BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by
Peoples Gas System
---/

Docket no: 080318-GU

Filed: March 20, 2009

CITIZENS' POST-HEARING BRIEF

The Citizens of the State of Florida, by and through the Public Counsel and undersigned counsel, pursuant to Order No. PSC-09-0121-PHO-GU, Issued March 2, 2009, hereby file this Post-Hearing Statement in the above-referenced docket.

STATEMENT OF BASIC POSITION:

Citizen's fundamental and basic position is that the Company has not undertaken all reasonable efforts to curtail costs in the face of the severe and lengthening recession. Citizens' case acknowledges that a need for rate relief exists. The need is less than $5 million as opposed to the $26.5 million the company is requesting. Specifically, rates should be allowed to increase no more than $4,063,593

The evidence in this case must be viewed and weighed against the extraordinary and historic times of today. Many Floridians are hurting. Hundreds of thousands are out of work. Others have had pay and benefits curtailed. Businesses are closing and bankruptcies are up. The real estate market is stagnant. These are matters of everyday common knowledge which need not be ignored by decision makers in the quasi-legislative arena that is PSC ratemaking.

In holding the company to its burden of proof, four major areas must be closely scrutinized against the general economic climate. This case is based upon a projected test year that was based on a budget development process that was undertaken far earlier in the year than ordinarily

done and at a time when the economic woes of 2009 were ***not*** known and well before the credit crisis and the onset of deep recession of the fall of 2008.

We object to the requested return on equity increase from the currently authorized ROE of 11.25% to 11.5%. The evidence shows that this is excessive. Under the traditional return on equity standards of the Commission the ROE should be no more than 9.25%. The company's proposed ROE is 125 basis points above the ROEs that the company's ***very own*** list of comparable gas companies are currently receiving. 100 basis points on ROE equals about $4.5 million in revenue requirements. That 125 basis point difference alone costs consumers about $5.6 million.

Secondly, the company has made projections of the rate base growth that are unreasonable based on the evidence and current economy and the realities of the real estate market which drives its revenue producing growth in plant.

Citizens also object to the inclusion of compensation in the way of bonuses, stock options, restricted stock and other mechanisms of incentive compensation that are excessive and inconsistent with their stated purposes. In these historic and extraordinary times we submit that it is not reasonable to expect customers to bear these types of costs at a time when the labor market may not be as competitive as in the past.

Finally, the evidence shows that Peoples has entered into a contract with an affiliate to market its services to large developers at a time when the customer growth and real estate market are virtually stalled. This transaction with a sister company is not cost effective, not in the best interests of the ratepayers and not reasonable in light of the minimal benefits that the evidence will show.

On matters of policy, Peoples has requested creation of two riders that would allow them to surcharge the customers for certain types of capital costs. These are unprecedented requests and we believe unwarranted. The evidence does not support the notion that these are the type of costs that are volatile and susceptible of scrutiny outside of a base rate case. We also urge the

Commission to refrain from creating riders in this case when all other types of true capital cost recovery mechanisms have been – to date – created by the legislature and are generic to the applicable industry.

In ordinary conditions the evaluation of a purely projected and subjective rate filing is difficult. In today's worsening economy the Company's projection-based request is deserving of much more scrutiny and heightened skepticism. In several areas listed above PGS has largely not met their burden of proof.

Attached to this Post-hearing Statement is an exhibit containing a schedule of the Citizens recommended adjustments. Where an issue is just a fallout, Citizens have not chosen to brief, but do not abandon positions previously taken unless the subsidiary issues dictate otherwise.

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

Position:

* Distribution plant should be reduced by $15 million to account for the historical level of capital spending, the unwarranted excessive increase in capital spending in the base year and *projected* capital spending for the test year when contrasted with the economic conditions in the service territory and the State *

Discussion:

Citizens witness Helmuth Schultz identified early on that capital spending for the two year period of 2008 – 2009 were well over historical levels. TR 623-625. Through discovery the Citizens have sought to find the reasons for this. An initial wrong turn due to some errors in company-provided documents has not ended our concerns. TR 603-604. Nor has it caused us to retreat from our recommendation that ratebase should be reduced for excessive and unjustified capital spending.

In its 2008 business plan, PGS identified a major challenge that future growth was not positioned right on or next to existing facilities. TR 79-80; EXH 90, BSP 2969. Therein, the company identified responses to this challenge that included best practices and identification of priority projects with subheadings that included the term "future revenue growth." Id.

Against this backdrop, PGS President Cantrell conceded that revenue producing capital expenditure per customer (for convenience here "RPCEC") increased significantly. These dollars make up about two thirds of the capital spending and thus impact the rate base more than any other item in the case. The 2008 Business Plan projected an increase by each year respectively from 2005 – 2008 from $1,263 to $1,696, to $2,444 to $3,580. This nearly three-fold increase would be significant enough were it not for the fact that actual RPCEC had increased to $4700 based on the Companies revised actual 2008 capital expenditures. TR 84.

When compared to forecasts of capital expenditures made in recent years, these numbers are alarming, both as to magnitude and when compared to the business climate in which the company is operating.

In 2005, 2006 and 2007 PGS made multi-year forecasts of the capital budget for 2007, 2008 and 2009. EXH 13, OPC POD No.1, BSP 8111, 8125, 8126, 8163. In those forecasts, total capital expenditures ranged from $40-$50 million for the years 2008 and 2009. Likewise forecast RPCEC ranged from $1170 to about $2000. Only in the June 2008 version of the forecast (dated July 1, 2008) does the capital budget forecast increase by 24% to the original as-filed 2008 budget of $62 million and the 2009 projection of $60 million (20%). Id at 8136.

In spite of indications at the time of filing that 2008 was not looking good from a business climate standpoint (TR 86), and in spite of the obviously worsening conditions, PGS surprisingly overspent that 2008 budget by another $6.5 million or 10%. Alarmingly, despite knowing that 2009 is going to be economically worse than thought at the time of filing, no bottom line change has been proposed by PGS in the capital spending for the test year.

Citizens do not dispute that the Company spent $68.5 million in 2008. We do dispute the contention that this level of capital expenditure was reasonable or prudent under the circumstances. Historical capital budget and actual expenditures with the Revenue Producing dollars shown in ( ) are as follows:

YEAR	Budget	Actual	
2004	$39.9	$37.9	($30.5)
2005	40.0	42.3	(27.5)
2006	50.9	53.8	(34.5)
2007	50.0	48.1	(30.1)
Average	$45.2	$45.5	($30.6)

EXH 83; EXH 90, BSP 2990, 2997, 3004, 3011. (Dollars in millions)

The increase from $48.1 million to $68.5 million in total capital spending from 2007 to 2008 is 42%. When compared to the negligible year-to-year changes over the prior 4 years during better economic times, this spike in spending does not appear prudent. Alarmingly, revenue producing capital expenditures of $44.1 million in 2008 increased 47% over 2007 levels. Notably the preceding 4 year average annual revenue producing expenditure is only $30 million. Nowhere is there any justification for this enormous jump in ratebase.

Witnesses Cantrell and Higgins mention adding 100,000 customers over the 6 year period from 2004 through the projected test year. TR 49, 313. All of this growth occurred in the first 4 years as projected growth for 2008 and 2009 is virtually nonexistent. Average customers grew a mere 794 from 2007 to 2008, while year end customers dropped by 580 over the same two years. EXH 13, Staff Int. No. 130. Clearly, at least from the time of the time of filing, customer growth does not explain or justify this spike in 2008-2009 capital expenditures.

