

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

FILED

JUL 17 2007

PETITION OF OHIO VALLEY GAS, INC. FOR (1))
 AUTHORITY TO INCREASE ITS RATES AND CHARGES)
 FOR GAS UTILITY SERVICE; (2) APPROVAL OF NEW)
 SCHEDULES OF RATES AND CHARGES AND CHANGES)
 TO ITS GENERAL RULES AND REGULATIONS)
 APPLICABLE TO GAS UTILITY SERVICE, INCLUDING)
 INCREASES IN CERTAIN NON-RECURRING CHARGES; (3))
 AUTHORITY TO IMPLEMENT A NORMAL)
 TEMPERATURE ADJUSTMENT MECHANISM AND DEFER)
 THE NORMAL TEMPERATURE ADJUSTMENT MARGINS)
 FOR FUTURE RECOVERY OR REFUND; (4) AUTHORITY)
 TO IMPLEMENT A PIPELINE SAFETY COMPLIANCE)
 COST TRACKING MECHANISM AND DEFERRAL)
 ACCOUNTING OF SUCH COSTS UNTIL THE EFFECTIVE)
 DATE OF THE TRACKING MECHANISM; (5) APPROVAL)
 OF NEW DEPRECIATION RATES; AND (6) APPROVAL)
 PURSUANT TO I.C. 8-1-2.5 OF SUCH ALTERNATIVE)
 REGULATORY PLAN OR PLANS AS MAY BE)
 REASONABLE, NECESSARY AND APPLICABLE TO SUCH)
 AUTHORITY, APPROVALS AND DEFERRALS)

INDIANA UTILITY
REGULATORY COMMISSION

CAUSE NO. 43208

PREFILED TESTIMONY OF

GREG A. FOSTER – PUBLIC’S EXHIBIT - GAF

ON BEHALF OF THE

INDIANA OFFICE OF

UTILITY CONSUMER COUNSELOR

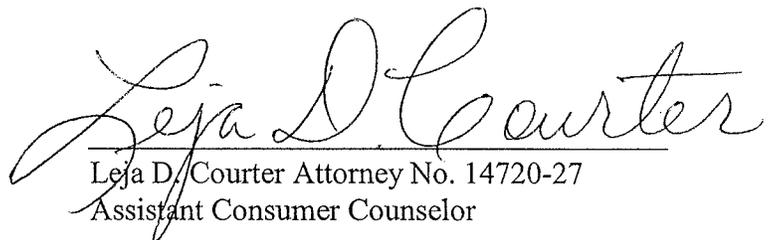
JULY 17, 2007

CERTIFICATE OF SERVICE

This is to certify that a copy of the foregoing **OUCC PREFILED TESTIMONY OF GREG A. FOSTER** has been served upon the following counsel of record in the captioned proceeding by electronic service and/or by depositing a copy of same in the United States mail, first class postage prepaid, on July 17, 2007.

Parr Richey Obremskey & Morton
Larry J Wallace
201 N Illinois Street, Suite 300
Indianapolis, IN 46204
(317)269-2500
ljwallace@parrlaw.com

Ohio Valley Gas Corporation
Ronald L. Loyd
111 Energy Park Drive
P. O. Box 469
Winchester, IN 47394 - 0469
(765)584-6842
rloyd@ovgc.com


Leja D. Courter Attorney No. 14720-27
Assistant Consumer Counselor

INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR
115 West Washington Street, Suite 1500 South
Indianapolis, IN 46204
infomgt@oucc.IN.gov
317.232.2494 - Phone
317.232.5923 - Facsimile

PREFILED TESTIMONY OF GREG A. FOSTER
CAUSE NO. 43208
OHIO VALLEY GAS INC

1 **Q: Please state your name and business address.**

2 A: My name is Greg A. Foster, and my business address is 115 W. Washington
3 Street, Suite 1500 South, Indianapolis, Indiana 46204.

4 **Q: By whom are you employed and in what capacity?**

5 A: I am employed by the Indiana Office of Utility Consumer Counselor ("OUCC")
6 as a Utility Analyst in the Natural Gas Division of the OUCC's Energy Group.

