PEOPLES GAS SYSTEM

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

Docket No. 020384-GU

In Re: Application for a rate increase by Tampa Electric Company d/b/a Peoples Gas System.

**Submitted for Filing:
11/12/2002**

REBUTTAL TESTIMONY AND EXHIBITS OF:

J. PAUL HIGGINS
On Behalf of Peoples Gas System

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is J. Paul Higgins 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 Director, Finance & Budget.

Q. ARE YOU THE SAME J. PAUL HIGGINS WHO HAS PREVIOUSLY FILED DIRECT TESTIMONY ON BEHALF OF PEOPLES GAS IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF THIS REBUTTAL TESTIMONY?

A. My rebuttal testimony is directed to several adjustments proposed by the witnesses for the Office of Public Counsel ("OPC") related primarily to Rate Base and Net Operating Income for the projected test year. In addition, I will address one adjustment proposed by Mr. Roger Fletcher, a Utility Systems Engineer employed by the Commission.

Q. CAN YOU PROVIDE A BRIEF OUTLINE OF THE ADJUSTMENTS YOU WILL BE DISCUSSING?

A. Yes. I will be providing testimony regarding the following adjustments proposed by OPC and / or the Commission Staff:

- Rate base reduction due to 2002 additions being under budget
- Rate base reduction related to 2003 plant additions
- Rate base reduction related to CWIP
- Rate base reduction related to materials and supplies inventory

- Expense reduction for "Payroll Trended" items
- Expense reduction for "Other Trended" items
- Payroll reduction related to reduced number of employees
- Reduction to bad debt expense
- Expense reduction related to incentive compensation
- Expense reduction related to "cost savings programs"
- Expense reductions related to Tampa Electric charges
- Expense reductions related to TECO Energy allocated charges
- Expense adjustment related to account 922
- Expense reduction for payroll taxes
- Depreciation expense adjustment resulting from depreciation study

Q. WHAT ADJUSTMENTS DID MS. DeRONNE PROPOSE TO THE COMPANY'S PLANT IN SERVICE INCLUDED IN THE MFRs FOR THE PROJECTED TEST YEAR?

A. Ms. DeRonne proposed two adjustments to the Company's Plant in Service balance included in the MFRs. First, she made an adjustment of ($9,957,000) based on her finding that the Company's actual capital expenditures during 2002 were below its budgeted amount through August 31, 2002. Second, she reduced the Company's proposed plant additions for the 2003 projected test year from $60.3 million to $57.9 million. The net impact on the Company's 13-month average plant in service balance for the 2003 projected test year of both these adjustments would be a reduction of $11,144,341.

Q. DO YOU AGREE WITH MS. DeRONNE'S PROPOSED ADJUSTMENTS TO PLANT IN SERVICE?

A. No.

Q. PLEASE EXPLAIN.

A. In the case of the first adjustment, Ms. DeRonne erroneously examined only the plant in service line of the balance sheet. She failed to take into consideration any changes in Construction Work in Progress ("CWIP") during the year which affect the Company's total plant investment and its rate base. The Company is not, in fact, below its 2002 capital additions budget by the $9,957,000 she calculates in her testimony.

In the case of the second adjustment, Ms. DeRonne makes several statements that are debatable. First, her preference for a four-year average as opposed to the five-year average used by the Company in its projections is simply a matter of professional opinion. Including the Company's 2002 budgeted amounts in the five-year average is an appropriate analytical measure in my opinion. The Company invests a good deal of time and effort in preparing its annual capital budget and, absent unusual circumstances, normally spends funds in close proximity to its budgeted amounts. Ms. DeRonne also suggests eliminating the inflation factor used in projecting some of these categories, stating that "the amount of increases and decreases each year do not correspond to the rate of inflation in those periods". That may be the case for certain categories, but on average, the Company's plant additions are of the type that are subject to inflationary pressures. Accordingly, the Company believes the application of an inflation factor is appropriate in this case.

Finally, I would note that the OPC's witnesses include the inflation factor for some adjustments and exclude it for others. While this may appear inconsistent, they do achieve a certain consistency. That is, their decisions appear to be based on the effect the factor's inclusion or exclusion will have on the Company's revenue requirements. Almost without exception, OPC's witnesses consistently choose the option (*i.e.*, inclusion or exclusion) that will result in the greatest reduction in the Company's revenue requirements.

Q. HAS ANY OTHER TESTIMONY BEEN INTRODUCED REGARDING ADDITIONS TO PLANT IN SERVICE?

A. Yes. Mr. Roger Fletcher has recommended that rate base be reduced for projects that have been delayed or canceled. These adjustments are discussed at lines 3 through 9 on page 5 of his direct testimony.

Q. PLEASE EXPLAIN PEOPLES' OBJECTION TO MR. FLETCHER'S PROPOSED ADJUSTMENT TO RATE BASE RELATED TO DELAYED OR CANCELED PROJECTS.

A. Mr. Fletcher's proposed adjustment reducing rate base for specific construction projects that have either been delayed or canceled is flawed for two reasons. First, while Mr. Fletcher's analysis considers projects that were canceled, he fails to recognize that other construction projects may have taken their places. Peoples' capital budget has two distinct purposes. First and foremost, it is the Company's authorization by the Board of Directors to spend money to grow and expand the gas distribution system. Second, the budget is an operating guideline for the Company on how the money authorized might be spent. At the time budgets are prepared, Peoples identifies specific projects that might be constructed during the following year based on the best information available at that time. As the year progresses, facts and circumstances can, and often do change, and as a result the Company must constantly reevaluate its capital spending options. New and different projects can, and often do, appear that have potential returns higher than projects originally contemplated, or that for strategic reasons are better investment opportunities for the Company. The Company prioritizes its spending in order to pursue the best projects, recognizing the budgeted amount authorized by the Board of Directors.

Second, Mr. Fletcher has identified projects that have been postponed from 2002 until 2003. While he suggests an adjustment to the base year +1 (2002) to remove these projects from rate base, no further adjustment is proposed to include them in 2003, the projected test year.

Q. **MR. HIGGINS, IS IT YOUR TESTIMONY THAT THE COMPANY'S PLANT IN SERVICE BALANCES ARE CORRECT AS STATED IN THE MFRs AS FILED?**

A. No. Despite the problems with Ms. DeRonne's and Mr. Fletcher's analyses mentioned above, plant in service included in rate base should be reduced for several reasons. The Company is under budget in 2002, although not by the nearly $10 million calculated by Ms. DeRonne. Based on actual expenditures through September 2002, the Company now estimates that its 2002 plant additions will be approximately $53.4 million as compared to its capital budget of approximately $60.8 million, which was the basis of the 2002 projected additions included in the MFRs.

Additionally, the Company now expects its 2003 plant additions to be approximately $48.3 million rather than the $60.2 million included in the filed MFRs.

Accordingly, the Company has calculated the impact of these changes in capital expenditures as shown on Exhibit ____ (JPH-2). These changes result in a reduction to the 13-month average plant in service and accumulated depreciation of $14,512,000 and $394,000, respectively. In addition, depreciation expense for the projected test year would be reduced by $612,000.

Q. DOES PEOPLES AGREE WITH MS. DeRONNE'S PROPOSED ADJUSTMENT REMOVING CONSTRUCTION WORK IN PROGRESS (CWIP) FROM RATE BASE?

A. Absolutely not. Ms. DeRonne correctly asserts that rate base should include only those items that are used in providing service to the ratepayers. Her proposed adjustment, however, displays a lack of understanding of gas utility construction projects in general and of Peoples Gas construction projects in particular. Gas construction projects are typically short-term in nature and, in fact, are generally in-service before the charges ever appear on the Company's books and records. The balance in CWIP most often represents a timing difference between the time the work is completed, the time invoices are received and recorded on the Company's books, and the time final completion notices are received and processed. As such, balances in CWIP generally do, in fact, represent plant that is used in providing utility service to customers and should therefore be included in rate base.

Q. MS. DeRONNE STATES IN HER TESTIMONY THAT THE FLORIDA PUBLIC SERVICE COMMISSION HAS ALLOWED CWIP IN RATE BASE IN SOME INSTANCES, BUT THAT INCLUSION HAS BEEN FOR EXCEPTIONAL CIRCUMSTANCES AS OPPOSED TO BEING THE NORM. IS THIS A CORRECT STATEMENT?

A. No, it is not. The Commission has in the past demonstrated an awareness of the nature of gas construction projects, and has typically allowed CWIP in rate base in gas company rate proceedings. In fact, the Commission has stated: "Construction Work in Progress is historically not at issue in gas rate case proceedings due to the short term nature of gas distribution system construction projects and the associated small dollar investment." (Order No. 16313, Docket No. 850811-GU, issued July 8, 1986).

Q. MORE SPECIFICALLY, HAS PEOPLES GAS HISTORICALLY BEEN ALLOWED BY THE COMMISSION TO INCLUDE CWIP IN RATE BASE FOR PURPOSES OF DETERMINING ITS REVENUE REQUIREMENTS?

A. Yes. In the past 20 years, Peoples has been involved in five rate proceedings before the Florida Commission (Docket Nos. 810302-GU, 830123-GU, 850811-GU, 891353-GU, and 911150-GU). CWIP has been approved for inclusion in rate base in every one of these rate proceedings.