The question arises: why didn't the company cut back spending in the face of daunting economic conditions? Capital expenditures are controllable. At one time, it was an incentive payment goal under the RSVP plan, though seemingly abandoned after 2005, Hrg. Ex. 13, OPC Int. 41; Higgins Deposition at 47. PGS has shown that it can make substantial cuts in its capital budget. In 2003 after conclusion of the last rate case, the test year capital budget was dramatically

slashed. Overall, in 2003 the capital budget was under spent by 17.4%, while revenue producing capital expenditures were cut 6.5% and maintenance was cut by 47%. At the same time overall plant additions for the 2003 test year were a staggering $72.7 million. Additions to plant in service in the years between rate case test years averaged just 41.9 million. EXH 13, OPC Int. No. 26, pp. 3-11 of 23.

During the current rate case, fueled by a $26.8 million CWIP balance at 2008 year end (which is 56% greater than the 2007 balance), and the large budget overrun, PGS has increased rate base significantly. This increase has come came at a time of no customer growth, when housing starts are stalled, when the real-estate market is in a "meltdown" (PGS witness Murry, TR 762) and unemployment is very high while inflation is at or below zero. Expenditures of this level in these times cannot be considered prudent, fair or reasonable.

Regardless of whether it is by design or not, it appears that PGS is asking current customers to unfairly bear the cost of the downturn in the economy. Additionally, they are asking current customers to shoulder the cost of extending facilities to position the company to meet or serve future demands regardless of the cost effectiveness or viability of the facilities' extensions.

Evidence of this is found in the testimony of President Cantrell who testified that an initial or rough cut at the rate case in November of 2007, showed only a $15-20 million increase in revenues. When asked what caused that increase to the $26.5 million pending request, he said it was the worsening economy. TR 86-87. Coupled with RPCEC sharply increasing from $1,263 to $4,700, the overall spike in capital spending and the lack of any capital expenditure reductions in 2009, it appears that existing customers are being asked in this rate case to insulate the company from the cost of the economic woes and to strategically position the company to be able to serve revenue growth at some unknown time in the future.

Citizens cannot find any evidence that the company has taken steps to control costs and match costs to the customers who should pay them. The Vice President of Operations Bruce Narzissenfeld even testified as late as January 30, 2009 that "nothing has occurred which would

cause the Company to believe that its 2009 projections should be changed..." TR 221. As noted above, in 2003 after the order in the last case was final, the company cut the overall capital budget 17%. They have demonstrated that it can be done. Witness Narzissenfeld testifies with seeming pride that the company spent within 3% of its budget on average over the last 5 years. TR 219. A closer look reveals that for the base year of this rate case (2008), they overspent by 10% and for the post-decision 2003 test year, they under spent by 17%. In this light, the 3% figure seems rather meaningless and in the end only proves that the company has the ability to spend what is allocated unless a reason arises in their self interest to spend more or less.

In this situation there are plenty of reasons that less should be spent. 12 projects have experienced delays, cost deferrals or cancellation between the time of filing and the hearing. These delays caused a reduction in the original budgeted revenue producing category of $6,973,735 or 43% of the original category total. Binswanger Late Filed Deposition Exhibit 1.

Witness Narzissenfeld testified that these delays were primarily due to the real estate market. A prime example: extension of mains to and within Palm Coast was originally budgeted for $6,686,300. Under cross examination, he admitted that the project cost in the two years had been scaled back in half due to the real estate market. TR 246-247; EXH 13, OPC POD 72; Binswanger Late Filed Deposition Ex, 1. Nevertheless, many of these dollars ended up being reallocated for spending in 2009, with no assurance or evidence that they would be spent that year either. For 2009, over $8 million of revenue producing projects were reduced or eliminated from the initial budget included in the MFRs. These dollars were replaced by other projected projects or increases to the tune of about $5 million.

However due to the economic climate, Citizens submit that more credence should be given to the company's actions in elimination of needed spending than in *ad hoc* location of these new offsets increases that just "gap" the budget. A good example of the speciousness of this budgeting exercise is the sudden addition of the Nocatee project of $981,694 in the reprojected 2009 capital budget. In November, the company provided an interrogatory seeking to justify the GSR rider and claiming that the absence of the rider caused them to lose the Nocatee project. TR 583-585; EXH. 13, Staff Int. No. 44. As if almost by magic that then "lost" project of only a few months

ago has reappeared to plug a $1 million gap caused by loss of originally projected real estate projects.

Even on the maintenance side of the budget, the company has opportunities to cut spending. With the net reduction of $2,958,262 in revenue producing dollars in the late filed reprojection (Binswanger Late Filed Exhibit No. 1), the maintenance budget increased by the exact amount. This dollar for dollar shift raises questions about the accuracy of the PGS capital budgeting and casts doubt on the known and measurable nature of the reprojected additions. In the maintenance category, "new" dollars of $2,121,180 materialize, while $906,539 goes away. It is pretty clear that if the company estimates that dollars will NOT be spent, then there is no reason to question. Citizens re-emphasize, however, that when new last minute dollars appear in order to "plug" the budget so that it doesn't change by one single dollar, then the reliability of those new additions must be questioned.

Furthermore, the initial municipal projects or road relocations figure of $3.8 million was originally an estimate based on an historical average. EXH 13, OPC POD No. 72, BSP 41167; TR 572. In the new reprojection, those estimated dollars have increased $1,743,621. The projects that help bring the recasting of the budget to an exact dollar match of the original forecast have lots of zeros, indicating softness in the estimates. In fact, under cross examination, witness Narzissenfeld admitted that he couldn't say with certainty that the relocation projects were going to materialize in 2009. TR 252. When asked if he could state "with any degree of certainty that each and every one of these projects will occur in the year 2009," witness Narzissenfeld – PGS Vice President of Operations – stated:

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

TR 252.

Other than citing unidentified, uncredited reports about a federal stimulus bill, no evidence was offered as to the occurrence of the new projects above even the historical estimate developed for the filing. Noticeably absent for the company's justification was any timeline on receipt of funds from the federal government, appropriation by the Florida Legislature and sufficient lead time for the letting of the projects, the notification of PGS and other utilities, the time needed to

coordinate with other utilities and the engineering that needs to be done. Common sense indicates that between now and the end of the year, stimulus – driven road projects will not drive costs in 2009.

Clearly there is a problem here. Fortunately, there are ratemaking principles which exist to address this problem. In addition to the tests of fair and reasonableness as well as prudence, there are concepts of matching current customers to current expenditures that apply. PGS provides good service to its existing customers. However, the placement of facilities to serve future growth means that current customers are not only providing a return on facilities that are being placed for customers whose revenue should offset that future cost, but they are also potentially allowing the company to "gamble" on whether growth materializes.

There is no direct evidence that this is occurring, but there is plenty of indirect evidence. Historical levels of plant growth, CWIP and capital expenditures were moderate and steady after the 2003 test year spike. Projections of acquiring new revenue/customers were also steady. Only in the run up to the current case have these numbers been rapidly skewing upward as discussed above. OPC witness Schultz identified the bulge in the capital additions and proposed a reasonable adjustment based on what appeared to be overstated costs of piping. After the company discovered that an error in discovery caused this seem to be the case, further review of discovery and additional responses indicated that the increase was just excessive based on historical levels and the state of the business climate.

Absent an adjustment by the commission, there would be no check on PGS' capital spending, regardless of the true current demand and regardless of even future demand. Citizens recognize that certain fixed, unavoidable costs coupled with a drop in per customer usage can cause rates to increase. We do not accept that where costs can be avoided, that the company should be allowed to simply spend what its executives and parent company authorized it to spend.

This record is replete with evidence that the projected ratebase proposed by the company is overstated under the circumstances. The 2008-2009 capital expenditures yearly average was $64.3 million. The average for the prior 4 years was $45.2 million. $6.9 million of originally

forecast 2008 revenue projects were reduced, deferred or cancelled. Likewise in 2009, $3,629,794 of revenue producing projects have been reduced, deferred or cancelled. In 2009, $2,958,262 of net reductions to the revenue producing budget was offset dollar-for-dollar in soft maintenance projections.

