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b. Docket No. 080318-GU – Petition for rate increase by Peoples Gas System

c. Peoples Gas System

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e. The attached document is Peoples' Brief and Post-Hearing Statement of Issues and Positions.

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PEOPLES GAS SYSTEM

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 080318-GU

IN RE: PETITON FOR RATE INCREASE BY PEOPLES GAS SYSTEM

BRIEF AND POST-HEARING STATEMENT OF ISSUES AND POSITIONS

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TABLE OF CONTENTS

BRIEF AND POST-HEARING STATEMENT OF ISSUES AND POSITIONS

Summary and Introduction 1

Rate Relief Requested 1

Other Relief Requested 3

The Current Economy 3

I. 2009 is the Appropriate Test Period (Issue 1) 4

II. The Appropriate ROE for PGS is 11.5% (Issue 14) 4

"Simply Wrong" 6

III. PGS's Proposed Capital Structure is Appropriate (Issue 15) 7

IV. Under Rule 25-14.004, F.A.C., No Parent Debt Adjustment is Warranted (Issue 39) 7

V. Plant In Service for the Projected Test Year Must Be Increased to Reflect Actual Capital Spending for 2008 (Issue 5) 9

VI. PGS's Total (Including "Incentive") Compensation is Reasonable (Issues 28 and 32) ....12~~1~~

"Incentive" Compensation ....12~~1~~

Merit Increase Guidelines ....14~~3~~

Other Payroll 14

VII. The Company's Demonstrating and Selling Expenses in Account 912 are Reasonable, and No Adjustments are Warranted (Issue 35) 15

VIII. The Expense of Directors & Officers ("D&O") Liability Insurance is an Ordinary and Necessary Business Expense and Should Be Allowed in the Amount Projected by the Company (Issue 36) 16

IX. The Costs Allocated to PGS by TECO Energy are Reasonable and Appropriate, and Should Be Approved for Recovery (Issue 37) ....18~~7~~

X. Recovery of the Gas Cost Portion of Bad Debt Expense Should Be Authorized Through the PGA as are All Other Gas Cost-Related Expenses (Issues 30 and 31) 18

DOCUMENT NUMBER-DATE

02480 MAR 20 8

FPSC-COMMISSION CLERK

XI. Inclusion of Pipeline Integrity Management Expenses of $750,000 for the Projected Test Year is Appropriate (Issue 33) 19

XII. The Commission Should Authorize PGS to Establish a Storm Damage Reserve (Issue 34) 20

XIII. Rate Case Expense in the Amount of $1 Million, Amortized Over Three Years, Should Be Approved for Ratemaking Purposes (Issue 29) 21

XIV. $500,000 is a Substantial Amount, and the Appropriate Amount of Off-System Sales to Be Included in Revenue for the Projected Test Year (Issue 23) 23

XV. The Company's Rider GSR Should Be Approved as Filed (Issue 54) 25

XVI. Commission Approval of Rider CR Would Assist in Expanding the Availability of Natural Gas to Areas Not Currently Served, and to Achieving Important Carbon Reduction Goals (Issue 55) 27

Conclusion 29

Post-Hearing Statement of Issues and Positions 29

Test Period 29

Quality of Service 30

Rate Base 30

Cost of Capital 31

Revenues 32

Expenses 32

Revenue Requirements 35

Rates 36

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by Peoples Gas System.

DOCKET NO. 080318-GU
Filed: March 20, 2009

**PEOPLES GAS SYSTEM'S
BRIEF AND POST-HEARING
STATEMENT OF ISSUES AND POSITIONS**

Peoples Gas System ("PGS", "Peoples" or the "Company"), pursuant to the Commission's Order Establishing Procedure issued August 21, 2008, as modified by the Prehearing Order issued March 2, 2009, submits this its Brief and Post-Hearing Statement of Issues and Positions:

BRIEF

SUMMARY AND INTRODUCTION

Rate Relief Requested

Despite significant expense control efforts, and after careful analysis, PGS seeks Commission approval to increase its base rates and services charges to produce additional annual revenues of approximately $26.5 million based on a 2009 projected test year. The increase is designed to recover the Company's cost of service and afford it an opportunity to earn a compensatory return on its investment, including a fair and reasonable return on equity of 11.50% within a range of 10.50% to 12.50%, a fair and appropriate return to attract capital. Based on its capital structure for the 2009 projected test year, PGS seeks Commission approval for an overall allowed return (based on the 11.5% midpoint of the cost of equity) of 8.88%.

PGS also seeks approval for other changes that will result in an increased ability to recover costs associated with safely and reliably providing clean-burning natural gas to more Floridians. As of the end of 2008, PGS served about 334,000 customers.

DOCUMENT NUMBER-DATE
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PGS's base rates were last increased in January 2003, the first increase since early 1993. Over the six years since that increase, a number of factors have contributed to the necessity for the relief sought in this case, which factors are described in more detail in the testimony of PGS President William Cantrell (TR 46-47). Among other things, from 2002 through 2007 the Consumer Price Index ("CPI") increased more than 17%, requiring not only that PGS pay more for goods and services it needs to provide safe, reliable natural gas service, but also contributing to an increase in PGS's direct and indirect payroll costs. The costs of steel and plastic pipe, the core of the Company's infrastructure investment, as well as insurance and health care, were among the largest increases -- significantly higher than general inflation during this period. PGS's depreciation expense also substantially increased as a result of new depreciation rates ordered by the Commission after the Company's 2006 depreciation study.

Over this same period, while expanding its system to bring clean-burning natural gas to more than 100,000 new customers and adding or replacing more than 1,500 miles of pipe in its system to serve its customers, PGS experienced a decline in the average per-customer gas consumption on which its 2003 rates were based, due at least in part to the Company's energy conservation programs and more efficient appliances. PGS's residential customers now use about 11% less gas (more than a month's average usage) than in 2002. Because the Company's rate design is largely based on customers' consumption of gas, PGS has in essence been penalized for its conservation efforts, adversely affecting its ability to recover its costs of providing service and earn a reasonable rate of return on the property it has devoted to public service.

The Company must control expense levels, while continuing to provide safe, reliable service, and further enhance the services available to its customers because PGS's customers

have other available energy choices. While electricity is a necessity for every customer, natural gas service is not. The natural gas business in Florida is highly competitive, evidenced by the fact that only one of 10 electric customers is a natural gas customer. Every Florida natural gas customer uses gas as a matter of choice. PGS's expense-control efforts have resulted in its operation and maintenance ("O&M") expenses being more than $11 million, or 14.4%, less than the Commission's benchmark for 2007, the historic base year in this proceeding.

Other Relief Requested

Other changes for which PGS seeks approval to better reflect the costs of providing safe, reliable service to customers, which will be covered separately in the portions of this brief that follow, include recovery of the gas cost portion of bad debt expense through the purchased gas adjustment clause ("PGA"), rather than through base rates; establishment of an unfunded storm damage reserve; and a new Gas System Reliability Rider and Carbon Reduction Rider, both tariff cost-recovery mechanisms. Virtually all rate and rate design issues in this case (except "fallout" issues dependent on the revenue requirements that are ultimately determined, and the two riders mentioned above) have been stipulated.

The Current Economy

Undersigned counsel stated at the outset of the hearing in this case that there is no "good" time for a public utility to seek base rate relief, and that the current economy and continuing market turmoil make this a "less good" time than it would otherwise be. Notwithstanding the current economic situation, the base rate relief PGS is seeking is absolutely necessary for it to have the opportunity to earn a reasonable and compensatory return on its investment in property it has devoted to providing natural gas service to the public.

In the remainder of this brief, PGS will address (not necessarily in the order of the issues

identified in the Prehearing Order) the key issues raised during the course of the hearing that merit discussion beyond the limited commentary contained in the Company's Post-Hearing Statement of Issues and Positions.

I. 2009 IS THE APPROPRIATE TEST PERIOD (Issue 1)

PGS and the Commission Staff are in agreement that calendar year 2009 is the appropriate test period to be used to determine rates in this proceeding. The Office of Public Counsel ("OPC") took no position on the issue. (Prehearing Statement, Section VIII, Issue 1)

The Florida Industrial Gas Users ("FIGU"), although presenting the testimony of no witnesses, "cautioned" against the use of projected test years, suggesting that such years "vary from the statutory mandate of §366.06 Florida Statutes." No citation of authority is necessary for the proposition that this Commission has used projected test years for the purpose of establishing rates for electric and natural gas utilities for many years. Indeed, the Minimum Filing Requirements ("MFRs") prescribed by the Commission for both electric and natural gas utilities specifically contemplate the use of projected test years for the purpose of a revenue requirements proceeding such as this one.