7 **Q: Please describe your background and experience.**

8 A: I received a Bachelor of Science degree in Economics from Indiana University in
9 1992. I have been a Certified Public Accountant and a member of the Indiana
10 CPA Society since 2002. After an internship at the Hudson Institute, I spent three
11 years in the commercial lending department of NBD Bank. In 1996, I accepted
12 my first staff accounting position. I continued my accounting education and
13 passed the Uniformed CPA examination in 1999. I have also held positions in the
14 private sector as Assistant Controller, Controller, and Regional Controller with
15 ADESA, as well as Accounting Manager and Corporate Controller with J.D.
16 Byrider/CNAC.

17 **Q: Have you previously testified before the Indiana Utility Regulatory**
18 **Commission?**

19 A: Yes.

20

21 **Q: What is the purpose of your testimony?**

1
2 A: I will present the OUCC's analysis and recommendations regarding Ohio Valley
3 Gas Corporation's (OVGI's) pro-forma adjustments to Annualized Payroll,
4 Payroll Taxes, and Group Insurance. I will also discuss Petitioner's capital
5 structure. Petitioner's investor provided capital is 100% common equity. As I
6 will explain, the decision to finance the utility entirely with equity contributes
7 significantly to higher income tax expenses, revenue requirements, and rates.

8 **Q: What have you done to prepare to testify in this proceeding?**

9 A: I reviewed the Petition, pre-filed testimony, and exhibits. I was a member of the
10 OUCC audit team performing the field review. I also met with staff members of
11 Petitioner and the OUCC to discuss issues in this Cause.

12 **Payroll and Payroll Taxes**

13 **Q: Please discuss your proposed adjustment to annualized payroll and payroll**
14 **taxes.**

15 A: The OUCC proposes an adjustment to reduce OVGi's pro-forma annualized
16 payroll by \$3,374 and a related adjustment to payroll taxes of \$309. These
17 adjustments reflect the retirement of a particular employee (the retiree). The
18 retiree will not be replaced. His duties will be assumed by another employee. An
19 adjustment to expenses should be made to reflect this reduction in staff.

20 **Q: How was the amount of the adjustment determined?**

21 A: OVGC's sister company (OVGI) receives a 4.95% allocation of "Corporate"
22 payroll according to Exhibit SMK-3, page 6, filed in Cause No. 43208. The test
23 year contains the retiree's full year of salary. As depicted in my Exhibit GAF-1, I
24 have removed \$68,160 (26 bi-weekly pays at \$2,621.54 per pay). I then

1 multiplied this amount by 4.95% to arrive at OVGI's allocation of \$3,374.

2 I then multiplied the OVGI payroll allocation of \$3,374 by the applicable
3 Social Security, Medicare, and State Unemployment rates to derive the additional
4 \$309 adjustment related to payroll taxes. This brings the entire adjustment to
5 \$3,683 for OVGI.

6 **Group Insurance**

7 **Q: Please explain your Exhibit GAF-2 regarding Group Insurance.**

8 A: Exhibit GAF-2 is a recalculation of OVGI's total insurance cost reflecting current
9 employment insurance coverage levels.

10 **Q: What type of Group Insurance plan does OVGI have?**

11 A: OVGI has a self-funding group insurance plan. Employees contribute through bi-
12 weekly payroll deduction to the plan. When a claim is filed, the employee pays a
13 deductible and the remainder is then billed to the company.

14 The OUCC does not object to the calculation of OVGI's "rate per life"
15 which is OVGI's cost. However, in light of more recent data available since the
16 end of the test year, the OUCC believes an adjustment should be made based on
17 the actual level of expenses reflected on the most recent invoice (#22425 dated 6-
18 1-2007). The OUCC proposes an adjustment of \$44,041 reflecting one less
19 employee at the employee only coverage rate.

20 **Capital Structure**

21 **Q: What types of investor provided capital does Petitioner rely upon for its**
22 **capital structure?**

23
24 A: The investor provided capital is 100% common equity and zero percent long term
25 debt.

