BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Request for rate increase by Gulf Power Company.) DOCKET NO. 010949-EI

VOLUME NUMBER 9

Pages 901 through 1042

IN RE: HEARING

BEFORE:
CHAIRMAN LILA A. JABER
COMMISSIONER J. TERRY DEASON
COMMISSIONER BRAULIO L. BAEZ
COMMISSIONER MICHAEL A. PALECKI
COMMISSIONER RUDOLPH "RUDY" BRADLEY

DATE: TUESDAY, FEBRUARY 26, 2002

TIME: COMMENCED AT 9:00 A.M.

PLACE:
FPSC
4075 ESPLANADE WAY
ROOM 148
TALLAHASSEE, FLORIDA

REPORTED BY: NANCY S. METZKE, RPR, CCR

APPEARANCES: (As heretofore noted.)

INDEX

EXHIBITS - VOLUME VI

P R O C E E D I N G S

CHAIRMAN JABER: Let's get back on the record. Staff, Edward Bass, is your next witness?

EDWARD D. BASS, II

was called as a witness on behalf of the FPSC Staff and, having been duly sworn, testified as follows:

EXAMINATION

BY MS. STERN:

Q Good morning, Mr. Bass. You've been sworn in, correct?

A Correct.

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

A Edward D. Bass, II. My business address is 2540 Shumard Oak Boulevard, Tallahassee, Florida.

Q In what capacity are you employed by the Public Service Commission?

A I'm employed with the Florida Public Service Commission as a regulatory analyst in the Division of Auditing and Safety.

Q Have you provided prefiled direct testimony in this docket?

A Yes, I have.

Q Do you have any changes or corrections to make to your testimony?

A No, I do not.

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

A Yes.

MS. STERN: May we please have the testimony of Edward Bass inserted into the record as though read?

CHAIRMAN JABER: The prefiled direct testimony of Edward D. Bass, II shall be inserted into the record as though read.

DIRECT TESTIMONY OF EDWARD D. BASS II

Q. Please state your name and business address.

A. My name is Edward D. Bass II and my business address is 2540 Shumard Oak Blvd., Tallahassee, Florida 32399-0850.

Q. By whom are you presently employed and in what capacity?

A. I am employed by the Florida Public Service Commission as a Regulatory Analyst III in the Division of Auditing and Safety.

Q. How long have you been employed by the Commission?

A. I have been employed by the Florida Public Service Commission since July, 1997.

Q. Briefly review your educational and professional background.

A. In 1995, I received a Degree in Accounting from the University of Florida. I worked for the Department of Management Services as an Accountant I and II for thirteen months before joining the Commission staff as a Professional Accountant. I was promoted to my current position in June, 2001. I am also a Certified Public Accountant licensed in the State of Florida.

Q. Please describe your current responsibilities.

A. Currently, I am a Regulatory Analyst III with the responsibilities of planning and directing audits of regulated companies, and assisting in audits of affiliated transactions. I also am responsible for creating audit work programs to meet a specific audit purpose.

Q. What is the purpose of your testimony today?

A. The purpose of my testimony is to sponsor the staff audit report of Gulf Power Company, Docket No. 010949-EI. The audit report is filed with my testimony and is identified as EDB-1.

Q. Was this audit report prepared by you or under your direction?

A. Yes, I was the audit manager in charge of this audit.

Q. Please review the work you and the audit staff performed in this audit.

A. We compiled supporting documentation for rate base components for the year ended December 31, 2000, performed a judgmental sample of plant in service additions, compiled accumulated depreciation and traced depreciation rates to Commission orders, and scanned projected plant in service for the 12-month period ended May 31, 2003. We also toured the construction site of Plant Smith Unit 3 - Combined Cycle, performed a judgmental sample of transactions related to the construction of Plant Smith Unit 3 - Combined Cycle, toured two sites included in plant held for future use, scanned the utility's continuing property records, verified adjustments to rate base in accordance with Commission Order No. 23573, issued October 3, 1990, and compiled working capital accounts.

We also compiled supporting documentation for net operating income components for the year ended December 31, 2000, performed a judgmental sample of operation and maintenance (O&M) expenses and examined the invoices and other supporting documentation, and compiled advertising expenses included in the year ended December 31, 2000. We also recalculated depreciation expense, compiled support for taxes other than income and income taxes, and verified adjustments to net operating income in accordance with Commission Order No. 23573, issued October 3, 1990.

We also compiled supporting documentation for capital structure components for the year ended December 31, 2000, traced principal amounts and interest rates to supporting debt instruments, verified costs rates used in the computation of the cost of capital, and scanned the reconciliation of capital structure with rate base.

Other miscellaneous procedures we performed include scanning the utility's board of directors' minutes for the 12-month period ended December 31, 1998 through the second quarter of 2001, scanning the utility's outside auditor's working papers for the 12-month period ended December 31, 2000, and obtaining a description of the utility's O&M expense budget process.

Q. Please review the audit exceptions in the audit report.

A. Audit Exceptions disclose substantial non-compliance with the National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts (USOA), a Commission rule or order, and formal company policy. Audit Exceptions also disclose company exhibits that do not represent company books and records and company failure to provide underlying records or documentation to support the general ledger or exhibits.

Audit Exception No. 1 discusses Advertising Expenses. The utility's Minimum Filing Requirements (MFRs), Schedule C-26 and general ledger include four advertising accounts: 930.100 - General Advertising - Salaries, 930.110 - General/Institutional - Production, 930.120 - General/Institutional - Media, and 930.180 - Industry Sponsored Advertising. These four accounts total $226,000 for the historical year and $550,000 for the test year. The utility's MFR Schedule C-3 reflects an adjustment in the amount of $223,000 ($226,000 x .9822560 jurisdictional factor) to remove all of the expenses in each of these accounts related to image enhancement advertising for the historical year ended December 31, 2000. However, the utility did not make an adjustment to remove these image enhancement advertising expenses from the test year.

Commission Order No. 6465, issued January 17, 1975, in Docket No. 9046-EU, a general investigation of promotional practices of electric utilities, states that advertising which has as its primary objective the enhancement of or preservation of the corporate image of the utility shall be disallowed for rate making purposes.

I have reviewed these image enhancement advertising expenses for the historical year ended December 31, 2000. In accordance with Commission Order No. 6465, the utility should make an adjustment to remove the projected image enhancement advertising expenses in the amount of $539,000 ($550,000 x .9803411 jurisdictional factor) from the test year ended May 31, 2003. The utility should also review its expenses for the projected test year ending May 31, 2003 to assure that any amounts related to this exception are also removed.

Audit Exception No. 2 discusses Lobbying Expenses and Donations. The utility's operation and maintenance (O&M) expenses for the historical year ended December 31, 2000 include $7,000 recorded in account 930.200 - Industry Association Dues, $500 recorded in account 500.000 - Operation Supervision and Engineering Expenses, and $600 recorded in account 500.000 - Operation Supervision and Engineering Expenses.

The $7,000 was for the utility's membership dues for Associated Industries of Florida, of which 100 percent is related to lobbying activities. The $500 was a charitable contribution to St. Andrew Bay Center. The $600 was paid for a golf tournament donation.

The Uniform System of Accounts, 18 CFR 101 includes Account 426.1 -

Donations, which includes all payments or donations for charitable, social, or community welfare purposes; and Account 426.4 - Expenditures for certain civic, political and related activities, which includes expenditures for the purpose of influencing public opinion with respect to the election or appointment of public officials, referenda, legislation, or ordinances.

In accordance with the Uniform System of Accounts, 18 CFR 101, the utility should make an adjustment to properly classify these O&M expenses for the historical year ended December 31, 2000. The utility's MFRs reflect $7,000 in membership dues for Associated Industries of Florida for the projected test year ended May 31, 2003. The utility should make an adjustment to properly classify this expense for the projected test year ended May 31, 2003. The utility should also review its O&M expenses for the projected test year ended May 31, 2003, to assure expenses are properly classified in accordance with the Uniform System of Accounts. Proper classification of these expenses will remove them from the determination of revenue requirement.

Q. Please review the audit disclosures in the audit report.

A. Audit Disclosure No. 1 discusses the Caryville - Plant Held for Future Use. The utility's Minimum Filing Requirements (MFRs), Schedule B-3 reflects $3,164,000 in total plant held for future use, for the projected test year ended May 31, 2003. One of the properties include in this plant held for future use is the Caryville electric generating plant site with a book value of $1,356,000. The audit staff toured the Caryville plant site and observed the following. The Caryville electric generating plant site is located in Washington and Holmes Counties. It is an irregular plot covering over 2,000 acres. The site consists of mostly wooded land, with a small part bordering on the Choctawhatchee River. The land is fenced and posted. The utility has described the land as used to plant, cultivate, and harvest timber and pulpwood. The land is classified as agricultural for property tax purposes.

The utility acquired the site in 1963 and has not built a plant on it. However, the utility has made several capacity additions to other sites since then, which include the acquisition of fifty percent of Plant Daniel, upgrades to Plant Crist and Plant Smith, and the acquisition of land in 1998 for the Mossy Head generating plant site. The utility's 46KV line cuts through and divides the northern sector in Holmes County and a county maintained road cuts through and divides the southern sector in Washington County. The land is not currently being used for utility purposes except for a small plot in the southeast sector which houses an antenna for the Southern Company radio/telephone network and the 46KV line.

There is evidence that small portions of the land have been farmed at one time. During the last rate case, a large portion of the land was used as a sod farm. The sod farm operation has ceased and the land is back in timber and pulpwood production as evidenced by large areas of planted pine trees.