PGS submits that the calendar year 2009 is an appropriate test year to be used for establishing the revised rates petitioned for by the Company, and no party to this proceeding has suggested a different period which it contends is more appropriate.

II. THE APPROPRIATE ROE FOR PGS IS 11.5% (Issue 14)

An allowed return on common equity ("ROE") of 11.5%, supported by the expert testimony of Dr. Donald Murry, is appropriate for PGS. His recommended 11.5% ROE is appropriate and conservative (TR 166-168) especially considering the turmoil in worldwide

capital markets that has ensued since this case was filed and the Commission's last decisions[1] on the issue.

Dr. Murry studied the recent and continuing volatile credit and equities markets, other financial statistics, current gas utility earnings and market-based measures of capital costs. (TR 131) During this credit crisis, Dr. Murry noted that the Federal Reserve (the "Fed") took unprecedented actions to enhance credit availability in an effort to reverse economic decline. (TR 127, line 25, through 128, line 23) The Fed's actions have forced interest rates on short-term Treasury securities down, with increases in the long-term rates for corporate bonds. (TR 130-131; 769)

Dr. Murry considered a group of comparable companies representing healthy natural gas utilities to derive an appropriate ROE for PGS. On average, these companies expect common equity returns of 11.5% for 2008. (TR 140; Exhibit 21) He evaluated the results of Discounted Cash Flow ("DCF") and Capital Asset Pricing Model ("CAPM") analyses in the context of current market conditions and relative risks to estimate the appropriate return for PGS based on the proxy companies. (TR 141-142) The results from what Dr. Murry considered the relevant DCF analyses were 10.04% and 11.02%, with the relevant CAPM results being 12.46% and 13.01%. Dr. Murry found the relevant range of these results to be from 11.0% to 12.5%. After performing these market-based analyses, Dr. Murry concluded that the current market volatility, together with the expected continuation of increases in long-term interest rates, suggest a return near the middle of the market-based results. (TR 166)

Dr. Murry also compared PGS's after-tax interest coverage ratio (2.69 times) under his recommended range and the Company's capital structure with those of the proxy companies

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[1] *In re: Florida Public Utilities*, Order No. PSC-08-0327-FOF-EI (5/19/08), pp. 34-38; *In re: St. Joe Natural Gas Company*, Order No. PSC-08-0436-PAA-GU (7/8/08), pp. 5-7.

(3.75 times) to verify the reasonableness of his recommended ROE, and concluded that his recommended allowed ROE for PGS was "very conservative. . . . If anything, these coverages call into question whether my recommended return will be adequate to attract capital if market volatility continues or worsens." (TR 167-168)

"Simply Wrong"

OPC presented the testimony of Dr. J. Randall Woolridge, the deficiencies in whose testimony were addressed in Dr. Murry's rebuttal testimony. Dr. Murry's rebuttal pointed out that Dr. Woolridge's testimony failed to adequately consider the consequences of the current financial meltdown and the worldwide economic crisis, also noting that significant portions of Dr. Woolridge's testimony were virtually verbatim restatements of older testimony from rate cases in other states pre-dating the current economic crisis. The data used by Dr. Woolridge in his analyses predates, for the most part, the recent and continuing economic turmoil. (TR 773)

Dr. Murry characterized as "simply wrong" Dr. Woolridge's conclusion that long-term capital cost rates for U.S. corporations are currently at their lowest level in more than four decades – a theme appearing throughout his testimony. (TR 774) Dr. Woolridge at no place in his testimony reviewed or considered current utility market bond rates more recent that 2007. (TR 774-775) Dr. Woolridge suggested that stock prices have increased, when they have actually declined more than 50% over the past year, vividly demonstrating that his testimony ignored current economic reality. (TR 789) Dr. Murry said that "[a]ll other things being equal, the less an investor is willing to pay for a share of stock, the higher the cost of equity" (TR 764), and called the decline in stock prices "an inescapable demonstration of rising equity costs." (TR 789)

The testimony of Dr. Woolridge did not cause Dr. Murry to recede from his

recommended allowed ROE for PGS of 11.5%; rather, the current market conditions, overlooked by Dr. Woolridge, which have continued to decline, bolster his recommended return. (TR 789-790) Dr. Woolridge's recommended return is barely at or above the current costs of corporate debt, "is unrealistic by any reasonable measure of current returns on investments of equivalent risk" (TR 790), and would not satisfy the fair rate of return standards of the U.S. Supreme Court's decisions in *Bluefield* and *Hope*.[2] (TR 772) PGS submits that the ROE established in this case should be at the very high end of whatever range the Commission deems appropriate in view of the Company's excellent quality of service.

III. PGS'S PROPOSED CAPITAL STRUCTURE IS APPROPRIATE (Issue 15)

No party to this proceeding has questioned the appropriateness of the Company's proposed capital structure for the purpose of establishing new base rates in this proceeding. PGS's projected 13-month average financial capital structure consisting of 54.7% equity and 45.3% debt should be approved. The equity ratio represents the manner in which PGS has been financed, although it is lower than what was approved in the Company's most recent base rate proceeding (57.43%),[3] and lower than the equity ratios of the comparable group of companies examined by Dr. Murry (TR 134).

IV. UNDER RULE 25-14.004, F.A.C., NO PARENT DEBT ADJUSTMENT IS WARRANTED (Issue 39)

Under Rule 25-14.004, F.A.C., three conditions must be met before the rule requires the adjustment to income tax expense provided by the rule. First, there must be "parent debt that

[2] *Bluefield Waterworks and Improvement Company v. Public Service Commission*, 262 U.S. 697 (1923), as further modified in *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944).

[3] Order No. PSC-03-0038-FOF-GU at page 23.

may be invested in the equity of the subsidiary [regulated company]." Second, a parent-subsidiary relationship must exist. Third, the parties to the parent-subsidiary relationship must join in the filing of a consolidated income tax return. There is no question that the second and third requirements are met in the case of PGS and TECO Energy. The first requirement, however, is not met, because there is no parent debt of TECO Energy that has been invested in PGS.

Witness Gillette stated that, while debt currently exists at the parent,

> . . . this debt is related to TECO Energy's investments in its failed TPS merchant power projects. TECO Energy did not raise debt to invest in Peoples, nor did it invest the proceeds of the debt it did raise as equity in Peoples. (TR 103, lines 9-12)

Mr. Gillette's statement under oath, quoted above, constitutes evidence that no debt of PGS's parent was ever invested in PGS.[4] While OPC has taken the position that an adjustment per the rule should be made (a mere conclusion of law unsupported by the facts), there is no evidence (testimony or exhibit) of record in this proceeding that even remotely contradicts Mr. Gillette's testimony. In the absence of such evidence, the presumption of the rule that investments of TECO Energy in PGS were made in the same ratios as exist in TECO Energy's capital structure has been rebutted. Imposition of the rule's adjustment in this case would ignore both the rule's own provision that its presumption is rebuttable, and the clear evidence in this case in the form of Mr. Gillette's testimony. It would also ignore the first requirement of the rule mentioned above – if there was no parent debt invested in the equity of PGS, then there could be no "parent debt that may be invested in the equity" of PGS.

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[4] While prior Commission decisions have referenced the difficulty of "tracing funds" -- *e.g.*, Order No. PSC-92-0708-FOF-TL, *In re: Application for a rate increase by United Telephone Company of Florida* -- there is no need here to trace funds, as Mr. Gillette testified unequivocally that TECO Energy never invested the proceeds of debt as equity in PGS, and no party offered any evidence to the contrary.

The Company agrees with the purpose and intent of the adjustment contemplated by the rule. However, application of the rule's adjustment in this case would be contrary to that purpose and intent inasmuch as, based on the evidence, this is a case to which the rule was never intended to apply. If the presumption of the rule cannot be rebutted, there is no rationale for the rule's statement that the presumption *is* rebuttable. The rule should have simply stated its application to any regulated company with a parent with any debt and with which the utility joined in filing a consolidated return.

V. PLANT IN SERVICE FOR THE PROJECTED TEST YEAR MUST BE INCREASED TO REFLECT ACTUAL CAPITAL SPENDING FOR 2008 (Issue 5)

Plant In Service must be increased by $6.4 million to reflect that the Company's capital expenditures for 2008 exceeded its projections for the year by approximately $7 million.

