

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)
MICHIGAN GAS UTILITIES CORPORATION)
for authority to increase retail natural gas rates.)
_____)

Case No. U-15990

DIRECT TESTIMONY OF

LISA J. GAST, CPA

FOR

MICHIGAN GAS UTILITIES CORPORATION

July 1, 2009

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**QUALIFICATIONS
OF
LISA J. GAST, CPA
PART I**

1 **Q. Please state your name, business address and position.**

2 A. My name is Lisa J. Gast. My business address is Integrys Business Support, LLC
3 (“IBS”), 700 North Adams Street, P.O. Box 19001, Green Bay, WI 54307-9001. I am
4 Manager, Financial Planning and Analysis in the Treasury Department of Integrys
5 Energy Group, Inc (“Integrys”). Both IBS and Michigan Gas Utilities Corporation
6 (“MGUC”) are wholly-owned subsidiaries of Integrys. Integrys resulted from the
7 February 21, 2007 merger between WPS Resources Corporation and Peoples
8 Energy Corporation.

9
10 **Q. For whom are you providing testimony?**

11 A. I am providing testimony on behalf of MGUC.
12

13 **Q. Please describe briefly your educational, professional, and utility background.**

14 A. I graduated from the University of Wisconsin – Green Bay in 1984 with a Bachelor’s
15 Degree in Accounting. I received a Masters Degree in Business Administration
16 (“MBA”) from the University of Wisconsin - Oshkosh in 1995. My professional
17 designations are Certified Public Accountant (“CPA”) and Certified Treasury
18 Professional (“CTP”). I joined the Treasury Department at Wisconsin Public Service

1 Corporation (“WPS Corp”) in April of 2001. In my current position, I am responsible
2 for the capital structure forecasts for each of our regulated utilities.

3

4 **Q. Have you previously testified before any regulatory agency?**

5 A. Yes, I have. I have filed testimony before the Michigan Public Service Commission
6 (“MPSC”) on behalf of Michigan Gas Utilities Corporation (“MGUC”) in Case No. U-
7 15549 and on behalf of Upper Peninsula Power Company (“UPPCO”) in Case No. U-
8 15988. I have also filed testimony before the Minnesota Public Utilities Commission
9 on behalf of Minnesota Energy Resources Corporation (“MERC”) in Docket No.
10 G007,011/GR-08-835. Both UPPCO and MERC are sister companies to MGUC.

**LISA J. GAST, CPA
DIRECT TESTIMONY
PART II**

1 **Q. What is the purpose of your pre-filed direct testimony?**

2 A. The purpose of my pre-filed direct testimony is to:

- 3
- 4 1. Present MGUC's capital structure and cost of capital for the 2008 historic
5 test year,
- 6
- 7 2. Present MGUC's capital structure and cost of capital for the 2010
8 projected test year,
- 9
- 10 3. Explain the differences in adjusted common equity between the 2008
11 historic test year and the 2010 projected test year,
- 12
- 13 4. Describe the required Common Equity Ratio for the 2010 projected test
14 year,
- 15
- 16 5. Describe the required Return on Common Equity ("ROE") for the 2010
17 projected test year, and
- 18
- 19 6. Present the required information regarding credit ratings and financial
20 metrics.
- 21

22 **Q. Are you sponsoring any exhibits in this proceeding?**

23 A. Yes, I am. I am sponsoring Schedules D1 through D5 of Exhibit A-4 (LJG-1) for the
24 2010 projected test year, and Schedules D1 through D8 of Exhibit A-14 (LJG-2) for
25 the 2008 historic test year.

26

27 **Q. Were these exhibits prepared by you or under your direction and supervision?**

28 A. Yes, they were.

29

30 **Q. Please explain Schedules D1 through D5 of Exhibit A-4 (LJG-1).**

31 A. In general, Schedules D1 through D5 of Exhibit A-4 (LJG-1) support and calculate
32 MGUC's capital structure, cost of capital, and required rate of return for the 2010
33 projected test year.

34

1 Schedule D1 develops MGUC's 2010 projected test year overall rate of return of
2 7.7851% based on MGUC's 13-month average capital structure, and a 12.00% ROE,
3 as shown on Line 22.

4
5 Schedule D2 develops MGUC's 2010 projected test year embedded cost of long
6 term debt of 5.9000%, based on a 13-month average, as shown on Line 21. No new
7 debt issues are forecasted for the test year.

8
9 Schedule D3 develops MGUC's 2010 projected test year cost of short-term debt of
10 4.5636%, based on a 13-month average, as shown on Line 12.

11
12 Schedule D4 indicates that MGUC has no preferred equity outstanding, as shown on
13 Line 2.

14
15 Schedule D5 develops MGUC's 13-month average balance of Adjusted Common
16 Equity of \$89,753,101 for the 2010 projected test year, as shown on Line 16. MGUC
17 requests a 12.00% ROE for the 2010 projected test year in this general rate case
18 proceeding, as supported by Mr. Paul R. Moul's testimony and analysis.