Q. PEOPLES' LAST RATE CASE WAS MORE THAN 10 YEARS AGO. ARE YOU AWARE WHETHER THE COMMISSION'S POLICY REGARDING ALLOWANCE OF CWIP IN RATE BASE IN GAS UTILITY RATE CASES HAS CHANGED?

A. In more recently completed rate proceedings, the Commission appears consistent in its position. In orders for City Gas Company of Florida (Docket Nos. 960502-GU and 000768-GU) and Chesapeake Utilities (Docket No. 000108-GU), Construction Work in Progress was included in rate base for purposes of determining the utilities' revenue requirements.

Q. DOES PEOPLES AGREE WITH THE ADJUSTMENT TO THE WORKING CAPITAL COMPONENT OF RATE BASE PROPOSED BY MS. DeRONNE?

A. No. Ms. DeRonne proposes a reduction of $151,738 in working capital reflecting a reduction in materials and supplies inventory. While history reflects that the Company has done an excellent job of managing this working capital component downward over the past several years, the precision suggested in Ms. DeRonne's adjustment is not always possible when projecting balance sheet accounts. The Company's balance in this account over the past 12 months has ranged from a high of close to $1 million to a low of about $750,000. As stated by Ms. DeRonne, the most recent 13-month average is approximately $850,000. However, her proposed adjustment again does not allow for an inflation factor, nor does it allow for potential growth in this account as a result of customer and gas system growth. Finally, as noted above, precision when projecting balance sheet accounts is not typically achievable within the level of magnitude of the adjustment suggested by OPC. Accordingly, the Company believes its inclusion of $1 million as the balance for this account for the projected test year is reasonable and appropriate.

Q. WHAT ADJUSTMENTS HAS OPC PROPOSED TO THE COMPANY'S OPERATIONS AND MAINTENANCE ("O&M") EXPENSES INCLUDED IN THE MFRs?

A. OPC has proposed numerous adjustments to the Company's O&M expense for the projected test year, most of which were included in the testimony of Helmuth W. Schultz, III. In total, these adjustments would reduce the Company's 2003 O&M expense by $9,266,864.

Q. ARE THESE ADJUSTMENTS, WHEN VIEWED IN TOTAL, REASONABLE?

A. Absolutely not. The end result of making all adjustments suggested by OPC's witnesses would be absurd and suffer from significant flaws. In proposing adjustments in a case such as this, an accountant should be guided in the end by an overall test of reasonableness, sometimes referred to as a "sanity check." The OPC has omitted any type of sanity check from the analysis conducted by its witnesses. In the end, if the answer obtained is unreasonable, there are obviously flaws in the assumptions or the calculations used to obtain the answer. I will attempt to enumerate these flaws during the remainder of my rebuttal testimony.

Mr. Schultz is suggesting that the expense level in the projected test year -- two years after the historic base year -- should actually be significantly lower than in 2001, even given known and relatively certain expense increases. That is, his position is that the 2001 O&M expense level is overstated by millions of dollars. In essence, without reference to any yardstick, or the benefit of any comparative data, his testimony is that the Company's expense level is improper.

Q. DOES THIS CONCLUSION MAKE SENSE TO YOU?

A. Not at all. The Company's 2001 O&M expense, after deducting energy conservation expenses, was $52.4 million. If all the adjustments proposed by Mr. Schultz were to be made, the 2003 O&M expense would be $51.2 million, or an amount lower than the 2001 actual amount. With several known material increases to the 2001 expense level, including payroll, health care costs, pension expense, and liability insurance just to name a few, this conclusion is absurd.

Q. IN PROPOSING CERTAIN O&M ADJUSTMENTS, WHAT ASSUMPTIONS DID MR. SCHULTZ MAKE REGARDING O&M TRENDING?

A. Basically, in testifying that the Company should not have used trend factors in projecting any of its 2003 O&M expenses, Mr. Schultz's assumption appears to be that a Company can continue to reduce its expenses indefinitely. He has assumed that cost reduction efforts can continue into the future without providing a basis for that assumption and, in effect, penalized the Company for its success over the past five years in controlling its O&M expenses.

Q. CAN THE COMPANY'S COST REDUCTIONS BE EXTENDED INDEFINITELY?

A. Definitely not. Taken to its extreme, Mr. Schultz's assumption would lead to the conclusion that as the Company continues to grow and continues to add customers and miles of main to its system, its O&M expense would eventually approach zero. Obviously, the assumption underlying his efforts in this area is fallacious. Penalizing the Company for the very cost-reduction efforts that have helped it avoid a rate case for 10 years is particularly harsh. The Company is an operating utility, not a "dot com" company. There are no economies of scale or technology solutions that will change-out meters, repair leaks, etc., for a growing customer and asset base at ever-decreasing costs. In order to maintain adequate safety and customer service levels, certain expenses will increase over time as a result of increases in numbers of customers and the size of the gas system itself. A further reduction in employees, for example, would ultimately result in lower levels of customer service and perhaps compromised safety. I don't believe these results would be in the best interest of the Company's ratepayers.

Q. HAS THE O&M TRENDING METHODOLOGY USED BY THE COMPANY, AND THE USE OF THE SPECIFIC TREND FACTORS THEMSELVES, BEEN EMPLOYED IN OTHER NATURAL GAS RATE CASES IN FLORIDA?

A. Yes. To the best of the Company's knowledge, this exact approach has been used in every natural gas rate case since at least 1981. While this fact alone is not a reason for accepting the methodology, the Florida Commission has obviously deemed this a reasonable way to estimate O&M expenses in a projected test year for ratemaking purposes.

Q. PLEASE EXPLAIN THE COMPANY'S RELIANCE ON THE COMMISSION-PRESCRIBED TRENDING METHODOLOGY.

A. While Peoples does not prepare its annual budget or manage its business on the "FERC account" basis used in the trending approach, the Company followed the Commission's methodology in order to prepare its MFRs. At the end of this exercise, the Company reviewed the results for reasonableness (*i.e.*, conducted a "sanity check"). In the Company's view, the overall results provided by the use of the O&M trending methodology were reasonable. Accordingly, the Company believes the approach is a reasonable way to estimate the projected O&M expenses for the 2003 projected test year.

Q. DOES THE OPC'S APPROACH IN PROPOSING ADJUSTMENTS TO THE COMPANY'S O&M EXPENSE RESULT IN ANY DOUBLE-COUNTING OF PROPOSED REDUCTIONS?

A. Yes. As will be shown in detailed discussion regarding specific O&M accounts, the OPC's use of varied approaches in calculating their proposed expense adjustments results in several instances of "double-dipping." In some cases, the OPC witnesses took a "high level" approach in calculating their proposed adjustments (for example, in reviewing "payroll trended" and "other trended" items). They then focused on specific expense accounts and proposed further adjustments to those accounts, on top of the general adjustments initially calculated. In fact, certain of their testimony is contradicted by the inclusion of some of their proposed adjustments. All in all, this double-dipping is part of the reason the end result of the adjustments proposed by the OPC fails a simple sanity check.

Q. HAVE YOU REACHED ANY BROAD CONCLUSION REGARDING THE METHODOLOGY USED BY THE OPC IN PREPARING ITS PROPOSED ADJUSTMENTS TO THE COMPANY'S O&M EXPENSE?

A. I believe that Mr. Schultz engaged in a series of mathematical exercises in order to determine his proposed adjustments. While we have not had the luxury of recreating each of his mathematical calculations, I believe that while his mathematics may be accurate, there was scarce application of judgment in reaching his conclusions. Further, Mr. Schultz's testimony contains several conclusions that are based on either an incorrect or an incomplete understanding of the facts and circumstances surrounding the issue in question.

Q. WHY IS THE USE OF THE TRENDING METHODOLOGY PRESCRIBED IN THE GAS UTILITY MFRs APPROPRIATE IN THIS CASE?

A. The Company has analyzed its O&M expenses from 1991, the year of its last rate proceeding, through 1996, the year prior to the merger with TECO Energy. In doing so, the Company reviewed its actual O&M expenses from fiscal years 1991 through 1996 as compared to a trended O&M expense beginning in fiscal 1991 and using customer growth and inflation as the trend factor. The 1991 actual O&M expense was $40.2 million. Using the trending methodology, the 1996 O&M benchmark expense would be $52.4 million. Actual O&M expense for 1996 was $52.2 million, or a variance of less than one half of one percent. Accordingly, the trending methodology would have been highly predictive of the actual cost of Company operations during this time period.

Since the time of the merger with TECO Energy, many changes have occurred at the Company that make this type of analysis more difficult. In fact, it is over this period that the Company has attempted and accomplished several significant cost-saving efforts that, again, have enabled the Company to avoid a rate proceeding prior to the present time. In examining the present state of the Company's operations and expenses, however, it is apparent to the Company that further significant cost savings are not achievable without seriously jeopardizing the Company's level of customer service and its excellent safety record. The Company is beginning to see, and expects to continue to see, more typical trend increases in O&M expenses in the upcoming years.

