PEOPLES GAS SYSTEM

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

Docket No. 080318-GU

In Re: Petition for rate increase by Peoples Gas System

Submitted for Filing: August 11, 2008

DIRECT TESTIMONY AND EXHIBITS OF:

WILLIAM N. CANTRELL
On Behalf of Peoples Gas System

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is William N. Cantrell 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 the President of Peoples Gas System ("Peoples" or the "Company") and have served in that position since 1997.

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

A. After growing up in Tampa, Florida and attending H.B. Plant High School, I attended the Georgia Institute of Technology, graduating in 1974 with a Bachelor of Science degree in Electrical Engineering. In 2005, I was honored as a Distinguished Engineer Alumnus from Georgia Tech. I attended evening classes at the University of Tampa and graduated Magna Cum Laude in 1979 with a Masters Degree in Business Administration. I am a long time trustee of the University of Tampa. I began my professional career in June 1974 with Florida Power Corporation and began working for Tampa Electric in June 1975. I worked in various departments, including Power Plant Engineering, Environmental Planning, Generation Planning, Fuels and Production. In 1997, I became the President of Peoples Gas System. Currently, I am a board member of the Florida Natural Gas Association and the Southern Gas Association ("SGA") of which I will become chairman in 2009, and am a trustee of the American Gas Foundation ("AGF").

Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

A. As President, I am responsible for establishing the goals and objectives of

the Company. These include ensuring the safety, training, and overall welfare of our workforce, providing excellent service to our customers and the communities we serve, expanding our infrastructure to the tens of thousands of Floridians who desire natural gas for comfort, value and environmental responsibility, and delivering a reasonable return to shareholders who have invested in our company.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will provide an overview of how Peoples operates its distribution system to provide high quality service to our customers. I will describe the important benefits that natural gas provides to Florida and how Peoples can support energy policy in the state. I will also explain why Peoples is seeking increases in its base rates at this time. In doing so, I will describe some of the more significant factors that have contributed to the Company's decision to seek rate relief, as well as some of the actions the Company has taken to avoid having to do so until the filing of this case. I will also identify the other witnesses who will provide direct testimony in support of the Company's case and will give a brief summary of the subject matter on which they will testify.

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

A. Yes. I am sponsoring, and prepared or caused to be prepared Exhibits ____(WNC-1) through ____(WNC-3), to which I will refer later in my testimony.

Q. PLEASE PROVIDE SOME BACKGROUND INFORMATION ON PEOPLES, INCLUDING ITS ORGANIZATIONAL STRUCTURE,

AND THE TERRITORY AND CUSTOMERS IT SERVES.

A. Peoples Gas System is a subsidiary of TECO Energy, Inc. ("TECO Energy"), and currently operates the largest natural gas distribution system in the State of Florida. Peoples became part of TECO Energy in June 1997. At that time, Peoples served about 200,000 customers in 19 counties. As of the end of December 2007, the Company provided natural gas service to over 334,000 customers in 37 counties. Of this total, approximately 305,000 were classified as residential customers and 29,000 were classified as commercial or industrial customers. During the year ended December 31, 2007, Peoples sold 70,086,000 therms to its residential customers, and transported or sold 1,332,458,000 therms to its commercial and industrial customers, for a total of 1,402,544,000 therms. A "therm" is a unit of heat equal to 100,000 British Thermal Units or BTUs.

Peoples has been a leader in safety, winning awards from the American Gas Association ("AGA") for several years. As described later, Peoples has strived for and been successful at continuously improving customer service.

The distribution systems through which Peoples delivers gas to its customers are located in 14 separate geographical areas (divisions) within Florida, and these areas are combined into three "regions" that serve well over 100 franchised areas, as well as adjacent non-franchised areas. The regions are currently structured as follows:

the **South Region**, consisting of the Daytona Beach, Eustis, Orlando, Palm Beach, Southwest Florida and Dade-Broward

divisions;

the **West Region**, consisting of the Tampa, St. Petersburg, Lakeland, Avon Park and Sarasota divisions; and

the **North Region**, consisting of the Jacksonville, Panama City and Ocala divisions.

Each region is administered by a General Manager who is responsible for all operations and maintenance within the region. These General Managers report to the Vice-President, Operations. Peoples' corporate headquarters, located in Tampa, includes corporate offices and staff, as well as support services for the regions. A map showing generally the areas within which Peoples currently distributes gas is attached to my testimony as Exhibit ___(WNC-1).

Q. HOW DOES PEOPLES OBTAIN THE NATURAL GAS IT DELIVERS TO ITS CUSTOMERS?

A. The natural gas Peoples delivers to customers through its distribution system is received directly through three interstate pipelines, each regulated by the Federal Energy Regulatory Commission, or "FERC." Natural gas is delivered through Florida Gas Transmission Company ("FGT"), through Southern Natural Gas Company ("Southern") in Peoples' Jacksonville division, and through Gulfstream Natural Gas System ("Gulfstream") in Peoples' Lakeland, Tampa, Sarasota, Avon Park and Orlando divisions. Receiving gas supply through multiple interstate pipelines gives Peoples valuable flexibility and reliability in providing and maintaining service to its customers. The map attached to my testimony as Exhibit ___(WNC-2) visually depicts the locations of the three

interstate pipelines.

Q. IN GENERAL, HOW DOES PEOPLES DETERMINE ITS SOURCES OF NATURAL GAS SUPPLY?

A. Peoples uses a competitive bidding process to obtain a portfolio of supplies from numerous third-party suppliers that reflects balance among cost, reliability and operational flexibility in order to meet its obligation as a public utility to provide safe, adequate and efficient service to the general public.

Q. IS PEOPLES ABLE TO PURCHASE ALL ITS SUPPLIES FOR A LONG TERM AT A LOW FIXED PRICE TO STABILIZE THE COST OF GAS IT DELIVERS TO ITS SALES CUSTOMERS?

A. It could, but it wouldn't be prudent to do so. Peoples' system supply requirements vary significantly not just from year to year, but month to month and day to day. Demand for gas often varies dramatically within a month. Even though Peoples, as required by the Commission's rules, made transportation service available to all non-residential customers in 2000, customers continue to transfer from sales service to transportation service under the Company's Natural Choice program, and each transfer requires the Company to reassess its system supply requirements (*i.e.*, the requirements of the Company's sales customers).

Consumption of gas by Peoples' transportation customers varies significantly from day to day. Because Peoples receives significant portions of the total transportation volumes at a uniform daily delivery rate, Peoples must often increase or decrease quantities purchased for its system supply by significant increments to balance daily receipts and

deliveries of gas. Peoples must buy some of its total system requirements under "swing" contract arrangements, and uses swing gas, peaking gas, pipeline balancing volumes and pipeline no-notice service to meet extreme variations in delivered volumes.

Q. DOES PEOPLES EARN A RETURN ON THE GAS IT SELLS TO ITS SALES CUSTOMERS?

A. No. The costs of the gas commodity, and its transportation to the Company's system, are recovered by the Company on a dollar-for-dollar basis through the purchased gas adjustment ("PGA") clause, and are not the subject of this case. Peoples' bill to a transportation customer includes no charges for the gas commodity since the customer has purchased it from an entity other than Peoples. The Company makes no profit on the gas, and is indifferent as to whether a customer eligible for transportation service selects that service or sales service. The base rate for service is the same in either case.