1 **Q: Is OVGI's capital structure representative of a normal capital structure?**

2 A: No, the use of 100% common equity is very unusual as demonstrated by my
3 Exhibit GAF - 3.

4 **Q: Please explain Exhibit GAF - 3.**

5 A: This schedule is a side by side comparison of various capital structures based on
6 investor provided long term capital. It displays the investor provided capital
7 structures of OVGC, OVGI, three (3) other gas utilities with pending rate cases,
8 Mr. Maul's sample group of gas utilities, and the S&P Public Utilities composite.
9 The purpose of Exhibit GAF - 3 is to simply establish the fact that Petitioner's
10 100% equity capital structure is not normal and out of step with industry practice
11 in general. For example, Mr. Maul's group of gas utilities indicates, based on
12 permanent capital, a five year average of Long-Term Debt, Preferred Stock, and
13 Common Equity Ratios of 49.8%, 0.5%, and 49.7% respectively.

14 **Q: Is Petitioner's capital structure an efficient capital structure?**

15 A: No, 100% common equity is an extremely expensive capital structure. It results
16 in less competitive gas rates for homes and businesses in Petitioner's service
17 territory, when compared to a capital structure that uses a reasonable balance of
18 long term debt and equity capital.

19 **Q: Please explain Exhibit GAF - 4.**

20 A: This schedule is an illustrative calculation of two types of capital structures and
21 their respective influence on the revenue requirement. Utility A has a 100%
22 common equity capital structure and Utility B has a balanced capital structure
23 with a combination of common equity and long term debt. Each component of

1 Utility B's capital structure carries its own respective cost rate. The balanced mix
2 of debt and equity tends to lower Utility B's weighted cost of capital (8.83%).

3 **Q: Did you utilize the same cost of equity for Utility A and Utility B?**

4 A: Yes, purely for illustrative purposes, I utilized Petitioner's proposed 11.75% cost
5 of equity capital in Exhibit GAF-4. OUCC witness Bradley Lorton explains the
6 OUCC's objections to Petitioner's proposed 11.75% cost of equity. One could
7 certainly argue that a higher cost of equity should be used for Utility B, which has
8 debt in its capital structure. However, performing a study to determine this
9 increment is not warranted under the circumstances since we are not utilizing
10 Exhibit GAF-4 to calculate any adjustment to Petitioner's revenue requirement.
11 Again, Exhibit GAF-4 is purely for illustrative purposes. Other illustrative
12 examples using different cost rates could certainly be developed, but the general
13 result would be the same. *The failure to take at least some advantage of lower*
14 *cost debt capital, with tax deductible interest, drives up return requirements,*
15 *income tax expenses, overall revenue requirements and rates.*

16 **Q: Please explain in more detail.**

17 A: In Exhibit GAF-4, I provide an illustration of the influence on revenue
18 requirements associated with a \$1 million plant investment for both Utility A and
19 Utility B.

20 For Utility A, the return required to compensate investors would be
21 \$117,500. However, this amount must be "grossed up" for income taxes to
22 determine the full impact on revenue requirements. Grossing up for income taxes
23 results in a revenue requirement of \$207,965.

1 Utility B has a distinct cost advantage over Utility A due to its use of a
2 balanced mix of debt and equity capital. For Utility B, the return required to
3 compensate investors would be \$88,258. Grossing up for income taxes results in a
4 revenue requirement of \$129,655.

5 Reasonable use of long term debt is beneficial and results in more
6 competitive utility rates for Indiana homes and businesses. Not only does it
7 reduce the weighted cost of capital, but every dollar of interest has the extra
8 benefit of being tax deductible, thus lowering income tax expense and further
9 lowering the revenue requirement. In Exhibit GAF-4, for every \$1 million of
10 plant investment, Utility A's 100% equity capital structure costs the rate payers an
11 additional \$78,310 over that of Utility B.

12 **Q: Please explain Exhibit GAF-5.**

13 A: An alternative way of illustrating the additional cost associated with a 100%
14 equity capital structure is to calculate percentage return requirements that are
15 "grossed up" to reflect income taxes. Exhibit GAF-5 depicts the effect of
16 grossing up the cost rates of Utility A's and Utility B's capital structures to reflect
17 the income tax implications of equity and debt financing.