Q. CAN YOU ADDRESS MR. SCHULTZ'S RELIANCE, IN PROPOSING CERTAIN ADJUSTMENTS, ON AN OVERALL DECLINE IN THE NUMBER OF PEOPLES' EMPLOYEES BETWEEN 1992 AND 2001?

A. Yes. For administrative convenience, the Company previously maintained all employees of both the utility and certain affiliated companies at the Peoples Gas System level. In 1992, the number quoted by Mr. Schultz of 1,216 included not only employees of Peoples Gas System, but also those of Peoples Gas Company, our then-affiliate in the propane business, as well as those of Peoples Sales & Service, an affiliate in the appliance sales and installation business. Since that time, the Company has exited both of those affiliated businesses, resulting in a significant drop in the number of employees. The former propane company housed approximately 175 employees, while the sales and service company, although difficult to precisely estimate due to overlapping duties with Peoples Gas, held approximately 200 employees. Moreover, many corporate functions formerly performed by Peoples Gas System employees before the merger with TECO Energy are now performed by Tampa Electric or TECO Energy employees and included in intercompany charges. Accordingly, Mr. Schultz has not compared "apples to apples" in terms of numbers of employees in reaching his conclusion regarding a calculated 38.7% reduction in the Company's number of employees during the period from 1992 through 2001. Having said that, there has been a real reduction in the number of Company employees as a result of certain Company initiatives such as regionalizing operations and the leveraging of certain technologies.

Q. IN VIEW OF YOUR PREVIOUS TESTIMONY, DOES THE COMPANY AGREE THAT MR. SCHULTZ'S PROPOSED ADJUSTMENTS FOR "PAYROLL TRENDED" AND "OTHER TRENDED" O&M EXPENSE OF $1,198,657 AND $1,868,945, RESPECTIVELY, ARE APPROPRIATE?

A. No, for the reasons I have previously expressed.

Q. PUTTING ASIDE FOR A MOMENT YOUR DISAGREEMENT WITH THESE ADJUSTMENTS PROPOSED BY MR. SCHULTZ, DOES MR. SCHULTZ COME TO ANY CONCLUSIONS AFTER PROPOSING THESE ADJUSTMENTS?

A. Yes. Mr. Schultz, on page 9 of his direct testimony, and after considering the effects of the trending adjustments he has proposed, states that the $15,397,969 expense for Account 921 for the projected test year "appears reasonable without applying a trending rate."

Q. WHAT IS THE SIGNIFICANCE OF THIS STATEMENT BY MR. SCHULTZ?

A. It is significant because, after stating that the projected test year expense for Account 921 appears reasonable, he later proposes two additional adjustments to Account 921 related to Tampa Electric Company charges to Peoples, and another adjustment to the same account for TECO Energy costs allocated to Peoples. These additional adjustments, each of which I will address later in my rebuttal testimony, result in the "double-dipping" to which I have referred previously. The impact of these additional adjustments to an expense Mr. Schultz had previously found reasonable are depicted on my Exhibit ____(JPH-3). As shown by that exhibit, making all of the adjustments to Account 921 proposed by Mr. Schultz would result in a projected test year expense for that account which is $1,736,411 less than the actual expense for the account in the 2001 historic base year.

Q. HAS MR. SCHULTZ PROPOSED OTHER ADJUSTMENTS IN RELIANCE ON A PURPORTED REDUCTION IN THE COMPANY'S NUMBER OF EMPLOYEES?

A. Yes. In his Exhibit____(HWS-1), Schedule E, Mr. Schultz proposes a reduction in O&M expense of $625,543 based on a projected reduction in the Company's employee complement. I disagree with Mr. Schultz's analysis. First, I disagree with his use of a beginning-of-year/end-of-year average in this analysis. Month-to-month fluctuations, seasonality, vacant positions, and other factors can have an unintended effect on this type of analysis.

More importantly, Mr. Schultz's beginning number of 686 employees for December 2000 is flawed. This number includes 70 employees who, as of December 31, 2000, were marketing employees of the utility. As of January 1, 2001 (*i.e.*, as of the next day), these employees became employees of TECO Partners and are excluded from the December 2001 employee count of 655 used by Mr. Schultz. Had Mr. Schultz adjusted his analysis for this shift in employees, rather than showing a decrease in the average number of employees from 671 in 2001 to 651 in 2002, his corrected numbers would show an increase from an average of 636 in 2001 to an average of 651 in 2002. This increase, while again affected by the use of simple year-end averages, supports the Company's use of payroll plus customer growth in the trend analysis used to prepare its 2003 projected test year O&M expense. With increased activity due to an increase in the number of customers and in the size of the Company's gas system, the number of employees is expected to continue to increase incrementally in the future.

Q. AT PAGES 19 TO 20 OF HIS DIRECT TESTIMONY, MR. SCHULTZ EXPRESSES CERTAIN "OTHER PAYROLL CONCERNS." CAN YOU ADDRESS THESE CONCERNS?

A. Yes. Under the heading "Other Payroll Concerns," Mr. Schultz expresses three such concerns. First, he states that "it appears that the amount in the filing may have reclassified some of the energy conservation payroll to Account 926 instead of removing it as indicated in the filing." I can find no basis for this statement. There is no connection between energy conservation expenses and account 926, which is primarily used to record employee benefits. The Company has not included any payroll related to energy conservation in account 926.

Second, Mr. Schultz is concerned with what he characterizes as the apparent inconsistency of information related to the Company's "RSVP+" incentive pay in 2001. The referenced discrepancy is simply the result of the timing of this incentive payment and the difference between the estimated incentive accrual and the actual incentive payout. This payment, which related to the year 2000 (as shown in the Company's answer to OPC's Interrogatory No. 31), actually occurred in January 2001. While the Company accrued an estimated amount in December 2000 for incentive payments, the actual payout in January 2001 was higher than the accrued amount, resulting in the expense variance mentioned in the monthly variance reports. The Commission's auditors have examined incentive payments and accruals and their impact on the historic base year expenses.

Lastly, Mr. Schultz expresses concern regarding references to severance payments in the Company's June 2002 variance report. The Company was asked in OPC's Interrogatory No. 20 if it offered or intended to offer any early retirement "plans" during the 2001 historic base year and subsequently. The Company has not offered, nor does it intend to offer, any such "plans." In June 2002, however, three individuals terminated service with the Company, and these individuals were provided severance packages. These severance packages were simply cash payments, with none of the characteristics of typical "early retirement plans."

Q. DOES PEOPLES AGREE WITH MR. SCHULTZ'S PROPOSED ADJUSTMENT TO THE COMPANY'S PROJECTED BAD DEBT EXPENSE?

A. No. Mr. Schultz proposed to reduce this expense by $878,774 for the 2003 projected test year. In calculating the write-off percentage he used to apply to 2003 projected revenues, Mr. Schultz did not adequately consider certain items that are included in the historical gross revenues but excluded from the 2003 projected gross revenues. Specifically, these items are gross receipts taxes, franchise fees, energy conservation revenues, and off-system sales. Therefore, either Mr. Schultz's bad debt factor is too low or the gross revenue amount he multiplied by the bad debt factor is too low, either of which results in a calculated expense that is too low.

Q. PLEASE EXPLAIN IN MORE DETAIL.

A. Certainly. The gross revenue amounts in Mr. Schultz's testimony include all items included in revenues by the Company, including the above-noted items. Off-system sales, while a large gross revenue amount historically, were excluded from projected test year revenues. The other items are of a pass-through nature and were not included in the projected years in the MFRs for the sake of expediency. In other words, one would either have to recalculate the factor excluding these items <u>or</u> make provision for these items in the projections in order for Mr. Schultz's calculation to be appropriate.

Q. DID MR. SCHULTZ DO EITHER?

A. No. As a result, his calculated bad debt expense for 2002 and 2003 is too low.

Q. COULD MR. SCHULTZ HAVE BEEN AWARE OF THIS DISCREPANCY?

A. He could have been and would have been had he asked. In fact, he points to a discrepancy between the 2002 budgeted gross revenues of $292 million and the 2002 gross revenues of $242 million included in the MFRs, and states that "it is inconceivable that a Company could prepare two projections for the same year with significantly different revenues, yet reflect the same amount of bad debt expense." In fact, there are significant differences between these two projections, with over half of this difference being due to the items noted above. The remainder of the difference represents changes in assumptions from the 2002 budget to the 2002 MFR projection for PGA expense per therm, projected bills and therms, and an amount included in the 2002 budget for rate relief. I would note that Mr. Schultz drew his conclusion about a significant expense item without asking for clarification about the difference in the amount to be multiplied.

Q. SHOULD THERE BE ANY CHANGE IN THE COMPANY'S BAD DEBT EXPENSE FOR 2003 AS INCLUDED IN THE MFRs?

A. Yes. In retrospect, the Company would take a different approach in estimating this expense if it were to re-file its projections. The budgeted amount for 2002 does, in hindsight, appear to be high (although it was lower than the 2001 actual expense). The Company, has, therefore, recalculated its projected bad debt expense for 2003 using a four-year average of bad debt expense as a percentage of <u>adjusted</u> gross revenue. For the historical periods, the Company has removed the impact of off-system sales in calculating a bad debt rate of 0.4027% of adjusted gross revenues. The Company then applied this factor to an adjusted gross revenue amount of $269,353,847, an amount which represents the gross revenues as calculated on MFR Schedule G-2, Page 8d plus estimated amounts for energy conservation, gross receipts, and franchise fee revenues. The result of this calculation yields a projected bad debt expense of $1,084,688 for the 2003 projected test year. Thus, as shown on Exhibit ____ (JPH-4), the Company would propose to reduce this expense by $633,606 from the amount included in the MFRs as filed.