The utility entered into an agreement on November 9, 2000, with the Brunson Landing Hunt Club to allow the club to hunt on the Caryville and Mossy Head properties. The hunt club provides liability insurance to cover its activities. The agreement includes an initial term of five years beginning September 1, 2000 and terminating on August 5, 2005, and is renewable. The hunt club is not obligated to pay the utility rent for the years 2001 through 2003. For the years 2004 and 2005 the hunt club will pay the utility a annual rental payment of $3,600 for use of the land. Since revenues are not to be received until 2004, no revenues are reflected in the test year ended May 31, 2003. Disclosure No. 1 was written to provide information regarding the plant held for future use.

Audit Disclosure No. 2 discusses the Corporate Office - Third Floor. During the company's last rate proceeding, in Docket No. 891345-EI, the Commission ordered the utility to remove the cost of the third floor of the corporate office from plant in service. The utility's Minimum Filing Requirements (MFRs), Schedule B-4 reflects an adjustment to remove $4,031,000, for the historical year, from plant in service for the cost of the third floor of the corporate office. However, the utility did not make an adjustment to remove the cost of the third floor of the corporate office in the projected test year ended May 31, 2003. The utility states that the adjustment is no longer needed since the third floor of the corporate office is used and useful for utility operations.

In 1999, audit staff toured the third floor of the corporate office. At that time the utility stated that the third floor is primarily used for storage of records retention; spare office furniture; miscellaneous supplies for the kitchen, print shop, safety and health, and power delivery. It also contains a workshop for building maintenance. Over 90% of the 52,000 square feet of office space is utilized. The current audit staff also toured the third floor of the corporate office and concurs with the utility's statement above.

Audit Disclosure No. 3 discusses the Corporate Office Restaurant and Bank. The utility rents a portion of its corporate office space to Norma's Restaurant. In addition, the utility donates office space within its corporate office to Gulf Power Employees Credit Union. The employee cafeteria currently being leased to Norma's Restaurant serves the function of providing employees with food service. During the 1990 rate case review of the utility's corporate office building, the amount of investment related to the cafeteria space was reviewed and allowed in rate base. Norma's Restaurant opened for business in 1997 to provide cafeteria service for the occupants of the building, catering in the building, and a restaurant open to the general public. By leasing the space to Norma's as a public restaurant rather than operating the cafeteria only for employees through a management company, or operating it with utility employees, the utility has lowered costs through a reduction in the custodial staff that supported catering in the building and eliminating the cafeteria management fee. The utility improved the quality of service to its employees while at the same time reduced its costs and increased lease revenue. Norma's Restaurant is billed a monthly lease payment. These monthly lease payments are recorded in Account 454 - Rent from Electric Property.

The services provided by the credit union are an employee benefit to the utility's employees. Banking services such as check cashing, loans, investments, and other services are available to employees at no cost to the utility. The credit union's office space is donated. This disclosure was written to provide information.

Audit Disclosure No. 4 discusses Other Operating Revenues. The utility's Minimum Filing Requirements (MFRs), Schedule C-10 reflects other operating revenue amounts for the historical year and projected test year. Account 454 - Rent from Electric Property decreased from $5,323,000 to

$4,837,000, or 9.1% from the historic year to the test year. Account 456 - Other Electric Revenues increased from $5,016,000 to $6,248,000, or 24.5%.

The decrease in Account 454 - Rent from Electric Property primarily reflects an accounting change to no longer credit miscellaneous revenue for billings made to affiliates for their use of building space and office furniture and equipment. These billings are now being credited to expense to properly offset the building and equipment costs with the amounts being recovered from affiliates.

The increase in Account 456 - Other Electric Revenues reflects an increase in revenues related to the utility's share of wheeling and transmission service related transactions and cogeneration service charges. Disclosure No. 4 was written to provide information.

Audit Disclosure No. 5 discusses the Operation and Maintenance (O&M) Expense Budget Process. My understanding of the O&M expense budget process is as follows. The utility's Chief Financial Officer (CFO) reviews budgeted revenues forecasted for the period and communicates a budget message that outlines the goals and objectives of the utility and gives guidelines to the planning units for development of their budgets and forecasts. The budget message issued by the CFO includes an inflation rate. The rate of inflation provided for the 2003 forecast was 2.4 percent. Southern Company Services utilizing forecast data obtained from Regional Financial Associates (RFA), now known as Economy.com, Inc. develops these rates of inflation. The budget message also includes customer growth rates provided by the Marketing Department. The customer growth rate provided for preparing the O&M budget was 1.7 percent for 2003. Salary escalation rates are furnished annually by

Human Resources and sent by separate correspondence to the manager of the planning unit. The labor escalation rate used for the 2003 forecast was 4 percent.

The utility has 29 planning units that roll up into 5 functional areas to develop the utility's O&M expense budget. Each planning unit receives the budget message which contains the inflation rates and customer growth rates. The planning units are not required to use the inflation rates or customer growth rates provided in the budget message. This information provided in the budget message is used as a guideline or reference tool for the planning units. These planning units use a modified zero base budgeting methodology. This methodology allows the planning units the flexibility to build their budget program by program each year. Some planning units that have little variation from the prior year may use the prior year approved budget and adjust the dollars for escalation and/or new programs.

Each planning unit develops its budget by FERC Sub account. If the planning unit can develop the amount to budget for a specific O&M expense, the developed amount becomes the budgeted amount for that specific O&M expense. Each planning unit maintains supporting documentation for these developed amounts. If the planning unit is unable to develop the budgeted amount for a given expenditure, then the inflation rate or customer growth rate provided in the budget message may be used. Therefore, it is possible that a FERC Sub account could contain known developed amounts and amounts adjusted by inflation rates and/or customer growth rates provided in the budget message.

Corporate Planning reviews submittals for compliance with the company guidelines and compiles the data for review by the CFO and leadership team.

Any changes are documented and then the approved budget is sent to the planning units. Each planning unit monitors their budget to actual comparison using the accounting reporting on-line system referred to as Southern Financial Information Access System (SOFIA). Quarterly reports are required that explain any variance plus or minus 10 percent and the variance amount is greater than or equal to plus or minus $25,000. Year-end projections are also received from each planning unit. This disclosure was written to provide information.

Q. Does this conclude your testimony?

A. Yes.

BY MS. STERN (Continuing):

Q Mr. Bass, did you also file an exhibit, EDB-1, along with your testimony?

A Yes, I did.

Q Do you have any changes to make to that exhibit?

A Yes, Page 10, Paragraph 4 of my exhibit originally contained information that Gulf requested to be treated as confidential. This request has been withdrawn, and this information is no longer confidential.

Q Thank you.

MS. STERN: And this information is the declassified information that is now being passed out to the parties and the commissioners, and we ask that it be incorporated into Exhibit EDB-1. We also ask that the exhibit be marked for identification at this time.

CHAIRMAN JABER: EDB-1 will be Exhibit 47. And let the record reflect that that includes the modification made today.

MS. STERN: Okay. And Mr. Bass is available for cross examination.

CHAIRMAN JABER: Do you have -- did you have a summary, or you don't want to give a summary?

WITNESS BASS: I have a summary.

BY MS. STERN (Continuing):

Q I'm sorry. Give your summary, Mr. Bass.

CHAIRMAN JABER: Go ahead.

A Good morning, commissioners, Madam Chairman, and parties. The purpose of my testimony is to present the staff's audit report. The audit report addresses two exceptions and five disclosures.

Exception Number 1 of the audit report reflects an adjustment to advertising expenses related to image enhancement. Exception Number 2 reflects an adjustment FOR lobbying expenses.

Disclosure Number 1 discloses several facts related to the Caryville Plant site included in the utility's Plant Held for Future Use. Disclosure Number 2, discloses the results of the audit staff's tour of the utility's third floor of the corporate office. Disclosure Number 3 discloses the facts pertaining to the corporate office restaurant and credit union. Disclosure Number 4 provides a comparison of other operating revenues between the historical year and the projected test year. And finally, the last disclosure, Number 5, discloses the process by which the operations and maintenance expense budget was prepared.

This concludes my summary. Thank you.

CHAIRMAN JABER: Thank you, Mr. Bass.

MS. STERN: Thank you. Now Mr. Bass is available for cross examination.

CHAIRMAN JABER: Major?

MR. ERICKSON: No questions.

CHAIRMAN JABER: Mr. Gross?

MR. GROSS: No questions.

MR. PERRY: No questions.

EXAMINATION

BY MR. BURGESS:

Q Mr. Bass, if I could get you to reference Page 4 of your testimony, beginning on Line 7. You address the issue of image enhancement advertising expenses. You indicated that you have reviewed the expenses. Does that also mean that you have reviewed certain advertisements themselves for content?

A Correct.

Q And did you look at the advertisements -- are you familiar with the testimony filed by Kimberly Dismukes in this docket?

A Yes.

Q Did you review the advertisements that she cited?

A Yes.

Q Are you in agreement that those advertisements incorporated image enhancement?

A Yes.

Q Do you think it's possible for Gulf to get out its message with regard to conservation and other educational matters without engaging in the type of image enhancement that might be found objectionable?

A Could you repeat that question for me, please?

Q Yes. Do you think that Gulf can get out the substance of its message on certain topics, educational topics, like conservation and that sort of thing, without engaging in image enhancement in the process?

A Yes.

MR. STONE: Commissioner Jaber, I would object to the question. There is not a proper foundation. There has been no foundation to establish Mr. Bass is an expert in advertising or communication, and so he's being asked for an opinion with regard to matters that are beyond the scope of his testimony and beyond the scope of his stated expertise.

CHAIRMAN JABER: Okay. Mr. Burgess, I heard two objections. You haven't laid a proper foundation, and this is beyond the scope of his testimony.