In the last case, which was stipulated, an adjustment of $15.377 million was made for "cancelled, delayed, or under budget additions." In this case there is evidence that these same conditions have occurred in both 2008 and 2009. Over $10 million have been identified from Binswanger Late-filed Exhibit No. 1. Coupled with the economic conditions and the excess over the historical levels of spending, the commission should reduce the projected ratebase by $15 million. This would be consistent with the adjustment made in the last case and would insure that revenues, and costs are appropriately matched while providing a check on excessive spending to pursue ever elusive customer growth.

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

<u>Position:</u>

CWIP appears to be excessive consistent with the analysis on Issue 5

<u>Discussion</u>:

Citizens have no specific adjustment to recommend to any particular CWIP project. However, the CWIP balances for 2008 and 2009 continue the theme that resonates in Issue 5. Per the MFRs, projected base year (2008) CWIP was $25,028,580. Final CWIP amount for 2008 was $26,863,863. Binswanger Late Filed Deposition Exhibit No. 7. This compares unfavorably to the 2003-2006 average CWIP balance of $14,771,750. Interestingly in 2003 the final CWIP balance was $16,685,000 even though the amount used for setting rates in the 2003 test year was $21,277,545. See, Order No. PSC-03-0038-GU, issued January 6, 2003 in Docket No. 020384-GU; *In Re: Petition for rate increase by Peoples Gas System*. Is there a theme here?

Citizens believe that the ***projected*** CWIP for 2009 represents yet another opportunity for the Company to curtail costs and reduce the impact of the economy on their customers. Together with the capital budget these overlapping dollars represent the bulk of additions to plant-in-service that make up rate base. The fact that 2008 and 2009 CWIP mirror the 2008 capital budget at a time of dire economic conditions and no growth and a stagnant real estate market is just further evidence that the Commission should find that the Company failed to meet its burden of showing the projected rate base is reasonable or that they will even achieve the claimed levels.

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

Position:

The appropriate return on common equity for the 2009 projected test year is 9.25%, as of December 18, 2008. The cost of equity for PGS has not been affected upward by the current economic crisis. Countervailing factors in the economy have generally left the cost of equity recommendation by Dr. Woolridge unaffected

Discussion:

The Citizens recognize that the posture of the decision on this issue is somewhat unusual. The Return on Common Equity (ROE) that will be authorized will be largely influenced by the Commission's decision in Docket No 080317-EI (*In Re: Petition for Rate Increase by Tampa Electric.*) the cost of capital witnesses for the company (Murry and Gillette) and the OPC are the same. Both companies are divisions of the same company. Having said this, the Tampa Electric decision will be based on a separate record and the decision in this case will be legally required to be made on this record.

Nevertheless, Citizens note that to the extent that the PSC has established a ROE for Tampa Electric of 11.25% relative to a request of 12.0% by Tampa Electric, and PGS has requested a ROE of 50 basis points lower than its sister division, a ceiling of 10.75% for PGS must be assumed. Even so, Citizens continue to believe that Dr. Woolridge's analysis is soundly based in theory and in fact. Furthermore, Dr. Woolridge has appropriately explained and justified his expert recommendation relative to the conditions in today's economic climate.

In this case, PGS has requested that its authorized ROE be increased from the current level of 11.25% to 11.50%. The basis for this request is witness Dr. Donald A. Murry's testimony. Though witness Gordon Gillette also testifies in support of the requested ROE, his testimony does not rise truly to the level of expertise in cost of capital. The Citizens have offered the expert testimony of Dr. J. Randall Woolridge. Both witnesses utilize the Discounted Cash Flow (DCF) and Capital Asset Pricing Models (CAPM).

Citizens' witness Woolridge noted on the stand that the primary difference between his formulation of the DCF results and PGS witness Dr. Murry's formulation is that witness Murry excluded about 80% of his DCF results. This has overstated his overall result by 200-300 basis points. Dr. Woolridge points out that the rationale of utilizing the high end of the range due to "issuance costs and market pressure" is unfounded. As Dr. Woolridge notes, there are no documented issuance or floatation costs or market pressures indicated in the proceeding. TR. 739. Even where the Commission has recognized flotation costs, they have been well below this range. In *In Re: Gulf Power Company*, Docket No. 010949-EI, Order No. PSC-02-0787-FOF-EI, issued June 10, 2002, the Commission found a flotation cost adjustment of 20 basis points to be reasonable, for example. This bias in Dr. Murry's results grossly overstates the cost of Common Equity. Absent such a bias, his DCF results would be in line with Dr. Woolridge's.

With respect to Dr. Murry's CAPM results, he conceded on the stand that his results are overstated by about 100 basis points by using outdated long term treasury rates. TR 183. He further conceded that ignoring the current (2008) market return of a negative 35% also upwardly biased his results. TR. 184-184.

Clearly, Dr. Murry's results are skewed by his exercise of judgment -- as he calls it (TR 176) – and have overstated his recommended ROE.

Despite criticisms by Dr. Murry that Dr. Woolridge has not fully taken current conditions into account, Dr. Woolridge explained in his update on the stand, how countervailing forces in the market kept his DCF and CAPM results in line with his November/December 2008 formulation.

TR. 741. Citizens submit that Dr. Woolridge's estimation of the cost of common equity does not suffer from any theoretical flaws or bias. The difficulty that some may have with it is that it yields a number that is below a visceral "double" digit threshold and that it does not have a sufficient 'spread" above bond prices.

The answer to any of these concerns is that they do not account for the likelihood that investor expectation has been adjusted and perhaps in a more permanent way. Furthermore, Dr. Woolridge explained that a test of reasonableness for his admittedly low number when compared to historical standards (TR 710) is validated when compared to the financial performance of the proxy group. As he noted, at the time of filing his testimony, the mean current return on equity and market-to-book ratio for the group are 10.6% and 1.66, respectively. He pointed out that this demonstrates that these companies are earning returns on equity above their equity cost rates. This is evidence that the recommended ROE is reasonable and consistent with the financial performance and market valuation of the proxy group.

Citizens would note that authorized returns for the proxy group average 10.23% with four of the nine companies at 10.10% or less. Murry Deposition Exhibit No. 2. While slightly higher than Dr. Woolridge's recommendation, they do indicate that the required returns for the proxy companies are no greater than the low 10% range. This vindicates Dr. Woolridge's methodology and his application of it to PGS.

In sum, the Citizens do not concede that the appropriate ROE for PGS is at or above 10%. Dr. Woolridge's testimony provides objective, unbiased analysis that supports an ROE of 9.25% which is validated by reasonableness checks and consistent with similarly situated gas companies. PGS witness Murry, on the other hand, has significant upward bias in his recommendation, which yields an unreasonably high ROE.

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

Position:

The PGS capital structure as filed is not inappropriate so long as recognition is given that its level of equity is higher than the proxy group used for purposes of determining an appropriate cost Common equity.

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

Position:

The appropriate cost rate of short term debt for the test year is 1.76% per the testimony of Dr Woolridge.

Discussion:

Per the Testimony of Dr Woolridge, the appropriate cost of short term debt for PGS is 1.76%. This is based on the current LIBOR rate and a small program financing fee of .18%. The company's proposed rate is based on outdated cost information from the summer of 2008. TR 670.

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

Position:

OPC objects to the Company approach to increase accumulated deferred taxes but concedes that it must follow the resolution in Docket No 080317-EI.

Discussion:

Even though this issue was raised in filing on August 2008, the company did not make any FERC filing identifying any uncertain tax positions, including this issue even thought the company raises the specter of a violation of the tax code here with a large negative impact.

OPC recognizes that this issue may follow the decision in the Tampa Electric Case since the two companies are operating divisions of the same legal entity.

