CONFIDENTIAL

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:

BRUCE NARZISSENFELD
On Behalf of Peoples Gas System

6.12.04

DECLASSIFIED

CONFIDENTIAL

This docketed notice of intent was filed with Confidential Document No. 12334-02 The document has been placed in confidential storage pending timely receipt of a request for confidentiality.

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Bruce Narzissenfeld 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 Controller.

Q. ARE YOU THE SAME BRUCE NARZISSENFELD WHO HAS PREVIOUSLY FILED DIRECT TESTIMONY ON BEHALF OF PEOPLES IN THIS PROCEEDING?

A. Yes.

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") and 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 OPC and / or Commission Staff adjustments:

- Accumulated deferred income tax increase related to bonus tax depreciation
- Expense reduction related to executive stock grants and incentive compensation
- Expense reduction related to Supplemental Executive Retirement Plan (SERP) cost allocated from TECO Energy

- Expense reduction related to advertising
- Expense reduction related to sales and marketing
- Expense reduction related to rate case expense
- Expense reduction related to the meter sampling program
- Rate Base reduction related to non-utility use of land and structures

Q. DO YOU AGREE WITH MS. DeRONNE'S PROPOSED ADJUSTMENT OF $7,992,760 TO ACCUMULATED DEFERRED INCOME TAXES TO REFLECT THE IMPACT OF BONUS TAX DEPRECIATION CONTAINED IN THE ECONOMIC STIMULUS PACKAGE SIGNED INTO LAW IN MARCH 2002?

A. No. The Company agrees that an adjustment is appropriate for the impact of bonus depreciation on accumulated deferred income taxes; however, we disagree with Ms. DeRonne's calculation of the amount.

Q. HOW DOES YOUR CALCULATION OF BONUS DEPRECIATION DIFFER FROM MS. DeRONNE'S?

A. My calculation differs in two respects. First, my calculation reflects Peoples' capital spending as revised in Exhibit ___ (JPH-2) prepared by Company witness Mr. Higgins. Second, as stated in her testimony and on Exhibit ___ (DD-1) , Schedule D, Page 2, Ms. DeRonne assumes 100% of the Company's projected additions qualify for bonus depreciation. She also testifies that "...the Company's tax department would be more qualified to make an exact determination" of which additions will qualify for bonus depreciation. The Company's calculation on Exhibit ___

(BNN-2) reflects the tax department's review of capital projects and the exclusion of those additions related to contracts entered into prior to September 11, 2001.

Q. WHAT HAVE YOU CALCULATED THE INCREASE IN ACCUMULATED DEFERRED INCOME TAXES TO BE RESULTING FROM BONUS TAX DEPRECIATION?

A. The Company has calculated an adjustment of $4,278,225 to the 2003 projected test year 13-month average accumulated deferred income tax balance, which is detailed on Exhibit____(BNN-2). Additionally, it should be noted that accumulated deferred income taxes are temporary in nature and will eventually reverse. Therefore, while the new law does have an impact on the Company's 2003 accumulated deferred income taxes included in capital structure, the Company's revenue requirements in future years will be adversely impacted when these temporary differences reverse.

Q. DOES THE RECOGNITION OF BONUS DEPRECIATION ON ACCUMULATED DEFERRED INCOME TAXES REQUIRE ANY OTHER ADJUSTMENT TO THE COMPANY'S CAPITAL STRUCTURE?

A. Yes. To appropriately reflect the Company's capital structure, it is necessary to decrease short-term debt by the identical amount that accumulated deferred income taxes are increased in connection with the recognition of this bonus depreciation.

Q. WHY IS THE ADJUSTMENT TO SHORT-TERM DEBT APPROPRIATE?

A. To the extent bonus depreciation generates cash, this cash will be used to reduce the Company's short-term borrowings.

Q. OPC'S WITNESS CICCHETTI PROPOSED THAT THIS ADJUSTMENT BE MADE PRO-RATA OVER ALL INVESTOR SOURCES OF CAPITAL. WHY IS THIS NOT APPROPRIATE?

A. It is not appropriate because the other sources will not be affected by this adjustment. In addition to short-term debt, the other investor sources of capital are customer deposits, long-term debt and equity. The Company will not refund deposits to customers. The Company, in all likelihood, will not reduce long-term debt because of "make-whole" provisions in the agreements as well as the relatively small dollar amounts in relation to the total debt outstanding. The Company's equity would not be affected because the Company already dividends 100% of its earnings to its parent. Thus, what the Company would actually do with the additional funds generated by bonus depreciation is reduce short-term debt, which is why the appropriate adjustment is to short-term debt, rather than a pro-rata application over all investor sources of capital.

Q. HAVE YOU REVIEWED MS. DeRONNE'S PROPOSED ADJUSTMENT TO OPERATIONS AND MAINTENANCE ("O&M") EXPENSE TO REMOVE PROJECTED EXECUTIVE STOCK GRANTS, AND MR. SCHULTZ'S ADJUSTMENT TO REMOVE INCENTIVE COMPENSATION COSTS ALLOCATED FROM TECO ENERGY?

A. Yes.

Q. HOW DO YOU RESPOND TO THESE PROPOSED ADJUSTMENTS?

A. In her testimony, Ms. DeRonne proposed an adjustment of $444,000 to reduce O&M expense for executive stock grants. Mr. Schultz proposes a similar adjustment of $289,975 to eliminate restricted stock as shown on Exhibit_____ (HWS-1), Schedule H. Neither of these adjustments should be made.