MR. BURGESS: Yes, and then I didn't hear any explanation for not laying the proper foundation. I went through whether he had -- was familiar with the content of the advertisements. I asked him whether he examined them to determine whether they incorporated image enhancement in those advertisements, and then I asked him whether he thought it was possible for them to achieve it. I don't know. I think there has been adequate foundation laid for the question.

With regard to his expertise, the complaint that he -- or the adjustment that's recommended by the Commission staff pursuant to this testimony is that image enhancement advertising be removed; and so, obviously, he has offered it, and it has not been objected to with regard to its removal. So, you know, I think it's reasonable to ask him whether it can be -- whether he thinks that the necessity of providing the information that Gulf believes needs to be provided through its advertising can be done without image enhancement.

CHAIRMAN JABER: Okay. Objection overruled. I'll allow the question.

And, I believe, Mr. Bass, your answer was yes?

WITNESS BASS: Correct.

CHAIRMAN JABER: Okay. Next question.

MR. BURGESS: Thank you. That's all the questions we have. Thanks.

CHAIRMAN JABER: Okay. Commissioners, do you have any questions?

COMMISSIONER PALECKI: Yes.

CHAIRMAN JABER: Let's do that before we allow Gulf Power.

COMMISSIONER PALECKI: With regard to the Caryville site, are you aware how the Commission treated that site in the last rate case?

WITNESS BASS: Yes.

COMMISSIONER PALECKI: And what did the Commission do in the last rate case? I recall it was an issue. I just don't recall what the outcome was.

WITNESS BASS: It was included as plant held for future use in the last rate case.

COMMISSIONER PALECKI: And is that why you made it an audit disclosure rather than an audit exception?

WITNESS BASS: Correct.

COMMISSIONER PALECKI: Do you recall what the Commission's reasoning was with regard to plant held for future use at that time? I guess what I'm trying to ask, at that time were there any tentative plans even that there would be a plant built at that site? Are there any such plans now? Is this something we should take a closer look at?

WITNESS BASS: It is my understanding that there were plans for that site in the future.

MS. STERN: I might be able to help with that question.

CHAIRMAN JABER: Not if you're going to testify.

MS. STERN: Oh, okay.

CHAIRMAN JABER: But maybe on redirect you can flesh some of that out.

MS. STERN: Okay.

CHAIRMAN JABER: Okay.

COMMISSIONER PALECKI: You said there were plans in the last rate case?

WITNESS BASS: Yeah, it's my understanding that there were plans for that site in the future.

COMMISSIONER PALECKI: Are there plans now for that site?

WITNESS BASS: I don't recall any plans for that site.

COMMISSIONER PALECKI: Do you know if there was any analysis done as to whether it was a promising site for a power plant within any time in the near future? The reason I'm asking is because I was involved as staff in the last rate case. I recall that that was a major issue, and I just haven't seen that level of analysis in this case.

WITNESS BASS: I haven't conducted any analysis on that, but I believe that site -- it is hard to find sites like that, and I believe that site is a valuable site for the future for generation.

COMMISSIONER PALECKI: Thank you.

CHAIRMAN JABER: Redirect.

MR. STONE: Commissioner, if I may, I have one question I would like to ask on cross.

CHAIRMAN JABER: Yes. I'm sorry. Go ahead.

EXAMINATION

BY MR. STONE:

Q Mr. Bass, your exception with regard to advertising, that was to point out the fact that the Commission policy, as historically applied, would exclude image-building advertising; is that correct?

A The existing policy, correct. Yes.

Q Okay. You're not advocating a particular policy for the Commission, but rather pointing out that the policy exists today and that this advertising would not be consistent with that policy?

A That is correct.

Q But, again, you are not actually advocating one policy either way?

A Right.

Q Okay. So if the company was coming before this Commission in an effort to change that policy and the Commission were to agree with the company, then that would eliminate the concern you had with regard to the exception?

A Correct.

Q Thank you.

MR. STONE: I have no further questions.

CHAIRMAN JABER: Ms. Stern.

EXAMINATION

BY MS. STERN (Continuing):

Q Mr. Bass, in the course of this audit, is it correct that you reviewed a number of advertisements from Gulf?

A Yes.

Q Can you estimate about how many?

A Several hundred.

Q So would it be fair to say then you've seen -- you've seen a good deal of ads?

A Yes.

Q And what -- how did you decide on whether or not an ad was image enhancing or not image enhancing?

A What I looked at was, if the ad contained information pertaining to the conservation -- to a conservation area, safety, customer information, that ad was included, or I accepted that ad. If the ad simply built relationships, enhanced image, did not contain any of those things, conservation, any of those types of things, I excluded the ad.

Q If an ad was -- if an ad -- say just an ad just had good sense, the good-sense logo, would that ad be included for recovery?

A Yes.

CHAIRMAN JABER: I'm sorry, Ms. Stern, to interrupt.

May I take you back, Mr. Bass, to the answer you just gave. If the ad simply built relationships, I think is what you said, focused on building relationships and enhanced customer relations, you didn't accept the ad? Did I hear you correctly?

WITNESS BASS: Yes, that's correct, Madam Chairman.

CHAIRMAN JABER: Okay. But this Commission would accept -- and I'm recognizing you probably can't answer this question. That's all right. But this Commission would expect an electric company or any company, for that matter, that we regulate, to have good relations with its customers?

WITNESS BASS: Correct.

CHAIRMAN JABER: So how do you draw the line? In your own mind, when you're trying to figure out what adjustments to make, what's your thought process?

WITNESS BASS: Like I said earlier, we look at the ads. When we review the ads, if the ads contain information that provide customer information, safety, conservation, we include the ads. If the ad is simply enhancing the image of the company, then we exclude the ad.

CHAIRMAN JABER: And how do you determine if the ad is enhancing the image of the company for the purpose of enhancing customer relations? You know, how do you make that determination?

WITNESS BASS: Can you repeat that question for me?

CHAIRMAN JABER: Sure. I guess I'm just looking for that fine line that I'm sure we must have to find. If the ad is enhancing the image of the corporation, of the company, because they're trying to enhance their customer relationship, how do you make the determination whether that's an appropriate ad to include in their expenses? Let me rephrase it. If we believe, if we believe the ad is enhancing the company image for the purpose of enhancing customer relationships, would you agree that we should allow that expense?

WITNESS BASS: I'm sorry. Can you repeat that one again for me?

CHAIRMAN JABER: Sure. If this Commission were to take a look at the ads and found ads that enhanced Gulf Power's company image for the purpose of enhancing customer relationships, would you agree with me that that expense should be included?

WITNESS BASS: Yes.

CHAIRMAN JABER: Okay. I'm sorry. I wasn't being very articulate.

Ms. Stern.

BY MS. STERN (Continuing):

Q You cite to an order in your testimony, 64-65, I believe, and that order contains some guidance on what types of ads to include and to exclude, correct?

A Correct.

Q And what is that guidance?

A I couldn't understand you.

Q I'm sorry. What is the guidance in that order?

A The guidance that I used was if the primary objective is to enhance the corporate image, then those are the ones that we disallowed.

Q Okay. And we had previously marked yesterday an exhibit. I believe it was Exhibit Number 22. It was Gulf's response to an OPC request for production, and I believe you should have it in a folder by your desk.

A Yeah, I have that.

Q Do you have that?

A Uh-huh.

Q Could you just turn to the part of that exhibit, the Part C, and turn to Page 24? There is an ad there, and take a moment to review the ad.

A You know what, I don't have a page number on that one. I want to get one that I'm looking at the same thing you're looking at to make sure I'm looking at the same thing.

(DOCUMENT TENDERED TO THE WITNESS BY MR. STONE).

MS. STERN: Thank you, Mr. Stone.

WITNESS BASS: Okay.

BY MS. STERN (Continuing):

Q Okay. Why would you recommend -- Can you just characterize this ad? For example, would you say that it describes different people using -- coming home and using electricity?

A That's correct.

Q It shows a man coming home at night, turning on the lights; is that correct?

A Correct.

Q And it shows a woman cooking dinner, or it describes a woman cooking dinner?

A Correct.

Q And a woman reading a story to her child?

A Correct.

Q And then it concludes, "An evening made possible by Gulf Power with some of the lowest rates in the country." It's what we call a valuable relationship, correct?

A Correct.

Q And why did you exclude this ad?

A I excluded this ad because there is nothing -- this ad is enhancing the image of the company, of Gulf Power.

Q And does it offer any information on conservation or encouragement toward conservation?

A No, it does not.

Q Or safety?
A No, it does not.
Q Or electric efficiency?
A No, it does not.
Q And if it offered any information on any of those things, would you have excluded it?
A No.
Q Okay. Now let's turn to an ad that's in Part A.
(WITNESS COMPLIED).
Q Okay. I'm looking at Page 6 of 13 of Part A.
A Okay, I'm there.
Q It's a billboard?
A Uh-huh.
Q Could you just describe the billboard?
A The billboard shows the good cents. It's got a seal in the upper left-hand corner, good cents cooling, and it says, "The sweat stops here, Gulf Power, a Southern Company," and it lists a toll free number.
Q Okay. And this ad was allowed, right?
A Correct.
Q And why was it allowed?
A Because it contains information related to a conservation program.
Q Okay.
MS. STERN: Okay. That's all the questions I have.

CHAIRMAN JABER: Mr. Bass, I'm going to ask you to walk me through all of these ads and tell me which ones were allowed and which ones weren't so I have an understanding in my mind of examples.

Starting with Page 6 of 13, you just got done testifying that that one was allowed.

COMMISSIONER PALECKI: Which document are we on?

