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
NINTH DAY
AFTERNOON SESSION

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Florida Public Service Commission

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

Thursday, June 21, 1990

Met pursuant to adjournment at 1:00 p.m.

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

APPEARANCES:

(As heretofore noted.)

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I N D E X

WITNESSES

Index Continued:

EXHIBITS

Number:	Identified	Admitted
626 (Late-Filed) (Scarbrough)	3847	Withdrawn
626 (Late-Filed) (Scarbrough)	3855	
627 (Late-Filed) (Scarbrough)	3859	
44 Through 45 (Gilbert)	3876	
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AFTERNOON SESSION

(Hearing reconvened at 1:00 p.m.)

ARLAN E. SCARBROUGH

having been previously duly sworn as a witness on behalf of Gulf Power Company, resumed the stand as a rebuttal witness and testified as follows:

CONTINUED CROSS EXAMINATION

BY MS. RULE:

Q Mr. Scarbrough, I would like to ask you some questions that other witnesses have thoughtfully referred to you.

A All right.

Q Beginning with the Faith Building, when was the sale of the Faith Building completed? Mr. Conner was absolutely certain that you were holding all the facts on that.

A All right, let me see if I can't ferret that out here. February of 1989.

Q Pardon me? February?

A February of 1989.

Q Was there a gain on the sale?

A No, there was a loss.

Q When was the property purchased?

A I don't know.

Q Does 1983 sound correct?

A Subject to check.

Q I'm not sure what that means anymore. (Laughter) And does it sound right about $210,000 purchase price?

A It was exactly.

Q Okay. And it was sold in February of '89 for 150,000?

A Less the sale price and everything, we ended up getting a net out of it 139,608.

Q And how did you book the result?

A That property was in nonutility property. When it came unoccupied in 1987, we moved it into nonutility property. And, therefore, the loss was booked below the line to Account 421.

Q Mr. McCrary was certain that you could tell us about expendable items. And I'm looking at the transcript --

CHAIRMAN WILSON: About what?

MS. RULE: Expendable items that Commissioner Gunter asked about.

Q (By Ms. Rule) I believe the reference was to the example of gloves?

A Uh-huh.

Q And Commissioner Gunter was wondering how expendable items -- the examples he used were nuts and bolts and gloves, aprons and blankets -- how they are treated for accounting purposes?

A Okay. Actually, gloves and what we call minor materials, nuts and bolts, are handled differently. Gloves, of course, go into Stores when they're purchased, any material and supplies, as do the nuts and bolts, and you buy them in bulk quantity.

On the gloves, when you issue the gloves, they go into a -- that's charged to a clearing account and that gets cleared through all construction expenditures on an overhead basis. But those are not reissued. I mean, in other words, you have to check those out. When you check those out, they're charged into a clearing account and they're spread to all the construction jobs.

Now, the other minor materials, nuts and bolts, this kind of thing, is the same thing. When we buy those, they go into the 154 Account, the "Stores Account." When you issue those and put them in the bin, if you buy maybe about 20 boxes of bolts, let's say, they all go into Stores. When you take a box out and you put it in the bin, you charge that the same way as you do with gloves, to an overhead account and it gets cleared to all construction expenditures. However, that's a free issue. In other words, you don't have to write a requisition or anything. You know, the utility men on the line trucks, they go in there and get whatever they need to put on the line trucks and so forth, and they just take those out of the bin and there is no accounting for that. You only do that like one box or two boxes, however they have it out in the free issue bins.

So that's how they're handled basically, it's all charged to a clear account and then spread over all the jobs.

Q When you clear it out of the clearing account, does it go to construction and O&M or just construction?

A Either construction or O&M, either one, whatever, yes.

MS. RULE: Commissioner, did that answer your question?

COMMISSIONER GUNTER: Yeah. That was raised, Mr. Scarbrough, and I suppose that you've got things like hot sticks and blankets, and those are done generally the same way?

WITNESS SCARBROUGH: That's true, but those would not be free issue.

COMMISSIONER GUNTER: Those questions were raised, might have been in Croft's deposition. If you read his deposition, I'm sure you did --

WITNESS SCARBROUGH: Uh-huh.

COMMISSIONER GUNTER: -- where he talked about gloves that were too bulky that folks didn't use, they were going to throw them away, so they put them on the line truck, line power truck. Sticks that perhaps had some malfunction or something, where they took them apart and took some of the parts and made another whole, and some blankets and that kind of stuff. You treat those generally the same way?

WITNESS SCARBROUGH: That's right, exactly.

COMMISSIONER GUNTER: All right.

Q (By Ms. Rule) Mr. Scarbrough, another issue that came up during Mr. McCrary's testimony was temporary investment of Gulf funds through Scott Addison. Where is Scott Addison's business located?

A The last time I knew, he was in Atlanta.

Q Were Gulf funds invested through Scott Addison?

A Now, are you talking about pension funds now?

Q Any funds. I believe -- well, Mr. McCrary said he thought there were some temporary investment of some Company funds, at one time, through Scott Addison.

A That's true. I just wanted to make sure that I -- (Pause) and the answer to that is yes. I concur with what he said. We did, in fact, issue some, not through him but through a firm that he worked with, Johnson and Lane.

Q Why?

A He called -- this is -- he called Dick Fowler, and this happened in 1983. He called Dick Fowler and made a recommendation, asked if we had any temporary cash. And Dick Fowler, who is the person that we have basically on a day-to-day basis, one of his responsibilities is to invest temporary cash and, of course, to borrow short term borrowings when we need that.

And he asked Dick Fowler if we had any temporary cash. And it just so happened at that particular time, we did. We had quite a bit, as a matter of fact, because that's when we were building funds to buy into Scherer 3, which we did in '84.

And he said, you know, they had some good, secure investment, this firm he worked for, Johnson and Lane. And asked if we might be interested in, you know, getting into it. If we did, he had a person that worked for the firm, Mr. Cameron, that would call us and talk to us about it.

Mr. Fowler pushed this up the line. Because normally, normally when we invest in short-term investment, we do it one of two ways: We either do it locally or we do it through New York. And they generally will do it through a New York bank.

Dick Fowler, since it was an unusual type of thing and, of course, knowing who had made the phone call, went up to see Mr. Unruh, who was the treasurer of our Company. Of course, Mr. Unruh came up to my office and pushed it even up further and asked me -- told me what they were talking about, what the deal was, and this type of thing.

I told him, and I made this decision: that we would invest $500,000 at the rate they had quoted. And the rate that they had quoted was for the same base -- the same time period, was about 1.5 percentage points better than we could get on anything else.

This investment was in with a firm savings and loan in Harrison, Arkansas, who invested in Gennie Mae certificates, which simply means they were backed by government securities. The rate was 10.25%. The rate that we were getting about that identical same time period on investment with Sun Bank was 8.85. As I said, the rate here was 10.25.

Made the decision to invest $500,000 with

Johnson and Lane, not through Scott Addison. Scott Addison made the contact. Now, what he ended up getting out of it, I don't know. But the person we dealt with was a person by the name of Don Cameron.

We made the investment for 90 days. Of course, we got our money at the end of 90 days, no problem whatsoever. Good return, very secure investment. And never had any further transactions with them.

Q So that was the only time?

A Yes.

Q And where is that office located, Atlanta?

A The Johnson and Lane office, I think, they may have branch offices, I think they're headquartered in Augusta, Georgia.

Q And who is Scott Addison?

A Scott Addison is, at that particular time, was a broker with Johnson and Lane brokerage house, and he is the son of Mr. Ed Addison, who is the President of and Chief Executive Officer of The Southern Company.

Q And at that time, what was Mr. Addison's position?

A That particular time, he was, as I just stated, President and Chief Executive Officer of The Southern Company.

Q Why didn't you do business with somebody in Pensacola or Jacksonville, or some other Florida city, at that time?

A Well, first of all, what he recommended to us had the equivalent security that we would look for. We only invest temporary cash in very, very secure instruments that are backed by, generally, by the federal government or they're insured by the FDIC, those types of things. And he had the highest rate that was available by far -- I say "by far," roughly 1.5%, 1.4%, for one for an equivalent time period. We decided to go with that; it turned out great.

Now, to sit here and tell you that because it was Mr. Addison's son that that didn't cause us to take maybe a harder look at a recommendation that somebody called us about, I would not tell you that. We did take a look at that. But had he come in and said he had a good deal for us, you know, on a Texas oil well venture, no way we would have dealt with him.

He basically had a rate available for us on the same identical type securities that we normally invested in. It was a better rate, and we went with it. And that's the answer to it.

Q If somebody had called up out of the blue, would they have gotten the same treatment?

A Probably not.

Q With regard to Issue 6, Mr. Scarbrough, I'd like to ask you some questions about Caryville sod farm operation.

Southern Sod Company leases approximately 200 acres from Gulf at the Caryville plant site, is that correct?

A Yes.

Q And that's about 10% of the acreage at Caryville?

A Yes.

Q What's the annual lease income?

A Just a moment. We'll see if we can get it for you. (Pause)

For 1989, and to my knowledge the rate hasn't changed, in 1989, it was $3,450.

Q Was that lease value determined by an estimate made by the Holmes County Extension Director in about 1986 at Gulf's request?

A I really can't tell you. I have been told that we were leasing some other property in that area that some folks were farming, and that's the rate we were getting for that, and that's the reason we arrived at that. But what you have said could be accurate, I'm just not familiar to that detail with how they arrived at that figure.

Q And I believe, then, that they got the estimate from the Holmes County Extension Director for the soybean land; is that the land you're referring to?

A For the farming, yes.

Q And his estimate of the fair market value back in 1986 was about 10 to $15 per acre, is that correct?

A Subject to check, yes.

Q Would the price estimate for soybean land be substantially different than that for land used in growing sod?

A I wouldn't think so, but it could. I wouldn't think that it would be any difference, but, you know --

Q Does that mean you don't know?

A That's exactly right.

Q Thank you. Does Gulf charge the sod farm operation for a pro rata share of the Caryville property taxes?

A No. All of that is included in the lease payment, just like it is to the farmers.

Q And subject check, are property taxes in Washington County $2,192, and in Holmes County, $2,577 net of the early payment discount?

A It sounds reasonable, subject to check.

Q Earlier we discussed the Applicance Sales Division and Vision Design, and those are nonutility operations using Gulf's facilities. In your rebuttal that Gulf allocates investment and expenses of the appliance operation to below-the-line revenues and expenses instead of charging rent, is that correct?

A That's correct.

Q Why not treat the sod farm the same way?

A Well, first of all, that's just not the way we decided to do it, bottom-line answer to it. The reason that we did it that way, first of all, we did not know how long we were going to be in the sod farm business. We had already had an agreement with the farmers where we were leasing this land to them for farming. We established this rate and we adopted the same rate.

Q I don't think that answer is responsive. I asked you why didn't you treat it the same way, and I think your answer was basically because we didn't.

A I think that's probably the answer.

Q Oh, well. Can you tell me on the sod farm, is electric consumption metered and billed at a tariff rate?

A No, it's metered and billed at the average generation cost.

Q Why?

A That's the way we bill all the electricity to our nonutility properties.

Q What would base revenues have been under the appropriate tariff?

A I would not know.

Q Can you provide that?

A Now?

Q Now or in a late-filed exhibit.

A We may have it. Just a minute, let's see. (Pause) We don't have that available, Marsha.

Q Can you provide it in a late-filed exhibit?

A Yes.

MS. RULE: I believe that would be 626.

CHAIRMAN WILSON: 626, and what is that?

MS. RULE: Let's call that "Sod Farm Electric Consumption."

(Late-Filed Exhibit No. 626 identified.)

CHAIRMAN WILSON: Why wouldn't you charge -- if somebody is leasing that land for a sod farm, right?

WITNESS SCARBROUGH: Yes.

CHAIRMAN WILSON: Why wouldn't you charge them a regular rate for use of electricity?

WITNESS SCARBROUGH: No, no, no. The sod

farm --

CHAIRMAN WILSON: Am I misunderstanding?

WITNESS SCARBROUGH: The sod farm is not being leased. That's just an interdepartment journal voucher entry. That's our sod form, and the lease rates she's talking about is how we determine the amount that we transfer from the utility side of the business over to the nonutility side of the business. And we give the utility part of the business credit for that.

CHAIRMAN WILSON: Doesn't that give your sod farm a competitive advantage not paying comparable electric rates as a competitor would pay?

WITNESS SCARBROUGH: Well, obviously if it ends up with a lower bill, it would given them a competitive advantage.

CHAIRMAN WILSON: What would be the reasoning behind doing it that way, if there is any?

WITNESS SCARBROUGH: Because that's what our costs are. I mean we -- our cost, average cost of generation, and that's how we arrived at the cost, and that's what we use it for. But, clearly, if you compare it to another sod farm, and they're paying the tariff, obviously that is a competitive advantage. I would agree with that.

CHAIRMAN WILSON: Under that kind of approach, you could go into any kind of business, nonutility business that was energy intensive, and have a substantial advantage over a competitor in that business, if you were charging to sell just cost, embedded average cost of --

WITNESS SCARBROUGH: I reckon that's true, but when you look at the sod farm the purpose -- if you look at it from a retail ratepayer standpoint, that entire property, I think, had been justified as plant held for furture use, the entire amount. And that's what it's being held for. It's being held as a future generating site.

And what we thought we could do is get into that business and maybe make a little profit on it and felt like that the customer would benefit to the extent that we reduced his revenue requirements, and that's exactly what we did. Now, we could have made the decision not to get into the sod farm business and the -- the retail customer would not have gotten credit for anything. But the fact that we made the decision to get in it benefited the ratepayer.

CHAIRMAN WILSON: So anything you could do with that, regardless of how you structure it, if it offsets any of the costs of preserving that as plant held for future use, then that would justify it for the benefit of retail ratepayers?

WITNESS SCARBROUGH: No question -- if, in fact, it reduces the requirements to the retail ratepayers, by us getting into that. Had we not gotten into it, there would have been nothing to credit to the electric part of the business.

COMMISSIONER GUNTER: Before you -- as part of your exhibit, you're primarily -- the thrust of your exhibit is the sod farm, right?

MS. RULE: I believe we already requested a late-filed exhibit on the Appliance Division.

COMMISSIONER GUNTER: Before we finalize that, do you follow the same pricing methodology to your appliance activity for their energy use also?

WITNESS SCARBROUGH: Yes, we follow that same thing on all of our nonutility endeavors.

COMMISSIONER GUNTER: And your -- where you have an allocation of space, how do you work that?

WITNESS SCARBROUGH: We allocate that same figure that I just described to her on the basis of square foot, square feet.

CHAIRMAN WILSON: Didn't we ask for a late-filed exhibit on that, on direct?

WITNESS SCARBROUGH: You asked for a

late-filed exhibit on this subject. I don't know if it's precisely --

CHAIRMAN WILSON: You went into what your method of allocation is where you have a shared building.

COMMISSIONER GUNTER: Yeah, this is a little different than that allocation, and I would wonder if Staff Counsel would not want, rather than just the sod farm, but all the nonutility operations so that you have a better feel of what the electric sales could have been versus what they were.

MS. RULE: Well, Staff and I were --

CHAIRMAN WILSON: I think we already asked for that.

MS. RULE: We did on the electric sales.

COMMISSIONER GUNTER: You've already got that one?

MS. RULE: I believe -- I'm not sure if this is the right number, but I believe it's Late-Filed 563. We talked --

COMMISSIONER GUNTER: That's capacity payments.

CHAIRMAN WILSON: 564 is affiliate charges, and I think that's what it is.

MS. RULE: Yeah, 564.

COMMISSIONER GUNTER: Did you address -- did you ask in that exhibit, was that specifically asked for, the differences in energy charges?

MS. RULE: Well, I'll tell you what my notes say on that.

COMMISSIONER GUNTER: Versus the tariff rates, versus what they actually were?

CHAIRMAN WILSON: I believe that is.

MS. RULE: It's for appliance buildings and division design building, exhibit showing metered consumption, dollar amount allocated, amount that would have been billed under applicable tariff.

COMMISSIONER GUNTER: So if you have the --

CHAIRMAN WILSON: Didn't include the sod farm because the only things we were talking about there were ones with shared buildings?

MS. RULE: Yes.

CHAIRMAN WILSON: And I don't think the sod farm would have been included in that.

COMMISSIONER GUNTER: Mr. Chairman, the reason I asked the question, there are a number of buildings -- if you went back to the exhibit we were talking to Mr. Conner on, there are a number of buildings that are not shared but are dedicated.

MS. RULE: Those are the Mary Esther, Panama

City, and the Pensacola appliance buildings.

COMMISSIONER GUNTER: You don't have the kilowatt hours that were utilized or were billed to those non -- those dedicated facilities?

MS. RULE: That's what 564 is. It specifically referenced the Panama City, the Mary Esther, and Pensacola appliance buildings and the Vision Design buildings, and those are the stand alone buildings.

COMMISSIONER GUNTER: And you're satisfied that you have included in that late-filed exhibit the kilowatt hours that they use, the differences in rates, okay?

MS. RULE: Metered consumption, dollar amount allocated, amount that would have been billed under the applicable --

COMMISSIONER GUNTER: As long as you all are satisfied.

MS. RULE: Why don't we then, for 626, add on -- right now that's the sod farm electric consumption with the metered amount, metered consumption, amount that would have been billed and dollar amount allocated. Let's also, just because it's an exhibit in progress, let's add on the shared buildings, buildings that are shared between appliance and utility, because our other exhibit did only cover the stand-alone buildings. And that would be Exhibit 626, Mr. Scarbrough.

CHAIRMAN WILSON: Actually, you know what we ought to do is roll all this back into that exhibit we did, put it all in one exhibit, put it in 564, include the sod farm, shared buildings, stand-alone buildings.

WITNESS SCARBROUGH: Everything into 564?

CHAIRMAN WILSON: Right. That way we'll have it all on one page.

MS. RULE: Thank you. Staff will withdraw 626, then, and 564 will be changed.

Q (By Ms. Rule) Mr. Scarbrough, you've been provided with a late-filed exhibit request, have you not?

A Yes, I have. If I could just find it here.

Q And the title is, "Lobbying and Other Related Expenses."

A Here it is.

MS. RULE: Commissioners, in order to save time on questioning, we are asking Mr. Scarbrough for a late-filed exhibit, and I believe this one would be numbered 626, providing amount budgeted for 1990, 1990 adjustments, agreed-upon treatment and book treatment for certain listed items.

Could we have Late-Filed Exhibit No. 626 assigned to this?

CHAIRMAN WILSON: Yes, 626.

(Late-Filed Exhibit No. 626 identified.)

Q (By Ms. Rule) And in connection with this exhibit, or this subject of this exhibit, Mr. Scarbrough, I have a few questions.

In the 1988 tax savings docket, did Gulf agree to remove from rate base 25% of the Tallahassee office investment and 100% of Earl Henderson's expenses?

A Yes.

Q Does Gulf agree to do so in this docket?

A Yes.

Q The late-filed exhibit request that you have references certain work orders from Southern Company Services.

A Yes.

Q 4750-01, -21 and -30. Could you tell me whether the services provided by the Southern Company pursuant to these work orders would be similar in function to -- similar to the function fulfilled by Gulf's Tallahassee office?

(Pause)

A It's similar in that there are a lot of activities carried on in that building, some of which are lobbying, and so yes, it's similar.

Q With regard to Issue 29, Mr. Scarbrough, the question being, "what adjustment to rate base is necessary to reflect the proper treatment to rebuilds and renovations which were expensed?"

A Yes.

Q You discuss at Page 8 through 13 of your testimony, some heavy line vehicle rebuilds. Could you please explain those rebuilds?

A Yes. What we do is we take a vehicle in, heavy line trucks, it's got hydraulic booms on them and these types of things, and we rebuild everything except the overall cab, we don't replace the cab. We rebuild such things as the engine, transmission, brakes, and those types of things. Basically, try to put it back in as good as new condition.

Q Why should these operations not have been capitalized?

A Because the retirement unit manual calls for a capitalization of only replacement of a cabin chassis, and we are simply replacing the components, rebuilding the components.

Q What retirement unit manual are you referring to?

A The one at Gulf Power Company, which is, of course, consistent with the one prescribed by the Florida Public Service Commission.

Q Do you have Exhibit 479 before you?

A Yes.

Q And what is that?

A This is the Florida Public Service Commissions' list of retirement units, Pages 497 through 100.

Q Are any of the replaced items shown on the list in Exhibit 479? (Pause)

A I don't see any, not that we expensed.

Q During the process of the rebuilds, were any minor items, which didn't previously exist as part of a retirement unit, added?

A Not to my knowledge, no. Because basically the retirement unit manual that we have, which is -- it's the same retirement unit manual as prescribed by the Florida Public Service Commission, is basically the same retirement unit manual we had when the Commission issued their retirement unit manual, that we had to make very, very few modifications to our Retirement Unit Manual.

My understanding, I was not there during the workshop, it was my understanding that, basically --

the investor-owned utilities in Florida basically adopted Gulf Power Retirement Unit Manual, and to my knowledge none of these items were part of a -- of another retirement unit.