Citizens question why the company cannot seek a private letter ruling with the facts presented with the commission staff's input and if the IRS rules that they are already in compliance with the code with respect to normalization, the associated revenue requirement benefit could be flowed through the PGA clause. If the Commission follows the company proposal, they should at least follow Commission precedent and adjust the deferred tax balance by reconciling the capital structure to ratebase for these dollars over investor sources of capital

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

Position:

*The appropriate weighted average cost of capital for the projected test year is subject to the resolution of other issues but should be no greater than 7.77%. *

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

Position:

Off System sales should be included in TY revenues at the $2 million level based on historical levels of OSS sales and to provide the proper incentive for sales that have benefit for the shareholders

Discussion:

Citizens submit that the outdated Off System Sales (OSS) sharing threshold should be raised from the 1994 level of $500,000 to $2 million. Over the previous four years the Company has made OSS in each year of greater than $2 million and they have averaged $2,258,556 over that same period. TR 639. Since revenues above $500,000 are currently "shared" 75/25 between shareholders/customers, the setting of the bar too low is inconsistent with the concept of providing an "incentive." TR 630.

For the test year, the Company has only included the $500,000 in OSS. MFR G-6, p. 8 of 9. In rebuttal, the Company defends the very low threshold OSS based on uncertainties in the market. TR 508-510. Tellingly, the company has not disclosed on the record, their projected or budgeted

level of OSS sales for 2009. This is significant because the company has the burden of proof to demonstrate why the low threshold should be retained.

It is undisputed that PGS tracks and budgets OSS at the very highest levels of the company. President Cantrell admitted to this on the stand. At TECO Energy Board of Directors Meetings, he regularly reports on OSS sales and in recent years has described them in glowing terms: "strong," and "ahead of plan". TR 90-92, EXH 91. Obviously recent history has shown the $2 million sales level is achievable, measurable and known.

Furthermore, in 2008, PGS made significant capital expenditures and included them in the ratebase request in this case. The capital costs were for serving affiliate Tampa Electric's Bayside Power Station and for facilitating OSS. TR 89; TR 253; EXH 13, OPC POD No. 3, BSP 3398; OPC POD No.1, BSP 2779; Binswanger Deposition, at 71.

Witness Binswanger testified that $3.2 million associated with the lateral that was installed and placed on PGS' books in order to serve Bayside. Binswanger Deposition at 71. Witness Narzissenfeld testifies that a large portion of the $6.8 million 2008 capital budget overrun was $4 million "more than was contained in the original MFRs." TR 234-235. In addition, company budget documents from late 2007 identify the projected impact of the Gulfstream lateral in the 2008 capital budget as being $5 million. EXH 13, OPC POD No.1, BSP 2779-2780.

Regardless of the exact amount, the capital impact of the pipeline used to facilitate OSS is significant. Witness Cantrell admitted that the Company hoped that the lateral or pipeline would "enhance our ability to [make OSS]." TR 89. He reported to the TECO Energy Board in the summer of 2008 when discussing Second Quarter 2008 results, that the pipeline had initiated service. EXH 13, OPC POD No. 3, BSP 6091.

The bottom line is that PGS has expended significant capital dollars on a budget busting project they hope will enhance OSS. The Company fully expects these costs to be borne by the ratepayers. The evidence is overwhelming that the threshold should be reset at the $2 million level. This sends the correct signal and allows the company to renew their efforts to leverage

ratepayer funded facilities for OSS sales that can benefit shareholders directly. They have not met their burden of demonstrating that the $2 million threshold is unachievable.

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

Position:

No. the trend rates used by the company did not contemplate the significant drop in inflation. The company chose the TY and has the burden of proving its assumptions. No evidence offsetting adjustments have been offered, but the company acknowledges that factors would be lower today.

Discussion:

Keeping in mind that PGS chose its test year and has the burden of proof to demonstrate that their proposed projected expense adjustments are reasonable, prudent and not overstated, Citizens submit that the inflation factor used for non-payroll, trended expenses should be updated. The company chose the inflation projection for justifying their rate increase. It is their burden to demonstrate that their presentation is accurate and reflective of conditions when rates will be in effect.

PGS has admitted that the inflation factors have changed. For this reason, Citizens propose that the company should utilize the factors that are known at this time. At the time the case was prepared and filed, PGS used projections for 2008 and 2009. New "actual" CPI-U is available for 2008 and a new projection is available for 2009. This is consistent with the methodology used when preparing the case.

In preparing its filing, PGS utilized Moody's "Economy.com" service projections. This was almost 9 months prior to the hearing. At that time, the full effect of the recession and the direction of inflation were not known. (Their finance expert Dr. Murry certainly got it wrong regarding inflation and oil prices in his testimony, TR 125-130.) The company acknowledges that the current trend factors from the identical private sector source have changed for 2008 and

2009. At the time of filing, the factors for CPI- U were 2.9 and 2.1 for 2008 and 2009 respectively. The current factors from Economy.com are 3.8 and -1.1 respectively. TR 391-393; Higgins Late Filed Deposition Exhibit No. 9, p. 2.

Witness Higgins acknowledged that utilizing the current factors and recasting the non-payroll trended amounts using certain assumptions applied to MFR G-2, pp. 10-14 of 32 would yield a reduction in test year expense. The most straightforward application of the current factors (substituting the new numbers for the old) would reduce expense by $245,164. He further agreed that modifying the adjustment to use the updated 2008 factor (increase from 2.9% to 3.8%) while holding 2009 to zero would yield a reduction of $130,115. He also agreed that using the original 2008 factor and holding 2009 factor at zero would yield a reduction of $218,723. TR 395-398.

Witness Higgins did not fully embrace the adjustment or state a preference for one scenario over the other. He did suggest that other offsets such as revenue decreases might militate against the new expense reductions. However, he also conceded that there is not a direct correlation between CPI and revenue. TR 389. In the end he just stated that he would "prefer" to use the "as filed" factors. Interestingly, PGS President Cantrell suggested in cross-examination that they were adding commercial customers and that that type of customer brings in more revenue. He also claimed that the company added more than a thousand new restaurants in 2008. TR 71, 84. Notable too is that no party or Staff has taken issue with the company's revenue forecast or billing determinants. Witness Higgins basis for preferring not to update was that the federal economic stimulus efforts could cause upward change in inflation and he cited recent changes in the factors over the last few months. Of note, the changes were downward. TR 394. While theoretically this could happen, the evidence in the case indicates otherwise.

In this vein, other diverse, reliable sources seem to have developed somewhat of a consensus that indicates that inflation projections for 2009 will hold at or near zero. *Blue Chip* reports quarterly CPI forecasts for 2009 dated March 1, 2009 that implies a rate (average of all four quarters) of 0.375%. EXH 102. A month earlier the same service was forecasting 2009 annual inflation at 0.6%. Murry Deposition Exhibit No 3. This slightly downward and zero-hugging trend seems to dampen witness Higgins concern about inflation moving upward. In similar vein, the United

States Congressional Budget Office (CBO) projects 2009 CPI-U at 0.1%. EXH. 96, p.2 Even the 2010 CPI forecast by *Blue Chip* is also trending slightly downward from 2.0% to 1.9% when the two monthly reports are compared. The CBO estimate is likewise in-step, forecasting 2010 inflation at 1.7%.

In sum, from a burden of proof and fairness to customers' standpoint, the Commission should adjust trended non-payroll expense by $245,164. This figure is urged over the other two options because it is the most objective and consistent with the Company's methodology for trending expenses.

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

<u>Position:</u>

* Yes, per the analysis on Issue 25, expenses should be reduced $245, 164.*

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

<u>Position:</u>

Yes. Expense should be reduced $210,199 to account for the slowdown in customer growth. Incentive compensation should be reduced by $2,714,400 due to excessive amounts relative to any benefits produced for ratepayers. A further reduction of $697,861 should be made for the company's failure to explain or justify this amount.

<u>Discussion:</u>

Citizens propose three adjustments here. One is for projected payroll increases related to customer growth that is not going to occur under any scenario advanced by the company. The second is to reduce incentive compensation for lack of customer benefit. The third is to adjust expense for an unexplained level of dollars that appear to be for payroll, but for which there are no position or job description explanation.