CHAIRMAN JABER: I'm sorry, Mr. Palecki. That's Exhibit 22. It's Gulf Power's response to OPC's Request for Production 12.

COMMISSIONER PALECKI: Thank you.

CHAIRMAN JABER: And Page 7 of 13?

WITNESS BASS: This ad is also included. This ad was previously approved for recovery in base rates.

CHAIRMAN JABER: Okay. The next page?

WITNESS BASS: This ad was also previously approved for recovery through base rates.

CHAIRMAN JABER: Okay. Page 9 of 13?

WITNESS BASS: Also recovered through base rates.

CHAIRMAN JABER: Ten of 13?

WITNESS BASS: Also recovered in base rates.

CHAIRMAN JABER: Eleven of 13?

WITNESS BASS: Also recovered in base rates.

CHAIRMAN JABER: The next page?

WITNESS BASS: Covered in base rates.

CHAIRMAN JABER: Page 13 of 13 just looks like the previous ad on this issue, but larger.

WITNESS BASS: It appears to be.

CHAIRMAN JABER: So that's allowed, isn't it.

WITNESS BASS: Yes, that's included in base rates.

CHAIRMAN JABER: Okay. So any of the ads in this exhibit -- Which ads in this exhibit then were not allowed?

WITNESS BASS: If you look in Exhibit B --

CHAIRMAN JABER: Okay.

WITNESS BASS: -- those are the ads that are recovered through the Conservation Cost Recovery Clause.

CHAIRMAN JABER: Even 5 of 18 (sic), Exhibit B, Page 5 of 8?

WITNESS BASS: That is my understanding.

CHAIRMAN JABER: Okay. Well, what's the difference between Page 5 of 8 and Page 6 of 8 with the other ads that we went through in Exhibit A that refer to good cents?

WITNESS BASS: It is my understanding some of the good cents ads are recovered in the Conservation Recovery Clause; some of them are recovered in base rates.

CHAIRMAN JABER: Is that because that's the way the company has presented it?

WITNESS BASS: Yes, that's my understanding.

CHAIRMAN JABER: Okay. Page 7 of 8, Exhibit B, was that recovered?

WITNESS BASS: That is also recovered in the Conservation Recovery Clause.

CHAIRMAN JABER: Okay. So is it safe for me to assume that the ads -- the expenses were recovered either through rates or through the recovery clauses, and the only reason they might have been recovered through the clauses is because Gulf Power made that request in the clause filing?

WITNESS BASS: Yes, that's my understanding.

CHAIRMAN JABER: Okay. Can you show me an example anywhere of an ad where it was just company enhancement and nothing else in your opinion?

WITNESS BASS: On exhibit -- in Exhibit C, those ads. The one we looked at earlier, 24, on Page 24, which is Page 2 of 5 of Exhibit C.

CHAIRMAN JABER: Okay. Thank you.

COMMISSIONER PALECKI: Mr. Bass, the standard for cost recovery is the same whether you're talking base rates or the Recovery Clause, correct?

WITNESS BASS: Could you repeat that again? I'm sorry.

COMMISSIONER PALECKI: Isn't the standard the same, that there has to be -- well, I would imagine for the Conservation Clause it needs to be a conservation message.

WITNESS BASS: Correct.

COMMISSIONER PALECKI: Base rates, it can be conservation, safety, or other important information related to a customer.

WITNESS BASS: Correct.

COMMISSIONER PALECKI: And that's based upon a line of Commission precedent that basically says that, where you have a monopoly relationship, that the customer should not have to pay for advertising that's purely image enhancing since the customer really doesn't have a choice as to whether to choose Gulf Power or another provider for electricity?

WITNESS BASS: Yes.

COMMISSIONER PALECKI: And that's pretty much the philosophy the Commission has adopted over the years?

WITNESS BASS: That's correct.

COMMISSIONER PALECKI: And so for this Commission to allow ads that are purely image enhancing, we would have to break that precedent? And if we decided we wanted to allow cost recovery of that ad, we would basically have to break away from the past Commission's decisions?

WITNESS BASS: Yes.

COMMISSIONER PALECKI: Has there ever been a suggestion that there be a limit placed on advertising expenses and just let the utility spend -- make the ads whatever they want, but they can't spend any more than that capped amount?

WITNESS BASS: I'm not aware of that. I don't -- Can you ask me that question again?

COMMISSIONER PALECKI: Has there ever been a cap placed upon -- just an amount that, you know, the Commission -- I guess what I'm trying to think of, is there another way that we could protect the ratepayers without limiting the utility to specific types of ads; and that is, by placing a cap on the pure -- on the absolute amount that they can spend on advertising or that they could recover?

WITNESS BASS: Yes, I think that is an option.

COMMISSIONER PALECKI: Do you know if that has ever been considered by this Commission?

WITNESS BASS: Not to my knowledge.

COMMISSIONER PALECKI: Thank you.

CHAIRMAN JABER: Any other questions, commissioners?

(NO RESPONSE).

CHAIRMAN JABER: Okay. That would be Exhibit 47, Ms. Stern, admitted without objection.

Thank you, Mr. Bass.

WITNESS BASS: Thank you.

CHAIRMAN JABER: Gulf Power, that brings us to your rebuttal case.

MR. MELSON: And Mr. Benore's rebuttal testimony has already been given.

CHAIRMAN JABER: Right.

MR. MELSON: We'd like to ask that Mr. Roff's prefiled rebuttal testimony be inserted into the record as though read.

CHAIRMAN JABER: The prefiled rebuttal testimony of Donald S. Roff shall be inserted into the record as though read.

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony and Exhibit of
Donald S. Roff
Docket No. 010949-EI
In Support of Rate Relief
Date of Filing: January 22, 2002

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

A. My name is Donald S. Roff, and I am a Director with the public accounting firm of Deloitte & Touche LLP. My business address is 2200 Ross Avenue, Chase Tower, Suite 1600, Dallas, Texas 75201.

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

A. Yes. Exhibit (DSR-1) was prepared under my supervision and direction.

Counsel: We ask that Mr. Roff's Exhibit (DSR-1) consisting of five schedules, be marked for identification as Exhibit No. ____.

Q. Please summarize your education and working experience.

A. My education and working experience are summarized on Schedule 1 of my rebuttal exhibit.

Q. Have you ever testified before other regulatory bodies on depreciation issues?

A. Yes. A list of my regulatory appearances is contained on Schedule 2 of my rebuttal exhibit.

Q. What is the purpose of your rebuttal testimony?
A. The purpose of my testimony is to respond to the direct testimony of Michael J. Majoros and William W. Zaetz relating to depreciation and dismantlement issues.

Q. Are you familiar with Gulf Power's 2001 Depreciation Study that was utilized in the preparation of Gulf's Minimum Filing Requirements?
A. Yes. The 2001 Depreciation Study was prepared for Gulf by Deloitte & Touche, and I supervised and directed that project.

Q. What are the issues addressed by Mr. Majoros and Mr. Zaetz?
A. Mr. Majoros specifically addresses the Company's proposed depreciable life of 20 years for Smith Unit 3. He further recommends minimum life spans for the Company's other generating units. Finally, he recommends that the Commission reconsider the issue of dismantlement costs. Mr. Zaetz merely concludes that the dismantlement of the Company's existing generating units is an unlikely event.

Q. Do you agree with the Office of Public Counsel's (OPC) proposals?
A. No. First, let me address Mr. Zaetz's conclusion regarding dismantlement of the Company's generating facilities. Mr. Zaetz presents a summary of a survey of retired generating units and related dismantlement activities. Based upon the survey, he concludes that utilities do not necessarily dismantle generating units when they are retired for a variety of undisclosed reasons, although he does offer one example of when a utility

would not dismantle a facility. Based upon this one statement, he concludes that the dismantlement of Gulf's existing units is an unlikely event. This is an insufficient basis to ask this Commission to abandon its long-standing practice of allowing recovery of projected dismantlement costs. The Florida Public Service Commission (FPSC) provides very specific guidance on how to account for and recover dismantlement costs. In fact, the Staff Report on Gulf's Depreciation Study provides a current update of dismantlement costs and the related recovery of these estimates. As I discuss below, the Company has accepted the Staff's revised calculations and requests the inclusion of those amounts in its revenue filing. I also believe this Commission should ignore Mr. Zaetz's testimony and conclusion as being unfounded and not supported.

Q. Please address Mr. Majoros' testimony and recommendations.

A. Mr. Majoros challenges the Company's proposed life span and average service life for the Smith Unit 3 facility. He makes reference to an analysis of retired steam and other production units. Lastly, he appears to rely on the experience of Mr. Zaetz.

Q. Do you agree with Mr. Majoros?

A. No. Mr. Majoros seems to cling to a "one size fits all" mentality. By this I mean: he collects a sampling of data, extrapolates a result, and then claims this result must apply to everything else. Moreover, it is unclear as to how his analysis was conducted. Based upon the calculations set forth on Schedule 4 of my exhibit, even if you accept his methodology, I do not agree with his results. I have prepared Schedule 4 which is a re-creation of Mr. Zaetz's Exhibit ___ (WMZ-5), which was relied upon by Mr. Majoros. I have corrected what I believe are some incorrect figures from his exhibit, as well as eliminated duplicate entries and a nuclear unit. This exhibit develops a capacity weighted average life span of 38.2 years, much lower than the 55 years espoused by Mr. Majoros. In fact, the range of span lives shown on my Schedule 4 is from ten (10) years to sixty-three (63) years. Equally significant is the fact that few retirements of large generating units have been recorded. This precludes the generic use of his analysis for all types of generating facilities, and makes it particularly inapplicable to large units such as Smith Unit 3.