Q In what account are these vehicles booked?

A You mean when we purchase a new vehicle?

Q Yes, sir.

A 392. Primary account.

Q Do you have Exhibit 420 before you?

A I don't see it. Could you give me a hint?

Q That would be Item 5 of PSC Data Request 100. It has some information regarding Southern Company Service charges to Gulf.

A Just a moment, please. (Pause)

Q It should have been in the information packet in --

A I have it.

Q Thank you.

Gulf is underbudget $273,000 in SCS O&M charges for the first quarter of 1990, correct?

A Yes.

Q Can you provide, by function, actual versus budgeted, Southern Company Services O&M expenses for January through May, 1990?

A Yes.

Q Can you do that now or would it be better provided it in a late-filed?

A No. That would have to be in a late-filed exhibit. I do not have it with me. No.

CHAIRMAN WILSON: 627.

(Late-Filed Exhibit No. 627 identified.)

Q January through May 1990, actual versus budgeted SCS O&M charges.

Mr. Scarbrough, in 1989, tax savings docket, does Gulf's level of expense for bad debt expense include an $813,000 adjustment?

A Yes. In fact, it includes a credit amount for bad debt expense.

Q And does that relate to the change in the method of computing bad debt expense?

A Yes.

Q With regard to Issue 98, Mr. Scarbrough, I'd like to ask you a few questions about tax services provided for officers and management of Gulf.

A Yes.

Q Can you tell me which firms provide the tax service?

A The primary dollars, the firm that is billed the most is Arthur Andersen and Company. I'm not sure of all the others, but basically, to my knowledge, it's basically a local CPA firm in Pensacola. But I do not have absolute knowledge of that being a fact, but I know that the local CPA firm does do some of the tax returns. Now, if they do them all, I'm not sure.

Q Would that be Robert Benz and Company?

A Yes.

Q What service does Arthur Andersen provide?

A Well, they basically prepare t e tax return, the income tax return.

Q Do they do tax planning?

A Oh, yes, they would; on request they would, yes.

Q Would they represent executives or management at IRS audits?

A Yes.

Q Prepare personal financial statements?

A I would say they probably would if requested, yes. It's not done in the normal course of their endeavor, but I think there is enough latitude there, if the individual utilizing that service, which in our particular case, or course, is just one person, which is our President, Chief Executive Officer. I'm sure if he asked them to do that, that they would provide that service.

Q Now you said just one person. Is just one person eligible for these tax services?

A The others are eligible only for tax services and there is a cap, of course, on the amount that they can expend in a year.

Q What's the cap?

A $1500 per individual. We have budgeted -- as I remember correctly, we have in this budget $400 per person.

Q With a cap of 1,500?

A Right.

Q Can you tell me what services Robert Benz and Company would provide?

A Simply prepares the income tax return. Take all the data to him, and he perhaps it.

Q What employees or what type of employees are eligible for the services?

A Mr. McCrary is available for the service provided by Arthur Andersen and Company, which would include some of the things that you discussed, as far as from a tax planning area, and the four VPs are eligible for the tax service, it has a cap on it.

Q Is there any cap on the amount of tax services Arthur Andersen could provide for Mr. McCrary?

A Not to my knowledge.

Q That's all I have for Mr. Scarbrough.

COMMISSIONER EASLEY: What about the other CPA firm, who is eligible for that; or is that different people, different employees?

WITNESS SCARBROUGH: Only the VP, Mr. McCrary, can use Arthur Andersen.

COMMISSIONER EASLEY: No, I meant the other CPA firm, I can't think of the name.

WITNESS SCARBROUGH: Robert Benz?

COMMISSIONER EASLEY: Yeah.

WITNESS SCARBROUGH: Who is eligible? Well, it's not defined that he's the one that can do it. They can choose whoever they want to. It just so happens they have chosen him, that's an individual decision based on up to a cap of $1500.

COMMISSIONER EASLEY: Okay, so it's -- they can take one or the other, but the cap still applies?

WITNESS SCARBROUGH: Anybody they want.

COMMISSIONER EASLEY: I misunderstood. Thank you.

WITNESS SCARBROUGH: I'm sorry.

COMMISSIONER GUNTER: Mr. Scarbrough, we had a lot of discussion last week on dollars that had been extended on the grand jury, an investigation and all that kind of stuff. And it just -- I don't know why I didn't think of it last week, but did Southern Company or Southern Company services expend any time and effort, money on that grand jury investigation?

WITNESS SCARBROUGH: Yes.

COMMISSIONER GUNTER: Have those, and those allocation process that have come from Southern Company services or Southern Company to Gulf, have those amounts been excluded?

WITNESS SCARBROUGH: They have been excluded, yes.

COMMISSIONER GUNTER: Do you know that?

WITNESS SCARBROUGH: Yes.

COMMISSIONER BEARD: UPS sales, 149 megawatts being sold right now? Is that right? Okay. And when the money is paid to Gulf Power by Southern Company, how is it handled, how is it accounted for?

WITNESS SCARBROUGH: It was taken in as cash and it's credited to Account 447, Nonterritorial Revenue.

COMMISSIONER GUNTER: That's a below-the-line account?

WITNESS Well, it's an above-the-line account, but it is, for retail ratemaking, it's removed below the line or excluded, it's taken out. Took all the investment, all the revenue, everything is taken out.

COMMISSIONER GUNTER: Okay, so if we were to include the 63 megawatts of Scherer that's been requested, okay, and we truck along to 1995 and the 15 years following that, you would have 63 megawatts in rate base for ratemaking purposes, is that correct?

WITNESS SCARBROUGH: Up until what?

COMMISSIONER BEARD: Well, in 1995 -- let's say we have a rate case today and we don't have another one for ten years.

WITNESS SCARBROUGH: All right.

COMMISSIONER BEARD: Okay, and I've got 63 megawatts in rate base for Plant Scherer, right?

WITNESS SCARBROUGH: Yes.

COMMISSIONER BEARD: Okay. Now, 1995, I've got the ratepayers paying for that 63 megawatts in rate base, but they are not getting any revenue relief because of the UPS sales?

WITNESS SCARBROUGH: They're not paying for it. Monthly -- there's been a lot of discussion about this.

COMMISSIONER BEARD: Well, I need to understand it.

WITNESS SCARBROUGH: Maybe I can explain this. Monthly, we file a Surveillance Report with this Commission, and on that Surveillance Report the only thing that's included on that Surveillance Report that ends up showing a return is those things that are allocated to the retail jurisdiction and the revenues from the retail jurisdiction. Everything else has been taken out. Everything. I mean this thing is dynamic. One of the things I -- you know, look at each month, we get that Surveillance Report, I look at it, the first thing I do is go and look at that return.

COMMISSIONER BEARD: So, you would remove any megawatts from rate base in the Surveillance Report associated with UPS sales?

WITNESS SCARBROUGH: Absolutely.

COMMISSIONER BEARD: Okay

WITNESS SCARBROUGH: Absolutely.

COMMISSIONER BEARD: Okay, that's what I needed to understand.

COMMISSIONER BEARD: Okay, that's what I needed to understand.

CHAIRMAN WILSON: Let me make sure I understand this. You include it when you're calculating rates, if we're in a rate case?

WITNESS SCARBROUGH: If it's serving a retail customer. For instance, right now the 149 megawatts is not serving retail customers, so it's out.

CHAIRMAN WILSON: Right. It's not included in calculating rates?

WITNESS SCARBROUGH: That's exactly right. The day that changes, it will be automatically removed out.

CHAIRMAN WILSON: For surveillance report purposes?

WITNESS SCARBROUGH: Absolutely. It's the same way, as we add facilities, as we build transmission lines, distribution lines, new business, production modifications, all those kinds of things, those things also are added to the rate base.

CHAIRMAN WILSON: And they appear in the surveillance report, even though they weren't --

WITNESS SCARBROUGH: They appear in the surveillance report and they come down and you get a return.

CHAIRMAN WILSON: Even though they were not included in the calculations for rate base?

WITNESS SCARBROUGH: Absolutely. What this does, it allows us each month to look at the return -- which is, of course, very dynamic. I mean, if the tax rates go up or down, cost of money goes up or down, plant service expenditures, retirements, O&M expenses, customer growth, off-system sales cost controls, everything is built into that surveillance report.

So all you have to do -- and also, I might say the Commission's auditors audit that surveillance report once a year, at least once a year. All you have to do is look at that return provided on that surveillance report. We look at it; and if it's within some reasonable range we think we can live with, we don't do anything. I assume that when the Commission Staff gets it, they take a look at it; and as long as it's within the range, they don't do anything. Theoretically, this could go on through infinity. Because it's so dynamic, all these things are changing back and forth.

For instance, if you approve a return, a return on equity in this particular proceeding, and somehow or another the return falls 300 basis points six months from now, the Commission may be looking at that and look at that return and say, "The return we gave them back in August of 1990 is higher than what's reasonable today," and you make a decision based on that.

On the other side of that, if all of a sudden, as it has before, the prime rate goes to 20, cost of money goes up, cost of equity goes up 16, 18%, we can look at that and say, you know, "They gave us this return, it's significantly less," then we can take attention.

That surveillance report is very dynamic, it includes every single thing that affects retail rates. You look at the return and you can make decisions based upon looking at that return. Of course, you all can satisfy yourselves that the items on there are probably calculated to include every item, you do that through your audit procedure.

CHAIRMAN WILSON: By the same token, if we set rates in this proceeding which include all of your current generation plants -- what's your biggest generation plant, Crist?

WITNESS SCARBROUGH: Plant Crist, yes.

CHAIRMAN WILSON: Which unit?

WITNESS SCARBROUGH: Which unit? Unit 7.

CHAIRMAN WILSON: That's what?

WITNESS SCARBROUGH: 500 megawatts.

CHAIRMAN WILSON: 500 megawatts. If in six months you decided to make UPS sales out of Crist, you sold 100% of the capacity of it to whoever, your next month's surveillance report would take your investment in Crist 7 out?

WITNESS SCARBROUGH: Yeah, and everything that goes with it, all the expenses.

CHAIRMAN WILSON: The revenues and everything else?

WITNESS SCARBROUGH: Everything that goes with it.

CHAIRMAN WILSON: The rates set in this proceeding, though, would include Crist?

WITNESS SCARBROUGH: That's correct.

CHAIRMAN WILSON: Your surveillance report is dynamic but your rates aren't?

WITNESS SCARBROUGH: The rates are not. But also if that happened as you described, you have other things in a short period of time you may not offset, but there would be other things daily, monthly, that would be adding to that on the other side that we would not be getting rates to cover.

CHAIRMAN WILSON: The rate of return is calculated based on the interaction of the investments you have, the expenses you incur, and the revenues you receive?

WITNESS SCARBROUGH: Yes, sir.

CHAIRMAN WILSON: Those things can go up and down, sideways and backwards?

WITNESS SCARBROUGH: Absolutely.

CHAIRMAN WILSON: And when you boil it all down, it comes down to a rate of return?

WITNESS SCARBROUGH: That's exactly right.

CHAIRMAN WILSON: Just like coming in here and saying, "We need," what is the total revenue requirements you requested?

WITNESS SCARBROUGH: $26,295,000.

CHAIRMAN WILSON: That's the incremental addition. What's the total revenue requirement?

WITNESS SCARBROUGH: The total revenue requirement? I don't know, retail $400 million or something like that.

CHAIRMAN WILSON: I was going to say, you just come in and say, "Well, we need $400 million, doesn't make any difference what our investment is, because that changes all the time, or our expenses or anything, we want $400 million." The way we check that is to look at surveillance?

WITNESS SCARBROUGH: Exactly. And then satisfy yourself it's prepared properly. And I assure you to the best of our ability it is prepared properly. One of the things we tried to do, we tried to make all those adjustments that were made in the last case. If you disallowed the lobbying expenses, or for charitible contributions, all those kind of things, we tried to make all those adjustments.

CHAIRMAN WILSON: I was just making sure that it was clear that Commissioner Beard's question about the UPS sales, that we're talking about two different things, we're talking about setting rates and then we're talking about monitoring your rate of return, earned rate of return?

WITNESS SCARBROUGH: That's correct.

CHAIRMAN WILSON: On surveillance reports. Something that's either in or out of rate base at this point may or may not be in or out of rate base in six months?

WITNESS SCARBROUGH: Absolutely. In fact you can guarantee it won't all be, for sure. We'll probably retire something tomorrow which won't be in there. And you could replace it at a higher cost. I mean, just every single thing that affects our operation from a financial standpoint is included in that surveillance report.

CHAIRMAN WILSON: Questions, Commissioners? Questions? Redirect?

MR. HOLLAND: I think I only have one question.

I hope you know the answer, Mr. Scarbrough.

WITNESS SCARBROUGH: I do, too. You give me more trouble than anybody.

CHAIRMAN WILSON: Let me jump in here, I just had a thought.

MR. HOLLAND: Yes, sir.

CHAIRMAN WILSON: If the Commission, for instance, did not include a lump of investment, one of your plants or a piece of one of your plants, which is one of the issues we're talking about here today, --

WITNESS SCARBROUGH: Didn't include what?

CHAIRMAN WILSON: A piece of one of your plants, your investment in one of the plants today?

WITNESS SCARBROUGH: Okay.

CHAIRMAN WILSON: And tomorrow you made UPS sales out of it and that covered your revenue requirement, wouldn't make any difference, would it?

WITNESS SCARBROUGH: If you disallowed it and tomorrow we sold it?

CHAIRMAN WILSON: Uh-huh.

WITNESS SCARBROUGH: Doesn't make any difference, right.

CHAIRMAN WILSON: Because when you filed your surveillance report, it wouldn't be on there?

WITNESS SCARBROUGH: You got it, that's exactly right.

REDIRECT EXAMINATION

BY MR. HOLLAND:

Q Mr. Scarbrough, to your knowledge, has Arthur Anderson ever prepared a financial statement for Mr.

McCrary?

A I have no earthly idea what they've done for him. I see the bill and I get him to approve it. And I know that the basic thing they're doing is preparing his tax return. And other than that, I have no personal knowledge of what they do for him as far as --

Q You just don't know whether they --

A I don't know precisely what they do, but I know what the provisions are of that agreement.

Q Are the basic provisions for them to take the data provided by him and prepare a tax return?

A That's the basic requirement, yes.

Q With respect to the surveillance report, if 63 megawatts of Plant Scherer were included for ratemaking purposes in Gulf's rate base, and in 1991 or 1992 -- let's say 1993 is when I believe it actually will happen -- that 63 megawatts is removed for surveillance purposes?

A You mean if we sold the entire 63 megawatts?

Q Sold the 63 megawatts in unit power sales. Assuming everything else had remained static and you had not made any additional investment, what would that cause the return on the surveillance report to do?

A It would cause the return on the surveillance report to go up.

Q Okay. And if in the meantime between 1990 and 1993 you had made investment which was greater than the investment associated with Plant Scherer -- and I believe that, for the purposes of this rate case, is about $50 million -- what would it cause your return to do?

A It would cause it to go down. But this wouldn't happen in 1993, it would happen as you go along every month.

MR. HOLLAND: That's all I have.

CHAIRMAN WILSON: All the exhibits for this witness are late-files, is that right? Other than the ones that have already been identified by stipulation? All right, thank you very much.

(Witness Scarbrough excused)

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CHAIRMAN WILSON: Call your next witness.

MR. HOLLAND: I believe our next witness is Mr. Gilbert.

CHAIRMAN WILSON: Let's stand at ease about five minutes while we change witnesses.

D. P. GILBERT

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

DIRECT EXAMINATION

BY MR. HOLLAND:

Q Mr. Gilbert, are you ready?

A I'm ready.

Q Mr. Gilbert, you've testified previously in this docket?

A I have.

Q And you've prefiled testimony in this docket entitled "The Rebuttal Testimony of D. P. Gilbert"?

A That's correct.

Q Do you have any additions or corrections to make to the testimony?

A Yes, I have several corrections. On Page 11, Line 9, change the "9" to "8." Page 11, Line 12, change the "9" to "8." Page 11, Line 17, change "39" to "38." Page 11, Line 18, change "9" to "8."

Now, skip to my Schedule 9 of my exhibits, Page 1. The title is incorrect, change the word "Complement" to "Total." And in that schedule, after Line 27 should come Line 28, which was omitted in error, and that line should read, under the first column, "Stenographer, Central Division, Authorization No. 406900," and under the last column, "It was budgeted."

Q With those --

A I have one other.
Q I'm sorry.
A On Page 2 of Schedule 9, the same change in the title, change "Complement" to "Total."
That's concludes my errata.
Q With those changes, if I were to ask you the questions today that are contained in your testimony, would your answers be the same?
A Yes, they would.
MR. HOLLAND: Mr. Chairman, we'd ask that Mr. Gilbert's rebuttal testimony be inserted into the record as though read.
CHAIRMAN WILSON: His rebuttal testimony, without objection, will be so inserted.
Q (By Mr. Holland) And, I believe, Mr. Gilbert, your exhibits have been stipulated to and were premarked.
A Yes.
(Exhibit Nos. 44 and 45 previously stipulated into the record.)

Record Copy

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony of
D. P. Gilbert
In Support of Rate Relief
Docket No. 891345-EI
Date of Filing May 21, 1990

Q. **Mr. Gilbert, have you previously submitted testimony in this proceeding?**

A. Yes. I submitted prefiled direct testimony in this proceeding in support of the filed rates for Gulf Power Company. In addition, I have sworn to and have been deposed on these same matters taken at the request of the Office of Public Counsel (OPC).

Q. **Have you reviewed the testimony and exhibits of the witnesses intervening in this proceeding?**

A. Yes.

Q. **Does the testimony of Helmuth W. Schultz, III address subjects that fall in your area of responsibility?**

A. Yes.

Q. **Are there any viewpoints expressed in the testimony of Mr. Schultz that cause you concern?**

A. Yes. Several of Mr. Schultz's points are based on incorrect information. I will comment on

Mr. Schultz's testimony as it relates to Gulf's operations and maintenance budget process.

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 DPG-2, comprised of 2 schedules, be marked as Exhibits 44-45.

Q. Please explain how the Reference Level is used in Gulf's budget process.

A. The Reference Level is a level of O & M expenses established by the Budget Committee during each year's budget process which is used to determine the amount of documentation required to be submitted to the Budget Committee for review in the budget approval process. The planning units must provide documentation justifying increases or decreases from the Reference Level.

Q. Please describe what is meant by the term Corporate Controlled as used in Gulf's budget process.

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 individual responsible for monitoring the item, a group of individuals, or other companies' input to control the expenditure. Gulf removes the Corporate Controlled expenses for the purposes of 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. **Mr. Schultz is concerned that Company adjustments made to the 1989 Budget Reference Level were not appropriate and have flowed forward into the 1990 Reference Level. Were the adjustments inappropriate or in violation of the Company's budget policy?**

A. No. The corrections were appropriate and do not represent violations of the Company's budget policy. As Mr. Schultz stated, the 1989 Reference Level was supposed to be the 1988 budget less 1988 Corporate Controlled and 1988 non-recurring items. The corrections to the Reference Levels of the various planning units were made to reflect as accurately as possible the level of expenses related to normal operations that are under the direct control of the department heads of those planning units.

Q. **Did these adjustments to the Reference Level affect the total 1989 Budget?**

A. These corrections to the Reference Level did affect the level of documentation required to be submitted by a planning unit but did not affect the final level of the budget.

Q. **Mr. Schultz stated on page 5 of his testimony that 14 of 21 planning units had 1989 Reference Levels that were not equal to the 1988 budget less 1988 Corporate Controlled and 1988 non-recurring items. Was there an adjustment which accounted for most of these changes?**

A. Yes. Of the 14 planning units to which Mr. Schultz referred, corrections were made to the Reference Levels of 13 of the planning units to reflect the repeal of the Florida sales tax on services. The increased sales taxes had been approved in the 1988 budgets as a recurring cost and had to be removed to ensure that the 1989 budgets would not include this level of expense since the tax was repealed. The total correction amounted to a total reduction to the affected Reference Levels of $431,041. As Mr. Schultz stated on page 6 of his testimony, this correction was disclosed in the 1989

Budget Message.

Q. **Were any other changes made in calculating the Reference Levels?**

A. Yes. In the 1987 and 1988 budgets, the cost of operating and maintaining the Corporate Office Building was included in the budget as a Corporate Controlled item. These costs were considered Corporate Controlled in those years because the Company had just completed construction of the building and there were warranties on equipment and machinery in the building which were expiring at different times. These factors made it difficult to budget exactly what the O & M costs would be. Designating the new Corporate Office Building as Corporate Controlled made it much easier for the Budget Committee to analyze the budget requests of the General Services Planning Unit during the transition period. When the last of the warranties expired in 1988, the Corporate Office O & M was no longer considered Corporate Controlled and was, therefore, included in the Reference Level of the General Services Department. This change was made in order to reflect that the General Services Department Head was responsible for the costs associated with the operation and maintenance costs of the Corporate Office Building. This change places the budget dollars with the responsible department head. This change was also disclosed in the 1989 Budget Message.