19

20 **Q. Please explain Schedules D1 through D8 of Exhibit A-14 (LJG-2).**

21 A. In general, Schedules D1 through D8 of Exhibit A-14 (LJG-2) support and calculate
22 MGUC's capital structure, cost of capital, required rate of return for the 2008 historic
23 test year. These schedules also provide the required information regarding credit
24 ratings and financial metrics.

25

1 Schedule D1 develops MGUC's 2008 historic test year overall rate of return of
2 7.2779% based on MGUC's 13-month average capital structure, and a 10.45% ROE,
3 as shown on Line 22.

4
5 Schedule D2 develops MGUC's 2008 historic test year embedded cost of long term
6 debt of 5.9000%, based on a 13-month average, as shown on Line 21.

7
8 Schedule D3 develops MGUC's 2008 historic test year cost of short-term debt of
9 4.0195%, based on a 13-month average, as shown on Line 12.

10
11 Schedule D4 indicates that MGUC has no preferred equity outstanding, as shown on
12 Line 2.

13
14 Schedule D5 develops MGUC's 13-month average balance of Adjusted Common
15 Equity of \$102,036,012, for the 2008 historic test year, as shown on Line 16.

16
17 Schedule D6 provides the current and historic credit ratings along with the
18 associated outlooks for senior unsecured debt, junior subordinated debt, and
19 commercial paper for MGUC's parent, Integrys, as published by Standard and Poor's
20 ("S&P"), and Moody's Investors Service ("Moody's"). Integrys is not rated by Fitch
21 Ratings, and has no senior secured debt. MGUC is not rated by any service.

22
23 No information on utility corporate bond issuances is presented in Schedule D7 as
24 MGUC last issued debt on April 1, 2006 as part of Integrys' acquisition of MGUC
25 from Aquila, and this debt was issued more than 24 months prior to the filing of the
26 instant general rate case. The debt was issued in three equal parts with durations of

1 7, 10 and 15 years and rates of 5.72%, 5.76%, and 5.98% respectively. Integrys
2 was the lender.

3

4 Schedule D8 calculates financial metrics on both a financial and ratemaking basis for
5 historic years 2004 – 2008, and the 2010 projected test year, with and without rate
6 relief.

7

8 **Q. Does MGUC present any other evidence on cost of capital?**

9 A. Yes, it does. Mr. Paul R. Moul of P. Moul & Associates provides evidence on
10 MGUC's cost of equity. He presents analytical studies employing various industry
11 models.

12

13 **Q. Is MGUC publicly traded?**

14 A. No, it is not. Integrys holds 100% of the common stock of MGUC. Integrys is traded
15 on the New York Stock Exchange under the symbol "TEG".

16

17 **Q. How were interest rates on short-term debt forecasted?**

18 A. The monthly short-term interest rates are based on the 1-month commercial paper
19 rates from Economy.com as of September 12, 2008. The short-term interest rates
20 also reflect MGUC's allocation of the costs of credit facilities held by Integrys.

21

22 **Q. How were the rates for the intercompany long-term debt from Integrys
23 established?**

24 A. The long-term agreements were established on April 1, 2006, which is the date that
25 Integrys (then known as WPS Resources Corporation) acquired MGUC from Aquila,
26 Inc. Because April 1, 2006 was a Saturday and the capital markets were therefore
27 not open for business, the interest rates used in the agreements were based on the

1 March 31, 2006 benchmark treasury rates, plus a re-offer spread, and an issue fee
 2 spread, applicable to Integrys' credit strength. These spreads were determined by
 3 polling 3 investment banking firms and averaging the results. See the table below
 4 for a summary of the rates by maturity.

5

	7 Year (2013)	10 Year (2016)	15 Year (2021)
Benchmark Treasury Rate	4.86%	4.85%	4.85%
Average Re-offer Spread	0.76%	0.83%	1.05%
Average Issue Fee Spread	0.11%	0.09%	0.08%
All-In Fixed Rate (360 day) (Stated Rate in Agreements)	5.72%	5.76%	5.98%
All-In Fixed Rate (360 day) ÷ 360 x 365 Effective Rate (rounded)	5.80%	5.84%	6.06%

6

7 **Q. What were Integrys' credit ratings on March 31, 2006?**

8 A. Integrys' senior unsecured debt was rated A by Standard & Poor's and A1 by
 9 Moody's.

10

11 **Q. What were Aquila's credit ratings on March 31, 2006?**

12 A. Aquila's senior unsecured debt was rated B- by Standard & Poor's and B2 by
 13 Moody's.

14

15 **Q. Why was this approach taken for the long-term debt issuances?**

16 A. This approach is used by Integrys to provide long-term financing to its smaller
 17 subsidiaries on a cost effective basis. Due to the relatively small size of debt
 18 offerings that its smaller subsidiaries could place into the financial markets, Integrys
 19 determined the most cost effective way to finance these companies was to issue

1 intercompany loans with fixed terms and fixed rates at the estimated rate that it could
 2 attain for larger, higher rated financings. The smaller subsidiaries have benefited
 3 with economics that they could not have achieved on their own due to the small size
 4 of debt issuances and, in the case of MGUC, lack of track record as a standalone
 5 corporation. Smaller issues of unrated utilities would typically see higher transaction
 6 costs and size premiums that apply to smaller issuances. This approach has
 7 provided long-term financing to Integrys' smaller subsidiaries at a lower cost than
 8 they could achieve from an external third party.