Payroll related to customer 'growth"

Payroll should be reduced by $210,199 in order to remove trending adjustment added by the company for customer growth. As explored in several issues there is very little customer growth. In fact, the year end counts from 2007 to 2008 indicate that the company lost around 580 customers overall. EXH 13, Staff Int. No. 130. Clearly if the company is to be held closely to its burden, there is no justification for any customer growth-driven employee addition. The entire global economy is doing more with less; there is no reason to expect PGS to be granted an exception. The company should not be allowed to increase overall expense by the use of factors when the result yields the equivalent of several positions that are not logically going to be required. The company's burden is to justify new positions by describing the specific need, not through benign neglect or budgetary creep in the trending process.

Incentive Compensation

The more vexing question is what to do about incentive compensation. Citizens' contention regarding PGS' incentive compensation is simple. The company has not justified the plan as one that provides incentives or rewards performance. As such the level of compensation appears excessive and is unwarranted in today's severe recession.

Witness Schultz recommends disallowance because the Company failed to provide evidence through discovery that shows that Peoples Gas has set out goals for payment of bonuses or incentives. As detailed in his testimony, the discovery responses were incomplete and did not show goals or results for some categories. Additionally, payouts were made where goals were missed and other times goals were lowered even when they had been met in prior years. TR, T. 634-637.

Clearly, the company's burden of proof was not met in this case. Obviously, incentive compensation and payment for performance cannot be measured in the test year, so historical results were evaluated. Mr. Schultz testimony is replete with examples. For one, customer service and safety goals were identified in one discovery response and the results were omitted in

another. The Citizens and thus the Commission have inadequate information for evaluation. TR. 636.

Other evidence indicates that in three out of five years the target amount of payment was not paid out while in the other two years the target was exceeded. TR 636. This evidence of inconsistency coupled with the appearance that the incentive goals and payment are more related to financial performance indicate that there is a lack of proof that ratepayers benefit from incentive compensation as administered by PGS.

Although he filed testimony that sought to defend the incentive payment process, PGS witness Higgins had to concede under cross examination that that there were some goals that were abandoned (capital budget), some that were inexplicably not shown (customer service and safety) though he could not say why. Higgins Deposition, 47. He also agreed that the company's explanations provided no explanation as to how the objectives were set. Deposition at 48.

An undeterminable amount of management incentive compensation appears to be tied to financial performance. Higgins Deposition at 76-79. There is no justification provided by PGS why the ratepayers should bear this cost.

The bottom line is that PGS has what is styled an incentive compensation plan that has little consistency in application or achieving

Most surprising was that the company defended the compensation plans – though flawed – by stating that they were immune from the ravages of the economy. In response to discovery and in deposition and on the stand, witness Higgins repeatedly asserted that:

> The rationale for compensation plans such as Peoples' is simply not affected by the current economic conditions.

Exh 13, Staff Int.No.108; Higgins Deposition at 49; TR 402.

While the Commission heard evidence that company's around the country and world were cutting salaries, bonus, incentive compensation and the like. Even so, PGS maintains that it should continue to pay incentive compensation regardless of the economy, the state of competitive labor market and large unemployment numbers. TR 402-412. It seems unreasonable to assume that PGS or any other business is immune to national and global market forces when it comes to labor. Any comparative studies they used for compensation were certainly produced well before the current economic climate and would not represent today's environment.

Incentive compensation should be disallowed both as it relates to PGS' payroll and any allocated costs from affiliates. At a minimum, incentive compensation related to financial results should not be allowed as no ratepayer benefit can be shown.

The "missing" $697,000.

OPC witness Schultz has identified $697,861 of payroll expense that has not been justified or associated with any positions that the company has identified in the filing or testimony. This situation is described at TR 632-634. In rebuttal, Witness Higgins tries to explain that the issue arises due to the differences between the Commission MFR requirements and the Company budget. TR 377-378; 413-414. His reconciliation however is done on a total O&M basis and does not address the specific concern about payroll and whether there is nearly $700,000 of dollars that are buried in the budget relating to job positions that are not described or perhaps are unfilled.

The issue can be looked at slightly differently from witness Schultz testimony as follows. If you take the O&M amount of $23,917,929 on OPC Int. No. 61 (EXH 13) for 2007 and deduct the incentive compensation of $1,850,598 also identified in the response you get $22,067,331. This amount is found on line 1 MFR G-2, Page 19. The incentive compensation is deducted because it is included on line 3 of MFR G-2. The 2009 O&M balance on Interrogatory No. 61 is $27,716,212. By deducting the 2009 incentive compensation of $2,714,400 the resulting O&M amount is $25,001,812. The amount on MFR G-2 is $23,632,084. This indicates that there

remains a difference of $1,369,728. The Company has included in line 3, for 2009, $364,000 (Account 871) for new employees for the gas control function. This was explained in the response to OPC Interrogatory No. 82 (EXH 13). This leaves $1,005,728 of unexplained and/or unidentified compensation expense in the filing for 2009 under lines 2 or 3 of Schedule G-2, p. 19. Since $307,867 has been adjusted separately elsewhere the remaining unexplained dollar amount is $697,861. The $307,867 is presumed in account 907-910 in the 2009 amount on OPC 61 since these dollars were in the 2007 amount. Witness Higgins acknowledged that the response to Interrogatory 61 was accurate. TR 415. He also acknowledged, after some initial uncertainty, that there appeared to be as many as 28 unfilled or vacant positions that may not have been accounted for in the filing. TR 414-418. At least 15 of these positions remained vacant the entire length of 2008. TR 417; EXH 99.

Citizens submit that the Company has failed to reconcile the specifics of the payroll component of O&M and this may be due in part to discrepancies in filled and vacant positions. Certainly there is significant doubt as to whether a portion of the overall payroll request is based on jobs that will not be filled. In asking customers to pay higher rates in these economic times, it is doubly incumbent upon the company to justify all positions and payroll expenses when so many of their customer base is out of work. TR 65-66. Payroll expense should be reduced $697,861 for lack of justification.

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

Position:

Rate case expense should not exceed $684,500 and should be amortized over no less than 5 years consistent with historical spacing of rate case filings.

Discussion:

As noted by OPC witness Schultz rate case expense has increased 212% since the last case as compared to the growth in inflation of only 18.4%. TR 647-649. Citizens are proposing a slight reduction in overall rate case expense of $65,500 for lack of documentation. The main disagreement is the amortization period. There was a 6 year period between the this case and the

prior. Thus the three year amortization period is unjustified. Citizens recommend 5 based on Mr. Schultz testimony. TR 647-649.

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

Position:

No. Uncollectible expense recovery is properly a matter for base rate treatment. Recovery through the PGA Clause will reduce scrutiny and company incentive to pursue collection.

Discussion:

As demonstrated in the testimony of OPC witness Schultz, the company proposal to move a potion of bad debt expense to PGA clause recovery is not a good idea. TR at 611-612. This change in regulatory approach would be unprecedented and would change the company's incentive relative to collection of these costs. The Commission should refrain from making a change like this based on the limited record for one company. Although the Citizens do not favor moving these costs to clause recovery, a generic or rulemaking proceeding is the only place this issue should be considered.

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

Position:

*Yes. Bad debt expense should be increased by $723,580, and should be based on a four-year average. This adjustment is designed to reflect the removal of the gas cost portion from the Purchased Gas Adjustment Clause as discussed in Issue 30. *

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

Position:

Yes. Employee welfare/activity expense should be reduced $172,881 to match these expenses to the appropriate trending and inflation factors. Also, $569,500 of expense related to restricted stock grants and stock options should be reduced due to the excessive nature of this type of expense.

Discussion:

There are two types of adjustments needed in this category. As witness Schultz demonstrates, the company has included $164,500 of unexplained costs after under calculating an adjustment to remove expenses. TR 638-639. Making this adjustment requires removing a total of $172,881 from Employee Welfare/Activity expense.