Q. **Please discuss the other reference level adjustments referred to by Mr. Schultz.**

A. Prior to the 1989 budget year, Gulf's cost of administering the Pension Plan ($48,673) and the Employee Savings Plan ($16,630) was included in the Corporate Controlled amounts for these items. In 1989, Gulf removed the costs from Corporate Controlled and included them in the Reference Level of the Employee Relations Department. This change was made to more properly reflect the costs which are under the direct control of the Employee Relations Department Head.

Minor transfers in four planning units were made to correct errors in the Reference Levels between labor and other expenses. The total amount involved in these corrections was $38,000 (net) and had no impact on the total Reference Level.

In summary, all of these changes were made by the Corporate Planning Department in order to state as accurately as possible the level of expense representing normal operations in each planning unit.

Q. **Were the above changes to the reference level approved by the Budget Committee?**

A. Yes.

Q. **Do you agree with Mr. Schultz's proposed reduction to the non-labor, non-corporate controlled Employee Relations Budget?**

A. No. On page 10 of his testimony, Mr. Schultz recommends that O & M expenses be reduced by $728,826 due to adjustments to the Employee Relations Reference Level. This recommended reduction is without basis and should not be made.

Q. **Do you have a schedule which shows the components of the Employee Relations 1989 Budget and that of historical years?**

A. Yes. Schedule 8 of my exhibits shows 1986 through 1989 expenses for Employee Relations separated into Labor, Corporate Controlled, and Other expenses.

Q. **Which items in Employee Relations are defined as Corporate Controlled for the 1989 budget process?**

A. Employee Relations Corporate Controlled are post

Retirement Benefits consisting of Pensions, Employee Group Life and Medical Insurance, and Supplemental Pension Benefits; Employee Group Insurance paid by the Company and the Employee Contribution to Insurance; and the Company's matching contribution to the Employee Savings Plan.

Q. **How do you calculate the proper 1989 Reference Level for Employee Relations non-labor, non-corporate controlled expenses?**

A. Start with the 1988 budget of $9,973,884, subtract $7,722,550 Corporate Controlled and $1,457,453 Labor and the Reference Level Other is $793,881.

Q. **Why did this other amount appear to be $114,534 per the 1988 Resource Request B-3 form?**

A. The $114,534 was a miscalculation and was given to Employee Relations in the 1988 Budget Message. They then used it on their Budget Request (B-3) Form.

Q. **What caused the miscalculation?**

A. The 1987 budget amount for Employee Group Insurance, a Corporate Controlled item, was $1,882,139. That amount consists of the gross payout for insurance of $2,530,139 found in account 926-200 and the employee contribution which offsets the expense to the Company of $648,000 in account 926-201. The gross amount of $2,530,139 was backed out in the budget message calculation of Employee Relations 1988 Reference Level instead of the net amount of $1,882,139. This caused the understatement of the Reference Level on Employee Relations Resource Summary Form (B-3).

Q. How did your department correct this error?

A. The correction of $648,000 was added back to Employee Relations budget on the approval letter.

Q. What other way could you have corrected this error?

A. The B-3 Form Reference Level could have been corrected and the effect would have been exactly the same.

Q. What was the purpose of the correction?

A. The purpose was to correct an error made in the Budget Message to more accurately state the Employee Relations Budget.

Q. Did the Budget Committee approve this correction?

A. Yes.

Q. Was the 1989 Reference Level of $793,881 for the

Employee Relations Planning Unit overstated by $728,826 as alleged by Mr. Schultz?

A. No. Mr. Schultz did not thoroughly review the 1989 Reference Level and prior year actual expenses to determine the appropriateness of Gulf Power's Employee Relations Department Budget. My Schedule 8 shows this historical perspective.

Q. Did Mr. Schultz or the OPC staff seek to discover the nature of the changes made to the Reference Level?

A. To my knowledge, there were no requests made seeking explanations regarding the changes made to the Reference Levels for the 1989 budget.

Q. Do you agree with Mr. Schultz's assessment of the Company's 1990 labor budget?

A. No, although I agree that labor must be adjusted, I disagree with the methods used to calculate his adjustment and I feel that his adjustment is overstated.

Q. With what parts of Mr. Schultz's calculation methodology do you disagree?

A. First, he has used a one month sample to judge the annual vacancy rate. Also, he has attempted to develop an average salary of all existing employees in order to price the vacancies, when a better method would be the average salaries of the vacancies or the average salaries of all new hires.

Q. **Are you providing more current vacancy numbers than those provided by Mr. Schultz?**

A. Yes, Schedule 9 of my exhibits shows Gulf's vacancies as of May ~~9~~ 8, 1990. The total vacancies as of that time were 49, of which three are unbudgeted positions and therefore are not included in this case. Our vacancies through May ~~9~~ 8 for the purpose of this case are 46. The vacancy rate is a fairly volatile number. During the eight month sample period, January to August 1989, on which my hiring lag adjustment is based, the approved vacancy rate varied from a high of 49 to a low of ~~39~~ 38 for a weighted average of 42. Through May ~~9~~ 8 the total vacancy rate is within the range as established for the purpose of calculating the hiring lag adjustment.

Q. **Mr. Schultz states on page 14 of his testimony that failure to use the Company's labor model in certain planning units shows a lack of consistency in the operation of the Company's formal budgeting process.**

Do you agree?

A. No. The labor model, or salary budget system, that Mr. Schultz discussed is used by approximately 76 percent of the planning units. The use of this model is not mandatory and is provided as a tool to be used in preparing the labor budgets.

Several planning units have utilized other labor budgeting tools and models for several years prior to the introduction of the model referred to by Mr. Schultz. Each of these alternatives, as well as the salary budget system, produce essentially the same estimates of labor costs.

As noted by Mr. Schultz in his testimony, the Company reviews for reasonableness the labor budgets of each planning unit. There is no adverse effect on the reasonableness of the Company's labor budget due to the use of differing labor budget tools.

Q. Mr. Schultz believes that "the credibility of the budget process must be considered, particularly when the budget itself is being used as the test year to determine rates." Has this budget been audited by anyone else?

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 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. Mr. Bell evaluated the financial forecast, of which the O & M budget is a component part, 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. **Beginning on page 15 of Mr. Schultz's testimony, he states that the Company does not adjust its Reference Level for variances between prior years' budget and actual inflation rates or budget to actual expenditures. Please discuss the effect on the 1990 Operations and Maintenance (O & M) budget.**

A. Gulf's budget process begins with the development of goals and objectives for the Company and the individual planning units. Next, totally apart from the Reference Level calculations, the O & M budget is then prepared by each planning unit and represents management's estimate of the resources necessary to accomplish the goals and objectives. As mentioned previously, the Reference Level is only utilized to determine the amount of documentation submitted to the Budget Committee. Any adjustment to the Reference Level for prior year inflation or budget variance would not affect the budget level but only the level of documentation provided to the Budget Committee.

Q. Does Gulf utilize an across the board, mandatory adjustment for prior year budget variances?

A. No.

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

A. Yes. In July and August of each year as the planning units develop their O & M estimates, the budget variance reports for the current and previous years are utilized. These, along with the knowledge, experience, and professional judgment of the management of each planning unit determine the affect the variances might or might not have on the budget year. Also, utilizing the budget to actual variance analysis in the preparation of the budget management corrects the variances caused by differences between the budget and actual inflation rates.

Q. **Mr. Gilbert, did the Office of Public Counsel (OPC) review detailed budget working papers of various planning units?**

A. Yes. Representatives of the OPC were given access to the detailed working papers of every planning unit that they requested be made available for their review. In addition, copies of specified working papers requested were provided in Gulf's response to the Public Counsel's review of the workpapers.

Q. **Mr. Schultz states on page 16 of his testimony that "except for Plant Crist, only portions of the necessary documentation were provided to us in support of total budget costs in the 'other' category." Is this a true statement?**

A. Yes. Gulf provided to OPC only the detail that was requested. During the OPC's review of the budget workpapers, Gulf's personnel answered questions and provided all documentation that OPC personnel requested. The Office of Public Counsel personnel requested documentation related to the total budgeted costs in the other category only for Plant Crist.

Apparently, Mr. Schultz would like the Commission to believe that the Plant Crist documentation was the only information available rather than the only information requested and subsequently provided.

Q. **On page 28 of his testimony, Mr. Schultz questions the amount of input which Gulf provides into the development of its Southern Company Services (SCS) budget. Please describe the SCS budget process and Gulf's involvement in it.**

A. Southern Company Services budget process is divided into three phases: preparation, review, and approval. Formal and informal communication between Gulf and SCS personnel and system project committees provide SCS with preliminary levels of service requirements for planning and budgeting purposes. During the preliminary phase, projects are evaluated and prioritized, scope changes are identified, and schedules are modified.

Gulf personnel are heavily involved in the process. There are 17 Gulf employees who are designated as SCS Budget Coordinators. These employees are General Managers, Managers and Vice

Presidents who are responsible for achieving the Company's Goals and Objectives. The coordinators provide direction to SCS for Gulf's SCS work level requirements. In addition to the coordinators' input, Gulf's section managers, supervisors, and staff personnel communicate frequently with SCS management and staff to plan and analyze the activities and services as well as the associated costs. Gulf personnel participate on system-wide committees like the System Planning Committee, the Operating Committee, and the Information Resources Sub-Plan Group. These committees provide valuable input often through detailed work plans outlining projects several years into the future. All of these inputs are reviewed by department heads at both Gulf and SCS.

Q. After this preliminary information about plans and budgets is developed by Gulf and SCS, what does SCS do?

A. The SCS budgeting department formalizes the amounts into a work order budget which indicates the preliminary budget estimates for each of The Southern Company's subsidiaries.

Q. Please explain Gulf's involvement in the budget review process.

A. The preliminary budget is sent to the operating companies for review, while various levels of SCS management also review the preliminary budget amounts. The activities, services, and committee recommendations may be reprioritized and changed in scope or modified in amount based upon reviews by SCS and Gulf management. These reviews focus on levels of service and reasonableness of amounts. Because of Gulf's and its sister companies' participation in the process, SCS budgeting and monitoring control practices, and continuous communication between SCS and the operating companies, there is a broad base of understanding of budget cost components. Budget revisions subsequent to this review process demonstrate the responsiveness of SCS and the effectiveness of budget reviews as viable cost control mechanisms.

Q. Does Gulf participate in the approval process?

A. Yes. After an agreement is reached at the coordinator level, SCS senior level executives present the budget to each of The Southern Company subsidiaries' Vice Presidents and CEOs. Adjustments made in these meetings are included in the final approved SCS Billing Budget.

Q. Who participates in this meeting at Gulf?

A. Gulf's Budget Committee, the President, and senior level executives of SCS are involved in the meeting to approve the SCS Billing budget.

Q. Please summarize your testimony concerning the SCS budget process.

A. Throughout the preparation, review, and final approval, Gulf personnel continuously communicate the work requirements, the service levels, and the committee recommendations to ensure that goals and objectives will be met at a reasonable cost to Gulf.

Q. Mr. Gilbert, please summarize your rebuttal testimony.

A. My rebuttal testimony addresses several of Mr. Schultz's assertions regarding the Company's Operation and Maintenance (O & M) expenses. I have explained the adjustments made in calculating the 1989 Reference Level and clarified several of the points with which Mr. Schultz attempted to cast doubt upon Gulf's budget process.

In summary, Gulf's budget process is straightforward and logical, and the resulting budget is based on the plans, goals, and objectives of the Company.

Q. Mr. Gilbert, does that conclude your testimony?

A. Yes.

Q (By Mr. Holland) Would you please summarize your testimony?

A My rebuttal testimony addresses several of Mr. Schultz's assertions regarding the Company's operation and maintenance expense. I have explained the adjustments made in calculating the 1989 reference level and clarified several of the points which Mr. Schultz attempted to cast doubt on Gulf's budgeting process. Mr. Schultz based several points in incorrect information.

Also, Mr. Schultz makes an adjustment to Gulf's labor budget. Gulf agrees that a hiring lag adjustment should be made. We disagree with Mr. Schultz' method in the dollar amount of his adjustment.

We have budgeted 1625 full-time and part-time employees for 1990. For the purpose of this case we have removed 38 in my hiring lag adjustment. This resulted in a budgeted number for personnel of 1,625, less the 38 in my hiring lag adjustment, for a total of 1,587. As of May 31st, the number of actual full-time and part-time employees on board is 1,587.

Therefore, rather than Mr. Schultz' vacancy rate of 58 as of February, I feel that the 38 projected in my hiring lag adjustment is presently being achieved and is representative of the period the rates will be in effect.

In addition, Gulf is incurring labor expenses from two unbudgeted sources. The first source are unbudgeted temporaries, many of which are filling some of the vacancies. The O&M cost of these temporaries is projected for 1990 at $87,902. Gulf offset its hiring lag adjustment with these costs, but Mr. Schultz did not.

The second source of unbudgeted labor expense being incurred is the difference between the 3% assumed for our 1989 union contract settlement and the November 16th, 1989 actual settlement of 3.7%. This 3.7, or the difference between these, is not included in our budget. This would amount to $175,000 of O&M expense in 1990. This concludes my testimony -- summary.

Q Summary.

A Summary.

MR. HOLLAND: Tender Mr. Gilbert.

CHAIRMAN WILSON: Staff?

CROSS EXAMINATION

BY MR. PALECKI:

Q Mr. Gilbert, when the error in the calculation of the 1988 reference level was discovered and the changes were made to correct that error, was there any written documentation concerning the amount of -- or the figure that was added back?

A Yes, there was. We received a letter from the planning unit that was affected by the error, identifying the error and requesting that these funds be reinstated to their budget. This was done so in our approval letter that went back to them, and, of course, this was approved by our Budget Committee.

Q Are you aware of whether or not that letter documenting the error has been supplied to Staff?

A I am not aware if it has or has not.

MR. PALECKI: We'd like to ask for that as the next consecutive late-filed exhibit.

CHAIRMAN WILSON: Exhibit 628.

(Late-Filed Exhibit No. 628 identified.)

MR. PALECKI: Short title would be "Documentation of Error in Calculation of 1988 Reference Level."

Mr. Gilbert, that's the last cross-examination question I have for you, but your rebuttal testimony has raised the need for two additional late-filed exhibits. First of all, could you please provide a late-filed exhibit giving the 1985 through 1989 actual and budgeted O&M nonrecurring expenses for turbine and boiler inspections, vehicle rebuilds, and other, the "Other" category? And the short title will be "Budgeted O&M Expenses."

The second --

CHAIRMAN WILSON: That will be 629.

(Late-Filed Exhibit No. 629 identified.)

A Could we put "Nonrecurring" in that title so we don't get confused?

Q Yes, Budgeted "Nonrecurring" Expenses, O&M Expenses.

The second item that we would like you to provide us is for the 1990 budget, please provide nonrecurring expenses by functioning -- or, excuse me, by functional O&M account.

A We can do that.

MR. PALECKI: And the short title will be, "Nonrecurring Expenses by Functional O&M Account." And could we have a number on that?

CHAIRMAN WILSON: Yes, that would be 630.

(Late-Filed Exhibit No. 630 identified.)

MR. PALECKI: Thank you. We have no further questions from Mr. Gilbert.

CHAIRMAN WILSON: Questions, Commissioners? No questions? Redirect?

MR. HOLLAND: No.

CHAIRMAN WILSON: Thank you very much.

(Witness Gilbert excused.)

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MR. STONE: Call Mr. McMillan.

RICHARD J. McMILLAN

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

DIRECT EXAMINATION

BY MR. HOLLAND:

Q Mr. McMillan, you have previously testified in this docket?

A Yes, I have.

Q And have you caused to be filed additional testimony entitled, "Rebuttal Testimony of Richard J McMillan"?

A Yes, I have.

Q Do you have any additions or corrections to that testimony?

A No, I do not.

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

A Yes, they would.

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

CHAIRMAN WILSON: His testimony, without objection, will be so inserted into the record.

(Witness McMillan's rebuttal exhibits previously stipulated into evidence.)

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony of
Richard J. McMillan
Docket No. 891345-EI
Date of Filing May 21, 1990

Q. Please state your name, business address, and occupation.

A. I am Richard J. McMillan, my business address is 500 Bayfront Parkway, Pensacola, Florida, 32501, and my business title is Supervisor of Financial Planning.

Q. Are you the same Richard J. McMillan who filed direct testimony in this proceedings?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. I will address the inappropriateness of many of the adjustments proposed by Mr. Hugh Larkin in his direct testimony, and Mr. Schultz's proposed disallowance of Gulf's 1990 bank service charges and lines of credit fees.

Q. Mr. Larkin has proposed changes to the Company's plant-in-service and accumulated depreciation balances, and depreciation expense. Are his proposed adjustments

reasonable and accurate?

A. No. Mr. Larkin's methodology of estimating plant-in-service by using linear regression with actual plant balances from January 1988 through February 1990 is invalid. Several large adjustments and retirements took place during this time period which would distort a linear regression. First, there was a large decrease in plant-in-service in June 1988 caused by the entry to move the Scherer Plant Acquisition Adjustment from Account 102 to Account 114 (approximately $9 million), and by the discontinuance of the manual control account journal entry that cleared all DSO's to plant-in-service in the month they were spent (approximately $9 million). Second, during 1988 and 1989 the Plant Daniel Coal Cars were retired, thus decreasing plant-in-service by $9.5 million (with an offsetting decrease to accumulated depreciation). Finally, in December of 1989, a portion of the purchase price of Plant Scherer Unit 3 was refunded by Georgia Power, resulting in a $5.3 million decrease to plant-in-service. These large non-recurring decreases caused the results of Mr. Larkin's linear regression to be misstated, thereby understating plant-in-service. Using linear regression of actual data to project future balances may be distorted by unusual or non-recurring fluctuations in the actual data, and will not properly reflect the expected fluctuations in projected data that are reflected in the construction budget.

Gulf's Capital Additions Budget and the 1990 forecast of our plant data is a more accurate basis for estimating future plant balances. Construction expenditures through March are only under budget by $1.5 million due primarily to a slight delay on a few large production projects, which are expected to catch up in the second quarter.

As Mr. Larkin pointed out, Gulf's plant-in-service balances for December 1989 through March 1990 are under budget. This is due mainly to the adjustments in late 1989 related to the refunds from Georgia Power Company and Ogelthorpe Power Corporation regarding the reduction in the Plant Scherer Unit 3 purchase price. In addition, the retirements associated with a few large projects were over budget during this period, which is simply a timing variance (not permanent) caused by several retirements which were booked earlier than projected in the budget. This variance in plant-in-service caused by retirements is offset in the accumulated depreciation reserve by the same amount. The effect of the variance in retirements on net plant is zero.

Q. **What about Mr. Larkin's calculations for depreciation and the reserve for accumulated depreciation?**

A. Mr. Larkin's understatement of plant-in-service also affects the calculation of depreciation expense and the reserve for accumulated depreciation. Based on these understated levels of plant, Mr. Larkin calculates a reduction in depreciation and amortization expense of $967,297. As stated earlier, the Company's projections for plant-in-service, adjusted to reflect the reduced costs related to Plant Scherer Unit 3, are more accurate and reasonable; therefore, no other adjustments to depreciation expense is warranted. Nevertheless, the adjustment Mr. Larkin calculated was also in error. After Mr. Larkin calculated his revised electric depreciation and amortization expense based on his understated plant balances, he compares his figure to the incorrect amount for the Company's projected expense. The Company figure he uses includes $255,000 related to the amortization of the plant acquisition adjustment. This $255,000 is not included in Mr. Larkin's revised calculation, causing his adjustment to be overstated by the $255,000. Although Gulf does not agree with Mr. Larkin's revised expense calculation, the correct adjustment to depreciation expense using his figures would be $712,297 instead of

$967,297. This adjustment also causes accumulated depreciation to be understated.

Q. **Are there other errors in Mr. Larkin's calculation of the reserve for accumulated depreciation?**

A. Yes. Mr. Larkin also has two other errors in his projection of the depreciation reserve balance. First, his reserve balances excluding the JDITC balance (column (e) of Schedule HL-4) for actual January and February of 1990 are understated by $200,000 and $399,000, respectively. The $399,000 error carries forward to the projected amounts for March through December of 1990. The second error is an overstatement of the reserve balance related to the JDITC amount shown in column (f) of Schedule HL-4. In Order No. 16257 issued June 19, 1986, the Commission decided that the depreciation reserve imbalance adjustment should offset the JDITC amount. The net of these balances is $290,000 in December of 1989. This is the net amount that is actually in the reserve, not the $5,648,000 shown on Schedule HL-4. When these two corrections are made, Mr. Larkin's adjustment to the Company's filing would be a <u>decrease</u> of $1,513,000 instead of an increase of $3,715,000, which resulted in a $5,228,000 understatement of net plant.

Q. Mr. McMillan, what is your conclusion with respect to Mr. Larkin's calculation of these plant items?

A. It is obvious that Mr. Larkin's calculation of plant balances, without proper consideration of the forecasted level and timing of construction expenditures, plant additions and retirements, cost-of-removal and salvage, does not result in reasonable or accurate projections for plant-in-service, accumulated depreciation, or depreciation expense. The Company's projections, adjusted to reflect the revised costs related to Plant Scherer Unit 3, are more accurate, and properly reflect Gulf's 1990 test year amounts.