OPC witness Helmuth Schultz proposed reductions to three categories of PGS's Plant In Service for 2008 and 2009 totaling $15,277,686, together with corresponding reductions in Accumulated Depreciation and Depreciation Expense. The proposed reductions ignore reality in that the Company's rate base for 2008 is now known, and exceeds the Company's projection for that year by approximately $6.4 million. (TR 233) Exhibit 83 shows clearly that the total of the three plant categories used by Mr. Schultz to determine his adjustment exceeds the Company's projections for these three categories as filed by the Company. With respect to 2009, even Mr. Schultz recognized that over the past five years, the Company's capital expenditures had averaged approximately 97% of the budgeted amounts (TR 623). No adjustment is warranted to the Company's projected Plant In Service for 2009 as proposed by Mr. Schultz. However, Plant In Service for the projected test year should be increased to recognize that actual rate base for

2008 exceeds -- by about $6.4 million -- the Company's projected rate base as filed in the MFRs.

Mr. Schultz's adjustments were based on erroneous information provided by the Company in responses to discovery, the errors in which were not discovered until reading Mr. Schultz's direct testimony some three months after the discovery responses were served.[5] Mr. Schultz used footages for various types and diameters of pipe based on actual expenditures and footages of mains and service closed to plant in 2007 as the basis for his calculated adjustments. Notwithstanding the erroneous information with respect to footages provided by PGS, Mr. Schultz's adjustments based on such information assumed a method of projecting Plant in Service not used by the Company in projecting its capital expenditures (or the resulting increases in Plant in Service and rate base) for 2008 and 2009.

In rebuttal to Mr. Schultz's testimony, PGS witness Bruce Narzissenfeld testified that:

> There were other data points from which Mr. Schultz could have validated his calculated adjustment for 2008, but failed to do so. For example, Peoples' answer to OPC's Interrogatory No. 1 (served almost three months before Mr. Schultz's testimony was filed) reflected that Peoples had spent almost $41.6 million of its budgeted $62 million as of July 31, 2008. Peoples' answer to Staff Interrogatory No. 53 [Exhibit 8, p. 77], served November 12, 2008 – slightly more than a month before Mr. Schultz's testimony was filed – indicated that as of the date of the answer, Peoples' 2008 capital expenditures were expected to be $68 million, almost $6 million more than projected in the MFRs filed with the Company's petition. The answer also stated that there had been no changes to the projected 2009 capital expenditures shown on MFR Schedule G-1, page 26. (TR 220, line 15, through 221, line 2)

While Mr. Schultz used average costs per foot of various pipe diameters and types to calculate his adjustments, PGS witness Lewis Binswanger testified, on being deposed, that the unit cost developed for a particular project is a result, rather than the starting point for making

[5] Upon discovering its error, PGS immediately met with OPC and the Commission Staff, and thereafter provided to both OPC and the Staff whatever information was requested without the necessity for use of formal discovery. Company personnel also discussed the initially furnished erroneous information and the subsequently provided correct data with OPC, witness Schultz and Staff. This process continued until the date of the prehearing conference in this proceeding.

cost estimates, and that the unit cost for a particular project is not necessarily the unit cost for any other project. (Exhibit 8, pp. 2266, lines 7-19)

The "bottom line" is that for 2008, PGS overspent its capital budget used in projecting rate base for this proceeding by about $7 million, resulting in rate base being approximately $6.4 more than projected. Thus, the beginning point for projected 2009 Plant In Service is $6.4 million greater than was initially filed by the Company (Exhibit 8, pp. 2274-2275; Exhibit 83).

Mr. Narzissenfeld testified that he had made no changes to the initially projected $60 million in capital expenditures for the 2009 projected test year. (TR 233) He stated, however, that if the Company was to re-project rate base for the projected test year, it would be about $6.4 million more than contained in the Company's MFRs. Finally, when asked whether the Company's $60 million capital expenditure budget for 2009 was a number he was going to "try to reach," or the amount he had been "authorized to spend," Mr. Narzissenfeld testified:

> It's a – I mean, I'll just tell you straight out, it's a number I've been authorized to spend, and I view my biggest challenge in 2009 to stay within that number. The amount of municipal work, while we had a projection, is significantly more than that. We filed a late-filed exhibit, Binswanger Number 2 [Exhibit 8, pp. 2276-2278], where we had over 100 items listed. We were asked to quantify them as best we could, and it adds up to over $8 million, and we still had another 20 or 30 we didn't put dollars to.
>
> I'm not the expert on the stimulus bill, and I'm still trying to learn how it will impact things, but I hear it's going to be roads, bridges, places we have gas. And to the extent that activity occurs, we're going to have to do more relocations. It's going to be very challenging to stay within the 60 million, but I'm committed to doing that. (TR 258, line 21, through 259, line 11)

The record contains ample evidence to support an increase in PGS's projected Plant In Service and the resulting rate base for the projected test year.

VI. PGS'S TOTAL (INCLUDING "INCENTIVE") COMPENSATION IS REASONABLE (Issues 28 and 32)

"Incentive" Compensation

Only OPC has questioned the reasonableness of PGS's compensation, taking the position that all of the "incentive" portion of such compensation should be disallowed because of the nature of the goals to be met for the payment of the incentive portion of total compensation, and because the incentive portion of total compensation is "excessive" (although OPC's witness Schultz fails to specify in relation to what he deems such pay "excessive"). It should also be noted that the adjustment proposed by Mr. Schultz was based on no studies, and he suggested no alternatives ways for PGS to compensate its employees. (TR 427)

For a number of reasons, OPC's rationale for the disallowance proposed is seriously flawed when examined in relation to the facts. First, it ignores the fact that the total compensation of each PGS officer and other employee is established based on market data and benchmarking results for comparable positions. The total compensation for each employee is set near the market average for the comparable position based on this market data, which is obtained by the Company from a number of nationally recognized providers of such information. (TR 332)

Second, OPC's rationale ignores the fact that no more than the market-based total compensation (including the "incentive" portion) has been included in PGS's filing for the projected test year for the purpose of establishing rates in this proceeding. (TR 332)

Third, while PGS believes the goals established each year are reasonable and directed at customer-oriented operational and financial targets, OPC's rationale ignores the fact that the goals – whatever they might be in any year – place all or a portion of the incentive portion of

total compensation "at risk" (*i.e.*, it will not be paid absent achievement of the goals). (TR 359)

PGS could simply decide to scrap the incentive features of its compensation plan, and set the base salary of each officer and employee at the market average for the particular position. This would entirely eliminate witness Schultz's rationale for any adjustment, and force the OPC to come forward with evidence demonstrating that the Company's payment of total compensation at the market average for comparable positions is somehow unreasonable or imprudent. Mr. Schultz suggested no other manner in which the Company should pay its employees. (TR 427) Implied in his position, however, is the presumption that the Company should pay its employees at a rate below the market average.

PGS's compensation plan has been in effect for a number of years, and no adjustments with respect to incentive compensation were made in the Company's last rate case in 2003. Reducing or eliminating the "incentive" portion of the Company's pay would result in its employees' being compensated with pay less than employees in comparable positions at other companies (TR 361), adversely affecting PGS's ability to attract and retain a high quality workforce. (TR 332; 360-361)

Mr. Schultz characterized the restricted stock grants and options of the Company's long-term incentive compensation plan as "excessive" and proposed disallowance of 100% of such costs. (TR 639) In rebuttal, Mr. Higgins testified that Mr. Schultz's characterization of these items, without any supporting analyses, benchmarks or other data, was inappropriate and insufficient to warrant their exclusion from the Company's O&M expense, which is already below the Commission's benchmark. (TR 366; Exhibit 8, p. 123)

No adjustment to PGS's compensation for the projected test year should be made, as the amounts included for ratemaking purposes are reasonable and prudent.

Merit Increase Guidelines

During his deposition, PGS witness Paul Higgins advised that the assumptions used for employee and officer merit increases for the Company's 2009 budget were reduced in late 2008. Specifically, officer salaries were frozen at 2008 levels. The originally budgeted 4% merit increases in 2009 for exempt and non-covered, non-exempt employees, were reduced to 2% and 3.5%, respectively. (Exhibit 8, pp. 2089-2093; 2159) Based on these changes, the Company agrees that projected test year payroll expense should be reduced by $253,300.

