

**PEOPLES GAS SYSTEM
BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION**

Docket No. 080318-GU

**In Re: Petition for rate increase
by Peoples Gas System**

**Submitted for Filing:
August 11, 2008**

DIRECT TESTIMONY

**GORDON L. GILLETTE
On Behalf of Peoples Gas System**

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FPSC-COMMISSION CLERK

1 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS,**
2 **OCCUPATION AND EMPLOYER.**

3 A. My name is Gordon L. Gillette. My business address is 702 N. Franklin
4 Street, Tampa, Florida 33602. I am Senior Vice President and Chief
5 Financial Officer of Peoples Gas System (“Peoples” or “Company”), a
6 division of Tampa Electric Company (“Tampa Electric”) and Executive
7 Vice President and Chief Financial Officer of TECO Energy, Inc. (“TECO
8 Energy”).

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

11 A. I received a Bachelor of Science in Mechanical Engineering in 1981 and a
12 Master of Science in Engineering Management in 1985 from the
13 University of South Florida. In 2007, I completed the Advanced
14 Management Program at Harvard Business School. I am a registered
15 professional engineer in the state of Florida.

16 I joined Tampa Electric in 1981 as an engineer and worked in the
17 production and planning areas. I was promoted to Manager of Generation
18 Planning in May 1986 and later served as Manager of Bulk Power and
19 Generation Planning. I then became Director of Project Services for
20 TECO Power Services (“TPS”), responsible for fuel procurement,
21 environmental permitting and compliance, and power sales contract
22 administration.

23 In November 1994, I was promoted to Vice President of
24 Regulatory Affairs for Tampa Electric, and in November 1995, was named
25 Vice President of Regulatory and Business Strategy for Tampa Electric.

1 In March 1998, I was appointed Vice President of Finance and Chief
2 Financial Officer of TECO Energy and Tampa Electric. In 2001, I was
3 appointed Senior Vice President and Chief Financial Officer for TECO
4 Energy.

5 I was promoted to my current position of Executive Vice President
6 and Chief Financial Officer of TECO Energy in July 2004. I also serve as
7 the Senior Vice President and Chief Financial Officer of Tampa Electric.
8 As Chief Financial Officer, I am responsible for financial planning and
9 reporting, financing strategies and activities, and contact with the financial
10 community, including investors and rating agencies.

11 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

12 A. The purpose of my direct testimony is to describe how Peoples' need for
13 capital for system expansion will impact the need for external capital. I
14 explain the Company's capital structure and financial targets along with
15 why a parent company debt adjustment is unwarranted.

16 **Q. ARE YOU SPONSORING OR CO-SPONSORING ANY MINIMUM
17 FILING REQUIREMENTS?**

18 A. Yes, I am sponsoring Schedules C-26 (Parent(s) Debt Information) and
19 D-12 (Applicant's Market Data) of the Minimum Filing Requirements,
20 each of which was prepared under my supervision.

21 **Q. WHAT ARE SOME OF THE SIGNIFICANT BUSINESS DRIVERS
22 THAT HAVE IMPACTED PEOPLES SINCE ITS LAST RATE?**

23 A. Since the Company's last rate case filing in 2002, there have been
24 numerous challenges to the gas industry and to Peoples specifically. They
25 include a decline in per customer gas usage, increasing costs for materials,

1 labor, and operations and maintenance, and enhanced reliability and safety
2 regulations. At the same time, there is a growing need to expand the
3 natural gas infrastructure within Florida to help reduce greenhouse gas
4 emissions and improve consumers' carbon footprints. These trends are
5 described in more detail in the direct testimony of Bill Cantrell.

6 **Q. WHY IS PEOPLES REQUESTING A BASE RATE INCREASE?**

7 A. Since the Company's last base rate proceeding, Peoples has added
8 approximately 100,000 new customers. To serve this demand, the
9 Company has installed or replaced more than 1,500 miles of gas main in
10 the more than 200 communities it serves. The Company has also faced
11 increased requirements for maintenance capital expenditures, including
12 significant amounts for relocation of facilities due to rapid expansion of
13 highways and roads throughout the State.

14 Despite the initiatives and efforts the Company has undertaken to
15 manage costs, these actions are no longer sufficient to cover expenditures
16 to provide safe and reliable service. For 2008, the Company filed a
17 forecasted Surveillance Report with the Commission with an expected
18 return on equity ("ROE") of 9.30 percent. For 2009, without the revenue
19 requirements being sought, the Company's ROE is expected to be 5.61
20 percent. These returns are well below the bottom of Peoples' allowed
21 ROE range and are unsustainable. Peoples needs to be able to earn a fair
22 return on invested capital to be able to continue to access the capital
23 markets so that existing and new customers can continue to be served
24 reliably.

