERE ANY PROBLEMS WITH HIS PROPOSALS?**

A. Mr. Schultz proposes adjustments to reflect the "bid" amounts in the Company's contracts with the service providers. In some cases, the differences he mentions are simply differences due to the amounts included in the filing being estimates of expenses which, although based on the contracts, may have been rounded for estimation purposes. More importantly, Mr. Schultz's proposed $37,000 reduction for Huron Consulting Group is not reflective of that contract bid, which was for professional services only and did not reflect out-of-pocket expenses that are reimbursable by the Company.

Q. WHAT ADJUSTMENT DOES MR. SCHULTZ PROPOSE WITH RESPECT TO THE SERVICES OF C. HOLDEN?

A. Mr. Holden was retained as a contractor on an "as needed" basis to supplement the Company's accounting staff. While the related fees are paid on an hourly basis, the Company was required to estimate the total expenses expected for Mr. Holden's work. Mr. Schultz arbitrarily says that the amount related to Mr. Holden's contract should be reduced by 50% "because the Company should have been handling more of the rate case internally". Mr. Schultz's statement is totally unsubstantiated and is not based on any understanding of the Company's staff size, its workload, any studies of the same, or any information other than his arbitrary and conclusory statement. To provide the detailed information required by the Company for this proceeding requires quality professionals to supplement Peoples' existing staff. Mr. Holden is familiar with the Company and its accounting systems and he provided quality services. It would be significantly more expensive for the Company to maintain the level of resources required to process such a case on a permanent basis so that the resources were in place for periodic rate filings. Mr. Schultz's proposed adjustment for Mr. Holden's services, as well as his comments about the services of Huron Consulting Group and others, is inappropriate and unsubstantiated.

Q. MR. SCHULTZ RECOMMENDS THAT RATE CASE EXPENSE BE AMORTIZED OVER FIVE YEARS RATHER THAN THREE AS PROPOSED BY THE COMPANY. DO YOU AGREE?

A. No. While it is difficult to predict when Peoples will file its next base rate case, I am relatively certain it will be sooner than five years. Three years is an appropriate amortization period for rate case expense and no adjustment should be made.

Payroll Expense

Q. WHAT DIFFICULTY DOES MR. SCHULTZ HAVE WITH THE COMPANY'S PAYROLL INCLUDED IN THE FILING AND WHAT ADJUSTMENT DOES HE PROPOSE?

A. Mr. Schultz has basically two issues with the proposed payroll expense included in the filing. First, he goes to great lengths in discussing a purported discrepancy between the Company's MFR filing and an interrogatory response. Second, he takes issue with the Commission's prescribed method of projecting O&M expense in gas rate cases.

Q. CAN YOU SHED SOME LIGHT ON THE FIRST ISSUE?

A. Yes. As discussed more fully in my direct testimony, the Company employed its typical budget methodology in preparing its forecast of 2009 O&M expenses, including payroll. This methodology projects costs on a resource basis (payroll, material and supplies, outside services, etc.). For purposes of the MFRs (specifically MFR Schedule G-2, pages 10-19), the

Company prepared the "FERC account trending" analysis prescribed by the Commission for gas company rate cases. Although historical data for the base year segregates payroll in this approach, there is really no way to compare specific detailed cost information between Peoples' budget methodology and the Commission's FERC account trending methodology. The only valid comparison between these two methods is at the "total O&M expense" level. In that regard, the Company reconciled total O&M expense using these two distinct methods with immaterial differences. I discussed this minor difference in my direct testimony and in my Exhibit ___ (JPH-2). In noting the apparent discrepancy between the MFRs and an interrogatory response with respect to payroll expense, Mr. Schultz is basically attempting to reconcile expenses at a resource level, and that comparison cannot be accurately performed.

Q. WHAT CAN YOU CONCLUDE FROM THE RECONCILIATION OF TOTAL O&M EXPENSE SHOWN IN EXHIBIT ___ (JPH-2)?

A. Based on that reconciliation, it is apparent that the two methods produce almost the same result. This is a strong indication that the O&M expense requested in the filing is reasonable, including the payroll expense included in the filing.

Q. CAN YOU ADDRESS FURTHER MR. SCHULTZ'S PROPOSED ADJUSTMENT TO ELIMINATE $210,199 OF PAYROLL EXPENSE FROM THE FILING?

A. Yes. Mr. Schultz takes issue with the Commission's prescribed approach for calculating O&M expense in natural gas utility rate cases. The Company followed this approach in presenting its O&M expense, but as noted above and in my direct testimony, it also utilized its usual budget methodology to calculate O&M expense for the projected test year. In a few instances, isolated new positions were included in the 2009 payroll budget. These are clearly limited and do not reflect a significant increase in expense. Mr. Schultz's blanket approach lacks merit and justification, and it does not consider the Company's reconciliation of total O&M expense that I included on Exhibit ___ (JPH-2).

Storm Damage Reserve

Q. WHAT PROBLEMS DOES MR. SCHULTZ CITE WITH RESPECT TO THE COMPANY'S PROPOSAL TO ESTABLISH A MODEST STORM DAMAGE RESERVE?

A. Mr. Schultz takes issue with the Company's proposal for two reasons. First, he says there is no evidence that a significant level of storms will occur and result in damage. Second, he takes issue with the Company's proposal of an unfunded reserve, stating that it's not appropriate that the Company recover these funds "cost free" from the rate payers and use them for any purpose desired.

Q. PLEASE DISCUSS THE FIRST ISSUE RAISED BY MR. SCHULTZ.

A. His first point is not backed up by any evidence in the record, including his own testimony. He states that only two years of the 10 years examined by the Company experienced abnormal levels of damages from storms. In my view, this fact strongly supports the Company's position of having a steady accrual for a storm damage reserve rather than being faced with periodic and potentially significant expenditures following a storm. Mr.

Schultz has presented nothing to support the denial of the Company's proposal; simply stating his assumption does not prove it. To subject Peoples' customers to burdensome surcharges for storm costs based on Mr. Schultz's optimistic assumption would be inappropriate.

Q. PLEASE DISCUSS HIS ISSUE REGARDING THE UNFUNDED NATURE OF THE REQUESTED RESERVE.

A. Unfunded reserves are common in the electric industry, at least in Florida. An unfunded reserve is more cost-effective and reduces rate base. The unfunded reserve allows Peoples to secure its credit lines and otherwise reduces overall capital needs (for the benefit of customers). Mr. Schultz's concerns regarding this issue are unfounded.

Q. PLEASE SUMMARIZE WHY IT IS BENEFICIAL FOR RATEPAYERS TO EMPLOY A STORM DAMAGE RESERVE AS REQUESTED IN THIS PROCEEDING.

