77,153

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

In The Matter of	DOCKET NO. 891345-EI
Application of GULF POWER COMPANY for an increase in rates and charges.	HEARING THIRD DAY MORNING SESSION

VOLUME - V

Pages 622 through 802

FPSC Hearing Room 106
Fletcher Building
101 E. Gaines Street
Tallahassee, Florida 32399

Wednesday, June 13, 1990

Met pursuant to adjournment at 9:00 a.m.

BEFORE: COMMISSIONER MICHAEL McK. WILSON, CHAIRMAN
COMMISSIONER GERALD L. GUNTER
COMMISSIONER THOMAS M. BEARD
COMMISSIONER BETTY EASLEY

APPEARANCES:

(As heretofore noted.)

REPORTED BY: JOY KELLY, CSR,RPR
SYDNEY C. SILVA, CSR, RPR
Official Commission Reporters
and
LISA GIROD-JONES, CPR, RPR
Post Office Box 10195
Tallahassee, Florida 32302

I N D E X

WITNESSES

Index Continued:

EXHIBITS

P R O C E E D I N G S

(Hearing reconvened at 9:05 a.m.)

COMMISSIONER GUNTER: All right.

MR. STONE: Mr. Chairman, our next witness is Don Gilbert, who has taken the stand. I don't believe he's been sworn.

DONALD P. GILBERT

appeared as a witness on behalf of Gulf Power Corporation and, after being first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. STONE:

Q Would you please state your name and occupation for the record.

A Donald P Gilbert. I'm Manager of Corporate Planning. Business address is 500 North Bayfront Parkway.

Q Mr. Gilbert, are you the same Donald P. Gilbert that prefiled direct testimony in Docket 891345, dated December 15, 1989?

A I am.

Q Have you any changes or corrections to your prefiled direct testimony?

A I have some changes. Page 16, --

COMMISSIONER GUNTER: Hold on just a second, Mr. Gilbert, I apologize. Page 16?

A Page 16, Line 5, change the word "twelve" to "eight."

Schedule 7 in my exhibits, delete the reference to MFR F-11. I'm not responsible for that in this hearing.

Q With those changes, if I were to ask you the questions contained in your prefiled testimony, would your responses be the same?

A Yes, they would.

MR. STONE: Mr. Chairman, I ask that Mr. Gilbert's prefiled testimony be inserted into the record as though read.

COMMISSIONER GUNTER: It will be inserted into the record as though read.

(Exhibit Nos. 37 through 43 stipulated into evidence.)

Record copy

GULF POWER COMPANY

Before the Florida Public Service Commission
Direct Testimony of
Donald P. Gilbert
In Support of Rate Relief
Docket No. 891345-EI
Date of Filing December 15, 1989

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

A. Donald P. Gilbert, 500 Bayfront Parkway, Pensacola, Florida 32501.

Q. **Please describe your educational and professional background.**

A. I have a Bachelor of Science Degree in Industrial Technology from the University of West Florida. I have been employed with Gulf Power since 1964. In Marketing and Load Management, I was involved in the forecasting of customers and energy at the Division level until 1974 and have been similarly involved at the Corporate level since then.

From mid-1976 to 1978, I was Gulf's coordinator with Southern Company Services (SCS) and Data Resources, Inc. in the development of Gulf's econometric model.

I have been in my present position as Director of Corporate Planning since 1980.

Q. Please describe your responsibilities and duties as the Director of Corporate Planning.

A. My primary function is to ensure that Gulf's planning process is effective by establishing appropriate policies and procedures which provide consistency and continuity among strategic planning, budgeting, forecasting, and performance measurement.

In addition, I coordinate the overall planning effort, and I am responsible for the production of the Company's financial forecast.

Q. What is the purpose of your testimony?

A. My purpose is to provide an overview of the planning process which results in the production of Gulf's financial forecast. The financial forecast is the basis for Gulf's projected data for 1990 used in this rate case. Specifically, I will present an overview of Gulf's planning and budgeting process; outline the assumptions used in developing Gulf's financial forecast; describe the Capital Additions Budget process, the Operation and Maintenance Budget process, and Gulf's Responsibility Reporting System.

Q. Have you prepared an exhibit that contains information to which you will refer in your testimony?

A. Yes.

Counsel: We ask that Mr. Gilbert's Exhibit, comprised of 7 Schedules, be marked for identification as Exhibits 57-63 (DPG-1).

Q. Were all of the schedules in this exhibit prepared under your supervision?

A. Yes. Each schedule of this exhibit was prepared under my supervision and direction.

Q. Are you the sponsor of certain Minimum Filing Requirements (MFRs)?

A. Yes. These are listed on Schedule 7 at the end of my exhibit. To the best of my knowledge, the information in all of the listed MFRs is true and correct.

Q. Please describe Schedule 1 of your exhibit.

A. Schedule 1 is a flow chart of Gulf's annual planning and budgeting process. This is an ongoing process intended to develop a financial forecast for use by management as a tool in making decisions affecting the future direction of the Company. The chart shows the eight component budgets that are incorporated into Gulf's financial forecast, the relationship among the budgets, and their relationship to the financial model. In addition to the activities identified on Schedule 1, there are numerous reviews and approvals by Gulf's Budget Committee and the Chief Executive Officer as well as the review and approval of the Capital Additions Budget by our Board of Directors. These reviews and approvals are an integral part of our budgeting process. Schedule 1 indicates the individuals responsible for discussing in this proceeding each component budget, providing the assumptions incorporated in each budget, and developing the financial forecast.

Q. Please identify the eight component budgets which are incorporated into Gulf's financial forecast.

A. The eight component budgets which comprise Gulf's financial forecast are the:

- Customer Budget
- Energy Budget
- Peak Demand Budget
- Revenue Budget
- Fuel Budget
- Interchange Budget

- Capital Additions Budget
- Operation & Maintenance (O & M) Budget

Q. **Who will testify on the preparation of the eight component budgets in Gulf's financial forecast?**

A. As indicated on the flow chart of Schedule 1, the Customer, Energy, Peak Demand, and Revenue Budgets are the responsibility of Mr. Kilgore; the Fuel Budget is the responsibility of Mr. Parsons; the Interchange Budget is the responsibility of Mr. Howell, and the Capital Additions Budget is the responsibility of Mr. Conner, Mr. Howell, Mr. Jordan, Mr. Lee and Mr. Scarbrough. The Operation and Maintenance Budget will be discussed by Mr. Lee, Mr. Howell, Mr. Jordan, Mr. Bowers, and Mr. Scarbrough. Mr. McMillan will address the interface of the component budgets with the financial model in his testimony.

Q. **Has Gulf Power filed a listing of the assumptions used in developing Gulf's financial forecast?**

A. Yes. MFR F-17 lists the assumptions used in developing Gulf's financial forecast and the supporting basis for each assumption. Additionally, this MFR indicates the witness responsible for a specific assumption. Gulf's management believes the assumptions used in Gulf's financial forecast, as outlined on MFR F-17, to be reasonable in light of our experiences and the circumstances known to us at the time the assumptions were developed.

Q. **Who administers the budgeting process?**

A. The Budget Committee administers the budgeting process and approves all component budgets. Mr. Scarbrough serves as the Budget Committee Chairman.

Q. **Schedule 1 shows Corporate Planning's involvement in producing Gulf's financial forecast. Would you describe your department's role?**

A. Primarily, the department is responsible for coordinating the Capital Additions and O & M Budget processes. The department is also responsible for preparing for use in the Financial Model the information which is produced in the approved Revenue, Fuel, Interchange, Capital Additions, and O & M Budgets. Corporate Planning is involved in analyzing and updating the financial model logic to ensure accurate forecasts of the Company's financial results.

Q. Please describe Gulf's Capital Additions Budget?

A. The Capital Additions Budget consists of Plant Expenditure (PE) projects for additional property covering a period of six years. The PE's are categorized by Major Generation, Production, New Business, Transmission, Distribution, Joint Sub & Line, General Plant, and Miscellaneous Items. The PE's are identified as Specific PE's, Accumulation PE's, and Blanket PE's. Specific PE's are projects costing $50,000 or more that are individual in nature and may require expenditures in one or more years. Accumulation PE's include individual projects that generally cost less than $50,000, with each individual project listed as a line item on the PE. Blanket PE's include repetitive type plant additions which are not easily defined or distinguished as individual or separate projects at the time the budget is prepared.

Q. When is the Capital Additions Budget prepared?

A. There are two revisions to the Capital Additions Budget each year occurring in February and October. The February revision includes unforeseen new or revised projects for the budget year, adjustments for necessary projects being carried over from the previous year to the budget year (Unintentional Carryovers), or projects accelerated from a forecast year to the budget year. The February revision includes one budget year and five forecast years of information. The October revision includes the final budget estimate of the current year, and the initial budget for the coming year, including new and revised projects. The October revision includes two budget years (the current year budget and the conversion of the first forecast year to a budget year) and four forecast years.

Q. **Who is responsible for developing the Plant Expenditure (PE) projects and preparing the necessary documentation?**

A. The personnel responsible for the appropriate functional operating areas are responsible for the Plant Expenditures. The major portion of the Capital Additions Budget is prepared under the direction of Mr. Lee, Mr. Jordan, and Mr. Howell.

Q. **Who is responsible for reviewing the Plant Expenditure projects and the overall Capital Additions Budget?**

A. The Director or Manager responsible for each plant category of a PE is required to sign the PE to signify his review and approval of the proposed project. The Capital Budget Review Committee is responsible for reviewing all PE's and submitting the recommended Capital Additions Budget to the Budget Committee for final approval. After review and approval by the Budget Committee and the President, the budget is submitted to Gulf's Board of Directors for final approval.

Q. What is the Corporate Planning Department's role in the Capital Additions Budget process?

A. Corporate Planning performs mainly an administrative role in coordinating the preparation of the Capital Additions Budget. Corporate Planning is responsible for developing the Capital Additions Budget schedule, assuring the PE's are prepared in accordance with Company's procedures, compiling the PE's for the review and approval process, and preparing the approved Capital Additions Budget for interface with the Financial Model.

Q. Does Gulf monitor the actual construction expenditures against its approved budget?

A. Yes. On a monthly basis my Department furnishes a copy of the Comparison of Plant Expenditures to the Budget Committee members and Directors and Managers responsible for the Capital Additions Budget. This comparison indicates the deviation from budget by amount and percent for each PE, each plant category, and total Budget for the current month and year-to-date. Whenever a PE has a year-to-date budget variance of either 10 percent or $250,000, whichever is less (less than $10,000 need not be reported), a summarized report is be prepared by the responsible Director and sent to the appropriate Vice President. A copy of this report signed by the responsible Vice President is sent to the Manager of Financial Planning. The report explains by project the reasons for the deviation, the action contemplated to bring the project on schedule, and an estimate of the budget status at year-end or completion of the project. It is the responsibility of my Department to ensure this control is used.

Q. What is the amount of Gulf's 1990 Capital Additions Budget?

A. Gulf's total 1990 Capital Additions budget is $62.2 million. Schedule 2 of my exhibit shows Gulf's 1990 Capital Additions Budget by category. In addition, it shows the witness responsible for the PE's included in each category. Those witnesses are prepared to discuss the appropriate portion of the Capital Additions Budget.

Q. **Would you please state the purpose of your testimony as it relates to the O & M Budget?**

A. I will describe the preparation process and provide an overview of the assumptions used to prepare the 1990 O & M Budget. The following individuals are responsible for and are prepared to address the specific assumptions, details, and explanations related to the 1990 O & M Budget for the indicated functions.

Witness		Function
C. R. Lee	-	Production
M. W. Howell	-	Transmission
C. E. Jordan	-	Distribution; Transportation
W. P. Bowers	-	Customer Service & Information; Sales
A. E. Scarbrough	-	Customer Accounting; Administrative & General

The assumptions and their supporting bases for the 1990 O & M Budgets are outlined in MFR F-17.

Q. What is the amount of Gulf's 1990 O & M Budget?

A. The 1990 O & M Budget, exclusive of direct fuel and purchased power, is $129.7 million. Schedule 3 of my exhibit summarizes the 1990 O & M Budget by major functional categories.

Q. Please describe the Corporate Planning Department's role in preparing Gulf's O & M Budget.

A. Corporate Planning is responsible for maintaining a logical process for the preparation of the budget, for administering the process under the direction of the Budget Committee, and for providing the Budget Committee with the information they need to make budgetary decisions. Schedule 4 of my exhibit is a flow chart outlining the O & M Budget process. In addition to the Company-wide budget coordination responsibility, I am responsible for preparing Corporate Planning's departmental budget.

Q. Would you describe the process of preparing Gulf's O & M Budget, exclusive of fuel and purchased power?

A. Referring to my Schedule 4, the first step in Gulf's O & M Budget process is the issuance of the Corporate Business Plan. Each department, as a planning unit, then prepares objectives and goals which address its direction and major emphasis for the coming year. The planning unit goals and objectives support specific goals included in the Corporate Business Plan. Once developed, the department's goals and objectives are reviewed and approved by Gulf's management. After the individual departments' goals and objectives are approved, a Budget Message is issued by the Budget Committee Chairman. The Budget Message outlines the various budget guidelines and parameter assumptions and provides the Reference Level for each department for use in preparing the O & M Budget. The Reference Level is defined and established each year by the Budget Committee. The planning units are required to justify increases or decreases in expenses from the Reference Level. The Reference Level determines the amount of documentation required to be submitted to the Budget Committee for review in the budget approval process.

Q. How did the Budget Committee define the Reference Level for the 1990 O & M Budget?

A. The 1990 Reference Level is calculated to be the 1989 Budget less 1) 1989 Corporate Controlled expenses, 2) 1989 nonrecurring items, and 3) salaries for positions which were budgeted in 1989 but had not been added to the complement or which were budgeted in 1989 but had not been approved for filling for 12 months.

Q. **Please describe what is meant by Corporate Controlled items?**

A. Items included in Gulf's budget as Corporate Controlled represent large dollar expenditures which require the action of either an individual other than the person responsible for monitoring the item, a group of individuals, or the input of other companies to control the expenditure. Examples of Corporate Controlled expenses include the expenses of Plant Daniel, Plant Scherer, Pension and Benefit costs, Southern Company Services billings, Turbine and Boiler Inspections, and Transmission Line Rentals. Gulf removes the Corporate Controlled expenses when calculating the Reference Levels of specific planning units to properly reflect in the Reference Level only those expenditures over which the department head has direct control.

Q. **What is meant by nonrecurring items as used in Gulf's budget process?**

A. Nonrecurring items are defined as those items which do not recur for the planning unit in the budget year but may recur in future years or be incurred by other planning units. Major periodic and cyclical activities are included as nonrecurring items.

Q. **What was the purpose of the salary adjustment made in calculating the 1990 Reference Level?**

A. As indicated previously, we made an adjustment in calculating the 1990 Reference Level which removed the 1989 budgeted salaries for those vacant positions which had not been added to the personnel complement and those vacant positions which had not been approved for filling for 12 months. This adjustment was made so that all planning units affected would be required to rejustify those positions on Activity Analysis (B-4) forms. The adjustment did not indicate that the positions were not approved, only that if the planning unit budgeted that position, it would be necessary to provide current justification for the position.

Q. **Have any other salary related adjustments been made in the 1990 O & M budget?**

A. Yes. In addition to the salary adjustment discussed above, Gulf made an adjustment to eliminate the salaries associated with vacancies caused by normal personnel turnover.

Q. How was this adjustment calculated?

A. Gulf analyzed its vacancies for the ~~twelve~~ eight month period ending August 1989 and determined that, on average, 42 vacancies existed which were in the process of being filled. Included in the average of 42 vacancies were 4 positions which were eliminated in the 1990 budget resulting in 38 vacancies in process of being filled. We then determined the average salary of the new employees hired by Gulf during the same period and applied this average salary to the 38 vacancies. After adjusting this calculation to reflect the use of unbudgeted temporary employees to fill these vacancies, the resulting amount was $442,000. Approximately, $378,000 relates to O & M expense. Therefore, the 1990 O & M Budget has been reduced by $378,000 to reflect this hiring lag.

Q. Please describe the O & M Budget process after the issuance of the Budget Message.

A. Upon receipt of the Budget Message each department prepares the detailed budget which supports its approved goals and objectives for the budget year. The budget represents the funds the department management determines are required to accomplish its goals and objectives. The detailed budget is reviewed and approved by the responsible Vice President. After the department's budget has been reviewed and approved by the Vice President, it is submitted to Corporate Planning. Corporate Planning reviews the documentation for compliance with the Company guidelines and compiles the data for review by the O & M Review Committee.

The O & M Review Committee is established by the Budget Committee and is charged with review of all the Resources Requests submitted. Upon completion of the review the Committee makes a recommendation to the Budget Committee regarding the appropriate level of O & M expenses to approve. The Budget Committee reviews and approves the resource requests after considering the O & M Review Committee recommendation. After the initial approval of resources by the Budget Committee, each department provides the FERC account distributions for its approved resources. At this time, each department also forecasts O & M expenses for the next four years. An explanation is provided for any account which changed during the projected period by an amount which was different from the projected rate of inflation. Once the account number assignments and projections are developed and approved by departmental management, the budget amounts and forecasts are reviewed and approved by the Budget Committee and by the President.

Q. **How does Gulf's budget process incorporate the budget variances from the prior year into the budget estimate for the upcoming budget year?**

A. During July and August of each year as the planning units develop their O & M budgets, the budget variance reports for the current and previous years are utilized. These, along with the knowledge, experience, and professional judgement of the management of each planning unit, determine the affect the variances might or might not have on the budget year.

During the review process performed by the O & M Review Committee, the budget and actual expenditures, by FERC Account, for each planning unit for the years 198[illegible] - 1989 (6 months ended June 1989) were reviewed. The department heads were questioned as to the effect certain significant variances had on individual planning unit budgets and, if appropriate, the budgets were adjusted.

The Budget Committee was also provided budget and actual amounts by planning unit for use in their review prior to approving the 1990 O & M Budget.

Q. Mr. Gilbert, has the Company included in its budgeted Operations and Maintenance (O & M) expenses any nonrecurring expenses which should be disallowed?

A. No. Gulf's nonrecurring expenses as I have defined on page 14, consist of $7,158,205. Turbine and Boiler expenses and Vehicle Rebuilds which recur from year to year on different units account for $5,340,000 and $116,500 respectively, of the $7,158,205. The remaining $1,701,705 is not an excessive amount of periodic or cyclical expense for a representative test year. Although those specific activities will not recur next year, similar activities will occur. This is a conservative estimate of cyclical activities for which Gulf will have to budget beyond 1990.

Q. How are the costs associated with the recent Federal investigations of Gulf Power handled in this case?

A. Gulf has identified $615,000 associated with the

Federal investigation in its 1990 O & M Budget and has made a Net Operating Income (NOI) adjustment to remove these budgeted expenditures from consideration in this case. These costs will be borne by Gulf's stockholders. These adjustments are identified in Mr. McMillan's testimony.