Q. What conclusions do you draw from your analysis?

A. First and foremost, the life spans used for calculating the recommended depreciation rates for Gulf Power Company's generating units are within a range of reasonableness, consistent with past experience and in line with general industry practice. This is further substantiated by the fact that the Staff Report on Gulf's Depreciation Study accepts the Company's depreciation results for Production Plant. Schedule 5 of my exhibit reveals the range of life spans used for Gulf Power Company's units.

Q. In your opinion, can Mr. Majoros' life analysis be used as a basis for determining the appropriate life span and average service life for Smith Unit 3?

A. No. There are no retirements of modern combined cycle units in this database. The analysis presented by the Company is based upon sound judgments and reliance on projected operational characteristics. In addition, the Staff Report finds the proposed 20-year life of Smith Unit 3 to be within the limits of reasonableness and consistent with other similar units within the Commission's jurisdiction. Mr. Majoros' testimony should be rejected.

Q. Do you have any other concerns or comments on the testimony of Mr. Majoros?

A. Yes. His statement beginning on page 5, line 14, extending through page 6, line 3, relating to the relationship between average service life and life span and the effect of interim retirements displays a fundamental lack of understanding regarding the components of average service life. Mr. Majoros is correct that interim retirements impact the relationship between span life and average service life. He is also correct that more future interim retirements will reduce the average service life relative to the span life. What he has ignored, apparently, is that past replacements or additions have a much greater impact on the relationship between average service life and life span. This is the case for the Plant Smith Steam Units 1 and 2. This fact has been recognized in the stratification of the Plant components used to develop the depreciation rates. Per Staff requirements, the asset base for all production units was stratified by Company engineers into life of plant elements, 35-year life elements and 20-year life elements. This grouping serves to develop an appropriate average service life, regardless of the plant life span.

Q. Is Mr. Majoros' testimony consistent with Gulf's Depreciation Study filed in Docket No. 010789-EI?

A. No. Mr. Majoros' testimony is also inconsistent with the Staff Report on Gulf's Study. While I don't agree with everything in the Staff Report, it produces an overall reasonable result that supports a level of depreciation and dismantlement that is in line with what the Company is requesting. Schedule 3 of my exhibit illustrates the differences between the depreciation recommendations in the Staff Report and the recommendations in the 2001 Depreciation Study. The Company is willing to adopt all of the recommendations contained in the Staff Report in order to resolve the depreciation and dismantlement issues in this proceeding. In his rebuttal testimony, Mr. Labrato has quantified the effects of the Staff Report on the test year depreciation and dismantlement expense.

Q. Please summarize your testimony.

A. My testimony is based upon a thorough review and analysis of the testimony of Mr. Majoros and Mr. Zaetz, and the Staff Report on Gulf's Depreciation Study. The Staff has done a very thorough job of evaluating the 2001 Depreciation Study and the Company's filing. For the most part, the Staff is in agreement with the Company. Where there is a difference, the Company accepts the Staff recommendations. OPC's witnesses provide no specific depreciation quantifications and present unjustified conclusions and recommendations. The Company will adopt the Staff recommendations and the effect of such changes should be appropriately reflected in its current revenue filing through revised depreciation rates and charges. The testimony and recommendations of OPC's witnesses should be given little or no weight and should be rejected as unfounded.

Q. Does this complete your testimony?
A. Yes.

MR. MELSON: And we would ask that his exhibit DSR-1 be identified as Exhibit 48, and we would move it into the record.

CHAIRMAN JABER: DSR-1 is Exhibit 48 for the hearing, and it will be admitted into the record without objection.

MR. MELSON: We'd next ask that the prefiled rebuttal testimony of Robert D. (sic) Bell be inserted into the record as though read.

CHAIRMAN JABER: The prefiled rebuttal testimony of Robert A. Bell shall be inserted into the record as though read, and he has no exhibits.

MR. MELSON: That's correct.

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony of
Robert A. Bell
In Support of Rate Relief
Docket No. 010949-EI
Date of Filing: January 22, 2002

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

A. My name is Robert Bell. I am Vice President of Compensation and Benefits for Southern Company. My business address is 270 Peachtree Street, NW, Suite 800, Atlanta, Georgia 30303.

Q. What are your responsibilities and duties as Vice President of Compensation and Benefits?

A. I am responsible for directing the design, implementation and administration of compensation and benefits for Southern Company. My duties include ensuring that Southern Company provides wages and benefits that are competitive and support the Company's objectives for attracting, retaining and motivating employees. I am also responsible for ensuring that the Company complies with federal and state legislation governing employee compensation and benefits.

Q. Please describe your educational and professional background.

A. I earned a Bachelor of Business Administration (BBA) degree from Georgia State University in 1972. During my 29 years with Southern Company, I have held positions of increasing responsibility in Human Resources at Georgia Power, Southern Nuclear Operating Company and

Southern Company Services, Inc. My background and experience include assignments in the areas of Staffing, Equal Employment Opportunity, Human Resource Planning, and Compensation. I was named General Manager of Human Resources at Southern Nuclear Operating Company in 1988 and Director of Compensation and Benefits at Southern Company Services in 1991. I was named Vice President of Compensation and Benefits in 2000. I am active as a member of The Conference Board Research Council on Employee Benefits and the Edison Electric Institute (EEI) Compensation and Benefits Committee. In the past, I have served as a member of the Institute of Nuclear Power Operators' (INPO) Human Resource Planning Committee and EEI's Affirmative Action Committee.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to comment on the positions taken by Helmuth W. Schultz, III, in his testimony in regard to incentive compensation, in light of the Company's compensation philosophy.

Q. What do you mean by the phrase "compensation philosophy?"

A. Most companies have developed a compensation philosophy to guide all compensation decisions. The compensation philosophy typically provides for the definition of the labor market, the appropriate mix of fixed and incentive pay, and the comparative level vis-a-vis the competitive market at which pay will be targeted.

Q. What is Gulf Power's compensation philosophy?

A. Gulf Power Company's philosophy is derived from the Southern Company compensation philosophy. Gulf Power's compensation philosophy is centered on the need to attract, retain, and motivate talented employees. Marketplace realities and the need to provide top quality service to our customers dictate this. In order to attract, retain, and motivate employees, Gulf Power offers a compensation plan that consists of base salaries and incentive compensation. Base salaries are targeted at or near the median of the appropriate external comparator. Through the Company's incentive pay plan, employees can earn up to an amount targeted at the top quartile of the industry.

In order to keep employees focused on excellence, the Company has placed a significant portion of an employee's pay "at risk." The pay is "at risk" because it must be re-earned each year, as opposed to base salary, which rarely declines in amount. It is important to note that the pay is "at risk" for the individual employee; however, the Company anticipates that total compensation expense will remain relatively constant over time, thereby enabling the Company to continue offering total pay that is market competitive. Only through performing well and meeting customer needs do employees have the opportunity to be paid at the top quartile of the industry.

Q. Mr. Schultz suggests that a portion of Gulf Power Company's projected compensation for the test year should be disallowed. Is Gulf Power's overall compensation package reasonable and appropriate?

A. Yes. Each year, we conduct an analysis of overall compensation. The Company utilizes compensation surveys developed by independent consulting firms to perform these analyses. Data is drawn from approximately 40 surveys that contain salary data for hundreds of jobs from a wide variety of companies. These surveys reflect the appropriate geographic and industry labor segments for the areas in which we recruit our talent. The process of defining total compensation for each position is reasonable and appropriate and consistent with sound compensation practice. Current analysis shows Gulf Power's pay to be both consistent with its compensation philosophy and current market.

Mr. Silva and Mr. Twery will provide more information on the competitiveness of Gulf Power's compensation in their testimony.

Q. Does this conclude your testimony?

A. Yes.

MR. MELSON: And we would ask that the panel testimony of Mr. Silva and Mr. Twery be inserted into the record as though read.

CHAIRMAN JABER: The prefiled rebuttal testimony of Tony A. Silva and Scott C. Twery shall be inserted into the record as though read.

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony of
Tony A. Silva and Scott C. Twery
In Support of Rate Relief
Docket No. 010949-EI
Date of Filing: January 22, 2002

Q. Mr. Silva, would you please identify yourself and Mr. Twery for the record, including your positions and business address?

A. I am Tony Silva, a Principal Consultant with Hewitt Associates, and with me is Scott Twery, an Actuarial Consultant, also with Hewitt Associates. Our business address is 3350 Riverwood Parkway, Suite 80, Atlanta, Georgia 30339.

Q. Mr. Silva, please describe your educational and professional background.

A. Prior to joining Hewitt, I was the Compensation Manager for the corporate headquarters of a large, high technology manufacturer. I also worked in various Human Resources areas including Employee Relations, Staffing, Compensation, Human Resource Planning, and also Marketing. I have an M.B.A. from Duke University's Fuqua School of Business and a B.A. in Management from Eckerd College. I am an active member of the American Compensation Association, and I have earned the designation of Certified Compensation Professional (C.C.P.).

I have been with Hewitt Associates for 12 years and have worked with over 100 organizations, including Southern Company, to assist them with a wide variety of Compensation and various related Human Resource issues. I have extensive experience in the areas of total compensation strategy, market-based pay design, performance management, job evaluation, hourly compensation plans, variable pay program design, sales incentive compensation and alternative reward programs.

Q. Mr. Twery, please describe your educational and professional background.

A. I graduated from the University of North Carolina's actuarial science program in 1980. Since then, I have become a Fellow of the Society of Actuaries, an Enrolled Actuary and a member of the American Academy of Actuaries.

I have worked as an Actuarial Consultant at Hewitt for 21.5 years. Currently, my work is focused on helping clients with the design, financing and administration of retirement benefit plans. In addition, I help clients evaluate the comparability or competitiveness of their benefit plans to those of other employers.