Citizens also recommend that restricted stock and stock option projected expenses be removed for the test year as they are excessive in today's economy. This results in a further adjustment of $569,500. TR 639-640.

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

Position:

*Projected test year pipeline integrity expense should be reduced by $250,000 to $501,500. *

Discussion:

PGS proposal to annually recover $751,500 in speculative pipeline integrity expense from customers is unwarranted and unjustified on the record. The expense level is based largely on guesswork and not even on existing rules or regulations. The prior 5 years of expense for the pipeline integrity work amounted to an average of $114,000. As detailed in Witness Schultz's testimony the test year amount is largely non-recurring and the anticipated future annual amount is no more than $550,000. Even though the estimates are largely based on guess and rules and regulations that are not in place, Citizens are not recommending disallowance of the entire amount. Mr. Schultz has conservatively recommended an adjustment to reduce the request to $501,500. TR 640-642.

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?

POSITION:

No. The need for an unfunded reserve of $1 million and $100,000 annual accrual appears overstated based on experience.

Discussion:

Peoples Gas' experience relating to storms does not support the need for a $ 1 million reserve or an accrual to establish one. The company's initial accrual was based largely on guesswork and not based on any actuarial or scientific study. As it turned out, the estimate included costs that should not have been included, causing the initial $100,000 accrual request to be trimmed to $75,000. TR 308. Even after making the adjustment, the company does not indicate that the reserve amount of $1 million is being adjusted. Clearly this is further evidence of a revenue requirement result orientation approach rather than one that is driven by experience or true need. Witness Schultz demonstrates that the need for the accrual is not supported by actual cost and includes improper costs and is essentially based on an average of two averages rather than experience that is indicative of future storm costs. TR 645-646.

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

Position:

*Yes. Projected demonstrating and selling expenses should be reduced $2,000,530 due to the ineffectiveness of this service that is provided by an affiliate. *

Discussion:

PGS has a contract arrangement with an affiliate TECO Partners, Inc. (TPI) to perform marketing activities, designed primarily to sign up new customers. TR 420. This contract was not competitively bid. TR 422. In 2009, the company expects to spend $6.1 million with the affiliate, with $2.6 million geared toward signing potential new customers. TR.659. In the test

year, the Company says it "absolutely" expects to sign 12,000 new customers. TR 425. Citizens have a serious concern that this expectation is unrealistic and that the payment of $2.6 million is impudent when the benefit appears illusory at best.

Witness Higgins acknowledged that the signings are only a potentiality and that no new signing obligates the signer to become a PGS customer or buy a single therm of gas. TR 425. He further acknowledged that for 2003 through 2007, TPI averaged signing 9,720 customers. He also admitted that that was when the economy was much better than it is today. TR 421.

In justifying his confidence that 12,000 signings would occur in the current severe recession, Witness Higgins pointed to the Nocatee development, which he described as "being on the drawing board." He said that if TPI was successful in signings there, they would go a long way toward meeting the 12,000 signings goal.

There are two problems with this optimism. First, it contrasts with reality and the fact that only about three-fourths of the 12,000 signings amount had been annually achieved over the last 5 years – when times were good. Second, the Nocatee example is not a good one, since that development has been in a state of flux as evidenced by the discussion elsewhere relating to the capital budget (Issue 5) and the CR rider (Issues 54 and 55). Company documents even indicate that the Nocatee development has been on the drawing board since 2004. EXH 13, OPC POD 17, BSP 8263-8264. Therein the projections of housing units and PGS capital extensions did not materialize when the real estate market was hot. It cannot be assumed that the Nocatee Units will just appear and justify this $2.6 million expenditure.

Witness Higgins says that if they do not get the new signings, then PGS will not pay. That is all well and good for PGS, but unfortunately since they are "absolutely" expecting a big increase in signings just as the economy worsens, they have projected full payment in 2009 expense projections included in test year expense. If a true-up occurs it will be after the fact and only to the benefit of the shareholders. For this reason, the Commission should exercise a healthy skepticism under the circumstances and accept witness Schultz's adjustment to reduce expense by $2,144,100. TR 651.

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

Position:

No. The entire projected DOL insurance expense should be eliminated since the insurance benefits primary shareholder defending lawsuits from shareholders.

Discussion:

Directors and officers liability (DOL) insurance exists primarily to protect shareholders from lawsuits by fellow shareholders regarding actions of the board of directors who are hired by shareholders. As such there is very little in the way of ratepayer benefit. Citizens witness Schultz describes how there is very little in the way of ratepayer benefit for this type of insurance. TR 642-644. The entire amount of $342,000 should be removed from test year expense in order to allocate the cost to the shareholder beneficiaries.

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

Position:

*Yes. $1,262,437 of allocated incentive and bonus compensation and DOL expense should be removed. *

Discussion:

As detailed in the testimony of Citizens' witness Schultz, any incentive or bonus compensation allocated to PGS from TECO should be disallowed for the same reasons he recommends disallowance for directly incurred incentive and bonus compensation. TR 651-652. The appropriate adjustment is to remove $1,261,437.

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

Position:

Yes. PGS has failed to rebut the presumption that debt from the parent company is invested in the equity of PGS in the same ratio that it exists in the parent capital structure. Income tax expense should be reduced $833,124.

Discussion:

The company seeks to avoid application of the Parent Debt Adjustment (PDA) mandated by rule 25-14.004, F.A.C. without making any effort to overcome the presumption required by the rules. The only effort to avoid the adjustment is found in the pre-filed direct testimony of parent (TECO Energy) Chief financial Officer, Gordon Gillette. His testimony in "rebuttal" consists of four sentences containing 65 words. Therein he merely denies that the $400 million was raised for anything but TECO Energy's failed merchant plants or that the proceeds from those debt issuances was invested in PGS' equity. TR 103.

This testimony utterly fails to even meet the presumption, much less rebut it. Notably, witness Gillette does not even assert that whatever investment of debt proceeds that occurred did not displace or free up general corporate funds for use elsewhere in the corporation. To the contrary, in fact, in his deposition he acknowledged that the proceeds from the TECO Energy bonds sales were not segregated in the sense that funds could be traced or were segregated at the parent company level. Gillette Deposition at 39-40.

He also conceded that the controlling legal documents did not place any restrictions on the use of the proceeds or limit them to merchant plant projects. Id. at 40. Witness Gillette further admitted that the proceeds from the $400 million of debt in question were available for general corporate uses. Id.

Clearly, the evidence in this case is well short of rebutting, and in fact bolsters, the presumption that the PDA should be made. The commission has previously held that it is difficult to meet and defeat the PDA rule presumption that the parent debt is invested in the subsidiary equity in the same proportion it exists in the parents overall capital structure. See, Order no. PSC-00-

2054-PAA-WS, issued October 27, 2000; Docket No. 990939-WS, *In Re: Application for Rate Increase in Martin county by Indiantown Company, Inc.*

The Commission should adjust the income tax expense for the parent debt adjustment as follows:

Debt Ratio of Parent		0.1902
Debt Cost Rate of Parent	x	0.073
	=	0.0138846
Consolidated Tax Rate	x	0.38575
	=	0.005355984
Subsidiary Equity (Paid in Capital)	x	$155,550,169
Parent Debt Adjustment	=	$833,124

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 PGS, 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.

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 PGS, 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.

Position:

*No. PGS has not demonstrated that regulatory oversight of these costs should be removed from base rates review. These type costs are not sufficiently large or volatile as to warrant recovery in

a "clause" mechanism, nor has PGS proposed any downward ROE adjustment in the event the rider is adopted. *

Discussion:

The Company has suggested that the Commission create two riders or clause mechanisms that would allow them to recover costs, including capital costs, between rate cases, Citizens strongly object to creation of these mechanisms on several bases.