Q. WHAT IS THE DIFFERENCE BETWEEN "SALES" CUSTOMERS AND "TRANSPORTATION" CUSTOMERS?

A. Sales customers purchase natural gas from Peoples on a "delivered" basis; that is, Peoples buys the gas from a supplier, has it delivered to the Peoples system through an interstate pipeline on which Peoples has contracted for capacity, and delivers the gas through the Company's distribution system to each customer's meter. Sales customers receive a single bill each month from Peoples, which includes applicable base rate charges that are the subject of this case, a PGA charge to recover the cost of the gas and other charges (various taxes, energy conservation charges,

franchise fees, etc.). Sales customers consist primarily of residential and small commercial customers.

Q. WHAT IS A "TRANSPORTATION" CUSTOMER?

A. There are two types of transportation customers. The first type consists of customers – generally larger volume users – who buy their natural gas from a supplier or marketer other than Peoples. These customers arrange for their gas to be delivered to an interstate pipeline, and contract with the pipeline to transport the gas to the Peoples system. These customers also contract with Peoples to deliver the gas across Peoples' system to their gas consuming facilities.

The second type of transportation customer is one whose usage may not be large enough to justify the customer's contracting individually with a gas supplier for supply, and/or with an interstate pipeline for the capacity required to deliver the gas to the Peoples system. These customers are served under Peoples' Natural Choice Transportation Service program. They contract with a natural gas marketer that has been qualified by Peoples as a "pool manager," and participate in a "pool" of customers. The pool manager buys gas for the entire customer pool it serves, and holds transportation capacity on an interstate pipeline to deliver the gas to the Peoples system. Peoples transports the gas it receives from the pipeline for the pool manager's account (which customers in the pool have purchased from the pool manager) to the customers' locations. These customers receive two bills each month – one from the pool manager for the cost of the gas as delivered to the Peoples system, and one from Peoples for transporting the gas through its system

to the customers' locations.

Q. HOW DOES PEOPLES RECEIVE DELIVERIES OF NATURAL GAS FROM THE INTERSTATE PIPELINES YOU'VE MENTIONED AND THAT ARE DEPICTED ON EXHIBIT ___(WNC-2)?

A. As I stated earlier, Peoples receives its gas supplies through three separately owned transmission pipeline systems – FGT, Southern and Gulfstream -- each regulated by the FERC. FGT was the first pipeline to deliver natural gas in Florida in the late 1950s. FGT delivers natural gas to Peoples through interconnects or "city gates" at more than 59 locations from Panama City to Miami. Southern began delivering natural gas to Peoples in or about 1991 in the Jacksonville area at one city gate. Gulfstream began delivering natural gas in Florida in 2002 through a pipeline system that originates in Mobile, Alabama, proceeds along the sea bed of the Gulf of Mexico, and makes landfall in Manatee County, Florida. Peoples receives natural gas from Gulfstream at six different locations, primarily in central Florida. As I also mentioned earlier, receiving natural gas supply through multiple interstate pipelines gives Peoples valuable flexibility and reliability in providing and maintaining service to its customers.

Q. HOW DO CUSTOMERS IN FLORIDA UTILIZE NATURAL GAS?

A. Residential customers use gas for a variety of uses including water and space heating, cooking and clothes drying. Commercial natural gas customers use gas in many of the same ways and include hospitals and associated health care facilities, lodging, education, food service, grocery

stores, laundry, dry cleaning and recreation facilities. Industrial customers use gas in a variety of ways and include businesses such as construction (production of shingles, drywall, cement and asphalt), agriculture (fruit processing, freeze protection and aquaculture), manufacturing (aluminum extrusion, steam generation, paper and phosphate), and food processing (dairy, bakery and bottled water).

Q. PLEASE PROVIDE AN OVERVIEW OF TRENDS IN RESIDENTIAL GAS USE.

A. Compared to many areas of the United States where natural gas is nearly a necessity for home heating because of cold winters, average usage per residential customer in Florida is low. That already low usage per customer has been gradually declining due to a number of factors, not the least of which is Peoples' aggressive conservation programs. However, although usage per customer is declining, existing and new residents of Florida continue to want access to natural gas because of its beneficial characteristics. While our customer base and the costs to serve that growing base have continued to increase, because we have helped our customers use natural gas more efficiently our revenues have not increased proportionally.

Q. WHAT ARE SOME OF THE BENEFITS OF NATURAL GAS?

A. First, most of the natural gas Peoples distributes is domestically produced. Approximately 84% of natural gas consumed in the United States is produced in the United States and most of the remaining 16% is produced in Canada.

Next, natural gas is extremely reliable. Transmission capacity into

Florida has tripled in the last 10 to 12 years. As I have described, we now have multiple interstate transmission pipelines in multiple corridors bringing natural gas into Florida and the capacity on those pipelines is already planned to increase further. In addition, natural gas storage facilities and the import of liquefied natural gas ("LNG") augment the supply picture.

Q. ARE THERE OTHER BENEFITS FROM UTILIZING NATURAL GAS?

A. Yes. Natural gas is a very energy efficient fuel. It can be used directly in appliance and other applications without the energy loss associated with the conversion to electricity. When the full cycle of producing, processing and transporting is considered, natural gas, when delivered directly to a customer is about 90% efficient compared to about 30% if electricity is utilized. There are several benefits derived from this high energy efficiency. The first benefit is that if natural gas is employed in direct use applications, less total energy is used to provide the same or enhanced service to our customers. The second benefit is that if natural gas is employed in direct use applications, power plants do not have to operate as much. In fact in 2007, had Peoples residential customers and only 25 percent of commercial customers used all electric appliances, the construction of an additional 600 megawatt power plant would have been required to generate over 3.5 million MWh of power.

Finally, natural gas is the cleanest of all fossil fuels. In addition to containing little or no sulfur, particulates or mercury, natural gas has 30 percent less carbon than oil and 45 percent less carbon than coal. So,

when natural gas is combusted, there is less carbon dioxide (CO_2) emitted. Combining the low carbon content of natural gas with the energy efficiency of its direct use results in opportunities to greatly reduce our carbon footprint. "Carbon footprint" is a measure of the impact human activities have on the environment in terms of the amount of CO_2 produced. Studies have shown that a consumer replacing an electric water heater with a natural gas tankless water heater can reduce his or her carbon footprint by about 3,000 pounds annually. Adding a dryer, range and furnace to the water heater can result in a total reduction of about 4,000 pounds of carbon dioxide annually. Displacing the 3.5 million MWh of electricity I have just mentioned with natural gas applications would provide a reduction of over 1.5 million tons of carbon dioxide on an annual basis. Thus, direct use of natural gas should play a vital role as a solution to environmental challenges in the future.

Peoples has aggressively promoted the efficient use of natural gas in the past, through our conservation programs and appliance rebates and through expanding our distribution system to provide natural gas, and therefore carbon reduction, to customers in many areas around the state. Our company plans to continue these activities in the future.