Q. PLEASE EXPLAIN YOUR RATIONALE FOR NOT MAKING THESE ADJUSTMENTS.

A. Incentive compensation, including executive stock grants, is an integral component of the total compensation package provided to officers. At both TECO Energy and Peoples, the determination of compensation for officers is administered by the four member Compensation Committee of the Board of Directors, which is composed entirely of independent, non-employee directors. This Committee recommends to the full Board the total compensation package for officers. The objective of the Company's compensation program is to attract and retain the talent needed to manage and build the Company's business. The Committee seeks, therefore, to provide compensation that is competitive. To assist the Committee in its determination of fair and appropriate compensation, the compensation and benefits consulting firm Towers Perrin performs annual studies of the value of total compensation provided to officers, as it compares to that paid in the energy services industry and in general industry. A copy of the most recently received executive summary from Towers Perrin is attached as Exhibit____(BNN-3). In determining an officer's compensation, the

Committee first determines the appropriate total value of compensation and then allocates this total amount among base salary, annual incentive awards and long-term incentive awards. Towers Perrin compared officers' compensation to a composite in which the energy services industry was weighted at 60% and general industry at 40%. The results of this study found that officers' cash compensation (which is defined as base salary plus annual incentive award) was at the 50th percentile and long-term incentive awards (which consist of equity-based grants in the form of stock options and restricted stock) were at the 62nd percentile. Accordingly, the inclusion of both the incentive award and the stock grants as components of officers' compensation yields results that are comparable with both the energy services industry and general industry. These awards and grants are appropriate components of the compensation package necessary to attract and retain the talent needed to manage and build the company's business. They are components of a total compensation package and do not represent "additional," "extra" or "excessive" compensation as asserted by Ms. DeRonne and Mr. Schultz.

Q. DO YOU AGREE WITH MR. SCHULTZ'S PROPOSED ADJUSTMENT TO REMOVE SERP COSTS ALLOCATED FROM TECO ENERGY?

A. No. Mr. Schultz proposes an adjustment of $159,647 on Exhibit____ (HWS-1), Schedule H. This adjustment should not be made.

Q. PLEASE EXPLAIN YOUR RATIONALE FOR NOT MAKING THIS ADJUSTMENT.

A. The provision of a SERP is an integral component of the total benefits package provided certain officers of the corporation. The objective of the Company's executive benefit program is to assist in the attraction and retention of the talent needed to manage and build the Company's business. Oversight of the corporation's executive benefit program is the responsibility of the four member Compensation Committee of the Board of Directors, which is composed entirely of independent, non-employee directors. This Committee recommends to the full Board benefits for officers of the corporation. The Committee seeks to provide a comprehensive benefit program that is market competitive. To assist the Committee in evaluating the market competitiveness of the corporation's executive retirement program, the compensation and benefits consulting firm Towers Perrin recently conducted a study of the executive retirement program. Part of the study was to determine how TECO Energy's SERP program compares to those provided in the energy services sector, as well as in general industry. Towers Perrin concluded that the SERP program of TECO Energy is within the boundaries of competitive practices for an organization of TECO Energy's size, stature, and industry profile. The program is fully competitive with both general industry and the energy industry. The SERP is a component of a total benefit package and does not represent "additional," "extra" or "excessive" compensation as asserted by Mr. Schultz. Therefore, no adjustment should be made.

Q. HAVE YOU REVIEWED THE ADVERTISING EXPENSE ADJUSTMENT PROPOSED BY MS. DeRONNE AND PRESENTED ON HER EXHIBIT ____(DD-1), SCHEDULE C-4?

A. Yes. In general, the Company finds Ms. DeRonne's proposed adjustment of $127,757 reasonable. Staff witness Mr. Rohrbacher has also reviewed the advertising that is referred to by Ms. DeRonne and has proposed an adjustment of $132,285. The Company 's concern is that only one of these adjustments should be made, not both.

Q. HAVE YOU REVIEWED MS. DeRONNE'S TESTIMONY REGARDING PEOPLES' OUTSOURCING OF ITS SALES AND MARKETING FUNCTIONS TO TECO PARTNERS?

A. Yes. She makes a number of observations regarding Peoples' decision to outsource these functions, and on her Exhibit ___ (DD-1), Schedule C-3, ultimately proposes an adjustment to reduce sales and marketing expense in the 2003 projected test year by $802,122.

Q. DISREGARDING FOR A MOMENT THE PRECISE ADJUSTMENT PROPOSED BY MS. DeRONNE, ARE THE OBSERVATIONS SHE MAKES REGARDING THE COMPANY'S DECISION TO OUTSOURCE THESE FUNCTIONS ACCURATE?

A. No. Ms. DeRonne gives the impression that inadequate due diligence was performed in the formation of TECO Partners and in the decision by Peoples to outsource its sales and marketing functions to this organization. The decision to outsource the sales and marketing function was carefully examined and this decision was discussed with the Commission Staff prior to commencement as well as disclosed through Peoples' filing of its 2001 FPSC Annual Report (FERC Form 2).

Q. MS. DeRONNE STATES SHE WAS TOLD BY UNIDENTIFIED "COMPANY PERSONNEL" THAT THE COST REDUCTIONS PROPOSED AS A RESULT OF OUTSOURCING THESE FUNCTIONS WOULD BE 10% IN THE FIRST YEAR, WITH ADDITIONAL 3% DECREASES THEREAFTER. IS THIS STATEMENT CORRECT?

A. I have no idea what Ms. DeRonne may have been told, but her fixation on a 10% savings in the first year of the arrangement is simply mistaken. No one in the Company is aware of any documentation indicating that the savings would be 10% in the first year of the arrangement, nor was it ever the expectation of anyone in Peoples' management that a 10% savings would be realized in the first year. If, in fact, Ms. DeRonne was told by "Company personnel" of anticipated 10% cost reductions in the first year, such personnel was or were uninformed of the facts, and/or whatever statement he, she or they may have made was either spoken, or taken by Ms. DeRonne, out of context. No 10% savings from the outsourcing by Peoples of its sales and marketing functions was at any time ever contemplated.