18 Again for illustrative purposes, a cost of equity of 11.75% grossed up for
19 taxes equates to a 20.80% pre-tax return requirement. Utility A's overall pre-tax
20 return requirement would be 20.80% since Utility A is 100% equity. By using a
21 blend of debt and equity, Utility B's pre-tax return requirement would be much
22 lower at 12.97% as shown in Exhibit GAF-5.

1 **Q: What do you recommend in this Cause regarding Petitioner's 100% equity**
2 **capital structure?**

3 A: I recommend the Commission approve the 8.5% cost of equity proposed by
4 OUCC witness Bradley Lorton rather than Petitioner's proposed 11.75% cost of
5 equity.

6 In any future rate cases where Petitioner might again propose a 100%
7 equity capital structure, I recommend the Commission order the Petitioner to put
8 forth a study that demonstrates why a 100% equity capital structure is prudent,
9 efficient and consistent with "best practices" in the gas distribution industry.

10 **Q: Does this conclude your testimony.**

11 A: Yes, it does.

12

13

14

15

16

OHIO VALLEY GAS INCORPORATED
CAUSE NO. 43208

Adjustments

Annualized Payroll

This adjustment reduces payroll to reflect a retiring employee

| <u>Line No</u> | <u>Retiree- retiring July 2007</u> | | |
|----------------|----------------------------------------------------------------------|-----------------------|-------------------|
| L1 | Amount in pro forma | 26 pays at \$2,621.54 | \$68,160 |
| L2 | Payroll Adjustment for Retiree | | <u>(\$68,160)</u> |
| L3 | Annual Payroll Adjustment for Retiree - Inc allocation (L2 * 4.95%) | | <u>(\$3,374)</u> |
| L4 | Annual Payroll Adjustment for Retiree- Corp allocation (L2 * 95.05%) | | <u>(\$64,786)</u> |

Payroll Taxes

This adjustment reduces payroll taxes to reflect the OUCC payroll adjustment

| | | | |
|-----|------------------------------------------------------------------------|--------------|-------------------|
| L5 | Payroll adjustment from above | | <u>(\$68,160)</u> |
| L6 | Social Security | (L5 * 6.20%) | (\$4,226) |
| L7 | Medicare | (L5 * 1.45%) | (\$988) |
| L8 | State UC - Florida | (L5 * 0.12%) | \$0 |
| L9 | State UC - Nebraska | (L5 * 0.80%) | \$0 |
| L10 | State UC - Indiana | (L5 * 1.50%) | (\$1,022) |
| L11 | Payroll Tax adjustment | | <u>(\$6,237)</u> |
| L12 | Annual Payroll Tax Adjustment for Retiree - Inc allocat (L11 * 4.95%) | | <u>(\$309)</u> |
| L13 | Annual Payroll Tax Adjustment for Retiree- Corp allocat (L11 * 95.05%) | | <u>(\$5,928)</u> |

OHIO VALLEY GAS INCORPORATED
CAUSE NO. 43208

Adjustments

Annualized Payroll

This adjustment reduces payroll to reflect a retiring employee

| <u>Line No</u> | <u>Retiree- retiring July 2007</u> | | |
|----------------|----------------------------------------------------------------------|-----------------------|-------------------|
| L1 | Amount in pro forma | 26 pays at \$2,621.54 | \$68,160 |
| L2 | Payroll Adjustment for Retiree | | <u>(\$68,160)</u> |
| L3 | Annual Payroll Adjustment for Retiree - Inc allocation (L2 * 4.95%) | | <u>(\$3,374)</u> |
| L4 | Annual Payroll Adjustment for Retiree- Corp allocation (L2 * 95.05%) | | <u>(\$64,786)</u> |

Payroll Taxes

This adjustment reduces payroll taxes to reflect the OUCC payroll adjustment

| | | | |
|-----|------------------------------------------------------------------------|---------------|-------------------|
| L5 | Payroll adjustment from above | | <u>(\$68,160)</u> |
| L6 | Social Security | (L5 * 6.20%) | (\$4,226) |
| L7 | Medicare | (L5 * 1.45%) | (\$988) |
| L8 | State UC - Florida | (L5 * 0.12%) | \$0 |
| L9 | State UC - Nebraska | (L5 * 0.80%) | \$0 |
| L10 | State UC - Indiana | (L5 * 1.50%) | (\$1,022) |
| L11 | Payroll Tax adjustment | | <u>(\$6,237)</u> |
| L12 | Annual Payroll Tax Adjustment for Retiree - Inc allocat (L11 * 4.95%) | | <u>(\$309)</u> |
| L13 | Annual Payroll Tax Adjustment for Retiree- Corp allocat (L11 * 95.05%) | | <u>(\$5,928)</u> |