Q. DOES THE COMPANY AGREE WITH MR. SCHULTZ'S PROPOSED REDUCTION IN PAYROLL EXPENSE OF $856,343 RELATED TO INCENTIVE COMPENSATION?

A. Definitely not. Mr. Schultz broadly states that this type of pay is inequitable and that at least a portion of it should be borne entirely by the Company's shareholders. He states that "the payment of incentive compensation could be construed as a second payment for the same service," and characterizes it as "extra" and excessive."

Q. DOES THE COMPANY AGREE WITH MR. SCHULTZ'S STATEMENTS AND CHARACTERIZATIONS REGARDING THE INCENTIVE PORTION OF PEOPLES' EMPLOYEES' COMPENSATION?

A. Absolutely not. They are not only incorrect, but also clearly inappropriate in view of the fact that Mr. Schultz has offered no alternative compensation which he deems reasonable, and against which a comparison might be made to reach his conclusions and characterizations.

Q. IS PEOPLES' PAY STRUCTURE FOR ITS EMPLOYEES, INCLUDING THE BASE PAY AND INCENTIVE PORTIONS,

COMPARABLE TO MARKET VALUE FOR THE SAME OR SIMILAR POSITIONS?

A. Yes. Peoples conducted a comprehensive study of all its positions and the related pay structures for the year 2001. As part of this study, detailed job descriptions were prepared for each position, and a significant amount of market data was accumulated for purposes of comparison to Peoples' pay structure, both with and without incentive pay.

Q. WHAT WERE THE FINDINGS OF THIS STUDY WITH RESPECT TO THE COMPANY'S PAY STRUCTURE IN RELATION TO JOB MARKET VALUE?

A. The study showed that, on average, Peoples' base salary was approximately [redacted] the average "job market value" ("JMV") for comparable positions. When coupled with the Company's incentive pay, employees' total pay was [redacted] the JMV for comparable positions (see Exhibit____(JPH-5)). Accordingly, the Company believes that its pay structure, including base pay and all incentives, is reasonable and in fact conservative in relationship to the overall market value.

Q. WHAT IS THE PURPOSE OF COMPANY GOALS AND HOW DO THEY RELATE TO INCENTIVE COMPENSATION?

A. Peoples' annual incentive is calculated based on Company goals and individual goals that are established each year. Goal setting is considered to be an important function of the Company as it provides a fair and measurable way to judge the performance of the Company as well as its employees. Peoples establishes two types of goals and further breaks down the goals into specific categories including financial and individual/

functional goals. The Company has financial goals in order to maintain competitiveness and to encourage employees to work together to maximize efficiencies. Individual incentives are measured and paid based on both the profitability of the Company and individual performance in relation to specific goals. In order to accomplish this, employees set specific individual goals that are performance-based. Both financial and performance-based goals challenge employees to perform at a high level, resulting in improved customer service, enhanced safety performance, and satisfactory financial performance. It must be understood that the incentive portion of each Peoples employee's compensation is merely a part of the employee's total compensation that has been made contingent on performance in relation to the goals. It is not a bonus which is payable in addition to the total compensation which would otherwise be payable to the employee.

Q. DO THE COMPANY'S SHAREHOLDERS BEAR ANY BURDEN WITH RESPECT TO THE COST OF INCENTIVE COMPENSATION THAT IS BASED ON QUANTIFIABLE FINANCIAL GOALS?

A. Yes, definitely. In contrast to Mr. Schultz's main argument that this benefit accrues to shareholders while being borne by the ratepayers, the very payment of these incentive amounts reduces the Company's net income and, accordingly, its earnings per share available for distribution to the shareholders in the form of dividends.

Q. ARE FINANCIAL GOALS AND OTHER GOALS DISTINGUISHABLE?

A. Yes. Financial goals represent a portion of each employee's incentive amount, and individual goals represent the balance of the incentive.

Q. HOW ARE THE INCENTIVE PAYMENT AMOUNTS DETERMINED?

A. Corporate goals are reviewed quarterly with a final review at the end of each year. Each goal has a percentage scale and is paid according to performance. For example, in 2001 a region that achieved 95% of its team goal was paid only 75% of the associated payout within that specific category in accordance with measures set at the beginning of the year. The Company does not arbitrarily pay out 100% of the incentive portion of employees' compensation, but rather carefully measures and rewards employees if performance and expectations are met. This ensures that employees, ratepayers and shareholders are treated fairly.

Q. PLEASE SUMMARIZE THE COMPANY'S POSITION ON THE ADJUSTMENT RELATED TO INCENTIVE COMPENSATION PROPOSED BY MR. SCHULTZ.

A. The proposed adjustment should not be made. Peoples considers the incentive component of its employees' total compensation not only as a prudent expense, but an expense which is as beneficial to the Company's ratepayers as it is to the employees and shareholders. Based on the study conducted by the Company, the Company's total pay, including incentive pay, is not only reasonable, but below the relevant market value for similar positions. It represents an integral part of the management efforts which have enabled the Company to maintain an exemplary customer service and safety record. This has benefited the ratepayers as the Company has been able to avoid filing for a rate increase for over 10 years.

Q. DOES THE COMPANY AGREE WITH THE OPC'S PROPOSED ADJUSTMENT RELATING TO "COST SAVING PROGRAMS"?

A. No. The proposed adjustment would reduce meter and regulator expense by $275,000 for the projected test year. Meters and regulators are capital expenditures, not O&M expense items. Accordingly, any "new" savings are reflected in reduced capital additions rather than as reductions to O&M expense.

Q. WHAT ADJUSTMENTS DOES MR. SCHULTZ PROPOSE WITH RESPECT TO O&M EXPENSE CHARGES TO PEOPLES FROM TAMPA ELECTRIC COMPANY?

A. Mr. Schultz proposes two adjustments related to charges from Tampa Electric. The first is a $325,300 reduction in "other not trended" costs in Account 921, and the second is a $1,019,217 "annualization adjustment" which primarily relates to Account 921.

Q. DOES PEOPLES AGREE WITH THE FIRST OF THESE PROPOSED ADJUSTMENTS?

A. No. Mr. Schultz's testimony contains no justification for this adjustment to "other not trended" costs in Account 921, the effect of which would reduce the Company's projected test year costs back to 2001 levels.

Q. DID THE COMPANY PROVIDE INFORMATION ON THE "OTHER NOT TRENDED" ADJUSTMENTS TO THE OPC?

A. Yes. My detailed work papers regarding the specific items included in "other not trended" were provided to the OPC.

Q. DID THOSE WORK PAPERS CONTAIN ANY INFORMATION REGARDING ACCOUNT 921?

A. Yes. The Account 921 items included in "other not trended" were telecommunications expense, information technology, and payroll processing costs. Each of these charges does, in fact, come by way of a direct charge from Tampa Electric. In the case of two of these items, the amounts included in my 2002 and 2003 projections were lower than the amounts in the 2001 base year. Since we knew these costs were expected to decline, we made the appropriate adjustment in "other not trended." In the case of information technology costs, the reverse is true. These costs have increased over those in the base year, so the appropriate adjustments were made.

Q. IN PROPOSING THE $325,300 ADJUSTMENT, DID MR. SCHULTZ ADDRESS ANY OF THESE SPECIFIC PROJECTIONS?

A. As far as I can tell, he did not. Rather, he simply proposed a $325,300 reduction in Account 921 to take the account back to its 2001 level of expenses.

Q. IS THIS ADJUSTMENT, IN FACT, CONTRADICTED ANYWHERE IN MR. SCHULTZ'S TESTIMONY?

A. In my opinion, yes. As I have previously testified, during his discussion on combined trend rates and Account 921, Mr. Schultz makes the statement that "comparatively, the amount appears reasonable without applying a trending rate to the base year "Other Trended" cost category in Account 921". In making this statement, Mr. Schultz was including the proposed increase in "other not trended" of $325,300 as reasonable in comparison to the four-year average for this account.

Q. DOES MR. SCHULTZ'S CONCLUSION REGARDING ACCOUNT 921 HAVE ANY IMPACT ON THE SECOND OF HIS PROPOSED ADJUSTMENTS TO TAMPA ELECTRIC CHARGES?

A. Yes, it does. The conclusion quoted above appears to declare Account 921 balances "reasonable" after deducting Mr. Schultz's proposed adjustments to Account 921 for "payroll trended" (a $22,938 reduction in expense per his Exhibit ____(HWS-1), Schedule A) and "other trended" (a $1,138,446 reduction in expense per his Exhibit ____(HWS-1), Schedule B). While I have previously testified that the Company does not agree with the proposed reductions related to trending, Mr. Schultz then proposes to reduce Account 921 expense even further by three more adjustments: the $325,300 reduction discussed above, a $1,019,217 reduction in Tampa Electric charges (termed the "annualization adjustment"), and a $730,861 reduction in TECO Energy charges. The bulk of Tampa Electric and TECO Energy charges are included in Account 921, so any adjustments to these costs would be primarily related to Account 921.