Q. DO YOU HAVE ANY EMPIRICAL OR OTHER EVIDENCE THAT DEMONSTRATES THE EFFICIENCY AND ENVIRONMENTAL BENEFITS YOU HAVE DESCRIBED?

A. Yes. Earlier this year, Black and Veatch Corporation released a study titled "Direct Use of Natural Gas – Implications for Power Generation, Energy Efficiency, and Carbon Emissions." The study was prepared for

the AGF and its purpose was to examine the market impact of the increased direct use of natural gas for residential and commercial end uses.

Q. WHAT MARKET IMPACTS WERE ADDRESSED?

A. Black and Veatch focused on overall energy usage, total energy costs, and total CO_2 emissions for a wide range of scenarios encompassing high and low CO_2 restrictions, high and low technology and high and low gas supply cases.

Q. WHAT WERE THE RESULTS OF THIS STUDY?

A. In all scenarios the increased direct use of natural gas reduced overall energy consumption, reduced the total price of energy and lowered total carbon emissions. In addition, a significant amount of new power generation was avoided. The Executive Summary of the study is attached to my testimony as Exhibit ___(WNC-3). I want to point out that this study concluded that Florida is one of the areas in the United States that would most benefit from the increased direct use of natural gas.

Q. WHAT IS THE SIGNIFICANCE OF THESE BENEFITS IN THIS CASE?

A. The United States Congress continues to consider the passage of legislation that addresses climate change issues by mandating, in some fashion, reduction of carbon emissions. The Florida Legislature this year also passed legislation requiring various actions to reduce energy usage with the goal of reducing carbon emissions. It is clear from the AGF study that increasing the availability and direct use of natural gas is a very cost-effective way to help accomplish this goal.

However, despite the benefits of natural gas I have just described,

and the state and national pressure to lower carbon emissions, expanding our system to make natural gas available to more areas and customers in the state is a real challenge.

Q. TO WHAT CHALLENGE DO YOU REFER?

A. Most of our customer additions are new homes in new housing developments. Many of these developments are located some distance from interstate natural gas transmission pipelines or our existing gas mains and are built out over multiple years. Unless Peoples is able to commit to a developer that we will extend our gas mains to the project prior to the time construction of the development commences, the developer will not be willing to design the homes for gas use. So Peoples must spend significant capital dollars up front, even though revenues only grow gradually over multiple years as homes are completed and families move in. Without the ability to recover these up front costs in a timely manner, Peoples is not always able to make this commitment. Then, as additional development occurs in the same area, construction becomes more costly and thus even more challenging. As a result, customers lose the opportunity to have natural gas service and the state loses the opportunity for significant carbon reductions. Lewis Binswanger will describe this challenge in more detail and support the Company's proposal to address this.

Q. IN GENERAL, WHAT RELIEF IS PEOPLES SEEKING IN THIS RATE PROCEEDING?

A. Peoples is proposing an increase in its base rates to account for changes in its rate base and operating expenses since its last base rate proceeding.

The Company is also seeking approval for two new tariff-based cost recovery mechanisms. The new base rates and other mechanisms will provide Peoples a better opportunity to achieve its allowed rate of return and recover its cost of service, and allow the Company to better provide safe, reliable service in a manner that is environmentally responsible and consistent with federal and state policies.

Q. WHEN WAS PEOPLES LAST RATE PROCEEDING?

A. Peoples' last rate case (Docket No. 020384-GU) was filed in June 2002. The final order (Order No. PSC-03-0038-FOF-GU) was issued on January 6, 2003, and a clarifying order (Order No. PSC-03-0415-FOF-GU) was issued on March 25, 2003. Through those orders, the Commission authorized the Company to revise its rates and charges so as to produce a return on common equity ("ROE") within the range of 10.25% to 12.25%, with a midpoint of 11.25%.

Q. IS PEOPLES CURRENTLY EARNING A REASONABLE RETURN ON COMMON EQUITY?

A. No. The Company's achieved ROE as of December 31, 2007 was 9.96% and, based on the Company's projections, is expected to drop further by the end of 2008. As Paul Higgins will testify, without rate relief, the adjusted ROE for 2009 is expected to drop further to 5.61%.

Q. WHAT ARE THE ADDITIONAL REVENUES FOR WHICH PEOPLES SEEKS APPROVAL IN THIS CASE?

A. Based on the 2009 projected test year, the Company requires a revenue increase of $26,488,091 to earn a fair return on its investment.

Q. WHY IS IT NECESSARY FOR PEOPLES TO SEEK RATE

RELIEF AT THIS TIME?

A. In the more than five years since Peoples was last authorized to increase or adjust its rates, a number of factors have contributed to the necessity for the Company to seek this adjustment. The Consumer Price Index ("CPI") during the period 2002 through 2007 increased more than 17%, which has not only required that the Company pay more for the goods and services it purchases, but also contributed to a steady increase in the level of the Company's direct and indirect payroll costs. The core of Peoples' infrastructure investment consists of thousands of miles of steel and plastic pipe of varying diameters. The costs of these materials have increased by more than the average increase in the CPI since the Company's last rate case. The cost of steel pipe of the diameters generally used by Peoples has more than doubled, and corresponding costs of plastic pipe have increased more than 45%. Additionally, as Mr. Higgins will testify, the costs of insurance and health care have continued to escalate at rates significantly higher than that of general inflation. Since Peoples' last rate case, additional compliance costs, such as those associated with Pipeline Integrity Management requirements of the U.S. Department of Transportation's Pipeline and Hazardous Materials Safety Administration, have been imposed on the Company, and have contributed to the increase in the cost of providing service to customers. As a final example, Donna Hobkirk will testify that the depreciation rates ordered by the Commission as a result of the Company's last depreciation study (Docket No. 060496-GU) resulted in a substantial increase in depreciation expense.

Notwithstanding the added customers and the accompanying

increase in the size of the Company's distribution system, the Company has been experiencing a declining use per residential customer from the average usage levels on which our current rates were based. As Susan Richards will testify, this continues a pattern that gas distribution companies across the nation have experienced over the last couple of decades. This long-term pattern is partially due to increasing appliance efficiency and tighter building standards, but in addition, Peoples has embraced and aggressively promoted energy efficiency with technologies like tankless water heaters, which use fewer therms a year than tank water heaters. The decline in per-customer use has accelerated in recent years due to price elasticity associated with the rising cost of natural gas. Our residential customers now use approximately 11% less gas than they did in 2002. That is more than one month's average usage. Our combined efforts have lowered customer's bills over the last six years and we are proud of the achievement. However, since the recovery of costs under Peoples' current rate design is largely based on customers' consumption of gas, the declining use per customer has, in effect, penalized Peoples for its conservation efforts, and adversely impacted Peoples' ability to recover its cost of service and earn a reasonable rate of return.

Q. IS ENERGY EFFICIENCY IMPORTANT TO FLORIDA?

A. Yes. This is one of the most important issues facing Peoples and its customers at this time. It is also fundamentally important for state energy policy. Peoples needs to be able to expand its system to offer the energy efficiency and carbon reduction benefits of the direct use of gas in lieu of electricity to more citizens of Florida. That will increase gas use in those

applications but decrease gas use overall through less need for gas-fired power generation. Peoples also needs to continue promoting conservation and energy efficiency to all of its customers by offering programs and incentives for efficient gas use. That also decreases overall gas use through efficiency but decreases Peoples' revenues and therefore its ability to earn its allowed return.