Q. In Gulf's plea agreement with the United States Government, several specific instances were cited of payments to various political, civic, and other organizations made by vendors and then billed to Gulf as some other expenses. Are any of these expenditures included in Gulf's 1990 O & M budget?

A. It is my opinion that these questionable payments are not included in Gulf's 1990 O & M budget for the following reasons: (1) The expenditures identified in the later years of the plea agreement (1988 & 1989) related almost exclusively to payments made through advertising agencies. In 1989 Gulf is ceasing to do business with the agencies mentioned in the plea agreement and their contracts are not being renewed in the future. It should be noted that Gulf could be required to make payments to these agencies in the future through the cooperative advertising program with various builders. Under this program a builder could select one of these agencies and Gulf would be required to pay a portion of the builder's advertising costs directly to these agencies. This in no way detracts from the fact that the questionable payments are not included in Gulf's 1990 O & M Budget. In 1990 advertising initiated by Gulf will be handled by a new agency which was chosen through a thorough selection process. This new agency is not associated with any questionable dealings mentioned in the plea agreement. (2) The plea agreement mentioned that retainer fees were used to reimburse vendors for several questionable payments. There is no retainer fee for the new advertising agency budgeted in 1990. (3) The Company's business dealings with Ray Howell ceased in late 1988. The graphic artist layout activities performed by Mr. Howell have been performed in 1989 in house or by other vendors. The 1990 budget is based upon the costs incurred in 1989 for those graphic services not on 1988's cost. (4) There were no questionable items noted in 1989 by the plea agreement.

Q. What rate of inflation is used by Gulf in the preparation of its Operation & Maintenance (O & M)

Budget?

A. The Budget Message issued by the Budget Committee includes the inflation rate to be used by the planning units in preparing the O & M budget. The rate included in the Budget Message is the latest available estimate of the Consumer Price Index - Urban for the budget and forecast years at the time the Budget Message is issued. The rate of inflation for 1990 used in preparing the O & M budget is 4.4%.

Q. How is this inflation rate used by the planning units?

A. This inflation factor is used by the planning units to escalate the nonlabor expenses, either budget or actual, when such escalation is the most appropriate method of budgeting the expense.

Q. How is the O & M Budgeting process used by Gulf Power Company?

A. Gulf uses the budgeting process as a comprehensive management tool both to plan and to control the Company's operations. Through the budgeting process, we establish goals, objectives, and priorities, attempt to anticipate events, and establish the appropriate level of expenses. The process permits us to address and approve the specific dollar impact of selected operating alternatives. Additionally, the O & M Budget approved by the Budget Committee is a direct input into our Responsibility Reporting System which produces monthly Budget Comparison Reports. These reports compare actual amounts to budgeted amounts and provide dollar and percent variances by account number and by responsibility location.

Q. Do intermediate and lower level managers receive Budget Comparison reports?

A. Yes, they do. It is Gulf's philosophy that the individual preparing a budget is also the individual responsible for controlling that budget. Managers down through the supervisory level receive the Budget Comparison reports.

Q. Does Gulf's upper management monitor the Company's actual performance as compared to the budget?

A. Yes. Schedule 5 is an example of a Budget Variance report. Each quarter the departments are required to submit Budget Variance reports which include explanations for significant variances from budget and projections of the year-end variances by FERC account. Those reports are submitted to the appropriate Vice President for approval. Significant projected year-end variances are presented to the Budget Committee for review and approval.

Q. **Does Gulf have a method to review possible exceptions to the approved O & M Budget?**

A. Any activity requiring funding of more than $25,000 during the budget year, not provided for in the budget, must be presented to the Budget Committee for approval or disapproval.

Q. **Have the financial model results and the various component budgets been reviewed by an outside party?**

A. Yes. Mr. Mark R. Bell, an expert witness, of Arthur Andersen & Company has provided testimony in this case relating to his review of the accuracy with which the Company's budgeting process forecasts the test period financial results, the overall reasonableness of the assumptions made by the Company to develop those results, and the consistency of the data used in applying those assumptions throughout the forecast. Mr. Bell evaluated the financial forecast against the AICPA's

"Guidelines for Prospective Financial Statements." His testimony states that he found:

> ...the system used by the Company conforms with relevant professional standards, is adequate for its purpose, is complete and logically founded, and can be relied upon to produce consistent, reliable results.

Q. How is the financial model utilized in preparing Gulf's financial forecast?

A. The outputs from Gulf's budgeting process comprising the eight component budgets, other income and balance sheet accounts, and the financial assumptions are input into the financial model, which in turn generates the financial and accounting statements that comprise Gulf's financial forecast as shown on my Schedule 6. Mr. McMillan is prepared to discuss the financial model in detail.

Q. Mr. Gilbert, would you please summarize your testimony?

A. Gulf utilizes a very straightforward, logical, and comprehensive process in developing the eight component budgets that are incorporated into its financial forecast. This budgeting process is performed annually and results in a forecast that management uses as a tool in planning and decision making. We believe the assumptions contained in each budget are reasonable in light of our experiences and perceptions of the future and that they have been obtained from the best sources available at the time the budgets were developed. Gulf inputs the information contained in the eight component budgets, other income and balance sheet accounts, and the financial assumptions into a detailed computer-based financial model that generates the accounting statements that comprise our financial forecast.

Q. Does this conclude your testimony?
A. Yes, it does.

Q (By Mr. Stone) Mr. Gilbert, do you have a summary of your testimony?

A I do.

Q Please proceed.

A The purpose of my testimony is to provide an overview of the planning and budgeting process which is resulting in the production of Gulf's financial forecast. This financial forecast is the basis of Gulf's projected data for the 1990 test year used in this case.

Specifically, I have provided, in addition to the overview of the planning and budgeting process, an outline of the assumptions used in the forecast, a description of the capital additions budgeting process, a description of the operation and maintenance budget process, a description of the responsibility reporting system.

I have also identified the eight component budgets which are inputs to our financial forecast, and I have identified the witness or the witnesses who will testify on each of those budgets.

I have also testified on why I am convinced that no amounts associated with the prior illegal activities as identified in Gulf's plea agreement with the United States government are included in this case.

In summary, I would like to remind that you that Gulf's planning and budgeting process is performed annually. It is a logical, straightforward process, based on the goals and objectives of the Company. We use this budget in our day-to-day operation of the Company. The assumptions used in the budget and the financial forecast are from the best source available at the time the budgets and forecast were developed.

And in conclusion, I would like to point out that this forecast is Gulf's plan of operation for 1990. And I believe that this forecasting process, along with the commitment of Gulf's management to keep costs low, is what has allowed Gulf historically to maintain our operating costs per kilowatt hour as one of the lowest in the Southeast.

That concludes my summary.

MR. STONE: I tender Mr. Gilbert for cross examination.

COMMISSIONER EASLEY: Mr. Stone, were his exhibits among those that were stipulated to?

MR. STONE: That is correct.

COMMISSIONER EASLEY: Thank you.

MR. BURGESS: We have no questions.

MR. BURGESS: We have no questions.

MR. PALECKI: Staff has a few questions.

We'd like to ask about the adjustments made to remove the effective vacancies on the labor complement.

CROSS EXAMINATION

BY MR. PALECKI:

Q Did you make an adjustment in the filing to consider vacant positions?

A Yes, sir, I did.

Q And how many vacancies have you listed?

A In that adjustment?

Q Yes.

A The method we used in looking at that adjustment was to look at the first eight months of 1989 and average that period. The vacancies, the approved vacancies during that period of time, varied from a high of 49 to a low of 38. They averaged 42.

In our budget message for the '90 budget, we had adjusted several types of positions that were in the complement or not in the complement from the reference level, asking the planning units to come back and rejustify those positions.

Three of the vacancies that were on our vacancy list at the time that we were making the adjustment had been dropped from the complement. So we took those out -- actually it was four, not three -- which gave us a figure of 38 positions as being representative of a typical turnover rate for Gulf Power Company.

Q Mr. Gilbert, could you provide us, as a late-filed exhibit for each of those 38 positions on the job title, the beginning and maximum salary level for that position, the functional group of expenses that the salaries would be charged, and finally, the amount of the adjustment made by Gulf by function. And I would like that as late-filed exhibit entitled, "Data on Adjustment for Vacant Positions."

MR. STONE: Mr. Palecki, may I ask you a question? Did you realize that the vacancies he's talking about are averages over the period and, therefore, it might be difficult to identify specific -- as I understand it, it was the average vacancy.

WITNESS GILBERT: That's correct.

MR. STONE: When you're talking about -- it's a dynamic thing where the actual job positions out are going to differ over time.

Q (By Mr. Palecki) Weren't there specific vacancies that you've referred to in the interrogatories, in the data that you supplied the Staff?

A There are two sets of data. The first was that supporting the calculation that I made in this case. And what I thought you were asking for was the data supporting that calculation. The second set of data was provided in my rebuttal testimony, which was a single month's vacancy at a point in time, specifically as of May 8th. When you take a point in time, you can look at the specific positions in the vacancy. When you do it over a period of time, it is a dynamic thing. It does involve several groups of salaries. (Pause)

Q We would like to have that information for the point in time that you've referred to.

A The May 8th that I provided in my rebuttal testimony? We can do that.

CHAIRMAN WILSON: All right, that would be 565?

MR. PRUITT: That is correct.

CHAIRMAN WILSON: Late-filed.

MR. PALECKI: Short title would be "Data on Adjustment for Vacant Positionss."

(Late-Filed Fxhibit No. 565 identified.)

Q (By Mr. Palecki) Gulf has budgeted approximately 11.5 million in fringe benefits for 1990, or an increase of about $443,000 over 1989, is that correct?

A Subject to check, yes, I'd say that's correct.

Q Can you explain how the budgeted amounts for fringe benefits was developed?

A You would have to look at several different accounts, but let me see if I can simplify it.

With the exception of payroll taxes, Gulf uses a method based on the previous year's actual employees, and that is brought forward to the budgeted year for pensions, medical insurance, employee savings plan, everything that is in benefits, with the exception of payroll tax, lags one year. It is based on the data through May from the previous year, and is not inflated, with the exception of payroll is concerned, merit increase assumption. And therefore, it's not reasonable, in making a vacancy adjustment, to adjust out benefits other than payroll taxes. We don't include the growth in employees in those benefit estimates. We base is on last year's employees.

Another way to say that is that for 1990's -- '91's budget, we will base it on the actual number of employees we have in 1990, or for 1990's budget, we base it on the actual number of employees we had in 1989. It has nothing to do with the vacancy rate. Vacancy rate does not enter into it.

Q We'd like an additional late-filed. Could you include in this late-filed a detailed listing of each fringe benefit shown on Schedule C-33, Page 100 of the C Schedules, the amount budgeted, less your adjustment included in the filing? If there are no individual fringe benefits associated with those vacant positions, could you provide a detailed explanation for the omission?

A Let me clarify one thing. When you say the adjustment made in the filing, we made no adjustment to benefits in the filing.

Q Could you explain that, please?

A When we made our vacancy adjustment, we did not include the benefits because we didn't feel like it was appropriate. We did not include payroll taxes, in error. We should have included payroll taxes. We did not. So, in fact, any adjustment we made in my prefiled testimony, we made no adjustment to benefits.

My question to you is, since we made none, it's not necessary that we include any adjustment to benefits.

Q We'll withdraw that request for the late-filed.

Mr. Gilbert, you have been listed by Gulf as a witness who is available to testify concerning the Audit Disclosure No. 42, which specifically is the assertion that Gulf Power does not true up its current year's reference level for variances resulting from the previous year. And I refer you to Page 80 of 114 of Exhibit No. 430.

CHAIRMAN WILSON: Excuse me just a minute. Did we get a number for that late-filed exhibit you just asked for?

MR. PALECKI: We withdrew that.

CHAIRMAN WILSON: You withdrew that, okay.

Q (By Mr. Palecki) Specifically, the Staff's assertion is that they have been unable to verify Gulf's representations that it has trued up the reference levels, and I have a copy of Gulf's Audit Disclosure which was filed June 11th, 1990, wherein Gulf asserts that it has provided verification and basically asserts that it has trued up it's current year reference levels. Are you able to provide any documentation for the assertions that you've made? And, specifically, I'm referring to audit disclosure No.42, budget variances and the company comment thereon?

A Let me clear up one thing. The disclosure states that we don't true up the reference level for budget deviations.

Q Correct.

A That in itself is a true statement. With the exception that in the 1990 budget message we did remove two types o' employees from the compliment. Employees that were not in the compliment were subtracted from the reference level, employees that had not been where the positions had been vacant for 12 months were removed from the vacancy level.

Now, the other point I'd like to make at this time is that truing up the reference level and truing up our budget estimates are two separate things, and let me explain that.

Gulf begins it's budgeting process by issuing a corporate business plan. That's made up of goals and objectives in the strategic direction of the company. The 17 planning units then develop their own goals and objectives, in support of the corporate goals and objectives.

Once those are approved, they then develop a budget that supports those goals and objectives. The method used in developing those budgets are zero based budgeting methodology, trending methodology, or they may take their estimates direct from a contractural agreement. Those estimates are developed completely independent of the reference level. That reference level is very similar to the Commission's benchmark.

The Commission goes back to a year that its comfortable with, in this case the 1984 rate case of Gulf Power Company. It builds forward using customer growth and inflation, until it reaches a level of expenses for the questioned year and then has the company explain any deviation above that expense level. Gulf's reference level is very similar to that.

The year we're most comfortable with is the previous year's budget but rather than add two we subtract from that reference level in order to get more detailed explanations. So, when you say that we did not true up the reference level, we did for vacancies. That is totally different than saying we did not true up our budget estimates for budget variations because we did that.

And I think for a Macro test, if you just look at our 1989 budget versus our 1990 budget, our '90 budget only increased four-tenths of 1% over our '89 budget, so I think that's indication that we have taken into consideration budget variance in developing that budget. I will say that the Staff's statement that we did not include it in our reference level is partially correct but not totally correct.

Q When you assert that you have taken into consideration budget variances, and you have asserted that in your audit disclosure, in reponse to this audit report, what documentation have you provided to that effect?

A We have two methods by which we capture budget deviation. Quarterly we do a budget deviation report. Each department looks at their budget variances, they explain them, over certain preset dollars amounts, and they then make an estimate of where they will be at year end. Though this is a separate operation from the budget it's an integral part of the budget, in that beginning immediately with the first month we issue those budget deviations the planning unit begins to see where their assumptions may have been wrong, they may see changes in scope in specific projects.

The way our system is set up, rather than handle the budget deviation on the front end by adjusting the reference level as the Staff suggests, we handled it on the back end of our budget process through what we call modified activities. We have a modified -- a new and modified activity form called a B4.

The B4 reflects the changes to the budget over the reference level. When you look at those B4s, which have been provided to the Staff, 22% of them are negative B4s, they subtract from the reference level.

Many of those are budget deviations. And if you've got the time, I'd be glad to read from them to show you how those are captured.

Q That won't be necessary. I just have a couple more questions. Your rate, request for rate increase in this docket, is one-half million dollars greater than your request in the docket that was withdrawn, the rate case that was withdrawn last year, is that correct?

A Subject to check, I believe that's correct.

Q What was the amount of fine that was charged by the Federal Court as a result of your plea of guilty?

A It's a half million dollars, but it has nothing to do with that increase.

MR. PALECKI: Thank you. I have no further questions.

COMMISSIONER GUNTER: Commissioners?

COMMISSIONER BEARD: No.

COMMISSIONER EASLEY: I have one quick one. Can you make just as quick a statement as to the reason why the half million is more than the original rate case request?

WITNESS GILBERT: Well, there are a number of factors. We've had one year of growth. You had the effect of inflation that's one more year. We had merit increases one more year, which would all far exceed the half million.

We had offsets in reductions to our budget where we had either changed programs, where we had negotiated better prices, or whatever. We had negative changes to last year's budget of about 700 -- excuse me, $7.5 million.

So some things went down, inflation and merit went up, and so it's just purely circumstantial that the difference between the two requests in this case happens to be a half million.

COMMISSIONER EASLEY: Remind me, did I see a document that delineates the differences between the two cases that comes close to providing that information?

WITNESS GILBERT: I'm not sure, I don't recall.

COMMISSIONER EASLEY: I may be thinking of something in the tax case.

MR. HOLLAND: Commissioner Easley, I think there is an exhibit to Mr. Scarbrough's testimony, if I'm not mistaken, that compares '89 actual to '90 budget. Let me --

COMMISSIONER EASLEY: But that's not directly to the two rate case requests, as I recall.

MR. HOLLAND: No, it doesn't, it doesn't reconcile the $500,000. I don't think there is.

COMMISSIONER EASLEY: You don't remember a document that does that?

MR. HOLLAND: No, ma'am.

COMMISSIONER GUNTER: Yes, because the MFRs give you '89 actuals and '90 projections. They are full of those tables.

COMMISSIONER EASLEY: Yes.

MR. HOLLAND: Right.

COMMISSIONER GUNTER: But not rate relief request to rate relief request --

MR. HOLLAND: Right, correct.

COMMISSIONER EASLEY: Yeah.

COMMISSIONER GUNTER: -- that I've been able to find.

MR. HOLLAND: No, I don't think so.

COMMISSIONER EASLEY: Would that be a real difficult document to come up with?

WITNESS GILBERT: It would be --

COMMISSIONER EASLEY: Pretty extensive, I would guess.

WITNESS GILBERT: -- an extensive document, because we did not take last year's request and add $500,000 to it.

COMMISSIONER EASLEY: I understand that.

WITNESS GILBERT: Every line item in this case changed because that's the way we do our budget. We start from scratch.

COMMISSIONER EASLEY: Thank you.

COMMISSIONER GUNTER: Mr. Gilbert, I don't have any inquiry, but I'm trying to understand Issue 74 and what efforts the Company went through, Issue 74 on Page 40 of the Prehearing Order.

WITNESS GILBERT: Yes, sir.

COMMISSIONER GUNTER: And the issue is, "Has the Company properly removed from the 1990 expenses all costs related to the IRS grand jury and other similar investigations?"

Would you explain what you all did, how you all went about that to make sure that none of those costs were there? You know, that's a -- it's just sort of a curious kind of thing with me as to what actions you all took. I don't find anywhere, you know, everybody says, "Well, we did that," but I don't know how, how you all went through making the determination of what should be removed, what should be left, and what have you.

WITNESS GILBERT: I will be glad to do that.

COMMISSIONER GUNTER: Okay.

WITNESS GILBERT: First, we started with two documents. Let me begin by saying that we had already put our budget together at the time that Gulf entered into a plea agreement with the United States Government, so that document came after-the-fact.

COMMISSIONER GUNTER: Sure.

WITNESS GILBERT: What I did have was our Auditing Department's notes, their Audit Reports. What we took was those two documents -- the Audit Reports of the investigations of Gulf Power Company, the plea agreement from the United States Government, and they did have additional information through their subpoena power that we did not have.