OHIO VALLEY GAS INCORPORATED
CAUSE NO. 43208

Adjustments

Line 40 - Group Insurance

| Reviewed invoice # 22425 dated 6-1-2007 | | | | | |
|------------------------------------------|-----------------------------|--------|----------|--------|-------|
| current number of employees and coverage | | | | | |
| | Employee | Spouse | Children | Family | total |
| Health | | | | | |
| | Ohio Valley Gas Inc | 9 | 3 | | 13 |
| | Ohio Valley Gas Corporation | 73 | 23 | 3 | 103 |
| | Total | | | | 116 |

Line No

| Corp - Recalculated Schedule - to reflect current coverage using June 2007 invoice (OUCC proposal) | | | | | | |
|----------------------------------------------------------------------------------------------------|--------------------------------------------|--------|---------|--------|-------|------------|
| L1 | District Office lives | Health | 13 | 3 | - | 1 |
| L2 | Rate per life (OVGC cost) | | 5,252 | 1,506 | 1,031 | 2,537 |
| L3 | Cost (line 1 times line 2) | | 68,280 | 4,519 | - | 2,537 |
| | | | | | | 75,336 |
| L4 | General Office lives | | 38 | 11 | 2 | 2 |
| L5 | Cost (line 4 times line 2) | | 199,587 | 16,571 | 2,061 | 5,074 |
| L6 | Appl Petitioner (Line 5 times 11.82%) | | 23,591 | 1,959 | 244 | 600 |
| | Proforma Total Health Insurance | | | | | 26,393 |
| | Proforma Total Dental | | | | | 5,280 |
| | Proforma Total Life | | | | | 3,152 |
| | Proforma Total Group Insurance Cost | | | | | 110,162 |
| | Less: expense applicable to parent company | | | | | (4,259) |
| | Less: expense capitalized | | | | | (4,259) |
| | Total OUCC proforma | | | | | 105,903 |
| | Actual 12 months ending - June 2006 | | | | | 149,944 |
| | Total Adjustment (Increase / (Decrease) | | | | | (44,041) |
| | Less: Petitioner's Adjustment | | | | | (38,789) |
| | Incremental OUCC Adjustment | | | | | \$ (5,252) |

Utility Capital Structures
(based on investor provided long term capital)

| | Ohio Valley Gas Corp 2006 Audit Financial Statements | | Ohio Valley Gas Inc 2006 Audit Financial Statements | | Vectren South (1) | | Vectren North (2) | | Midwest Gas (3) | | Maul Sample Gas Utilities (4) | | S&P Public Utilities (5) 5 year average | | | | | | | | |
|-----------------|---------------------------------------------------------|------------|--------------------------------------------------------|----|-------------------|--------|-------------------|---------------|-----------------|----|----------------------------------|--------|--------------------------------------------|------------|--------|----|-------------|--------|----|----------------|--------|
| Common Equity | \$ | 18,772,467 | 100.0% | \$ | 4,343,901.00 | 100.0% | \$ | 549,508,000 | 54.9% | \$ | 467,281,000 | 55.7% | \$ | 8,719,239 | 69.2% | \$ | 196,404,460 | 49.7% | \$ | 5,678,922,900 | 39.5% |
| Long Term Debt | \$ | - | 0.0% | \$ | - | 0.0% | \$ | 451,347,000 | 45.1% | \$ | 371,338,000 | 44.3% | \$ | 3,874,242 | 30.8% | \$ | 196,799,640 | 49.8% | \$ | 8,453,687,760 | 58.8% |
| Preferred Stock | | | 0.0% | | | 0.0% | \$ | - | 0.0% | | | | \$ | 1,975,900 | 0.5% | \$ | 1,975,900 | 0.5% | \$ | 244,409,340 | 1.7% |
| Totals | \$ | 18,772,467 | 100.0% | \$ | 4,343,901.00 | 100.0% | \$ | 1,000,855,000 | 100.0% | \$ | 838,619,000 | 100.0% | \$ | 12,593,481 | 100.0% | \$ | 395,180,000 | 100.0% | \$ | 14,377,020,000 | 100.0% |