Other Payroll

While no position was taken on the subject in the Prehearing Order, OPC witness Schultz proposed a reduction in PGS's payroll expense as a result of a $697,861 difference between payroll expense included in the Company's MFRs (Exhibit 9) and PGS's answer to OPC's Interrogatory No. 61, which Mr. Schultz characterized as "unexplained." (TR 633-634)

PGS witness Higgins explained that the purported discrepancy arises from the difference between the manner in which the Company builds its budget and the manner in which expenses are projected in the MFRs. Witness Higgins testified that the Company employed its typical budget methodology in preparing its forecast of 2009 expenses, including payroll. That methodology projects costs on a resource basis (payroll, materials and supplies, outside services, etc.). For purposes of the MFRs, expenses are projected using the "FERC account trending" analysis prescribed by the Commission. As witness Higgins further explained, although this latter approach segregates historical payroll data for the historic base year, there is really no way to compare specific detailed cost information between the Company's budget methodology and the Commission's FERC account trending methodology. Mr. Higgins concluded by stating that Mr. Schultz was basically attempting to reconcile payroll expense at a resource level, a

comparison that cannot be accurately performed. (TR 377, line 21, through 378, line 13; 413, line 14, through 415, line 6) Witness Schultz's testimony fails to establish the need for any adjustment to PGS's payroll expense for the projected test year as the result of his attempted reconciliation of a number that is irreconcilable. PGS, was, however, able to reconcile total O&M expenses developed by the two methods to within an immaterial difference. (TR 326-327; Exhibit 49)

VII. THE COMPANY'S DEMONSTRATING AND SELLING EXPENSES IN ACCOUNT 912 ARE REASONABLE, AND NO ADJUSTMENTS ARE WARRANTED (Issue 35)

PGS properly forecasted the expenses in Account 912 for the projected test year and no adjustment to such expenses is warranted. These expenses for the 2007 historic base year were 57.6% less than the Commission's O&M benchmark for the category. (TR 318) The projected expense for 2009 is significantly lower than the expense allowed by the Commission in the Company's last base rate proceeding in 2003, and some 25% below the costs that were experienced in 2001, the first year performance of the sales and marketing function was outsourced to TECO Partners, Inc. ("TPI"). (TR 423)

OPC witness Schultz proposes an arbitrary reduction of this expense for 2009 of approximately $2 million, based largely on a misunderstanding of the Marketing Services Agreement (Exhibit 8, pp. 299-312) between PGS and TPI (an affiliate of PGS), pursuant to which TPI performs sales and marketing functions PGS formerly performed "in house" with its own employees. (TR 422) The agreement is a marketing arrangement that covers a broad range of services, basically all aspects of sales and marketing. (TR 420) Mr. Schultz's proposed adjustment was also flawed because he failed to acknowledge the difference between "new

signings" and "new customers." (TR 373-374)

In responding to OPC's position that the arrangement was "ineffective," Mr. Higgins responded:

> . . . frankly, if we could find other areas of the company to outsource to anybody, an affiliate or non-affiliate, and reduce expenses over a seven- or eight-year period by 25 percent, we would be doing that every day of the week. (TR 424)

VIII. THE EXPENSE OF DIRECTORS & OFFICERS ("D&O") LIABILITY INSURANCE IS AN ORDINARY AND NECESSARY BUSINESS EXPENSE AND SHOULD BE ALLOWED IN THE AMOUNT PROJECTED BY THE COMPANY (Issue 36)

OPC witness Schultz proposed disallowing all of the Company's Directors and Officers ("D&O") liability expense, arguing (without the basis of any studies) that ratepayers receive no benefit from the coverage. (TR 642, 368) He said, arbitrarily, that if the Commission found justification for ratepayers paying this expense, the level of expense should be set at the level that existed in 2003. (TR 644)

In rebuttal, PGS witness Higgins stated that D&O insurance is a cost of doing business every bit as essential as traditional property and casualty insurance, and clearly a necessity for any large corporation. He testified that it would be impossible for PGS to attract and retain highly qualified directors and officers to manage and oversee the conduct of its business without the protections afforded by D&O coverage. Such insurance coverage, according to witness Higgins, is maintained by virtually all publicly traded entities, and provides a measure of balance sheet protection from losses from lawsuits, thereby safeguarding the utility from financial stress and preserving capital for uses that ensure the efficient and continuing delivery of gas service to customers. (TR 369)

Mr. Higgins continued by stating that premiums for D&O insurance fluctuate as a result of the same market forces that affect the premiums for other types of insurance. He listed factors that were the primary drivers of a significant change in the market for this coverage in the early 2000s, which was manifested by a significant contraction of the availability of, and an increase in the pricing for, D&O coverage. (TR 370)

Mr. Higgins stated that while PGS's cost of D&O coverage had stabilized since 2007 to a point representing the current "market" pricing level, it would be a challenge to sustain the cost included in its 2009 budget forecast because of negative insurance market influences expected as a result of the current financial market distress. (TR 370) He characterized Mr. Schultz's suggestion that the level for this expense be set at the 2003 level as "arbitrary and totally inappropriate." (TR 371)

Finally, Mr. Higgins pointed out that Mr. Schultz had "double dipped" in his attempt to reduce this item of the Company's expense. He explained that the Company incurs the full amount of D&O insurance expense via an allocation of TECO Energy general and administrative ("G&A") expenses; that is, PGS incurs no direct expense for D&O insurance. (TR 371) By recommending a disallowance of $342,000 in expense (that exists only through the TECO Energy allocation of G&A expenses), and then recommending a disallowance of amounts (including approximately $337,000 for D&O insurance expense) included in TECO Energy's G&A allocation to PGS, Mr. Schultz would have the Commission remove this expense twice. (TR 372) No adjustment to remove any portion of D&O insurance expense is appropriate, and in any event the expense must not be removed twice.

IX. THE COSTS ALLOCATED TO PGS BY TECO ENERGY ARE REASONABLE AND APPROPRIATE, AND SHOULD BE APPROVED FOR RECOVERY (Issue 37)

Mr. Schultz recommends exclusion of expenses for incentive compensation, restricted stock grants and options, and D&O insurance allocated to PGS by TECO Energy for the same reasons he proffered for disallowing these expenses to PGS. (TR 651-652; 371-372) As previously noted, his recommended disallowance of D&O insurance expense under this issue would remove the expense twice. See VIII, *supra*. While his recommended adjustment was prorated based on his recognition that the projected test year allocations are lower than in the historic base year, there is no basis for the adjustment proposed. (TR 372)

X. RECOVERY OF THE GAS COST PORTION OF BAD DEBT EXPENSE SHOULD BE AUTHORIZED THROUGH THE PGA AS ARE ALL OTHER GAS COST-RELATED EXPENSES (Issues 30 and 31)

The Company has proposed to recover the gas cost portion of bad debt expense through the PGA solely as a result of the Commission's policy of recovering all gas related costs through that clause (Issue 30), and made a pro forma adjustment in its filing to remove this cost (46%, or $723,580, of total bad debt expense) from O&M expenses originally included for recovery through base rates. (TR 355-356)

Mr. Schultz claims that this change would result in a softening of the Company's efforts to collect bad debt, and that the PGA is virtually an automatic pass-through of the expenses it is designed to recover. (TR 611) In rebuttal, Mr. Higgins testified that regardless of whether PGS recovers the gas cost portion of bad debt expense through base rates or the PGA, the Company would continue to use all appropriate resources to recover the full amount of any accounts

receivable, and that Florida has no "automatic" pass-through clauses, including the PGA. (TR 356) If the Commission elects not to approve the proposed change for recovery, the Company's pro forma adjustment must be reversed, thereby increasing the amount to be recovered through base rates, a point on which both Mr. Schultz and the Commission Staff agree.

XI. INCLUSION OF PIPELINE INTEGRITY MANAGEMENT EXPENSES OF $750,000 FOR THE PROJECTED TEST YEAR IS APPROPRIATE (Issue 33)

In 2007, PGS incurred approximately $250,000 in O&M expenses for *transmission* pipeline integrity activities (mandated by PHMSA's[6] rules implementing the Pipeline Safety Act of 2002), and its 2008 budget contemplated a similar level of expense for these activities. (TR 342) A small portion of the pipes in the Company's system are classified as "transmission" facilities (113 miles) to which PHMSA's rules apply. The remaining thousands of miles of the Company's pipe (Exhibit 8, pp. 292-293) are classified as "distribution" facilities.