A. There are several customer advantages to Peoples' having a reasonable storm damage reserve: costs are spread over a longer period of time, overall costs are lower in the long term, and rate shock is mitigated or avoided when a storm does hit. Peoples' proposed reserve is prudent and appropriate, the amount is reasonable, and no adjustment is warranted.

Employee Benefits Expense

Q. WHAT ADJUSTMENTS ARE PROPOSED BY MR. SCHULTZ RELATED TO CERTAIN EMPLOYEE-RELATED EXPENSES?

A. Mr. Schultz takes exception to two employee benefit expenses. His first adjustment, totaling approximately $8,400, is because the Company failed to adjust its regulatory adjustment in excluding certain costs from regulatory Net Operating Income by an inflation factor. While this adjustment is clearly not material to this proceeding, Mr. Schultz is correct.

Q. WHAT IS THE SECOND ASPECT OF MR. SCHULTZ'S PROPOSED EXPENSE REDUCTION IN THIS AREA?

A. Mr. Schultz takes exception to an additional $164,500 of costs related to new employee-related programs. He characterizes these items as "additional unjustified costs" and simply proposes an adjustment to remove the entire $164,500.

Q. ARE THESE COSTS "UNJUSTIFIED" AS CHARACTERIZED BY MR. SCHULTZ?

A. No. Mr. Schultz's own testimony describes the nature of these items. Other than his own characterization, Mr. Schultz provides no explanation as to why he believes these costs are unjustified other than the fact that they are new. As noted in my direct testimony, the Company's budget process for purposes of this rate proceeding included making a request to field and corporate managers with respect to any new prudent expenses anticipated in 2009. In the case of the costs in question, the Company's Human Resources area provided detailed information noting these additional employee costs.

Q. WHY IS MR. SCHULTZ'S PROPOSED ADJUSTMENT TO REMOVE THE $164,500 INAPPROPRIATE?

A. Mr. Schultz inappropriately picks and chooses certain categories of expenses that happen to be higher than specifically selected previous years and calls for reductions in test year expenses. He completely ignores all of the other categories of expenses that are lower than previous years. Blindly cutting certain expenses in isolation, without considering all other expenses and revenues for the test year, is one-sided and totally inappropriate.

Q. DO YOU HAVE SPECIFIC EXAMPLES WHERE THE COMPANY HAS PROJECTED A LOWER EXPENSE LEVEL FOR 2009 THAN IT ACTUALLY EXPERIENCED IN RECENT YEARS?

A. Yes, there are several such instances. In 2007, health care expense exceeded $4.0 million. For the 2009 projected test year, the Company included health care costs at $3.6 million. Additionally, pension expense, which was $2.1 million in 2007, is projected to be $1.7 million in 2009. Ironically, both of these items are recorded in account number 926, the same account number used for the employee-related expenses Mr. Schultz proposes be disallowed.

Q. HOW IS THIS RELATED TO MR. SCHULTZ'S PROPOSED ADJUSTMENT FOR EMPLOYEE-RELATED EXPENSES?

A. Ultimately, Mr. Schultz proposes an adjustment that results in 2009 expenses reverting back to the 2007 amounts. If 2009 expenses should be adjusted to match historical amounts, then in order to be fair, Mr. Schultz must make similar adjustments for expenses like health care and pension expenses. This targeted isolated approach is obviously unfair and imbalanced and should not be the basis for an adjustment to revenue requirements. In the end, none of these expense items should be adjusted. The expenses in question are based on reasonable and prudent cost projections based on the facts and circumstances that are expected to exist in the 2009 projected test year.

<u>Short-Term Debt Rate</u>

Q. **PLEASE ADDRESS THE DIFFERENCE BETWEEN DR. WOOLRIDGE'S PROPOSED COST OF SHORT-TERM DEBT COMPARED TO THE COMPANY'S.**

A. Because of the volatility and uncertainty surrounding short-term interest rates, the Company utilized average historical LIBOR rates in developing its proposed short-term interest rate of 4.5%. Dr. Woolridge bases his recommendation on the December 17, 2008 LIBOR rate. Current LIBOR rates are at historical lows reflecting the current turmoil in the financial markets. Rates have been extremely volatile and presumably will continue to be volatile for the foreseeable future. It is therefore prudent to use a historical average LIBOR rate as the Company proposes rather than a rate at a particular point in time as Dr. Woolridge has done to determine future short-term funding costs.

<u>Interest Synchronization and Income Taxes</u>

Q. **WHAT DOES MR. SCHULTZ RECOMMEND REGARDING THE ISSUES OF INTEREST SYNCHRONIZATION AND INCOME TAXES?**

A. Both of these items are "fallout" issues and the adjustments proposed by Mr. Schultz are necessary only if his other adjustments are accepted. Since the Company does not agree with any of these other adjustments, these fallout adjustments are not necessary.

<u>Summary of Rebuttal Testimony</u>

Q. **PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.**

A. I have delineated the concerns and disagreements regarding the substance of the testimonies of OPC witnesses Schultz and Woolridge. Their assertions contain a variety of points that are not accurate, not logical, not appropriate, and/or not in accordance with prior Commission practice. I have presented facts and information that support the Company's petition, the reasonableness and prudence of amounts and positions presented by Peoples, and the appropriateness of the revenue requirement contained in its filing.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

BY MR. WATSON:

Q. Mr. Higgins, please summarize your direct and rebuttal testimony.

A. Good afternoon, Commissioners. My direct testimony presents a general overview of Peoples' case and demonstrates that the O&M expense for the historic base year in this case is less than the Commission's benchmark for those expenses by $11 million or 14 percent. I explain the company's historic and projected test year rate base and O&M expense and describe the budgeting and MFR processes used to develop those projections. I also explain the calculation of the company's cost of capital for the projected test year, as well as factors and assumptions used in projecting rate base, O&M expenses, and cost of capital in the 2009 projected test year.

I also offer testimony regarding the appropriateness of establishing a storm damage reserve and our proposal to change the accounting treatment of bad debt expense to record the fuel portion of collectible expense in the purchased gas adjustment clause rather than as a part of base rates.

Finally, I testify to the calculation of the revenue requirements of the company and the $26.5 million revenue deficiency Peoples is seeking authority to recover through the new base rates and charges proposed in this proceeding.

The operating costs and investment amounts presented in our case are reasonable and prudent and represent the financial and operating circumstances the company will have at the time the proposed rates go into effect. The additional revenue requirement I support will allow the company an opportunity to earn a fair rate of return on the company's investments in property dedicated to public service. Without the rate relief the company seeks in this case, our return on equity in 2009 will be 5.6 percent, well below the bottom of our current authorized range.