We took those documents. First, we reviewed those against our 1990 budget work papers for every planning unit. We went back in and we physically looked for any items. The thing we gleaned from that was that most of these in the -- let me back up a second. We also looked at previous years.

The thing we gleaned from that was that many of these activities, illegal activities, took place through retainers. Where they weren't through retainers, they were substituted and displaced budgeted items and were disguised as budgeted items, mostly in the advertising area.

Gulf does not budget for illegal activities, as do most companies, you just don't do that. Although most companies, I'm sure, have some type of illegal activities they're unaware of, you just don't budget for those things. So what we had was items that had been presented for a specific purpose through the budget process that were diverted to the other activities and disguised as a budgeted activity.

Now, some things that I know about 1990 that would prohibit these expenses from being there and hopefully from anything like this happening again -- although no budgeting process would protect you from the type of collusion that went on:

I know that those retainers are not there. They have been physically removed. They're not in the budget.

I know that the agencies involved no longer have contracts with the Company.

I know that the individuals involved in this who were part of the collusion are no longer with the Company. Specifically, where most of the problems were involved was in advertising. Those advertising agencies are no longer there. The '90 budget was put together with the help of a new advertising agency, and I feel very comfortable that what we have identified is some legal fees on behalf of the Company and SES.

And we did overlook one thing, we weren't perfect. Imbedded in one of the new activity forms was a $5,000 expense for Arthur Andersen in anticipation of their support of us on any presentations to the Board's, or review with our Board of Directors. And we caught that after we filed the case and we have stipulated to that.

I feel very comfortable that we have removed everything associated with that.

COMMISSIONER GUNTER: Let me ask you a question. The only time previously I can recall we were in a situation like this was back when AT&T was involved in the anti-trust litigation at the federal level, which gave rise to the breakup of AT&T in 1984 by the Federal Court system. And I just don't recall at that time period, but just wanted to explore with you. Attached to Mr. Scarbrough's testimony was the analysis of O&M expense, you know, which dealt with previous periods escalated up. And, in fact, in the MFRs, there are 1989 actuals and '90 projections, and what have you, all the way through.

Has there been any thought -- and I'm trying to make sure that I understand O&M benchmark, which you're not specifically charged to testify to, but, you know, you're in the planning and projection business. I'm wondering about the appropriateness, for instance, regardless of who perpetrated an act -- whether it would be, you know, the buck stops with the Chief Executive Officer. Like with AT&T, back with DeButz and Company.

How about the expenses associated with however many employees that were required to testify, prepare testimony, retrieve records, copy, do all of those kinds of things, travel, per diem, that were involved in that investigation which ultimately Gulf plead to?

For purposes of doing an analysis, an O&M benchmark analysis of actual '89 expenses, some of those were in '89. Were those removed so that you could make a comparison of the actual electricity generating side of Gulf and taking out those expenses that were involved in that outside activity so that we could get a 1989 making electricity and 1989 involvement with the grand jury?

WITNESS GILBERT: Let me see if I can set you at ease. I've thought of the same thing.

COMMISSIONER GUNTER: And I understand that's, those don't always match, Mr. Gilbert.

WITNESS GILBERT: Right.

COMMISSIONER GUNTER: I want to make sure you understand. They don't always match, because I know that there were folks with Gulf -- because you all have got a ton of folks that are at least in the experience in the years I've been here, have been dedicated to providing electric service to their customers. And in no way any of my comments are intended to cast doubt on those folks. I'm trying to just look at dollars. And I recognize a lot of those folks got their job done and then worked long hours in doing this other piece. I understand that.

WITNESS GILBERT: Right.

COMMISSIONER GUNTER: Because the electric service was still provided and you all didn't have a big bump of people, and somehow all the work got done and people got called to Atlanta, and what have you. I understand that. But when I put -- purely, when I take the personal side out and look at the dollars that were involved, and there are two ways to look at that. Have you all done that kind of analysis?

WITNESS GILBERT: We have looked at those expenses. And I agree with you that the exempt personnel that are paid on a salary basis, there is no incremental expense there. There was an imposition on their time. Certainly, no responsibilities were removed from them. They still had the same job to do. They had to work nights, weekends to make up the difference.

On a lot of the travel expense associated with witnesses in the grand jury investigation, those are paid for by the U. S. Government. I mean, that's part of their -- they house them if they have to stay over, they pay their travel, they give them meal expense, so forth and so on.

We did have some internal travel expense associated with people visiting with our lawyers, and so forth and so on. We did have some copying expense associated with those type expenses. I can't say any of those were -- and when you look at the entire O&M cost of Gulf Power Company -- were significant.

COMMISSIONER GUNTER: Well, let me ask you this. Did you all have a, did Mr. Scarbrough, through folks that work for him, did you all have a piece of correspondence that came down from Accounting that said, "Hey, wait a minute. Everybody that spends any time on this project, charge your, on your time sheet, charge your account to No. 1235, so that we have a way to capture all the time that has been spent on that, regardless of whether it's for, you know, for money purposes or whatever." Did you all get one like that?

Did everybody in the Company charge that number?

WITNESS GILBERT: No, sir, we did not do that.

COMMISSIONER GUNTER: Wouldn't that have been advisable to have done that?

WITNESS GILBERT: In retrospect, Monday morning quarterback, yes. We were actual -- in the actual process, every month we thought it was going to be over with, and it just drug on and on and on.

COMMISSIONER GUNTER: It's like my hurting foot. I keep from going to the doctor, because I know it's going to be better tomorrow. But it's not getting any better.

WITNESS GILBERT: We did not capture the labor hours, the direct labor hours, of the exempt or nonexempt. We did capture some overtime for those that were paid overtime and caused to work overtime in copying some of the stuff. And we do know about some of the travel and copying expenses. So to those extent, we can identify those expenses.

COMMISSIONER GUNTER: All right, fine.

WITNESS GILBERT: Let me add one other thing. When we filed our filing in this '89 tax rule that we just filed back in March, we subtracted those expenses we know about out of that tax rule.

COMMISSIONER GUNTER: All right. I'm beating a dead horse. I have nothing further, Mr. Chairman.

CHAIRMAN WILSON: Redirect?

MR. STONE: Yes, please.

REDIRECT EXAMINATION

BY MR. STONE

Q Mr. Gilbert, to follow up just a moment on what Commissioner Gunter was asking you, the travel and copying that took place in 1989 related to the grand jury, was any of that budgeted in 1989?

A No.

Q Were any of the expenses of employee activity, were they budgeted in 1989?

A Would you repeat that question?

Q Were any of the expenses in employee activity associated with those, helping with the grand jury and things of that sort, were they budgeted in 1989?

A Were the employee's actual expenses for his normal work routine budgeted?

Q Well, I realize that their normal work routines were budgeted. Did you budget extra for those extra activities related to the grand jury?

A No.

Q Subsequently, have you had to budget any of those materials for those expenses in 1990?

A No. None that we haven't removed from this case. The only ones that were budgeted were some legal activities and Arthur Andersen, which we've removed all those from this case.

Q Did the Company have to hire any additional personnel to perform the activities that related to the Grand Jury?

A None that I'm aware of.

Q Basically then, Mr. Gilbert, is it true that none of these activities have any affect on the 1990 budget which is the basis of the test year?

A That's correct.

Q In addressing some of the things that changed between the 1989 test year and the 1990 test year, there were some additions to rate base early in 1989, were there not?

A There were additions to --

MR. BURGESS: I'm going to have to object to the question. He's getting too leading. I'm going to have to object on the basis of it being a leading question.

Q (By Mr. Stone) If there were additions to the rate base in 1989, would the effects of 13-month average rate base, would they be fully reflected in the 1989 test year?

A That's correct.

Q Would they or would they not?

A Rate base is cumulative as far as any construction is concerned. So anything that was in 1989 would be in 1990.

Now, if you're talking about variations, variations to our plant in service for 1989 would not carry forward into 1990 because we picked a new starting point for the plant-in-service numbers.

Q Perhaps the question may be better addressed to Mr. McMillan, but in terms of 13-month average rate base, some of those effects are delayed because of the 13-month average, is that correct?

A That's correct.

MR. BURGESS: I'm going to have to object. He's leading the witness.

CHAIRMAN WILSON: That's a very leading question. You're going to have to rephrase that.

MR. STONE: I'll explore it with Mr. McMillan.

Q (By Mr. Stone) Mr. Gilbert, do you know whether the -- you mentioned that the individual planning units do their own budgetings on a zero-based or a trending of it, use different analyses, that it's not based on the reference, although they do budgeting, is that correct?

A That is correct. And the reference level, like the benchmark, only determines how much documentation you'd get.

Q Those budget papers in the individual planning units, have they been made available in this rate case?

A Primarily to Public Counsel. The Public Counsel requested selected work papers, and the Staff has been provided all the B-4 documents that are the justification documents.

MR. STONE: We have no further questions.

COMMISSIONER GUNTER: Mr. Chairman, I have one, just a clarification as a result of those closing questions.

Mr. Gilbert, I understand that you're not responsible for Schedule C-21, at least you're not the witness identified in the MFRs, but your information, when you go for 1990, the test year, from your planning activity there would have been a portion of that which comes from your efforts, would they not?

WITNESS GILBERT: I'm not sure what C-21 is.

COMMISSIONER GUNTER: C-21 is the detailed changes and expenses when you're talking about O&M, and you're taking the prior year, which year ended 1989, and then they've got the 1990 test year. So when you're in 1989, you were budgeting forward for 1990, is that correct?

WITNESS GILBERT: That's correct, but this is not year-end data. This is nine months actual, four months, three months --

COMMISSIONER GUNTER: Looking at the heading up on the right-hand side, type of data shown.

WITNESS GILBERT: Right.

COMMISSIONER GUNTER: Projected test year ended 1990.

WITNESS GILBERT: That's correct.

COMMISSIONER GUNTER: Prior year ended 1989. I'm just looking at the MFRs and I'm taking that at face value. It said that the projected 1990 data shown in Column 3, and I guess it's the same, I'm just looking at C-21, Page 4 of 7.

WITNESS GILBERT: Yes, sir, that's correct. But in the negotiation of the MFRs, the prior year was defined as nine months actual, three months projected for O&M.

COMMISSIONER GUNTER: Let me jump over that. But some of your information would have come from there, is that right?

WITNESS GILBERT: Yes, sir.

COMMISSIONER GUNTER: In counsel's statement they asked you a question did you budget for any of the expenses in the Grand Jury investigation, and your answer, of course, was no, you didn't have any way to forecast that. But in the prior year, if I'm reading the heading on C-21 correctly, these are actual expenses that were incurred by the Company in 1989, is that correct?

WITNESS GILBERT: Through September.

COMMISSIONER GUNTER: Through September. So the heading up here is incorrect?

WITNESS GILBERT: That's correct. It was defined as part of the MFR process.

COMMISSIONER GUNTER: Okay, fine. I'm not taking exception to that. I'm just trying to understand what the MFRs tell me, because it says ended 1989. It didn't get down to the point that you're getting at.

WITNESS GILBERT: We filed a --

COMMISSIONER GUNTER: But the actual expenses you incurred in 1989 for our evaluation, are those expenses you incurred in 1989, whether they were planned for in '88 to happen in '89 or not, Is that right?

WITNESS GILBERT: Essentially that's correct, yes.

COMMISSIONER GUNTER: Okay.

MR. PALECKI: Mr. Chairman, I have one further question based on what --

CHAIRMAN WILSON: All right.

REDIRECT CROSS EXAMINATION71

BY MR. PALECKI:

Q Isn't it true that as part of your own job functions at Gulf you were required to divert time as a result of the Grand Jury investigation?

A Are you asking me personally?

Q Personally.

A I have very little to do with that specific investigation in '89.

Q You had to back the numbers up, didn't you?

A As part of this case I had the task of searching our budget work papers to see if any of the related activities were involved that was really not part of the investigation completely. It was as a result of this case.

Q Do you have any doubt that employees at every level of management at Gulf were diverted from their normal, daily tasks as a result of the investigation?

A In 1989?

Q Either in 1989 or at the time of the investigation.

A I'm sure there were many employees that were diverted from their tasks. As I say, as far as I know, no responsibilities w re removed from any employee. To the extent we worked any overtime because of that, where it was paid overtime and incurred incremental expenses, we have ajdusted that out of the '89 tax savings rule filing. As far as exempt employees that had to work overtime, we have to work overtime all the time. We don't get paid one dime for it. There was no incremental expenses associated with that type of employee.

MR. PALECKI: No further questions.

CHAIRMAN WILSON: All right. Nothing further?

MR. STONE: None with this witness.

CHAIRMAN WILSON: His exhibits have been stipulated?

MR. STONE: That is correct.

CHAIRMAN WILSON: Thank you very much. You may be excused.

(Witness Gilbert excused.)

- - - - -

CHAIRMAN WILSON: Call your next witness.

MR. STONE: Mr. Mark Bell. (Pause)

Mr. Chairman, I don't believe Mr. Bell was here on Monday when the witnesses were sworn.

CHAIRMAN WILSON: Raise your right hand,

please.

(Witness Bell sworn.)

CHAIRMAN WILSON: Thank you. Go ahead.

MARK R. BELL

was called as a witness on behalf of Gulf Power Company and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. STONE:

Q Would you please state your name, your employer, and your business address for the record?

A My name is Mark R. Bell. I am a partner with Arthur Andersen. My address is 133 Peachtree Street, Atlanta, Georgia.

Q Are you the same Mark R. Bell that has prefiled direct testimony in Docket No. 891345 dated December 15, 1989?

A Yes, I am.

Q Mr. Bell, do you have any changes or corrections to your testimony?

A No, I do not.

Q So if I were to ask you the questions contained in your prefiled direct testimony, your responses, would they be the same?

A Yes, they would.

MR. STONE: Mr. Chairman, I would ask that Mr.

Bell's testimony be inserted into the record as though read.

CHAIRMAN WILSON: Without objection, it will be so inserted into the record.

MR. STONE: Mr. Bell's exhibits have been previously identified as stipulated.

(Exhibits 46, 47 and 48 previously stipulated into the record.)

Record Copy 685

GULF POWER COMPANY

Before the Florida Public Service Commission
Direct Testimony of
Mark R. Bell
In Support of Rate Relief
Docket No. 891345-EI
Date of Filing December 15, 1989

Q. **Would you please state your name, business address, and occupation?**

A. My name is Mark R. Bell. My business address is 133 Peachtree Street, N.E., Atlanta, Georgia, 30303. I am a partner in the accounting firm Arthur Andersen & Company.

Q. **Would you please state your educational and professional background?**

A. I joined Arthur Andersen & Co. in 1967 following graduation from St. Louis University with a Bachelor of Science degree in Accounting. I am a Certified Public Accountant in the states of Georgia, California, and Missouri, and I am a member of the American Institute of Certified Public Accountants (AICPA).

Q. **Would you briefly describe the work of Arthur Andersen & Co.?**

A. The firm has approximately 160 offices, of which about one-half are in the United States and the other half in other parts of the world. We work with all types of businesses, both regulated and nonregulated.

Q. What is the nature of the work you have performed at Arthur Andersen & Co.?

A. While I have had experience in a number of industries, a significant portion of my career has been devoted to regulated industries, including electric utilities, water and sewer, gas and telephone companies.

I have conducted and supervised independent audits of the financial statements of public utilities and have supervised work in connection with the issuance of securities of these companies. I have also assisted in numerous rate filings on a wide range of topics before various state regulatory bodies. My experience before the Florida Public Service Commission includes testifying in Gulf Power Company's last two retail rate hearings on my independent review of the Company's financial forecasting system. Consequently, I am familiar with the Company's forecasting techniques and its planning and control systems.

Q. What are your present responsibilities at

Arthur Andersen & Co.?

A. Currently, I am partner-in-charge of the audit division responsible for our regulated industries practice in the Atlanta office, which serves as the concentration office for our regulated industry services in the southeastern United States. In addition, I serve as the engagement partner for Gulf Power Company and several other electric utilities and telephone companies.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present the results of my independent review of the financial forecasting system used by the Company, including my review of the accuracy with which the system forecasts the test period financial results, the overall reasonableness of the assumptions made by the Company to develop those results, and the consistency of the data used in applying those assumptions throughout the forecast.

Q. Do you have an exhibit which accompanies your testimony?

A. Yes.

Counsel: We ask that Mr. Bell's Exhibit, comprised of 3 Schedules, be

marked for identification as
Exhibits 46-48 (MRB-1).

Q. Were all of the schedules in this exhibit prepared under your supervision?

A. Yes. Each schedule of this exhibit was prepared under my direction and supervision.

Q. Please describe your review of the financial forecast made by the Company for purposes of this proceeding.

A. The review was made under my direct supervision and consisted of two parts. The first part was a review of the Company's financial forecasting system itself; the second part was a review of the specific forecast of the 1990 test period as summarized in Mr. McMillan's Schedules 2 and 3.

Q. Do you have a schedule which shows an overview of the financial forecasting process?

A. Yes. My Schedule 1 illustrates, in summary form, the Company's process for preparing forecasts. This system is described in detail by Company witnesses Scarbrough, Parsons, Howell, Jordan, Lee, Kilgore, Bowers, Gilbert and McMillan. As the schedule illustrates, input is developed by various departments whose personnel are qualified in specific areas such as economic forecasting, operations, engineering, accounting, and finance. This input reflects the Corporate Business Plan as approved by the Company's top management as well as the key assumptions that are approved for consistent application throughout the forecast. The Corporate Planning Department has primary responsibility for collecting data to be used in the forecast from the appropriate source departments, communicating the forecast guidelines to those source departments, validating internal consistency of data, producing the financial model using the source budgets and obtaining appropriate management review and approval.

The Budget Committee reviews the forecast on a planning unit level both before and after the planning unit budget is allocated to FERC account numbers. The final approved forecast is an input to the Company's responsibility reporting system, which provides monthly and quarterly reports showing actual results compared to the forecast, and which management uses to control and monitor the various departments of the Company.

Q. Have there been any significant changes or enhancements to the financial forecasting system since your review in connection with the Company's 1984 retail rate case, Docket No. 840086-EI?

A. Yes. The Company has made several significant enhancements to its financial forecasting process.

Q. Please describe those enhancements.

A. First, the Company has implemented computer applications which provide interfaces of the output of the construction budget model and miscellaneous model calculations to the financial model. Previously, these items were manually interfaced.

Second, the Company has adopted the Utility Fuel Inventory Model (UFIM) developed by the Electric Power Research Institute (EPRI) to assist in the determination of a strategic coal inventory policy. This model was designed to "strike a balance" between the cost of holding fuel and the expected cost of running out of fuel.

Third, the Company has enhanced the long-term customer, energy, and demand forecasting methodologies by adopting various econometric models such as the REGIS, COMMEND and HELM models discussed in Mr. Kilgore's testimony.

Finally, the Company has made several changes in its O & M budget process related to (1) the reference levels used by the planning units in preparing their budgets, (2) the information used by the O & M Budget Review Committee, and (3) the budgeting of the personnel complement.