The Company has included $750,000 in O&M expense for the 2009 projected test year for activities required to comply with transmission pipeline integrity requirements, as well as new *distribution* pipeline integrity management requirements proposed by PHMSA in the *Federal Register* for June 25, 2008 (73 FR 36015). The final rule is expected to be adopted some time in 2009. (TR 343) PGS witness Higgins sponsored Exhibit 51, an analysis used to project the expense for these activities for the projected test year. Not all of the $750,000 (including approximately $450,000 for transmission pipeline integrity management and $50,000 for the assessment of voltage drops in the system) is associated with the new distribution

[6] Pipeline and Hazardous Materials Safety Administration of the U.S. Department of Transportation.

integrity management rule. (TR 345)

While not every item of expense is expected to occur in every year, PGS believes its inclusion of $750,000 for this category of expense for the projected test year is reasonable for ratemaking purposes, and should be approved by the Commission.

XII. THE COMMISSION SHOULD AUTHORIZE PGS TO ESTABLISH A STORM DAMAGE RESERVE (Issue 34)

Peoples seeks Commission authority to establish an unfunded storm damage reserve on its books so the Company does not have to incur large, unusual and unpredictable costs in any particular year as the result of a storm. (TR 379-380) The Company in its filing proposed an annual accrual of $100,000.

In support of the request, PGS performed an analysis of its books and records for the 10-year period from 1998 to 2007. The results of that study were initially displayed on Exhibit 50, attached to PGS witness Higgins' direct testimony. During his deposition, Mr. Higgins stated that – subsequent to the filing of his direct testimony – he had learned certain costs may not be charged against the reserve, and reduced the amount of the requested annual accrual to the reserve to $75,000. (TR 308)

OPC's witness Schultz proposed that no reserve be established for two reasons; first, that the proposal assumes a significant storm will occur, and second, that the reserve is not necessary because in only two of the 10 years covered by Mr. Higgins' analysis (2004 and 2005) did the Company incur any abnormal costs from storms. (TR 645) He concluded by stating that the expense incurred in 2004 and 2005 – when adjusted to eliminate certain charges – was not

significant in view of the Company's total O&M expenses. (TR 646)

The fact that PGS had significant damage from storms in only two of the 10 years analyzed strongly supports the Company's position that a steady accrual for a reserve is more appropriate than its being faced with periodic and potentially significant expenditures following a storm. (TR 379) With respect to Mr. Schultz's objection to a reserve's being unfunded, unfunded storm damage reserves are common in the electric industry, at least in Florida. An unfunded reserve is more cost-effective and reduces rate base. (TR 380) No party questioned the Company's assertion that all Florida investor-owned electric utilities, and one Florida natural gas utility, have Commission-approved storm damage reserves.

PGS submits that its proposal to establish an unfunded storm damage reserve with a reasonable annual accrual, so that storm-related costs are spread over a longer period of time, is beneficial to customers and the Company, and is reasonable and prudent. (TR 380) An annual accrual of $75,000 is both modest and appropriate.

XIII. RATE CASE EXPENSE IN THE AMOUNT OF $1 MILLION, AMORTIZED OVER THREE YEARS, SHOULD BE APPROVED FOR RATEMAKING PURPOSES (Issue 29)

PGS's filing in this case initially included $750,000 in rate case expense, such amount to be amortized over a period of three years. (Exhibit 9, p. 63)

OPC's witness Schultz characterized this expense as "excessive" (again with no explanation of in relation to what), and argued both that PGS's existing accounting staff should have been able to handle more tasks internally and that costs should be limited to stated contract amounts bid by consultants and experts used by the Company. (TR 647-648)

In rebuttal, Mr. Higgins stated that the Company's assembly of the filing in this case

required resources incremental to PGS's day-to-day business operations. Just as the intervenors hired outside resources to assist in this case, PGS hired consultants to assist in case preparation and serve as expert witnesses. He explained that PGS is staffed only to handle ongoing, day-to-day responsibilities, and that the additional workload of this proceeding required supplementing the Company's existing team. (TR 375)

Mr. Schultz's proposed $37,000 reduction for Huron Consulting Group is not reflective of Huron's contract bid, and his arbitrary 50% reduction to the amount related to Mr. Holden's contract "because the Company should have been handling more of the rate case internally" are totally unsubstantiated, and not based on any understanding of the Company's staff size, its workload, any studies of the same, or any information other than his arbitrary statement. (TR 376)

As of December 31, 2008, PGS had incurred $725,926 of the $750,000 of rate case expense it had projected in its filing. (Exhibit 8, pp. 109) More than two months remained before the hearing in this case – roughly equivalent to the waiver given by Peoples at the request of Staff of the statutory time period within which the Commission would have been required to dispose of this base rate proceeding. This waiver, and the resulting additional time, resulted in additional discovery by the parties. The amounts actually paid through the end of 2008 included no legal or consulting fees associated with preparation for, or presenting witnesses at the hearing. For these reasons, total rate case expense is estimated to be $1 million or more.

In countering Mr. Schultz's assertion that the expense should be amortized over five, rather than the three years proposed by the Company, Mr. Higgins stated that – while difficult to predict when PGS's next case would be filed – he was "relatively certain it will be sooner than five years." (TR 377)

The Company submits that the expense it will actually incur in the preparation and presentation of this case is reasonable, and should be permitted, with an amortization period of three years.

XIV. $500,000 IS A SUBSTANTIAL AMOUNT, AND THE APPROPRIATE AMOUNT OF OFF-SYSTEM SALES TO BE INCLUDED IN REVENUE FOR THE PROJECTED TEST YEAR (Issue 23)

Off-System Sales ("OSS") are sporadic, opportunistic transactions that are highly dependent on market conditions. PGS has included $500,000 of OSS to reduce the revenue requirements for the projected test year. It did so because this was the amount included in revenue "for purposes of setting rates" in its last base rate proceeding.[7] The amount is substantial, especially at a time when OSS have declined by 36%,[8] with further decline expected, and represents a significant reduction to revenue requirements in this proceeding while not establishing an unreasonably high "hurdle" for the Company. Currently, all OSS revenues benefit the general body of ratepayers with 25% of such revenues going above the line as revenue to offset O&M expenses and 75% of such revenues going to the PGA as a reduction to gas and gas-related costs recovered through the clause. (TR 341)

OPC witness Schultz proposes that OSS included in revenue for the purpose of setting rates be increased to $2 million for the projected test year (TR 630), but demonstrated a

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[7] Order No. PSC-03-0038, p. 6.

[8] Peak OSS occurred in 2006, and declined 7.9% in 2007 and 31% in 2008 (Exhibit 8, p. 2262).

misunderstanding of the sharing mechanism. His testimony reflects his belief that the amount included in revenue is a "trigger" for the sharing of OSS revenues, and that no sharing would occur until after the threshold, whatever it might be, has been attained. (TR 630-631).

In rebuttal, PGS witness Binswanger stated that Mr. Schultz's adjustment, based on a five-year average of OSS, was made without any market considerations that must be addressed to determine and quantify the future ability of the Company to make OSS in any amount, and the net margins or prices at which such sales – if any – might be made. (TR 508-510)

The current economic crisis has resulted in reduced consumption by some PGS customers served directly through the Company's system. However, it may have an even greater impact in reducing opportunistic OSS to entities (primarily electric generators) not connected to the PGS system. These entities hold their own interstate pipeline capacity, and have relied on the Company's OSS to meet gas requirements in excess of their contracted demand. In essence, there may well be fewer opportunities for OSS because of decreased electric demand. Even if opportunities remain, the net margins may well be less than those used by Mr. Schultz in calculating his adjustment.

The $500,000 of OSS revenue included by PGS for the projected test year is a substantial and appropriate amount, while a historical average may create a hurdle the Company cannot achieve.[9] If PGS is able to make OSS at a greater level, and is put in an overearnings posture (in which case PGA customers experience an increased benefit), the Commission has ample authority to require refunds to customers. (TR 509-510) However, if PGS is not able to make OSS at the level needed to clear a higher "hurdle," then the Company will simply not earn at the

[9] It should be noted that Rate Schedule OSS was first approved outside of the context of a base rate case; that is, there was no reduction of any revenue requirements associated with the Company's then 50% of OSS net margins. Order No. PSC-94-1187-FOF-GU.

level of ROE used to establish the new rates in this case. This is a simple matter of fairness. The Commission has a remedy for any PGS overearnings, but the Company is without remedy if the higher level of OSS cannot be achieved.

If Mr. Schultz's adjustment is adopted, the rate schedule should be modified to provide that the first $2 million in OSS net margin shall be included by the Company as revenue, and that ***sharing with the PGA does not commence*** until OSS net margins exceed $2 million.