9
 10 **Changes to MGUC's Adjusted Common Equity from 2008 to 2010**

11 **Q. Please explain why MGUC's year end adjusted common equity decreased from**
 12 **\$112,014,149 for the 2008 historic test year to \$91,697,381 for the 2010**
 13 **projected test year without rate relief, and to \$91,910,065 for the 2010 projected**
 14 **test year with rate relief.**

15 **A.** The change in MGUC's year end adjusted common equity is due to equity returns to
 16 Integrys, retained earnings, and reductions in utility equity adjustments. A summary
 17 of these changes with and without rate relief is included in the following table.

<u>Common Equity</u>	<u>Without Rate Relief</u>	<u>With Rate Relief</u>
Actual 12/31/08*	\$112,014,149	\$112,014,149
Equity Returns	(36,000,000)	(41,000,000)
Retained Earnings	7,905,040	13,117,724
Reduced Utility Equity Adjustment**	7,778,192	7,778,192
Projected TY 12/31/10	\$91,697,381	\$91,910,065

18 * Includes Equity Adjustments for Goodwill, Tradename, and associated
 19 Deferred Taxes.

20
 21 ** Reduced Utility Equity Adjustment results from Deferred Tax cash
 22 flows related to Goodwill and Tradename.
 23

1 **Q. What is the basis for the adjusted common equity reflected on Schedules D1**
2 **of Exhibit A-14 (LJG-2) and Exhibit A-4 (LJG-1)?**

3 A. These amounts reflect the average balances in common equity after adjustments for
4 non-utility investments, see Ms. De Cramer's Workpapers for 2010, pages 134 and
5 135, and Ms. De Cramer's Workpapers for 2008, pages 134 and 135. These
6 investments are primarily goodwill and tradename related to the acquisition of MGUC
7 by Integrys in 2006. Goodwill and tradename are being excluded from the Common
8 Equity balances because they are assumed to be funded with Common Equity
9 capital (i.e., all MGUC debt is assumed to support utility operations). Additionally,
10 the deferred income taxes related to the non-utility investments were adjusted as
11 well to arrive at the deferred income taxes supporting utility operations.

12

13 **Q. What amount of equity in the capital structure do you feel is appropriate for**
14 **MGUC?**

15 A. A common equity ratio of 50% to 55% (after considering adjustments related to non-
16 utility investments) is required to provide MGUC the financial health and flexibility it
17 requires to respond to the changes and challenges of the utility industry.

18

19 MGUC is currently targeting a common equity ratio of 50.26% for the 2010 projected
20 test year. During the 2008 historic test year, MGUC maintained a 49.62% common
21 equity ratio.

22

23 Business risk is greater today than in earlier decades and this increased business
24 risk is reflected in the more stringent benchmarks now being used by the various
25 credit rating agencies. Business risk can be offset somewhat with decreased
26 financial risk by maintaining a lower debt ratio which in turn increases interest
27 coverage.

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Q. What benefits does a capital structure with a higher equity ratio provide?

A. An adequate equity ratio provides the ability to resist negative financial pressures and creates a buffer to protect against unexpected adverse developments so that distortions can be quickly remedied without impairing either the orderly conduct of the business, or the credit quality of present or future securities issues. This will help ensure that MGUC has access to capital at reasonable rates when MGUC needs it, thereby benefiting its customers.

The Required ROE

Q. What is MGUC's recommendation for the cost of equity capital for MGUC?

A. MGUC is requesting a 12.00% ROE for the 2010 projected test year as described in the pre-filed direct testimony of Mr. Paul R. Moul.

Q. What effect would a fair return on common equity have on the other securities of MGUC?

A. An adequate ROE would permit MGUC to raise capital when needed, at reasonable rates, especially during periods of "tight" credit markets. An adequate ROE is a positive way of ensuring MGUC's ability to continue to provide safe, reliable and cost effective energy services to its customers.

Q. In summary, what is your recommendation regarding the required common equity ratio and the required ROE for the 2010 projected test year?

A. MGUC recommends that the average common equity ratio be set at 50.00% with a ROE of 12.00%. These values are recommended because:

1. They are necessary to provide a fair return to investors commensurate with competitive investment vehicles available,

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2. There is a notable increase in business risk associated with the increased uncertainty in the utility industry, and
3. They recognize that MGUC has delivered, and will continue to deliver, reliable service at a reasonable cost to its customers. Therefore, the shareholder should be properly compensated for delivering on its commitment to those customers.

9 **Q. Does this complete your pre-filed direct testimony?**

10 A. Yes, it does.