Over the last two years, I have monitored what other utilities are doing to address these opportunities, participated in numerous conferences and roundtable debates addressing the issues, worked with independent groups to refine and clarify calculations and conclusions, and led efforts to communicate the importance of these findings. In particular, I have met with hundreds of stakeholders in Florida, including customers, city and county officials, business leaders and elected officials. Although continuing dialogue will reveal even more opportunities, our proposals in this proceeding will provide immediate solutions to the challenge of meeting increasing needs of our population is an energy efficient, cost effective way.

Q. WHAT CAPITAL INVESTMENTS HAS PEOPLES MADE SINCE ITS LAST RATE PROCEEDING?

A. The Company has continued to expand its pipeline distribution system in order to make natural gas available as an energy-efficient, low-carbon energy choice to more customers in Florida. In addition, Peoples has invested capital to maintain facilities necessary to operate our system in a safe and reliable manner. Peoples also spends significant capital dollars to relocate its lines as required for municipal and other governmental

improvement projects. During the period 2004 through 2007, Peoples has made capital expenditures of over $182 million to provide service to existing and new customers. As Bruce Narzissenfeld will testify, during 2008 and the 2009 projected test year, we will spend an additional $122 million. Since new base rates were last set by the Commission, the estimated impact on Peoples' revenue requirements have been increased by more than $25 million just by the expansions of the Company's distribution system to add approximately 100,000 new residential and commercial customers.

Q. WHAT EFFORTS HAS PEOPLES MADE SINCE ITS LAST RATE CASE TO CONTROL OPERATING EXPENSE LEVELS?

A. Peoples has made substantial efforts to control expense levels and avoid the need for rate relief. The Company has implemented organizational and operational enhancements through consolidation of facilities, and standardization of business practices and processes that have helped to control operating and maintenance expenses for the benefit of the general body of ratepayers. For example, we improved our operations by reducing our division offices from 15 to 14. We also combined our four regional areas into three, thereby reducing supervisory and administrative costs. Since its last case, Peoples has also combined its four separate call centers into a single virtual call center. This resulted in additional reductions of supervisory and administrative costs. Through these restructurings, Peoples was able to reduce its workforce by approximately 11% while improving service levels. As a result of these and other measures, Peoples' annual operating and maintenance expense has increased only

modestly since the last rate case at an average annual rate of 3.9%.

Q. HAVE THERE BEEN SPECIFIC ACTIONS TAKEN BY PEOPLES TO IMPROVE THE LEVEL OF SERVICE PROVIDED TO CUSTOMERS?

A. Yes. Peoples has invested heavily in improving service to customers since our last rate case. I mentioned previously that we had consolidated from four separate regional call centers into a single virtual call center. This consolidation allowed us to centralize leadership for the function and standardize procedures and service levels for all of our customers. Our call center agents are focused on meeting the needs of our customers and because of their constant contact with customers are often the first ones to identify areas where we can take action and improve service. One area they identified as an area of opportunity was meter reading. Customers are more security conscious than ever before, and as a result our meter readers are increasingly challenged by fences and locked gates that force us to estimate meter readings. But estimated reads frustrate customers and often lead to unexpected true-ups when actual reads can be taken. In response, we put in place a company-wide initiative to hold estimates to 1% or less of all of our reads. Our team members have focused hard and have met this target through increased communication with customers and the use of automated meter reading on the most inaccessible meters.

Another challenge customers gave us was to provide next day service when they called us to have service restored or turned on. We felt strongly that our customers deserved this enhanced level of service and have accomplished it successfully for more than two years now.

We've also made investments in technology that have enhanced service levels for our customers. In just the last year, we have replaced the Interactive Voice Response ("IVR") system for our call center. The new IVR system is easier for customers to use and offers services that were not available in our previous system. Customers can now find a convenient location for automated bill payment, or obtain contact information for a licensed gas contractor 24 hours a day, seven days a week. With our old system, this information was only available when speaking with a customer service representative during normal business hours. We have seen the number of customers whose needs are met entirely without ever needing to talk with one of our agents increase about 40%. This has made our agents more accessible to those customers who actually need to speak with us.

We also brought our electronic bill website online earlier this year and customers have responded positively to the option of receiving their monthly bills online.

Q. HOW DO YOU MEASURE THE SUCCESS OF CUSTOMER SERVICE INITIATIVES SUCH AS THESE?

A. It is difficult to measure success with any real precision. However, one measure would be the level of customer complaint activity at the Commission. During 2007, a total of 74 complaints were made to the Commission by Peoples' more than 334,000 customers. Thirty-seven were related to service, and 37 to billing. While I would obviously prefer to have no complaints of any kind, that is probably unrealistic, but the 74 complaints represent only about two one hundredths of one percent of

Peoples' total customer base. We hope the very small number of complaints suggests the Company's customer service efforts are well received.

Q. WILL THE BASE RATES AUTHORIZED IN PEOPLES' LAST RATE CASE PRODUCE THE COMPANY'S CURRENTLY AUTHORIZED RATE OF RETURN?

A. No. As Mr. Higgins will testify, absent the rate relief sought, projections for the 2009 projected test year show an overall rate of return of 6.02%, equating to an ROE of 5.61%. This ROE can be compared to the 11.25% ROE midpoint currently authorized by the Commission, and to the 11.50% ROE midpoint supported by Dr. Donald Murry, and is not adequate to maintain Peoples' financial integrity.

Q. WHY WON'T THE BASE RATES AUTHORIZED IN THE LAST RATE CASE PRODUCE THE AUTHORIZED RATE OF RETURN?

A. The Company's authorized rates are currently inadequate primarily because of the effects of inflation and the capital invested to respond to customer demands for natural gas. The service rates authorized in the Company's last rate proceeding were based on the costs the Company was projected to incur in its fiscal year ended December 31, 2003. Peoples is seeking approval in this proceeding for rates necessary to recover its cost of service for the 2009 projected test year. Although the Company has been successful in expanding its customer base, the effects of continuing inflation on the Company's operating and construction costs, declining base rate revenues from existing customers and the continued expansion and improvement of the Company's distribution system, have combined to

render the previously authorized rates inadequate for recovery by the Company of its cost of service. Those rates will not produce a fair rate of return on the property of the Company used and useful in providing public service in the projected test year.

Q. WHAT OTHER WITNESSES WILL TESTIFY ON BEHALF OF PEOPLES IN THIS PROCEEDING, AND ON WHAT AREAS OR TOPICS WILL THEY TESTIFY?

A. There are 11 other witnesses who will provide direct testimony on behalf of Peoples.

Gordon Gillette, the Chief Financial Officer of TECO Energy, will testify regarding the Company's capital structure, the Company's strategies with respect to credit ratings and access to capital markets, and why no debt should be imputed to Peoples through a parent company debt adjustment.

Dr. Donald Murry, of C. H. Guernsey & Company, will present testimony with respect to the appropriate ROE for Peoples.