Q. WHAT SAVINGS DID THE COMPANY ANTICIPATE IN THE FIRST YEAR?

A. The savings contemplated were estimated at 3%, which represented the absorption by TECO Partners of salary increases and inflation.

Q. MS. DeRONNE HAS TESTIFIED IT IS CORRECT, AS STATED IN MR. SIVARD'S TESTIMONY, THAT THE MFRs INCLUDE REDUCTIONS FOR BOTH 2002 AND 2003 FROM SALES AND MARKETING EXPENSE RECORDED ON THE COMPANY'S BOOKS IN 2001. HOWEVER, SHE HAS ALSO TESTIFIED THAT THE SALES EXPENSE RECORDED IN ACCOUNT 912 FOR 2000, PRIOR TO OUTSOURCING THE SALES AND MARKETING FUNCTION, INCREASED FROM $3 MILLION IN 2000 TO $8 MILLION IN 2001. IS MS. DeRONNE'S TESTIMONY IN THIS REGARD CORRECT?

A. Yes, the increase of $5 million is mathematically accurate. However, it does not compare the total sales and marketing expense in various accounts in 2000 with similar accounts in 2001.

Q. PLEASE EXPLAIN HOW THESE ACCOUNTS SHOULD BE COMPARED.

A. The correct analysis has been completed and is contained in Exhibit_____ (BNN-4), which is identical to Peoples' answer to Staff's Interrogatory No. 105. This schedule considers all categories of expenses that are associated with the performance of the sales and marketing services versus considering only the sales expenses charged to Account 912. Considering Account 912 expenses on a stand alone basis is not a correct or appropriate approach to determine actual sales and marketing expenses incurred by the Company. Ms. DeRonne's acknowledges this fact in her testimony when she states "Consequently, a comparison of only Account 912 to determine the impact of the cost reductions would not reflect an accurate comparison of sales and marketing costs before and after the separation of TECO Partners, Inc.".

Q. MS. DeRONNE STATES THAT NO COST BENEFIT ANALYSIS WAS CONDUCTED BY THE COMPANY PRIOR TO ITS DECIDING TO OUTSOURCE THE SALES AND MARKETING FUNCTIONS. IS THIS CORRECT?

A. Yes. No formal cost benefit study was performed. However, as stated earlier, the Company carefully reviewed and thought out the decision to outsource its sales and marketing function. The outsourcing arrangement was not a last minute decision. An analysis was conducted and the characterization of how the amounts to be paid under the contract between Peoples and TECO Partners were determined was appropriately described in Peoples' answer to Staff's Interrogatory No. 106. As stated in the Company's answer to that interrogatory, Peoples did not perform a formal "cost-benefit analysis." Peoples performed an in depth analysis of its 2000 expenses to determine the total cost of its sales and marketing activities regardless of where the costs might have been charged (depreciation expense, taxes other than income, G&A expense, etc.). TECO Partners then agreed to perform the same level of sales and marketing for less than Peoples would have otherwise paid. The decision to outsource was a simple matter of getting the same services for less money. Again, stated in simple terms, it was a very easy decision for the Company to make that they could receive, and are now receiving, the same services for less money.

Q. IS PEOPLES GAS THE ONLY COMPANY FOR WHICH TECO PARTNERS PROVIDES SALES AND MARKETING SERVICES?

A. No. Peoples is only one of TECO Partners' 17 customers.

Q. MS. DeRONNE EXPRESSES SOME CONCERNS REGARDING THE CONTRACT BETWEEN TECO PARTNERS AND PEOPLES. CAN YOU ADDRESS HER VARIOUS CONCERNS?

A. Yes. First, Ms. DeRonne expresses concern because the 2001 contract anticipates a payment from Peoples to Partners of $8.75 million, but when compared to the revised marketing costs for 2000, it was $8,751,680. She observed that these amounts are very close, and do not reflect a 10% savings. Her observation that the two amounts are very close is correct. However, as I have previously testified, Ms. DeRonne's impression that there would be a 10% savings in the first year of the arrangement is erroneous.

Second, Ms. DeRonne was concerned because the agreements involved the shifting of Peoples Gas employees to a non-regulated affiliate company. These shifts of employees were reported on the FPSC Annual Report (FERC Form 2) which contains a specific area for reporting transfers.

Third, Ms. DeRonne states that very little information was provided to justify the contract amounts and the level of expenses included in the projected 2003 test year for these agreements. This is simply not the case. First and foremost, the MFRs clearly state that the level of expenses included for the payments required by the Company's contract are projected to decrease 3% from the 2002 contract payments. Aside from this, the Company firmly believes that it was more than cooperative in providing to the OPC and the Commission Staff virtually every one of the broad categories of documents relating to TECO Partners and the Company's decision to outsource its sales and marketing functions. The Company also responded to numerous interrogatories propounded by both the OPC and the Commission Staff, and responded to all audit requests on the subject made by the Commission's audit personnel. Ms. DeRonne's concerns are simply unfounded.

Q. MS. DeRONNE HAS SUGGESTED THAT THE COMMISSION CONSIDER INITIATING A MORE IN-DEPTH INVESTIGATION INTO THE RELATIONSHIP BETWEEN TECO PARTNERS AND PEOPLES GAS SYSTEM. DO YOU AGREE WITH THIS?

Given the complete disclosures as indicated in the Company's FERC Form 2, discussions with the Commission Staff, and representatives of the Office of Public Counsel (including Ms. DeRonne), the audit recently conducted in this rate proceeding, and the Company's responses to voluminous discovery in this case, Peoples believes the investigation suggested by Ms. DeRonne would be redundant. Nevertheless, the Company would not oppose such an investigation because it firmly believes the actions it has taken in connection with the outsourcing of the sales and marketing functions to TECO Partners have been prudent, appropriate, reasonable, and completely "above board."