Q. **Can you describe these changes to the Company's O & M budget process in further detail?**

A. Yes. First, the Company has refined its procedures for establishing the reference levels used by each planning unit to budget O & M expenses. The 1990 reference level is defined as the 1989 budget less (1) nonrecurring items, (2) corporate controlled items, and (3) salaries for positions which were budgeted in 1989 but had not been added to the complement or which were budgeted in 1989 but had not been approved for filling for 12 months. Each planning unit must provide detailed justification for all expenses budgeted in excess of the reference level and this justification is closely scrutinized by Corporate Planning, the O & M Review Committee, and the Budget Committee. The reference level is discussed in further detail in Mr. Gilbert's testimony.

Second, Corporate Planning has added a new budget to actual comparison report to the information provided to the O & M Review Committee for use in its review of the O & M budget. This report provides a three-year historical analysis of budget to actual variations by FERC account for each planning unit. The O & M Review Committee carefully reviews all budget requests compared to prior years' history. To obtain the Committee's approval of budget requests, each planning unit must be able to explain and support any budget requests which appear unusual in light of prior year budget to actual variances.

Finally, the Company has established a methodology to adjust the forecast for a personnel "hiring lag." As discussed in Mr. Gilbert's testimony, this adjustment deducts from the forecast the estimated salaries associated with vacancies caused by normal turnover. I will discuss this adjustment further later in my testimony.

Q. Has the Company implemented any of the recommendations you made in your testimony in the Company's 1984 retail rate case relating to your review of the Company's 1984 forecast?

A. Yes. I noted that several of my previous recommendations were implemented. Among them were the following:

- The Company has automated the interface between its revenue subsystem and its financial model.
- The Company has developed complete, detailed, user-oriented system documentation for the financial model.
- The Corporate Planning Department now performs detailed reviews of each planning unit budget. Corporate Planning's reviews include reasonableness checks of amounts budgeted using the budget assumptions approved by management. The planning units are required to provide detailed justification for any areas that are budgeted for increases other than those due to inflation.

Q. In your review of the Company's forecasting process, did you note any further improvements that could be made?

A. Yes. I noted one area where further improvement in the system could be made. I considered this in my review of the forecast, and it does not modify my overall conclusions on the forecasting system. The recommendation is that the Company should continue to automate the miscellaneous forecast calculations and utilize the interface capabilities for the financial model. This would reduce the risk of clerical or data input errors and expedite the generation of the financial model.

Q. Please describe the scope of your review of the financial forecasting system.

A. I utilized a work program designed to evaluate the forecasting system in light of the relevant professional standards. My review indicated that the Company has a forecasting system which is effective and which meets all of the relevant professional standards for such a system.

Q. What "relevant professional standards" did you use in evaluating the Company's financial forecasting system?

A. I evaluated the Company's financial forecasting system against the professional standards outlined in the American Institute of Certified Public Accountants' (AICPA) "Guide For Prospective Financial Statements." This official pronouncement of the AICPA establishes the broad principles and requirements that govern the preparation of financial forecasts.

The AICPA guidelines provide a comprehensive statement relating to the preparation of forecasts and as such, can be used to determine that a forecast is prepared in a reasonable and prudent manner. The statement establishes a set of criteria against which a forecasting system can be evaluated. The implementation of the guidelines was intended to lead to increased confidence on the part of users that due care is exercised in the preparation of forecasts. The 11 specific guidelines in this statement are included in my Schedule No. 2.

Q. **Are these the same standards you used to evaluate the Company's financial forecast in its 1984 retail rate case?**

A. No, not exactly. The AICPA's "Guide for Prospective Financial Statements," which was issued in 1986, established new standards for the preparation of financial forecasts. The new guidelines are essentially the same as those applicable at the time of the 1984 retail rate case except an additional standard has been added -- "Financial forecasts should be prepared in good faith." This new standard requires that forecasts be prepared without undue optimism or pessimism and that care be exercised to ensure that forecasts are not misleading to third-party users. The use of good faith has always been implicit in the guidelines for the preparation of financial forecasts. The new guidelines simply establish good faith as a separate explicit standard.

Q. **Please summarize the procedures utilized in your review of the Company's financial forecasting system.**

A. I employed the following procedures in reviewing the financial forecasting system. First, I developed an overall understanding of the Company's activities which, when combined, comprise its forecasting system. I also followed flow of data from the originating departments through the forecasting system to the final preparation of the forecast itself. This procedure was undertaken to complete my understanding of the processes used by the organizational units within the Company in the preparation of the financial forecast.

The second step of my review consisted of the identification and review of the specific procedures followed by the Company personnel in preparing the forecast. The purpose of this step was to verify that adequate procedures were in place to ensure the accuracy and completeness of the forecast if those procedures were followed.

Finally, certain compliance tests were performed, and certain documentation and reports were reviewed to verify that the system was in fact operating as designed. This work also included ensuring the internal consistency of data used in the forecast.

Q. Please describe your review of the specific 1990 forecast.

A. In addition to the work on the forecasting system which I just described, the clerical accuracy of the financial model input and output was tested on a scope basis. This included recalculating many of the computations made by the model. The input data was referenced to the appropriate source documents and was traced through the model processing into the forecast output, which is summarized on Schedules 2 and 3 of Mr. McMillan's testimony.

The key assumptions approved by management set forth in MFR F-17 were verified to be those actually used in the forecast. Further, the forecast was reviewed for the appropriate interrelationships of the data generated and for the conformity with proper rate making procedures and generally accepted accounting principles.

Q. During your review, did you note any changes or adjustments which should be reflected in the 1990 forecast for purposes of this proceeding?

A. Yes, I noted several adjustments which were identified either by Company personnel or my personnel. Most of these adjustments were made on Schedules 6 and 8 included in Mr. McMillan's testimony. These generally relate to the following areas:

(1) certain administrative and general expenses related to the IRS and Grand Jury investigations;

(2) certain utility plant and related accumulated depreciation items also related to the IRS investigation; and

(3) other miscellaneous items excluded from net operating income or rate base due to regulatory precedents.

Adjustments were not made, however for the following items:

(1) certain revenues were not forecasted;

(2) changes in the forecast will be necessary to reflect adjustments to be made related to certain exceptions noted in the recent Federal Energy Regulatory Commission (FERC) audit.

Q. Please discuss the revenues which the Company did not forecast.

A. The Company did not forecast any economy energy sales. This treatment is consistent with prior forecasts and was discussed in the Company's 1984 retail rate case, Docket No. 840086-EI. Although I recognize that the large number of variables involved in economy energy transactions make these revenues very difficult to forecast, I continue to believe they should be included in the forecast. However, since 80 percent of economy energy sales profits are credited to retail ratepayers through the fuel adjustment clause, and the remaining 20 percent is retained by the Company's stockholders in compliance with Commission Order no. 12923, there is no consequential effect on the proposed retail rate increase resulting from the omission of these sales from the forecast.

Q. Please describe the adjustments that will be made related to the FERC audit.

A. Certain FERC findings have been recorded by the Company during 1989 and are properly reflected in the 1990 forecast. Other audit findings are currently being resolved and the related effects on the financial statements and thus, the 1990 forecast, have not been determined at this time. As discussed in Mr. McMillan's testimony, the Company will provide to the Commission any adjustments to the forecast which result upon final resolution of the FERC audit issues.

Q. **Mr. Bell, you mentioned other adjustments related to the Grand Jury and IRS investigations which were reflected in the forecast and which are included on Schedules 6 and 8 in Mr. McMillan's testimony?** Did you **review these adjustments?**

A. Yes. Given the concerns about the Company's accounting system and controls and the potential impact on the forecast related to the recent IRS and Grand Jury investigations, I performed detailed reviews of portions of the forecast related to those areas in the Company which could be affected. Specifically, I reviewed the forecasted costs associated with marketing, public relations, and legal expenses. I also reviewed the adjustments to test period operating income related to legal fees and to test period rate base related to charges for transformers and their repair.

Q. **During your review of these specific areas, did anything come to your attention that causes you to believe that the 1990 financial forecast specifically** includes costs related to the alleged irregularities discussed in the Company's plea agreement with the United States Government, or legal fees forecasted as a result of activities associated with the Grand Jury or IRS investigations?

A. No. I specifically reviewed the 1990 budget support for various marketing and public relations activities and compared the 1990 budget to the corresponding 1989 budget. I noted that certain costs, such as those for retainers for certain outside services, were included in the 1989 budget but were specifically excluded in 1990. In addition, I reviewed the O & M amounts budgeted for legal fees, including those amounts allocated to Gulf by Southern Company Services. I noted the budgeted costs included amounts related to the IRS and Grand Jury investigations. These amounts were specifically excluded from Net Operating Income (NOI) as an adjustment included in Mr. McMillan's Schedule 8. Although I cannot give absolute assurance that no costs related to any prior irregular activities are budgeted in 1990, I did not note any such budgeted costs in my review which were not specifically excluded from NOI by the Company.

I also reviewed the Company's adjustment to rate base related to transformers and other costs which were determined to be improperly capitalized due to illegal activities. Again, although I cannot say with absolute assurance that all such charges have been identified and properly removed from rate base, I believe the Company has made a good faith effort to identify such items and to properly adjust the forecast.

Q. Mr. Bell, did you have any additional findings which would affect the 1990 forecast used in this proceeding?

A. Yes. I noted that the hiring lag adjustment made by the Company in its O & M forecast does not necessarily reflect the Company's hiring plans and may result in an overstatement of O & M expenses in the forecast. However, I also noted that the Company's forecast for union salaries was understated. The effect of understating these wages would essentially offset the effect of understating the hiring lag.

Q. During the course of your review, did you note any variances between the assumptions used in the forecast and conditions as they subsequently developed?

A. Yes. I noted three areas where conditions changed between the time the forecast was prepared and the date of my review. In each case, the forecast was based on the best information available at the time, but conditions outside the control of the Company subsequently developed in a manner different from that reflected in the forecast.

First, the forecast was prepared using an estimated salary increase of 3 percent for union personnel. Subsequent to the forecast preparation, the union contract was renegotiated and an actual base salary increase of 3.7 percent was determined. Thus, as I discussed previously in my testimony, O & M expenses related to union wages are understated in the Company's 1990 forecast. In addition, several union positions were upgraded which will also result in additional salaries expense which was not forecasted.

Second, the Company used an estimated 1990 inflation rate (as measured by the CPI--all urban consumers) of 4.4 percent in the 1990 forecast. Subsequently, some economists have raised their projections of the 1990 increase in the CPI to as high as 6.0 percent. Although the inflation rate assumed by the Company is certainly not unreasonable, the forecast may, in fact, understate those expenses affected by the CPI.

Finally, two changes have occurred subsequent to the preparation of the forecast related to items that affect the Company's capital structure, and thus cost of capital. First, it has been determined that a

$3 million capital contribution from the Southern Company forecasted for December, 1989, will not be received. Second, a deferred tax liability of $1.9 million has been reclassified to current income tax liabilities. At the time the forecast was prepared, the Company did not believe the tax liability would be payable in 1989. The total effect of these two changes is a slight increase in revenue requirement.

Q. **Mr. Bell, does the 1990 forecast represent the actual plans of the Company for that year?**

A. Yes, it does. The 1990 forecast becomes the budget for 1990.

Q. **Are the people responsible for preparing the budget also held accountable for achieving it?**

A. Yes. The final approved budget becomes the basis for the Responsibility Reporting System. The budget is prepared at the section or location level by the appropriate managers and supervisors. These budgets are combined into departmental budgets, and departmental budgets are combined into planning unit budgets. These budgets are then forwarded to the four functional Vice Presidents before being reviewed by the Budget Committee and President. The Responsibility

Reporting System follows the same line of reporting.

The Responsibility Reporting System generates monthly budget-to-actual comparisons at the section or location level. Summary reports are prepared on a monthly basis for review by higher levels within the Company. At the end of each quarter, reports are prepared at the planning unit level which provide a detailed explanation for budget variances greater than 5 percent and $1,000. In addition, a positive statement must be made as to whether or not it is estimated that the budget will be achieved by the end of the year. If the budget cannot be achieved by the end of the year, then approval must be obtained at the Vice President and Budget Committee levels. If the budget variance is not approved, then the planning unit must take the necessary steps to come within the budget for the year.

Q. Have you verified that the Responsibility Reporting System you have just described is operating as designed?

A. Yes. On a test basis, I have verified by examination of supporting evidence that the Responsibility Reporting System is operating as described above.

Q. Mr. Bell, what conclusions have you drawn from your

review of the Company's financial forecasting system and the 1990 forecast?

A. In my opinion, the financial forecasting system and the procedures employed in the preparation of the forecasted data are in compliance with the guidelines in the American Institute of Certified Public Accountants' "Guide for Prospective Financial Statements."

My review indicated that the systems and procedures used by the Company are in place and are operating effectively. The data flow is subject to validation, and the forecast includes all important data. There is adequate participation, review, and approval by management.

The forecasted data on Schedules 2 and 3 of Mr. McMillan's exhibit is an accurate simulation of the financial results of the underlying assumptions and those assumptions provide a reasonable basis for the forecast. If these assumptions prove true, the 1990 forecasted test period results should become the actual financial results of the Company except for the effect of the differences discussed earlier in my testimony.

Although the key assumptions developed and approved by management represent future events not susceptible to verification at the time the forecast was prepared, they were developed in good faith in a reasonable and prudent manner and were obtained from reliable sources.

Q. **Mr. Bell, you stated that the 1990 forecast is based upon assumptions not susceptible to present verification. How can the Commission be assured that the use of the forecast in this rate proceeding is fair to the Company's customers?**

A. The testimony of several Company witnesses describes in detail how the financial forecasting system works and the accuracy with which it projects actual results. I have previously concluded that this system can be relied upon to develop forecasts in a reasonable and prudent manner which represent the most probable financial result of the forecast test year. My review confirms that management has a well-developed system with an ability to accurately forecast the cost of service.

In addition, an analysis of the components of the forecast revenue requirements will show that the components which affect the level of base rates are not susceptible of misestimation to any great degree and the Company has historically forecasted these components with great accuracy.

Q. **Please explain.**

A. The Commission has adopted a fuel adjustment cost recovery mechanism which provides for the recovery of fuel cost. The Commission has established a similar mechanism for the recovery of certain conservation program expenditures. Therefore, these costs have no impact on the proposed adjustments to base rates and can be eliminated from further analysis.

What remains to affect base rates is other operating expenses, return, taxes on return, and the marginal revenue from variations between forecasts and actual base rate revenues. Recent history shows that variation between forecast and actual amounts of these items has been minimal in relation to total revenue requirements applicable to base rates.

Q. **What is the basis for this conclusion?**

A. I have analyzed the comparisons of forecast to actual amounts for the years 1985, 1986, 1987 and 1988 as shown on Schedule 3 of my exhibit. My analysis excludes fuel and conservation clause revenues and energy revenues associated with unit power and other off-system sales agreements which are treated as nonjurisdictional by this Commission. I applied the percentage variance for these years to the actual base rate revenues for those years in order to evaluate the significance of these variances in terms of total base rate revenue. The impact of these variances is minimal, as shown by my analysis.

Most of the operating expense items are relatively fixed in nature, and when considered in light of known cost levels in prior years, their cost can be easily forecast, particularly in the short run. Therefore, the cost of operations applicable to base rates is not susceptible to misestimation to any great degree, given the level of sophistication of the Company's forecasting process.

In addition, an integral part of the forecasting system described earlier in my testimony is the Company's Responsibility Reporting System. This Responsibility Reporting System supports the Company's financial planning and control process and enhances the ability of management to achieve forecast results insofar as economic events, activities, and costs are controllable. For example, management requires specific plans of action to correct interim budget-to-actual deviations to the extent expenditures are controllable.

Q. Why do your calculations on Schedule 3 not include amounts for variances between forecast and actual return on common equity, income taxes, and fuel and interchange costs?

A. The appropriate return on common equity for the test period is a matter that will be determined by decision of the Commission. Income taxes are a function of the return on equity capital. Hence, the historical forecast variation range is not relevant. Fuel and interchange costs are recovered through the fuel and purchased power recovery clause as I previously discussed.

Q. Please summarize your testimony.

A. Based upon the review described earlier in my testimony, in my opinion, the financial forecasting system used by the Company conforms with relevant professional standards, is adequate for its purpose, is complete and logically founded, and can be relied upon to produce consistent, reliable results.

With only the immaterial differences discussed earlier in my testimony, the 1990 forecast represents an accurate simulation of the financial results which should occur if the key assumptions prove true. While the key assumptions represent future events not susceptible to present verification, they were developed in good faith in a reasonable and prudent manner. In my opinion, the use of a 1990 forecasted test period is appropriate for setting rates.

Q. Does this conclude your testimony?
A. Yes, it does.

Q (By Mr. Stone) Mr. Bell, do you have a summary of your testimony?

A Yes, I do.

Q Please proceed.

A My testimony addresses our independent review of the Company's financial forecasting system and the specific review of the Company's 1990 financial forecast used in the rate case. My review included examination of the financial forecasting system against the professional standards outlined in the American Institute of Certified Public Accounts' Guide for Prospective Financial Statements. It also included testing the accuracy with which the system forecast, the test period financial results, the overall reasonableness of the assumptions made to develop the results and the consistency of the data used in applying these assumptions.

Based on my review, I have concluded that the Company's financial forecasting system conforms with the official guidelines established by the AICPA, provides a well-documented audit trail, and is adequate for its intended purpose.

I have also concluded that the 1990 financial forecast was prepared in good faith and, with differences noted in my direct testimony, reflects the actual results that would occur if the assumptions proved true.

In summary, the Company's financial forecasting system conforms with relevant professional standards, is adequate for its purpose, is complete and logically founded, and can be relied on to produce consistent, reliable results.

In addition, the 1990 forecast represents an accurate simulation of the financial results which should occur if the key assumptions prove true. While the key assumptions represent future events not susceptible to the present verification, they were developed in good faith in a reasonable and prudent manner, and that is my summary.

MR. STONE: Tender Mr. Bell for cross examination.

COMMISSIONER GUNTER: Let me ask Counsel a question. In trying to make sure to get the issues that Mr. Bell is responsible for, are those listed correctly? For instance, is Mr. Bell going to testify on the lobbying expenses, the nonrecurring out-of-period expenses? Because his name is not listed back in the text on those issues, but he's got issues that don't appear to -- maybe I'm just not capable of reading his testimony.

MR. STONE: Mr. Gunter, I think I can explain that. When we were preparing the prehearing statements and the resulting Prehearing Order, the Audit Report had not been finalized. And at the final Prehearing Conference it was agreed that some of the witnesses would be presenting supplemental testimony on audit issues.

The way we identified that was to take a listing that had been provided to us by the Staff, we went down and it had identified which issues they thought the audit points related to. And we listed our witnesses that would be addressing those audit points. In some respects their testimony -- or what they would be assisting the Commission with in regards to those issues, would be on aspects of those issues and not really supporting the issue itself.