Q. IS THIS THE "DOUBLE DIPPING" YOU REFERRED TO EARLIER IN YOUR TESTIMONY?

A. Yes. He characterizes the Account 921 expense as reasonable after certain proposed adjustments, but thereafter proposes over $2 million of additional reductions to this account.

Q. DOES PEOPLES AGREE WITH THE METHODOLOGY USED BY MR. SCHULTZ FOR HIS PROPOSED "ANNUALIZATION ADJUSTMENT" RELATED TO TAMPA ELECTRIC CHARGES?

A. No, because there is no basis supporting his calculation of this "annualization adjustment." In his calculations, Mr. Schultz annualizes actual expenses through August 2002. First, annualizing costs may not be appropriate, as the timing of certain costs is not evenly spread over the year. Second, and more importantly, Mr. Schultz then compares these annualized 2002 costs to the 2001 base year charges to calculate his proposed adjustment. To the extent there are changes in these charges from year to year (something about which Mr. Schultz complains in his testimony), comparing 2002 costs to 2001 costs is like comparing apples to oranges. It is simply not a valid comparison.

Q. WERE THE TAMPA ELECTRIC AND TECO ENERGY CHARGES SUBJECT TO AUDIT BY THE PSC AUDITORS?

A. Yes. These charges were included in the historic base year and were subjected to extensive audit procedures by the Commission's auditors.

Q. YOU MENTIONED THAT MR. SCHULTZ COMPLAINED IN HIS TESTIMONY ABOUT FLUCTUATIONS IN TAMPA ELECTRIC'S CHARGES TO PEOPLES. WHAT WAS THE NATURE OF HIS COMPLAINTS?

A. Mr. Schultz cited the increase in these costs from 1999 to 2000 and a large decrease in these costs from 2000 to 2001. He stated that despite this decrease, the Company appears to have reflected an increase in these charges for 2002 and 2003.

Q. CAN YOU EXPLAIN THE SIGNIFICANT DECREASE FROM 2000 TO 2001 IN TAMPA ELECTRIC CHARGES?

A. Yes. About three quarters of this decrease resulted from the Company's moving from a centralized call center to regionalized customer response centers. The centralized call center service was provided by Tampa Electric employees, while the new region-based customer response centers are operated by employees of Peoples. This change occurred in late 2000, so those Tampa Electric charges essentially went away in 2001.

There were several other fluctuations in Tampa Electric charges from 2000 to 2001, both increases and decreases. Another large reduction was in the information technology ("IT") area as singled out in Mr. Schultz's testimony. During the course of 2001, Peoples made certain short-term decisions in the IT area to manage these costs downward. An example of such cost management was the delay of certain software maintenance payments. These are costs that, while avoidable in the short term, are not avoidable in the long term. Accordingly, the 2002 IT budget amount was used to project 2002 costs in the filing and as a basis for estimating 2003 costs.

Information technology has long been one of the Company's largest cost areas. In fiscal 1996 (*i.e.*, the year prior to the merger with TECO Energy), after deducting the costs of telecommunications that were formerly recorded in the same department as IT costs, the Company's IT expenses were slightly more than $4 million. The Company then trended this cost from 1996 to 2003 using as trend factors inflation only and customer growth times inflation.

Q. WHAT WERE THE RESULTS OF THIS TREND ANALYSIS?

A. Using an inflationary factor alone, the Company's 2003 IT costs would have been approximately $4.74 million, or approximately $170,000 higher than the costs included by the Company in the MFRs. Using the customer growth times inflation trend factor, the Company's 2003 IT costs would have been over $6.85 million, or nearly $2.3 million higher than the costs included in the MFRs.

Q. WHAT DOES THIS ANALYSIS TELL YOU ABOUT THE TAMPA ELECTRIC INFORMATION TECHNOLOGY COSTS INCLUDED IN THE COMPANY'S PROJECTIONS?

A. Based on this analysis, it appears that the Company has been able to effectively manage its IT costs since the merger and that the costs included in the MFR projections appear reasonable.

Q. CAN YOU DRAW ANY GENERAL CONCLUSIONS REGARDING TAMPA ELECTRIC CHARGES FROM THIS EXERCISE AND FROM THE O&M BENCHMARKING ANALYSIS INCLUDED IN THE MFRs?

A. Yes. I believe that effective cost management of general and administrative ("G&A") costs in this manner since the merger with TECO Energy is the main reason the Company passes the O&M benchmark test for G&A expenses by over $8.2 million (see MFR Schedule C-34).

Q. MR. SCHULTZ CLAIMS AT VARIOUS POINTS IN HIS DIRECT TESTIMONY THAT PEOPLES FAILED TO PRODUCE DOCUMENTS RELATED TO THE CHARGES MADE TO THE

COMPANY BY TAMPA ELECTRIC. DOES THE COMPANY AGREE WITH THESE CLAIMS?

A. No. This is truly one of the most befuddling elements of this entire proceeding. The OPC is claiming that they were not provided documents they requested that would have allowed them to assess the reasonableness of the Tampa Electric charges. For example, Mr. Schultz claims that the one-line descriptions on Tampa Electric's invoices to Peoples for various types of charges are not sufficient justification for these costs.

Q. DID THE OPC ASK FOR CLARIFICATION OF THOSE "ONE-LINE DESCRIPTIONS"?

A. No, it did not. The OPC did ask for detailed Tampa Electric Company budget and variance documents that would have provided little, if any, assistance in evaluating these charges, which are provided by the "shared services" portions of the Tampa Electric organization. These Tampa Electric departments represent a very small piece of the overall electric company. Tampa Electric is a large operating electric utility including electric generation, transmission, and distribution functions. Cost centers such as IT are simply support functions for Tampa Electric, and to the extent that synergies among affiliated companies can be achieved by a shared services arrangement, these are provided in a shared services format. The annual budgets and variance reports for Tampa Electric as a whole would shed no light on the shared services departments.

Q. WHY DOES THE OPC CONTEND THAT THEY NEED THESE DOCUMENTS IN ORDER TO ASSESS THESE COSTS?

A. My only conclusion can be that the OPC does not comprehend the nature of shared services within a large, multiple operating company organization such as TECO Energy. If they do understand this, then their requests for such documents represent nothing more than a fishing expedition for information related to the electric utility that is inappropriate within the proceedings of this rate case.

Q. YOU HAVE INDICATED THAT THE TAMPA ELECTRIC BUDGET AND VARIANCE INFORMATION WOULD HAVE PROVIDED LITTLE, IF ANY, ASSISTANCE TO THE OPC EVEN IF IT HAD BEEN PRODUCED. DIDN'T MR. SCHULTZ ALSO CLAIM THAT PEOPLES HAD NO WAY OF MAKING SUCH A STATEMENT IF IT DID NOT HAVE SUCH INFORMATION?

A. Yes. Mr. Schultz's claims in this regard refer to statements made by Peoples' counsel in response to OPC's motion to compel production of Tampa Electric budget and variance information. Counsel was able to make the statement with which Mr. Schultz disagrees after seeking from Tampa Electric, and being given limited access to, a portion of Tampa Electric's budget information for the Tampa Electric departments which made charges to Peoples, in an effort to reach some settlement to avoid responding to the motion to compel. I also reviewed the limited information provided at that time. The fact remains, however, that the information sought by the OPC from Peoples belonged to Tampa Electric, was not within the control of Peoples so as to be able to be produced, and was not sought by the OPC from Tampa Electric Company.

Q. DOES THE COMPANY AGREE WITH MR. SCHULTZ'S PROPOSED ADJUSTMENT REDUCING PEOPLES' O&M EXPENSE RELATED TO CHARGES FROM TECO ENERGY?

A. No, with one exception. Mr. Shultz has proposed a $730,861 reduction in TECO Energy charges which he characterizes as "excessive and/or inappropriate." He identified six specific items he considers inappropriate, and the Company disagrees with his proposed adjustment as to five of the six listed.

Q. WITH WHICH ITEM INCLUDED IN THIS ADJUSTMENT DOES THE COMPANY AGREE?

A. The Company would not object to the proposed adjustment for "stadium costs/centennial celebration." In retrospect, this item should have been charged by the Company to Account 426, a "below the line" account that is not considered in the ratemaking process. Mr. Schultz included a reduction of $21,300 for this item at line 4 of Schedule H of his Exhibit ____(HWS-1).

Q. PLEASE EXPLAIN THE COMPANY'S DISAGREEMENT WITH THE FIVE OTHER ITEMS INCLUDED IN THIS ADJUSTMENT?

A. The five other items comprising this proposed adjustment relate to incentive compensation, supplemental retirement plan, restricted stock grants, executive food, and the TECO Arena. As discussed earlier, the Company disagrees with Mr. Schultz's entire line of testimony regarding incentive compensation. In proposing this portion of the adjustment, he makes no comparison which would suggest that the total compensation package of either Peoples or TECO Energy employees does not represent fair, market-based pay. Rather, he states broadly that incentive compensation is "additional pay for the same work" and proposes an adjustment which would disallow it. In the case of TECO Energy employees (as discussed further in the testimony of Bruce Narzissenfeld), the compensation committee of the board of directors is charged with ensuring that officers' pay, including incentives, is in line with industry averages. Thus, the adjustment for this item proposed by Mr. Schultz is inappropriate.