Q. What is the purpose of your testimony?

A. The purpose of our testimony is to describe the Company's market-based pay design, in response to the testimony of Helmuth W. Schultz, III. Our testimony will include an explanation of how salary surveys are used to determine the market value of various jobs and how the data supports the Company's compensation philosophy. Survey data is used extensively by Hewitt to assist clients with pay plan design and administration.

Q. Do you agree with Mr. Schultz's concerns about the reasonableness of Gulf Power's incentive compensation?

A. No. Mr. Schultz's concerns are the result of an inappropriate comparison. Rather than compare incentive compensation to gross payroll and fringe benefits, it is more appropriate to evaluate Gulf Power's total cash compensation (base + incentive) against the market to insure competitiveness. The survey data referenced earlier provides total cash compensation for various jobs in the relevant market.

Q. Is Gulf Power's overall compensation package competitive?

A. Yes. To ensure Gulf Power's pay policy is aligned with the external market, a "Market Position" report is normally produced on an annual basis. An estimated market value is determined for each specific benchmark job and the data is consolidated to determine a weighted average market position for each job group at Gulf Power Company including both base pay and total cash compensation (base + incentive) data. Organizations are considered to be "at market" if their pay policy falls between +/- 10% to the market. An analysis of Gulf Power's pay policy to the market was conducted in August 2001. The report confirmed Gulf Power's total compensation pay policy compared to actual pay levels is not only within the +/- 10% guideline, but is also within +/- 5% for all job groups, on average.

Q. What companies was Gulf Power compared against to produce the market position report?

A. The number and type of companies that participate in a specific survey will vary. Southern Company Services Compensation personnel, with support from Gulf Power Human Resources employees, match Gulf Power jobs to jobs in third-party salary surveys. Southern Company participates in approximately 40 surveys annually that represent hundreds of jobs from a wide variety of companies and they reflect the appropriate geographic and industry labor segments for the areas in which they recruit talent.

Q. Do you have a summary of your testimony?

A. Yes. In closing, the market position report for Gulf Power supports the Company's compensation philosophy and is well within the parameters to be considered at market.

Q. Does this conclude your testimony?

A. Yes.

CHAIRMAN JABER: And they have no exhibits.

MR. MELSON: That's correct. And before we take the next witness, I understand from talking with other counsel that there is no cross examination for Witness Howell on rebuttal. He appears down toward the bottom of the list. And if the commissioners have no questions, we'd ask that he be excused from appearance, and we would deal with his testimony when we got to that point.

CHAIRMAN JABER: Commissioners, are you ready to say you don't have questions for Mr. Howell, or do you want to address that after lunch?

COMMISSIONER PALECKI: I don't have questions.

COMMISSIONER DEASON: I have no questions.

CHAIRMAN JABER: You do or you don't?

COMMISSIONER DEASON: No.

CHAIRMAN JABER: Okay. We will excuse Mr. Howell from rebuttal testimony.

Anything else, Mr. Melson, before we take up Mr. McMillan.

MR. MELSON: No, ma'am.

CHAIRMAN JABER: Okay. Let's call Mr. McMillan.

CHAIRMAN JABER: Mr. McMillan, you remember that you were sworn yesterday. You were sworn yesterday?

WITNESS McMILLAN: Yes, ma'am.

EXAMINATION

BY MR. BADDERS:

Q Mr. McMillan, are you the same R. J. McMillan who testified previously in this docket yesterday?

A Yes.

Q Have you prefiled rebuttal testimony consisting of six pages?

A Yes.

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

A Yes, I do. If go to Page 4, Line 4, I'm changing the 312 thousand to 218 thousand.

Q And with that change, if I were to ask you the same questions today, would your answers be the same?

A Yes.

MR. BADDERS: We ask that the prefiled rebuttal testimony of Mr. McMillan be inserted into the record as though read.

CHAIRMAN JABER: The prefiled rebuttal testimony of Mr. McMillan, Richard J. McMillan, will be inserted into the record as though read.

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony of
Richard J. McMillan
Docket No. 010949-EI
In Support of Rate Relief
Date of Filing: January 22, 2002

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

A. My name is Richard J. McMillan, and my business address is One Energy Place, Pensacola, Florida 32520. My title is General Accounting Manager.

Q. Are you the same Richard J. McMillan who provided direct testimony on Gulf Power's behalf in this docket?

A. Yes.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to respond to the testimony of Helmuth W. Schultz, III, pertaining to the proposed adjustment to the property insurance reserve accrual and the testimony of Kimberly H. Dismukes pertaining to the proposed adjustments related to affiliated transactions and wholesale related costs.

Q. On page 31 of Mr. Schultz's testimony, he recommends an adjustment to reduce the level of property insurance expense in the test year. Is this adjustment appropriate?

A. No. As stated by Mr. Schultz and also reflected on MFR C-28, the Company has projected a property insurance reserve balance of only

$16.5 million at May 31, 2003 using very conservative estimates for the charges to the reserve (for example, no costs for hurricanes were included). As stated in MFR C-28, the target level for the property damage reserve is $25.1 million to $36 million. The target level was approved by the Commission in Docket No. 951433-EI, based upon a storm damage study the Commission required Gulf to file in Order No. PSC-96-0023-FOF-EI. Based upon its review of the study, the Commission approved the $3.5 million reserve accrual and the reserve target level of $25.1 million to $36 million in Order No. PSC-96-1334-FOF-EI. The projected reserve balance is still significantly below the approved target level, and obviously one significant hurricane could easily wipe out the entire projected reserve balance.

Q. Have there been any changes since Gulf's MFR filing that would affect the projected property insurance expenses?

A. Yes. Property insurance costs have actually increased as a result of the terrorist events of September 11. The premiums for the Company's all-risk property insurance policy, which covers our generating plants and general plant, have increased $380,000 or 60 percent; and the deductible increased from $1 million to $10 million. Additionally, due to the inability to procure lower deductible amounts in the external insurance market, Southern has elected to self-insure through a captive insurance company for any property losses between $2 million and $10 million, at an estimated cost to Gulf of approximately $243,000 a year. The $1 million increase in uninsured deductibles will also result in increased charges to the reserve in the future.

Based on the actual costs for renewing our all-risk policy alone, the property insurance expenses in the test year are understated by $623,000. Therefore, the test year expenses should be increased $623,000, not decreased as proposed by Mr. Schultz.

Q. Are there also problems with Mr. Schultz's calculations related to his proposed adjustment to property insurance?

A. Yes. There are errors in his calculations. These errors include improperly using the 2000 index on a five-year average and using the wrong test year amount for the property insurance reserve accrual.

Q. Beginning on page two of Ms. Dismukes' testimony, she discusses affiliate transactions and proposes a significant adjustment to the test year related to Southern Company Services (SCS) allocated costs. Is this appropriate?

A. No. The SCS expenses included in the test year are reasonable and representative of future costs. Her proposed adjustment is based upon a reallocation of SCS costs to include Southern Power Company (SPC), a new Southern subsidiary. Although SPC will receive some SCS allocated costs, increases in SCS's total costs and changes to the other affiliates' statistics and allocations may offset most if not all of this impact. The more relevant question is whether the test year level of SCS costs is reasonable and representative of future periods when the rates will be in effect. I looked at the following two scenarios to test the reasonableness of the test year amounts. First, I applied the 2002 budget allocation ratios (which reflect the inclusion of SPC) to the SCS budget data used in preparing this filing, and Gulf's allocated costs actually increased $215,000 ~~$312,000.~~ Next, I compared the test year SCS O & M amounts to the recently completed SCS 2002 Budget, and Gulf's test year O & M amount increased by $1.5 million. This demonstrates that not only is the test year estimate reasonable, but based upon the most recent SCS budget, the test year O & M amounts are $1.5 million understated.

Q. Are there other problems you discovered in Ms. Dismukes' affiliated transaction testimony and proposed calculations?

A. Yes. The non-regulated percentages she calculates on her Schedule 1 are calculated incorrectly and are overstated due to a math error. The math error is caused by incorrectly using the regulated subtotal, instead of the total, as the denominator. This overstates the non-regulated amounts and results in the total percentages exceeding 100 percent. Also, her breakdown of regulated to non-regulated is actually a comparison of the electric core subsidiaries to all other subsidiaries. Several of the subsidiaries listed under the non-regulated section are regulated, such as Southern Company Services, Southern Nuclear, and Southern Electric Generating Company (SEGCO). As a result of these errors, Ms. Dismukes significantly overstates the non-regulated percentages.

Also, as stated on page 9, Ms. Dismukes adjusts numerous allocators using projected or estimated 2003 data for SPC. This is flawed for numerous reasons. For example, all of the other subsidiary statistics would also be increasing during this period and would have to be updated to the same period. Ms. Dismukes uses a factor of seven to estimate several statistics without any support for a correlation in this relationship. Her use of calendar year 2003 goes beyond the test year, which ends in May of 2003. Also, she assumes SPC should receive allocations for all SCS allocated activities other than those allocated based on customers, which is incorrect. This last error alone results in an overstatement of approximately $600,000 in her adjustment. Finally, according to page 10 of her testimony, Ms. Dismukes modifies or adjusts numerous allocation methods and these changes alone result in an overstatement of approximately $450,000 in her adjustment. The SCS allocation methods are approved by the Securities and Exchange Commission (SEC) and cannot be arbitrarily changed.

The SCS amounts included in the test year are conservative and were based upon the best estimates available at the time of the filing. Based upon the most recent SCS budget estimates, which include SPC in the allocations, Gulf's O & M costs are projected to be $1.5 million higher than the test year amounts included in this filing.