COMMISSIONER GUNTER: So the rate of return issue, Issue 38, that has to do with mismanagement, that issue he's going to talk about from a budgeting standpoint? Is that how these are fitting together? I'm trying to understand how the witnesses are going to address each issue because I want to make sure every issue is covered by the witness. Do you understand what I'm saying?

MR. STONE: I do.

COMMISSIONER GUNTER: I just got a little lost.

COMMISSIONER BEARD: Because of the timing of the Staff Audit, the out-briefing with respect to the prehearing, we, in fact, continued the prehearing to identify if, one, were there any additional issues as a result of that audit. It ended up not being because a large number of the -- for lack of a better word -- "discrepancies," if you will, or disagreements, could be rolled into Issue 38 and then certain other issues. And it was my ruling that, where necessary, additional testimony addressing specifically the audit discrepancies, disagreements, whatever, would be allowed to try to cover that.

COMMISSIONER GUNTER: Okay. So that would help on out-of-period nonrecurring expenses, lobbying and the management question on rate of return, is that right? Is that the way I'm understanding this now?

MR. STONE: Yes, sir.

MR. HOLLAND: Let me add one thing, though, and one of the additional reasons that Mr. Bell is listed on Issue 38, is that he was involved in the audit process throughout the period of the various investigations and, in fact, participated to some extent and could address questions relative to management and how they handled the investigation.

COMMISSIONER GUNTER: Okay. I just needed to understand that, Mr. Bell. I apologize.

WITNESS BELL: That's fine.

COMMISSIONER GUNTER: It was sort of procedural before we got into at any point that I might want to inquire.

CROSS EXAMINATION

BY MR. BURGESS:

Q Mr. Bell, in some areas does Gulf employ a zero-based budgeting process?

A In some areas they do, yes.

Q And in other areas do they trend forward previously-
budgeted expenses?

A In some areas they do, that's correct.

Q In those areas where they zero-base budget, I want to ask a couple of questions, specifically, with regard to those.

Did you go back, or did you actually explore the reasonableness of the cost levels associated with the programs that were being built up in the zero-base process?

A In those areas that we looked at -- and I need to call your attention to the fact that we did look at every area we did attest of the Company's systems, -- in those that we did we looked at, you know, the reasonableness of what was developed, of course.

Q When you say you looked at some areas and not others, so there would be some areas in which the Company employed a zero-base system, and you looked at what you considered to be a sample that would give you what you needed in order to determine whether the process was a reasonable one, is that correct?

A We looked at a sample that really developed a level of comfort that the system worked as described, and then, you know, we worked from that level of comfort.

Q Okay. Would I be correct to say that you really couldn't attest to the reasonableness of the numbers budgeted under the zero-base process, unless you were able to explore and examine the reasonableness of each of the programs that were being built up under the zero-base process?

A Well, I don't think that's entirely true because I think, you know, when we undertake our work, we understand the business that the company is in and, of course, the programs are described in the budgeting process. And so I think we have several, what I would call reference points, to check on. So I don't believe that's entirely true. I think we do have a reasonable basis to determine whether those kind of programs make sense in light of the kind of business that the company is in.

Q Okay. Addressing specifically those areas that were budgeted on a zero-basis, or on a zero-base that you didn't look at specifically.

A Right.

Q Could I make the -- could I reasonably make the statement that you cannot attest to the reasonableness of the level of those particular areas?

A I don't believe so because, you know, we conducted an audit process, you know, a "audit process" on the Company's forecast. We got comfortable with the Company's systems and procedures and the integrity of that process to develop a system. We tested that, so we have a high level of confidence that we can say that, you know, the budgeting process was done in a reasonable manner, and it's appropriate for the purpose for which it is being used. So I think we have developed a high enough confidence level in our work to be satisfied that the budgeted does produce a reasonable result.

Q Well, on those areas that are zero-base budgeted, and that you did examine the specific programs to determine the reasonableness of the levels budgeted, what did you use to examine the reasonableness of those programs?

A What we do is in a particular program we look at -- you know, we go through the form where those programs are developed, we view what those programs are, and, you know, that they make sense in light of the business that the Company's in. And then, you know, you make sure that the cost meets what I call the reasonable and prudent standard test.

Q And how do you do that?

A Well, I mean there are people that actually undertake, you know, the work on the review,, you know, our professionals that are experienced in working in public utilities and understand the business they are in. If there is questions about it, you know, we go back to the individuals who develop the budget and say, "Okay, what is this for, what does this program do? What kind of support do you have for these costs?"

Q When you say the people that actually undertake the review, you're talking about your auditors?

A Arthur Andersen people, that's correct.

Q And they examine specific program costs for reasonableness?

A Right.

Q What do they do? What do they test it against? Is there anything other than -- excuse me.

You indicated that they have a certain amount of experience, if I can characterize it as such in this area. And so, therefore, that experience enables them to perform certain reasonableness tests. Is there anything beyond experience? Is there any --

A Oh, absolutely. If there is, for example, if a cost is just -- I mean, if a projected cost doesn't make sense, or it's not completely understood, then we go back to the individual who develops the information and say, "Well, what is this for, how did you get to this cost, does this make sense?"

Q So then you go back to the individual in Gulf Power Company --

A At Gulf Power.

Q -- who made the cost projection. And involve yourself in some type of interview where you examine the reasonableness?

A Exactly, and look at whatever support that individual would have for those costs.

Q So, then what you have to do to determine the reasonableness of the program-by-program buildup on the zero-based budgeting, is involve yourself in an exchange with the individuals who actually estimated the cost for particular programs?

A That would be correct.

Q And then would I understand correctly, that the ability of a particular individual to accurately estimate the cost of a future program would bear on the reasonableness of the estimate, of the estimated costs?

A Well, the ability and whatever support there may be, whether there are, you know, potential contracts or whatever.

Q Well, then if that is a factor in determining the reasonableness of the total buildup or the zero-base, wouldn't it be true that in the areas that you didn't deal with the individuals and, therefore, didn't get a feel for the individual's capability along those lines, that you would have less of an ability to understand or to judge the reasonableness of the total zero-base build up?

A No, I don't. Because again, we're testing the Company's process and the Company has a process through its budget committee which it critically reviews that report, so that process is reviewed by management at a higher level, at the budget committee level.

What we do in our review is on a test basis -- make sure that process works and that's why I come back to the confidence factor, that what we're doing is testing the process in developing a leve. of comfort with the process. We have developed a high level of comfort or confidence with the process, so that assures us in those areas that we don't review that it follows the management process.

For example, the budget committee -- those areas are critically reviewed, those people are required to support that and that gives us the confidence to report as we have on the forecast.

Q So when you say you have confidence in the reasonableness of the levels that have been budgeted in the zero-base system, that's based on your confidence in the Gulf Power people, to provide a system of budgeting rather than any confidence in the individual cost estimates of the programs themselves?

A Right. We're, our review --

Q Excuse me.

A -- is of the forecasting system, and in the test to make sure that forecasting system works and produces the results that it says it does.

COMMISSIONER EASLEY: Mr. Burgess, could I try?

MR. BURGESS: Sure.

COMMISSIONER EASLEY: Mr. Bell, in testing the process, and in going back to the employees that were the ones who in effect supplied the forecast, are there industry standards, any kind of tables that act as a sanity check against which you can verify percentages, numbers, whatever it takes to say, "X program budgeted at $3 million is within a range." Are there outside checks?

WITNESS BEll: What we do is not so much on programs, but from a overall perspective we take the sanity check on the forecast. For example, we look at, you know, the number of employees in the forecast versus, you know, the actual year, and a number of data like that to make sure that the forecast makes sense. It's your sanity check.

COMMISSIONER EASLEY: Okay. What I'm trying to get to is your sanity check of those numbers, does it include any generic industry information against which you're making that sanity check?

WITNESS BELL: It does on a macro basis, but not down to a program level. Because --

COMMISSIONER EASLEY: But there is available on a macro basis such guidelines, if you will?

WITNESS BELL: Well, yeah, like, you know, customers per employee and things like that.

COMMISSIONER EASLEY: On the areas where you do examine in depth, do you check them against those guidelines?

WITNESS BELL: On the program level there really are no industry standards. When you get down to a specific program, let's say like a program within the marketing area, there really are no industry standards in those areas. So that information is not available.

COMMISSIONER EASLEY: Maybe "standards" is the wrong word. Experience, perhaps. Is there anybody that says electric utilities tend to spend on conservation programs $300 per employee, or $1,200 per customer, or something like that floating around?

WITNESS BELL: I have not seen down to that level of detail, that there and more, you know, employees per customers, things like that level.

COMMISSIONER EASLEY: Okay. So it's really --

WITNESS BELL: -- it's more a macro.

COMMISSIONER EASLEY: I'm looking for information apparently nobody's developed.

WITNESS BELL: Not that we would be comfortable that it would be reliable enough to make some reasonable --

COMMISSIONER EASLEY: Well, then ,how when you look at these, if Gulf people tell you that program X, whatever it is you've decided to look at, and when I say program I'm including whatever function, whether it's a relationship of employees to customers, or whatever it is that you're looking at, that the cost, projected cost is $5 million. Outside of the fact that it doesn't sound very high, what do you use for measure it against?

WITNESS BELL: Well, you know, for example, if you take -- let me just give you a example like turbine and boiler maintenance. I mean, there is support for those estimates in the projects. They have outside engineering firms, you know, give them estimates to support how much it's going to cost to do, you know, that specific piece of maintenance, so I mean, you know, that's the kind of thing that you look at. In that example.

COMMISSIONER EASLEY: Thank you.

Q (By Mr. Burgess) Mr. Bell, moving on to the items that are trended from a previous budget, is your performance or your activity very similar; that is, that you would actually go back through and look at the previous budget in some areas, in some depth and then, perhaps, past somewhat on the reasonableness of that, and then involve yourself in the process?

A It would be similar, yes.

Q And would it be true that there would be some of the areas of the budget that are trended, that you haven't taken that same depth and gone back and reviewed the previous budget to determine specifically its reasonableness and pass judgment on that?

A That's correct. But again, I want to point out we develop a confidence level with the process, and it's a very high confidence level, and that what we rely on.

Q But again there, you explore some in depth and some you would attest to the reasonableness, but it would be more on the grounds of your confidence in the process --

A Right.

Q -- rather than looking at the reasonableness of the numbers themselves?

A Well, you do both. You step back when you're done with the forecast and look at the reasonableness of the results and make sure it makes sense.

Q What would you use to look at that?

A Well, you would use a number, what I call macro benchmark. You make sure that kilowatt hours per customer, you know, tie into prior-year trends. You compare it to prior year trends, basically, and make sure it's in the context of prior-year trends.

Q So at that point you're talking about ultimate macro; that is total company?

A Right, the total company basis. That it makes the number of employees make sense, given, you know, the prior years and what the new programs are.

Q Do you have a -- what would be the approximate number of, or percentage of, programs that you would have looked back into in the depth in which you're actually examining the reasonableness of the previous budget versus those at which you gain confidence because you believed in the budgeting process?

A Let me -- you're asking how many specific programs we tested in detail?

Q Yes.

A Let me just -- (Pause). We did about 25%.

Q Okay. And on the zero-base budgeting?

A That would be overall.

Q Overall.

A Zero, I don't have the number for what it would have been.

MR. BURGESS: Thank you, Mr. Bell, that's all we have.

MS. RULE: Staff has no questions.

COMMISSIONER EASLEY: Major?

MAJOR ENDERS: I have no questions.

COMMISSIONER EASLEY: While you all are looking, let me ask a "curiosity question," as Commissioner Gunter would say.

Mr. Bell, are you familiar with the terms "rational" versus "incremental" budgeting?

WITNESS BELL: I'm familiar with incremental budgeting; I'm not familiar with the term "rational."

COMMISSIONER EASLEY: Okay. That took care of that very quickly. Thank you.

COMMISSIONER BEARD: Mr. Bell, on Page 26 of your direct testimony, Lines 20, 21 and 22 there, "The 1990 forecast represents an accurate simulation of the financial results which should occur if key assumptions proved true."

WITNESS BELL: Yes, sir.

COMMISSIONER BEARD: So your audit, in essence, is based on key assumptions?

WITNESS BELL: Yes, sir.

COMMISSIONER BEARD: Okay. And those key assumptions depends, obviously, on the person making them can change and, obviously, future events can affect their accuracy, right?

WITNESS BELL: Yes, sir.

COMMISSIONER BEARD: Okay. Thanks.

CHAIRMAN WILSON: Redirect?

MR. STONE: None. We have no redirect of this witness.

CHAIRMAN WILSON: All right. Exhibits have been stipulated?

MR. STONE: That is correct.

CHAIRMAN WILSON: All right, sir, thank you very much, you may be excused.

(Witness Bell excused.)

CHAIRMAN WILSON: Let's take a 10-minute break and then we'll take the next witness..

(Brief recess.)

- - - - - -

(Hearing reconvened at 10:40 a.m.)

COMMISSIONER GUNTER: Let's get started.

MR. HOLLAND: Commissioner, Mr. McMillan is our next witness, and I do not believe he has been sworn.

COMMISSIONER GUNTER: Raise your right hand.

RICHARD J. McMILLAN

was called as a witness on behalf of Gulf Power Company and, after being first duly sworn, testified as follows:

MR. HOLLAND: There is one preliminary matter before we put Mr. McMillan on that needs to be taken care of with respect to the Prehearing Order. We noted in going back through the Order that four schedules attached to his direct testimony had not been pre-marked. We need to get numbers for those.

COMMISSIONER GUNTER: All right.

MR. HOLLAND: If you will look at his first schedule to his direct testimony, the second page, Schedule 16 through 19 have not been pre-numbered.

COMMISSIONER GUNTER: All right. We've got everything up to Schedule 16, is that correct?

MR. HOLLAND: Yes, sir.

COMMISSIONER GUNTER: What's that next number, Mr. Pruitt?

MR. PRUITT: 566.

COMMISSIONER GUNTER: Have you all been numbering them individually?

MR. HOLLAND: We should. That's how we've been doing it.

COMMISSIONER GUNTER: All right. 567, was that right?

MR. PRUITT: 566.

COMMISSIONER GUNTER: I've already got -- okay, 566 would be Schedule 16, 567 would be 17, 568 Schedule 18 and 569 would be Schedule 19.

DIRECT EXAMINATION

BY MR. HOLLAND:

Q Mr. McMillan, would you state your name and your business address, your position with Gulf Power Company?

A My name is Richard J. McMillan, my business address is 500 Bayfront Parkway, and my title is Supervisor of Financial Planning.

Q Mr. McMillan, have you filed testimony in this docket entitled, "Direct Testimony of Richard J. McMillan?"

A Yes, I have.

Q Do you have any corrections to that testimony?

A No, I do not.

Q If I were to ask you the questions today contained in that testimony, would your answers be the same?

A Yes, they would.

MR. HOLLAND: Mr. Chairman, we'd ask Mr. McMillan's prefiled testimony be inserted into the record as though read.

COMMISSIONER GUNTER: It will be inserted into the record as though read.

MR. HOLLAND: As I stated earlier, his

exhibits, I think all of his exhibits have been stipulated to.

COMMISSIONER EASLEY: Including those four?

MR. HOLLAND: Including those four, I believe.

(Exhibit Nos. 49 through 63 previously stipulated into the record.)

(Exhibit Nos. 566 through 569 marked for identification)

GULF POWER COMPANY

Before The Florida Public Service Commission
Direct Testimony of
Richard J. McMillan
In Support of Rate Relief
Docket No. 891345-EI
Date of Filing December 15, 1989

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

A. Richard J. McMillan, 500 Bayfront Parkway, Pensacola, Florida, 32501.

Q. **Please describe your educational and professional background.**

A. I graduated from Louisiana State University in 1976 with a Bachelor of Science Degree in Accounting. Immediately following graduation, I was employed by Gulf Power Company as an Internal Auditor. I have held various accounting positions, including Staff Internal Auditor, Staff Financial Analyst, Staff Accountant, Coordinator of Internal Accounting Controls, and in July 1982, I was promoted to my current position as Supervisor of Financial Planning. During my employment, I graduated from the University of West Florida in 1983 with a Master of Science Degree in Business Administration.

Q. **Briefly describe your duties and responsibilities as**

Supervisor of Financial Planning.

A. I am respc .sible for preparing the Company Operating Budget and Forecast, administering the Capital Additions Budget, preparing various regulatory reports such as the FPSC Surveillance Report, rate relief studies and filings, and preparing or assisting with various financial analyses and reports for management and outside parties.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present Gulf's financial forecast, which is the basis of the projected data for the 1990 test period, and to develop the test year rate base, net operating income (NOI), and cost of capital, and to calculate the resulting revenue deficiency which the Company is currently identifying in this filing. In addition, I will support the calculation of the Unit Power Sales amounts which were directly allocated to that jurisdiction.

Q. Have you prepared an exhibit that contains information to which you will refer in your testimony?

A. Yes.

Counsel: We ask that Mr. McMillan's Exhibit, comprised of 19 Schedules, be marked for identification as Exhibit 49-63 (RJM-1)

Q. Were all of the schedules in this exhibit prepared under your supervision?

A. Yes.

Q. Are you also the sponsor of certain Minimum Filing Requirements (MFRs)?

A. Yes. These are listed on Schedule 19 at the end of my exhibit.

Q. Mr. McMillan, you have indicated that you will present and support the financial forecast used in developing the 1990 test year data. Please explain what you are supporting in this filing.

A. As noted by Mr. Gilbert in his overview of Gulf's planning and budgeting process, there are eight component budgets which are prepared outside of my area and are supported by other witnesses in this proceeding. These component budgets are noted on Mr. Gilbert's Schedule 1, and the responsible witness is specified for each. I am supporting how the outputs from these component budgets were utilized, in conjunction with other information and data, to develop the Company's financial forecast and Annual Operating Budget, which I have used in developing the Company's 1990 test year rate base, net operating income, and capital structure.

Q. **Please explain how the financial forecast was developed.**

A. The outputs from Gulf's budgeting process, comprising the eight component budgets, are formatted and tailored in a manner to facilitate their input into the financial model, along with various other income statement and balance sheet amounts, which in turn generates the financial and accounting statements that comprise Gulf's financial forecast.

Q. **What is the financial model to which you have referred?**

A. The financial model is a computer-based model that simulates Gulf's actual financial and accounting results based on a given set of inputs. This model enables management to evaluate the effect of various operating alternatives and to generate financial statements for a given set of assumptions. Gulf's Annual Operating Budget is produced by the financial model based upon the outputs of Gulf's budgeting process. Schedule 1 is a summarized flowchart of the financial model inputs and outputs required in producing the financial forecast.

Q. Please describe Schedules 2 and 3.

A. Schedule 2 is Gulf's 1989 and 1990 projected Balance Sheets, which are the basis for developing the rate base and capital structure. Schedule 3 is the 1989 and 1990 Income Statements used in developing net operating income. These financial statements from the financial model are based on Gulf's 1990 Budget, which is based on actual data through August 1989, and the current budget estimates for September 1989 forward.