Q. WHAT ABOUT MR. SCHULTZ'S PROPOSED ADJUSTMENT FOR SUPPLEMENTAL RETIREMENT PLAN AND RESTRICTED STOCK GRANTS?

A. Again, in the case of these two adjustments, Mr. Schultz makes a broad statement that these items are "excessive costs" and "excessive benefits" without making any comparison which would justify these conclusory characterizations. The rebuttal testimony of Peoples witness Bruce Narzissenfeld will further address the costs associated with the supplemental retirement plan and restricted stock grants in support of the Company's position that Mr. Schultz's proposed adjustment with respect to these items should not be made.

Q. PLEASE EXPLAIN THE COMPANY'S DISAGREEMENT WITH THE EXECUTIVE FOOD ITEM OF THIS PROPOSED ADJUSTMENT.

A. This expense represents an allocated portion charged to Peoples for the cost of food provided for meetings held by TECO Energy executives. As a matter of administrative convenience, many meetings of these executives are held during either the breakfast or lunch hours. These are working meetings, and food is typically provided during these meetings so that the business discussions occurring during the meetings can continue without an interruption for breakfast or lunch. In the Company's view, these expenses are prudent in that they allow the Company to maximize the productivity of its employees, and the amount ($10,173) attributable to this item should not be adjusted out of the Company's O&M expense.

Q. LASTLY, WHAT ABOUT THE "TECO ARENA" ITEM INCLUDED IN THIS ADJUSTMENT?

A. This item, an expense of $175,000, is for the naming rights for an arena in Southwest Florida. This portion of the proposed adjustment is not appropriate because the $175,000 expense is recorded in account 426, a "below the line" account which is not considered in this rate proceeding. The expense is not included in either the 2001 base year or the 2003 projected test year expenses. Thus, no adjustment is necessary.

Q. ARE THERE ANY OTHER DIFFICULTIES WITH MR. SCHULTZ'S PROPOSED ADJUSTMENTS RELATED TO TECO ENERGY COSTS?

A. Yes. As discussed earlier regarding Tampa Electric costs, since these costs are included in Account 921, any further adjustments to Account 921 on top of the initial adjustments I have previously discussed represent "double-dipping" of adjustments. Moreover, and as I have previously testified, the additional adjustments contradict Mr. Schultz's own testimony regarding the reasonableness of Account 921 expense after taking into consideration his initial "trending" adjustments. My Exhibit ____(JPH-3) depicts these points more graphically.

Q. DID MR. SCHULTZ PROPOSE ANY OTHER ADJUSTMENTS RELATED TO NET OPERATING INCOME ("NOI")?

A. Yes. He proposed an adjustment to reduce the credit calculated in Account 922 and an adjustment to reduce payroll tax expense due to his proposed adjustments reducing payroll expense.

Q. PLEASE DISCUSS THE ACCOUNT 922 ADJUSTMENT.

A. To his credit, Mr. Schultz's proposed adjustment to Account 922 represents possibly the only case in which the OPC proposes to give the Company what it would consider to be equitable treatment. Since the credit in Account 922 is based on certain other account balances, the OPC appropriately considered and attempted to calculate a reduction in this credit as a result of the reductions it proposed to certain other accounts.

Q. IS THE OPC'S CALCULATION OF THE ADJUSTMENT TO ACCOUNT 922 PROPER?

A. Sadly, no. As discussed earlier, the bulk of Tampa Electric charges are recorded in Account 921. In Schedule C of his Exhibit ____(HWS-1), Mr. Schultz failed to reduce Account 921 by the two adjustments he proposed for Tampa Electric charges (one for $325,300 and one for $1,019,217). In fact, had Mr. Schultz reflected these two adjustments on this schedule, he might have realized the "double-dipping" error described earlier.

Nonetheless, the Company agrees with only one adjustment reflected on Schedule C of Mr. Schultz's Exhibit ____(HWS-1) – the $21,300 reduction to Account 921 related to "stadium costs/centennial celebration." The impact of this adjustment on Account 922, using the Company's trended amount of $24,617 as the adjustment, would be to reduce the credit in Account 922 by $3,909.

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY REGARDING O&M EXPENSE.

A. As stated at the beginning of my testimony as it relates to Peoples' O&M expense, the OPC has proposed adjustments which would reduce O&M expense by a total of $9,266,864. Based upon my previous testimony, the Company agrees with three adjustments that, in total, would reduce its projected test year O&M expense by $654,314. The analysis underlying the adjustments proposed by the OPC's witnesses was lacking due to the failure to apply reason and judgment; in short, by their failure to subject their analyses to any sanity check.

Q. DOES THE COMPANY HAVE A POSITION ON MR. SCHULTZ'S PROPOSED REDUCTION IN PAYROLL TAXES?

A. As I have previously discussed at length, the Company does not agree with any of Mr. Schultz's proposed adjustments to payroll expense. Therefore, any adjustment to payroll taxes would also be inappropriate.

Q. WHAT IS MS. DeRONNE'S TESTIMONY REGARDING DEPRECIATION EXPENSE?

A. Ms. DeRonne proposed an adjustment to reduce depreciation expense by $457,256. This adjustment resulted from her proposed reductions to the Company's Plant in Service. Additionally, Ms. DeRonne states that the Company's depreciation rates included in the MFRs "should be replaced by the rates ultimately adopted by the Commission in the depreciation case" (study).

Q. DO YOU AGREE WITH MS. DeRONNE'S TESTIMONY REGARDING DEPRECIATION EXPENSE?

A. Regarding the proposed reduction to depreciation expense, the Company has calculated its own adjustment to depreciation expense as originally filed as a result of expected reductions in capital expenditures (see Exhibit____(JPH-2)). The Company agrees with Ms. DeRonne's statement regarding the impact of the depreciation study results.

Q. HAS THE COMPANY CALCULATED THE IMPACT OF THE NEW DEPRECIATION RATES APPROVED BY THE COMMISSION IN THE DEPRECIATION STUDY?

A. Yes. The impact of the new rates represents an increase of $219,125 in depreciation expense over the amounts as originally filed and is reflected on Exhibit _____ (JPH-6).

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.

PEOPLES GAS SYSTEM
Revised Projection of Plant Additions
(000's)

	2001 Dec	2002 Jan	2002 Feb	2002 Mar	2002 Apr	2002 May	2002 Jun	2002 Jul	2002 Aug	2002 Sep	2002 Oct	2002 Nov	2002 Dec	2002 Total	13 Month Average
AS FILED															
Plant in Service															
Plant in Service Additions		$4,721	$5,002	$5,260	$4,598	$4,611	$4,745	$4,923	$5,034	$5,093	$5,444	$5,516	$5,818	**$60,764**	
Plant in Service Retirements		500	500	500	500	500	500	500	500	500	500	500	500	6,000	
Plant in Service ending balance	$694,160	698,381	702,882	707,643	711,740	715,852	720,096	724,519	729,053	733,646	738,590	743,606	748,924		$720,699
Depreciation Expense		(2,442)	(2,459)	(2,477)	(2,493)	(2,505)	(2,517)	(2,530)	(2,543)	(2,557)	(2,571)	(2,586)	(2,601)	(30,282)	
Accum. Depreciation Adjustments		(29)	-	-	-	-	-	-	-	-	-	-	-	(29)	
Depreciation Retirements		500	500	500	500	500	500	500	500	500	500	500	500	6,000	
Depreciation Removal Cost		134	134	134	134	134	134	134	134	134	134	134	134	1,608	
Amortization Expense		(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(271)	
Accumulated Depreciated Subtotal		(1,859)	(1,848)	(1,866)	(1,881)	(1,894)	(1,906)	(1,919)	(1,932)	(1,946)	(1,960)	(1,974)	(1,990)	(22,974)	
Accumulated Depreciation ending balance	(238,397)	(240,256)	(242,104)	(243,970)	(245,851)	(247,744)	(249,650)	(251,569)	(253,501)	(255,447)	(257,406)	(259,381)	(261,371)		(249,742)
Net Plant in Service	$455,763	$458,125	$460,779	$463,673	$465,890	$468,107	$470,446	$472,950	$475,552	$478,200	$481,184	$484,225	$487,553		$470,957
REVISED															
Plant in Service															
Plant in Service Additions		$4,992	$5,240	$3,887	$5,824	$4,418	$3,583	$3,939	$3,393	$3,055	$4,420	$5,348	$5,292	**$53,392**	
Plant in Service Retirements		500	500	500	500	500	500	500	500	500	500	500	500	6,000	
Plant in Service ending balance	$694,160	698,651	703,392	706,779	712,103	716,021	719,104	722,543	725,436	727,991	731,911	736,759	741,552		$718,185
Depreciation Expense		(2,470)	(2,458)	(2,474)	(2,488)	(2,502)	(2,513)	(2,524)	(2,534)	(2,541)	(2,550)	(2,563)	(2,576)	(30,193)	
Depreciation Retirements		500	500	500	500	500	500	500	500	500	500	500	500	6,000	
Depreciation Removal Cost		134	134	134	134	134	134	134	134	134	134	134	134	1,608	
Amortization Expense		(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(23)	(271)	
Accumulated Depreciated Subtotal		(1,858)	(1,847)	(1,863)	(1,877)	(1,891)	(1,902)	(1,912)	(1,922)	(1,930)	(1,939)	(1,951)	(1,965)	(22,857)	
Accumulated Depreciation ending balance	(238,397)	(240,255)	(242,102)	(243,964)	(245,841)	(247,732)	(249,634)	(251,546)	(253,468)	(255,399)	(257,337)	(259,289)	(261,254)		(249,709)
Net Plant in Service	$455,763	$458,396	$461,290	$462,814	$466,262	$468,288	$469,470	$470,997	$471,968	$472,593	$474,573	$477,471	$480,298		$468,476