Q. DO YOU AGREE WITH MS. DeRONNE'S PROPOSED ADJUSTMENT TO SALES AND MARKETING EXPENSE OF $802,122?

A. No. The entirety of the adjustment is based on a 10% reduction of the Company's 2000 marketing expense as calculated by Ms. DeRonne. As I have previously testified, the 10% reduction is erroneous and unsupported. Therefore, this calculation is not accurate and no adjustment is required or should be made.

Q. DO YOU AGREE WITH MS. DeRONNE'S PROPOSED ADJUSTMENT TO RATE CASE EXPENSE?

No. The $60,000 adjustment proposed by Ms. DeRonne in her testimony is not appropriate. The expense proposed by the Company in the MFRs was based on two components: the dollar amount of rate case expense ($240,000) that the Company at that time estimated it would incur in the case, and the period of time over which this expense should be recovered (two years). Ms. DeRonne's proposed adjustment is directed to the amortization period component, so I will address that component first.

The amortization period chosen is largely a matter of judgment, giving consideration to past history as well as financial impact to the ratepayers. Through the many cost-saving measures implemented by the Company, which have been discussed throughout this proceeding, Peoples has been successful, until now, in avoiding a proceeding for increased rates for more than 10 years. To look at past history, one must go back to the period from 1981 to 1991. During that 10 year period, the Company had five rate cases, or an average of one every two years. The choice of an amortization period is a matter of judgment, and Ms. DeRonne's use of four years is no more supported than the Company's use of two years.

The other component – the expense estimated to be incurred by the Company in this proceeding – is no longer appropriate. The estimate of $240,000 at the time the Company's MFRs were filed was based on Peoples' experience in its past rate cases. However, the intensity of the discovery conducted in this proceeding has made past history meaningless. As a result, the Company has experienced, and is experiencing, significantly higher costs than have ever been incurred in its prior cases. Among the areas in which these higher costs have been incurred are higher overtime costs as a result of the Company's almost continuous efforts to respond to a vastly increased number of interrogatories and production requests, higher expert/outside witness costs as a result of multiple depositions, and higher legal costs as a result of the significant increase in discovery and resisting a motion to compel discovery from the Company of documents in the possession and control of its affiliates.

Q. DO YOU HAVE A REVISED PROJECTION OF THE COMPANY'S RATE CASE EXPENSE?

A. Yes. The Company's new and more accurate projection of its rate case expense is $350,000, or an increase of $110,000.

Q. WHAT EFFECT WOULD THIS HIGHER RATE CASE EXPENSE HAVE ON THE AMORTIZATION INCLUDED IN THE COMPANY'S MFRs?

A. Based on a two year amortization period, this higher cost would result in an increase in rate case expense amortization of $55,000. Thus, the amortization of rate case expense included in the projected test year should be increased from $120,000 to $175,000.

Q. ARE YOU FAMILIAR WITH THE ADJUSTMENTS PROPOSED BY MR. FLETCHER IN HIS TESTIMONY?

A. Yes.

Q. DO YOU AGREE WITH THE ADJUSTMENTS PROPOSED BY MR. FLETCHER?

A. I disagree with two of his proposed adjustments. First, Mr. Fletcher proposed an adjustment to reduce expenses in Account 878 by $1,617,598 related to the Company's meter sampling program. This adjustment is discussed at lines 11 through 19 on page 5 of his direct testimony. Second, Mr. Fletcher has proposed adjustments reducing rate base to reflect non-utility use of land and structures. These adjustments are discussed at lines 1 through 19 on page 4 of his direct testimony.

Q. IS MR. FLETCHER'S PROPOSED ADJUSTMENT OF $1,617,598 TO ACCOUNT 878, RELATED TO THE COMPANY'S METER SAMPLING PROGRAM, APPROPRIATE?

A. Absolutely not. There are at least two flaws in the stated rationale for the adjustment.

Q. WHAT IS THE COMPANY'S METER SAMPLING PROGRAM?

A. In 1998, the Company initiated a statistical meter sampling program pursuant to Commission Rule 25-7.064, to replace its former 10 year meter change-out program. The new program, which was approved by the Commission, is a sampling plan which uses military standard sampling techniques to identify how many meters will be removed from the field and tested to verify they satisfy meter accuracy standards. Based on the total number of meters that Peoples has in service, the military standard establishes 315 as the minimum number of meters that must be tested in order to insure the accuracy of the sample.

Q. PLEASE EXPLAIN THE FLAWS IN THE ADJUSTMENT PROPOSED BY MR. FLETCHER.

A. As I stated earlier, the military standard used in the new program establishes 315 as the minimum number of meters that must be tested in order to insure the accuracy of the sample. Mr. Fletcher incorrectly characterizes 315 as being the normal number of meters tested and proposes an adjustment to normalize expenses to that level. This is an incorrect adjustment to make because it assumes the only meters to be tested are those making up the minimum sample. Mr. Fletcher also contradicts his position regarding what is normal by pointing out that "since the initiation of the sampling program in 1998, each year the statistical sample group has failed to meet accuracy requirements." In other words, each year Peoples has been required to test more than the minimum 315 meters, so to say that 315 is "normal" is unsupported by the facts.

Q. WHAT ARE THE OTHER PROBLEMS WITH MR. FLETCHER'S PROPOSED ADJUSTMENT TO ACCOUNT 878?

A. Even if one was to accept that some normalization is appropriate (which Peoples does not accept), Mr. Fletcher's proposed adjustment to O&M Expense Account 878 is incorrect. In calculating his adjustment, Mr. Fletcher took into consideration Change-Out Installation Expense (estimated at $63.03 per meter), Meter Removal Expense (estimated at $13.45 per meter), and Meter Testing Expense (estimated at $6.00 per meter). When, in the course of the sampling program, the Company identifies a failed family of meters, the Company initiates a program to retire the meters in the failed family and replace them with new meters. As such, for the failed family of meters, the Change-Out Installation Expense of $63.03 per meter and the Meter Removal Expense of $13.45 per meter are charged to capital, not to O&M Expense in Account 878 as suggested by Mr. Fletcher.