Donna Hobkirk, Manager, Plant Accounting, will testify with respect to the Company's plant in service during the historic base year, the depreciation expense and reserves associated with that plant, and non-utility allocations of plant.

Bruce Narzissenfeld, Vice President of Operations, will describe the capital expenditures planned by the Company during 2008 and the 2009 projected test year.

Alan Felsenthal, of Huron Consulting Group, will address several aspects of the income tax calculations submitted by Peoples in this

proceeding.

Richard Wall, General Manager, South Region, will present information used to develop the miscellaneous service charges in the Company's tariff.

Susan Richards, Manager, Budget and Finance, will testify regarding customer and throughput forecasts and the base revenue budget for the 2009 projected test year.

Paul Higgins, Assistant Controller, will testify with respect to the Company's budget process, the O&M benchmark calculation, and the calculation of and foundation for the revenue requirements in the 2009 projected test year. He will also present the Company's proposals to establish a storm damage reserve, to change the method of recovering the portion of bad debt expense attributable to the cost of gas, and for the treatment of off system sales for purposes of this case.

Daniel Yardley, of Yardley and Associates, will testify regarding the cost of service study, billing determinants and appropriate rate design.

Lewis Binswanger, Director, Strategic Planning and Regulatory, will explain in more detail how we operate, and present testimony on the appropriateness of the Gas System Reliability Rider and the Carbon Reduction Rider for which the Company is seeking approval.

Finally, Kandi Floyd, Manager, State Regulatory, will present the new and revised tariff sheets reflecting the requested rate adjustments and other tariff changes for which Peoples seeks the Commission's approval and explain some of the non-rate tariff changes for which Peoples is seeking approval.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

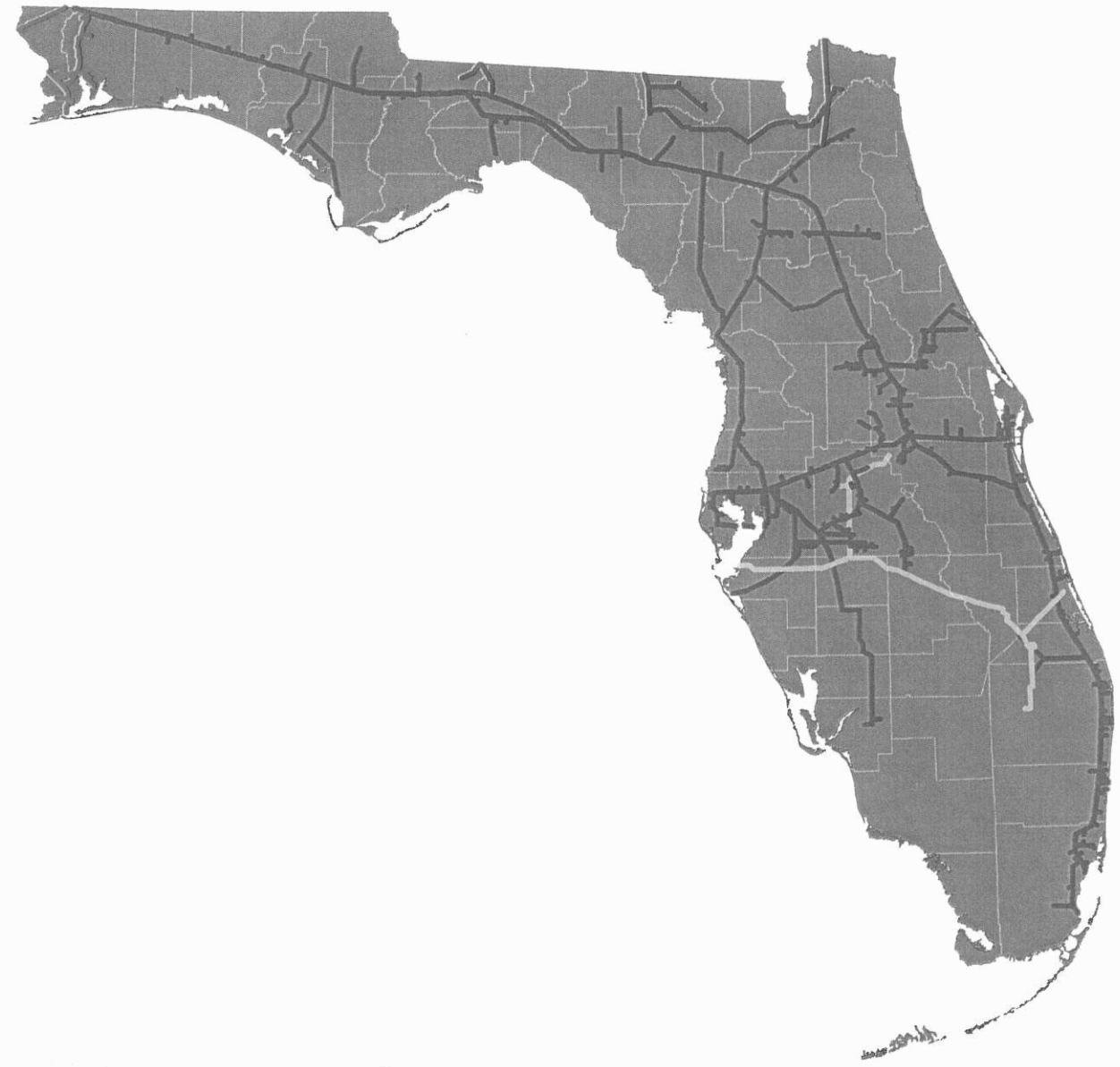
A. Peoples adjusted its base rates and customer charges in early 2003 as a result of the Commission's final orders in the Company's last rate case. Since then, Peoples has invested significant capital to provide clean, reliable, energy efficient natural gas to a growing customer base. Peoples continuing activities related to conservation, energy efficiency and system expansion are critical to state energy and environmental policy goals. Peoples has also worked hard to mitigate the impacts of rising costs in areas such as healthcare, materials and supplies, and depreciation expense, and to identify ways to address the impact of declining usage per customer.