Exhibit No. ______
Docket No. 020384-GU
Peoples Gas System
(JPH-2)

PEOPLES GAS SYSTEM
Revised Projection of Plant Additions
(000's)

AS FILED	2002 Dec	2003 Jan	2003 Feb	2003 Mar	2003 Apr	2003 May	2003 Jun	2003 Jul	2003 Aug	2003 Sep	2003 Oct	2003 Nov	2003 Dec	2003 Total	13 Month Average
Plant in Service															
Plant in Service Additions		$5,525	$5,525	$5,525	$4,851	$4,851	$4,851	$4,851	$4,851	$4,851	$4,851	$4,851	$4,851	$60,231	
Plant in Service Retirements		500	500	500	500	500	500	500	500	500	500	500	500	6,000	
Plant in Service ending balance	$748,924	753,948	758,973	763,998	768,349	772,699	777,050	781,401	785,752	790,102	794,453	798,804	803,155		$776,739
Depreciation Expense		(2,664)	(2,683)	(2,702)	(2,719)	(2,733)	(2,747)	(2,761)	(2,775)	(2,789)	(2,803)	(2,817)	(2,831)	(33,021)	
Depreciation Retirements		500	500	500	500	500	500	500	500	500	500	500	500	6,000	
Depreciation Removal Cost		138	138	138	138	138	138	138	138	138	138	138	138	1,651	
Amortization Expense		(34)	(34)	(34)	(34)	(34)	(34)	(34)	(34)	(34)	(34)	(34)	(34)	(408)	
Accumulated Depreciated Subtotal		(2,060)	(2,079)	(2,099)	(2,115)	(2,129)	(2,143)	(2,157)	(2,171)	(2,185)	(2,199)	(2,213)	(2,227)	(25,778)	
Accumulated Depreciation ending balance	(261,371)	(263,431)	(265,510)	(267,609)	(269,724)	(271,853)	(273,997)	(276,154)	(278,325)	(280,510)	(282,709)	(284,922)	(287,149)		(274,097)
Net Plant in Service	$487,553	$490,518	$493,463	$496,389	$498,624	$500,846	$503,054	$505,247	$507,427	$509,592	$511,744	$513,882	$516,005		$502,642
REVISED															
Plant in Service															
Plant in Service Additions		$3,779	$3,967	$4,103	$3,749	$3,867	$3,913	$3,804	$3,740	$4,183	$5,000	$4,198	$4,046	$48,349	
Plant in Service Retirements		500	500	500	500	500	500	500	500	500	500	500	500	6,000	
Plant in Service ending balance	$741,552	744,830	748,298	751,901	755,150	758,517	761,930	765,234	768,474	772,157	776,657	780,354	783,901		$762,227
Depreciation Expense		(2,634)	(2,647)	(2,659)	(2,672)	(2,683)	(2,694)	(2,706)	(2,717)	(2,729)	(2,743)	(2,757)	(2,769)	(32,409)	
Depreciation Retirements		500	500	500	500	500	500	500	500	500	500	500	500	6,000	
Depreciation Removal Cost		138	138	138	138	138	138	138	138	138	138	138	138	1,651	
Amortization Expense		(34)	(34)	(34)	(34)	(34)	(34)	(34)	(34)	(34)	(34)	(34)	(34)	(408)	
Accumulated Depreciated Subtotal		(2,031)	(2,043)	(2,056)	(2,068)	(2,079)	(2,091)	(2,102)	(2,113)	(2,125)	(2,139)	(2,153)	(2,166)	(25,166)	
Accumulated Depreciation ending balance	(261,254)	(263,284)	(265,327)	(267,383)	(269,451)	(271,530)	(273,621)	(275,723)	(277,836)	(279,961)	(282,101)	(284,254)	(286,420)		(273,704)
Net Plant in Service	$480,298	$481,546	$482,970	$484,518	$485,698	$486,986	$488,308	$489,510	$490,637	$492,195	$494,556	$496,100	$497,481		$488,523

Reduction in Capital Additions - 2003	($11,882)
Change in Plant In Service - 2003 13-month average	($14,512)
Change in Accumulated Depreciation - 2003	394
Change in Net Plant in Service - 2003	($14,118)
Change in Depreciation Expense - 2003	($612)

Peoples Gas System
Analysis of Account 921
Projected Test Year 2003

Exhibit No. ________
Docket No. 020384-GU
Peoples Gas System
(JPH-3)
Page 1 of 1

1	Expense - PTY 2003 as included in MFRs	$16,559,318	
2	Less initial adjustments proposed by OPC:		
3	Payroll trended	(22,938)	
4	Other trended	(1,138,446)	
5	Difference	35	
6	Subtotal	15,397,969	(a)
7	Less additional adjustments proposed by OPC:		
8	Tampa Electric "Other Not Trended"	(325,300)	
9	Tampa Electric "Annualization Adjustment"	(1,019,217)	(b)
10	TECO Energy Cost Adjustment	(730,861)	
11	Revised Expense per OPC for **PTY 2003**	$13,322,591	
12	Variance - OPC's PTY 2003 vs. PTY 2003 as filed	($3,236,727)	
13	Actual Expense - Historic Base Year **2001**	$15,059,002	
14	Variance - OPC's PTY **2003** vs. HBY **2001**	($1,736,411)	

15 (a) Amount described as "reasonable" per testimony of H. W. Schultz III.

16 (b) Majority of TEC charges are recorded in account 921.

Peoples Gas System
Calculation of Bad Debt Factor

	Write-Offs	Gross Revenue	Less Gross Off-System Sales	Adj. Gross Revenue	Bad Debt Factor
1998	$635,641	$252,807,000	$4,556,536	$248,250,464	0.2560%
1999	$840,410	$251,717,000	$16,165,307	$235,551,693	0.3568%
2000	$1,052,177	$314,459,000	$38,762,037	$275,696,963	0.3816%
2001	$1,797,754	$352,883,642	$38,218,318	$314,665,324	0.5713%
Totals	$4,325,982	$1,171,866,642	$97,702,198	$1,074,164,444	0.4027%
2003	**$1,084,688**	$269,353,847	$0	$269,353,847	0.4027%
	$1,718,294	Bad debt expense per original MFRs			
	($633,606)	Bad debt expense adjustment			

2003 Gross Revenue Calculation:	
Gross Revenues without EC or taxes	$244,218,918
Add: Estimated Energy Conservation Rev.	10,000,000
Gross Receipts & Franchise Fee Rev.	15,059,444
Staff Revenue Adjustment (Interrog. 125)	75,485
2003 Gross Revenue	$269,353,847

TECO
PEOPLES GAS

SURVEYS USED TO PERFORM JOB EVALUATIONS FOR 2001

Administrative Band

Compdata Survey Sponsored by The Florida Chamber of Commerce
- Compensation Data 2000 Florida

PricewaterhouseCoopers
- SGA 2000 Compensation Survey Participant Report

Technical Band

PricewaterhouseCoopers
- SGA 2000 Compensation Survey Participant Report

Compdata Survey Sponsored by The Florida Chamber of Commerce
- Compensation Data 2000 Florida

SURVEYS USED TO PERFORM JOB EVALUATIONS CONTINUED

TECO PEOPLES GAS

Professional Band

Watson Wyatt Data Services Industry Report
- -Materials Management Personnel Compensation
- -Scientific and Professional Compensation

PricewaterhouseCoopers
- -SGA 2000 Compensation Survey Participant Report

Towers Perrin
- -Energy Services Industry Middle Management & Professionals
- -General Industry Middle Management & Professionals

Management Band

Watson Wyatt Data Services Industry report
- -Supervisory Management Compensation
- -Materials Management Personnel Compensation

PricewaterhouseCoopers
- -SGA 2000 Compensation Survey Participant Report

TECO PEOPLES GAS

SURVEYS USED TO PERFORM JOB EVALUATIONS CONTINUED

Management Band

Towers Perrin

-Energy Services Industry Middle Management & Professionals

-General Industry Middle Management & Professionals

Senior Management Band

Towers Perrin

-Energy Services Industry Executive Compensation

-General Industry Executive Compensation

ID: Clas	Job Title:	Market Data Avg	Market Data 50th %	Market Data *TC Avg	PGS Base Avg	PGS *TC Avg	PGS Base Avg Vs Mkt Data Avg	PGS Base Avg Vs Mkt Data 50%	PGS *TC Avg Vs Mkt *TC Avg
[redacted]									