My rebuttal testimony addresses the errors, improper conclusions, and inappropriate adjustments submitted in the direct testimonies of the intervenors, primarily those of OPC's witness, Mr. Schultz.

This concludes my summary.

MR. WATSON: We tender the witness for cross-examination.

CHAIRMAN CARTER: Thank you. Mr. McWhirter.

MR. McWHIRTER: I have no questions of Mr. Higgins.

CHAIRMAN CARTER: Mr. Rehwinkel.

MR. REHWINKEL: Thank you, Mr. Chairman.

CROSS-EXAMINATION

BY MR. REHWINKEL:

Q. Good afternoon, Mr. Higgins.

A. Good afternoon.

Q. Kind of to start with, would you be able to give me a good estimate of what 100 basis points on return on equity --

A. Yes.

Q. -- is worth?

A. Yes. It's approximately $4.5 million revenue requirements.

Q. Thank you. You wish I would stop there?

A. No, I'm ready.

Q. I know you are. Maybe others do.

Mr. Higgins, I would like to ask you about inflation and the CPI used in your test year projections.

A. Okay.

Q. And I would ask you if you could turn to MFR Schedule G-2, page 10 of 31, which I think is numbered page 242, for those who have that version.

A. Okay. I have it.

Q. Can you tell me how CPI-U is used in your test year projections, please?

A. Yes. That would be trend factor rate number

4, inflation only. The historic base year plus 1, 2008, shows 2.90 percent, and the projected test year of 2009 shows 2.10 percent. That's also used in some of the compound factors, for example -- well, I guess specifically number 3, which is customer growth and inflation.

Q. Okay. And these CPI-U numbers come from Moody's.com; is that right?

A. That's correct. That's where we got our forecast at the time we prepared the MFRs.

Q. Okay. The forecast; right?

A. Right.

Q. And as part of your Late-filed Deposition Exhibit Number 9, you provided an update to that Moody's.com forecast; correct?

A. That's correct.

Q. And that shows a lower inflation factor for 2009; correct?

A. It's a higher factor for 2008 and a lower factor for '09; that's correct.

Q. And you have made no adjustment to trended expenses for the updated 2009 inflation factor; is that right?

A. No, we did not, just as we did not make other changes for things like revenue declines or things like that that have happened since the time of the MFRs. So that's correct. We did not change that.

Q. There's not a direct linkage between changes in the CPI and revenue, is there?

A. I would say there's not a direct linkage, that's correct, but certainly the economic factors that have resulted in the revised CPI forecast for Moody's Economy.com are reflective of some of the same things that are impacting things like our commercial load, so I think that there's certainly an indirect link.

Q. In looking at these trend rates for the 2009 projected year, which is the second column, the payroll only amount or rate is 4 percent; right?

A. That's correct.

Q. Now, is that factor still accurate?

A. That factor has been revised. That was in my Late-filed Deposition Exhibit Number 7, so that reflects the changes in merit increases for 2009.

Q. Okay. Now, what is the total adjustment that -- well, let me ask it to you this way. As a result of that board action, have you revised your non-- or your payroll expense for 2009?

A. Yes, we did. We revised in Issue 28 approximately $253,000 related to Peoples Gas, and also in Issue 37 related to TECO Energy, to reflect those changes.

Q. Okay. And what was the total amount?

A. That was -- well, it was $253,300 related to Peoples and 26,500 from TECO.

Q. Okay. What inflation rate did you use for 2009 in the MFRs?

A. 2.1 percent.

Q. Okay. Isn't it correct that the Commission uses the CPI-U as a measure of inflation in their ratemaking process?

A. Yes, as it relates to -- a couple of different ways. I think there's the benchmark test that we look at CPI in terms of expenses in the benchmark test. And then in terms of projecting the expenses as shown here on MFR Schedule G-2, pages 10 to 19, they're also used to trend the historic base year O&M expenses.

Q. Do you have your Late-filed Deposition Exhibit Number 9 with you?

A. I do.

Q. Can you tell me what the current projection of CPI-U average inflation growth rate for 2009 is?

A. It's negative 1.1 percent.

Q. You originally projected for 2008 2.9 percent for CPI inflation growth rate, but the rate turned out to be 3.8 percent; is that right?

A. That's correct.

MR. REHWINKEL: Mr. Chairman, I have passed out an exhibit entitled "CBO Report: The Budget and Economic Outlook; Fiscal Years 2009-2019." I would ask that that be given a number for identification purposes.

CHAIRMAN CARTER: Commissioners, 96 for your records.

(Exhibit 96 was identified for the record.)

BY MR. REHWINKEL:

Q. Are you familiar with the Congressional Budget Office, Mr. Higgins?

A. Just in passing, not in intimate detail.

Q. Are you aware that they make fiscal projections?

A. It appears that they do.

Q. Could I ask you to turn to the preface of the report, which is the fifth page of the report?

A. I'm there.

Q. Would you agree that this report provides baseline projections for preparing the federal budget?

A. Subject to check. I mean, I've not reviewed this document.

Q. Okay. This report appears to be dated January of 2009. Do you see that?

A. Yes.

Q. Can you turn to page 2 of the report, please.

A. Okay. I think I'm --

Q. Do you see at the very bottom on the right-hand side what the Congressional Budget Office anticipates the increase in CPI-U will be for 2009 and 2010?

A. It appears -- are you looking three lines from the bottom?

Q. Yes.

A. Okay. It looks like, based on this report, they're looking at 2009, the CPI-U would be 0.1 percent increase.

Q. What about for 2010?

A. 2010, higher at 1.7. Actually --

Q. You would --

A. Go ahead.

Q. Go ahead.

A. I was just going to say that the Moody's Economy.com shows 2.7 for 2010. Obviously, different forecasts.

Q. Yes. Mr. Higgins, can you tell me why the company does not feel it's appropriate to use a lower inflation factor for 2009 again?

A. Well, I think if you're going to look in retrospect, you know, first of all, you would have to look at 2008, which had the 3.8 percent increase versus the 2.9. So you would have a higher factor in '08 and then a lower factor in '09.

We did -- I did actually specifically take a look at O&M expenses within the last few weeks to see what changes, if any, we might have. Obviously, we've already spoken about the payroll changes, which have been agreed to, frankly, by the company.

We kind of do our budget -- as I explained in my direct testimony, we do our budget on a resource basis, not on this trending basis that's presented in the MFRs. But when I looked at it, there were certain things that -- we probably would have reduced expenses, but then there was a large item which would be significantly increased. That was pension expense. So all in all, our total expenses that I was projecting for '09 didn't substantially change.