Q. Is Mr. Larkins's adjustment to income taxes related to interest synchronization accurate?

A. No. First of all, Mr. Larkin has included the wrong amount for the interest deduction, per Company filing, on his Schedule HL-11. He used the jurisdictional interest per books amount of $30,871,000 from MFR Schedule C-44. The correct amount to use is the jurisdictional synchronized interest of $32,045,000 used by the Company in its interest synchronization calculation as shown on Schedule 15 of my prefiled direct testimony. This would result in a decrease in interest of $2,734,000 on Schedule HL-11 based on Mr. Larkin's revised rate base.

The second error related to interest synchronization is the direction of the adjustment to income taxes. A reduction in rate base results in a reduction in interest as shown on Schedule HL-11. A reduction in the interest deduction should result in an increase in income taxes. However, on page 1 of Mr. Schultz's Schedule HWS-1, income taxes have been reduced by the $587,000 calculated by Mr. Larkin, not increased as they should be. The correct adjustment for interest synchronization based on Mr. Larkin's revised rate base is to increase income taxes by $1,029,000 ($2,734,000 shown above x .3763), not to decrease income taxes by $587,000.

Q. Mr. Larkin has made an adjustment to remove the capitalized portion of the cancelled Southern Company Services (SCS) building. Is this appropriate?

A. No. The correcting entry to expense the cancellation costs related to the SCS building was recorded in May 1989. The financial forecast used in developing the 1990 test year included actual data through August 1989, therefore, the correcting entry has been properly reflected in the test year plant data and no adjustment is required.

Q. **Mr. Larkin has proposed disallowance of the insurance reserves included in Other Property and Investments until the Company can show the benefit to ratepayers of these reserves. Please explain the purpose of these reserves.**

A. The Southern electric systems' Public Liability and Directors & Officers Liability insurance coverages are obtained through four captive insurers:

1. Associated Electric & Gas Insurance Services (AEGIS),
2. Energy Insurance Mutual (EIM),
3. XL Insurance Company (XL), and
4. ACE Insurance Company (ACE).

It should be noted that these insurers are not pure captives, i.e., they were not created for the sole purpose of underwriting the risks of The Southern Company and its subsidiaries. In each instance, the captive is an association or group captive established by a group of companies to underwrite their collective risks. AEGIS and EIM provide coverage only to electric and gas utilities. XL and ACE provide coverage on a multi-industry basis, primarily to Fortune 500 companies.

Southern and Gulf's initial involvement with captives began on August 21, 1984, when we joined AEGIS. In conjunction with the August 21, 1985 renewal of the system public liability policy, a competitive bid was solicited from the commercial market. American Reinsurance Company/Reliance of Illinois offered a premium quotation of $5,200,000 for a policy limit of $5,000,000 in excess of a $1,000,000 deductible. AEGIS quote for broader coverage with a policy limit of $20,000,000, subject to a $1,000,000 deductible, was $2,112,600. The coverage was awarded to AEGIS. These premium quotations were for the system as a whole and the cost was allocated pro rata among the system companies. We continued to purchase excess Public Liability insurance, with limits above the AEGIS policy, and our Directors & Officers Liability insurance from the commercial insurance market until 1986.

Southern joined EIM, XL and ACE in 1986. These captive insurers were created in direct response to the insurance market crisis occurring at that time. The commercial insurance market was extremely restricted, terms of coverage were unreasonable and, where coverage was available, pricing was exorbitant. We simply could not fill our insurance requirements, at any reasonable price, with coverage available from the commercial market. The captives offered the only viable alternative and resulted in a significant savings in insurance premiums.

Q. **Is Mr. Larkin's adjustment to reduce fuel inventories appropriate?**

A. No. He has based his adjustment on an inappropriate interim adjustment. Additionally, the interim test period is not representative of the 1990 test period, and as discussed by Mr. Parsons in his prefiled direct testimony, Gulf's test year requested fuel inventory levels are reasonable and appropriate.

Q. **Mr. Larkin has proposed a reduction in plant materials and operating supplies of $2,307,000. Is this appropriate?**

A. No. He based his adjustments on the actual 13-month average for the period ending February 28, 1990, which is not representative of the test period. Just using actual balance as of February 1990, with no additional increase, would result in a significant reduction in his adjustment. The forecasted increases in our inventory balances are reasonable and necessary due to increasing costs, and the constantly increasing investment in additional electric facilities required to serve our customers. Gulf's projections for 1990 are reasonable, and are a more accurate estimate of the test year inventory requirements; therefore, no adjustment is appropriate.

Q. Is Mr. Larkin's adjustment to exclude Other Accounts Receivable from rate base appropriate?

A. No. These receivables include the amounts due the utility upon open accounts, other than the amounts related to associated companies and from our electric customers. The majority of these receivables are for pole attachment rentals (invoiced to non-associated companies) for which the revenues have been recorded in other operating revenues (Account No. 454-100). The remaining miscellaneous accounts pertain to pole/line damage claims and other miscellaneous utility billings. All of these amounts are properly included in rate base.

Q. Mr. Larkin has also excluded $136,000 of prepayments identified as other. Please explain what these "other" prepayments are.

A. Gulf's forecast of prepayments were prepared in four categories. Specific individual estimates were made for insurance, EPRI dues, and pensions. All "other" prepayments were estimated based on a three year historical average. These "other" prepayments are primarily comprised of prepaid licenses for motor vehicles, prepaid taxes, prepaid city and county occupational licenses, and prepaid registrar transfer and fiscal agent fees. The Company's estimate is reasonable, and should be included in rate base.

Q. **Mr. Larkin has excluded $30,000 related to "miscellaneous" deferred debits from working capital. Is this appropriate?**

A. No. This amount is a conservative estimate for the numerous miscellaneous charges that are always present in deferred debits which cannot be specifically identified in advance. The analysis, which Mr. Larkin states included no balance in the account for the actual month's of January through August 1989, is Gulf's budget workpaper utilized for the forecasted amounts, not an analysis including actual. The actual amounts for January through August 1989 averaged in excess of $100,000. The Company's estimate is reasonable, and is properly included in working capital.

Q. Is Mr. Larkin's adjustment to remove the Caryville

Subsurface Study from working capital appropriate?

A. No. As discussed by Mr. Parsons, the Caryville generating site and related costs are properly included in rate base.

Q. Should unamortized rate case expense be included in Working Capital?

A. Yes. This Commission recognizes that rate case expenses are a legitimate cost of doing business, and are, therefore, recoverable costs. Since the Commission required a two year amortization in our last two cases, we have included one-half of the expenses in 1990, and the remaining half in 1991. The unamortized balance in deferred debits is properly included in working capital, since these unrecovered costs do not earn a return. Not allowing a return on the amortized balance would unfairly penalize the stockholders for complying with state regulations and the Commission's rules and filing requirements.

Q. Are Mr. Larkin's proposed adjustments to allocate the 63 mw of Plant Scherer (available to serve the territorial customers) to the Unit Power Sales (UPS) jurisdiction appropriate?

A. No. Mr. Larkin states that his adjustment is based on

Dr. Rosen's testimony recommending that the 63 mw of Plant Scherer capacity be allocated to UPS. I was unable to find that recommendation in Dr. Rosen's testimony. Dr. Rosen does recommend disallowing the 63 mw of Plant Scherer, but does not propose imputing fictional UPS sales for the test period. Mr. Larkin's proposed calculations not only disallow the 63 mw of Plant Scherer, but also imputes additional investment and expenses to UPS, related to the transmission and general functions, based on the UPS allocations. The transmission and general plant investment and expenses recovered from the UPS customers are not directly related to Plant Scherer, but are the allocated costs which are credited to the retail customers. Were the Commission to remove the Company's total investment in Plant Scherer from rate base, as well as the associated expenses, then the total impact of the Plant Scherer UPS sales should likewise be removed. If the retail jurisdiction is not going to bear the burden of any of the Plant Scherer investment made for their benefit, they should certainly receive none of the benefits accruing from the UPS sales. While we have not, and see no need to make a precise calculation of the impact of Plant Scherer on the retail jurisdiction, when the credits from the UPS sales, and the Intercompany

Interchange Contract (IIC) are excluded, the retail revenue requirements for Plant Scherer, including the transmission line rentals and production related A & G, are approximately $2 million. However, the 63 mw of Plant Scherer is currently available to serve our territorial customers and no adjustment is appropriate. Mr. Larkin's adjustments are inappropriate, overstated, and inconsistent with Dr. Rosen's recommendation.

Q. Is Mr. Larkin's discussion and recommendation regarding the use of the 1/8 of O & M (Cash Work Capital) for UPS appropriate?

A. No. This commission requires that working capital be calculated using the balance sheet approach. Gulf's system or total company working capital and each jurisdiction (retail, wholesale, and UPS) has been calculated in accordance with this methodology, resulting in the appropriate retail working capital utilizing the balance sheet approach. Each of these jurisdictions has numerous differences in required ratemaking calculations, but for retail ratemaking, all calculations are done in accordance with Florida requirements. To pick and choose different calculations and amounts when and if it is advantageous is inconsistent and inappropriate. As noted above, the retail jurisdiction is already receiving significant benefits related to the UPS sales calculated in accordance with retail ratemaking requirements, and no additional adjustments are appropriate.

Q. **Should the net overrecoveries of fuel and conservation expenses be included in the calculation of working capital?**

A. No. The Company is required to return any overrecoveries to the ratepayers with interest, and conversely, the Company is allowed to recover any underrecovery from the ratepayers with interest. Therefore, following the Commission's guidelines that working capital excludes all accounts or items on which a return is earned or paid, both the over and under recoveries should be excluded from working capital.

The Commission staff has defended including the overrecoveries in working capital on the basis that the inclusion of any net overrecoveries of fuel and conservation expense in the working capital allowance has the effect of requiring the stockholders to pay the interest on these overrecoveries. It is further contended that if the net overrecoveries are excluded from the working capital allowance calculations, it is the ratepayers who must pay interest to themselves. This is not correct. In determining the amount for the fuel factor in the following recovery period, the budgeted fuel expense for the period is reduced by the prior overrecoveries <u>with interest</u>. This reduces the fuel revenues to be recovered from the ratepayers by the actual overrecovery, and the interest is paid to the customers through a reduction in their electric bills. The Company does not actually write them a check for interest, but does reduce their future bills for both the overrecovery and interest. Therefore, the customers do not pay the interest to themselves, but instead they receive credit for the interest through reduced billings.

Including overrecoveries in working capital not only requires the stockholders to pay the interest through a reduction in the fuel component of the customers bill, but would also compensate the customer at the overall rate of return, which includes equity returns. Not only is the stockholder paying twice, but a short-term interest rate is not comparable to our overall rate of return. As stated in Order No. 9273 (Docket No. 74680-EI), the Commission established the interest provision to counter any incentive to bias the projections in either direction. The Company agrees with the intent and purpose of this provision. Both the Company and ratepayer are properly compensated for over/under recoveries in the fuel and conservation dockets through the interest provisions. Therefore, both over and under recoveries should be excluded from working capital.

Q. **Are the temporary cash investments projected by the Company reasonable and needed for the provision of its regulated utility service?**

A. Yes. The Company's forecasted temporary cash investments are essentially all of its available working funds used for making disbursements. Beginning in 1988, Gulf consolidated its disbursement accounts maintained with several banks into one controlled disbursement account. This has enabled the Company to invest <u>all</u> idle cash until the checks are presented for payment. The change to this controlled disbursement account has resulted in improved banking services, reduced the cost of our banking activities, allowed optimization of the use and control of available cash, and resulted in overall savings to the Company and ultimately the ratepayers.

Q. **How should the temporary cash investments be removed**

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when reconciling rate base and capital structure?

A. The Company has removed temporary cash from rate base (working capital) and has adjusted it out of the capital structure on a pro-rata basis in accordance with the Commission's treatment in our last rate case. As stated above, these funds are essentially all of Gulf's available cash. The 13-month average amount of $6,399,000 (per MFR B-2a) is approximately 10 percent of our average monthly disbursements. In fact, the Company is projecting to borrow funds during five months of the test period. Unquestionably, these funds are required and necessary in providing utility services for our customers.

The Company has always maintained that these funds are a legitimate working capital requirement and should be included in working capital, and the related earnings generated by these funds used to offset the revenue requirements. This position is supported by Staff's witness, Mr. Seery, in his direct testimony on page 20. If the Commission decides to leave temporary cash in working capital, the earnings on these funds are projected to be $506,000 as shown on Schedule 3, page 15 of 16 of my prefiled direct testimony.

Q. Mr. Shultz has proposed disallowing the $223,000 in expense related to bank fees and lines of credit charges. Should any portion of this amount be disallowed from base rates?

A. Absolutely not. These costs are directly attributable to the Company's utilization of a controlled disbursement account and the payment of fees for certain lines of credit with area banks. This has resulted in a reduction in our banking costs, cash required for working capital, and the revenue requirements requested in this case.

Mr. Schultz's conclusion on page 57 of his direct testimony, that this expense should be borne by the stockholders of the Company since they clearly derive the benefits is totally ludicrous, and could not be further from the true impact on the Company's stockholders. As stated by staff witness, Mr. Seery, in his direct testimony on page 20:

> In general, short-term investments can be expected to earn less than the utility's overall cost of capital. Therefore, a blanket policy of excluding temporary cash investments from rate base could result in an asset, potentially necessary for the provision of regulated service, earning less than a fair rate of return.

Mr. Shultz's conclusion would result not only in excluding temporary cash investments from working capital, but that the stockholders should also pay all banking fees and charges. These banking fees are a legitimate and necessary expense required in the provision of utility services, therefore, the Company should be allowed to recover these costs from the ratepayers.

Q. **Does this conclude your testimony?**

A. Yes, it does.

Q (By Mr. Holland) Would you please summarize your tertimony, Mr. McMillan?

A Yes, I would. The primary purpose of my rebuttal testimony is to address the inappropriateness of Mr. Larkin's proposed rate base adjustment, Mr. Schultz' proposed disallowance of our bank service charges and line of credit fees.

As I have addressed in my testimony, Mr. Larkin's trending of plant balances completely ignores the level and timing of the Company's 1990 capital additions and retirements, and, therefore, results in a significant understatement of our net utility property.

The Company's projections adjusted to reflect the revised costs related to Plant Scherer are more accurate and properly reflect the expected 1990 test year amounts.

Based upon May actual results, Gulf's net Utility Plant is approximately $605,000 over budget, after the removal of the Plant Scherer purchase price adjustment.

Mr. Larkin has also proposed several inappropriate adjustments to working capital. Gulf's working capital calculations were based on the Commission's balance sheet approach, and all amounts were reasonable, utility related, and are properly included in working capital.

I've also addressed the inappropriateness of including fuel and conservation overrecovers in working capital. As stated in Commission Order No. 9273, Docket No. 74680-EI, the interest provision was established in that docket to counter any incentive to bias the projections in either direction. Since both the Company and the ratepayer are properly compensated for both over- and underrecoveries in the fuel and conservation dockets, it would, therefore, be inappropriate to include the overrecoveries as an offset in working capital.

I've also addressed the reasonableness of Gulf's 1990 forecasted temporary cash investments. These funds are essentially all of Gulf's available working funds. I have excluded these temporary cash investments from working capital in accordance with prior Commission treatment, and I removed them from the capital structure on a pro rata basis.

The company has always maintained that these funds are legitimate working capital requirement and should be included in working capital, with the related earnings from these funds used to offset any revenue requirements.

Staff's witness, Mr. Seery, supports this position in his direct testimony, and if the Commission were to decide to include temporary cash investments in working capital, Gulf's requested rate relief would increase by approximately $207,000.

One final point I'd like to make, is that Gulf's 1990 test year rate base amounts and NOI include 63 megawatts related to Plant Scherer currently serving our territorial customers. The remaining investment in this plant has been assigned to the UPS jurisdiction, along with the allocated transmission and general plant investment and expenses being recovered from our UPS customers.

If this Commission were to exclude all Plant Scherer investment, and the expenses from the retail jurisdiction, the retail customers should certainly not receive any of the benefits accruing as a result of these Scherer unit power sales. The net retail revenue requirements associated with production, transmission and general investment and expenses would be approximately $1.9 million, and if you would also consider the nonfuel energy dollars being recovered from the energy sales, relating to these contracts, the actual net effect on the retail revenue requirements are approximately zero. And that would conclude my summary.

MR. HOLLAND: Commissioners, with respect to the last item that he addressed and that's specifically Exhibit 575, I would like, as did Mr. Larkin, to have Mr. McMillan just track the Commission through what this exhibit is intended to show, and then I would tender Mr. McMillan for cross examination.

CHAIRMAN WILSON: All right.

Q (By Mr. Holland) Mr. McMillan, if you could, just explain what you intended to show in this exhibit.

A Basically, the exhibit that was identified as 575, if you look at Page 1, essentially all the amounts there that are labeled "1990 budget system Scherer" are the incremental Plant Scherer-related amounts that are included in Gulf's budget.

That would include the investment in the plan, any working capital at the plant site, plus the transmission line rentals and production related A&G that we pay Georgia Power for administering the contract or the actual running of the plant, and the transmission line rentals to get the power down to our territorial customers.

Those dollars are, in effect, the same amounts that would be reflected in the Interrogatory 144, that we were referring to the other day.

And you move down to the middle of the page, the amount that I have asterisked there and this was my primary point I was trying to make in my summary and as a result of this schedule, the adjustments that are being proposed by Staff and public council, are to remove all the plant-related amounts, which is roughly $3.6 million, and then you can see I have a subtotal there of 2,056,000, which is the jurisdictional amount of the production-related A&G and the Scherer transmission line rentals for a total of roughly $5.5 million.

Gulf cannot argue that these are the incremental costs related to Plant Scherer and are properly calculated, but there are other benefits that have accrued from these 149 megawatts that we're allocating to the unit power sales jurisdiction, related to our transmission, the transmission agreement, which is a part of the UPS contract, and also A&G expenses and investment.

And this is where it gets -- some people get confused because they are not familiar with those contracts. You can see on this first page all the Plant Scherer, the production-related calculations are essentially, you take the total Scherer amount and you hit it times the sales ratio, the 149 over the 212. It's clear-cut, straightforward.

The transmission agreement was actually a -- it's modeled directly after the IIC agreement, and in effect, what Gulf gets from the UPS customers is a percentage of our total transmission cost and total transmission investment and it's a relationship, a ratio of a total transmission, including the transmission line rentals relating to Scherer and Daniel, but you can't just hit the Scherer transmission line rentals times the sales ratio, because it's not that straightforward.

We've provided all those detailed calculations to both Staff and Public Counsel, they are aware of the calculations. And that's what I've attempted to very clearly layout on the second page, and I think no party yet that I know of, at least Public Counsel, they fully understood and agreed that the numbers detract.

If you look at my first column on Page 2, that's the total UPS adjustments that we have in the filing, right off Mr. O'Sheasy's Page 1, these numbers would tie right in, or also my rate base, NOI schedules and my prefiled exhibit.

You compare that to the UPS amounts that have been identified on the first page, which are just the production-related amounts, and that's what I've done on the second column.

If you net those two, these, the additional investment related to transmission and general plant, and the additional expenses related to transmission and the general A&G expenses, that we're actually recovering from UPS and we're giving the retail customer full benefit, full credit for that, dollar for dollar. I can account for that, down to the penny; any kind of breakdown that you want. And it's in the Cost of Service Study, in a lot lower level of detail than what I've got here. I was trying to lay something out that would be easy to understand.

But, essentially, you can see on Page 2, that as a result of these credits that we're providing to the retail customer, and actually allocate to UPS, they amount to $3.7 million in revenue requirements, which are being totally ignored in the proposed adjustments.

And we feel it only appropriate to ensure that the Commissioners understand that there is other benefits accruing from these sales to our customers. Not only are we able to delay them having to pay the high marginal cost of these plants, but we're being able to spread some of our general company overheads at the same time.

And that is why we're actually, as you can see there, we're actually recovering about 1.7 million more and giving credit to the customer for a 1.7 million more than we're actually paying, incrementally related to Plant Scherer.

And if you net that out, that gets you down to the the approximately 2 million that I talked about in the Prehearing Order. And then to really make it tie into the Cost of Service Study, and is truly another benefit of these sales, is the variable O&M or the nonfuel energy that we're recovering, primarily from Schedule R, because that's the replacement energy related to these sales that we're making out of our older units, which have a higher millage rate and, in effect, we're getting some of our maintenance cost from these other customers. And that amounted right at $2 million; and if you consider all those variables, really, out of the '90 test period, essentially there is no revenue requirements in that point in time.

And as you go out, by the time we're selling 220 megawatts, there is actually a negative revenue requirement. We're going to be giving the customer -- we're going to be recovering some of our overheads from these sales that we'll be giving the customer full benefit of.