Q. ARE YOU SUGGESTING THAT SEPARATE ADJUSTMENTS SHOULD BE MADE TO CAPITAL AND O&M EXPENSE RELATING TO THE METER SAMPLING PROGRAM?

A. No. In the case of the Meter Testing Expense, which is an O&M expense, no adjustment should be made for the reasons stated above; that is, the expense level included in the Company's MFRs is not abnormal or non-recurring. In the case of the Change-Out Installation Expense and the Meter Removal Expense, no adjustment should be made for two reasons. First, as previously stated, the level of meter change-outs is not abnormal. Second, even if it were deemed to be abnormal, accelerated meter retirements, shortened service life, and the associated removal costs are items that are usually dealt with in a depreciation study. In a depreciation study, average service life as well as higher negative salvage (removal cost) are items that are considered in setting appropriate depreciation rates. Thus, it would be inappropriate to make any adjustment to capital in this proceeding because these costs were prudently incurred and the assets are used and useful in providing utility service.

Q. MR. FLETCHER HAS PROPOSED AN ADJUSTMENT REDUCING RATE BASE TO REFLECT NON-UTILITY USE OF LAND AND OFFICES. DO YOU AGREE WITH MR. FLETCHER'S PROPOSED ADJUSTMENT?

A. In general, I do not disagree with Mr. Fletcher's analysis and the methodology used to allocate a portion of certain land and buildings to non-utility. There is, however, one portion of his adjustment that needs to be addressed.

As indicated by witness J. Paul Higgins, Peoples' capital spending in 2002 and 2003 will be less than was originally included in the MFRs. One of the items included in this reduction in spending for 2003 is the Company's elimination of its South Florida Regional Office. Mr. Fletcher correctly points out that this office will not be used and useful, and has included this in his proposed adjustment. If an adjustment is made to plant in service based on the Company's Exhibit____(JPH-2), then that portion of Mr. Fletcher's adjustment relating to the South Florida Regional Office should not be made as this would result in the adjustment's being doubled counted. Exhibit____(BNN-5) shows the adjustment proposed by Mr. Fletcher with the portion of the adjustment relating to the South Florida Regional Office removed.

Q. WHAT ARE THE COMPANY'S PLANS FOR THE SOUTH FLORIDA REGION OFFICE IF THIS BUILDING IS REMOVED?

A. In lieu of an owned facility, it is anticipated that office space will be leased. There is currently a proposal to lease 4,300 square feet at an annual rent expense of $67,865. As such, rent expense should be increased by $67,865 annually.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

PEOPLES GAS SYSTEM
Projected Test Year Ended December 31, 2003

Exhibit No. _____
Docket No. 020384-GU
Peoples Gas System
(BNN-2)

Additional Accumulated Deferred Income Taxes - Revised Depreciation Projections

Line No.	Description	Amount	Reference
1.	Revised 2002 Tax Depreciation	45,612,000	
2.	2002 Book Depreciation	30,193,000	Exhibit___(JPH-2)
3.	Projected 2002 Depreciation M-1	15,419,000	Line 1 Less Line 2
4.	2002 Depreciation M-1 Reported on MFRs	7,496,000	MFR Schedule G-2, p. 249
5.	Additional M-1	7,923,000	Line 3 Less Line 4
6.	Tax Rate	35%	
7.	Addition to Deferred Income Tax Balance - 2002	2,773,050	Line 5 x Line 6
8.	Revised 2003 Tax Depreciation	47,390,000	
9.	2003 Book Depreciation	32,409,000	Exhibit___(JPH-2)
10.	Projected 2003 Depreciation M-1	14,981,000	Line 8 Less Line 9
11.	2003 Depreciation M-1 Reported on MFRs	6,380,000	MFR Schedule G-2, p. 252
12.	Additional M-1	8,601,000	Line 10 Less Line 11
13.	Tax Rate	35%	
14.	Addition to Deferred Income Tax Balance - 2003	3,010,350	Line 12 x Line 13
15.	Total Addition to Deferred Income Tax Balance - Year End	5,783,400	Line 7 + Line 14
16.	Total Addition to Deferred Income Tax Balance - 13 Month Average	4,278,225	Exhibit___(BNN-2), page 2

PEOPLES GAS SYSTEM
Projected Test Year Ended December 31, 2003

Exhibit No. _____
Docket No. 020384-GU
Peoples Gas System
(BNN-2)

Additional Accumulated Deferred Income Taxes - Revised Depreciation Projections

	BEG BALANCE	JANUARY 2003	FEBRUARY 2003	MARCH 2003	APRIL 2003	MAY 2003	JUNE 2003	JULY 2003	AUGUST 2003	SEPTEMBER 2003	OCTOBER 2003	NOVEMBER 2003	DECEMBER 2003	13 MONTH AVERAGE	Reference
Accumulated Deferred Income Tax - Originally Reported	17,305,014	17,273,350	17,241,687	17,210,023	17,178,360	17,146,696	17,115,032	17,083,369	17,051,705	17,020,041	16,988,378	16,956,714	16,925,050	17,115,032	MFR Schedule G-1, p. 189
Increase to Deferred Income Tax - Revised Depreciation	2,773,050	3,023,913	3,274,775	3,525,638	3,776,500	4,027,363	4,278,225	4,529,088	4,779,950	5,030,813	5,281,675	5,532,538	5,783,400	4,278,225	Exhibit__(BNN-2), p. 1 of 2
Revised Accumulated Deferred Income Tax	20,078,064	20,297,263	20,516,462	20,735,661	20,954,860	21,174,059	21,393,257	21,612,457	21,831,655	22,050,854	22,270,053	22,489,252	22,708,450	21,393,257	

12377 Merit Drive, Suite 1200
Dallas, TX 75251-3234
972 701-2510
Fax: 972 701-2578
E-mail: ellermj@towers.com

Towers Perrin

VIA EXPRESS COURIER

PERSONAL AND CONFIDENTIAL

April 5, 2002

Mr. Clint Childress
Vice President - Human Resources
TECO Energy, Inc.
702 N. Franklin Street
Tampa, FL 33601

RE: 2002 Long-Term Incentive Strategy and Grant Guidelines

Dear Clint:

At your request, Towers Perrin has prepared this letter report detailing our recommended long-term incentive strategy and grant guidelines for TECO Energy executives and management. Our analysis and recommendations include prospective grant levels for approximately 34 executives and management employees.