Despite these efforts, the Company's earnings are now below the bottom of its authorized earnings range and are expected to decline further. These facts have made it necessary that Peoples request adjustments in its base rates and customer charges.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

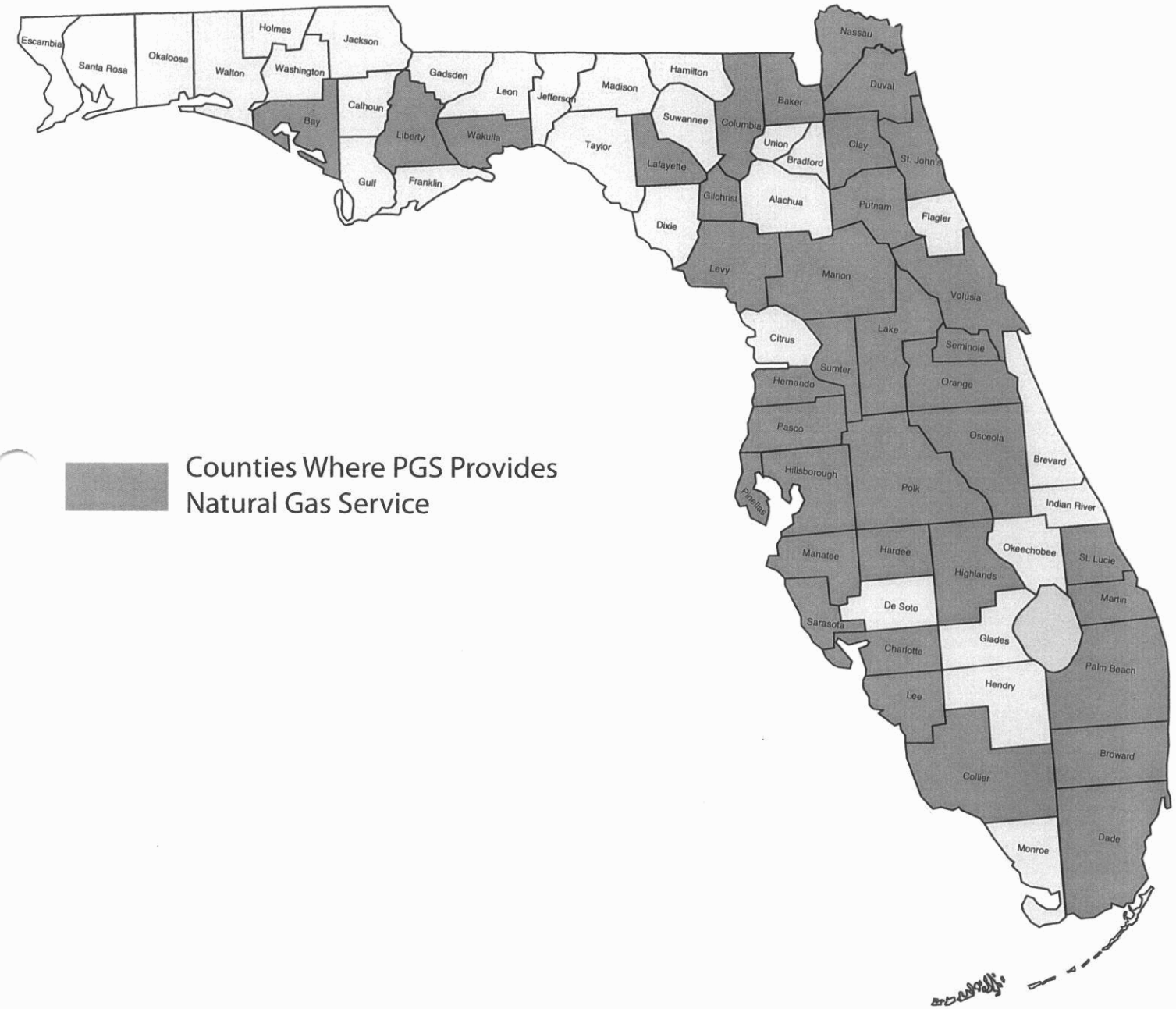
A. Yes, it does.

Interstate Gas Suppliers of Florida



TECO PEOPLES GAS

PGS Natural Gas Service Areas



Direct Use of Natural Gas

Implications for Power Generation, Energy Efficiency, and Carbon Emissions

April 2008

Prepared for the American Gas Foundation by:

Black & Veatch Corporation
5151 San Felipe, Suite 1900
Houston, TX 77056

1.0 EXECUTIVE SUMMARY

The North American energy market will experience continued uncertainty for the foreseeable future. In spite of notable increases in natural gas prices in recent years, the use of natural gas for power generation in the U.S. is expected to increase significantly in response to efforts to regulate greenhouse gas emissions. Concerns are also heightened regarding availability of energy supplies to meet growing demand. Both trends suggest that any comprehensive approach to addressing our nation's energy needs will include significant new commitments to both increasing energy efficiency and reducing the environmental impacts of energy use.

In addressing the challenge of meeting increasing demand for energy while also reducing greenhouse gas emissions restrictions through 2030, it is clear that a "silver bullet" does not exist. Rather it is prudent for policy makers to consider pursuing a number of alternatives which together yield a practical energy policy that advances energy efficiency and reduces CO_2 emissions while sustaining economic growth. The analysis presented in this report examines the potential for the increased use of natural gas in residential and commercial applications to increase the productivity of available energy supplies, reduce overall energy cost, and reduce related CO_2 emissions.

Purpose and Scope

The analysis summarized in this report examined the impact of the increased direct use of natural gas for Residential & Commercial ("R&C") end uses. End uses considered include space heating, water heating, cooking, and clothes drying. The study analyzes the effect of the increased direct use of natural gas on expected use of gas for electric generation and the net effect in total energy use, energy costs and CO_2 emissions.

Although there are several factors that drive the use of natural gas for power generation, there is a growing concern that the overall natural gas supply/demand balance could be adversely impacted as demand of natural gas for power generation continues to grow. The underlying framework of the study considers the impact of the increased use of natural gas for direct applications in a series of scenarios. This study examines the impact of future scenarios that may influence ongoing policy debate and establishes a quantitative approach that can be replicated or expanded for future analysis.

The scenarios identified key drivers of uncertainty within the natural gas market. The key uncertainties are the natural gas supply, new technology for R&C applications and the environmental regulations related to CO_2 emissions. The combinations of these three variables create five distinct scenarios.

- Reference Case – Baseline Technology/No CO_2 Restrictions
- Natural Gas Supply Lower & High Technology/High CO_2 Restrictions
- Natural Gas Supply Lower & 2006 Technology/High CO_2 Restrictions
- Natural Gas Supply Higher & High Technology/Low CO_2 Restrictions
- Natural Gas Supply Higher & 2006 Technology/Low CO_2 Restrictions

The scenarios employ assumptions regarding supply sensitivities as referenced in the Energy Information Administration's Annual Energy Outlook ("AEO") 2007[1] integrated price cases. The Natural Gas Supply Higher scenario drives lower prices and higher consumption of natural gas relative to the reference case. The Natural Gas Supply Lower scenario drives higher prices and lower consumption. The High Technology and 2006 Technology cases from the Energy Information Administration ("EIA") were incorporated into these two supply environments. Higher Technology refers to high efficiencies of appliances and building shells which lower energy consumption. Conversely, lower technology is linked to increased energy consumption. The effect of technology on energy consumption makes it a key variable for both supply worlds. The Low and High CO_2 restriction scenarios reflect implementation of moderate and stringent controls on CO_2 emissions from the U.S. electric sector. This will increase the use of natural gas fueled generation.

This study examined the impact of increased direct use of natural gas in the context of each scenario by forecasting primary energy consumption, energy costs, and CO_2 emissions with and without an assumed increase in the direct use of natural gas to half the R&C electric loads capable of operating on natural gas but currently powered by electricity. This scenario assumption of increased direct gas use amounts to about 7% of the total R&C electric load in 2030. The study also utilizes three underlying energy metrics that provide a clear measure of each scenario.