(1) Cause No. 43112 - Vectren South - Settlement - Appendix B - pg 2 of 2

(2) 43298 - Vectren North - Testimony Robert L Goocher - Exhibit RLB-2

(3) Midwest Natural Gas - Cause No. 43229 - Testimony Mercer - Mann Exhibit E

(4) 43208 / 43209 - Ohio Valley Gas Inc/Ohio Valley Gas Corporation - Petitioner's Exhibit No. PRM-1 pg 5 Schedule 2 [1 of 2]

(5) 43208 / 43209 - Ohio Valley Gas Inc/Ohio Valley Gas Corporation - Petitioner's Exhibit No. PRM-1 pg 7 Schedule 3 [1 of 3]

Capital Structure Comparison

| | Utility A | Utility B | Standard & Poor Public Utilities 2001-2005 (Average) Cause No. 43208/43209 (Exhibit PRM-1 pg 7) Schedule 3 [1 of 3] | | | | | | | | |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------|-------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------|----|----------|--|--------------------------------------------------|------------|-----------|--|
| <u>Capital Structure</u> | | | | | | | | | | | |
| Common Equity | 100.0% | 45.8% | 39.5% | | | | | | | | |
| Long Term Debt | | 54.2% | 58.8% | | | | | | | | |
| Preferred Stock | | | 1.7% | | | | | | | | |
| | 100.0% | 100.0% | 100.0% | | | | | | | | |
| | | | | | | | | | | | |
| Petitioner's Proposed Cost of Equity | 11.75% | 11.75% | | | | | | | | | |
| Cost of Debt | | 6.36% | | | | | | | | | |
| <small>Corporate Bond (Utility 25/30 year) A, (Value Line Selection & Opinion, Rpt Dated July 6,2007) Exhibit GAF-6</small> | | | | | | | | | | | |
| | | | | | | | | | | | |
| Weighted Cost of Capital (for illustrative purpose) | 11.75% | 8.83% | | | | | | | | | |
| | | | | | | | | | | | |
| Comparative Cost Calculation on \$1,000,000 of Plant | | | | | | | | | | | |
| Authorized Return | \$ 117,500 | \$ 88,258 | | | | | | | | | |
| (a) Authorized Return | \$ 117,500 | \$ 88,258 | | | | | | | | | |
| | | | | | | | | | | | |
| Income Taxes | | | | | | | | | | | |
| Federal (estimate - 35%) | \$ 72,788 | \$ 33,308 | | | | | | | | | |
| State (estimate - 8.5%) | \$ 17,677 | \$ 8,089 | | | | | | | | | |
| (b) Total Income Taxes | \$ 90,465 | \$ 41,397 | | | | | | | | | |
| | | | | | | | | | | | |
| Revenue Requirement (a + b) | \$ 207,965 | \$ 129,655 | | | | | | | | | |
| | | | | | | | | | | | |
| <table border="0" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 40%;">Annual Interest Expense *</td> <td style="width: 15%; text-align: center; border-top: 1px solid black;">\$</td> <td style="width: 15%; text-align: center; border-top: 1px solid black;">(34,490)</td> <td style="width: 30%;"></td> </tr> <tr> <td>Taxable Income (Used to calculate Income Taxes)</td> <td style="text-align: center; border-top: 1px solid black;">\$ 207,965</td> <td style="text-align: center; border-top: 1px solid black;">\$ 95,165</td> <td></td> </tr> </table> | | | | Annual Interest Expense * | \$ | (34,490) | | Taxable Income (Used to calculate Income Taxes) | \$ 207,965 | \$ 95,165 | |
| Annual Interest Expense * | \$ | (34,490) | | | | | | | | | |
| Taxable Income (Used to calculate Income Taxes) | \$ 207,965 | \$ 95,165 | | | | | | | | | |
| | | | | | | | | | | | |
| <table border="0" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 40%;">Incremental dollar cost to ratepayers of 100% equity capital structure</td> <td style="width: 15%; text-align: center;">\$</td> <td style="width: 15%; text-align: center;">78,310</td> <td style="width: 30%;"></td> </tr> </table> <p>*NOTE - Every \$ in interest has the benefit of reducing taxable income</p> | | | | Incremental dollar cost to ratepayers of 100% equity capital structure | \$ | 78,310 | | | | | |
| Incremental dollar cost to ratepayers of 100% equity capital structure | \$ | 78,310 | | | | | | | | | |