And that is really the whole purpose of this schedule, was to ensure that all variables are being considered, and if you're going to make adjustments if you're going to say "exclude the 63 megawatts," that's saying retail customers shouldn't pay anything for this plant, yet they should, you know, these other benefits are accruing directly as a result of our investment in that plant that we built for the customers' use, and that we're trying in every way we know how to minimize the effect to our customer, minimize the revenue requirements, and I'd be glad to answer any questions you all might have on it.

CHAIRMAN WILSON: Mr. Burgess.

CROSS EXAMINATION

BY MR. BURGESS:

Q Mr. McMillan, I just have a few questions with regard to the exhibit, the first page of it.

I'm down to the line of transmission and general amounts from Scherer UPS credited retail. Is the 3,757,000. Is this 1990 projections?

A Yes, it is.

Q And this is -- is this based on fees that Southern Company collects on the unit power sales?

A These are the fees that Gulf Power will actually will collect through Southern, who is our agent. All of our revenues are actually billed through

Southern Company Services and then they get one check for all the sales and we get our portion. This is Gulf's piece.

Q Right. This is Gulf's portion of the amount that Southern Company will collect from those off-system sales, is that correct?

A Correct. Which a good portion, I mean it's directly related to our Scherer sales.

Q Right. If it's for 1990 projected, do you have the -- any of the 63 megawatts projected for sale in 1990?

A No, we don't.

Q Okay, so this amount reflects the amount based on the 149 megawatts that are going to be sold, is that correct?

A That's correct.

Q On the next item down, the nonfuel energy, the variable O&M from Schedule R, is that also based on 1990 projected?

A Right out of our '90 forecast, that's correct.

Q And how do you determine what the nonvariable O&M would be? Isn't that based on a projection of the amount of times that people who have purchased capacity out of Scherer will, instead, buy energy from some other lower cost plant that's on dispatch at that point?

A Absolutely. That's true of all of our territorial and nonterritorial transactions. It's an estimate based upon the historical information, our estimate oil prices, et cetera. All those variables are considered and --

Q So it's based on a historical estimate as opposed to, I don't know, running any type of dispatch model or something like that for 1990?

A Well, I wouldn't say it's a historical estimate. I'm saying using based upon actual history and what we project, the energy markets and South Florida customers, they have discussions with them on an ongoing basis. The whole system is dispatched for our forecasts in the same manner as the monthly transactions take place in actual. I mean, we have a very sophisticated budgeting process which is explained in fairly good detail I think in the MFRs.

Q Right. And again, since this is projected for 1990, this would be projected for purchasers who have purchased the 149 megawatts of capacity from Scherer, is that correct?

A Would you ask that question one more time?

Q Yes. Is this amount, the $1,969,000 the estimated amount that you will get on this variable O&M

differential from the energy purchases by people who have purchased the 149 megawatts of capacity of Scherer?

A Yes. It's from the UPS customers. It would be all sales other than the base sales. We do have some variable O&M that we do recover that if they take energy out of the base unit, but it's very small, being a brand new unit. And the test period we estimate only about $100,000 of nonfuel energy. And we're giving the customer credit for that.

You can see that on Page 2, there's $2,095,000 total nonfuel or variable O&M, whatever term you would like to discuss, and $95,000 of that was related to the base energy and two million basically was out of our other units other than the base or the Scherer unit itself.

Q Right. And I'm just trying to find out -- you've answered the question. I would like to confirm that I understand fully, though, that this is from energy purchases associated with the 149 megawatts of capacity? Or is it some other purchases that are anticipated?

A Being an integrated system in the pool, the way the transactions occur, that particular piece could be from any of the unit power sales made by the

Southern System. But they are all related to unit power sales transactions. See, the replacement energy enables the Company to take energy off of any system, any unit in our system, if it's cheaper, they're going to buy it at our cost, based upon the dispatch.

Q Right, yes.

A So I can't say -- I can't sit here today and tell you that that is all FP&L who bought so many megawatts related to that. No, it could be -- it's just whenever they call the SCS center up there and ask them for energy and there's replacement energy, and Gulf Power's unit is the next one to dispatch, and we get our generation as a result of that sale. That is what would be captured here.

But I mean, technically, yes, it is related to the 149 megawatts, it's related to the unit power sales, particularly.

Q Okay, that's my question. I need you to go one step further because in the first half of your last answer, that is, that it's any sales made, I was then having problems as to why you then associated it with the removal of Plant Scherer altogether. And then in the second half I understood you to say yes, it is the variable O&M that's associated with the right to purchase any of the 149 megawatts of capacity and energy based off of that right.

A Well, there again, I think this will get back to why I only used the $2 million figure in the Prehearing Order. Because technically, as long as the system still had the same amount of unit power sales and we had none of them, we could conceivably have still got this variable O&M related to Schedule R. Because the R sales do not come necessarily just from the companies that are making unit power sales, it's the next available unit on the dispatch.

And I'm just saying if you look at all the variables, this is one thing that is benefiting the customer related to unit power sales. We've actually shifted $2 million out there to the UPS jurisdiction. I'm not saying if we did not have any unit power sales that that would go away. The customer would still get that benefit for the fuel.

When we do the fuel filings, in effect, those nonterritorial energy dollars would be, you know, he'd get a credit for that.

Q And so the removal of both of the amounts that we've discussed, or your proposition that if we're going to remove all the costs that the Staff and Public Counsel have suggested be removed that you have to remove various other credits including these two, are not really associated with the 63 megawatts so much as they are basic your underlying rationale being if you're going to remove that plant in total, then you need to remove these particular credits. Is that correct?

A Yes. That's -- well, I'm just saying -- right. If you're going to propose disallowing all of our transmission line rentals and production-related A&G without recognizing we've already given the customer -- the retail customer a credit for in excess of that amount, it would not be fair. It's not a fair characterization of what the retail revenue requirements are. Because we've actually reduced their revenue requirements by these amounts we're recovering from off-system customers.

Q But neither one of these credits are associated with the 63 megawatts that aren't going to be sold, do I have that correct?

A Absolutely not. That's correct. They're related to the 149 megawatts that we are selling out of that unit and, as I stated in the Prehearing Order, I think very clearly, if you're going to --your proposition a minute ago -- if you're going to disallow the whole plant, and so the customer obviously shouldn't have to pick up any cost, well, the flip side of that is they shouldn't be receiving any of the benefits that are accruing. At least give the Company the opportunity to offset some of those losses because we are recovering slightly more there

. But I think it would be appropriate to include the 63 megawatts, obviously. And if you look at all the pieces and all the benefits accruing from the sale of the 149 megawatts, there's literally no revenue requirements being placed upon the customer during the test period as we filed it.

Q Okay. I think I understand.

Now, the only other question I have is a general one with regard to some of the statements that I understand to be the rationale for this rate increase generally.

If, in fact, the removal of the 63 megawatts is almost a complete wash, basically a $72,000 negative revenue requirement effect, then it really didn't make up the bulk of the costs required, which drove this particular rate case, which is what I understand initial statements were to have been. Is that correct?

A You're talking about some of the opening statements?

Q Yeah.

A It is one of the primary reasons for this rate case. If you look back at the change that took place since 1988 to 1990, it's not so much just the '90 impact, but this is a perfect example.

I mean, look at these additional dollars that we're recovering here related to 149 megawatts. You've got to remember, when we were selling Daniel, we were selling 400-and-something megawatts. We were allocating a lot more administrative and general costs, a lot more general plant to the UPS jurisdiction. Now that we're putting that plant back in, those sales have been extinguished.

In effect, we're losing -- you see this 1.7 million here; you're probably going to multiply that by several factorials to consider how much more in unit power sales we were making back during that period.

And it gets back to the point that Mr. Scarbrough was making. Through the surveillance reporting, we were reporting the actual results as they occurred and pulling out all the amounts related to unit power sales. And whenever those unit power sales ended, these credits that we were getting related to those sales also ended.

So there's more, and I think that was one of my purposes here is to educate, hopefully, and show that there's been some misconstruements along the line.

I've heard different people make the statement that we're reaping windfall profits and big benefits. We're getting a very reasonable conservative return on equity on these sales and we're giving the retail customer dollar-for-dollar credit for everything we're getting. And I don't know how much fairer you could be.

Q But for 1990, anyway, what you're saying by this chart is the revenue requirement associated with the 63 megawatts, the incremental revenue requirement is a negative 72,000 if the adjustments that you're suggesting ought to be made when or if the Commission removes the 63 megawatts, is that correct?

A No. I wouldn't say that. I'm saying that this -- in the test period, this is what the net effect, considering the nonfuel variable O&M, would be the net revenue requirement to the retail customer. I do not feel --

Q Excuse me, you say the net revenue effect to the --

A To the retail customer.

Q Of removing the 63 megawatts.

A No, including the 63. The fact that we filed the case with 63 megawatts in territorial service, which 96 or 97% of that would go to retail, if you look at the other variables that have been allocated to unit power sales, they offset basically all the revenue requirements related to the 63 megawatts.

If I was going to remove the 63 megawatts, my statement would still hold, I still don't think it would be appropriate to make there variable O&M adjustment. I still think it would be more in the neighborhood of a $2 million impact, because these variable O&M dollars are being sold off-system and our customers shouldn't be expected to pay those costs.

But, recognizing we have forecasted to recover that much, $2 million of our total budgeted O&M, production-related O&M is being allocated to that jurisdiction.

Q Can you say at what point you would think that the credits should be included in here, included back to the retail ratepayers? What I'm getting at is suppose the transmission rental expense were included? Would you say then that,"Well, the transmission rental credits from the off-systems sales should then be included"?

A Well, are you saying just make the rate base adjustments and not make the NOI adjustments?

Q No. What I'm trying to do is zero in on the specific point at which you say, "Well, we're going to remove them." Because as I understand it, the removal of these items really is not due to the 63 megawatts being removed. Rather, that that completed total removal of all of the Gulf's ownership in the Plant Scherer capacity.

A You lost me somewhere.

Q Okay. When you suggest that the credit should be removed from the benefit of the retail ratepayer, okay.

A Right. And that would be the $3.7 million that I was referring to and is laid out on Page 2.

Q Right.

A You would take all the adjustments on Page 1, net them against --

Q Yeah.

A -- The ones on Page 2, I've got all the appropriate plant in service and depreciation identified.

Q I'm with you -- at least I think I'm with you on that. And the 1.969 million in the variable O&M differential?

A There, I don't believe that would be an appropriate adjustment. I think that should stick, whether you put it over to unit power sales or what, that, the customer, right now we do anticipate recovering those dollars and I think it would be appropriate, assuming the accuracy of our forecast is good, that the retail customers shouldn't be required to pay those dollars.

But I would think it would be appropriate to -- just like we've done on all the production expenses, backed out the amounts we're recovering related to UPS -- to remove the amounts we're recovering from UPS related to transmission and general plant and A&G.

It just so happens, you know, we're recovering more than our actual incremental costs and we're giving that benefit to the customer. Assuming that they're willing to accept responsibility for the plant. I mean, the plant was built for them and we're trying, the Company is making every effort to minimize the cost to the customer. And I think this demonstrates that there's very little cost to the customer.

Q Is it the plant or the transmission line rental or both, then, that drove the decision to say, "Well, we're going to put, then, the credit from the 149 megawatts back into, I guess, nonjurisdictional portion"?

A Well, what you got to keep in mind, Steve, is that's exactly what you got up above. I mean, what do you think those UPS amounts are up in the first page?

Those are all related to the 149 megawatts. All we are saying is do the same thing on transmission and A&G and you end up with a credit.

Q I understand that.

A Okay.

Q My question is --

A It makes perfect sense

Q At what point did you -- since that's associated with 149 megawatts that aren't in jurisdiction anyway --

A Right.

Q -- at what point did you decide that they should be taken away from jurisdictional credit at --

A At the point when you set the proposition up that the customer -- you should remove all impacts for Scherer. If you're going to take all the investment and all the expenses related to Scherer out, then that's where we -- at that point in time we say, "Wait a minute, we've already given them some substantial benefits here related to that plant and --"

Q I understand.

A " -- and it's only fair to identify those in that amount."

Q I'm aware of your position on that, and my question is, that's in response, as I understand it, to the removal of transmission line rental costs and the 63 megawatts of -- the investment in the 63 megawatts. Is it both or is it one or the other, or have you not defined it along those lines?

A I'm saying if you're going to remove all costs related to Plant Scherer, I don't care -- I mean these credits are related to the transmission in A&G, and I think if you're going to remove all the costs, you're going to have to remove the transmission line rentals and the production related A&G, but then at that point in time I think it's only appropriate that we remove all the other credits that we've already provided to the customer.

CHAIRMAN WILSON: Let me see, I think I understand what you're asking.

MR. BURGESS: I just wonder at what point they decided --

CHAIRMAN WILSON: If you say you removed 63 megawatts of Scherer, and that's all you do, does that result in the adjustment that you've proposed here?

WITNESS McMILLAN: Yes. Consistent with the way we're making all the adjustments. To remove 63 megawatts or remove all impacts of Scherer --

CHAIRMAN WILSON: I didn't say "all impacts of Scherer." I said 63 megawatts.

MR. McMILLAN: Well, that would, in effect, be all of Scherer. That's all we're asking for.

CHAIRMAN WILSON: Well, there's also some transmission rental.

WITNESS McMILLAN: Which are related to the 63 megawatts.

CHAIRMAN WILSON: All right. So it's a whole package, remove the 63 megawatts and the transmission rentals and the related to A&G?

WITNESS McMILLAN: Those are definitely directly -- the transmission line rentals and production related to A&G are directly related to Plant Scherer. Without Plant Scherer we wouldn't have those.

CHAIRMAN WILSON: All related to the 63 megawatts of Plant Scherer?

WITNESS McMILLAN: Well, it's actually, 263 -- that whole first column is total system, it's 212 megawatts, and if you look up at the top part of the page, what you got there really in the system column is our total investment and expenses related to Plant Scherer. 212 megawatts, that's the whole package.

The second column is just identifying the amounts related to the 149 megawatts that we're making from unit power sales out of that unit until you determine what was left in our territorial rate base, and then we hit that times the appropriate retail/wholesale jurisdictional factor, and that's what that second to the last column, that Scherer and retail in -- and you cannot do that -- I could have just thrown -- I have the breakdown back here. I could have just put a figure in here for transmission and A&G and then footnoted instead of putting an asterisk, but I thought it would be a lot clearer the way I've laid this out on Page 2, because people are going to go, "How do we know if we had that much?" It's pretty straight forward if you look at my UPS adjustments and how much is really related to just the production-related Scherer amounts, which everybody is wanting to pull out. We've already allocated a lot more out there to unit power sales.

Like I said, I have provided all the detailed calculations of all of those components to Public Counsel and Staff.

COMMISSIONER EASLEY: Mr. Chairman, I'd like to ask a question very slowly. This child over here has just gone crazy trying to keep up with this exchange.

Could it be said in one sentence what you're asking for is double entry cost accounting bookkeeping?

WITNESS McMILLAN: What we're asking for, I guess -- or what we are trying to present here is a fair representation of the true revenue requirements related to the Scherer investment that we've included in this file.

COMMISSIONER EASLEY: Maybe I didn't make it simple enough.

You're saying if you put a credit on one side, put a debit on the other to make it balance?

WITNESS McMILLAN: That's correct.

COMMISSIONER EASLEY: And if you do it for one component, you do it for all components?

WITNESS McMILLAN: That's correct.

COMMISSIONER EASLEY: Thank you.

CHAIRMAN WILSON: And your point in this exhibit is don't cut off your nose to spite your face?

WITNESS McMILLAN: No, I don't -- I mean, I didn't mean for it in that way.

CHAIRMAN WILSON: What it sounds like it says, if you do what you suggest is being done, then you're really hurting the ratepayers, you're not helping them.

WITNESS McMILLAN: Yeah, that was our point was, really, if you look at all the pieces, this thing is not, you know -- we made such a big to-do over these capacity coming back in, and due to these unit power sales and the way the calculations are done, there is really marginal impact at least in the '90 test period, to our retail rate request, when you consider all the pieces that we're already allocating over to UPS, and the customer is going to benefit handsomely over the course of this plant, I think as Mr. Howell eloquently presented to you all, and this clearly shows you -- I mean, when we get up to 212, we are going to be allocating more over there than the plant is costing. So they're going to be -- they're going to be actually receiving more through this allocation process than the actual plant itself.

COMMISSIONER BEARD: Let me, if I can, ask you a question.

It's your contention that Staff in their recommendation, or at least position to date, has not taken into account that transmission side?

WITNESS McMILLAN: You're talking about the unit power sales to credits from that? The numbers I've seen in the -- the only place there's really any numbers is in that spread sheet in the Prehearing Order, and they did not, that's correct.

COMMISSIONER BEARD: Well, let me ask you this: I may be in the wrong area, but if you decrease ratebase for the purposes of Plant Scherer by 52 million, which they did in their recommendation, and simultaneously you increase O&M related to Plant Scherer by 3.7 million, how do you account for that happening?

WITNESS McMILLAN: The increse in O&M is primarily driven by the IIC offset. The amount that we are getting through the pool related to 63 megawatts, if you were going to disallow the 63 megawatts already embedded in our financial forecast in O&M for purchase power, the capacity payments there would have beer -- either our receipts from the pool would have been much lower or our payment much higher had we not had that 63 megawatts serving the territorial customer in the capacity equalization payment. And that was roughly, I think, in the number had Staff had, we're roughly 5.5 million, and they were based on the interim calculations that we had provided, which I'm sure you finally remember those hearings, but we -- those were related to September, 12 months ended, September of '89, and you can see on Page 1 here, comparable figure would be the 4.9 or right at $5 million would be the ICC offset related to 63 megawatts in the '90 test period. So it's actually a little bit higher for the '90 test year.

But, that's why it goes the other way. If you sum up -- you see the 2.7, take that third column, if you take the 2,735,000 and then take 4953 --

COMMISSIONER BEARD: Whoa, slow down. Now, where are you?

WITNESS McMILLAN: Take Page 1.

CHAIRMAN WILSON: Slow way down.

COMMISSIONER BEARD: Page 1 of 2, I see the 2,375.

WITNESS McMILLAN: The third column is the territorial amounts?

COMMISSIONER BEARD: Uh-huh.

WITNESS McMILLAN: And you should get in the ballpark by taking the 2,735,000, the 1,822,000 related to transmission line rentals. They may have that one split out separately. I can't remember, to be honest with you. And 263,000, I know they did have that one in that production figure. And net that against 4.5 million, I think was the figure they were using. What they were actually using was that other interrogatory, that Interrogatory 144, and picked up the transmission line rentals either through our benchmark calculation, because we had actually split out the Scherer transmission line rentals and production-related A&G on that benchmark MFR.

COMMISSIONER BEARD: That's 4.8 million,

those three figures?

WITNESS McMILLAN: I think they did have the 1.8 million-eight on a separate line item, now that I remember. So if you take that out, it might get you a little closer.

COMMISSIONER BEARD: That will put you to 3 million.

CHAIRMAN WILSON: Mr. Burgess?

MR. BURGESS: That's all I have.

CROSS EXAMINATION

BY MS. RULE:

Q Mr. McMillan, are you familiar with Mr. Larkin's testimony wherein he recommended removal of $1,230,000 in working capital related to other accounts receivable?

A Yes, I am.

Q Do you know whether these type receivables were claimed by Gulf during the last rate case?

A Absolutely.

Q Did the Commission disallow that?

A No, they did not.

Q Mr. Larkin also recommended that $136,000 related to other current assets, $30,000 related to other miscellaneous deferred debits be removed from working capital. Are you familiar with that?

A Yes, I am.

Q Do you know if items of this nature were claimed by Gulf during its last rate case?

A Yes, they were.

Q Did the Commission disallow then?

A No, they did not.

Q Are the items in the miscellaneous deferred debit account recurring expenses?

A Which account? I'm sorry.

Q Miscellaneous deferred debit account.

A Yes, that was just a very conservative estimate of numerous little minor things that get recorded in the deferred debits, which would average normally a lot higher than that figure.

Q In your rebuttal testimony you mentioned that Mr. Larkin used the wrong amount for the interest deduction in calculating the interest synchronization adjustment, is that correct?

A Yeah, he did. He corrected that, by the way, in his revised exhibits that he filed.

Q In your testimony you were referring to both the adjustment to reconcile interest and income tax expense to the interest inherent in the capital structure and the adjustment for the tax effect of interest in the debt portion of ITC's, weren't you?

A His error there -- yes, that would be the same adjustment, right. He had made that -- he made the wrong adjustment related to the interest, picked up the wrong amount there. Then he had also made the sign in the opposite direction. So he had approximately about a 1.6 million error in his income tax adjustment.

Q When you stated that the correct starting amount would be $32,045, rather than the $30,871 on MFR C-44, is that correct?

A Yes, that's correct.

Q Isn't the $30,871 on MFR C-44 the interest expense used in the tax expense calculation?

A Yes. It's the jurisdictional amount of interest that would be in our total tax calculation, per books, not the syncrhonized interest amount based on the synchronized capital structure.

Q Why isn't that amount the correct starting point for the interest reconciliation adjustment?

A Because the Company had already made an interest synchronization calculation in our filing and NOI, which adjusted between the 30 -- was it 871, and the synchronized interest in the capital structure, which was reflected in my prefiled exhibit, Schedule 15.