Now, again, I'm talking about the way we look at it in terms of the resource basis. Obviously, you could look at it that way in hindsight and say, "Well, they prepared the MFRs this way. We've got to look at the 2009 factor and adjust it." But again, I'll point to the fact that at some point, you stop, and you've got to prepare the case, prepare the MFRs, prepare the testimony and submit it and go through the process. And if we were going to correct for certain things that have changed over that time, I mean, in fairness to all parties, you would have to look at all sides of it, and that would reflect revenues changes as well as expense changes.

Q. In this case, you have acknowledged that an adjustment is warranted for the payroll amount; is that right?

A. That's correct. And that's known knowledge at this point. That's correct.

I'll point out just one thing, if I could expand on CPI-U. I've got in my Late-filed Deposition Exhibit Number 9 -- on page 2 of 2, you can see there's -- this comes out, this forecast data comes out on a monthly basis. And as near as two months ago in November, there was an forecast of 1.2 percent for 2009, and four months ago in September, it was 2.4. So the month-to-month point estimate in CPI-U forecasted can change rather dramatically on a month-to-month basis. So we don't know -- two or three months from now, we may be looking at different data, so it's hard to say, "Well, it's negative 1.1, and that's what we should plug in."

Q. It's all a matter of guesstimation; correct?

A. Economic forecasts, right.

MR. REHWINKEL: Mr. Chairman, I have passed out an exhibit I would ask be marked as an exhibit for identification purposes, and this is Late-filed Deposition Exhibit Number 9, Higgins, and Inflation Adjustment Calculations.

CHAIRMAN CARTER: Okay. For the record, Commissioners, that will be Number 97.

(Exhibit 97 was marked for identification.)

BY MR. REHWINKEL:

Q. Mr. Higgins, what I have passed out to you is a 10-page exhibit, and the first two pages are your Late-filed Deposition Exhibit Number 9. And I'm going to represent to you that the next three pages take the other trended amounts from MFR Schedule G-2 and just change the inflation impact in there based on a couple of scenarios, and I would like to ask you about that. Would you accept, subject to check, that these amounts in this document are accurate representations of MFR G-2 as shown in the source?

A. Subject to check, yes.

Q. Okay. Would you agree that if you take those dollars and you apply an inflation factor -- well, let's look at the first scenario following your Late-filed Deposition Exhibit Number 9, up in the upper left-hand corner where it says zero percent increase for 2009.

A. Okay.

Q. Does it look reasonable to you that if you make that adjustment, the expenses for 2009 would decrease $218,723?

A. Can I ask a clarifying question?

Q. Yes.

A. What does this assume for 2008?

Q. This does not change 2008.

A. It leaves it as filed in the MFRs?

Q. Correct.

A. Okay. Yes, the change actually looks reasonable based on some similar calculations that I made.

Q. Okay. Now, if I look at -- turn to the -- to two pages beyond that, where it says actual 2008 and reprojected zero percent increase for 2009. Do you see that?

A. Yes.

Q. Now, this one, I will represent to you, updates 2008 for the 3.8 number that's included in your Late-filed Number 9 and then uses zero percent for 2009. Does that $130,000 negative impact look reasonable to you?

A. Yes.

Q. From a mathematical standpoint?

A. Yes.

Q. Now, on the page before that, where it says actual 2008 and reprojected percent increase for 2009, if you look -- this, I represent to you, changes the CPI-U for 2008 to 3.8 percent and then uses the negative 1.1 updated 2009 factor from your Late-filed Number 9. Do you see that?

A. Yes, I see it.

Q. And that yields an impact on expenses of 245,164. Does that mathematically look correct?

A. That looks reasonable, yes.

Q. Okay. Of these three scenarios, are any of them ones that you would find to be reasonable from a ratemaking standpoint?

A. Again, I guess I'm hesitating, going back to what I said on the negative 1.1, and three or four months ago they were looking at a higher rate. So I -- you know, I think it is somewhat of a crap shoot in terms of what do you pick for 2009. I mean, the 3.8 is a known quantity for 2008. 2009 could be zero. It could be negative 1.1.

I mean, there's a lot of stimulus dollars placed in the economy. I don't know how fast that's going to factor in, but I think the longer term -- and Dr. Murry is a better expert on this, but the longer term expectation is that that could have inflationary pressures on the economy.

Now, will that happen in 2009? I don't know, and I'm not an economist. But again, I guess my premise would be that without going back to change other factors as filed, I think I would prefer to look at the as-filed projections.

Q. I understand. Thank you.

Let's turn now away from the inflation issue to incentive compensation. Is it correct that for the test year, you have $2.7 million of incentive compensation budgeted?

A. Yes.

Q. And you have proposed no type of change to that type of compensation or amount for the test year; is that right?

A. No, we have proposed no change.

Q. Isn't it correct that the purpose of incentive compensation is to incent employee behavior to accomplish one or more company objectives?

A. I would agree with that.

Q. And one way to do that is to set goals and then pay additional compensation when those goals have been accomplished; correct?

A. Well, I guess I would question your characterization of additional compensation. You know, as we pointed out in my rebuttal testimony fairly clearly, what the company attempts to do is pay the positions at market average, and we simply have a strategy that reflects the payment of a portion of that as fixed and a portion as variable.

So when you characterize it as additional compensation, you're characterizing it as such as the -- as it's on top of what would be maybe, let's say, a market average, whereas what our approach is is to pay the market average portion -- a portion of that as fixed, as base, and a portion as variable, the total of which is the market average.

Q. So if I change the question to ask you, one way to do that is to set goals and then pay incentive compensation when those goals have been accomplished, you would agree?

A. State it again. I'm sorry.

Q. If I just changed the word "additional" to "incentive."

A. One way to do what, though? I'm sorry, Charles.

Q. Okay. I'll move on.

A. I'm sorry.

Q. That's okay.

A. I'm just trying to follow you, and I'm -- yes.

Q. Under the approach that we've been discussing, you put some compensation at risk, so to speak.

A. Right.

Q. And as the theory goes, the employee works harder to achieve the goals and earn the incentive; is that right?

A. That's correct. I believe that's our approach.

Q. That's the theory that you described?

A. Right, right.

Q. Now, you did not at any time when you implemented incentive compensation lower salaries in order to put compensation at risk, did you?

A. I'm not aware of, frankly, the answer to that question, but I know that incentive comp has been around at the company since I've been here for 16 years, so that would have been sometime in the early '90s at the earliest when that was implemented. And really, I'm not sure of the answer.