XV. THE COMPANY'S RIDER GSR SHOULD BE APPROVED AS FILED (Issue 54)

The Company's Gas System Reliability Rider ("Rider GSR") – more fully described in the statement of Issue 54 in the Prehearing Order – is an appropriate mechanism for the recovery of revenue requirements associated with government-mandated investments for relocation of its facilities and O&M expenditures, over neither of which the Company has any control, and which the Company would have no ability to recover absent the filing of a petition for new base rates or a limited proceeding. PGS's standard practice is to install facilities at the edge of public rights-of-way, which is substantially less expensive than installations on private property. (TR 471) Installing in public rights-of-way, however, subjects the Company to requirements of federal, state and local governmental bodies to relocate facilities when ordered to do so. In many cases, PGS receives no reimbursement of the resulting expenses, but must comply just to meet its obligation to provide service to customers served through the facilities. (TR 472-473) The Company's capital budget for these types of unreimbursed expenditures is $6.3 million for 2008 and $3.8 million for the projected test year. (TR 475) PGS will also incur federally mandated

O&M expenditures as a result of PHMSA's rules governing transmission and distribution pipeline integrity. See XI, *supra*.

Rider GSR would not permit recovery of revenue requirements associated with any government-mandated relocations or O&M expenses included for the purpose of establishing rates in this proceeding, or of revenue requirements associated with any such relocations that are not used and useful. Recovery of these costs would continue only until the Company's next base rate proceeding, after which the process would be continued on the terms described. An annual true-up under the rider would ensure that customers pay no more and no less than is appropriate.

OPC witness Schultz opposed the approval of Rider GSR and the Company's proposed Carbon Reduction Rider ("Rider CR") (see XVI, *infra*) on similar grounds: that the amounts to be recovered are too small; that the mechanisms provide for "automatic" or "guaranteed" recovery of costs; that the riders would increase Commission administrative costs; that there is no need to change prior ratemaking treatment of the costs involved; and – finally – that if the Commission should approve the riders, it should consider some unspecified reduction in the ROE allowed to account for lesser risk. (TR 614-616)

In rebuttal, PGS witness Binswanger, with respect to both Rider GSR and Rider CR, pointed out that there are no "automatic" cost recovery clauses in Florida, that both riders contemplate thorough review by the Commission, and that Rider GSR was very similar to the Environmental Cost Recovery Clause under which electric utilities are permitted to recover revenue requirements associated with capital costs and O&M expenses incurred to comply with government-mandated programs. (TR 495-496) He pointed out several states that either have permitted, or are contemplating, recovery mechanisms such as Rider GSR. (TR 496; Exhibit 87; Exhibit 8, pp. 2281-2444)

With respect to the possibility that PGS's ROE might need to be reduced if the riders are approved, Mr. Binswanger deferred to PGS witness Dr. Murry, who said in rebuttal that no adjustment to the allowed ROE in this case is required because the proxy group of companies he analyzed to determine an appropriate ROE for the Company had riders or other cost recovery mechanisms in place that were accounted for in the proxy group's stock prices and allowed returns. (TR 761; 783-786)

With respect to Rider GSR, Mr. Schultz also objected that the Company could be put in an overearnings posture if certain base rate type costs are shifted to recovery through the rider. (TR 613) Mr. Binswanger said this argument missed the point -- that there would be no "shifting of costs," because recovery through the rider would include only those incremental costs incurred beginning in 2010. (TR 502) He stated further that the annual average of $4.28 million for these expenses is not small by Company standards, that these expenses occur every year without providing any incremental revenue, and that the level of such expenses could well be increased by the federal economic stimulus bill, which includes $90 billion for the modernization of roads, bridges, transit and waterways. (TR 504-505)

PGS submits that Rider GSR should be approved by the Commission as an appropriate manner in which PGS can recover government-mandated capital and O&M expenses over which it has no control without having to file a base rate or limited proceeding.

XVI. COMMISSION APPROVAL OF RIDER CR WOULD ASSIST IN EXPANDING THE AVAILABILITY OF NATURAL GAS TO AREAS NOT CURRENTLY SERVED, AND TO ACHIEVING IMPORTANT CARBON REDUCTION GOALS (Issue 55)

PGS has proposed Rider CR to address, manage and encourage the expansion of the

availability of natural gas to areas not currently served – primarily new residential developments not located near interstate pipelines or existing Company supply mains. (TR 467) It is designed to address the significant regulatory lag that exists when supply mains (which do not directly produce any revenue for the Company, but must be in place for the Company to obtain any revenue from new developments) are installed. (TR 485) The rider would apply to recover revenue requirements associated with only supply main extensions greater than 4 inches in diameter, or that are certified to operate at a pressure greater than 60 psig,[10] and that serve Company distribution systems serving primarily residential customers. (TR 487) As stated in the statement of Issue 55 in the Prehearing Statement, recovery of revenue requirements associated with any such installations would continue only until the earlier to occur of the end of a five-year period following the installation, or the effective date of new base rates established in a proceeding subsequent to this one.

OPC witness Schultz expressed the same difficulties with Rider CR as he expressed regarding Rider GSR, which are addressed at XV, *supra*. In addition, he expressed the view that "growth should pay for itself" (TR 619), and that – because of the recessionary nature of today's economy – there is no justification for allowing a mechanism for recovering the cost of supply mains to new developments. (TR 620)

In rebuttal, Mr. Binswanger testified that – in suggesting that new growth pay for itself – Mr. Schultz seemed to be suggesting some incremental cost of service pricing, without offering any specifics on how this should be implemented, or its implications for other aspects of the Company's historic embedded cost of service pricing. (TR 505) He also said Mr. Schultz's suggestions concerning the rider totally ignored the reality that customer additions (and the

[10] Pounds per square inch gauge.

resulting revenues) resulting from capital expansions occur over a number of years. The supply main, which Rider CR is designed to address, must be in place before the very first customer in a development can obtain natural gas service, even though full build-out of the development may take 10 or more years. (TR 506)

With respect to Mr. Schultz's assertion that Rider CR is not appropriate because of current economic conditions, Mr. Binswanger stated that "if economic conditions are such that no developments are occurring then no supply main would be installed and there would be no revenue requirements to recover through the rider." (TR 507)

Finally, Mr. Schultz never addressed the fact that Rider CR would assist in achieving the carbon reduction goals expressed in state legislation and Governor Crist's Executive Order No. 07-127 by reducing carbon emissions attributable to each residential customer by about 4,000 pounds annually with a net annual energy savings of about $75, when compared to a like residential customer with all electric appliances. (TR 479)

PGS submits that Rider CR should be approved by the Commission to assist in achieving these worthy goals, and to deal with the significant regulatory lag faced by the Company in recovering revenue requirements associated with the installation of supply mains to serve new, primarily residential developments.

CONCLUSION

As stated by undersigned counsel in his remarks at the outset of the hearing, PGS has come very, very close to the goal of filing a petition for base rate relief that – after thorough examination by the Commission Staff and the intervenors – should be granted with only minor adjustments. Those minor adjustments have been recognized in this brief, and no other adjustments are appropriate.

POST-HEARING STATEMENT OF ISSUES AND POSITIONS

TEST PERIOD

ISSUE 1: Are the historical base year ended December 31, 2007, and the projected test year ending December 31, 2009, the appropriate test years to be utilized in this docket?

PGS: *Yes. The calendar year 2009 is appropriate because it best represents the operating conditions during the period when the new rates will be effective.*

STIPULATED
ISSUE 2: Are the projected bills and therms for the test year ending December 31, 2009 appropriate for use in this case?

PGS: *Yes. The projected bills and therms for the test year ending December 31, 2009 are appropriate for use in this case.*

QUALITY OF SERVICE

STIPULATED
ISSUE 3: Is the quality of gas service provided by PGS adequate?

PGS: *Yes.*

RATE BASE

ISSUE 4: **DROPPED**

ISSUE 5: Should any adjustments be made to Plant, Accumulated Depreciation, and Depreciation Expense?

PGS: *Yes. The 2009 13-month average net Plant In Service will exceed the amount projected by approximately $6.4 million due to actual results for 2008.*

ISSUE 6: **DROPPED**

ISSUE 7: Should any adjustments be made to reduce Plant, Accumulated Depreciation, Depreciation Expense, and other expenses to reflect non-utility operations?

PGS: *No. All required adjustments to remove non-utility items have been made for the 2009 test year.*

ISSUE 8: What is the appropriate amount of Construction Work in Progress (CWIP) for the 2009 projected test year?