MS. RULE: No further questions.

CHAIRMAN WILSON: Questions, Commissioners?

COMMISSIONER BEARD: Yeah, Page 2 of 2.

MR. HOLLAND: Commissioner, just before you start, just for the record, on that interest sync adjustment, Marsha, you said 30,000 and 32,000, and I think that it should be million, if I'm not mistaken.

WITNESS McMILLAN: That's correct.

MR. HOLLAND: I'm sorry, go ahead.

COMMISSIONER BEARD: The far left column, total Scherer UPS per filing, tell me what that is, that column?

WITNESS McMILLAN: The first column?

COMMISSIONER BEARD: Yes.

WITNESS McMILLAN: Those are the total amounts that we've allocated to the unit power sales jurisdiction in our cost of service study, which if you take Mr. O'Sheasy's cost to serve study, which is his prefiled exhibit, you would tie into these amounts right off of his Page 1, his rate base NOI amounts. You could also pick up these same exact numbers in several MFRs, and in my prefiled exhibit of rate base and.

COMMISSIONER BEARD: Well, I don't have those, and let's take one as an example, gross plant, 141,652, that represents -- for example, how many megawatts, since 129 represents 149 megawatts?

WITNESS McMILLAN: That would actually represent the total amount of plant in-service that we're billing to unit power sales customers related to 149 megawatts, but it includes the production-related amounts from Page 1, which is what's in that second column. It was also in the second column on the first page. And it also included the allocated amounts related to transmission lines.

COMMISSIONER BEARD: Slow down.

WITNESS McMILLAN: And general plant.

COMMISSIONER BEARD: The second column on both pages I understand what that is, okay. You're billing -- I still don't understand Column 1. You are billing -- no. Column 2 is 149 megawatts. If you take rate base of 184075 and 149 megawatts over 212 gives 129.

WITNESS McMILLAN: That's correct.

COMMISSIONER BEARD: Okay, but your billing, instead of 129, you're billing 141?

WITNESS McMILLAN: That's correct.

COMMISSIONER BEARD: You're billing to the customer?

WITNESS McMILLAN: And giving the retail customer credit for that full amount we're billing them.

Let me just briefly, like I was mentioning earlier, the transmission is done on a percentage of our total transmission system, not just the Scherer transmission line rentals. It includes those, but it's a percentage of totals. So they're actually, we're billing them for rate base and expenses.

COMMISSIONER BEARD: You're getting ahead of me and all that is good, but I want to understand the chart and make sure I understand. You're telling me the actual production cost at Scherer was only 129, reduction in territorial requirements, that means that in theory, Gulf Power's ratepayers are getting the benefit of that 12376?

WITNESS McMILLAN: Yes, sir.

COMMISSIONER BEARD: Once you take all the numbers out?

WITNESS McMILLAN: That's correct. Because we're giving him credit and removing the total amount that we're getting from UPS, not just the production-related amount.

COMMISSIONER BEARD: Okay, now if I'm not mistaken, and I coundn't find it, I looked real quick through the schedule, but I thought Staff gave you a credit for the 939 somewhere in those schedules.

WITNESS McMILLAN: I'm sorry, what did you think they gave me?

COMMISSIONER BEARD: Up there, the net plant, revenue requirements, over the far right column, 939,000.

WITNESS McMILLAN: Yes, sir.

COMMISSIONER BEARD: I could have sworn somewhere in those schedules I saw where they had given you a credit for that; in other words, taken that into account.

WITNESS McMILLAN. No, I don't believe --

COMMISSIONER BEARD: I couldn't find it. But I will. I'll look until I find it, I've seen it somewhere. And then the actual 3757 down there, is really just the summation of the 2947 and the 810, right?

WITNESS McMILLAN: Yes, sir, that's the rate base and NOI revenue requirements. See, that's one thing -- that far right column is a revenue requirements calculations, so the actual adjustments that you would find in Staff's spread sheet would actually be the column before that.

COMMISSIONER BEARD: Not if they were giving you revenue adjustment.

WITNESS McMILLAN: Right. If you had

something showing the revenue requirement impact.

COMMISSIONER BEARD: Well, you might have thought the same thing, otherwise it would have seemed you would have added the 939 to the other two figures to get your actual amount.

WITNESS McMILLAN: Well, the 939 is included in the 810. It's just a summation down

COMMISSIONER BEARD: You're right. I'm sorry. You are right. Okay.

MR. HOLLAND: No redirect.

CHAIRMAN WILSON: All right. Thank you very much.

(Witness McMillan excused.)

CHAIRMAN WILSON: Do you want to move this exhibit?

MR. HOLLAND: I thought it already had been, but it hasn't. That may be the one Steve was thinking about, that he was hoping you wouldn't get around to moving into evidence.

MR. BURGESS: I said I was going to remind you sooner or later.

MR. HOLLAND: Oh, Okay.

MR. BURGESS: Maybe next week.

CHAIRMAN WILSON: All right. You've moved that then. Without objection it's admitted into evidence.

CHAIRMAN WILSON: Call your next witness.

MR. HOLLANP: Call Mr. Jackson.

CHAIRMAN WILSON: Let's take a few minutes while he takes the stand.

(Exhibit No. 575 received into evidence.)

(Recess taken)

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ROBERT H. JACKSON, SR.

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

DIRECT EXAMINATION

BY MR. HOLLAND:

Q Would you state your name, your business address and your position with Gulf Power Company?

A My name is Robert H. Jackson, Sr. My business address is 500 Bayfront Parkway, Pensacola, Florida. Gulf Power Company. I'm the General Manager of Employee Relations.

Q And Mr. Jackson, have you prefiled testimony in this document entitled, "The Rebuttal Testimony of R. H. Jackson"?

A Yes, sir.

Q Do you know need to make any additions or corrections to that testimony?

A One minor correction. Page 12, Line 13, change "92%" to "91%."

Q And with that correction, if I were to ask you the questions today that are contained in your testimony, would your answers be the same?

A They would.

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

CHAIRMAN WILSON: Without objection his testimony will be so inserted into the record.

Record Copy

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony of
R. H. Jackson
In Support of Rate Relief
Docket No. 891345-EI
Date of Filing: May 21, 1990

Q. Please state your name and business address.

A. Robert H. Jackson, 500 Bayfront Parkway, Pensacola, Florida 32501.

Q. What is your present position with Gulf Power Company?

A. I am the General Manager of Employee Relations.

Q. What are your responsibilities and duties in that position?

A. I am responsible for managing the functions of employment, organizational development, training and safety, labor relations, compensation, benefits, payroll, and claims within Gulf Power Company. My duties involve the formulation and recommendation of department and corporate objectives and the development of plans for ensuring that the Company complies with federal and state regulations governing the various Employee Relations functions.

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

A. I graduated from the University of North Alabama in 1963 with a Bachelor of Science degree in Education. Following graduation from college, I entered the U. S. Army where I served for thirteen (13) years in various combat and administrative positions in the United States and Vietnam, attaining the rank of Major. In 1974, I received a Master of Science degree in Education from the University of Oklahoma. Following my early retirement from the Army in 1976, I attended the University of West Florida where I received a Master of Science Degree in Business Administration in 1979. I became an instructor at the Pensacola Junior College until my employment with Gulf Power Company in 1980 in the Employee Relations Department, where I have held various positions until I was named Director of Employee Relations in 1985 which was changed to General Manager in 1990.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present and justify Gulf Power's salary and benefit programs and specifically rebut the testimony of Mr. Schultz and the position taken by him with respect to the Company's Productivity Improvement Program, Performance Pay Plan, Relocation Program, Fitness Program, Supplemental Benefit Program, Development Program, and the Employee Savings Plan.

Q. On page 45 of his direct testimony, Mr. Schultz has recommended for ratemaking purposes, disallowance of the entire $464,177 budgeted for the Productivity Improvement Program, further stating that incentive compensation duplicates salaries and wages. Is such an adjustment reasonable and equitable?

A. No. First of all, Gulf's incentive compensation does not duplicate salaries and wages. The Productivity Improvement Program (PIP) is a part of Gulf's management total compensation package and should be recorded as an allowable O & M expense for ratemaking purposes. Gulf's base salaries are at or lower than the market median. If Gulf's employees were only receiving their present base salaries, they would be compensated for their efforts much lower than the market median for total direct compensation. Paying only base salaries at this level will not attract, motivate or retain the qualified top management employees Gulf needs in order to provide reliable electric service. Without both our incentive programs, PIP and the Performance Pay Plan, our base salaries would have to be increased significantly in order to fairly compensate our employees and to have any hope of being able to compete for talented personnel in the marketplace. Thus, the adjustment proposed by Mr. Schultz is not in the best interest of our customers.

Throughout American industry, placing part of one's pay at risk has proven to be a substantial management motivator. The Productivity Improvement Program is designed to reward productivity while forcing management to be conscious of the potential long-term economic impact on day-to-day decisions. PIP is a long-term incentive plan, based on a four-year average of Return on Common Equity compared to a peer group of utilities. The median base salaries, together with the PIP incentive opportunity, leave management's total compensation below our pay philosophy as approved by our Board of Directors, which is to compensate our employees at the 75th percentile of utilities.

By shifting compensation dollars from a fixed-cost to a variable-cost, the design of our pay system places reasonable restraints on base salary dollars while offering potential additional salary dollars that are paid only on an incentive basis for achieving significant functional area and corporate goals. If these goals are not achieved, there is no payment under PIP. Employees do not benefit from this compensation in years in which the goals are not met because it is not a continuing part of their base salary, but is awarded strictly on a year-to-year basis.

Q. What amount should be allowed as O & M expense for the Productivity Improvement Program?

A. We agree with Mr. Schultz's recommendation to reduce the allowance by $358,209 because a major change in the PIP plan design was implemented after the budgeting process was completed. However, the remaining $105,968 should be allowed as reasonable O & M salary expenses.

Q. On page 48 of Mr. Schultz's testimony, he recommends that the test year O & M expense amount of $1,021,637 for the Performance Pay Plan be disallowed. Do you agree with this adjustment?

A. No. The Performance Pay Plan, like the Productivity Improvement Plan, should be allowed as a legitimate O & M expense along with salaries and wages since it is also part of the employee's total compensation.

In order to provide safe, reliable and reasonably priced service to our customers, Gulf depends largely on its experienced workforce. Therefore, Gulf is very concerned that its employees are paid in a reasonable manner, relative to the marketplace. There is a definite trend toward the adoption of annual award systems. Five years ago, only 37 percent of the 71 utilities surveyed had an annual award plan. As of May, 1989, 68 percent of these companies have implemented an annual award plan. Base salaries at the median of the market will allow Gulf to hire and retain the majority of its employees. However, in order to attract and retain highly productive employees with unique and specialized skills, Gulf must provide a pay delivery system for rewarding these top performers in a demonstrable, significant and equitable manner. The Company must channel the efforts of employees through organization and corporate goals which are aligned with individual goals. Compensation is then tied to the achievement of these goals, which creates a sensitivity to goal accomplishment not found in base salary-only type programs. Any goal achievement that produces a cost savings or productivity improvement will positively impact the customer, as well as the continued overall effort to attract and retain a highly motivated, well-qualified workforce.

Q. **On page 54 of Mr. Schultz's testimony, he contends that the 22% of the relocation budget, is for the cost of a realtor to sell the employee home under the relocation program. Does the 22% represent only a commission for selling the house?**

A. No. This cost (22%) is made up of all items that are part of a relocation company placing an employee's house in its inventory. Some of these items include: Appraisals, inspections, insurance, utilities, maintenance, interest on equity, title insurance expense, closing costs, mortgage charges, carrying cost, brokers expense and commission. The relocation of our employees is necessary in order to place the most qualified employee in vacant positions, usually at the supervisor level and above, which are created due to retirements, promotions, job rotations, etc.

If the Company did not pay for the employee's relocation expenses, a selected employee would be hurt financially by accepting a position involving a transfer. Due to the costs involved with relocations, employees usually would not move unless the expenses were paid by the Company and, consequently, the best employee might not be placed in a vacant position. Also, the relocations are at the request of the Company and in the Company's best interest; therefore, the Company and not the employee should bear the cost of the move.

Q. **Mr. Schultz contends on page 58 and 59 that Gulf's Fitness Program is just for "high level employees". Is this program for the executives only?**

A. No. The fitness program covers approximately 167 employees from supervisors through executives.

Q. **Is this program beneficial?**

A. Yes. This program was designed to include employees in whom the Company has invested substantial time and money. This investment is in training, experience, education, and these employees are considered a company asset. The program's preventive measures have proven most effective in helping the employees maintain good health and productive careers. This program has proven instrumental in lowering days off due to illness for these employees from 1983 to 1989, producing an average of 2.69 days per year less in time off for illness for participating employees compared to the remainder of the company for the same time period. Long term benefits associated with the emphasis on wellness are expected to continue due to this program.

Q. **Mr. Schultz has recommended elimination of the Supplemental Benefits budget. Is this reasonable?**

A. No. Mr. Schultz contends that the ratepayers do not receive any benefit from this company program. He is wrong. Our customers do benefit from the talented personnel we are able to attract and retain as top level managers at our Company. The Supplemental Benefit plan is also part of the Company's total compensation package. Without the Supplement Benefit Plan certain employees would be denied their pro rata share of certain benefits which are based on the amount of their direct compensation. The limit set up by the IRS for fringe benefits would have to be made up in additional direct compensation were it not for the Supplemental Benefit Plan. This type plan is not unique and is a common benefit offered by most utilities. For example, in a survey on Executive Compensation for 1989, conducted by Edison Electric Institute, 75% of the 106 companies surveyed had a comparable Supplemental Benefit Plan. For the 1990 survey, 82% of the 103 companies surveyed had a comparable supplemental plan. Clearly, the trend towards this type of plan is prevalent and is increasing each year. In order to effectively compete for and retain top quality management personnel, Gulf must meet the competition in the market place by providing the Supplemental Benefit Plan.

Q. Although he does not propose an adjustment to the expenses related to the Employee Savings

Plan, Mr. Schultz does recommend consideration of a cap on these costs. Is such a cap advisable?

A. No, because it would fly in the face of the program. The Employee Savings Plan was implemented to encourage employee ownership in the company and to supplement retirement income. As with all of our benefits, the Employee Savings Plan is part of the total compensation package offered by Gulf in order to attract and retain talented personnel. The 1988 EEI benefits survey indicated that ~~92%~~ 91% of the 120 companies surveyed had comparable savings plans. In 1989, 94% of the 130 companies surveyed had comparable plans. This plan helps Gulf Power to recruit and retain employees in a time when only minor improvements have been made to our pension plan.

Q. On page 55, Mr. Schultz recommended the removal of $72,250 in development or training cost. Should this cost be removed from the rate case?

A. No. These courses are a part of our on going training for employees at this level.

Due to the many changes that are occurring in the business community, it is important that employees who are making crucial long-term decisions be kept up-to-date on issues affecting the business world. Without continued training and developmental courses, Gulf's employees will be making decisions for the 1990's based on obsolete information of the 1980's. These costs of continuing education are very small in relation to the total investment and budget for expenses that are managed by our employees.

Q. **Do you have a summary of your testimony?**

A. Yes. The compensation program, Supplemental Benefit Plan, Relocation Plan, and Employee Savings Plan are all part of the total package that enables Gulf to be competitive in the market place for talented personnel. Without all component parts of the Company's compensation and benefit package, Gulf will face great difficulty attracting and retaining talented employees and moving them to fill jobs where they are needed best. It is also critical that we are able to train and educate our employees on the many changes occurring in the business world. All of these considerations have at their foundation, the best interests of Gulf's customers. It is only by attracting and retaining talented personnel, placing them in positions for which they are best suited, and keeping them up to date on the latest information in their field, that Gulf will be able to continue to meet its statutory obligation to serve our customers.

Q. Does this conclude your testimony?

A. Yes.

Q (By Mr. Holland) Mr. Jackson, would you please summarize your testimony in.

A Yes, sir.

The purpose of my testimony is to describe Gulf Power Company's total human resources cost and indicate its relative position in the market.

Specifically, it should be made clear that Gulf's total remuneration program, when compared to the market in which it must compete for its employees, is conservative positioned in both its cash compensation and its noncash.

Further, when viewing either segment, that is benefits or the cash compensation, it is c that the cost of each is below the average in the market. Therefore, it logically follows that total remuneration is at or below the market mean.

Addressing the cash portion first, much has been made of the incentive programs PIP and PPP. You may recall that the PIP, or Productivity Improvement Program, is the long-standing improvement program for executive management. The PPP, or Performance Pay Plan, is new and includes all noncovered employees, approximately 900.

A clearer perspective of these programs can be obtained by viewing the total cash compensation that flows to the Gulf's employees and see how this compares to other companies in the market. Data has been provided that shows Gulf's relative position to other Florida utilities, its peer group, and the Utility market in general.

It needs to be emphasized that when Gulf's base salaries and incentives are compared with only the base salaries of these groups, we are conservatively positioned. Considering that 68% of these companies also have incentive plans, Gulf's relative position becomes quite obvious.

Concerning Gulf's benefit package, one of the most comprehensive surveys of utility company benefits is conducted by EEI. Other survey results, Hewitt's, for example, are consistent with EEI results and place Gulf close to the same relative position in the market.

Theirs, that is EEI's, 1989 report showing comparison of overall benefits, place Gulf well below the population mean when considering those benefits paid for by the ratepayer. When our employees contribution to their benefit package is included, the overall value is raised to just below the mean.

In summary, when viewing Gulf Power's total remuneration program, both cash and noncash, it should be clear that we are at or below the market mean and should be allowed to include all these costs in the rate base. Thank you.

MR. HOLLAND: Tender Mr. Jackson.

MR. BURGESS: No questions.

CHAIRMAN WILSON: Questions? Questions?

CROSS EXAMINATION

BY MS. RULE:

Q Mr. Jackson, what year was Gulf's employee savings plan established?

A 1976.

Q In Gulf's 1984 rate case, did the Commission disallow any portion of the employee savings plan?

A No, ma'am.

Q Pardon me?

A No, ma'am.

Q What's the 1990 budgeted amount for the Company's contribution to the plan? (Pause)

A 1,398,500.

Q Is this amount over the benchmark for the plan?

A It appears to be 6.9% over the benchmark.

Q At Page 12 of your rebuttal testimony you mentioned a 1989 EEI benefit survey, and out of the 130 companies surveyed, could you tell me how many were comparable in size to Gulf?

A In that survey, it's called a Benval survey, is divided into four segments. It's divided up according to revenue, and we were compared to the group, Revenue Group B, and I can give you the revenue numbers there, but it's relatively the same size companies.

Q That's not necessary, Mr. Jackson. Do you know whether the employee savings plans of comparable companies were allowed in rates by their respective Public Service Commissions?

A No, ma'am, I do not know.

Q Could you describe the employee fitness program?

A The employee fitness program is a program for our upper level management, from I think it's about the top 170 people in the Company. It is designed to provide an exercise program, physicals, health counseling and a facility in which they can work out.

Q Was the program in existence prior to the 1984 rate case?

A Yes, ma'am, it was.

Q Was any amount disallowed by the Commission in that rate case?

A Not to my knowledge.

Q How many employees actively participate in the program?

A Right now, 164.

Q How do you define active participation?

A People who receive their annual physical, the counseling, and any other tests that are prescribed in that program.

Q In your testimony, you made the statement that the fitness program was instrumental in lowering days-off due to participating employees from 1983 to 1989. How many employees currently in the program have been in the program since 1983?

A I can't tell you how many are there, but that amount of time, being off from work, is that population of the 170 or so top people.

Q The same people.

A Well, it's the same positions, relatively the same positions. It's done by position in the Company, not picked-out individuals. If you rise to a certain threshold in the Company organization, then you become eligible for this benefit.

Q What's the average number of days off due to illness taken by participants in the program?

A Approximately 2.7 due to illness.

CHAIRMAN WILSON: Per year?

WITNESS McMILLAN: Yes, sir. You would

expect a lower number of hours off by upper-level people, but this is below the average.

Q The average is based on what?

A Based on other companies.

MS. RULE: No further questions.

CHAIRMAN WILSON: Questions, Commissioners? Any further questions?

MR. HOLLAND: No further questions.

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

(Witness Jackson excused.)

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CHAIRMAN WILSON: Call your next witness.

MR. HOLLAND: Call Mr. Bushart.

MR. HOLLAND: Mr. Bushart, are you ready? Mr. Bushart needs to be sworn.

ROBERT DUNCAN BUSHART

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

DIRECT EXAMINATION

BY MR. HOLLAND:

Q Mr. Bushart, is your microphone on? I can't see it. Okay.

Mr. Bushart, would you state your name,

business address and position with Gulf Power Company?

A My name is Robert Duncan Bushart. My business address is 500 Bayshore Parkway, Pensacola, Florida, 32501. I'm an economist and I am the Supervisor of Forecast and Marketing Planning for Gulf Power Company.

Q Mr. Bushart, have you caused to be filed in this docket testimony entitled, "The Rebuttal Testimony of Robert D. Bushart"?