Q. On page 11 of Ms. Dismukes' testimony she also proposes an adjustment of $1.2 million related to wholesale energy. Is this adjustment appropriate?

A. No. Ms. Dismukes has proposed disallowing the total costs related to the SCS wholesale energy marketing function, Southern Company Generation and Energy Marketing (GEM). The primary responsibility and purpose of

GEM is to provide energy at the lowest possible cost to meet the territorial needs of Gulf and the other Southern electric system operating companies. This is accomplished by securing the most economical energy from the off-system markets and maximizing wholesale energy sales from temporary surplus generating capacity. These activities benefit all territorial customers, resulting in lower fuel and purchased power energy and capacity costs for both the retail and wholesale customers. The retail customers receive over 96 percent of these benefits through the fuel and capacity cost recovery clauses.

The GEM costs related specifically to the wholesale customers were $243,000 in the test year. Mr. Labrato has properly removed these costs in the calculation of jurisdictional adjusted net operating income.

Q. Does this conclude your testimony?

A. Yes.

MR. BADDERS: Mr. McMillan does not have an exhibit with this set of testimony, so at this time I'll have him summarize his testimony.

CHAIRMAN JABER: Thank you.

A Good afternoon, or good morning in this case. The purpose of my rebuttal testimony is to address the proposed adjustment to property insurance expenses included in the testimony of Helmuth W. Schultz and, also, the proposed adjustments related to affiliate transactions in wholesale related costs included the testimony of Kimberly H. Dismukes. The wholesale related item has been stipulated to, I think, in earlier proceedings, so I will not go into that in more detail. But Mr. Schultz's proposed adjustment to reduce property insurance expenses is not justified and is inconsistent with prior Commission decisions.

The Commission approved the property insurance reserve accrual of 3.5 million dollars and the target level of the reserve of 25.1 to 36 million dollars in 1996 based on the storm damage study filed by the company. This study was required by -- to be filed by the company by the Commission as a result of the extensive storm damage that we received in 1995. We are not asking for any change from the 3.5 million, and the existing target is still appropriate.

The company's proposed balance in the reserve of 16.5 million dollars at the end of the test period is significantly lower than the target level approved by the Commission and could easily be wiped out with one major storm. The company's property insurance costs have actually increased as a result of the terrorist attacks on September 11th, and the test-year expenses should be increased by 623 thousand, not decreased as proposed by Mr. Schultz.

Ms. Dismukes proposed to reduce the Southern Company's services costs in our filing based upon a reallocation of costs to Southern Power Company, which is a new southern subsidiary. Although Southern Power will receive some SCS allocated costs, increases in other SCS costs and changes to the other affiliate statistics and allocations will offset most, if not all, of this impact.

As noted in my rebuttal testimony, Ms. Dismukes' testimony and proposed adjustment included numerous errors and inaccurate assumptions. The two most significant errors overstated her adjustment by over one million dollars. The SCS amounts included in Gulf's test-year request are reasonable and are actually less than the 1999 actual billings and the recently updated 2002 SCS budget.

In order to further validate the reasonableness of the test-year expenses, I looked at two scenarios: First, I applied the new 2002 SCS budget allocation ratios from the recent budget which included Southern Power Company and used that against the actual SCS budget data included in this test-year filing; and that actually increased Gulf's costs by 218 thousand dollars. Next, I compared the test-year SCS O&M amounts to the recently completed SCS 2002 budget, and Gulf's test-year O&M amount would be increased by a million and a half dollars, if I used the most current SCS budget data. The SCS allocated costs, included in the projected test year, were based upon the best data available at the time of filing and are actually one and a half million dollars less than the most recent SCS budget amounts and also one and a half million less than the 1999 actual SCS O&M billings.

That concludes my summary.

MR. BADDERS: We tender Mr. McMillan for cross.

CHAIRMAN JABER: Thank you.

Mr. Gross?

MR. GROSS: No questions.

MR. PERRY: No questions at this time.

CHAIRMAN JABER: Mr. Burgess?

EXAMINATION

BY MR. BURGESS:

Q Mr. McMillan, as I understand it, what you did to determine the appropriateness of the amount of the SCS allocation for the test year is you performed two exercises involving what you term as the recently completed SCS budget; is that right?

A The recently completed SCS budget, correct. I compared the total in the new budget to what we actually used in our forecasted test year, which was based on the 2001 budget with some updates. And, actually, that recent budget would have increased our request by a million and a half.

Q And this SCS budget that you used to arrive at your determination, is that filed?

A Is it filed? I've included it in my rebuttal testimony.

Q Was it filed -- When was it filed? When was it completed?

A It was completed during the discovery period.

Q And when was it filed?

A I used it as part of my rebuttal, but as far as the actual budget, I don't think there was any SCS budget filed in the case, separate.

Q Okay. So the budget itself, the document itself upon which you're relying, has not been filed in this case; is that correct?

A I guess I could agree with that.

Q All right. And do I understand correctly that you have made a one hundred thousand dollar error in arriving at your conclusions based on this budget that we haven't seen; is that right?

A I corrected one of my two tests that I did, correct.

Q Thank you.

MR. BURGESS: That's all we have.

CHAIRMAN JABER: Thank you, Mr. Burgess.

Staff?

MS. STERN: No questions.

CHAIRMAN JABER: Commissioners?

(NO RESPONSE).

CHAIRMAN JABER: Okay. Redirect?

MR. BADDERS: No redirect.

CHAIRMAN JABER: Thank you, sir.

Your next witness, Gulf.

MR. BADDERS: The next witness we call is R. M. Saxon.

R. M. SAXON

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

EXAMINATION

BY MR. BADDERS:

Q Mr. Saxon, are you the same Mr. Saxon who was sworn in yesterday and provided testimony yesterday morning?

A Yes, I am.

Q Have you prefiled seven pages of rebuttal testimony in this docket?

A Yes, I have.

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

A Yes, I do. On Page 6, Line 22, change $1,172,772 to $1,156,635. On the same page, Line 23, change $1,118,728 to $1,114,054.

Q With those changes, if I were to ask you the same questions today, would your answers be the same?

A Yes, they would.

MR. BADDERS: We ask that the prefiled rebuttal testimony of Mr. Saxon, be inserted into the record as though read.

CHAIRMAN JABER: The prefiled rebuttal testimony of R. Michael Saxon shall be inserted into the record as though read.

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony and Exhibit of
R. Michael Saxon
Docket No. 010949-EI
In Support of Rate Relief
Date of Filing: January 22, 2002

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

A. My name is R. Michael Saxon, and my business address is One Energy Place, Pensacola, Florida, 32520. I am the Manager of Corporate Planning for Gulf Power Company

Q. Are you the same R. Michael Saxon that provided direct testimony on Gulf Power's behalf in this docket?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address the testimony of Helmuth W. Schultz, III, as it relates to the O & M and Construction Budgets in general and specifically discuss those issues pertaining to Customer Accounts and a portion of General Plant.

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

A. Yes. Exhibit (RMS-2) was prepared under my supervision and direction.

Counsel: We ask that Mr. Saxon's Exhibit (RMS-2), consisting of three schedules, be marked for identification as Exhibit ____(RMS-2).

Q. Mr. Schultz raises some concerns about Gulf's Construction Budget. How would you respond to these concerns?

A. Gulf's Construction Budget is the Company's best estimate of future capital requirements as of a given point in time. While changing priorities require that adjustments be made from time to time, the Construction Budget is an accurate representation of planned construction activity. The actual results for 2001 are now available, and total capital expenditures were 1.85 percent under budget for 2001.

Q. Are you sponsoring a portion of the General Plant Budget in this filing?

A. Yes. My direct testimony states on page 7 that I am testifying to the portion of General Plant that relates to telecommunications, computer, and other equipment. These General Plant expenditures are projected to be $1.8 million in the test year. This is well within the range of normal expenditures for what Gulf has been spending for this portion of General Plant for the last three years and expects to spend for the period January 1, 2001 through May 31, 2002. Schedule 1 of my rebuttal exhibit gives a listing and a brief description of the projects that make up the $1.8 million.

Q. Are Mr. Schultz's comments regarding the appropriateness of the test year justified?

A. No. The test year represents the first full year of operations for our new combined cycle unit, Smith 3, and also the first full year new rates will be in effect as a result of this case. Gulf utilizes a very straightforward, logical, and comprehensive process in developing its budget. The projected test year reflects what the Company needs for normal utility operations.

Q. Has Gulf been responsive to the Office of Public Counsel's (OPC) request for information on the Company's budget detail?

A. Yes. Gulf has provided the budget detail requested by the OPC. OPC's request for Production of Documents (POD) No. 9 states - "Provide a copy of the O & M budget for the years 2000, 2001, 2002, 2003, and test year in the most detailed format available (i.e. cost center, budget center, etc.)." In response, Gulf provided the budget by cost center for each of the requested years. Each cost center represents one of the 29 planning units that prepare a budget. The five categories listed on the response to POD No. 9 are not grouped by FERC function, but rather by Vice-President reporting areas.

Q. Mr. Schultz refers to a more detailed response to POD No. 9. How was that provided?

A. Subsequent to a verbal request from the OPC consultants, Gulf prepared and provided an account and sub account (FERC/Sub) detail response to POD No. 9. Since Gulf's response to POD No. 9 is not a functional display of Gulf's budget (POD No. 9 is a reporting view by Vice President), the FERC/Sub information will tie only in total to the response to POD No. 9.

Q. Was additional information provided to the OPC consultants during their review of documents made available at Gulf Power Corporate headquarters?