PGS: *The appropriate amount of CWIP for the 2009 projected test year is $18,249,444 as reflected on MFR schedule, G-1 page 1.*

ISSUE 9: What is the appropriate 2009 projected test year Total Plant?

PGS: *$1,009,374,293, as reflected on MFR schedule, G-1 page 1, adjusted to reflect the $6.4 million increase in the 13-month average Plant In Service as of December 31, 2008.*

ISSUE 10: What is the appropriate 2009 projected test year Depreciation Reserve?

PGS: *$426,364,359 as reflected on MFR schedule, G-1 page 1, adjusted for the depreciation impact of the $6.4 million increase in Issue 9.*

ISSUE 11: **DROPPED**

STIPULATED
ISSUE 12: What is the appropriate 2009 projected test year Working Capital Allowance?

PGS: *The appropriate 2009 projected test year Working Capital Allowance is ($11,494,371).*

ISSUE 13: What is the appropriate projected test year Rate Base?

PGS: *$563,599,436 as reflected on MFR schedule G-1 page 1, adjusted to reflect the increase in total plant and depreciation reserve as of December 31, 2008.*

COST OF CAPITAL

ISSUE 14: What is the appropriate return on common equity for the projected test year?

PGS: *The appropriate return on common equity for the 2009 projected test year is 11.50% with a range of 10.50% to 12.50%.*

ISSUE 15: What is the appropriate capital structure for the projected test year?

PGS: *The appropriate capital structure for 2009 is the Company's proposed capital structure as shown on MFR Schedule G-3, page 2.*

STIPULATED
ISSUE 16: What is the appropriate cost rate of long-term debt for the projected test year?

PGS: *The appropriate cost rate of long-term debt for the projected test year is 7.20%, as shown on MFR Schedule G-3, page 3.*

ISSUE 17: What is the appropriate cost rate of short-term debt for the projected test year?

PGS: *The appropriate cost rate of short-term debt for the projected test year is 4.50%, as shown on MFR Schedule G-3, page 4. A recent annual average cost rate is more appropriate than is the rate at a particular point in time.*

ISSUE 18: What is the appropriate amount of accumulated deferred taxes to include in the capital structure for the projected test year?

PGS: *$27,670,682, as shown on MFR Schedule G-3, page 2.*

STIPULATED
ISSUE 19: What is the appropriate amount and cost rate of the unamortized investment tax credits to include in the capital structure for the projected test year?

PGS: *The appropriate amount and cost rate of the unamortized investment tax credits to include in the capital structure for the projected test year are $7,862 and 0%, respectively, as shown on MFR Schedule G-3, page 2.*

ISSUE 20: What is the appropriate weighted average cost of capital for the projected test year?

PGS: *The appropriate weighted average cost of capital for the projected test year is 8.88%, as reflected on MFR Schedule G-3, page 2.*

REVENUES

STIPULATED
ISSUE 21: Has PGS made the appropriate test year adjustments to remove revenues and expenses recoverable through the Purchased Gas Adjustment Clause?

PGS: *Yes.*

STIPULATED
ISSUE 22: Has PGS made the appropriate test year adjustments to remove conservation revenues and conservation expenses recoverable through the Conservation Cost Recovery Clause?

PGS: *Yes.*

ISSUE 23: What amount, if any, of Off-System Sales revenues should be included in the projected test year?

PGS: *$500,000 -- the amount included for ratemaking purposes in PGS's last base rate

proceeding, and PGS's 25% share of reasonably attainable off-system sales for 2009.*

ISSUE 24: What is the appropriate amount of projected test year total Operating Revenues?

PGS: *The appropriate amount of total operating revenues is $169,906,126, as reflected on MFR Schedule G-2, page 1.*

EXPENSES

ISSUE 25: Are the trend rates used by PGS to calculate projected O&M expenses appropriate?

PGS: *Yes.*

ISSUE 26: Should the projected test year O&M expense be adjusted for the effect of any changes to the trend factors?

PGS: *No.*

STIPULATED
ISSUE 27: Should any adjustments be made to the 2007 O&M expenses for staff Audit Finding Nos. 1 and 2, to address out-of-period expenses, reclassifications, and non-utility expenditures?

PGS: *Yes. Adjustments should be made to the 2007 O&M expenses to remove out-of-period, reclassifications, and non-utility expenses. Based on these trended adjustments, 2009 Office Supplies and Expenses, Account 921, should be reduced by $18,853 and Miscellaneous General Expenses, Account No. 930.2 should be reduced by $5,007.*

ISSUE 28: Should any adjustments be made to Account 920, Administrative and General Salaries, or any other accounts related to employee compensation?

PGS: *No. The Company's "incentive" compensation is only one component of the market-based total compensation for each PGS employee, and designed to motivate employees to achieve customer-focused operational and financial goals. Payroll expense for 2009 should be reduced by $253,300 due to the change in the 2009 merit increase guidelines.*

ISSUE 29: What is the appropriate amount of rate case expense and what is the appropriate amortization period for that expense?

PGS: *The appropriate amount of rate case expense and appropriate amortization period for that expense are $1,000,000 and three years, respectively.*

ISSUE 30: Is PGS's proposed recovery of the gas cost portion of bad debt expense through the Purchased Gas Adjustment Clause appropriate?

PGS: *Yes. Recovery of the gas cost portion of bad debt expense through the PGA Clause is consistent with the Commission's policy of recovering all gas cost-related expenses through the clause.*

ISSUE 31: Should any adjustments be made to bad debt expense?

PGS: *No. However, if PGS's recovery of the gas cost portion of bad debt expense through the PGA is not approved, bad debt expense must be increased by $723,580.*

ISSUE 32: Should any adjustments be made to Account 926, Employee Pensions and Benefits?

PGS: *No. PGS has properly forecasted employee pensions and benefits for the 2009 projected test year and no adjustment is warranted.*

ISSUE 33: What is the appropriate amount of pipeline integrity expense, if any, to be included in the projected test year?

PGS: *The appropriate amount for the projected test year is $751,500. The average expense over the next eight years is expected to be approximately $720,000.*

ISSUE 34: Should the Commission allow PGS to establish a storm damage reserve, and if so, what is the appropriate amount of annual storm expense accrual?

PGS: *Yes. A reserve will normalize the level of expense over time. The appropriate annual accrual is $75,000, reflecting exclusions of expense not permitted by Rule 25-6.0143, F.A.C.*

ISSUE 35: Should any adjustments be made to Account 912, Demonstrating and Selling expenses?

PGS: *No. PGS has properly forecasted Account 912 expenses for the projected test year, which are over 25% less than in 2001.*

ISSUE 36: Should the costs to fund Directors and Officers Liability Insurance be included in the projected test year?

PGS: *Yes. D&O insurance is an ordinary and necessary business expense for a publicly-owned utility and should be allowed in the amount projected.*

ISSUE 37: Should any adjustments be made to costs allocated by TECO to PGS?

PGS: *Account 921 should be reduced by $26,500 representing a reduction in payroll expense allocated by TECO to PGS due to the change in the 2009 merit increase guidelines. No other adjustment is appropriate.*

ISSUE 38: What is the appropriate amount of Taxes Other Than Income Taxes?

PGS: *The appropriate amount of Taxes Other Than Income Taxes is $10,823,933 as reflected on MFR Schedule G-2, page 1.*

ISSUE 39: Is it appropriate to make a parent debt adjustment as per Rule 25-14.004, Florida Administrative Code?

PGS: *No. A parent debt adjustment is inappropriate. No proceeds of parent debt have been invested in PGS.*

ISSUE 40: What is the appropriate Income Tax Expense, including current and deferred income taxes, ITC amortization, and interest synchronization?

PGS: *$9,204,184, as reflected on MFR Schedule G-2, page 29, increased to reflect the income tax effect of the adjustments in Issues 27, 28, 34 and 37.*

ISSUE 41: What is the appropriate amount of projected test year O&M Expense?

PGS: *$72,608,899, as reflected on MFR Schedule G-2, page 1, reduced by $328,660 to reflect the adjustments in Issues 27, 28, 34 and 37.*

ISSUE 42: What is the appropriate amount of projected test year Depreciation and Amortization Expense?

PGS: *$43,804,733, adjusted to reflect the depreciation impact of the increase in the 13-month average Total Plant as of December 31, 2008 (see Issue 9).*

ISSUE 43: What is the appropriate level of Total Operating Expenses for the 2009 projected test year?