First and foremost, Citizens have grave concerns about whether the Commission truly possesses the authority from the legislature to establish a mechanism to recover non-volatile, non-fuel, base rate costs. Other than citing statutorily created environmental cost recovery mechanisms in Florida and a statutorily created Missouri rider, Peoples Gas has not pointed -- in its filing -- any applicable authority or precedent for the Commission to establish a surcharge mechanism that removes costs normally reviewed in base rate proceedings and places them in an annual, streamlined clause recovery process. TR 496. (Oklahoma and Kansas were cited, but the company never gave any details about the mechanism or the source of authority).

At the present time, there are two true capital cost recovery mechanisms that the Commission administers. These are the Environmental Cost Recovery Clause and the Nuclear and IGCC Cost recovery Clause. Both ratemaking mechanisms are expressly authorized and established by the Florida Legislature. S. 366.8255 and s. 366.093, Fla. Stat.

The other clause mechanisms that the Commission has established on its own inherent or express authority have been generic to the industry type and are almost exclusively expense-related. It is certainly the case that at the time each clause was established it was exclusively for non-capital expense recovery. Only after experience and familiarity have certain *ad hoc* capital costs been allowed. Chief among this type of exception is homeland security cost recovery in the immediate and succeeding aftermath of the 911 attacks. Due to the exigencies of a national crisis, the Commission allowed the expedited cost recovery in order to assist in the strengthening of nuclear plant security. This type of accommodation does not serve as precedent for a single company seeking to establish a rider that would be unprecedented in Florida.

The other rate adjustment clauses established by the Commission are for readily auditable and sufficiently variable costs that they are amenable to streamlined annual review and cost recovery. These clauses are (1) Fuels and Purchased Power Cost Recovery Clause with Generating Power Incentive Factor; (2) Energy Conservation; (3) Purchased Gas Adjustment (PGA) True-Up; and (4) Natural Gas Conservation Recovery.

The Legislature has tacitly approved these expense-type recovery mechanisms and the Commission's establishment of them. They have not sought to curtail, modify or eliminate them while at the same time themselves statutorily establishing the two true capital cost recovery mechanisms. In fact, in these statutes, the Commission's rate adjustment clauses are recognized. S. 366.8255(2), Fla. Stat. ("...recovered through base rates or other rate adjustment clauses...."). Likewise, the nuclear cost recovery statute contains similar approving recognition. S. 366.093(2)(a), Fla. Stat. ("...recovery through the capacity clause"). This implicit approval contrasts with the Legislature's express creation of explicit capital cost recovery for significant capital cost items like environmental compliance costs and nuclear construction. Citizens respectfully suggest that the Commission should proceed cautiously in an area where the Legislature has acted where capital costs are at issue and has allowed the Commission significant latitude which it has exercised judiciously in limiting the types of costs eligible for streamlined annual recovery.

PGS has acknowledged that no other company in Florida has a rider like the two they are requesting be established. TR 496; EXH 13, OPC Int. No. 57. They cite two Electric case orders as potential precedent. Both cases were resolved by the Commission approving a stipulated settlement and are thus not precedent for what PGS seeks. Order No PSC-05-0945-S-EI resolved a Progress Energy Florida rate case and approved a company- and situation-specific stipulated one-time recovery of the annual revenue requirement (for one year) of an electric generating plant imminently going on line and into service. This was a negotiated temporary accommodation and not a fundamental policy change or precedent in the manner PGS' interrogatory response would suggest. See, *Order No PSC-05-0945-S-EI, issued September 28, 2005, in Docket No. 050078-EI, In re: Petition for rate increase by Progress Energy Florida,*

Inc. Likewise Order No. PSC-05-0902-S-EI was also a company-specific accommodation within a negotiated settlement of a rate case. If FPL wants to continue the exception, it must seek approval by the commission in a subsequent rate case, See, Order No. PSC-65-0902-S-EI, Issued September 14, 2005, Docket No. 050188-EI, *In Re: petition for rate increase by Florida Power & Light Company.*

Apart from the questionable legal basis for establishing the riders, there are strong policy and factual reasons not to grant the requested relief regarding the riders. Citizens' witness Schultz offers sound regulatory policy reasons for refraining from creating the mechanisms. He testifies that the riders would be inconsistent with basic regulatory theory, TR 613. They disconnect the recovery of costs from the risk compensation underlying the return on equity determination without a compensating reduction in return on equity. TR 621-623. Lessened oversight and inconsistency with general rider/clause creation (volatile expenses) are sound reasons for refraining from implementing the riders. TR 616. Furthermore, Witness Schultz points out that the facts do not indicate that the costs or impacts are material enough to warrant separate treatment. TR 618-619.

A good example is that the company has included in the GSR rider road relocation revenue requirement costs incurred after 2009. TR 502. At the same time they have included as part of the base rates request an estimate based on 3 years of historical costs. TR 572; EXH 13, OPC POD No, 72, BSP 41167. Prior to hearing the company has adjusted the 2009 components of the capital budget to show $5.4 million of estimated relocation costs. Binswanger Late-filed Deposition Exh. No.1. No evidence was produced that the $400,000 annual revenue requirement associated with the originally estimated relocation costs would not be covered by growth over time or fall within the 200 basis point range of reasonableness that the commission will establish in this case. Witness Binswanger conceded that in recent years this relatively minor annual revenue requirement was recovered in at least two recent years. TR 572-575.

Witness Schultz also demonstrates that the costs PGS seeks to recover under the GSR rider are not volatile or unpredictable such that they should be singled out for clause treatment. TR 616. This applies just to the capital (relocation) costs. The pipeline integrity costs are included in base

rates at an excessive level, well above historical experience. Under cross examination Witness Binswanger acknowledged that there was some uncertainty about whether the company would ever spend over the $750,000 of pipeline integrity expense to trigger GSR rider recovery. TR 504; 547-551. In fact from 2004-2008 the average annual expenditure for these tasks was $114,000. TR 586. Under cross examination witness Binswanger could not identify any actual regulations that are in place now that demand that a new clause be created. Binswanger, TR 516-518.

Although Citizens understand PGS' good faith effort to find a creative solution to recover its costs, the evidence is not compelling that these costs qualify for extraordinary treatment. The company acknowledges that no other company in Florida receives this type of cost recovery as a result of Commission decision, The only other state cited by PGS with capital costs recovery for relocations is Missouri, which as noted above has a ***statutorily*** authorized mechanism.

It is interesting to note that the absence of the GSR and the CR riders have not hampered PGS relative to the proxy group of company's chosen by their cost of capital witness Murry. Hearing Exhibit 92 demonstrates that PGS – without the capital cost recovery clause – has a higher or more favorable RAA regulatory rating than every other member of the proxy group – each of which is loaded up with clauses. Interestingly, Laclede which is the only cited example of having an analogous rider or "Infrastructure System Replacement Surcharge" which is broader in scope than the proposed GSR rider (Binswanger Late-filed Deposition Exhibit No. 4 at 1) is only rated "Average/2, while PGS – with no comparable rider -- has an "above Average/2" rating.

The company's Carbon Reduction or CR rider is even more problematic. The concerns raised with the capital expenditures on Issue 5 are applicable. The Citizens have a serious concern that ever increasing capital dollars are pursuing ever fewer customers and revenue opportunities. This concern appears to be more present with regard to the CR rider concept. It appears that PGS would request Commission approval in the annual PGA clause process for the general body of ratepayers to fund their forays into uncertain real estate developments and even pay for any errors in judgment in dealing with currently risky real estate markets. Witness Binswanger admitted in his deposition that the general body of customers would have no recourse in the case

of a development not materializing after they had been surcharged for the costs. Binswanger Deposition at 52-54.

The evidence in this case has exposed a disturbing trend of uncontrolled capital spending on real estate developments which have not materialized or proven out. This phenomenon has swollen the company's ratebase and a previously steady ratio of revenue producing capital to customer additions has tripled and nearly quadrupled over the last two years.