A I have.

Q Do you have any corrections on that testimony?

A Page 11, Line 16, change the number, "6.065" to "6.066."

Q With that correction, Mr. Bushart, if I were today to ask you the questions contained in your testimony, would your answers be the same?

A It would.

MR. HOLLAND: Mr. Chairman, we would ask that Mr. Bushart's testimony be inserted into the record as though read.

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

MR. HOLLAND: And his exhibits have been premarked and stipulated to.

CHAIRMAN WILSON: All right.

(Exhibit No. 293 stipulated into evidence.)

Record Copy

GULF POWER COMPANY
Before the Florida Public Service Commission
Rebuttal Testimony of
Robert D. Bushart
In Support of Rate Relief
Docket No. 891345-EI
Date of Filing May 21, 1990

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

A. My name is Robert Duncan Bushart, and my business address is 500 Bayfront Parkway, Pensacola, Florida 32501. I am an economist and I am the Supervisor of Forecasting and Marketing Planning for Gulf Power Company. I am also employed by the United States Army Reserve and assigned to the 361st Civil Affairs Brigade as Assistant Chief of Staff in charge of the 17 person Economics and Commerce section. In this latter position, I direct and supervise the analysis of Central and South American countries at the macro, micro and individual market segment level.

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

A. I received a Bachelor of Science degree in Chemistry in 1965 and a Master of Science degree in Economics from Murray State University in 1975. I attended the University of Kentucky and passed my preliminary examinations for admission to the candidacy for the

Ph.D. degree in 1978. In addition to micro and macro economic examinations my examination fields for candidacy for the Ph.D. degree included Environmental Economics; Energy Economics; Agricultural Economics; and Economic Policy.

Q. **Please describe your employment experience.**

A. Upon leaving the University of Kentucky, I accepted a position as Chief Economist at the West Florida Regional Planning Council and was the principal author of a two volume Economic and Policy Analysis of the Northwest Florida economy. I have taught micro, macro and managerial economics courses at the graduate and undergraduate levels at the University of West Florida and marketing and finance courses at the undergraduate level. In 1980, I accepted a position with Gulf Power Company as an Economist in the Marketing Department, where I have assisted in the development of the Company's customer, KWH sales, and revenue forecasts. In addition to forecasting, my principal duties were the economic analysis on projects involving marketing, research, and the load research as it applied to conservation and sales programs. In 1985 I was promoted to Senior Economist with basically the same responsibilities but with additional emphasis on the analysis of energy policies and their implications to the utility industry in general and specifically Gulf Power Company. In 1988 I was promoted to Supervisor of Forecasting and Marketing Planning. I supervise and direct the work of the economic, forecasting, marketing planning and administrative staff members comprising the Forecasting and Marketing Planning staff section.

Q. Mr. Bushart, what is the purpose of your testimony?

A. The purpose of my testimony is to provide rebuttal to the statements made and positions taken by Mr. Helmuth W. Schultz, III contained in his direct testimony in this docket. I will be specifically addressing his position regarding the reduction in overall cost of service as a result of our marketing programs.

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

A. Yes.

Counsel: We ask that Mr. Bushart's Exhibit, comprised of 1 Schedule be marked for identification as Exhibit# 293. (RDB-1)

Q. Would you please explain your duties as Supervisor of Marketing Planning?

A. I direct the analysis and conceptualization of marketing planning to ascertain what kinds of marketing programs are appropriate for the residential, commercial and industrial classes. Our analysis establishes that these programs are beneficial to both the participating customer and the general body of ratepayers. There are basically two types of marketing programs designed for each of our primary customer classes.

Q. Would you please explain these two basic types of marketing programs?

A. The two basic types of marketing programs are conservation marketing programs and sales marketing programs. Conservation marketing programs are designed to cost-effectively minimize the on-peak consumption of electrical energy while satisfying our customers' needs. Sales marketing programs are designed to satisfy our customers' needs primarily during off-peak periods when their cost causation is zero or very small. Both types of marketing programs contribute to lowering of the average total cost of electric energy, thereby contributing to the well being of the citizens of our service area.

Conservation marketing programs lower the average total cost by cost-effectively deferring current and future investments in transmission and generation facilities needed to ensure reliable and cost-effective electric service during the summer peaking periods.

Sales marketing programs contribute to lower average total cost by spreading the fixed cost necessary to serve the summer loads over more kilowatthours. Both types of marketing programs used separately or in conjunction with each other are cost-effective for Gulf's general body of ratepayers. The lowering of the average total cost of electrical service relative to what it would have been without the marketing program increases both the consumer surplus of each individual residential customer and the profitability of our commercial and industrial customers. This is not only directly beneficial to the citizens of our service area as residential customers but also contributes to the overall well being of our nation by making the goods and services produced within our service area more competitive in the international marketplace.

Q. **Do you consider Gulf Power Company to be a low cost provider of electrical service?**

A. Yes. Gulf Power is one of the lowest cost electrical service providers in the Southeastern United States. The philosophies of management on both cost containment and the efficient utilization of current and past investments are major contributors to the low cost of electrical energy in our service area.

Q. **Have you prepared an analysis that supports your position?**

A. I will address the economic analysis used in evaluating our marketing programs and this relationship to fixed invested capital. I will use the residential market for this analysis though a similar analysis can be used in the marketing programs for the commercial and industrial classes. I will illustrate that it is beneficial for the general body of ratepayers for Gulf Power to pursue off-peak sales in the residential market.

Q. **What data does Gulf Power have on competitive and non-competitive consumption in the residential sector?**

A. Gulf Power conducted the Energy Efficient Home Study in 1985 to specifically determine the demands and consumption caused by heating, ventilation and air conditioning units (HVAC), water heating units, and the whole-house consumption. In addition, Gulf Power measured the gallons of hot water that the residential units consumed. All data was recorded in 15 minute intervals so that the primary cost causality could be determined for these residences and these principal energy consuming units. This data was collected on a random sample of recently constructed Good ¢ents homes with conventional water heating, Good ¢ents homes with advanced water heating systems and conventionally constructed homes. This load research project was undertaken to both gather data on our existing residential conservation marketing programs and to form the basis for changes, if required, in future marketing programs.

Q. **Would you summarize the findings of the Energy Efficient Home Study as they relate to your analysis?**

A. My Schedule 1, page 2 indicates that non-competitive loads amounted to 11,263 KWH and the competitive loads of water heating and heating amounted to 6,194 KWH. In addition, the water heating load contributed 0.21 KW to the summer coincident peak.

Q. **Is Gulf Power Company a summer peaking utility?**

A. Yes. Gulf and the Southern Company System plan generation for only summer peaks. Gulf Power has had two winter peaks in the past thirty-five years. These winter peaks occurred on the coldest and fourth coldest days based on over 100 years of historical weather data. The Southern electric system has not had a winter peak since 1951. Southern's reserve margins, after scheduled and planned generation maintenance to cover the summer peak periods, are significantly higher in the non-summer months. The transmission systems of both Gulf and Southern are designed to meet the summer peaking loads. Gulf's Ten-Year Site Plan includes two peaking units designed to ensure reliable generation capabilities for the summer period. These units will be dual fueled to ensure that the least cost fuel is available for utilization when needed.

Q. Does it cost Gulf more in fixed investments to serve the competitive loads of water heating and heating?

A. Yes. It requires an additional investment of about 5.7 percent above the investment necessary to ensure reliable service for the non-competitive loads during the summer months.

Q. Does this increase the total base rate revenue requirements for Gulf?

A. Yes. However, that is not relevant. What is both relevant and important is that this incremental investment is cost-effective from the general body of ratepayers' perspective.

Q. Why is this beneficial to all other customers?

A. The additional 5.7 percent investment increases overall sales of electrical energy by about 50.0 percent, while satisfying the customers' needs in a cost-effective manner. These increased sales not only cover this 5.7 percent incremental cost but also spread the fixed investment necessary to serve the summer peaking load over many more kilowatthours, thereby decreasing the average total cost from what it otherwise would have been.

Q. Have you estimated the cost to serve the competitive load vs. the cost to serve the non-competitive loads?

A. Using the 1990 Cost-of-Service information filed in this docket, the residential class was allocated $711,411,000 of gross capital investment or $2,806 on a per residential customer. Non-competitive load cost requirements are $2,654 and competitive load cost requirements are $152 per customer. This indicates that it is over nine times as costly to serve the non-competitive load as it is to serve the competitive load on a per kilowatthour basis. This large differential in cost to serve is because the vast majority of our residential investment is required during the summer peaking period and would be non-productive during the remainder of the year if not for competitive sales.

Q. Have you estimated the base rate revenues generated by both the competitive and non-competitive sales?

A. Yes, using the Energy Efficient Home Study and the tariffs approved in the 1984 Gulf Power Company rate case, the competitive sales generate $200 and the non-competitive sales generate $461 in base rate revenues per customer.

Q. Have you estimated the payback on the difference between the competitive investment and the non-competitive investment?

A. Yes. Using the base rate revenues and the separated investment cost derived above, the simple payback analysis results in the competitive investment being recovered in 0.76 years while the non-competitive investment takes 5.8 years. This is summarized in my Schedule 1, page 2.

Q. Have you prepared an exhibit showing the assumed loss of competitive load sales for 100,000 residential customers?

A. Yes, I have prepared a partial analysis on the assumed loss of competitive sales on 619,400,000 KWH representing the sales to 100,000 residential customers. The 100,000 residential customers represent the appropriate number of competitive load customers Gulf has added since 1972. Kilowatthour sales are decreased 18.6 percent, revenues are decreased 15.2 percent and invested capital is decreased 5.4 percent. This results in a decrease in base rate revenue requirements of $5,218,050.

However, the base rate cents per KWH is now required to increase to all residential customers for all consumption by 18.0 percent (4.674 ¢/KWH compared to 3.960 ¢/KWH). Average total cost increases to all residential customers by 11.8 percent (6.780 ¢/KWH compared to ~~6.065~~ 6.066 ¢/KWH) for all KWH consumed, thereby decreasing consumer surplus to the citizens of our service area. The results of this analysis are illustrated in my Schedule 1, page 3.

Q. Does this conclude your testimony?

A. Yes, it does.

Q (By Mr. Holland: Mr. Bushart, would you summarize your testimony.

A Gulf Power Company and this Commission have the common goals of ensuring that the customers receive reliable electric service at the lowest possible cost consistent with a fair and equitable return on investment.

The purpose of my testimony is to provide rebuttal to the position taken by witness Schultz, concerning the benefits of Gulf's customer service and information programs. I will be specifically addressing his position on the change in overall cost of service as a result of our programs.

My testimony and my schedules show.

One, that customer service and information programs lower the cost of electric service.

Two, that it is cost effective to increase off-peak energy sales.

Three, the cost of serving noncompetitive loads is nine times as expensive as serving competitive loads.

And four, my schedule proves that the costs are lowered to all customers when Gulf sells electric heating and water heating competitive loads.

In order to achieve our goal of lower cost of service, Gulf must implement customer service and information programs that will reduce on-peak energy consumption, which reduces requirements for expensive investments. And at the same time, we need to increase off-peak energy consumption, thereby spreading fixed cost over more units of production. Both of these activities result in lowering of the average total cost of energy services to the general body of ratepayers.

Q Does that conclude your summary?

A It does.

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

MR. BURGESS: No questions.

CROSS EXAMINATION

BY MS. RULE:

Q On Page 8 of your prefiled testimony, you use the figure of 5.7% for additional investment to serve competitive loads. How do you calculate 5.7%?

A On Page 3 of my Schedule 1, the relationship of 38,000 -- $38,537,000 to $672,874,000. The 38 million is the incremental investment required to serve the competitive loads above that which would be necessary to serve noncompetitive loads.

Q In your analysis of how costs would increase for residential customers, did you take into account the impact of IIC revenues?

A Of which revenues, ma'am?

Q Pardon me?

A You said ISC?

Q No, IIC.

A No, ma'am, I did not take into consideration those revenues.

Q Why not?

A Because it is a partial analysis. The reduction of those revenues may or may not be offset primarily because if the magnitudes of the reduction occurring in the nonsummer periods occurred, this Commission would require us to form some -- file some other cost of service methodology. It is a partial analysis, it is not a total analysis.

Q Did you consider the impact on O&M?

A Yes, ma'am.

Q In your exhibit labeled in your testimony RDB-1, Schedule I, on Page 2, could you tell me -- and that's been assigned hearing Exhibit 293 -- how did you arrive at the base rate revenues that you have listed as being 200 and $461 dollars?

A The base rate revenues were calculated by taking the 1984 approved base rate cents per kilowatt hour, multiplying those by the competitive kilowatts hours sold, and the same for the noncompetitive kilowatt hours sold, utilizing both summer and winter cents per kilowatt hour base rate revenue requirements.

Q Do you mean competitive loads that could be served by gas as well?

A Yes, ma'am, or any other fuel service.

Q How is the payback calculated?

A The payback is calculated by taking the capital requirements of $152 per customer to serve this load, divided by the base rate revenues of $200. 152 divided by 200 is .76 years. The same thing is calculated on the 2654 capital requirements to serve the noncompetitive load, divided by the $461 dollars of base rate revenues.

MS. RULE: Thank you. No further questions.

COMMISSIONER EASLEY: I can't stand a wishy-washy witness. It was a pleasure to hear somebody be that incisive and that clear. Thank you.

MR. HOLLAND: That was a compliment, Mr. Bushart.

COMMISSIONER EASLEY: Yes, it was.

(Laughter)

CHAIRMAN WILSON: Any questions, Commissioners?

MR. HOLLAND: No.

CHAIRMAN WILSON: It is a pleasure to hear a straightforward answer.

COMMISSIONER EASLEY: It sure is.

CHAIRMAN WILSON: Which we don't always get.

WITNESS BUSHART: I thank you, sir.

CHAIRMAN WILSON: Thank you.

(Witness Bushart excused.)

CHAIRMAN WILSON: Call your next witness.

MR. HOLLAND: Call Mr. Bowers.

W. P. BOWERS

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

DIRECT EXAMINATION

BY MR. HOLLAND:

Q Mr. Bowers, you have previously testified in this docket?

A Yes, I have.

Q Have you caused to be filed rebuttal testimony entitled "Rebuttal Testimony of W. P. Bowers"?

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 today the questions contained in your testimony, would your answers be the same?

A Yes, they would.

MR. HOLLAND: Mr. Chairman, we would ask that Mr. Bowers' testimony be inserted into the record as though read.

CHAIRMAN WILSON: The testimony, without objection, will be so inserted into the record.

MR. HOLLAND: I believe Mr. Bowers' exhibits have been premarked and stipulated to.

(Exhibit 169 previously stipulated into the record.)

Record Copy

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony of W. P. Bowers
In Support of
Docket No. 891345-EI
May 21, 1990

Q. Please state your name and business address.

A. My name is W. P. Bowers. My business address is 500 Bayfront Parkway, Pensacola, FL 32501.

Q. Are you the same W. P. Bowers that has filed prefiled direct testimony in the docket dated December 15, 1989?

A. Yes.

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

A. Yes.

Counsel: We ask that Mr. Bowers' Exhibit comprised of 1 ~~schedules~~ schedule be marked for identification as Exhibit 169. (WPB-2)

Q. What is the purpose of your testimony?

A. I am presenting testimony in rebuttal to the statements made and positions taken by Mr. Helmuth W. Schultz, III contained in his prefiled direct testimony in this docket. I will specifically address his positions concerning Customer Service and Information, Customer

Service and Information Benchmark, Marketing and Economic Development.

Q. **What is your position regarding Mr. Schultz's statement that certain programs previously recovered through Energy Conservation Cost Recovery (ECCR) were rejected by the Commission as not cost-effective?**

A. Mr. Schultz is incorrect. We believe, and have provided substantial evidence which shows, that the Good ¢ents New Home and Good ¢ents Improved Home programs are cost-effective to the Company and its ratepayers and that the services provided through these programs are demanded by and highly valued by our customers.

Mr. Schultz's testimony demonstrates his lack of understanding with regard to utility conservation programs in general and the Energy Conservation Cost Recovery clause in particular. Programs included in ECCR do not necessarily have to be quantifiable on their own nor do they have to be cost-effective on their own. The burden of proof on a Company is that the entire conservation plan must be cost-effective. For example, the Commission has recognized since 1981 that the benefits associated with consumer education programs cannot be quantified. Nevertheless, until

October 1, 1989, the expenses for these programs have been recovered through ECCR.

As shown in Gulf's response to Item No. 109 of Staff's Seventh Set of Interrogatories in this docket, pages 2 - 20, the programs which are quantifiable are cost-effective. They are less cost-effective than in prior years for one primary reason -- the avoided unit used in the calculation is a combustion turbine rather than a higher cost intermediate or base load unit.

In its analysis of the benefits of these programs, the Commission must take into account the demand and generation expansion planning cycle. It is natural that there will be periods in which a system has no need for additional base load generation. Our present generation expansion plan does not call for construction of additional base load capacity through the year 2010. We do plan to add lower cost peaking capacity beginning in 1995. Under these scenarios, there may be periods when conservation programs of utilities will be less cost-effective or will fall short of being cost-effective as calculated under the Commission's methodology. The Commission, apparently anticipating the cyclical nature of demand growth in generation construction, and desiring to maintain the viability of conservation programs even during the periods which the programs might be marginally or less than cost-effective, adopted Rule 25-17.008(3). This subpart of Rule 25-17.008 provides as follows:

> (3) This rule does not require the Commission to approve a program shown to be cost-effective under it, nor does it preclude the Commission from approving a program shown not to be cost-effective.

This provision in the Rule also recognizes that there may be programs which, although not cost-effective or marginally cost-effective under the Commission's methodology, may provide benefits sufficient to justify the Commission's support and, therefore, cost recovery. Although we utilize this tool as one of many screening mechanisms, there certainly is no requirement that the ECCR test for cost-effectiveness be applied as a condition for recovery through base rates for programs or services.

Q. **Why is Gulf Power Company seeking to have the costs of these programs recovered through base rates?**

A. Gulf firmly believes that it is in the long-term best interest of all of Gulf's customers for the Company to continue to provide these programs. The Company respects the Commission's decision that it is not presently appropriate to allow recovery of these programs through ECCR. Therefore, we have included the expenses for these programs in the 1990 test year budget used to determine the revenue requirements for base rates.

Q. What is different between the two rate mechanisms that justifies including a program in base rates that has been excluded from ECCR?

A. In their recommendation to discontinue recovery of certain programs through ECCR, Staff was particularly concerned that the direct pass through nature of the ECCR mechanism does not serve to limit program expenditures. The nature of the ECCR mechanism makes it difficult for the Staff to identify a proper limit on these expenditures. On the other hand, the nature of base rates, because expenses of a utility have a direct effect on the utility's earned rate of return, effectively limits the amount of money the ratepayers will be called upon to pay in regard to such programs.

It is important to note that Gulf Power Company's participation in conservation type activities did not begin with the creation of the ECCR mechanism. Before ECCR, Gulf's conservation activities were recovered through base rates.

Q. **What evidence concerning the cost-effectiveness or the level of customer satisfaction with the programs has Mr. Schultz presented in his testimony?**

A. Mr. Schultz merely stated his opinion, which is not supported by any quantitative analysis of the cost-effectiveness of, or the consumer demand for, the services. It is somewhat disturbing that the position of the Office of Public Counsel is to deny the citizens they purport to represent in this proceeding the products and services which their clients and our customers have indicated they desire from Gulf Power Company.

Mr. Schultz is, in essence, testifying that our customers demand that we provide nothing more than reliable electric service to their meters. They are, under his scenario, unconcerned about price, efficiency, conservation or comfort. I firmly believe that, were we to cease all efforts in this area, the number of customer complaints to this Commission would increase and the high level of customer satisfaction which we have historically enjoyed would be diminished substantially.

The Good ¢ents logo has enjoyed a high percentage of customer recognition. It is synonymous with energy efficiency and conservation. If these programs are discontinued, much of what we have gained will be lost.

We have, as a result of these programs, become the energy information supplier for our customers. We are viewed as the experts and are expected by our customers to supply more than electricity to the meter. The customer does not merely look to the insulation manufacturer, the window manufacturer, his architect, or in many cases his builder -- he looks to us. In many instances the motives of other providers of information may be other than what is the most energy efficient and cost-effective alternative. We have and believe we should continue to provide these services. The data and information we provide is accurate and, unlike other suppliers of such information, is not directed at the selling of a product, but instead the promotion of efficient use of energy. We have excelled in the area. Again, if we are forced out of this market, much of what we have gained will be lost. When the time comes that we are forced back into this market, and that time will come, it will cost far more than if we are able to maintain a presence in the market and sustain and grow on the successes of the past.

Q. **Would you please address Mr. Schultz's position on the Good ¢ents New Home Program?**

A. Mr. Schultz asserts that the program promotes appliances, that it is not necessary for the provision of electricity, that it duplicates the Florida Model Energy Code for Building Construction, that we are unable to demonstrate any effect on load and that all of Gulf's ratepayers pay when only a few benefit.