Tax Gross Up Example 100 % Equity Capital Structure

| <u>Description</u> | <u>Capital Structure Ratio</u> | <u>Before - Tax Cost Rate</u> | <u>Before - Tax Weighted Cost</u> |
|--------------------|--------------------------------|-----------------------------------|---------------------------------------|
| Common Equity | 100.0% | 20.80% | 20.80% |
| Long Term Debt | 0.0% | 0.00% | 0.00% |
| <u>Total</u> | <u>100.00%</u> | | <u>20.80%</u> |

Tax Gross Up Example With Balanced Capital Structure

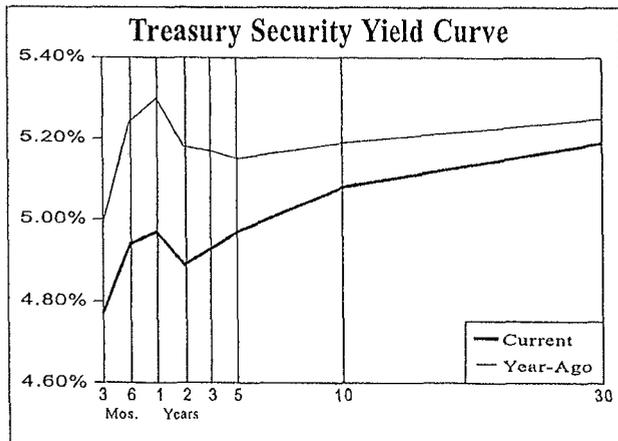
| <u>Description</u> | <u>Capital Structure Ratio</u> | <u>Before - Tax Cost Rate</u> | <u>Before - Tax Weighted Cost</u> |
|--------------------|--------------------------------|-----------------------------------|---------------------------------------|
| Common Equity | 45.8% | 20.80% | 9.52% |
| Long Term Debt | 54.2% | 6.36% | 3.45% |
| <u>Total</u> | <u>100.00%</u> | | <u>12.97%</u> |

Calculation of Before - Tax Cost Rate of Common Equity

| | |
|------------------------------------------------------|--------|
| Cost of Equity = | 11.75% |
| State and federal taxes combined = | 43.5% |
| Before-tax cost of equity [.1175 / (1-0.435)] = | 20.80% |