- Energy consumption (as measured in Quadrillion Btu)
- Total energy cost (as measured in 2005 dollars)
- CO_2 Emissions (as measured in millions of tons)

Some of the forecasting that was analyzed in this study was based on the AEO 2007. Although the AEO 2008 was released too late to incorporate in this study, B&V has reviewed the early release of the AEO 2008 and has come to the conclusion that, while the forecasts indicate lower natural gas and electric demand, there would still be significant savings in primary energy use, CO_2 emissions and the cost of energy from the increased direct use of natural gas with the use of the updated AEO forecast. The AEO 2008 forecasts a slight reduction in electric load growth from the 2007 forecast amounting to 5% less electric consumption in 2030. The natural gas consumption forecast for 2008 is 10% less in 2030 than the AEO forecast for 2007.

[1] *B&V utilized the high and low integrated price cases from AEO 2007.*

Major Findings

- Increased direct use of natural gas in R&C applications can increase the productivity of available energy supplies, reduce overall energy cost, and reduce related CO_2 emissions in all scenarios considered.

- Natural gas demand for power generation is expected to increase significantly in a CO_2 constrained world. Nuclear power and renewables could offset part of the increase but natural gas demand is still projected to increase over the forecast horizon with an accompanying upward pressure on gas prices.

- The increased direct use of natural gas for R&C applications rather than for power generation is expected to decrease energy consumption in the United States. Within the scenarios considered, a shift of 7% of the total electric load for R&C applications to natural gas, indicates that the energy savings can range from 1.25-2.00 quadrillion Btu in 2030 – or 6% of total energy consumption growth projected by AEO through 2030. In the absence of restrictions on CO_2 emissions, there is a greater proportion of coal fired plants in the electric generation mix. Coal generation gets displaced when the increased direct use of gas for R&C applications decreases electricity demand.

- Depending on the scenario, the avoided generation capacity is forecast to range from 63 to 80 GW. The avoided investment costs are forecast to range from $49 billion to $122 billion.[2]

- With restrictions on the total level of CO_2 emissions, natural gas generation is displaced when the increased direct use of gas for R&C applications decreases electricity demand. A larger market percentage of the direct use of natural gas for R&C applications drives a net decrease in overall gas consumption as well as energy costs (since the decrease in gas demand for power generation is higher than the increase in direct use of natural gas in the R&C sectors).

- In the scenario where CO_2 restrictions match the levels proposed by the Lieberman-Warner Senate bill currently being debated in Congress, the value of the reduction in energy costs is significant and ranges from $18 to almost $29 billion dollars by the year 2030.

- Emissions are decreased in all scenarios considered. The highest impacts are in the Reference Case where coal fired generation is displaced. The CO_2 constrained scenarios also show a decrease in CO_2 emissions when there is a greater direct use of gas in R&C applications.

[2] The estimate of avoided electric generating capacity in GW was based on simplified assumptions of the demand for uses that can be served by natural gas or electricity at the time of peak demand for supplying electric utilities. A detailed analysis of residential and commercial electric load patterns by end use coincident with electric system peaks would be required to better estimate the avoided generation capacity. Such a detailed analysis should be included in subsequent investigations.

- There are regional implications to CO_2 emissions regulations and the direct use of natural gas for R&C applications rather than for power generation. Some of the states with larger potential for greater direct use of natural gas for R&C uses are also the states applying CO_2 restrictions in advance of any restrictions by the federal government, notably, these include California, Florida and the Northeast states participating in the Regional Greenhouse Gas Initiative ("RGGI"). For these states, the increased use of natural gas by R&C customers stands to reduce overall costs of energy supplies and reduce emissions consistent with state goals. Several measures are being considered to decrease emissions, and the front runners among these are increased end use efficiency, increased nuclear generation and increased use of renewable fuels. However these measures alone are unlikely to reduce CO_2 emissions to the projected targets and a combination of multiple smaller measures are required to approach the CO_2 target.

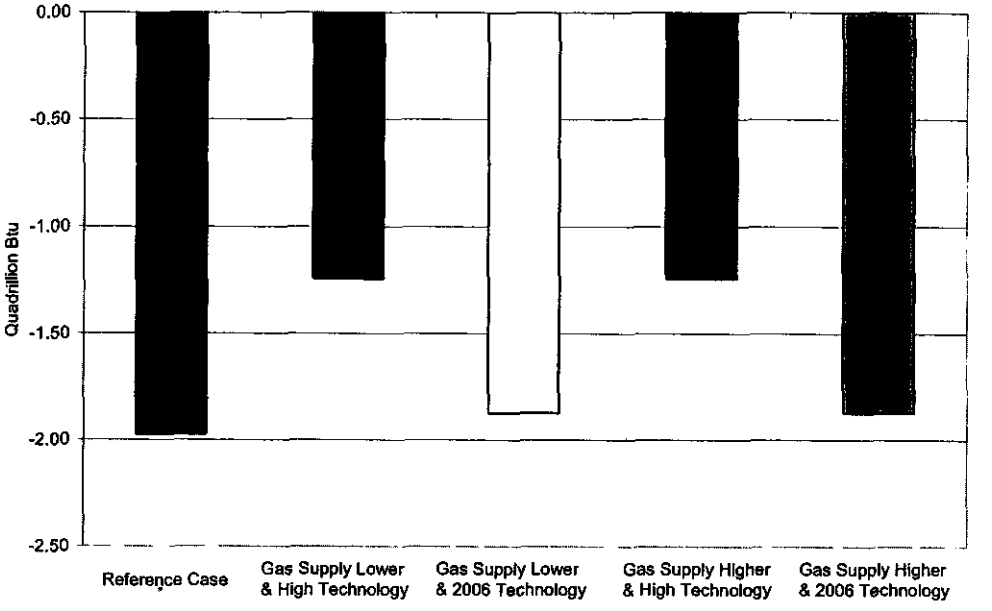
Summary Results

The analysis assessed the net impact through 2030 of an increase in direct use of natural gas for R&C applications and entailed the following steps in order to examine the impact on the U.S. energy market:

- Forecast the impact of the increased natural gas demand from shifting a percentage of current electric demand for switchable R&C applications to natural gas;
- Forecast the impact of corresponding decreased electricity demand for R&C applications; and
- Estimate the net impact on the energy requirements in the U.S. from a shift in R&C demand from electricity to natural gas.

The net impact on energy consumption from the increased direct use of natural gas for R&C applications instead of for power generation is shown in Figure 1.1. The analysis indicates a net decrease in the total energy consumption in the United States that ranges from 1.25 quadrillion Btu to almost 2 quadrillion Btu in 2030. The greater efficiency of natural gas in the R&C applications when compared to electricity is the contributing factor that drives the expected savings in energy. The "real energy" analysis takes into account the efficiency of the appliance and the overall energy acquisition and delivery process.