Competitive Analysis and Methodology

In recent years, Towers Perrin has developed long-term incentive grant guidelines for TECO Energy executives at the 50th and 62nd percentiles of the competitive market. For the past two years, the Compensation Committee has allowed for grants to occur at the 62nd percentile. We are recommending that the Committee consider adopting 62nd percentile grant guidelines for 2002 as well.

In developing our grant guidelines, we have used "blended rates" in consideration of the Company's sources of revenues: 60 percent of TECO's revenues are derived from the regulated utility business and 40 percent of TECO's revenues are derived from the non-regulated business sector. Accordingly, we have weighted our long-term incentive survey data as 60 percent energy services industry and 40 percent general industry to reflect the business sectors in which TECO Energy competes.

The competitive data has been developed using Towers Perrin's expected value methodology for the valuation of long-term incentive awards. Stock options have

Towers Perrin

been valued by use of the Black-Scholes Option Pricing Model. Key assumptions and terms used in calculating the expected value of a TECO Energy stock option are cited below:

Table A
Black-Scholes Option – Value of a TECO Energy Stock Option

Share Price	=	$26.94	(FMV on 3/19/2002)
Option Strike Price	=	$26.94	(FMV on 3/19/2002)
Option Term	=	10 Years	
Dividend Rate	=	5.61%	
Risk-Free Rate	=	5.69%	
Volatility	=	25.36%	
Black-Scholes Ratio	=	18.20%	
Stock Option Value	=	$4.91	

Recommended Form of Long-Term Incentives

For the past two years, TECO Energy has granted long-term incentives in two forms: (1) stock options and (2) performance-based restricted shares. The performance-based restricted shares are earned over a three-year performance period based upon TECO Energy's total shareholder return ("TSR," the gain in share price plus the value of reinvested dividends over the measurement period). The long-term incentive strategy has been to grant 50 percent of the competitive long-term incentive value at the 50th percentile in the form of stock options and 50 percent of the competitive long-term incentive value at the 50th percentile in the form of performance-based restricted stock. Based upon performance considerations, we have recommended to the Committee in each of the past two years to grant TECO Energy executives long-term awards at the 62nd percentile. This has been achieved by increasing only the performance-based restricted shares by the competitive amount to reach the 62nd percentile positioning.

For the 2002 award cycle, Towers Perrin recommends that TECO Energy make a slight shift in its long-term incentive strategy to address competitive market issues. We recommend that TECO Energy make grants in 2002 at the 62nd percentile of competitive practice in recognition of the Company's financial performance (to be discussed in detail in subsequent paragraphs of this letter) as well as including a third long-term element in the form of time-lapse restricted stock. The resultant long-term incentive strategy would have the following three components of long-term award opportunity at the 62nd percentile:

Towers Perrin

Table B
Recommended 2002 Long-Term Incentive Award Vehicles

LTI Element	Percent of LTI Component Expected Value
Stock Options	33.34%
Performance-Based Restricted Stock	33.33%
Time-Lapse Restricted Stock	33.33%

Time-lapse restricted shares differ from performance-based restricted shares in that the restrictions on full ownership lapse at the end of the designated restricted period based upon the passage of time only. We recommend that the TECO time-lapse restricted shares have 100 percent of the restrictions lapse after three years from the date of grant. Another distinction between time-lapse restricted shares and performance-based restricted shares is the preferential accounting treatment afforded time-lapse restricted stock. Time-lapse restricted shares are expensed by taking the grant price times the number of shares granted and amortizing the expense over the restricted period (three years). None of the appreciation in share price above the initial grant price has to be expensed with time-lapse restricted shares. Performance-based restricted shares receive variable accounting treatment in that any changes in share price and the number of shares earned must be expensed over the restricted period.

Our rationale in recommending the addition of time-lapse restricted shares to the TECO Energy long-term incentive strategy is two-fold. First, the addition of time-lapse restricted shares will better align TECO Energy with competitive practice in the utility industry. Many large utilities such as FPL Group, Progress Energy, Duke Energy, Entergy, Dominion, and The Southern Company have adopted time-lapse restricted share plans in recent years to assist their organizations with executive retention needs. Towers Perrin's Compensation Data Bank reported in late 2001 that 35 percent of the 78 companies in our electric utility/energy services database use time-lapse restricted shares. The second reason underlying our recommendation is the difficulty in establishing meaningful performance targets and metrics in the current economic environment. During the past 12 months, the electric utility industry has been affected by numerous external matters that have impacted performance — the California energy crisis, the greater uncertainty in many states regarding deregulation, the downturn in the U.S. and global capital markets, and more. These external events have made it increasingly difficult for utilities' top management to respond to a more competitive marketplace. As a result, many

Towers Perrin

companies have turned to time-lapse restricted stock to provide a portion of their long-term incentive opportunities to management.

Recommended Grant Levels

In the attached Exhibit 1, Towers Perrin has developed recommended grant levels for 34 TECO Energy executives and managers. The recommendations reflect the proposed executive compensation strategy of 33 percent stock options and 33 percent each in time-lapse and performance-based restricted shares. The new recommended approach results in approximately $400,000 more in prospective accounting expense and the same approximate number of shares (955,864 versus 953,944) than the prior approach of the past two years. Table C below sets forth a comparison of the two approaches from a prospective dilution and expense basis.