Q. You have summarized utility plant data on your Schedule 2. Have you prepared a report with a further breakdown of the plant balances?

A. Yes. Schedule 4 includes a further breakdown of the utility plant balances by FERC account, along with the monthly activity in these accounts. The projected plant data is based on the October 1989 Capital Additions Budget which is supported by various witnesses, as noted on Mr. Gilbert's

Schedule 2.

Q. Have you prepared a schedule which shows the derivation of rate base?

A. Yes. Schedule 5, entitled "13-Month Average Rate Base for the Period Ended December 31, 1990," reflects Gulf's 1990 test year rate base. Column one includes the 1990 budget data I previously presented on Schedules 2 and 4. The second column includes the regulatory adjustments required in order to restate the system or per books amounts to the proper basis for computing base rate revenue requirements. The third column includes the Unit Power Sales (UPS) adjustments which I will address in more detail later. The resulting net amounts have been jurisdictionalized by Mr. O'Sheasy in the cost of service study filed in this case.

Q. Please explain the rate base regulatory adjustments in column 2 of Schedule 5.

A. These adjustments are listed on page 2 of the schedule. Adjustments 1 and 2 were made to remove the utility plant investments which have been allocated to our Appliance Sales and Service function. These non utility amounts are based on an annual study conducted by the Plant Accounting Department and are primarily comprised of the building space, office furniture and transportation equipment utilized in the Appliance Sales and Service function. Adjustment 3 is for the removal of amounts in rate base arising out of several Company and other investigations into improprieties related to charges for transformers and their repair. Adjustment 4 is for the removal of the interest bearing construction work in progress (CWIP) included in the forecast. Since these projects are eligible for Allowance for Funds Used During Construction (AFUDC), they have been removed from rate base, and are listed on Schedule 6. Adjustment 5 includes the working capital adjustments, which are included on Schedule 7.

Q. Please explain Schedule 7, entitled "13-Month Average Working Capital for the Period Ended December 31, 1990."

A. As shown on this schedule, all items on the balance sheet which are not included in Net Utility Plant or Capital Structure were considered in developing working capital. All of the remaining accounts were examined, and I have excluded the amounts related to the non utility operations, fuel accounts, and accounts which earn or incur interest charges. The resulting total adjusted working capital was then allocated to the retail, Unit Power Sales (UPS), and other jurisdictions by Mr. O'Sheasy, with the exception of the UPS fuel stock, materials and supplies, and prepayments, which were calculated and directly assigned to UPS.

Q. **Before leaving the area of rate base, were there any adjustments made to rate base in the 1984 rate case that you are not making in this case?**

A. Yes. First, there were several adjustments related to forecast revisions which are not necessary in this case. Second, the adjustment to remove the Plant Daniel Rail Cars is no longer necessary since these cars have been retired and the current rail cars are being leased. Third, the minor adjustments to exclude a portion of the Bonifay and Graceville Commercial Offices have not been made. These contruction costs will be discussed in this filing by Mr. Conner. Fourth, the adjustment to disallow the investment related to the Leisure Lakes Subdivision has not been made. As discussed by Mr. Jordan, a large portion has been sold, and the remaining substation is used and useful electric investment and will remain so. The fifth adjustment not made concerns the unamortized rate case expenses related to this rate filing. This is a legitimate rate base item, and the Company should be allowed to recover these costs in full. The final item is the inclusion of the deferred credit related to the fuel and conservation over-recoveries in rate base, on which interest is paid, and should therefore be excluded from working capital. (The Commission adjustments not made are listed on MFR A-11.)

Q. Now moving to Net Operating Income (NOI), please explain Schedule 8 entitled "Net Operating Income for the Twelve Months Ended December 31, 1990."

A. This schedule is formatted in the same manner as the rate base schedule. The first column is based on the 1990 budget data from Schedule 3. The second column includes the regulatory adjustments, while the third column includes the UPS amounts. The jurisdictional factors and amounts were obtained from Mr. O'Sheasy's Exhibit. The regulatory adjustments in column two are listed on pages 2 and 3 of Schedule 8, with more detailed calculations presented on separate schedules as noted under the heading of Schedule Reference. As noted earlier, I will discuss the UPS adjustments and calculations later in my testimony.

Q. **Have you made the proper adjustments to remove all fuel and conservation revenues and expenses from NOI?**

A. Yes. As noted on pages 2 and 3 of Schedule 8, the fuel adjustments are 1, 4, and 5, and the conservation adjustments are 2, 10, and 13. Since these revenues and expenses are recoverable through the Fuel and Conservation Cost Recovery Clauses, they must be removed from NOI when determining base rate revenue requirements. The calculation of these adjustments is summarized on Schedules 9 and 10.

Q. **Please explain adjustments 3 and 14 on Schedule 8.**

A. These adjustments are necessary to eliminate county and municipal franchise fee revenues and expenses from consideration in setting base rates. As required by Commission Order 6650 in Docket No. 74437-EU, franchise fees are added directly to the county or municipal customer's bill and are not considered in determining base rate revenue requirements. The county and municipal franchise fee revenues which have been eliminated are shown on a separate line of the financial model income statement as reflected on my Schedule 3, page 11 of 16.

Q. **How have you treated industry association dues and institutional advertising?**

A. Although the Company feels that these costs are legitimate utility business expenses, in accordance with the current Commission policy to disallow institutional advertising and dues related to Chambers of Commerce and lobbying, I have removed these expenses from NOI in adjustments 6 and 7 on Schedule 8. Schedule 11 includes a listing by association of the dues related to the local Chambers of Commerce and groups affiliated with lobbying activities. Schedule 12 includes the compilation of institutional advertising by FERC account and sub-account number.

Q. **Please explain adjustment 8 related to marketing support activities and adjustment 9 related to investigation expenses.**

A. Expenses related to marketing support activities have been removed in adjustment 8, in accordance with the Commission's policy to disallow expenses that are promotional in nature as stated in Commission Order 6463. Adjustment 9 was made to remove all of the legal expenses associated with the investigations of alleged improprieties within the Company.

Q. Please explain adjustment 11 titled Peabody Equity Return on Schedule 8.

A. This adjustment is necessary to properly exclude from NOI the equity return related to our Peabody coal prepayment. All amounts related to this transaction have been removed from this case because these costs are being recovered in the Fuel Cost Recovery Clause in accordance with Commission Order 20133 in Docket No. 880001-EI. The total amount in the forecast has been eliminated through this adjustment and can be verified to my Schedule 3, page 13 of 16.

Q. Please explain your adjustment to Taxes Other Than Income?

A. Adjustment 15 on Schedule 8 is required to reflect the gross receipts taxes and FPSC assessment fees that are associated with the fuel, conservation, and franchise fee revenues which were removed in adjustments 1, 2, and 3. Schedule 13 shows the calculation of this adjustment.

Q. Please explain adjustment 16 on Schedule 3 to income taxes.

A. This adjustment is required to reflect the federal and state income taxes related to adjustments 1 through 15. Schedule 14 shows the calculation of the adjustment.

Q. Have you calculated the appropriate adjustment to income taxes to reflect the synchronized interest expense related to the jurisdictional adjusted rate base?

A. Yes. Adjustment 17 on Schedule 8 reflects the tax effect of synchronizing interest expense to rate base, and Schedule 15 shows the calculation of this adjustment. The jurisdictional capitalization amounts and cost rates were taken directly from Schedule 16, and the interest expense was taken from Schedule 3. As shown on Schedule 15, I have also included the imputed interest for Job Development Investment Tax Credits (JDITC) in accordance with the final IRS regulations allowing interest synchronization for JDITC.

Q. Do you have anything further to add to your discussion of how NOI was developed?

A. Yes. I would like to point out that the Company has made all the Commission adjustments made in our 1984 rate case except for those related to forecast corrections, benchmark O & M adjustments, and the area and economic development expenses. Mr. Bowers will address the appropriateness of our area and economic development expenses, and how they contribute to the Company's objective of minimizing the cost of service and revenue requirements of all our customers. The other operation and maintenance expenses are justified and supported by several witnesses in this case as noted on Mr. Gilbert's Schedule 3.

Q. Have you also developed the jurisdictional capital structure and cost of capital for the 1990 test year?

A. Yes. Schedule 16, page 1, shows the jurisdictional 13-month average amounts of each class of capital for the year ended December 31, 1990. It also shows the average cost rates and weighted cost components for each class of capital. Page 2 of this schedule shows how the jurisdictional capital structure was derived starting with the system amounts. Pages 3 and 4 show the calculation of the cost rates for long-term debt and preferred stock.

Q. How were the cost rates for short-term debt, customer deposits, and investment tax credits determined?

A. The short-term interest rates were based on the

October 1989 Data Resources, Inc. forecast of interest rates; the customer deposit cost rate was based on the effective rate for the period ending August 31, 1989; and the weighted cost for investment tax credits was calculated in accordance with current IRS regulations using the three main sources of capital.

Q. **Please explain how the jurisdictional capital structure was developed.**

A. As shown on page 2 of Schedule 16, I started with the 13-month average total company capital structure by class of capital. These total company amounts were calculated based on the projected balances on Schedule 2 of my exhibit. In columns 2 through 7, I have identified six adjustments which were removed from specific classes of capital, and the remaining adjustments required to reconcile rate base and capital structure were made on a prorata basis as shown in columns 10 and 11.

Q. **Would you explain the six items for which you have made specific capital structure adjustments?**

A. The first two, the "common dividends declared" and the "unamortized debt premiums, discounts, issuing expenses and losses on reacquired debt," are account specific and have been directly assigned to the common stock and long-term debt classes of capital. The next two, the "Daniel Coal Buyout" and the "Peabody Prepayment" financings, reflect the specific debt and equity funds used in these transactions, and subsequently approved by the Commission for recovery through the Fuel Cost Recovery Clause. The fifth item is for removing the non utility amounts from the three main sources of capital, and the sixth item is to remove the UPS capital structure amounts.

Q. **Please elaborate on the basis of the non utility and UPS capital structure adjustments.**

A. The non utility adjustment was removed from long-term debt, preferred stock, and common equity as a reasonable proxy for the pool of funds used in these activities. The rationale and justification for treating Gulf's non utility investments in this manner are discussed more thoroughly by Mr. Scarbrough and Dr. Morin in their testimony. The UPS capital structure adjustments are based on the debt, preferred, deferred taxes, and common equity that is recovered from UPS customers in those contracts.

Q. Does this conclude your discussion of how you developed the requested Cost of Capital?

A. Yes. These calculations result in an overall rate of return of 8.34 percent based on a requested return on equity of 13 percent, which is supported in the testimony of Dr. Morin.

Q. Have you calculated the jurisdictional revenue deficiency for the test period brought about by the difference in Gulf's achieved jurisdictional rate of return of 6.60 percent and the proposed rate of return of 8.34 percent?

A. Yes. The revenue deficiency is $26,295,000, as calculated on Schedule 17, which references the schedule where each figure was derived. Schedule 18 shows the calculation of the NOI multiplier.

Q. You have previously mentioned that you are supporting the UPS calculations that have been used in developing rate base, NOI, and capital structure in this filing. Would you explain how these amounts were calculated?

A. The UPS amounts, which have been identified on Schedules 5, 8, and 16, were computed in exactly the same manner as the amounts allowed in our 1984 rate case. The rate base and NOI amounts were calculated by applying the UPS sales ratio times the total Scherer related amounts. The sales ratio for production-related items in 1990 is based on 149 mw of Scherer UPS divided by 212.175 mw Scherer IIC system peak-hour capacity rating. The transmission sales ratio is based on transmission investment and expenses recovered from the UPS customer per the contracts. The general plant investment and A & G expenses were allocated to Plant Scherer and the transmission function based on salaries and wages, and then allocated to UPS based on the UPS sales ratios in accordance with the UPS contracts.

The resulting UPS adjustments are essentially all of the investment and expenses which are recovered from the UPS customers per the contracts, with the exception of three reporting differences, which are due to retail ratemaking requirements. The first difference is due to the UPS contracts utilizing month-end balances for investment, which results in a slight difference due to twelve month average versus thirteen month average investments. Second, the working capital in the UPS contracts includes materials and supplies, prepayments, and one-eighth of UPS O & M expenses. For retail ratemaking purposes, the Florida Commission requires the use of the balance sheet approach for determining working capital; therefore, the working capital for all jurisdictions (including UPS and wholesale) must be based upon the balance sheet approach in order to reflect the proper retail working capital requirements. The third difference between the UPS contracts and the UPS amounts reported in this filing is the inclusion of the unamortized JDITC in the capital structure, as required by this Commission. As stated above, these minor reporting differences are the result of retail ratemaking requirements, and are required in order to ensure that the UPS adjustments are calculated using the same methodology as the system or company totals from which they are being removed.

Q. How have you treated the 1989 Federal Energy Regulatory Commission's (FERC) Audit Exceptions in the development of the test year amounts?

A. The exceptions in the FERC Audit which the company concurred with have been properly reflected in the 1990 projections, but there are several material issues or audit exceptions which have not been resolved at the time of this filing. Therefore, we will furnish the Commission with any adjustments to my calculations which may be required upon the resolution o. these issues.

Q. Does this conclude your testimony?

A. Yes.

(End of Prefiled Direct Testimony)

Q (By Mr. Holland) Mr. McMillan, have you prepared a summary of your testimony?

A Yes.

Q Please summarize.

A The purpose of my testimony is to present and support Gulf's 1992 financial forecast. This forecast was used in preparing the 1990 test year amounts. I have also developed the jurisdictional rate base, NOI, cost of capital and revenue requirements as supported in my prefiled exhibits.

I'm also supporting the amounts allocated to the unit power sales jurisdiction. The retail revenue deficiency of $26,295,000, which I have calculated, is required to enable the Company to earn a 13% ROE, or return on equity, on its retail investments.

Based upon Dr. Morin's updated cost of equity to 13.5%, this would increase my retail revenue deficiency calculations by $2,562,000. This concludes my summary.

MR. HOLLAND: Tender Mr. McMillan for cross examination.

COMMISSIONER GUNTER: Mr. Burgess.

MR. BURGESS: Yes, sir.

CROSS EXAMINATION

BY MR. BURGESS:

Q Mr. McMillan, with regard to Issue 2, plant in service, are you aware -- are you familiar with Mr. Larkin's testimony on plant in service?

A Yes, I am.

Q Has he used actual for the first three months of the projected test year?

A Hold on one second. I think it was just through February.

Q Is December the first month of the 13-month average?

A Yes, through February of '90, that's correct.

Q So that would be the first three months?

A That's correct.

Q Have you examined his projections for the following two months, that is the fourth and fifth month of the test year, as it would compare to the actuals that have come in?

A His exhibits did not include a monthly breakdown of his estimates, but we went back and trended the figures based on the period that he defined. And as I stated in my -- really it's stated more completely in my rebuttal testimony, there were some major -- two refunds related to Scherer, Unit 3, and common facilities when making those adjustments of roughly $6 million, and there were one or two retirements that were booked early.

Other than that, we are essentially on budget. We agree with the forecast that we filed. His numbers are significantly understated by going back and using a prior 24-month period, which included some other large reductions in our plant in service that are nonrecurring in nature, such as the coal car retirements, et cetera.

Q Are you saying in response to my question, then, that you do not know what he budgeted or what he projected for the fourth and fifth month?

A Hold on a second. (Pause) I stand corrected. He did have an exhibit, HL-3, that showed some monthly estimates. (Pause)

Now, what was your specific question? You want me to compare actual to the numbers that he had in his exhibits?

Q For the month of March.

A We are showing approximately a $2,000 difference.

Q Okay, and for the month of April?

A Roughly about the same. We're pretty close to his figure. It's around $2,000 over his figure.

Q You're saying the actuals are coming in --

A Above his estimate, right.

Q By $2,000?

A Right. I'm sorry, $2 million.

Q And you said something before that in a previous answer; you said something about a correction that you had made as a result of a nonrecurring item. Would you please explain what you were referring to?

A As far as why his trend is too low?

Q You had -- specifically with regard to an answer you gave earlier.

A Right.

Q You said -- first you referred to an item regarding Scherer.

A That's correct.

Q Okay. Would you break that down for me please and tell me specifically what you are referring to?

A The Scherer piece?

Q Yes.

A Roughly, and I can't give you exact numbers, but basically you're looking at a $5.3 million adjustment to plant in service related to the renegotiated price for Unit 3 that we paid Georgia Power. They refunded us some dollars, of which those adjustments are also reflected in, I think, Issue 3 in the Prehearing Order. The remainder, there was about a million-three or four on deferred taxes, but plant in service figure actually was 5.3 million.

Then there was an additional adjustment related to our common facilities. Based on an SCS audit, we determined that there was a slight overcharge from OPC related to the common facilities, and that resulted in roughly a $630,000 reduction to plant in service related to Scherer also. So that the sum of those two, that's what I said was approximately $6 million.

Q Okay. And so what you're saying is your numbers -- your numbers -- were above the amounts actually coming in, but since you've made those adjustments, if you put those adjustments then back into your numbers, you're coming in as you would expect relative to your projections?

A That's correct.

Q Can you tell me for the month of March what your projection was relative to the actual that came in?

A Okay. Based on a March budget-to-actual, what do you want me to compare, just the plant in service amount?

Q Yes, please.

A The plant and service amount that we filed was $11.7 million over our actual March, which roughly 6 million of that was related to Scherer, an additional od$4 million was related to some retirements that were strictly a timing deal that hit earlier than what we had included in the forecast, and really that affects both plant in service and accumulated depreciation. So your net plant in effect, is zero.

And then there was a roughly 2 million, $2.6 million, worth of projects that had not cleared as of March, which a large portion of that is in CWIP, noninterest-bearing CWIP. So when you're doing your plant analysis, you really need to look at all components that affect the rate base, not what the variance is in just plant in service.

Q The timing question is one that you examine in projecting the plant in service balances by month for the projected test year, isn't it?

A Yes.

Q And that's one of the considerations you have to deal with in determining your projections?

A Yes, obviously. I mean, as I stated earlier, we are only about a million and a half under budget on construction expenditures. And that was directly a timing thing. We just closed our books for May and we are actually over budget, when we stated in my rebuttal testimony that we did know there were several production projects, that there was a couple months' delay, and we do know for sure that all those ha·e been caught up, and, in fact, we are over budget for the month of May.

So you start picking little, you know, small variances, and you try to make some adjustment in one piece. You need to look at the CWIP. See, he didn't make any adjustments to our CWIP, he just tried to adjust plant in service. And I'm saying that's inappropriate, because the monies have been spent and would be included in rate base, whether I've got it in plant in service or noninterest-bearing CWIP.

Q With regard to Issue 16, the working capital for UPS sales, if the Commission removes Plant Scherer, Gulf's share of Plant Scherer, from the jurisdictional rate base, would there be a certain amount of working capital associated with that, with the operations of Plant Scherer?

A That could be directly attributable to Plant Scherer?

Q Yes.

A Yes, that would be the fuel stockpile, obviously, and the other materials and supplies at the plant would be the primary dollars.