Q. Now, under the Peoples incentive plans, there have been instances where payments were made to employees even though the goals that were set out at the beginning of the year were missed; is that right?

A. Sometimes the way it works is that there's a partial payment. In other words, if it's not fully achieved, there would be a reduction in the payment, but they would get a partial payment as calculated.

Q. And other times, the goals were lowered in subsequent years, even when the same goals had been achieved in prior years; is that right?

A. I am not aware of specifics on that. I mean, the goals get revisited and reset every year.

Q. You're not saying that couldn't have happened?

A. No. That could have happened. I mean, there are times when it's appropriate, for whatever reason, to change the goals.

Q. Even when they have been achieved?

A. It depends -- yes. It depends on what's going on in terms of internally within the company. There could be reorganizational changes, for example, structure changes in personnel that would result in perhaps a revisiting of the goal.

Q. Okay. Since 2003, no eligible employee, numbering between 550 and 618 over that period of time, at Peoples Gas have completed a work year without receiving at least some incentive compensation; is that right?

A. That's correct.

Q. Now, you believe that there should be no change to your incentive compensation plan; correct?

A. Correct.

Q. And in Staff Interrogatory Number 108, you have stated that the rationale for compensation plans such as Peoples' is simply not affected by the current economic conditions; isn't that correct?

A. Just one second while I look through here.

Q. Sure.

A. I think I have it. Yes. I think what it states there is that the rationale for this type of structure doesn't change with the economy. I tried to be explicit in the deposition, but -- in other words, the rationale is that we're trying to pay a market average, a portion of which in a fixed piece and a portion in a variable piece.

So the economy doesn't necessarily -- the economy could change the market average. That's what it could change. What it doesn't necessarily change is how you pay that. Do you pay it all as base and fixed, you know, without regard to any goals, or do you pay a portion of it as fixed and a portion of it as variable? That's the philosophy that I'm stating that doesn't change with the economy.

Q. Okay. Isn't it true that large, well-respected companies all over the country are curtailing or considering curtailing these very types of incentive compensation plans?

A. Again, I mean, I think there's a lot of things happening across the economy, and that would include wage freezes or reduced increases, or even reductions or layoffs. All of that is being reported in the press.

Again, whether or not -- I mean, I think it would be shortsighted to change your compensation plan and just put everybody's pay in base just because the incentive -- now, if you wanted to reduce their pay, you wanted to do that and basically implement a pay reduction across everyone, that would be something that -- and I'm sure there are some companies that have done that, or just simply eliminated employees' positions.

Q. Your goal in your compensation plans is to be competitive in the marketplace; is that right?

A. That's correct.

Q. Are you familiar with Mercer?

A. That's one of the sources we would look at, yes.

Q. What about WorldatWork.org?

A. Yes.

Q. How about Empsight International, E-m-p-s-i-g-h-t?

A. Not specifically, no.

Q. Okay. How about Hewitt?

A. Hewitt, yes.

Q. What about Tower Perrin?

A. Yes, Towers Perrin.

Q. Haven't these respected compensation experts reported recently about a growing trend of large corporations cutting compensation, freezing salaries, and limiting bonuses?

A. I'm not aware of that. I mean, I'm not aware of those reports.

Q. You have not -- you haven't done any research or --

A. No. I'm covering the --

Q. Since the filing of the --

A. I'm not in the HR area. I'm in the accounting area. I mean, I'm sponsoring the payroll and the HR for this case, I'm not in the HR area per se.

Q. Would you have any reason to doubt that these compensation experts are reporting on a growing trend of large corporations cutting compensation, freezing salaries, and limiting bonuses?

A. I mean, I guess I would want to look at the reports before I characterized anything. Again, we did make that adjustment that we spoke of earlier to our 2009 increases, which reflected also a zero percent increase for officers, which was noted, I know, in the Tampa Electric case.

MR. REHWINKEL: Mr. Chairman, at this time I would like to pass out an exhibit for identification and have it numbered for identification purposes. And it's entitled "Articles on Compensation."

CHAIRMAN CARTER: Commissioners, for your record, this will be Exhibit 98.

MR. REHWINKEL: It's a 27-page exhibit.

(Exhibit 98 was marked for identification.)

BY MR. REHWINKEL:

Q. Mr. Higgins, can I ask you to turn to -- let me wait until your attorney has it.

Can I ask you to turn to the very first page of that exhibit? Do you see that this appears to be a printout of Mercer.ca report?

A. Yes, I see that.

Q. Can you read the first paragraph, first couple of paragraphs to yourself?

MR. WATSON: Mr. Chairman, I'm going to object at this point on two grounds: One, this is pure hearsay. Second, the witness has already explained that the TECO Energy companies, including Peoples Gas, have, as this headline on the first page of this exhibit says, frozen officers' salaries and trimmed the 2009 pay increases that were originally included in the filing, and we've given you the dollar effect of that, to reduce the revenue requirements we've applied for. So I'm not sure this is going anywhere at all. We've basically admitted what these articles apparently say. Of course, we haven't seen these 16 pages.

CHAIRMAN CARTER: Mr. Rehwinkel.

MR. REHWINKEL: Mr. Chairman, I appreciate Mr. Watson's objection. I was merely trying to test the witness's knowledge of the competitive marketplace to which he testifies. Certainly one of the backdrops of this case is the significant economic condition that we find ourselves in, and one of the issues in the case is whether compensation is justified under these existing conditions. And I was just trying to explore with the witness his understanding of the competitive marketplace that he testifies that Peoples competes in and bases their salaries on.

As to the hearsay nature of the objection, it's --

MR. WATSON: I'll withdraw the hearsay objection.

MR. REHWINKEL: I can move on from this particular article. I would just like to ask him if he's aware of any of the specific reports in here, and if he's not, he's certainly free to say that he's not.

CHAIRMAN CARTER: Hang on a second, because I think he has already said that.

Ms. Helton. Commissioner Skop. Before I rule, Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chairman. Just a question to the witness. I guess the rate case filing was for the historical base year ended 2007 and projected test year ending 2009; is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. And the date of the article that we're being asked to look at on page 1 of what has been marked for identification as Exhibit 98, do you see the date at the bottom right of that corner, or the bottom right of the page?

THE WITNESS: Yes.

COMMISSIONER SKOP: And could you please --

THE WITNESS: That's February 16, 2009.

COMMISSIONER SKOP: Okay. So if I understand the question correctly, this article indicates that some organizations have initiated salary freezes. Is that the nature of the article?

THE WITNESS: I'm sorry.