Table C
Comparative Analysis of New Recommended Approach to LTI Strategy with the Approach of the Prior Two Years

	Prior Approach Used in 2000 & 2001	Recommended Approach for 2002
1) Competitive LTI Expected Value @ 62nd Percentile for All Participants (in $000)	$10,315.0	$10,315.0
2) Recommended Stock Option Grant		
- Number of Shares	698,283	700,630
- Prospective Accounting Expense (in $000)	$0	$0
3) Recommended Performance-Based Restricted Stock Grant		
- Number of Shares	255,661	127,617
- Prospective Accounting Expense (in $000)	$6,887.5	$3,842.1
4) Recommended Time-Lapse Restricted Stock Grant		
- Number of Shares	N/A	127,617
- Prospective Accounting Expense (in $000)	N/A	$3,438.0
5) Totals for All Award Types		
- Expected Value (in $000)	$10,315.0	$10,315.0
- Number of Shares	953,944	955,864
- Prospective Accounting Expense (in $000)	$6,887.5	$7,280.1

Footnotes:

(1) The prospective accounting expense for time-lapse restricted shares is the present value of the share price times the number of shares granted.

(2) The prospective accounting expense for the performance-based restricted shares is the value of the share price at grant times an annual growth rate of 10 percent annually times the number of shares granted, for three years, discounted to today's present value at an annual discount rate of 6 percent.

It should be noted that the prospective dilution of 955,000 shares granted in options represents approximately .7 of one percent of total shares outstanding.

Finally, we should note that the current TECO Energy long-term incentive plan allows for the grant of time-lapse restricted shares. The plan has been approved by shareholders previously and would not require a shareholder vote in the current proxy.

Rationale for 62nd Percentile Grant Levels

TECO Energy's executive compensation philosophy has been to pay executives at the 50th percentile of competitive practice. The Company has maintained this policy for the past ten years or more; in 2000 and 2001, the Compensation Committee approved a departure from this practice by allowing the long-term incentive component to be 62nd percentile awards.

Towers Perrin has examined TECO Energy's performance compared to 12 other southern U.S. utilities in the attached Exhibit 2. The 12 comparator utilities were selected by Towers Perrin at random to show overall market results in the energy services sector in 2001 as well as over the past two to three years. TECO Energy's total return to shareholders for 2001 has been negative due to a downturn in share price which is not reflective of the Company's financial performance. TECO Energy ranks in the upper quartile on both return on equity and EPS growth for the past 12 months and three years, and it is on this basis that we support long-term incentive grants at the 62nd percentile in the form of performance-based restricted stock.

*   *   *   *

Towers Perrin

We hope that this letter and the attached Exhibits clearly portray our recommendations for the 2002 long-term incentive grants. Should you have any questions, please feel free to call me directly.