Q Is there a working capital component that's calculated into the UPS rate that's charged, or your off-systems sales are charged?

A To the UPS customer?

Q Yes.

A Yes, there is.

Q Is that based on a formula one-eighth O&M?

A A component of that is, the component we call cash working capital component, which would be, essentially, the UPS customer pays for their allocated percent of fuel stockpile, the other materials and supplies, prepayments, which are not very material but there's some deposits involved, and the remainder is what in the UPS contracts is considered cash working capital, which is based on a formula one-eighth O&M calculation.

Q Is there any reduction as a result of any credits associated with income tax, accrued income taxes, anything like that, or does that -- is your description all-inclusive of the working capital component that's determined for the UPS sales?

A Well, that description would be the total amount of working capital. You take one-eighth of the O&M, including the fuel burn at the base unit, and that's why --

You know, one of the things that causes that calculation to be volatile is it's not all fuel burn, it's just the fuel burn out of the base unit. So to the extent that they're not taking base energy, you can go from a very small amount of working capital to a large amount, as far as the billings to UPS.

And, obviously, we have done the working capital in this case for UPS related to the balance sheet approach, which that's what this Commission requires and what was approved in our last case, and is the only appropriate method to calculate the UPS jurisdiction because that's what the system calculations are based on is a balance sheet. You can't pick and choose what you're going to pull out of each column.

Q So what you're saying is if the Commission did remove it, that even though FERC jurisdiction would calculate it on a one-eighth, it would be more appropriate to move it on a balance sheet basis.

A In the retail calculations, absolutely. If you want me to calculate retail on a one-eighth, I can assure you, we did some quick calculations, that the retail working capital requirement is increased by over $40 million.

Q If you want me to calculate -- I'm just trying to understand the theory by which you would remove working capital component if the Commission disallows the Scherer plant.

A To me it would be the amounts related to the fuel stockpile, and the other materiels and supplies would essenti.ily make up the working capital that would be related to Scherer, the 63 megawatts that's out there.

MR. BURGESS: Thank you, Mr. McMillan, that's all we have.

COMMISSIONER GUNTER: Staff?

MS. RULE: Major Enders.

COMMISSIONER GUNTER: Excuse me, Major. I apologize.

MAJOR ENDERS: Nothing.

COMMISSIONER GUNTER: Staff?

CROSS EXAMINATION

BY MS. RULE:

Q Mr. McMillan, I would like for you, if you could, for you to prepare a late-filed exhibit comparing budget-to-actual plant in service, CWIP noninterest-bearing and accumulated depreciation.

MS. RULE: What number would be that be? Would it be Late-Filed 570?

Mr. Pruitt, is that correct, Late-Filed 570?

MR. PRUITT: 570.

Q (By Ms. Rule) And I would like you to use the same format as you used in your late-filed deposition Exhibit No. 5 in Public Counsel's deposition. Do you remember that one?

A Yes. That was done through February, if I remember correctly.

Q I believe that's correct.

COMMISSIONER GUNTER: Give me a short title for that.

MS. RULE: I'll give you a title. It's not that short.

"Comparison of Budgeted to Actual Plant In Service, CWIP Noninterest-Bearing and Accumulated Depreciation."

COMMISSIONER EASLEY: Period of time.

MS. RULE: Pardon me?

COMMISSIONER GUNTER: Period of time.

MS. RULE: I would like Mr. McMillan to use May 1990 instead of February 1990 figures as he used in the late-filed deposition exhibit.

COMMISSIONER GUNTER: All right.

(Late-Filed Exhibit No. 570 identified.)

Q Mr. McMillan do you have an exhibit packet in front of you that Staff has provided? I believe I see it at Counsel table.

A I have one now.

Q Thank you. Exhibit 431, which should be in that exhibit packet, do you have that?

A Yes, I do.

Q Part One of the Response to Interrogatory No. 88 contained in that exhibit shows a credit to accumulated deferred income taxes of $1,587,608, as part of the adjustment to record cash received from Georgia Power per reduction of the selling price for Scherer 3, is that correct?

A Yes.

Q Why is this amount different from the amount included for accumulated deferred income taxes as shown in Gulf's position on Issue 3?

A That figure, along with the accumulated depreciation and deferred tax amounts, will change because of the monthly amortization or your actual depreciation that we had in the budget based on the inflated price. And as you depreciate the plant with the higher number, obviously, you had more accumulated depreciation and it actually decreases this deferred tax amount as it's recorded on the books and recognized on the books.

So we have a schedule. We, basically, that

1-5-87 was as of December '89, and we went on ahead and computed what the impact of that would have been to have gone ahead through the end of 1990, the test period, and figured out what the 13-month average amount that was included in our forecast related to those amounts.

Q So this is for the end of '90?

A It's the 13-month average amount that would have been reflected in our '90 projections.

Q Are there any deferred taxes or investment tax credits associated with the acquisition adjustment recorded as a result of the purchase of a portion of the common facilities at Scherer?

A I don't believe there were any. These deferred taxes on the Unit 3 were related to the construction overheads, and there were none of those transferred from OPC in Dalton, so there were none. It was strictly an adjustment to plant-in-service and a small amount related to plant acquisition.

Q Did the refund that Gulf received in 1989 from Oglethorpe Power, related to the Scherer common facility purpose, have any effect on deferred taxes or ITCs?

A Well, obviously, over time it could, as your book tax timing differences related to depreciation.

But as of -- when we made this entry, there were no deferred taxes related to that refund.

Q If Scherer Unit 3 is excluded from rate base, it will be necessary to remove associated deferred taxes and ITCs, won't it?

A Yes. It should be.

Q I'd like you to refer to Exhibit 432, which should also be in your exhibit packet.

A I have that.

Q I'd like you to look at the second page, which contains a schedule showing operating expenses related to Plant Scherer in '89 and '90, and shows the 1990 jurisdictional ITC amortization of $96,000.

A Yes, that's the jurisdictional amount, right.

Q Has the tax expense in Gulf's filing been adjusted for this amount?

A The amortization ITC is a deduction. I mean, it's really not taxable per se. It's not a deductible item, so it would not be.

Q Okay. Gulf has projected working capital of $81,711,000, is that correct?

A That's correct. That's the jurisdictional amount, right.

Q Are you familiar with Mr. Larkin's testimony in which we recommends removal of deferred credit balances of certain expenses that OPC recommends exclusion?

A Yes.

Q If an adjustment is made by the Commission to remove certain expenses from operating income, such as supplemental pensions, post-retirement life and medical insurance, school plan appliances or Productivity Improvement Plan, would it be appropriate to remove the reserves associated with those expenses from working capital?

A I would assume it would be because we would be going back to a pay-as-you-go situation, so --

Q Gulf reduced expenses related to its Productivity Improvement Plan by $339,407 jurisdictional, and I believe that's reflected in Issue 92. Did Gulf reduce the reserve?

A I'm sorry, I didn't hear that question.

Q Okay. I believe in Issue 92, we find that Gulf reduced expenses relating to the Productivity Improvement Plan by $339,407.

A In the Prehearing Order? Where we've agreed to that, yes.

Q Did Gulf reduce the reserve?

A It has not been reduced, no.

Q What would the appropriate system and

jurisdictional adjustment to working capital be, if any?

A I'd have to calculate that.

Q Could you provide that in a late-filed exhibit?

A Yes, I could.

MS. RULE: I believe that would be Late-Filed Exhibit No. 571. System and Jurisdictional Adjustment To Working Capital Relating to PIP Reduction.

(Late-Filed Exhibit No. 571 identified.)

Q (By Ms. Rule) Mr. McMillan, is it correct that most of the proposed adjustments to rate base would also affect deferred taxes and also affect ITCs?

A Yeah, you could usually make that -- any of the plant-related adjustments would have some impact.

Q And would there be effects on both balance sheet accounts and income statement accounts?

A I don't know. Typically, what this Commission has done, and we've agreed is the only thing that makes sense, is to treat all funds as fungible and just make the adjustments on a pro rata basis, which, in effect, allocates some deferred taxes to any rate base adjustment. So under that scenario, any working capital or rate base adjustment would have some deferred taxes assigned to it.

Q Could you please provide a late-filed exhibit, and in the exhibit I'd like you to show by issue number, from the Prehearing Order, effects of proposed rate base adjustments on deferred taxes, and also on ITCs, in both the balance sheet and in the income statement.

COMMISSIONER GUNTER: Will you restate what you're asking for one more time?

MS. RULE: I'd like Mr. McMillan to provide a schedule indicating, by issue number, the effects of rate base adjustments that are proposed in the Prehearing Order on deferred taxes and ITCs, in both the balance sheet and in the income statement.

(Late-Filed Exhibit No. 572 identified.)

A I think the only one that we would agree should have a specific deferred tax adjustment is this Issue 3, where we have actually -- part of the refund was directly attributable to deferred taxes. All other rate base adjustments should hit that times your reconciled capital structure and whatever percent is in the capital structure -- I'd have to make some assumption.

Q I would like you to prepare the exhibit as if each issue was the only one being changed, and, therefore, any effect would be directly related to that proposed adjustment.

COMMISSIONER BEARD: Let me ask so I can understand based on what you asked and what I heard.

You're saying that in each instance you do a pro rata adjustment with the exception of this one?

WITNESS McMILLAN: Well, I mean, the Commission could make this one pro rata. We've identified how much of that refund was related to deferred taxes.

COMMISSIONER BEARD: I understand that. I mean, we can make them all specific, we can make them all pro rata, we can do anything in that sense. But it's your position that you would make those adjustments pro rata with this one exception?

WITNESS McMILLAN: That's correct. Because this one adjustment would actually have changed our budgeted deferred taxes. To go in and disallow a portion of a building, say, is not going to change our deferred taxes unless we write that off our books permanently. And to the extent that we're still depreciating the facilities, we would still have deferred taxes in our forecast related to those items. (Pause)

This one item, the Scherer purchase price, we've actually recorded on our books additional deferred taxes related to that, and that was not included in my forecast. So it would be appropriate to identify that.

COMMISSIONER BEARD: Are you asking for some different assumption in the treatment of deferred taxes? (Pause)

COMMISSIONER EASLEY: Are you saying that it would not have an impact on an expense item and, therefore, not on the taxes? Is that an oversimplification?

WITNESS McMILLAN: No. Just historically -- and I'm not sure or clear exactly what adjustment she wants me to go back on -- but if you really look at the nature of a working capital disallowance, there is no deferred taxes related to -- the deferred taxes, or the bulk of our deferred taxes, are property-related. There may be some small amount but it would be almost impossible to go in and isolate with -- it wouldn't be totally impossible. With the amount of time, you could go back and say, "Yes, there's so many dollars worth of deferred taxes related to this asset and then -- "

COMMISSIONER BEARD: Did I miss something, that this was specific to working capital?

MS. RULE: No, it's rate base adjustments.

COMMISSIONER BEARD: Rate base adjustments.

WITNESS McMILLAN: Which include working capital.

COMMISSIONER BEARD: Well, to the extent, for example, that we said no to Plant Scherer inclusion in rate base, that's a reduction in rate base; that would be a reduction, a specific reduction, of deferred taxes which would, in effect, change the weighting and everything else, correct?

WITNESS McMILLAN: We could do that on Scherer easily. I could identify those. Some of the other little minor disallowances that I may have more trouble trying to specifically identify deferred tax related to.

COMMISSIONER BEARD: Well, Mr. McMillan's position would be that any resulting -- that the result would be insignificant. He could certainly indicate that on the schedule.

COMMISSIONER GUNTER: Can you provide --

WITNESS McMILLAN: Let me put it this way: we've never attempted to go through and isolate deferred taxes related to every single asset. I mean --

COMMISSIONER BEARD: Wait now, let's don't cloud it up. It wasn't an asset, it was based on recommended --

WITNESS McMILLAN: Disallowances.

COMMISSIONER BEARD: -- disallowances, as opposed to the Prehearing Order. Example: Scherer.

WITNESS McMILLAN: Right.

COMMISSIONER BEARD: Okay?

COMMISSIONER EASLEY: Get him to weigh somehow --

COMMISSIONER BEARD: Can you track that out? Now, there are some others that, obviously, are in there that may not affect it at all, it may be an asterick, because you can't get your calculator to run that far out to the right?

WITNESS McMILLAN: Okay, we can do that.

COMMISSIONER BEARD: Is that?

MS. RULE: Thank you. Let me give a short title for that, that would be "Effects of Proposed Rate Base Adjustments."

COMMISSIONER GUNTER: That's Exhibit No. 572.

MS. RULE: Thank you.

COMMISSIONER BEARD: Late-filed.

Q (By Ms. Rule) Mr. McMillan, with regard to Issue 52, fuel expenses, related expenses. In Page 10 of your direct testimony you state that proper adjustments have been made to remove all fuel revenues and expenses from NOI. Is that correct?

A What was your last statement? I'm sorry?

Q Basically, asking you to confirm in your testimony that you state that proper adjustments have been made to remove fuel revenues and expenses from NOI?

A That's correct.

Q Do you have MFRs C-39 and 40 in front of you? You may or may not need to confirm this. Let me tell you what it says, and then you decide if you need to look at it. My understanding is that C-39 and C-40 show federal and state deferred tax expense associated with the Peabody coal buyout and the Daniel coal buyout.

Do you need to look at the schedule to confirm that?

A I'm familiar with those deferred taxes, yes.

Q Should --

A They do -- there are some deferred taxes related to our coal buyouts.

Q Shouldn't those deferred taxes be excluded?

A Well, not under Issue 52. I mean, there's no revenue or expense impact related to deferred taxes, per se. I mean, that's just a tax timing difference that's recorded on your balance sheet.

COMMISSIONER GUNTER: Let me ask you a

question. Where does the benefit, how do you calculate the benefit of those deferred taxes that occurred with the coal buyouts? Where is that calculation? Is it in the fuel adjustment?

WITNESS McMILLAN: No, it is not. The deferred tax piece of it is being included in our capital structure and would be reflected in the surveillance report based upon the jurisdictional reconciliation of rate base and capital structure.

COMMISSIONER GUNTER: Okay. And those are amortized back over the life of that contract, is that correct?

WITNESS McMILLAN: That's correct.

COMMISSIONER GUNTER: So if I understand correctly, they will be carried in the capital structure zero cost and amortization would be over the, again, repeating myself, amortization would be over the life of that contract?

WITNESS McMILLAN: The one related to the Daniel, the fuel coal one, that one is definitely -- was set up initially when we bought it out, and it's being amortized over the remaining life or the life of the buyout period. It's like nine years, I believe.

The Peabody one has to do more, it fluctuates, really, it's not as big of a deal. The difference there is a straight line write-off for tax purposes, versus what we've actually written off on our books. So it can go up or down, but it is included in zero cost in our deferred taxes in our --

COMMISSIONER GUNTER: How long was the Peabody contract?

WITNESS McMILLAN: 10 years, I believe.

COMMISSIONER GUNTER: 10 years. So those deferred taxes would have been where those little glitches your'rе speaking of, those deferred taxes would be written off in 10 years, is that right? I'm trying to make sure I understand.

WITNESS McMILLAN: The complete write-off would be completed after 10 years; therefore, there would be no deferred taxes after that.

COMMISSIONER GUNTER: All right.

Q (By Ms. Rule) Mr. McMillan, in your testimony you referred to the Peabody coal prepayment. Is that the same thing as the Peabody coal buyout that I mentioned?

A In actuality it is a prepayment. We did not buy out of that contract. And that's why I tried to stick with a prepayment where I could. Some places it may be listed as a buyout. Daniel was a buyout, and therefore we could -- but the other one related to the

Crist Plant, it was actually just a prepayment. We've got the same coal vendor, we just made him an up-front payment to get him a reduced coal price.

Q I would like to refer you to Issue 58, Mr. McMillan, dealing with bank fees and line of credit charges. Is it correct that Gulf formerly maintained compensating balances of 10% for lines of credit?

A Yes. We do -- we did, and we still do; I mean, for certain banks.

Q In 1988, did Gulf change its practice with regard to compensating balances?

A Yes. There was a change. With our large banks, we did, we were able to negotiate, actually paying them a fee versus leaving a 10% compensating balance at their bank as a form of compensation for lines of credit. As I stated earlier, we still do have some lines of credit with some smaller banks.

Q Why is Gulf still maintaining some lines of credit requiring compensating balances?

A Well, some banks aren't too -- you know, the smaller banks really, some of them didn't want to go to the one-eighth. It is a cheaper form to getting these fees, and we do need to have certain of these banks for our daily disbursements and that sort of thing, to be run through. And a compensating balance serves as a form of compensation to the bank. But I think we did file an interrogatory, I think a Staff or Public Counsel interrogatory, that lists the banks that we still have compensating balances with.

Q I believe Gulf is projecting to either pay fees or maintain compensating balances for approximately $48 million in lines of credit for 1990, is that correct?

A For 1988?

Q No, for 1990. I believe the figure is 48 million, projected?

A Yes. The combination of the banks that we are currently budgeted to use fees, and including the ones that we've got compensating balances, the sum of those two are 48 million.

Q And in 1989, the Company maintained 49 million in lines of credit, is that correct?

A Hold on. It's about the same amount, so I would agree with that, subject to check.

Q Would you also agree that for 1988, Gulf maintained 50 million in lines of credit?

A I don't have that with me, but I will agree with that, subject to check.

Q Thank you. If Gulf were to access lines of credit, where would that liability show up on the

balance sheet?

A You mean a compensating balance? If we maintained compensating balances as lines of credit?

Q No, if the Company were to access a line of credit?

A The liability would be in our notes payable line on the balance sheet.

Q I would like to you turn, if you would, please, to your prefiled testimony, Schedule 2. I believe that's been identified as Exhibit 50. (Pause) Do you have that?

A I have that, yes.

Q Did Gulf access any of its lines of credit in 1989?

A Yes. We did.

Q Where would that appear on that schedule, Schedule 2, Page 3 of 10? It's in Exhibit 50.

A Well, on Page 3 of 10 of that exhibit, I would include the 1989 actual amounts through August. And, so, there were two months at month-end that we actually had an outstanding notes payable, so they would be reflected in the months of May and June. (Pause)

We also, it appears, based on another document I have that shows daily borrowings, we actually had some borrowings in the month of February of $1 million, and also borrowed some money in both July and August, in addition to these two months.

Q Would that show up in any of the schedules attached to your prefiled testimony, or in any of the interrogatory responses you have given?

A It probably would not because everything that you've normally filed is on a calendar month basis. So you could have some borrowings at the beginning of the month that are repaid during the same month, and they net out to zero as far as any monthly balances. I could provide you a listing of the actual short-term borrowings during 1989.

Q Could you please do that?

A Yes.

Q Could you do that for both 1990 and 1989?

A 1990, I could give you like through June or May or June actual.

MS. RULE: Thank you. I believe that would be Late-Filed 573?

MR. PRUITT: 574.

CHAIRMAN WILSON: I don't have a 573. I have 572.

MS. RULE: We've got 572.