COMMISSIONER SKOP: As the article explains, one in four organizations has instituted a salary freeze for 2009 as a general --

THE WITNESS: Yes. I think that's right, yes.

COMMISSIONER SKOP: And would you agree that rate cases are, in terms of the test year, long-term, forward-looking exercises?

THE WITNESS: I would definitely agree with that, yes.

COMMISSIONER SKOP: So would it be fair to say that salary freezes would continue -- expect to be continued far into the history -- I mean far into the future?

THE WITNESS: I wouldn't expect that, no.

COMMISSIONER SKOP: Thank you.

CHAIRMAN CARTER: Ms. Helton.

MS. HELTON: I think that Mr. Felsenthal has testified or stated on the record that he is not an HR expert. But it's also my understanding from listening to the exchange between Mr. Rehwinkel and Mr. Felsenthal that he is the witness that's sponsoring the salary information for officers, so that puts us in a little bit of a bind. I think Mr. Rehwinkel also said he just had one more question about this particular exhibit. It seems to me that it would be reasonable to allow Mr. Rehwinkel to ask that question, and then we can move on.

CHAIRMAN CARTER: Mr. Rehwinkel.

MR. REHWINKEL: Thank you, Mr. Chairman. Does that mean I'm authorized to --

CHAIRMAN CARTER: Yes. You may proceed.

MR. REHWINKEL: Okay. Thank you. And Mr. Higgins is still Mr. Higgins.

MS. HELTON: I'm sorry. I got so caught up on saying his name right, I picked the wrong name.

THE WITNESS: Perhaps Mr. Felsenthal is listening to us.

MR. REHWINKEL: I understand. I think what the sheriff is doing down in Wakulla County is trying to get people to spell my name differently.

BY MR. REHWINKEL:

Q. I just would like for you to look through each of these articles and see if they report on any action or report by one of these respected organizations that you may be aware of after further reflection and review.

A. Well, I guess on the first one, on the Mercer article, it says executives -- just reading the headline, it says executives are less likely to get an increase than rank and file employees. I believe that's what our adjustment reflects.

The WorldatWork article actually has a positive comment. It says employers are still committed to rewarding employees, and our data shows 77 percent of employees can expect a pay raise, especially high performers.

I'm not familiar with the source here, Empsight.

Hewitt says most companies around the world are cutting 2009 salary budgets to help reduce costs. Again, our adjustment reflected that as well.

Towers Perrin indicates reductions. Towers Perrin says most companies are holding the line on salaries by cutting their 2009 merit increase budgets, which, again, that's what we did in the filing.

The Watson Wyatt article mentions cost cutting measures, including layoffs, hiring and salary freezes, and smaller pay raises.

Pay freezes spread in recession, and Florida unemployment rate rises.

So again, you know, I think -- and I try to look at the *Wall Street Journal* every day. I'm pretty aware of things that are going on. And, you know, again, I'll go back to the beginning, Mr. Rehwinkel, that, you know, we filed all the MFRs and did all our projections on the revenue side and expense side at a certain point in time. You stop, and you do all the discovery. I mean, if we wanted to revise certain expense projections, you know, we would have to go back and look at some of the revenue projections as well. And our indications are that if we did that, the revenue requirements -- I believe Mr. Cantrell spoke to this -- would actually be higher than those requested.

Q. Okay. Thank you. Moving away from Exhibit 98, would you agree that if companies with whom you compete in the labor market lower or freeze their benefits and Peoples makes no changes and pays incentive compensation at the level as projected, then you could well be above market in compensation?

A. I'm going to parse your question up a little bit. I apologize.

Q. That's okay.

A. The incentive comp I want to leave out of it, because, again, I was speaking of a way to pay market average, again, the philosophy being that a portion is fixed and a portion is variable, so that's where I said the philosophy doesn't change.

What could impact that is the market average, and that's to your point. So if the market average is such that the downturn is so profound that it reduces the market average and Peoples made no adjustments, then, yes, we could be paying then above the market average. But I wanted to leave the incentive comp out of it.

Q. Well, let me ask you this: Are market average salary comparisons done on a total cash compensation basis, or do they split out compensation based on at risk and not at risk?

A. The way we look at it is to pay the market average in those two components, at least two components. In the case of certain employees, it's three components. But that's the way we look at it. So the market average is figured out, and then we would pay base and incentive to that market average. That's the way that Peoples Gas does it. I'm not sure how the market averages per se, you know, are done in the data.

Q. Okay. But if the market comparison studies look at total cash compensation, that would also include any at-risk compensation that the subjects were paying; is that right?

A. I believe that's the case, yes.

Q. Okay. Moving to another area, in your deposition on pages 68 through 74, you testify about the inability to reconcile the total payroll amount identified in Interrogatory 61 with MFR G-2, page 19.

A. That's correct.

Q. Line 1; right?

A. Yes, subject to check. I don't have the deposition in front of me, but, yes, I did testify to that.

Q. Okay. You acknowledge that Mr. Schultz identified about $697,000 of payroll costs, in other words, dollars that were not trended and not related to new positions; is that right?

A. Yes, I acknowledge that he identified that in his testimony.

Q. The payroll dollars in G-2 are based on 2007 actual payroll; is that right?

A. That's correct.

Q. So you cannot tell the Commission what job functions the $697,000 specifically relate to, can you?

A. No. I think what I stated in the deposition was that the comparison that he was trying to make is, he's comparing two different types, two different types of forecasts. The way that we prepare budgets is on a resource basis, which would reflect payroll, materials and supplies, employee expenses, outside services, things of that nature. That's how we prepare the detailed budget.

The MFR presents them in a different fashion, on what we call a FERC account basis or a functional basis, and it has -- it does have payroll data split apart and then other payroll data, and that data is then trended on an account basis. So we did really both of those things in this case. We prepared our budget first the first way, and then we presented it the second way.

What I said in the deposition is that you can't really reconcile the data from a FERC account basis as presented in the MFRs to the resource basis, because there's some movement going on.

And I thought -- the example in the deposition I thought was pretty good. Whereas in one case, for example, one of our divisions in the '09 budget was forecasting to move meter reading services from an outside service to payroll dollars, so in the MFR, that wouldn't be on the payroll line. That would be on other -- non-payroll, other trended lines, whereas in the budget data, that would be in payroll. So it's very difficult, and there's movement like that.

And frankly, there's a lot of movement in payroll as well, and it depends on when you sit down and prepare it, because we do it on an individual person basis, and there's movement, there's vacancies, there's in-and-outs, there's additional positions sometimes, not many in this case. But at any rate, that's what I said. So you can't perform that reconciliation accurately.