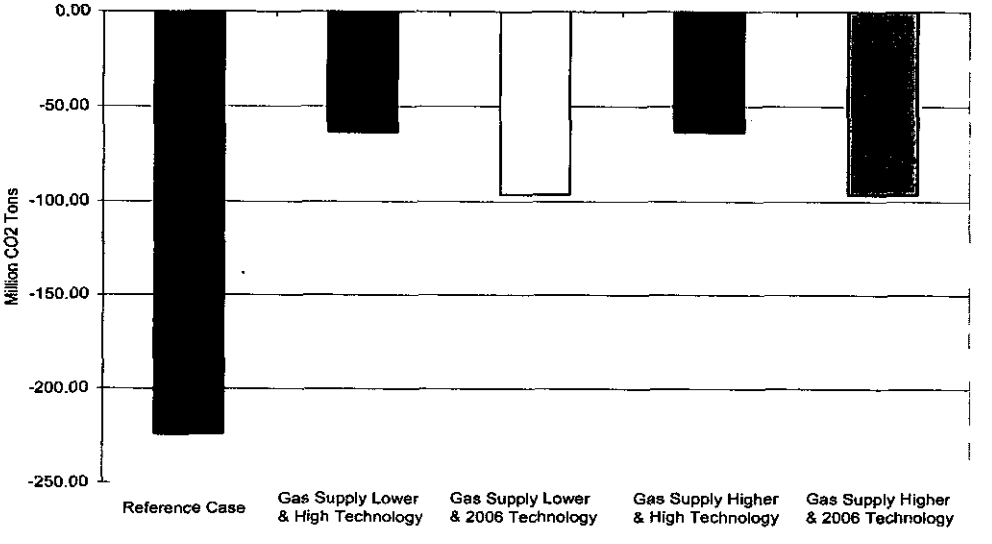
Figure 1.1: Decrease in Energy Consumption in 2030 – Real Energy



Source: EIA, B&V Analysis

The net impact on CO_2 emissions from the increased direct use of natural gas for R&C applications is shown in Figure 1.2. In all the scenarios considered, there is a net decrease in the total CO_2 emissions from the increased use of natural gas for R&C applications. The Reference Case shows the largest decrease in emissions of over 200 million tons of CO_2 driven by a decrease in coal fired generation. The decrease in CO_2 emissions in the other scenarios range from about 60 to almost 100 million tons of CO_2.

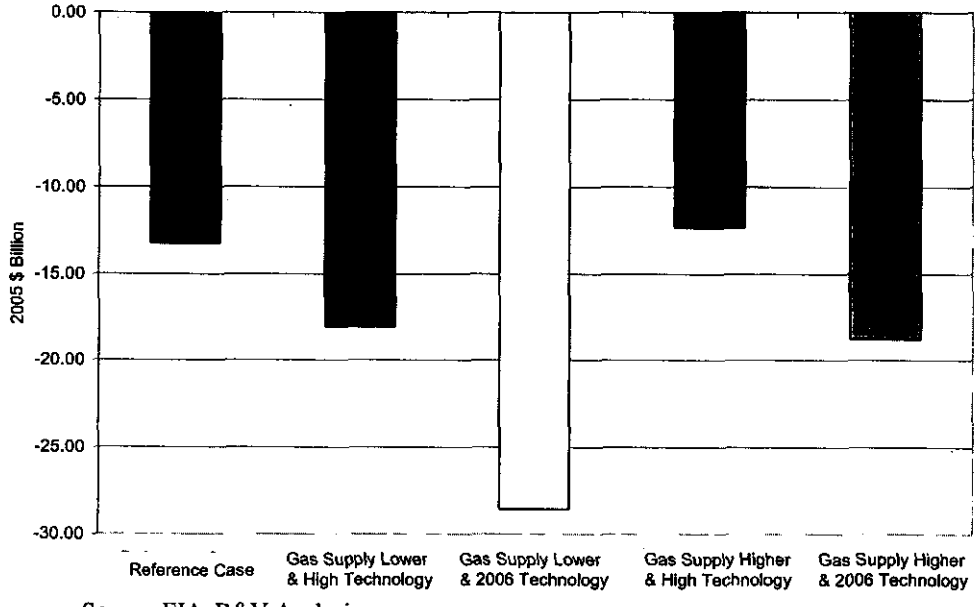
Figure 1.2: Decrease in Emissions in 2030 – Real Energy



Source: EIA, B&V Analysis

The net impact on the total energy costs for the U. S. is shown in Figure 1.3. In all the scenarios considered, there is a net decrease in the total energy costs in 2030. The savings in energy costs range from $12 billion to almost $29 billion in 2030.

Figure 1.3: Decrease in Energy Costs in 2030 – Real Energy



Source: EIA, B&V Analysis

Additional Observations

Expectation of Current Market Conditions for Natural Gas to Continue
Natural gas production in the lower 48, including both onshore and offshore production, is expected to peak in 2017 at 53.4 Bcf/day. With the exception of the Rockies and other unconventional plays, the supply of natural gas in the U.S. is projected to decline. There is an expectation of a flat trend in the domestic supply of natural gas in the U.S. Increased reliance on LNG is projected as imports increase to keep up with growth in the demand for natural gas. Appendix B provides a more detailed overview of natural gas supply in North America. Since the U.S. will be competing with countries that have very aggressive demand projections for natural gas, it is likely that the price of natural gas will continue to be sustained at the current high levels.

Drivers of Natural Gas Demand Remain Strong
Natural gas is a versatile fuel with a number of important characteristics that make it a premium fuel. It is a clean burning fuel with relatively low emissions when compared to coal, petroleum and other fossil fuels. As a fuel with a delivery efficiency amounting to about 90% from production to consumption, it offers an

extremely efficient alternative to serve end uses wherever applicable.[3] In contrast, the delivery efficiency for oil is 86% and the delivery efficiency for electricity is 27% as a result of the efficiencies of the source fuels used to generate the electricity as well as the losses during the conversion of the source fuel to electricity and the losses during the transmission of electricity to serve end use markets.[4] The real energy method for measuring efficiency used in this report takes into account these losses as well as the appliance efficiency. Natural gas also offers reliability of supply due to the large proportion that is domestically produced, the underground pipeline network that is not easily affected by weather and other disruptions, and the ability to store the gas and use it when required.

Gas Use for Power Generation is Expected to Increase Significantly

The power generation industry in the U.S. is facing serious uncertainty - maybe more serious than any uncertainty it has faced in the last 25 years. This uncertainty stems from a number of factors, including a national imperative calling for reductions in greenhouse gas emissions that are believed to be a major contributor to global warming. Natural gas demand for power generation is expected to increase significantly in the coming years. Increased end use efficiency, nuclear power and renewables may offset some of the increase, but gas demand for electricity production will increase multiple times before the U.S. gets even close to the CO_2 caps targeted in recently proposed legislation.

CO_2 Emissions Regulations Will Significantly Impact the Natural Gas Market

Emerging trends towards greater energy efficiency as well as a more highlighted focus on the environmental implications of our energy use further support the adoption of measures that would decrease energy consumption and reduce our environmental footprint. CO_2 emissions controls are expected to become a reality in the United States with several legislative climate change targets having been proposed in the 110th Congress. Several measures are being considered as means to help decrease CO_2 emissions to the levels that are being widely considered as likely targets in impending regulations.

[3] "Public Policy and Real Energy Efficiency, Assessing the effects of Federal policies on energy consumption and the environment", October 2005, American Gas Foundation.

[4] "Source Energy and Emission Factors for Residential Energy Consumption", August 2000, American Gas Association ("AGA").