CHAIRMAN WILSON: 573 the next number?

MR. PRUITT: Mr. Chairman, 573 was assigned to a request that Staff made for some projections, and I couldn't pick up the balance of the title.

MS. RULE: If you will give me one minute, I'll look at my questions and see. I may have numbered it on my questions.

CHAIRMAN WILSON: Okay, let's go ahead and check that. (Pause)

MS. RULE: Commissioner, the last one I have indicated in my notes was the, "Effects of Proposed Rate Base Adjustments."

CHAIRMAN WILSON: That's the last one I have, and that's numbered 572.

MS. RULE: That's what I have.

CHAIRMAN WILSON: All right, so the next one will be 573. And if there's one in between, if it shows up, we'll give it another number.

MS. RULE: And I believe that would be "Short-Term Borrowings, 1989 and 1990."

WITNESS McMILLAN: Yeah, that would be fine.

(Late-filed Exhibit No. 573 identified.)

Q (By Ms. Rule) Did Gulf access any of its lines of credit, or has Gulf so far accessed any of its lines of credit for 1990?

A Yes. We have.

Q Would that show up on Exhibit 50, Schedule 2, Page 8 of 10?

A Those would be our forecasted amounts, yes. Which would be on a calendar month basis, again. But as you can see, we were showing borrowing for five months there.

Q What is the maximum amount Gulf has had to borrow on its lines of credit for 1989 and thus far in 1990?

A I'm sorry?

Q What is the maximum amount Gulf has had to borrow on its lines of credit in 1989 and 1990?

A I don't have that figure calculated right in front of me, but it's approximately $30 million that we have outstanding, as of today, I believe.

Q Could you add that information to late-filed Exhibit 573?

A Yes.

Q Maximum amount borrowed in '89 and 90?

A Yes.

Q How does Gulf determine the total amount of lines of credit it should maintain?

A Basically, we look at our -- several factors. One of the factors being our forecasted cash position based on the budget. And just using this financial model, primarily, as a tool, we look at the maximum amount that we're showing as a short-term requirement.

And historically, we've added approximately $25 million. It just depends upon our construction program at the time and outside influences that we feel may have some impact on our potential -- could have a negative impact if we didn't have enough cash. But, you know, it's been running -- we've been trying to maintain lines somewhere in the neighborhood of 40 to $50 million, recognizing our cash volatility.

If you just look at our revenue flow, our source of revenues which are primarily from sales of electricity, between summer and winter they tend to fluctuate to the extent of 25 to $50 million, and we have to be prepared, or have the cash available, to absorb that type of cyclability in our revenues.

Q Can you provide me with the assumptions underlying those models?

A Well, the model, itself, includes our whole forecast. I mean, basically, it includes everything in our budget, all our operating expenses, construction program, interest rate assumptions. I mean, the financial model, as I addressed in my prefiled testimony, is our primary forecasting tool. It looks at all components of our forecast, our balance sheet and income statement. And it attempts to quantify the actual cash requirements.

We use it primarily to judge our external financing requirements. Because we recognize in this particular model, since it's strictly done on a calendar month basis, there does leave some leeway in there. And that's why I said, we usually add about a 25 to $40 million cushion. You could actually have that big a swings in our cash within a calendar month. And this thing -- we're only budgeting, on a forecaset, on a calendar month basis, which would not represent the large cyclability within the month itself.

Q Have you actually had a 25 to $40 million swing?

A Yes. As far as our disbursement requirements?

Q Yes.

A In our actual financing? You could easily that kind of change from one month to the next. If it hits in the month where we have dividend payments, and some type of other external requirement that's a big ticket item, you could easily see that.

If you go back when they used to -- I'll give you a good example of that. It was back when everybody used to actually receive that South African coal, when that ship came in it was roughly a $10 million payment whenever they unloaded that boat in Mobile. And you had to be prepared to cut that check. It may not come back for several months, but you needed the money whenever that boat was unloaded.

Q But isn't that sort of a planned event, as are dividends?

A It is somewhat planned, but it's -- that type of coal delivery was not -- you knew far enough in advance to make sure you had money available, but you had to have the lines. We can't wait the month we know something is coming and start scrambling around looking for lines of credit. That would not be a prudent thing to do. It may not be there when you need it. Somewhat like any other planning requirement, we are looking -- we are trying to minimize our costs, yet ensure that we've got adequate resources to do our -- to perform the daily requirements and the cash disbursements needed to provide utility service.

Q Mr. McMillan, in 1989, Gulf's actual expense for line of credit fees was roughly $54,000 versus $60,000 budgeted, is that correct?

COMMISSIONER EASLEY: Thousand or million?

MS. RULE: Thousand. This is expense for line of credit fees.

COMMISSIONER EASLEY: Oh, sorry.

A What were you looking at, 1989?

Q Yes, sir.

A What figure was that you used? I'm sorry.

Q I believe actual was $54,063, budgeted 60,000.

A I'll agree with that subject to check. I don't have that number in front of me.

Q Thank you. And through April 30th of 1990, I believe Gulf budgeted $20,000 for line of credit fees, is that correct?

A Yes.

Q But I believe for that period of time Gulf's actual expense for line of credit fees was $14,687. Can you confirm that?

A That's correct.

Q Can you explain the variance between budgeted and actual?

A I don't have that with me. I could get a -- there were some -- there were actually -- I think we showed it on an interrogatory, there was actually a contingency budgeted for the test period of seven -- what is it, $7,500 at 60,000, and that was with the anticipation that we would have to seek additional lines of credit. Based on our budget, we have not done that, obviously, through the first quarter because the 20,000 was basically one-third of the 60,000 that was budgeted. So I would assume the reason for the variance is the fact that we have not yet gone out and attained additional lines of credit.

Q Is there any reason why the Commission shouldn't just include actual expense rather than your budgeted expense here?

A Well, unless I can present evidence that we need that additional money, in this particular instance, I would say that probably wouldn't be unreasonable, but I need to -- I could probably, before I come back up for rebuttal, find out to make sure that that is the reason for the underage and that they have not already signed -- see, those contracts are signed on a calendar-year basis, usually starting April 1st, and so you may not have -- they may have actually signed some additional contracts that I'm not aware of.

Q Could you explain how actual line of credit fees are determined?

A The line of credit fees?

Q Yes, sir.

A They're basically one-eighth of 1% of the line of credit that we've attained.

Q Did you say one-eighth of 1%?

A I believe so.

Q I believe Gulf also incurs other bank fees. Can you explain what they are?

A Ma'am?

Q Gulf als. incurred some other bank charges and pays other bank fees. Could you tell me what they are?

A Yes. That's our bank service charges, which are just like you or I would have for running a checking account, be similar in nature. Effective in 1988 we basically changed our whole thinking as far as our disbursement methodology and consolidated all our disbursements out of one bank in Pensacola. Previous to that we had basic -- we had included demand costs or checking accounts at several banks which served as a -- to offset a lot of the bank service fees. You basically have a compensation balance for doing your disbursements.

In '88 we changed that. We've now got one disbursement account and we don't include or leave any cash in that account until the checks are actually presented for payment. They call the Treasury Department, tell them they've got $2 million; they need $2 million to clear some checks, and what it has done is enabled us to invest that cash up until the time it's needed.

And what has happened is -- and you can clearly see in our file data, we don't -- we are not asking for any cash, per se. I mean we -- it's actually a negative cash balance in the '90 test period.

If you go back to our last case, we actually had approved in excess of $5 million in cash, which were to compensate us for the compensating balances on lines of credit and the compensating balances related to our disbursement accounts, and that is really where the customer savings are recognized, is through a reduction in working capital since the Company has actually removed the temporary cash investments from working capital.

Q I believe Gulf currently records your other bank fee expense in Account 921, Office Supplies and Expenses, is that correct?

A That's correct.

Q And FERC has taken the position that the expense should be recorded in the account "Other Interest Expense." Is that also correct?

A That's correct.

Q Has that been resolved with FERC at this point?

A It has not. As far as I know, that's one issue that they're still reviewing, and we feel like it has been properly classified in O&M expenses as not an interest amount.

COMMISSIONER BEARD: I got to stop and back up a question.

You said that the temporary cash investments have been removed from working capital.

WITNESS McMILLAN: Yes, they have, in total.

COMMISSIONER BEARD: Your position on Issue 21 doesn't say that. "The Company believes it would be appropriate to include temporary cash investments in jurisdictional working capital." And the amount you referred to as $6.045 million.

WITNESS McMILLAN: Yes. If you read my first -- the very first sentence, I said, "Gulf's filing reflects that temporary cash investments have been removed from jurisdictional adjusted working capital consistent with the treatment in our last case." I just followed up the Commission's -- Witness Seery has actually put in the record that he agrees with what the Company has felt all along, that as long as the Company can justify those temporary cash investments as being reasonable and required for utility service, that they should be included in working capital and allowed the overall return and the earnings off of those should be included in NOI, and we would definitely agree with that statement.

COMMISSIONER BEARD: But in the interim, you have removed them from working capital?

WITNESS McMILLAN: That's correct. In the filing they've been removed.

COMMISSIONER BEARD: I am just trying to get apples to apples, because OPC is saying remove them, reduce working capital, and I don't want to double count.

WITNESS McMILLAN: Yes, they have been -- see, if you look at that jurisdictional balance sheet, that B-2-A, that's an unadjusted balance sheet, and some people get confused there. On that particular thing there is a jurisdictional amount of temporary cash showed over in the right column, but that is an unadjusted balance sheet. If you go to B-14, the working capital exhibit, it will clearly show the removal of all of the temporary cash investments, in my Schedule 7, in my working capital component of my rate base.

MS. RULE: Actually, Commissioner, I would like to follow up on what you brought up.

Q (By Ms. Rule) You testified, Mr. McMillan, that Mr. Seery essentially put in some testimony, with which Gulf agreed, about including temporary cash investments in rate case, correct?

A Yes, I do.

Q But his testimony indicates that the treatment of either cash balances or temporary cash investments should depend on their prudency, is that correct?

A I would have no problem with that.

Q And he also testifies that if Gulf can demonstrate through competent evidence that the temporary cash investments are necessary for the provision of utility service, then they should remain in rate base and earn at the Utility's overall rate of return. Is that a correct explanation of his testimony?

A That's a very straightforward synopsis, yes.

Q What competent evidence has Gulf provided that demonstrates that the temporary cash investments are necessary for providing utility service?

A Well, in my rebuttal testimony, I guess -- I made some -- I'm very unclear what he considers to be -- what he needs. Obviously as I've stated in my rebuttal, the $6.3 million is essentially all of our cash and represents less than 10% of one month's disbursements for Gulf Power Company, and in no way could be considered an excessive amount. And beyond that, I'm at a loss to what exactly he wants us to provide. We would be glad to provide whatever would be requested through discovery, but, you know, we don't know of any other way to pay our bills other than to have cash avaiable. Either you're going to have temporary cash, cash, or short-term debt, one of the three, because if you -- once you stop paying your bills, you're going into bankruptcy at that stage, and you'll be shut down. You've got to have liquid assets, in effect, is what I'm saying.

COMMISSIONER BEARD: Let me ask a procedural question, because I went through looking for the witnesses on 21. Seery wasn't listed. That's why I didn't look specifically back there.

MS. RULE: He's not testifying on that. It's a discussion in his testimony, but he's not specifically testifying on that. He's cost of capital.

COMMISSIONER BEARD: You're saying 6 million is your total cash on hand, on average on a given month?

WITNESS McMILLAN: On the 13-month average basis.

COMMISSIONER BEARD: On the 13-month average basis. What are your revenues, just roughly, coming in each -- monthly revenues?

WITNESS McMILLAN: On an annual basis roughly 450-, $500 million. I'd say on average you're looking at roughly $50 million, just to be a good, round figure.

COMMISSIONER BEARD: I had it closer to 40, but that's okay. You've got $40 million worth of revenue coming in every month. Your remaining cash on hand invested in short-term investments is the roughly 6 million?

WITNESS McMILLAN: That's correct.

COMMISSIONER BEARD: That's not the $6 million that you have to spend to pay your bills?

WITNESS McMILLAN: That's what, on average, was left over above -- over a 13-month period. Obviously, five months of the year we were actually in the short-term debt. Some months we had more than $6 million in temporary cash.

COMMISSIONER BEARD: I understand. I looked at these schedules. I just was hearing you say one thing and I misunderstood.

WITNESS McMILLAN: I mean it's not unusual to see 20-, 30-, $40 million swings in our cash position within a year because of the cyclicability of our revenues and our expenses.

COMMISSIONER BEARD: Typically, something your cash management people would plan for in advance?

WITNESS McMILLAN: That's correct.

Q (By Ms. Rule) Mr. McMillan, you provided Interrogatory Response No. 188 in Staff's Eleventh Set of Interrogatories, I believe, and that should be before you as Exhibit 439 in your packet. Could you take a look at that?

A Yes, I have that in front of me.

Q Is it your position that this interrogatory response provides competent evidence that temporary cash investments are necessary for the provision of utility service?

A That particular interrogatory, in effect, describes our cash or our disbursement process, and what I was -- what I guess I was emphasizing there is that the 6.3 million is the total amount of our liquid assets, I mean cash and temporary cash, and the fact that it does -- the temporary cash is approximately 10% of our monthly disbursement, do reflect to me that the Company has a very small, conservative estimate of temporary cash investments.

As I stated, I could probably go back to '89 or prior years and it would be much higher than the level that's in the '90 test period, and would be justified.

Q Well, the interrogatories state -- ask you to "Please provide a detailed explanation of what portion, if any, of the Company's 13-month balance of temporary cash investments are necessary for the provision of utility service and why?" And basically, the only thing I can find in your response is in the second paragraph, last sentence, where it says, "The Company again maintains these funds are required and necessary in providing utility services for our customers." And the rest seems to discuss the amount of it. Is that --

A Yeah, and in my very first sentence, obviously I tried to answer very directly. I said, "All of Gulf's temporary cash investments were required and necessary in the provision of electric service to our customers." And I go on to explain why I take that position. Like I said, I'm not clear exactly how you would -- what else would you recommend that I say, that I'm missing, I guess, is the question.

Q For example, have you provided Staff with a cash budget or any other schedule that would allow us to assess a temporary level of cash investment and make a determination if the level is reasonable?

A I have not been requested of one. I do have the statement that approximately $6.4 million is approximately 10% of our monthly disbursement, which would imply our monthly disbursement would be around $60 million.

Q So basically it appears that your responses are all necessary and this is 10%, is that what it boils down to?

A They are all necessary, absolutely. If you would like a cash forecast, I could provide one as a late-filed, but --

Q Well, the difficulty we have, Mr. McMillan, is that it's up to Gulf to prove its case and to provide the evidence. And what you're telling me is we haven't asked you the exactly correct question, and therefore, you haven't provided the evidence.

A What I'm saying is I'm not sure what you want for evidence, and I think the number is so conservative -- conservatively small that it wouldn't require additional support.

Q Could you provide the cash budget we discussed as a late-filed exhibit?

A Yes, I will

Q I believe that would be 574.

CHAIRMAN WILSON: 574.

MS. RULE: Let's just call it "Cash Budget."

(Late-Filed Exhibit No. 574 identified.)

Q How has Gulf determined the amount of temporary cash investments necessary to have on hand?

A How do we determine how much temporary cash we need on hand, is that the question?

Q How did Gul. determine the amount of temporary cash investments that were necessary? You say it's a conservative figure. How did you come up with it?

A Basically, I guess I need to explain how the budgeting process for cash works. In effect, we get all of the approved budgets, the capital, O&M, revenues, each of the approved budgets which were discussed with Mr. Gilbert's budgeting process. All of those budgets are then incorporated into a financial forecast in the financial model. Essentially our cash position, either temporary cash or short-term debt, is a resulting final balancing feature on the balance sheet. Of course, obviously, we have to put in projections for the receivables and payables and other liabilities of the Company, but essentially once you get that, the financial model then enables us to look at our external financing requirements in respect to our short-term cash position.

And the executive management, including the

Vice President of Finance, and my area and the Treasurer have discussions as far as the timing and the amount of any external financings. And that would actually be what would influence what our temporary cash or short-term debt amount is.

If we came out with a forecast that for whatever reason we were generating a lot of cash and our temporary cash had increased to 100 million, and we were looking down the road and didn't see a need for that cash, obviously at that point in time Gulf would take some -- we'd have to make some move to either retire some senior securities or something of that nature to extinguish the cash. That is not a good thing to do on a very short-term, narrow-defined point, because, I'm sure as you're aware, external financings are very expensive and they're very costly.

So the Company, a lot of times it's horizons two to three years. If you're showing $20 million in temporary cash this year and you need that six months later or the following year, it would not behoove you to go out and retire some debt and then have to refinance, do some more external financing the succeeding year for that. It would behoove you to hold on to that cash until it's needed. And that's done on a -- really, on an annual basis, when the budget's done, plus on a monthly basis by our treasurer in conjunction with my department as far as what our cash -- actual cash balances and requirements are.

Q Could you tell me why Gulf should maintain temporary cash investments of approximately $6.4 million when the Company has access to over $48 million in lines of credit?

A As I was just stating, the cash, the temporary cash is -- if you look at our forecast, we've only got seven months out of the year that we actually ended the month with cash. We cannot, on a monthly basis, because we've got $1 million in temporary cash, get rid of that. I mean, unless we can get our vendors to bill us in advance, which would not be a good move. The only other thing you can do is extinguish senior security amounts.

It's because of our cash volatility or the fluctuation due to seasonality of our revenues you're always going to see some fluctuation. In this particular case, in the test year, roughly half the year we've got temporary cash; half the year, we've got short-term debt, which tells me we're basically as tight as we can get as far as our cash, without monthly trying to extinguish senior securities, which that would not be a real viable solution to a month where you end with some temporary cash.

Q Can you explain the difference for me between letters of credit and lines of credit?

A The lines of credit are the actual balance that we can borrow from that bank. Letters of credit, I think, are just referring to the contracts that we may have with the specific financial institutions. They're all a line of credit.

Q Do you know the difference?

A I'm not sure. I don't know that there would be a difference there.

Q Pardon me?

A I'm not sure -- if you're referring to something that's different, no, I do not.

Q Do you know whether there's a difference between letters of credit and lines of credit?

A Yes, there is.

Q Do you know what the difference is?

A I'm not clear. I could get that after a break.

Q Could you tell me, if you know, if Gulf incurred expenses for letters of credit as opposed to lines of credit and what account would the expense be recorded?

A I don't believe there is any expenses related to the letters of credit, just the lines of credit.

Q Do you know?

A I will verify that.

Q Thank you.

COMMISSIONER GUNTER: This is an appropriate time, when we've got some items that can be done over the break, why don't we break for lunch now. Come back at 1:00.

MR. HOLLAND: Commissioner, before we break, you had requested Late-filed Exhibit No. 550 be handed out today and I have that to distribute to the parties.

COMMISSIONER GUNTER: All right. Give it out right after lunch.

(Thereupon, lunch recess was taken.)

- - - - -