PGS: *$135,961,429, reduced by $201,879 to reflect the after tax impact of the adjustments made in Issues 27, 28, 34 and 37, and increased to reflect the after-tax impact of the increase in depreciation expense in Issue 42.*

ISSUE 44: What is the appropriate amount of projected test year Net Operating Income?

PGS: * $33,944,697, as reflected on MFR Schedule G-2, page 1, increased by $201,879 to reflect the after tax impact of the adjustments made in Issues 27, 28, 34 and 37,

and decreased to reflect the after-tax impact of the increase in depreciation expense in Issue 42.*

REVENUE REQUIREMENTS

STIPULATED
ISSUE 45: What is the appropriate projected test year revenue expansion factor to be used in calculating the revenue deficiency?

PGS: *The appropriate projected test year revenue expansion factor to be used in calculating the revenue deficiency is 1.6436.*

ISSUE 46: What is the appropriate projected test year operating revenue increase, if any?

PGS: *$26,488,091, as reflected on MFR Schedule G-5, decreased by $331,808 to reflect the adjustments made in Issues 27, 28, 34 and 37, and increased by the impacts of the adjustments in Issues 13 and 44.*

RATES

STIPULATED
ISSUE 47: Are PGS's estimated revenues by rate class at present rates for the projected test year appropriate?

PGS: *Yes.*

STIPULATED
ISSUE 48: What is the appropriate cost of service methodology to be used in allocating costs to the rate classes?

PGS: *The appropriate methodology is contained in revised MFR Schedule H, and should reflect the Commission approved adjustments to rate base, expenses, rate of return, and net operating income.*

ISSUE 49: What are the appropriate customer charges?

PGS: *The appropriate Customer Charges are:

Rate Class	Annual therms	Customer Charge
Residential Service 1	0-99	$ 12.00
Residential Service 2	100-249	$ 15.00
Residential Service 3	250-1,999	$ 20.00
Commercial Street Lighting Service		$ 0.00
Small General Service	0-1,999	$ 25.00

General Service 1	2,000 - 9,999	$ 35.00
General Service 2	10,000 - 49,999	$ 50.00
General Service 3	50,000 - 249,999	$150.00
General Service 4	250,000 - 499,999	$250.00
General Service 5	500,000 +	$300.00
Small Interruptible Service	1,000,000 - 3,999,999	$300.00
Interruptible Service	4,000,000 - 50,000,000	$475.00
Interruptible Service Large Volume	50,000,000 +	$475.00
Natural Gas Vehicle Service		$ 45.00
Residential Standby Generator Service		$ 20.00
Commercial Standby Generator Service		$ 35.00
Wholesale Service		$150.00

The proposed customer charges provide customers with appropriate price signals concerning natural gas use, improve intra-class fairness and increase revenue stability.*

ISSUE 50: What are the appropriate per therm Distribution Charges?

PGS: *The appropriate per therm Distribution Charges are:

Residential Service - 1	$0.32034
Residential Service – 2	$0.32034
Residential Service – 3	$0.32034
Commercial Street Lighting Service	$0.19715
Small General Service	$0.36345
General Service 1	$0.28056
General Service 2	$0.24266
General Service 3	$0.21006
General Service 4	$0.15708
General Service 5	$0.11814
Small Interruptible Service	$0.07421
Interruptible Service	$0.03334
Interruptible Service - Large Volume	$0.00848
Natural Gas Vehicle Service	$0.18834
Residential Standby Generator Service	
0-20.0 therms	$0.00000
>20.0 therms	$0.32034
Commercial Standby Generator Service	
0-40.0 therms	$0.00000
>40.0 therms	$0.28056
Wholesale Service	$0.15571

The proposed distribution charges result in an appropriate level of revenues recovered from each class, supporting the Company's rate design goals and

contributing to greater inter-class fairness.*

STIPULATED
ISSUE 51: What are the appropriate Miscellaneous Service Charges?

PGS: *The appropriate revised miscellaneous service charges are as follows:

Service Charge	Staff Recommendation
Account Opening Charge	$28
Service Initiation Charge - Residential	$50 for initial meter
Service Initiation Charge - Other	$30 for each additional meter
Reconnection Charge - Residential	$70 for initial meter
Reconnection Charge - Other	$20 for each additional meter
Temporary Meter Turn-off Charge	$20
Failed Trip Charge	$25

*

STIPULATED
ISSUE 52: Is PGS's proposal to stratify its current single residential service class into three individual classes appropriate?

PGS: *Yes. The proposal allows the Company to recover a greater proportion of fixed customer-related costs indicated by the allocated cost of service study through customer charges, while at the same time managing the potential bill impacts for individual customers to reasonable levels. Absent establishing the three billing classes, the bill impacts associated with increasing fixed cost recoveries through the customer charge would be too large for smaller residential customers that use natural gas for fewer appliances.*

STIPULATED
ISSUE 53: Is PGS's proposal to reclassify certain customers appropriate?

PGS: *Yes. Redefining the GS-1 class (presently 1,000-17,500 annual therms) by moving the smallest GS-1 customers (up to 1,999 annual therms) into an expanded SGS rate class and moving the largest GS-1 customers (above 10,000 annual therms) into an expanded GS-2 rate class is appropriate to provide greater homogeneity and reduce the potential for intra-class subsidies.

At present all residential customers take service under the RS rate. The reclassification of a limited number of large residential customers addresses a separate issue, which relates to common areas of condominiums. Such use is considered residential even though the characteristics of the load are similar to use by larger GS customers. By expanding the eligibility of the GS-1 through GS-5 rate schedules to include residential use, the largest residential customers are included with similarly-situated non-residential customers for pricing purposes.

An additional benefit of this approach is that it clarifies the rights of condominium units to purchase their gas supply from a third-party pursuant to the Company's transportation service program. The deposit terms and conditions associated with residential service would continue to apply to condominium customers that are reclassified to a GS rate schedule.*

ISSUE 54: Should the Commission approve PGS's proposed "Gas System Reliability Rider," which would permit recovery of revenue requirements associated with eligible infrastructure system replacements (*e.g.*, replacements for existing facilities, relining projects to extend useful life of existing facilities, road relocation projects) and incremental O&M expenses, if any, incurred to comply with mandatory pipeline safety regulations? If approved as proposed by the Company, such recovery would continue until the effective date of revised base rates established in the Company's next base rate proceeding. The rider would also provide for the refund of O&M expenses, if any, incurred to comply with mandatory pipeline safety regulations, in excess of such expenses included in the Company's most recent base rate proceeding.

PGS: *Yes, to permit timely recovery of revenue requirements associated with government-mandated facility relocations or safety requirements, over which PGS has no control, between base rate cases.*

ISSUE 55: Should the Commission approve PGS's proposed "Carbon Reduction Rider," which would permit recovery of revenue requirements associated with incremental capital expenditures, if any, for installation of supply mains (as defined in the rider) to serve primarily residential developments? If approved as proposed by the Company, such recovery would continue until the earlier of (i) the end of a five-year recovery period, or (ii) the effective date of revised base rates established in the Company's next base rate proceeding.

PGS: *Yes, to permit timely recovery, for a five year period only per project, of revenue requirements associated with investment in supply main to connect primarily residential developments to gas supply sources.*

STIPULATED
ISSUE 56: What is the appropriate effective date for PGS's revised rates and charges?

PGS: *The revised rates and charges should become effective for meter readings on or after 30 days following the date of the Commission vote approving the rates and charges which, under the current schedule, would mean for meter readings taken on or after June 18, 2009.*

ISSUE 57: Should any of the $2,380,000 interim rate increase granted by Order No. PSC-08-0696-PCO-GU be refunded to the ratepayers?

PGS: *No.*

STIPULATED
ISSUE 58: Should PGS be required to file, within 90 days after the date of the final order in this docket, a description of all entries or adjustments to its annual report, earnings surveillance reports, and books and records which will be required as a result of the Commission's findings in this docket?

PGS: *Yes. PGS should be required to file, within 90 days after the date of the final order in this docket, a description of all entries or adjustments to its annual report, rate of return reports, and books and records which will be required as a result of the Commission's findings in this rate case.*

ISSUE 59: Should this docket be closed?

PGS: *Yes. This docket should be closed after the Commission has issued its final order and the time for filing an appeal has expired.*

Dated this 20th day of March, 2009.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and copy of the foregoing Brief and Prehearing Statement has been furnished electronically and by U. S. Mail this 20th day of March, 2009, to the following:

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