Selected Yields

| | Recent (6/27/07) | 3 Months Ago (3/28/07) | Year Ago (6/29/06) | | Recent (6/27/07) | 3 Months Ago (3/28/07) | Year Ago (6/29/06) |
|---------------------------------|---------------------|------------------------------|--------------------------|-----------------------------------|---------------------|------------------------------|--------------------------|
| TAXABLE | | | | | | | |
| Market Rates | | | | Mortgage-Backed Securities | | | |
| Discount Rate | 6.25 | 6.25 | 6.25 | GNMA 6.5% | 6.14 | 5.59 | 6.24 |
| Federal Funds | 5.25 | 5.25 | 5.25 | FHLMC 6.5% (Gold) | 6.29 | 5.67 | 6.43 |
| Prime Rate | 8.25 | 8.25 | 8.25 | FNMA 6.5% | 6.27 | 5.59 | 6.39 |
| 30-day CP (A1/P1) | 5.25 | 5.23 | 5.26 | FNMA ARM | 5.44 | 5.60 | 4.96 |
| 3-month LIBOR | 5.36 | 5.35 | 5.51 | Corporate Bonds | | | |
| Bank CDs | | | | Financial (10-year) A | 6.09 | 5.51 | 6.18 |
| 6-month | 3.11 | 3.14 | 3.09 | Industrial (25/30-year) A | 6.21 | 5.83 | 6.24 |
| 1-year | 3.73 | 3.82 | 3.94 | * Utility (25/30-year) A | 6.36 | 5.99 | 6.33 |
| 5-year | 3.95 | 3.92 | 4.05 | Utility (25/30-year) Baa/BBB | 6.53 | 6.14 | 6.71 |
| U.S. Treasury Securities | | | | Foreign Bonds (10-Year) | | | |
| 3-month | 4.77 | 5.04 | 4.99 | Canada | 4.62 | 4.10 | 4.59 |
| 6-month | 4.94 | 5.06 | 5.24 | Germany | 4.55 | 4.03 | 4.07 |
| 1-year | 4.97 | 4.91 | 5.30 | Japan | 1.88 | 1.68 | 1.93 |
| 5-year | 4.97 | 4.49 | 5.15 | United Kingdom | 5.42 | 4.93 | 4.72 |
| 10-year | 5.08 | 4.62 | 5.19 | Preferred Stocks | | | |
| 10-year (inflation-protected) | 2.70 | 2.16 | 2.57 | Utility A | 7.34 | 7.24 | 7.25 |
| 30-year | 5.19 | 4.83 | 5.25 | Financial A | 6.40 | 6.32 | 6.40 |
| 30-year Zero | 5.15 | 4.81 | 5.09 | Financial Adjustable A | 5.47 | 5.48 | 5.48 |



TAX-EXEMPT

| | Recent (6/27/07) | 3 Months Ago (3/28/07) | Year Ago (6/29/06) |
|------------------------------------------|---------------------|------------------------------|--------------------------|
| Bond Buyer Indexes | | | |
| 20-Bond Index (GOs) | 4.63 | 4.20 | 4.71 |
| 25-Bond Index (Revs) | 4.74 | 4.41 | 5.31 |
| General Obligation Bonds (GOs) | | | |
| 1-year Aaa | 3.73 | 3.55 | 3.65 |
| 1-year A | 3.83 | 3.65 | 3.78 |
| 5-year Aaa | 3.90 | 3.54 | 3.86 |
| 5-year A | 4.01 | 3.63 | 4.14 |
| 10-year Aaa | 4.10 | 3.72 | 4.22 |
| 10-year A | 4.60 | 4.24 | 4.58 |
| 25/30-year Aaa | 4.49 | 4.09 | 4.65 |
| 25/30-year A | 4.79 | 4.40 | 4.92 |
| Revenue Bonds (Revs) (25/30-Year) | | | |
| Education AA | 4.80 | 4.40 | 4.74 |
| Electric AA | 4.75 | 4.40 | 4.77 |
| Housing AA | 4.95 | 4.52 | 4.93 |
| Hospital AA | 4.90 | 4.51 | 5.03 |
| Toll Road Aaa | 4.85 | 4.39 | 4.87 |

Federal Reserve Data

BANK RESERVES

(Two-Week Period; in Millions, Not Seasonally Adjusted)

| | Recent Levels | | | Average Levels Over the Last... | | |
|----------------------------|---------------|--------|--------|---------------------------------|---------|---------|
| | 6/20/07 | 6/6/07 | Change | 12 Wks. | 26 Wks. | 52 Wks. |
| Excess Reserves | 1492 | 1658 | -166 | 1538 | 1561 | 1613 |
| Borrowed Reserves | 215 | 124 | 91 | 107 | 120 | 203 |
| Net Free/Borrowed Reserves | 1277 | 1534 | -257 | 1432 | 1441 | 1409 |

MONEY SUPPLY

(One-Week Period; in Billions, Seasonally Adjusted)

| | Recent Levels | | | Growth Rates Over the Last... | | |
|-------------------------------------|---------------|--------|--------|-------------------------------|--------|---------|
| | 6/11/07 | 6/4/07 | Change | 3 Mos. | 6 Mos. | 12 Mos. |
| M1 (Currency+demand deposits) | 1377.4 | 1402.8 | -25.4 | 1.3% | 1.3% | 0.5% |
| M2 (M1+savings+small time deposits) | 7247.6 | 7240.1 | 7.5 | 5.1% | 6.9% | 6.5% |