But what we did do, and that was shown in my exhibit to my direct testimony, was reconcile the O&M

expense in total between those two different methods, and we did so -- I believe that's -- let me just find it. I think it's my Exhibit 2. It's Exhibit JPH-2 to my direct testimony, where we reconciled those two different methods of doing things to within 0.1 percent, or less than $100,000, for the projected test year.

Q. But again, those numbers are projections?

A. They're both projections, both sides of them, yes, that's right.

Q. In your deposition, you indicated that the response to OPC Interrogatory 61 was accurate; is that right?

A. It's accurate to the best of my knowledge, yes.

Q. What is the 2009 employee count? Is it 613?

A. Subject to check, it sounds correct. I don't have it in front of me.

Q. Was the 2007 employee count 571? Actually, if you could check --

A. Yes. I have it now.

Q. So both of those numbers are correct?

A. They're correct to the best of my knowledge. Again, those are year-end. You know, it's a point in time for those numbers. I believe the '07 is a year-end. '08 and '09 were projections at this point in time as of year-end. But again, there's a lot of data. I've got some detail data on payroll, but there were vacancies and things like that involved in that.

Q. So the difference between 613 and 571 suggests a change of how many employees from 2007 to 2009?

A. The difference between those two numbers is 42.

Q. Okay. Do you have the response to OPC Interrogatory 125?

A. Can you tell me what the topic is?

Q. It's -- I don't actually have it with me right now. You don't have --

A. I can get it.

Q. Okay.

A. Okay. I have it.

Q. Isn't it true that this response reflects 42 positions?

A. Yes, it does, and it's a mixture of new and replacement positions. So replacement would be vacancies as of the time the data was prepared.

Q. And it shows 13 vacancies?

A. I don't see that.

Q. Do you know how many vacancies are in the 613 number?

A. I show approximately 30 replacement positions, so I don't know -- so 30 replacement positions, and then that would leave about 12 new positions.

Q. So 12 vacancies?

A. No. New positions is not the same as vacancies. New positions would be additions, additions to the complement.

Q. Are there 13 -- on Interrogatory Number 125, do you show 13 positions that have no filled to date, filled as in f-i-l-l-e-d?

A. Oh, I see what you're saying. Yes.

Q. Okay. Do you have Interrogatory 126 with you?

A. Yes.

Q. Isn't it true that this response reflects a number of positions that were vacancies as of December 2007 and subsequently?

A. I believe that's what this shows, yes.

Q. Does it show that there are still 15 positions still open?

A. I think I see eight.

Q. Well, look on the left-hand side starting with 32808, apprentice.

A. Okay.

Q. If you add those number of openings --

A. Oh, I see. Yes. I'm sorry. I see. There's eight lines, so --

Q. So if you added those, the five, two, two, two, one --

A. Yes, 15. Yes, 15. I'm sorry.

Q. Thank you. So you would agree that vacancies will exist?

A. I think at any point in time, vacancies exist, yes.

Q. Okay. Let me ask you about overtime. How much overtime is included in the projection for 2009?

A. I believe there's an interrogatory on that. If you want to take the time for me to find it, I could do that. I mean, I --

Q. Were you able to identify the amount of overtime that's projected in 2009?

A. It is included in the projections, yes. The way we do our budget does reflect overtime.

Q. But you can't tell --

A. No, I can tell. I think it was in an interrogatory. That's what I'm saying. I don't know it off the top of my head. I believe it might have been answered in an interrogatory. If we want to spend the time looking for it, I can do that.

Q. Well, isn't it true that your response was that your budget system did not allow you to calculate overtime in this scenario?

A. That was the Tampa Electric case.

Q. Okay.

A. I'm sorry. Ours does.

Q. Okay.

A. I mean, we have -- we do the payroll budget on an individual position basis at all the locations that exist, which is all our field locations and all the corporate departments, and then there is a spot in the budget area for overtime, so we can identify budgeted dollars. Actually, it might not indicate budget hours. I'm not sure. But we do identify overtime.

Q. Well, do you have the interrogatory response to OPC Number 31?

A. Yes, I believe I do.

Q. Actually, let me ask you to turn to 61, Interrogatory Response 61.

A. Okay.

Q. Does that show $2.9 million?

A. Yes. This is the one I was thinking of.

Q. Okay. I apologize for that rabbit trail.

Isn't it true that overtime is something that can be curtailed if financial conditions warrant it?

A. I think what I would characterize it as is overtime is an area that we attempt to manage and have attempted to manage. But I think that due to the nature of our work, there are certain 24/7 type requirements, response requirements and things like that, as well as workload fluctuations, that there's a certain amount of overtime that we will always have. I mean, it's not discretionary. We don't hand it out. We do try to manage it. But there are certain requirements to respond to emergencies and such, and after hours, that always exist.

Q. Let me turn to the TPI contract. You have a contract arrangement with an affiliate to perform marketing activities, designed primarily to sign up new customers; correct?

A. No, I wouldn't characterize it as that. It's a marketing arrangement that covers a broad gamut of services, sales and marketing related, all aspects of sales and marketing, not just the provision of new customers.

Q. That's not a primary function of that contract arrangement?

A. Clearly, sales and marketing efforts is -- I think, you know, adding customers or adding revenue is a primary function, yes. But what I said is I don't characterize it as the only thing that's in that contract.

Q. Yes. I used the term "primarily."

A. There are a lot of services in the contract, so --

Q. You paid that affiliate $6.1 million in 2008; is that right?

A. I believe we paid them less than that in 2008. I don't think I have it right in front of me.

Q. What about for --

A. The projection might have showed the 6.1, yes.

Q. What about for 2009? What are you projecting to pay them?

A. Actually, 6.1 is the projection for 2009, now that I'm looking at it. That's included in O&M expense. There's a portion in capital.

Q. And as part of that payment projection, you also expect them to sign up 12,000 new customers for 2009?

A. 12,000 signings, that's correct.

Q. Okay. For 2003 through 2007, TPI averaged signing 9,720 customers; is that right?

A. Subject to check, I'll accept that. That looks reasonable.

Q. Okay. That was when the economy was much better than it is today?

A. The economy was better at that time than it is today, yes.

Q. Now, TPI, which is the affiliate, was established with former Peoples Gas employees after TECO acquired Peoples Gas; is that right?

A. Yes. It was our former marketing area.

Q. Okay. And that contract was not competitively bid, was it?

A. No, it was not competitively bid at the time. We formed TECO Partners in 2001, and we've accumulated all the costs that we had in our marketing areas and reduced that right off the top initially, and then have subsequently continued to reduce that cost substantially over the ongoing years.