In essence the only thing that the CR rider would do in this current situation is to more quickly and more frequently place the risk of misjudgment and economic downturn on the general body of customers. Given the current state of the economy and real estate market, now is certainly not the time to implement an experimental rider mechanism that would not have adequate checks on company spending in speculative ventures.

There is also evidence that the need for the CR rider is overstated. In testimony filed on January 30, 2009, witness Binswanger cited a discovery response that purportedly described two developments that were lost due to the unavailability of the rider. One of the developments was Nocatee. TR 507; 583-585. The company filed a revised capital budget detail just prior to hearing in an effort to hold the budget projection at the same level. Nocatee showed up as a new 2009 development project on the new list to replace project(s) that had been delayed or cancelled. In addition to casting doubt on the company's judgment relative to the extension of viable developments, it certainly demonstrates that the lack of a CR rider may not be the true reason that projects are lost.

In sum, there appears to be questionable authority (or reason for caution) for establishing a company specific capital recovery riders. Clearly there is reason for the Commission to be hesitant to act when the Legislature has not acted nor apparently been asked. OPC witness Schultz has provided sound reasons based in regulatory theory why the Commission should withhold approval. Finally, the facts don't support the need or urgency for including the relocation costs in the GSR. There is abundant evidence that these costs have been recovered in the past. Likewise the pipeline integrity expenses appear to be overstated, thus leading to the

conclusion that a need for clause-type recovery does not exist. The regulations that are supposedly driving this expense category are either not in place or not generating incremental expense over normal levels. Finally, with respect to the CR rider, the supposed need has been contradicted by the company's own evidence. The potential for saddling the customers with imprudent costs in a bad economy is too great to experiment at this time.

Respectfully submitted,

J. R. KELLY
PUBLIC COUNSEL

Charles J. Rehwinkel
Associate Public Counsel

Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street, Room 812
Tallahassee, FL 32399-1400
(850) 488-9330

Attorneys for the Citizens of the
State of Florida

Peoples Gas System
Projected Test Year Ended December 31, 2009

Revenue Requirement

Docket No. 080318-GU
Citizen's Brief Exhibit1
Schedule A-1
Page 1 of 1

Line No.	Description	Per Company Amount	Maximum Per Citizens Amount	Reference
1	Adjusted Rate Base	563,599,434	556,199,233	Schedule B-1
2	Required Rate Of Return	8.88%	7.77%	Schedule D
3	Income Requirement	50,060,255	43,231,821	L.1 x L.2
4	Adjusted Net Operating Income	33,944,697	40,759,448	Schedule C-1
5	Income Deficiency (Sufficiency)	16,115,558	2,472,373	L.3-L.4
6	Earned Rate of Return	6.02%	7.33%	L.4/L.1
7	Gross Revenue Conversion Factor	1.6436	1.6436	
8	Revenue Deficiency (Sufficiency)	26,488,091	4,063,593	L.5 x L.7

Source: The Company amounts are from the Exhibit A to the Company Petition.

Peoples Gas System
Projected Test Year Ended December 31, 2009

Adjusted Rate Base

Docket No. 080318-GU
Citizen's Brief Exhibit1
Schedule B-1
Page 1 of 1

Line No.	Description	Per Company Amount	Citizens Adjustments	Per Citizens Amount	Reference
	Utility Plant				
1	Intangible Plant	15,050,317		15,050,317	
2	Distribution Plant	924,899,052	(7,500,000)	917,399,052	B-2
3	Construction Work In Progress	18,249,444		18,249,444	
4	Acquisition Adjustment	2,301,671		2,301,671	
5	General Plant	48,873,806		48,873,806	
6	Total	1,009,374,290		1,001,874,290	
	Deductions				
7	Accumulated Depreciation	(426,364,359)	108,750	(426,255,609)	B-2
8	Customer Adv. For Construction	(7,916,127)		(7,916,127)	
9	Net Utility Plant	575,093,804		567,702,554	
10	Working Capital Allownace	(11,494,371)	(8,950)	(11,503,321)	B-2
11	Total Rate Base	563,599,433		556,199,233	

Peoples Gas System
Projected Test Year Ended December 31, 2009

Net Operating Income Adjustments

Docket No. 080318-GU
Citizen's Brief Exhibit1
Schedule C-2

Line No.	Description	Per Citizens Amount	Reference
	Revenue		
1	Off-System Sales	1,500,000	Schedule C-3
	O&M Expenses		
2	Payroll Trending Adjustment	(210,199)	Schedule C-4
3	Incentive Compensation	(2,714,400)	Testimony
	Company Merit Payroll Adjustment	(253,300)	Higgins LFDE #7
	TECO Alloc Compensation Adj	(26,500)	Higgins LFDE #7
	Unsubstantiated Payroll	(697,000)	Issue 28
	Employee Benefits		
4	- Employee Welfare/Activity	(172,881)	Schedule C-5
5	- Executive Stock Grants/Options	(569,500)	Testimony
	Inflation Adjustment	(245,164)	Issue 25
6	Pipeline Integrity Expense	(250,000)	Testimony
7	Directors & Officers Liability	(342,000)	Testimony
8	Storm Damage	(100,000)	Testimony
9	Rate Case Expense	(113,100)	Schedule C-6
10	TPI Marketing Contract	(2,000,530)	Schedule C-7
11	Tampa Electric Charges	(1,261,437)	Schedule C-8
12	Uncollectibles Mechanism Reversal	723,580	Testimony
13	Total O&M Expense	(8,232,431)	
14	Depreciation Expense	(217,500)	Schedule C-9
15	Interest Synchronization Tax Adjustment	130,119	Schedule C-10
16	Income Tax Adjustment	3,838,186	Schedule C-11
	Parent Debt Adjustment	(833,124)	Issue 39
	Net Payroll Adjustment	3,135,180	

Peoples Gas System
Projected Test Year Ended December 31, 2009

Overall Cost of Capital

Line No.	Description	Capital	Ratio	Cost Rate	Weighted Cost Rate
1	Long Term Debt	222,773,987	39.53%	7.20%	2.85%
2	Short Term Debt	3,456,397	0.61%	1.76%	0.01%
3	Common Equity	273,561,565	48.54%	9.25%	4.49%
4	Customer Deposits - Res.	9,338,641	1.66%	6.00%	0.10%
5	Customer Deposits - Comm	26,309,935	4.67%	7.00%	0.33%
6	Inactive Deposits	480,368	0.09%	0.00%	0.00%
7	Deferred Taxes	27,670,682	4.91%	0.00%	0.00%
8	Tax Credit	7,862	0.00%	0.00%	0.00%
9		563,599,437	100.00%		7.77%
10	Weighted Cost of Debt (plus customer deposits)				3.28%

Source: Per Citizen's witness Dr. J.R. Woolridge.

CERTIFICATE OF SERVICE
DOCKET NO. 080318 -GS

I HEREBY CERTIFY that a copy of the foregoing **POST-HEARING STATEMENT OF THE OFFICE OF PUBLIC COUNSEL** has been furnished by U.S. Mail and electronic mail to the following parties on this 20th day of March, 2009.

Caroline Klancke
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Jennifer Brubaker
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Katherine Fleming
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Ansley Watson, Jr.
MacFarlane Ferguson & McMullen
P.O. Box 1531
Tampa, Florida 33601

Peoples Gas System
Ms. Paula K. Brown/Kandi M. Floyd
Regulatory Affairs
P. O. Box 2562
Tampa, FL 33601-0111

Matthew R. Costa
TECO Energy, Inc.
P.O. Box 2562
Tampa, FL 33601-0111

John W. McWhirter, Jr.
Florida Industrial Gas Users
c/o McWhirter Law Firm
P.O. Box 3350
Tampa, FL 33601-3350

Annette Follmer
US Gypsum Company
Energy Department
P.O. Box 809278
Chicago, IL 60680-4124

Charles J. Rehwinkel
Associate Public Counsel