25 **Q. WHAT IS THE COMPANY'S REQUESTED REVENUE**

1 **REQUIREMENT INCREASE, AND WHAT ARE THE KEY**
2 **COMPONENTS OF THE INCREASE?**

3 A. The Company is requesting an increase of \$26,488,091 in base revenues.
4 The requested increase represents the amount necessary to raise the
5 Company's projected 2009 net operating income ("NOI") level to the
6 required amount of \$50,060,255. The required NOI is based on the
7 Company's projected 2009 13-month average jurisdictional adjusted rate
8 base of \$563.6 million and a weighted average cost of capital of 8.88
9 percent. The weighted cost of capital assumes a jurisdictional adjusted 13-
10 month average capital structure consisting of 54.7 percent equity. It also
11 includes a ROE of 11.50 percent, a long-term debt rate of 7.2 percent, and
12 a short-term debt rate of 4.5 percent. Dr. Donald Murry provides the
13 support for the Company's requested ROE, and Paul Higgins' direct
14 testimony explains the details of the Company's revenue requirement
15 based on the 2009 test year as well as the budget process used to develop
16 sound and reliable projected test year financial statements.

17 **Q. WHAT IS THE COMPANY'S FINANCIAL OBJECTIVE?**

18 A. Peoples' principal objective is to maintain its financial integrity at a level
19 sufficient to be able to raise debt capital, and to maintain fair returns on
20 equity to be able to attract equity capital.

21 **Q. WHAT CREDIT RATING IS PEOPLES TARGETING IN THE**
22 **FUTURE AND WHY?**

23 A. Peoples is targeting ratings in the single "A" range. This rating is required
24 since Peoples is facing higher capital spending requirements combined
25 with significant economic challenges such as declining customer usage,

1 lower customer growth due to the distressed housing market, and higher
2 materials and labor costs to serve customers, all of which add additional
3 risk for the company. Debt ratings in the single "A" range would ensure
4 that Peoples has adequate credit quality to raise the capital necessary to
5 meet these challenges and fund the necessary capital requirements. We
6 believe that maintaining the equity ratio at this level should produce credit
7 ratings parameters for the Company that are in the single "A" range.

8 **Q. PLEASE DESCRIBE THE EARNINGS BEFORE INTEREST AND**
9 **TAXES TO INTEREST (EBIT/INTEREST) COVERAGE RATIOS**
10 **AS REPORTED IN MFR SCHEDULES G-3, PAGE 9, AND D-11.**

11 A. Peoples' coverage ratio for EBIT/Interest has been declining and is
12 projected to be 2.3 times in 2009. This same coverage ratio averaged
13 approximately 4.0 times in 2004 through 2006 before starting to decline in
14 2007. The 2.3 times represents an unacceptable level and is expected to
15 continue to decline without rate relief. The Company believes that a more
16 appropriate coverage ratio for 2009 is in the range of 4 times, which can
17 be achieved by a grant of the Company's requested rate relief.

18 **Q. HOW DOES THE COMPANY'S PROPOSED 54.7 PERCENT**
19 **EQUITY RATIO COMPARE WITH THE ALLOWED CAPITAL**
20 **STRUCTURE IN PEOPLES' PREVIOUS BASE RATE FILING?**

21 A. The proposed 54.7 percent equity ratio is very reasonable when compared
22 with the Commission's decision in the 2002 base rate proceeding
23 approving an equity ratio of 57.4 percent.

24 **Q. GIVEN THE COMPANY'S PROPOSED CAPITAL STRUCTURE**
25 **OF 54.7 PERCENT EQUITY, WHAT ARE THE EQUITY**

1 **INFUSIONS FROM TECO ENERGY FOR 2008 AND 2009 THAT**
2 **ARE NECESSARY TO ACHIEVE THIS CAPITAL STRUCTURE?**

3 A. No equity infusions are deemed necessary in 2008, and the 2009 planned
4 equity infusion from TECO Energy to Peoples is \$25 million.

5 **Q. DID PEOPLES MAKE A PARENT COMPANY DEBT**
6 **ADJUSTMENT IN ACCORDANCE WITH FLORIDA**
7 **ADMINISTRATIVE CODE RULE 25-14.004?**

8 A. No. Although the TECO Energy parent company currently has \$400
9 million of long-term debt, this debt is related to TECO Energy's
10 investments in its failed TPS merchant power projects. TECO Energy
11 did not raise debt to invest in Peoples, nor did it invest the proceeds of
12 the debt it did raise as equity in Peoples. Therefore, a parent company
13 debt adjustment is not appropriate.

14 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

15 A. Since its last base rate case, Peoples has had numerous challenges
16 including declining per-customer gas usage, increasing costs, and
17 enhanced reliability and safety regulations. While managing these
18 challenges, Peoples recognizes that there is a need to grow the natural gas
19 infrastructure within Florida to help reduce greenhouse gas emissions and
20 reduce consumers' carbon footprints. The Company has added
21 approximately 100,000 new customers and installed or replaced more than
22 1,500 miles of gas main to serve these customers. Maintenance capital
23 expenditures have increased as well partially as a result of the relocation
24 of facilities due to rapid expansion of highways and roads throughout the
25 State.

1 Peoples is requesting a base revenue increase of \$26,488,091. The
2 financial basis for this revenue requirement is a weighted cost of capital of
3 8.88 percent, which includes an 11.50 percent ROE and a financial equity
4 ratio of 54.7 percent. The requested ROE and equity ratio are important
5 for the Company to maintain and enhance its financial position to target
6 debt ratings in the single "A" range to ensure uninterrupted access to
7 reasonably priced debt capital. Finally, a parent company debt adjustment
8 is inappropriate since the \$400 million of existing parent debt was raised
9 on behalf of TPS and was not used to fund any equity infusions to
10 Peoples.

11 **Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY?**

12 **A. Yes.**

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