*TC = Total Compensation

ID: Clas	Job Title:	Market Data Avg	Market Data 50th %	Market Data *TC Avg	PGS Base Avg	PGS *TC Avg	PGS Base Avg Vs Mkt Data Avg	PGS Base Avg Vs Mkt Data 50%	PGS *TC Avg Vs Mkt *TC Avg
[redacted]									

*TC = Total Compensation

ID: Clas	Job Title:	Market Data Avg	Market Data 50th %	Market Data *TC Avg	PGS Base Avg	PGS *TC Avg	PGS Base Avg Vs Mkt Data Avg	PGS Base Avg Vs Mkt Data 50%	PGS *TC Avg Vs Mkt *TC Avg
[redacted]									

*TC = Total Compensation

SCHEDULE G-2 **Revised with rates proposed by PSC in Deprec. Study** CALCULATION OF THE PROJECTED TEST YEAR - DEPR & AMORT

FLORIDA PUBLIC SERVICE COMMISSION

EXPLANATION PROVIDE THE CALCULATION FOR DEPRECIATION AND AMORTIZATION EXPENSE FOR THE PROJECTED TEST YEAR

TYPE OF DATA SHOWN
PROJECTED TEST YEAR 12/31/03
WITNESS J P HIGGINS

COMPANY. PEOPLES GAS SYSTEM

DOCKET NO · 020384-GU

			Rates	ESTIMATED DEPRECIATION AND AMORTIZATION EXPENSE FOR THE YEAR ENDING 12/31/03												
LINE NO	A/C NO	DESCRIPTION	Proposed by PSC	Jan 2003	Feb 2003	Mar 2003	Apr 2003	May 2003	Jun 2003	Jul 2003	Aug 2003	Sep 2003	Oct 2003	Nov 2003	Dec 2003	TOTAL EXPENSE
1	375	STRUCTURES AND IMPROVEMENTS	2.700%	$ 37,163	$ 37,298	$ 37,433	$ 37,568	$ 37,703	$ 37,837	$ 37,972	$ 38,107	$ 38,242	$ 38,377	$ 38,511	$ 38,646	$ 454,857
2	376	MAINS - STEEL	3.700%	785,355	787,829	790,273	792,718	795,163	797,607	800,052	802,497	804,942	807,386	809,831	812,276	9,585,929
3	376 02	MAINS - PLASTIC	2 800%	418,684	423,620	428,578	433,536	438,494	443,453	448,411	453,369	458,327	463,285	468,243	473,201	5,351,201
4	378	M & R EQUIPMENT - GENERAL	3 900%	20,501	20,774	21,048	21,321	21,595	21,868	22,142	22,415	22,689	22,962	23,236	23,509	264,060
5	378 01	M & R EQUIPMENT - GENERAL	3 900%	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
6	379	M & R EQUIPMENT - CITY	3 000%	13,661	13,649	13,637	13,626	13,614	13,602	13,590	13,579	13,567	13,555	13,543	13,532	163,155
7	379 01	M & R EQUIPMENT - CITY	3 000%	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
8	380	SERVICE LINES -S TEEL	6 600%	198,910	199,271	199,632	199,992	200,353	200,714	201,075	201,436	201,797	202,158	202,519	202,880	2,410,736
9	380 02	SERVICE LINES - PLASTIC	4 400%	413,708	416,131	418,555	420,979	423,403	425,827	428,251	430,674	433,098	435,522	437,946	440,370	5,124,463
10	381	METERS	5 400%	114,130	114,369	114,608	114,847	115,086	115,325	115,564	115,804	116,043	116,282	116,521	116,760	1,385,339
11	381 01	METERS	5 400%	0	0	0	0	0	0	0	0	0	0	0	0	0
12	382	METER INSTALLATIONS	4 300%	90,202	90,674	91,147	91,620	92,093	92,566	93,039	93,512	93,984	94,457	94,930	95,403	1,113,627
13	383	REGULATORS	4 600%	35,047	35,255	35,464	35,673	35,881	36,090	36,298	36,507	36,716	36,924	37,133	37,341	434,329
14	384	REGULATOR INSTALL HOUSE	4 400%	32,245	32,417	32,589	32,761	32,933	33,105	33,277	33,449	33,621	33,793	33,965	34,137	398,292
15	385	M & R EQUIPMENT - INDUSTRIAL	3 000%	22,053	22,118	22,182	22,247	22,312	22,376	22,441	22,506	22,570	22,635	22,700	22,765	268,904
17	387	OTHER EQUIPMENT	7 900%	14,091	14,230	14,368	14,506	14,645	14,783	14,921	15,060	15,198	15,337	15,475	15,613	178,227
18	390	STRUCTURES AND IMPROVEMENTS	2 700%	2,071	2,063	2,055	2,047	2,039	2,031	2,024	2,016	2,008	2,000	1,992	1,984	24,330
19	391 00	OFFICE FURNITURE	9 700%	24,591	25,131	25,672	26,213	26,754	27,295	27,836	28,376	28,917	29,458	29,999	30,540	330,781
20	391 01	COMPUTER EQUIPMENT	19 800%	172,466	175,524	178,582	181,641	184,699	187,757	190,816	193,874	196,932	199,990	203,049	206,107	2,271,437
21	391 02	OFFICE EQUIPMENT/MACHINES	6 600%	2,552	2,549	2,546	2,542	2,539	2,536	2,532	2,529	2,525	2,522	2,519	2,515	30,406
22	391 03	OFFICE FURNITURE/EQUIP	-	-	-	-	-	-	-	-	-	-	-	-	-	0
23	392 01	AUTO & TRUCK LESS THAN 1/2 TON	14 300%	114,000	121,088	128,177	131,249	130,305	129,362	128,418	127,475	126,531	125,587	124,644	123,700	1,510,537
24	392 02	AUTO & TRUCK 3/4 TO 1 TON	11 300%	18,040	18,040	18,040	18,040	18,040	18,040	18,040	18,040	18,040	18,040	18,040	18,040	216,476
25	392 03	AIRPLANCES	1 700%	8,542	8,542	8,542	8,542	8,542	8,542	8,542	8,542	8,542	8,542	8,542	8,542	102,505
26	392 04	TRAILERS, OTHER	3 900%	822	819	816	814	811	809	806	804	801	798	796	793	9,689
27	392 05	TRUCKS OVER 1 TON	7 300%	6,302	6,252	6,201	6,151	6,100	6,050	5,999	5,949	5,898	5,847	5,797	5,746	72,292
28	393	STORES EQUIPMENT	11 300%	532	527	522	517	512	507	502	497	492	487	482	477	6,056
29	394	TOOLS SHOP & GARAGE EQUIPMENT	6 700%	21,189	21,284	21,379	21,474	21,569	21,664	21,758	21,853	21,948	22,043	22,138	22,232	260,531
30	394 01	TOOLS SHOP & GARAGE EQUIPMENT - CNG	6 700%	0	0	0	0	0	0	0	0	0	0	0	0	0
31	395	LABORATORY EQUIPMENT	5 000%	540	540	540	540	540	540	540	540	540	540	540	540	6,479
32	396	POWER OPERATED EQUIPMENT	6 300%	11,218	11,261	11,304	11,347	11,390	11,434	11,477	11,520	11,563	11,606	11,649	11,692	137,461
33	397	COMMUNICATION EQUIPMENT	9 700%	28,650	29,040	29,430	29,820	30,210	30,600	30,990	31,380	31,770	32,160	32,550	32,940	369,543
34	398	MISC EQUIPMENT	3 200%	834	834	834	834	834	834	834	834	834	834	834	834	10,009
35		TOTAL DEPRECIATION EXPENSE		2,608,097	2,631,130	2,654,156	2,673,165	2,688,159	2,703,153	2,718,147	2,733,141	2,748,135	2,763,129	2,778,123	2,793,117	32,491,652
36		AMORTIZATION EXPENSE		96,402	96,402	96,402	96,402	96,402	96,402	96,402	96,402	96,402	96,402	96,402	96,402	1,156,819
37		TOTAL AMORT & DEPR EXPENSE - REVISED		2,704,499	2,727,532	2,750,557	2,769,567	2,784,561	2,799,555	2,814,549	2,829,543	2,844,537	2,859,530	2,874,524	2,889,518	33,648,471
		TOTAL AMORT & DEPR EXPENSE - ORIGINAL MFRs		2,697,636	2,716,946	2,736,244	2,752,874	2,766,837	2,780,800	2,794,762	2,808,725	2,822,687	2,836,650	2,850,612	2,864,575	33,429,346
		INCREASE (DECREASE) FROM DEPRECIATION STUDY		$6,863	$10,586	$14,313	$16,693	$17,724	$18,755	$19,787	$20,818	$21,849	$22,881	$23,912	$24,943	$219,125

SUPPORTING SCHEDULES G-1 p 12, G-2 p 24

RECAP SCHEDULES G-2 p.1, G-2 p 5