Q. **Would you please address Mr. Schultz's contention that the Good ¢ents New Home program duplicates the Florida Model Energy Efficiency Code for building construction?**

A. The Good ¢ents Home Program offers superior services and benefits to our customers which are not provided through the Code. The Good ¢ents Program provides a vehicle to optimize compliance with the Code which is not universally enforced in Northwest Florida. The Code is, in actual practice, the minimum efficiency standards for building construction in the state. The Code does not provide the signals or incentives for builders to include the "optimum" in energy conserving technologies in new construction. In fact, builders can manipulate the Code to reduce air conditioning efficiencies and reduce insulation. In an article published in the April 1989 edition of American Gas, Mr. Edward P. Markette, Vice President of Sales at City Gas Company, was quoted:

> If the builder hooks up natural gas, he reduces the points (EPI) by 12 to 16... that might allow him to install less efficient air conditioning or less insulation. He may take the home back up to 99 points, but he's put some money in his pocket. The builders are beginning to jump on that.

Our aim with Good ¢ents is to optimize the efficiency of any and all structures, regardless of fuel source. Optimization of Code compliance includes proper installation and sizing of heating and air-conditioning equipment to insure savings are realized and to encourage efficiencies beyond those set as minimum. Proper installation also minimizes the service and maintenance expenses and optimizes the life of the equipment.

We are absolutely convinced that, without our involvement in and promotion of the Good ¢ents Home Program, the number of homes meeting even the minimum standards set by the Code would be far fewer than is now the case. Even as we discuss this issue, Congress is looking at Federal involvement to get organizations to provide services to consumers that are identical to Good ¢ents. In Senate Bill 1355, the United States Senate is considering funding organizations to assess efficiency standards of residences; determine monthly cost of suppling a residences' energy needs; make recommendations regarding cost-effective residential energy efficiency features; report results of such inspections to residence owners, residence purchasers and their lenders; and are capable of administering a uniformed energy efficiency rating system. These services are, in fact, what the Good ¢ents Home Program provides to all customers in Northwest Florida. If we are forced to shut the Good ¢ents Home Program down, the tremendous gains in educating the public of the importance of constructing energy efficient new homes which have been made since 1976 will be lost. That is not in the customers' best interest. Customer demand for the services will not end with the cancellation of this program or any other program. What will end is the Company's ability to respond to their demands.

Q. Please continue.

A. I have provided direct testimony and supporting evidence that address the basic issues Mr. Schultz raises concerning the program. His testimony contains a number of incorrect statements concerning the purpose and benefits of the program.

The Good ¢ents New Home Program, which was implemented in 1976, has never been used for the sales promotion of appliances. This Commission, from 1981, through 1987, continually reviewed and approved this program for recovery in ECCR. The Commission and its Staff are well aware of the purpose and intent of the program and of the success we have enjoyed with the program. The program promotes one thing -- energy efficiency. It has succeeded and will continue to succeed in this endeavor.

Mr. Schultz's position that the program is not necessary for the provision of electricity assumes that the only product ratepayers want from their utility is energy. This assumption is without substance or merit.

Mr. Schultz states on page 63 of his testimony at lines 12 - 14, that the degree of enforcement of the Energy Efficiency Code does not change the fact that the information is available, which, according to Mr. Schultz, makes the Good ¢ents Home Program unnecessary. The Code is not a vehicle for information exchange; it contains standards of construction that are not being enforced in Northwest Florida. Even if the Code is to be enforced, it can lead to less efficient structures and equipment, thereby causing peak demand growth at a higher rate than with the Good ¢ents program. He is indirectly advocating the unnecessary and uneconomical construction of generation as a substitute for the failure of a governmental program to meet the needs of our ratepayers. This position is in direct conflict with good business practice and legislative directives such as FEECA.

Mr. Schultz mistakenly asserts that Gulf's program has had no discernible effect on load and that a public utility should not fill any gaps or niches in the free market. The benefits produced by this program since 1977 are well documented in the ECCR dockets and FEECA reports.

Lastly, Gulf Power would not be filling any so called "gaps" if the needs of our ratepayers could be met by someone else. Mr. Schultz's statement that the market is free is ridiculous; a free market is void of governmental interference. Mr. Schultz is being retained by a governmental agency which maintains that, if a governmental program (The Model Energy Code) does not work, then the private sector should be prohibited from responding to private citizen (ratepayer) demand by providing cost-effective products and services. Before dictating what his clients (the ratepayers) want, Mr. Schultz should consider attempting to determine what services they demand. He has not. In contrast, we are in the marketplace and know the services our customers are demanding.

Q. Mr. Schultz asserts that the Florida Model Energy Code (FMEC) is available to the public and should dictate building efficiency standards. Does implementation of the Florida Model Energy Code provide the cost-effective benefits intended by FEECA for the ratepayers of Northwest Florida?

A. No. Even if the FMEC is enforced its design does not provide the optimum level of electrical peak demand reduction, which the Good ¢ents program provides. Not only does the Good ¢ents program improve the reduction in summer peak demand, but by encouraging the installation of heat pumps, it provides the participating customer lower energy bills as shown in Schedule 1, page 2.

Q. Are you saying in the same home in Northwest Florida that the cost of heating a home with a heat pump is cheaper than the cost of heating a home with natural gas?

A. Yes. In my Schedule 1, through engineering analysis, four homes of equal size built with the same thermal envelope are examined. The all electric home costs less to operate than any of the three homes utilizing natural gas. The two gas heat scenarios represent various levels of natural gas consumption based on appliance selection. Comparing the cost to heat the all electric home, you can see that the heat pump can do the job for $141 annually. The cost of heating the home with natural gas varies from $231 to $267.

Q. In total operating costs how do these homes compare?

A. The all electric home has the lowest operating cost, even though it has the highest E.P.I. rating which is the rating given according to the FMEC. This rating is intended to represent relative levels of energy efficiency in residential structures.

Q. How does this affect Gulf Power Company's marketing efforts?

A. If we were to exit from the marketplace and rely on the FMEC, the result would be costly to our customers. As you can see in my Schedule 1, page 2, there is significant room for movement in the E.P.I. ratings of the gas homes. This supports the statements of Mr. Markette, Vice President of Sales at City Gas Company, when he commented that the Code allows for less insulation and less efficient heating and cooling equipment. You can easily surmise that the Code allows just that. The result is homes built with less efficient cooling equipment and less thermal integrity which causes higher peak demand on our system, creating the need for additional generation which is costly to all ratepayers, especially when it is not necessary.

Q. **Mr. Bowers, is it the position of the Company that it should be permitted to advocate one energy source over another?**

A. No. This is not the intent of our programs. The intent is to insure informed decision making and to promote efficient use of energy. We recognize the impact additional peak demand has on the cost of electricity and strive to reduce the growth in peak demand. To the extent this is accomplished through compliance with our programs, we believe there is benefit to all customers. Additionally, we have an obligation to provide fair, accurate and straightforward information regarding energy costs to our customers. If the customer makes a misinformed decision, it not only can cost him/her money, but also has a detrimental effect on all customers.

Q. **Has Mr. Schultz correctly stated the test year expenses for the Good Cents Improved Home?**

A. No. Mr. Schultz did not account for the expenses of $152,393 that were recovered in ECCR. Gulf is asking for recovery of $457,390 in base rates.

Q. What is Mr. Schultz's position regarding the Good ¢ents Improved Home Program?

A. His position is essentially the same as the ones he has taken in regard to the Good ¢ents New Home Program. Once again, Mr. Schultz is exhibiting his lack of understanding of the program, the services it offers and the benefits it provides to the ratepayers. I have provided evidence, where Mr. Schultz has not, that the program is cost-effective, does not promote appliances and provides benefits to all ratepayers.

Q. Please discuss Mr. Schultz's positions concerning the Energy Education and Presentations/Seminars Programs.

A. Mr. Schultz's assertion that the Company could not demonstrate cost-effectiveness indicates that he does not understand the purpose or benefits of these programs. These programs provide general education to all of our ratepayers concerning energy services provided by the Company and other businesses including governmental agencies. They also provide information on energy technologies including those that use energy sources other than electricity. Finally, they are used to create demand for the products and services offered by or through our other programs. The programs were not removed from ECCR because the benefits derived from them were not quantifiable and, therefore, could not be evaluated utilizing a cost-effectiveness test. In Order No. 21317, page 9, the Commission stated:

> Now, however, we believe programs of this kind are a fundamental part of the customer service responsibility of such utilities and, therefore, do not require special...If the FEECA statute and ECCR were abolished tomorrow, customers would still call utility service offices to inquire about energy efficient products and uses. Utilities should and would provide such information on how to use its product wisely. The need for special treatment of such information services has long since passed, so we hereby order the elimination of these programs for ECCR purposes.

Q. **Do you have any further comments with respect to Mr. Schultz's recommendation on the Customer Service and Information Programs.**

A. Yes. Mr. Schultz has taken a position on four Customer Service and Information programs without presenting any evidence, other than his personal opinion, that they are not beneficial to the ratepayers and it is not "normal" for a utility to provide them. It is, in fact, normal for a utility to provide these services in some form. It would be abnormal not to provide the services. He is completely ignoring the fact that our customers want the products and services provided in the programs and that they are beneficial to the ratepayers. Mr. Schultz is merely substituting his opinion as a non-participant in any of the programs for the opinion of those who are participating and reaping the benefits. Gulf would carefully consider and act on any evidence provided by Mr. Schultz that demonstrates that our customers want us to stop providing them with any customer services other than electricity.

Q. **Mr. Bowers, Mr. Schultz takes the position that Gulf Power is over the benchmark in 1990 for Customer Service and Information. Do you agree?**

A. No. I presented in my prefiled direct testimony, Exhibit ___(WPB-1), Schedule 3, a calculation of the Customer Service and Information benchmark calculation that reflects the impact of the Commission decision regarding conservation expenses in our 1984 rate case.

Gulf Power Company is providing high quality, highly valued Customer Service and Information products and services, through more programs, to more customers and at a lower cost than in 1984 when all of the expenses for the programs being challenged were approved by the Commission. Gulf is actually below the benchmark $824,000. Any claim that we are over the benchmark ignores the FPSC's decision in 1984 to change the method of recovering some of the expenses. The FPSC approved all of the Customer Service and Information expenses requested in the 1984 rate case.

Q. **Please discuss Mr. Schultz's position regarding his adjustments to Customer Service and Information expenditures.**

A. Mr. Schultz defends his adjustment for the programs listed in his Exhibit __(HWS-13) based on the premise that whoever participates in a program should incur all of the cost. His position ignores the fact that all ratepayers accrue benefits from Gulf's programs including those that do not directly participate. This Commission has repeatedly recognized that all ratepayers benefit from this program and has rejected the position taken by Mr. Schultz.

Q. **Could you provide an example of how all customers benefit from such programs?**

A. Our industrial technology transfer and technology assessment programs have enabled us to work with two of our largest industrial customers concerning their plans to install cogeneration equipment beginning in 1987. We reached an agreement with each of these customers that changed the schedule of their projects until the generation capacity their projects would avoid would be needed by the Company. The agreements recognized the timing of their projects.

Q. How does this timing affect your ratepayers?

A. If the cogeneration of the two industrial customers projects were completed as originally scheduled, they would have avoided 57.5 MW of base load capacity and 435,000,000 KWH in energy sales. Gulf has sufficient base load capacity to serve retail loads including these customers in the near term; however, based on our current expansion plans, we will likely need additional capacity in the future. The agreements with the two customers recognize the benefits to retaining their loads in the short term and the long term benefits of encouraging customers to proceed with cogeneration plans when the timing is beneficial to Gulf's general body of customers.

Q. What do these contracts have to do with Mr. Schultz's position?

A. We were able to establish credibility and open lines of communication with these customers as a result of our Customer Service and Information programs. If the sales had been lost because of our lack of action, then all ratepayers would have suffered the consequences.

Q. How would all of your ratepayers suffer the consequences?

A. The revenue requirements for the 57.5 MW of load would have been shifted from the industrial rate classes to the residential rate class based on the cost-of-service methodology currently approved by the Commission. I might also add that this is a two-way street. The industrial customers have always paid their share of the ECCR expenses, including these directed solely at the residential class.

Q. Please discuss Mr. Schultz's position regarding marketing.

A. Mr. Schultz has taken two positions regarding marketing. First he is under the mistaken impression that a regulated monopoly lacks competition. Secondly, he believes that our marketing efforts are directed at indiscriminately increasing energy sales.

Q. Please discuss Mr. Schultz's first position.

A. Gulf Power Company, like every other regulated electric energy supplier in the United States, must meet competition daily in the marketplace. This competition comes in the form of the inefficient use of energy, causing greater demands and increased investment. Also, transmission access, whereby other utilities may serve loads in another utility's traditional service area; cogeneration that could result in the uneconomical loss of load; alternative energy suppliers who would take high load factor load resulting in increased costs to all ratepayers; and new technologies, such as fuel cells that would allow all customers to produce their own energy, all provide additional competition. This competition provides a great deal of pressure for Gulf to keep its product cost-effective both in the short-term and long-term.

Mr. Schultz's position fails to recognize that a regulated monopoly competes with all other private sector businesses for load, labor, capital and managerial ability in order to be the supplier of choice for consumer products and services. Acceptance of Mr. Schultz's position would mean that the owners and management of the regulated monopoly should ignore the demands of its customers for products and services and not try to control costs and price by investing in activities beneficial to the ratepayers. It is Mr. Schultz's opinion that, since we are a regulated monopoly, we will be fully compensated for any losses that result from marketplace competition. I do not believe that the Commission would support any efforts on our part to reduce load on our system when capacity has been built and is available to serve that load. Were we to do so and attempt to place the burden for the existing capacity on the residential ratepayers, the Commission would be first in line to condemn the Company.

Q. Please address Mr. Schultz's position regarding natural gas competition.

A. On page 73, lines 1 - 13, of his testimony, Mr. Schultz quotes a portion of an interrogatory response concerning natural gas competition and would have this Commission believe that the quoted portion is indicative of the existence of competition in the entire marketplace. The fact is the response is part of an explanation for the "historical" numbers of natural gas residential dwellings that were certified as being Good ¢ents Homes. The response has nothing to do with marketplace competition in the commercial, industrial and existing residential marketplace in 1990 and beyond.

Q. Please address Mr. Schultz's second position regarding your marketing efforts.

A. Mr. Schultz would have the Commission believe that our marketing efforts concentrate on "active selling and promoting of energy as defined in FEECA ..."; page 75, lines 2 - 3, of his testimony. The truth is that some of our efforts are concentrated on economically increasing off-peak energy sales and thereby spreading of fixed costs over more units of investment, resulting in a lower cost of service to all customers.

Gulf recognizes that cogeneration can be beneficial, and the Company is an active participant in the rule making proceedings with the Commission on this issue. We work with our customers, at their request, to analyze various options for fulfilling their energy needs.

The Commission has recognized the value of our efforts by approving two contracts with industrial customers that deferred their cogeneration projects and by approving a rate rider (Supplemental Energy, Schedule SE) that recognizes the benefits of off-peak energy sales.

The goal of our marketing efforts is to assist our customers achieve economic efficiency by providing the products and services that will enable them to make informed decisions regarding their energy investments.

Q. **What is Mr. Schultz's position regarding your economic development activities?**

A. His basic position is that the Company should not, under any circumstances, engage in any community and economic development activities because they are not beneficial to the ratepayers.

If you were to accept his position, then you must believe that uncontrolled and unpredictable growth is better than, or at least equal to, controlled and predictable growth. You must also recognize and accept the fact that low load factor growth is also better than, or at least equal to, high load factor. I am convinced that Mr. Schultz does not believe this, and neither does anyone else.

Florida is one of the country's fastest growing states. We have committed resources to allow us to be active participants in the community and economic development process to ensure that when growth does occur, the impact on our ratepayers will be beneficial. We are not now, nor have we ever been proponents of uncontrolled growth in demand in our service areas.

Surveys show that our customers rate our community and economic development activities as the number one program we should offer. Why is the Office of Public Counsel recommending that the customers be denied these activities, when over 88 percent of Gulf's customers desire that we participate in these efforts?

Q. Please summarize your testimony.

A. Gulf Power engages in Customer Service and Information programs based on the demands of our customers for high quality, energy related products and services. Our goal with these efforts is to help our customers make informed choices and achieve the highest level of economic efficiency from their energy investment. We are not offering these programs as a means of indiscriminately increasing demand for and sales of electric energy. Our customers would not tolerate this kind of action by the Company and we would not expect regulators to allow us to recover the expenses.

We do expect regulators to recognize the benefits that accrue to the ratepayers and their overwhelming acceptance of and voluntary participation in the programs. The Office of the Public Counsel is representing the Citizens of the State in this proceeding.

It is the residential customer who receives the primary benefits from these programs.

Q. Does this conclude your testimony?

A. Yes, it does.

Q (By Mr. Holland) Mr. Bowers, would you summarize your testimony?

A Yes, I will.

The purpose of my testimony is to rebut the positions taken by Mr. Schultz, witness for the Office of Public Counsel, as they pertain to the test year expenses for customer service and information and community and economic development. Mr. Schultz has made claims concerning the cost effectiveness of programs which are wrong and are not supported by evidence. The recommendations he has made are without sound reason and based on incorrect interpretations of this Commission's intentions and without regard to the Commission's orders and rules.

Gulf Power has repeatedly demonstrated the value of all of its programs, the benefits accrued to all customers and our customers' desire to have us provide these programs and services.

The determination of energy and demand reductions are arrived at using nationally and state-recognized energy simulated models. These savings are conservative and accurately reflect the thermal and operational characteristics of residential and commercial structures. Our objective is to provide long-term benefits to all customers at the lowest possible cost.

In addition to the engineering calculations and computer modeling, Gulf has provided this Commission the direct input from our customers, which also helps determine our service and program offerings. This input, obtained through customer resesearch and direct one-on-one contact, is vital to meeting our customers' expectations and needs.

Although Mr. Schultz does not claim to be an expert in marketing and customer service, he is recommending the disallowance of a great deal of expenses related to marketing and customer service without substantial evidence to support his position. He has taken positions that are contrary to previous Commission action, and in some cases essential to complying with Commission rules.

The thorough understanding of our market, our customers' needs and future expectations, along with a good management team, will enable us to continue serving the best interests of our customers. We have committed resources to programs and services, our employees are well-trained and motivated, and all our customers are benefiting from their efforts, which has resulted in long-term lower costs. Gulf believes that in the long run our Company does not gain at the expense of our customers and our customers do not benefit at the expense of our Company. Only when both benefit do either succeed. Thank you.

MR. HOLLAND: Tender Mr. Bowers.

CROSS EXAMINATION

BY MS. RULE:

Q Mr. Bowers, you've testified that the two Good Cents Programs cover not only the addition of conservation measures, such as extra insulation, energy-efficient appliances and the like, but also covers provision of information customers. Can you tell me what percent of the Good Cents Programs' expenses are attributable to providing such information?

A Marsha, we have a breakdown of the expenses, as far as the Good Cents Home, and I'll espouse those. In labor, we have approximately $467,000 for people in the field disseminating information to the builders, contractors, and to the homeowners. We have approximately 251,000 in materials and expenses which relate to booklets and brochures, energy simulations, computer modeling programs and other information. We also have $300,000 of advertising, which is direct information on mass media basis.

On the Good Cents improved home we have

$211,000 related to labor. We have $141,000 related to materials and expenses, and $104,000 related to advertising.

Q So then the labor would be the information function?

A Labor is a direct labor of carrying out the programs in the field. Materials and supplies are the materials used in getting the information to the consumers.

Q Can you divide the figures you gave me into expenses attributable to providing information and expenses attributable to adding conservation measures? Do you separate those figures out?

A No, we don't.

Q Can you? Can you give me a ballpark figure?

A No, because it's all information. The Good Cents Home Program is an informational program.

Q So then the labor would be the information component mostly?

A Not necessarily, because materials and expenses is also information that you give to the consumer.

Q You testified also that the Shine Against Crime Program includes both the change-out of existing facilities and installation of new facilities. Can you give me a percentage of the program expenses attributable to the change-out and a percent attributable to the installation?

A Again, it's all-encompassing. I can give you the breakdown of labor, materials and supplies and advertising, like I did for the other programs, but how do you separate the interconnection of that program activities? That would be difficult to do. I could give you a guess, but I don't want to do that.

Q Do you have any historical information in the past how that has worked?

A I would have to go back and find that out for you.

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

A Yes.

MS. RULE: I believe that would be 631. The title would be "Shine Against Crime Expenses for Change-outs Versus New Installation."

COMMISSIONER GUNTER: Give me that one more time.

MS. RULE: "Shine Against Crime Expenses for Change-outs Versus New Installation."

COMMISSIONER GUNTER: Okay. 631.

(Late-filed Exhibxit No. 631 identified.)

MS. RULE: No further questions.

COMMISSIONER GUNTER: Can we just stand easy for about five minutes?

WITNESS McMILLAN: Is that all?

COMMISSIONER EASLEY: No.

COMMISSIONER GUNTER: You can take a five-minute break.

(Brief recess.)

(Transcript follows in sequence in Volume XXVI.)

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