Q. The initial contract that you mentioned, was that in 2001, 2002?

A. 2001.

Q. The cost per signed customer was about $85.60; is that right?

A. That's not a statistic that we would look at. And again, I would say that the services provided are not just to sign new customers.

Q. For 2009, if you divide the variable portion of that contract by the expected 12,000 new customers, it would be $216.67 per customer signed?

A. Yes, but I -- subject to check. I haven't done the math. But I guess I would say this about the

TECO Partners contract: When we first did that, again, what we did was set up TECO Partners because we realized there were opportunities to leverage some of the things they were doing to really reduce the costs to the utility. That was the idea. And in fact, that's what has happened. So over the course of time, we are now some 25 percent or so below the level of costs that were experienced in 2001.

And kind of, I guess, an akin way to paying a portion of payroll as a variable piece, the idea of the contract is that a portion of that is paid on a variable basis as well. And in this case, 60 percent of that contract is fixed based on the services they provide, and 40 percent of it is variable based on something that we have decided to measure and compensate them on. In this case, it happens to be now, starting in 2008, customer signings, but it's not -- but we didn't put a value on the customer signings and then calculate the variable portion. I think it was a philosophy that this type of arrangement would work better from a utility standpoint, that you have the company on a variable basis such that if they didn't perform at that level, you would reduce payment to them. And that is in fact what happened in 2008, in actual.

But again, I guess I pretty much took strong exception to OPC's position on this. They characterized it in their position statement as an ineffective arrangement. And frankly, if we could find other areas of the company to outsource to anybody, an affiliate or non-affiliate, and reduce expenses over a seven- or eight-year period by 25 percent, we would be doing that every day of the week.

Q. The original contract cost in 2002 was about $8 million; is that right?

A. It was 2001, and I believe it was 8.75 million.

Q. Okay. And the fixed portion of that was about $4.2 million; is that right?

A. Subject to check. I don't know off the top of my head.

Q. Okay. For 2009, the fixed amount is just under $4 million, is that right, 3.9, something --

A. I believe that's correct.

Q. Now, over time, the variable portion of the contract has declined as new signings have declined; isn't that right?

A. I wouldn't -- no, that's not the way it has worked. I mean, that may be the case, that they've declined and signings have declined, although -- I'm looking at the answer to Interrogatory Number 127, and signings have frankly gone up and down over that time. So it's not a relationship that is one to one.

Q. You don't really expect to get 12,000 new signings under this contract for 2009, do you?

A. Absolutely.

Q. You do?

A. Well, I mean, yes. That's our job. And frankly, you know, there are developments -- obviously, there's a slowdown in the economy, there's no question. Some builders are building. If we don't get them, we won't pay TECO Partners the amount that's in the contract. But, no, we absolutely expect that. And I know there's a very large development in the Jacksonville area that's on the drawing board, and if that gets signed, that will go a long way toward meeting that goal.

Q. Is that Nocatee?

A. I believe so.

Q. In the past five years, like we said earlier, new signings have averaged around 9,700; correct?

A. Yes, subject to check.

Q. Okay. Any signing that TPI makes is not guaranteed to buy one therm from PGS or even become a customer; is that correct?

A. I would say that's correct, yes.

MR. REHWINKEL: Mr. Chairman, if you'll give me one minute, I think I may be done with questions for Mr. Higgins.

CHAIRMAN CARTER: Okay.

MR. REHWINKEL: That's all I have. Thank you, Mr. Higgins.

THE WITNESS: Thank you, Mr. Rehwinkel.

CHAIRMAN CARTER: Thank you. Staff.

MS. KLANCKE: Staff has no questions for this witness.

CHAIRMAN CARTER: Commissioners, anything from the bench?

Redirect?

MR. WATSON: Yes, sir.

REDIRECT EXAMINATION

BY MR. WATSON:

Q. Mr. Higgins, has Peoples included in its filing in this case any salaries or wages for either 2008 or the 2009 projected test year, including the incentive compensation portion, that were not targeted in total at the market average compensation for comparable positions?

A. No.

Q. Did Peoples rely on any studies to determine what that market average for each comparable position was?

A. Yes, yes.

Q. In your review of witness Schultz's testimony, did he reference any studies or say he made any studies on which to base the adjustments he had proposed to the compensation amounts included in Peoples' filing?

A. No, I didn't see any studies mentioned.

Q. Other than his suggested disallowance of all of the incentive portion of this market-based total compensation, did Mr. Schultz suggest any other way for Peoples to compensate its employees?

A. No, I didn't see that.

Q. If the goals associated with the incentive compensation portion -- or the incentive portion of total compensation included in this filing, whatever they might be for any given year, are met, at what level would Peoples employees and officers be compensated?

A. That would be at the market average.

Q. And if those goals, whatever they may be, are not met, at what level would the company's employees be compensated for that year?

A. That would be below the market average.

Q. You described generally in the TECO Partners or TPI sales and marketing agreement that the compensation to TECO Partners is broken into a fixed piece and a variable piece, did you not?

A. That's correct.

Q. Are there provisions in the contract for paying TPI less if they don't perform according to the contractual criteria?

A. Yes, there are.

Q. And those are spelled out in the contract?

A. Yes.

Q. Thank you very much.

A. That's in fact what happened, as I said, in 2008.

CHAIRMAN CARTER: Okay. Let's see. Now we've done this witness's direct and rebuttal. Anything further from any of the parties for this witness?

Hearing none, Mr. Higgins, you may be excused.

Let's deal with the exhibits.

MR. WATSON: Yes. I would move his Exhibits 48 through 53.

CHAIRMAN CARTER: Any objections? Without objection, show it done, Exhibits 48 through 53.

(Exhibits 48 through 53 were admitted into the record.)

CHAIRMAN CARTER: Mr. Rehwinkel.

MR. REHWINKEL: I would move Exhibit 96.

CHAIRMAN CARTER: Are there any objections?

MR. WATSON: No objection.

CHAIRMAN CARTER: Okay. Without objection, show it done.

(Exhibit 96 was admitted into the record.)

CHAIRMAN CARTER: Okay. Thank you, Mr. Higgins.

(Transcript continues in sequence in Volume 4.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA:

COUNTY OF LEON:

I, MARY ALLEN NEEL, Registered Professional Reporter, do hereby certify that the foregoing proceedings were taken before me at the time and place therein designated; that my shorthand notes were thereafter translated under my supervision; and the foregoing pages numbered 242 through 429 are a true and correct record of the aforesaid proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor relative or employee of such attorney or counsel, or financially interested in the foregoing action.

DATED THIS 5th day of March, 2009.

Mary Allen Neel

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