Very truly yours,

John R. Ellerman

JRE:dh

Attachments

EXHIBIT No.________
DOCKET NO. 020384-GU
PEOPLES GAS SYSTEM
(BNN-4)
PAGE 1 of 1

Marketing Dept Expenses
Period Ending: December 31, 2000

Account Number (xx = Division)	Salaries & Commission	Materials & Supplies	Employee Expense	Transportation	Outside Services	Advertising	Utilities	Allocations	Other Expenses	Total	Adjustments
01 xx 100 91201	203,691	3,163	3,259		1,557				6,830	218,500	
01 xx 100 91205	(39)		697							658	
01 xx 130 87901	-	318	-	-	-	-	-	-	-	318	
01 xx 130 88001	1,096	823	321	163	-	-	-	-	-	2,400	
01 xx 130 88601	-	-	-	-	2,073	-	-	-	-	2,073	
01 xx 130 90301	21,151	-	-	-	-	-	-	-	-	21,151	
01 xx 130 91201	1,227,844	39,708	384,684	30,539	67,989	-	27,113	-	286,473	2,064,350	
01 xx 130 91205	(381)	-	-	-	-	-	-	-	-	(381)	
01 xx 130 91301	15,376	842	1,513	-	-	129,908	-	-	-	147,639	
01 xx 130 91601	-	-	-	-	-	660	-	-	-	660	
01 xx 130 92001	231,652	-	-	-	-	-	-	-	-	231,652	
01 xx 130 92101	-	14,731	69,282	-	44,871	-	33,621	-	26,602	189,107	
01 xx 130 92501	-	171	88	-	259	-	-	-	-	518	
01 xx 130 92601	-	-	1,867	-	-	-	-	-	-	1,867	
01 xx 130 93001	-	-	500	-	-	-	-	-	-	500	
01 xx 130 93003	-	-	8,942	-	-	-	-	-	-	8,942	
01 xx 130 93101	-	-	-	-	-	-	-	-	5,173	5,173	
01 xx 130 93201	-	2,016	-	-	10,958	-	-	-	188	13,162	
01 xx 300 91201	426,717	-	-	-	-	-	-	-	-	426,717	
01 xx 300 91205	(1,447)	(1,791)	(4,076)	-	-	-	-	-	-	(7,314)	
01 xx 300 92001	647,227	-	-	-	-	-	-	-	-	647,227	
01 xx 301 91201	-	-	13,506	-	-	-	-	-	52,266	65,772	
01 xx 301 91301	-	-	-	-	-	652,920	-	-	-	652,920	
01 xx 301 92101	-	81,283	53,252	666	68,229	-	-	33,066	5,879	242,395	
01 xx 302 91201	-	59	54,224	-	22,303	-	-	-	-	76,586	
01 xx 302 91601	-	-	-	-	-	(9,150)	-	-	-	(9,150)	
01 xx 302 92101	-	-	-	-	-	-	-	67,652	4,000	71,652	
01 xx 303 91201	-	933	25,209	1	3,190	-	-	-	9,830	39,163	
01 xx 303 92101	-	8,833	57,450	-	29,489	-	-	10,193	16,377	120,342	
01 xx 304 91201	-	797	22,090	-	48,215	-	-	-	18,823	89,925	
01 xx 304 91301	-	-	-	-	-	23,069	-	-	-	23,069	
01 xx 304 92101	-	55	11,813	-	4,907	-	-	-	(19,528)	(2,753)	
01 xx 304 93003	-	-	15,932	-	-	-	-	-	-	15,932	
01 xx 305 92101	-	1,990	14,604	-	5,667	-	-	-	-	22,261	
01 xx 400 91201	7,263	1,843	2,698	-	1,720	-	3,903	-	(186)	17,241	
01 xx 400 91301	-	-	1,844	-	7,943	-	-	-	2,092	11,879	
01 xx 410 91201	-	8,032	2,869	-	7,308	-	-	-	-	18,209	
01 xx 410 91301	-	-	-	-	4,187	-	-	-	1,250	5,437	
Total O&M	2,780,149	141,803	742,570	31,369	350,864	797,407	64,637	110,931	416,069	5,435,799	
01 xx 310 90801	563,793	4,497	152,236	3,764	69,599	-	-	82,068	1,411,334	2,287,291	
01 xx 310 90901	-	(966)	-	-	-	930,300	-	-	-	929,334	
01 xx 311 90801	112,048	804	13,723	-	156,039	-	-	15,444	7,520	305,578	
01 xx 311 90901	-	-	-	-	-	46,360	-	-	-	46,360	
Total EC	675,841	4,335	165,959	3,764	225,638	976,660	-	97,512	1,418,854	3,568,563	
01 xx 700 01111	4									4	
01 xx 700 10700	728,568									728,568	
Total Capital	728,572	-	-	-	-	-	-	-	-	728,572	
02 xx 450 91201	1,377	108,437	14,573	-	-	38,091	-	256	1,017	163,751	
02 xx 450 91202	-	683	-	-	-	1,822	-	-	-	2,505	
02 xx 450 91301	-	7,707	-	-	-	136,460	-	-	-	144,167	
02 xx 450 92002	435,285	-	-	-	-	-	-	-	-	435,285	
Total Propane	436,662	116,827	14,573	-	-	176,373	-	256	1,017	745,708	
Total Marketing	$ 4,621,224	$ 262,965	$ 923,102	$ 35,133	$ 576,502	$1,950,440	$ 64,637	$ 208,699	$ 1,835,940	$ 10,478,642	$10,478,642
Adjustments for Teco Partners Contract											
Less:											
Advertising	-	-	-	-	-	(1,774,067)	-	-	-	(1,774,067)	
Propane Exp	(436,662)	(116,827)	(14,573)	-	-	(176,373)	-	(256)	(1,017)	(745,708)	
Energy Conservation (less Advertising)	(675,841)	(4,335)	(165,959)	(3,764)	(225,638)	-	-	(97,512)	(1,418,854)	(2,591,903)	(5,111,678)
Add:											
Executive Dollars (Dept. 900)	253,125	-	-	-	-	-	-	-	-	253,125	
RSVP Bonuses - Booked in Dept 903 @ 10%	461,822	-	-	-	-	-	-	-	-	461,822	
Fringe @ 15%	-								693,184	693,184	
Corporate Communications (Dept. 400 @ Cor	-	-	-	-	257,568	-	-	-	-	257,568	
Consultant - Portion not charged to Marketing	-	-	-	-	32,725	-	-	-	-	32,725	
Corporate Plane Expense	-	-	-	20,000	-	-	-	-	-	20,000	1,718,424
Function Realignment:											
Field Coordinators	(235,000)	-	-	-	-	-	-	-	-	(235,000)	
Cross Department Charges	(210,916)	(13,036)	(11,367)	-	(22,715)	-	(3,903)	-	(9,986)	(271,924)	
Builder Reps/Industrial Reps	675,841		165,959							841,800	
Liaison/Customer Service	(60,000)	-	-	-	-	-	-	-	-	(60,000)	
Economic Development	-	-	-	-	(300,000)	-	-	-	-	(300,000)	
CRC's (10 FTE's)	200,000	-	-	-	-	-	-	-	-	200,000	
Transfers from 300 to 320	(170,000)	-	-	-	-	-	-	-	-	(170,000)	4,876
Add: Utility Activities (CY'00) to be paid by Marketing in 2001											
Depreciation	-	-	-	-	-	-	-	-	160,880	160,880	
Telecom	-	-	-	-	225,000	-	-	-	-	225,000	
Legal	-	-	-	-	100,000	-	-	-	-	100,000	
Rent	-	-	-	-	-	-	-	-	483,360	483,360	
Employee Events	-	-	10,000	-	-	-	-	-	-	10,000	
MetroStudy - Residential Surveys (700-001-02	-	-	-	-	54,180	-	-	-	-	54,180	
G&A	-	-	-	-	-	-	-	420,000	-	420,000	1,453,420

Total Contract Amount - Trued Up through December 31, 2000 $ 8,543,684

SOUTH FLORIDA REGIONAL OFFICE BUILDING REMOVAL AS PROPOSED BY MR. FLETCHER

	Account 374	Account 375	Account 390	Total
Plant Adjustment				
Proposed Adjustment	$637,019	$1,194,393	$46,105	$1,877,517
Less S. Florida Regional Office	589,000	1,069,145	0	1,658,145
Revised Adjustment	$ 48,019	$ 125,248	$46,105	$ 219,372
Depreciation Reserve Adjustment				
Proposed Adjustment		$ 51,160	$ 7,576	$ 58,736
Less S. Florida Regional Office		26,878	0	26,878
Revised Adjustment		$ 24,282	$ 7,576	$ 31,858