A. Yes. Based on a verbal request from the OPC consultants during their review of discovery at Gulf's Corporate Office, Gulf promptly prepared and provided a monthly detail by FERC/Sub for each of the years 2002 and 2003. This information consisted of a total of 78 pages for each year. For FERC Account 500, Gulf's Production function uses several additional fields to help them track their costs by plant, unit, and/or project. The 116 entries for FERC Account 500 have other segment characteristics used by Production to help them monitor their actual & budget expenses. Schedule 2 of my rebuttal exhibit is a monthly FERC/Sub listing for the years 2002 and 2003. This schedule has summed up for each FERC/Sub the information contained on the 78-page document provided earlier.

Q. Does Gulf's O & M quarterly variance report submitted in response to OPC's POD No. 4 suggest that a more detailed budget exists?

A No. Mr. Schultz had difficulty comparing Gulf's response to POD No. 9 and its response to POD No. 4 due to a reorganization at Gulf in the summer of 2000 that shifted some of the Planning Unit responsibilities among the Vice-Presidents. The format of our variance report did not reflect this change until the year 2001. Also on the variance report provided in response to POD No. 4, the Southern Company Services charges are listed with each Planning Unit and on the response to POD No. 9 they are all listed in one Planning Unit. Schedule 3 of my rebuttal exhibit displays the response to POD No. 9 and reconciles it to the response to POD No. 4.

Q. Is Gulf's O & M quarterly variance report sufficiently detailed for the Company to use as a tool for decision making and planning?

A. Yes. Gulf's O & M variance reports help the Company monitor expenses and aid in year-end forecasting for each of the Planning Units. Explanations are required when a variance meets the guidelines as outlined in my direct testimony on page 10, lines 21 through 23. These explanations are usually handled in a memo format. The variance reports are prepared in a functional format by each Planning Unit and are not meant to provide a detailed breakdown. If additional detail is required, my department addresses the issue with the Planning Units and questions are answered.

Q. On pages 17 and 18 of Mr. Schultz's testimony, there is a discussion on the number of positions and associated expenses for the projected test year. Do you agree that the 19 positions should be removed from the projected test year?

A. No. The positions reflected in the test year and beyond represent the employees that Gulf intends to have during the test year in order to accomplish its objectives, including the new activities and programs that are to be implemented within the Power Generation and Power Delivery areas as described in the direct testimony of Mr. Moore and Mr. Fisher. Gulf's test year expenses include six cooperative educational students not included in the actual 2000 number; an addition of 11 positions in Power Delivery for a class of employees that will be trained together in the earned progression program; and two positions in the Company's Leadership Development program. Gulf utilizes the cooperative education program to provide a resource pool of potential employees that have some working knowledge of the Company and a proven track record of ability. The Leadership Development program is used to broaden the experience of selected employees in order to have a group ready to assume increasingly responsible positions, as they become available.

Q. Please address Mr. Schultz's concern that there is a lack of justification for the significant increase in the Account 90300205-Postage.

A. In the preparation of the 2001 budget and forecasted years, an error occurred in the breakdown of expenses budgeted to accounts 90300205-Postage and 90300202-Operations. A portion of the amount in the test year for Account 90300205-Postage should have been budgeted in Account 90300202-Operations. If the correct amount were budgeted for Account 90300205-Postage in the test year it would be ~~$1,172,772~~ $1,156,635. This compares favorably to actual Postage for 2000 of ~~$1,118,728~~ $1,114,054. Had the correct amount been budgeted for Account 90300202 – Operations, the test year amount would still be under the 2000 Actual for this account.

Q. Are the adjustments to customer record expenses proposed by Mr. Schultz appropriate?

A. No. The Company centralized the operations and maintenance of the corporate and district facilities and began charging the associated expenses to functional accounts in order to more accurately track facility expenses to the functions. Prior to this time, these expenses were being budgeted and charged in an Administrative and General account. A change in the allocation of these charges for customer record expenses accounts for $657,754 during the test year, which explains why the test year is higher than the year 2000 expenses. Mr. Schultz's adjustment of $546,261 to customer records is not justified when taking this into consideration.

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

A. My rebuttal testimony addresses several of Mr. Schultz's assertions regarding the Company's O & M and Construction budgets. I have addressed Mr. Schultz's concern on my portion of the General Plant Construction Budget, the issue of new employees, and the Customer Accounts expense in the test year.

Q. Mr. Saxon does that conclude your testimony?

A. Yes.

BY MR. BADDERS:

Q Mr. Saxon, do you have one exhibit attached to your testimony consisting of three schedules?

A Yes, I do.

Q Do you have any changes or corrections to your exhibit?

A I do not.

MR. BADDERS: We ask that Exhibit RMS-2 be identified at this time.

CHAIRMAN JABER: RMS-2 is identified as Exhibit 49.

BY MR. BADDERS:

Q Mr. Saxon, will you please summarize your testimony?

A Yes, I will. Thank you.

A The purpose of my testimony is to respond to the testimony of Helmuth W. Schultz, III on certain issues raised in this proceeding. In the testimony of Mr. Schultz, he raises some concern about the construction budgets. Gulf's construction budget is our best estimate of the future capital requirements at a given point in time. It is an accurate representation of Gulf's planned construction activity.

Mr. Schultz questioned the justification of general plant expenditures. The portion of the general plant construction budget I am sponsoring relates to telecommunications, computer and other equipment. These expenditures are projected to be 1.8 million in the test year. These are prudent and necessary expenditures for Gulf's test year.

Another concern of Mr. Schultz is the appropriateness of the test year. Gulf's test year represents the first full year of operation of our new combined cycle unit, Smith 3, and also is the first full year new rates will be in effect as a result of this case. The projected test year reflects what the company needs for normal utility operations.

In addition, Mr. Schultz raises concerns about the level of budget detail provided by the company. Gulf has been responsive to all discovery requests from the Office of Public Counsel. We have provided exactly what has been formally requested, and in addition, we have responded to two verbal requests from the OPC consultants.

Mr. Schultz recommends that the 19 additional positions in the test year be disallowed due to lack of justification. Mr. Fisher will support 11 of these additional positions for our earned progression program. I have supported the two new leadership development positions and explained the six cooperative education positions.

The leadership development program is used to broaden the experience of selected employees in order to have a group ready to assume increasingly responsible positions as they become available. The cooperative education program provides a resource pool of potential employees that have a working knowledge of the company and a proven track record of ability.

Mr. Schultz recommends an adjustment to customer accounting expense related to postage. 489 thousand dollars was budgeted postage that should have been budgeted to operations. Once corrected, postage for the test year would only be 43 thousand dollars over the 2000 actual. And operations will remain under the 2000 actual; therefore, Mr. Schultz's recommended adjustment is not justified.

The final adjustment proposed by Mr. Schultz is for customer records expense. The company centralized the operation and maintenance of corporate and district facilities, and in 2001 began charging the associated expenses directly to functional accounts in order to more accurately track facility expenses to the functions. Prior to this time, these expenses were charged to an administrative and general account. When taking this into consideration, Mr. Schultz's adjustment is not justified. This concludes my summary.

MR. BADDERS: We tender Mr. Saxon for cross.

CHAIRMAN JABER: Thank you.

MR. GROSS: I have no questions.

CHAIRMAN JABER: Okay. Mr. Burgess.

EXAMINATION

BY MR. BURGESS:

Q I just have some questions along the lines of -- as I understand it, you're saying that Mr. Schultz's adjustment to postage was unjustified and -- is that correct?

A That's correct.

Q And what he relied on in making his adjustment was Gulf's numbers that they said were relating to postage; is that right?

A That's correct. This error first manifested itself in the second quarter of 2001. When we realized the error existed, our budget was already locked for purposes of beginning to develop our case, so we were unable at that point to make the correction, but will be corrected in the next budget cycle.

Q So what you're saying is the adjustment he made is unjustified because you gave him erroneous information initially? The company gave him erroneous information initially; is that right?

A That amount of money did appear in the wrong subaccount, yes, sir.

Q So, in fact, based on the information he had at the time, his adjustment was justified?

A Yes, sir.

Q Thank you.

MR. BURGESS: That's all we have.

CHAIRMAN JABER: Thank you, Mr. Burgess.

Staff?

MS. STERN: Yes, we have some cross questions.

MR. HARRIS: Thank you. I'm sorry.

EXAMINATION

BY MR. HARRIS:

Q Mr. Saxon, I wanted to -- I believe your correction to your testimony took care of my first question, but I wanted to refer you to Page 7 of your rebuttal testimony.

A All right, sir.

Q And this is in reference to Issue 71b, Customer Records Expense. My understanding from your rebuttal testimony is that a $657,754 adjustment should be made; is that correct?

A Should not be made.

Q Should not be made?

A Yes, sir.

Q Okay. And that number does what to the amount that you filed as part of your cost for this issue?

A That amount is included in Customer Records Expense for the test year.

Q Okay.

A As I mentioned, in 2001, facilities and costs, operation maintenance costs, began being charged directly to the planning units; and that is what has manifested this change in customer records. There would be a corresponding adjustment in the A&G accounts.

Q Okay. So the test-year amount that you have should include this 657,754 amount, but that amount will not be included in the different account, the A&G account?

A Yes, sir, that is correct.

Q Okay. Do you happen to know what Gulf's actual Customer Records Expense is supposed to be for the test year with this adjustment made?

A This is really not an adjustment being made. It was budgeted this way to start with. I think it appeared to be a significant increase from 2000 to the test year which caused it to be questioned, but this is not an adjustment that's being required. This is the way it was budgeted in the beginning. So there is no adjustment within our budgeting process that's required.

Q This is an explanation of why that increase appears so large?

A That's correct.

Q Do you know whether the budgeted test-year amount is proportionate to the actual expenses indexed forward from 2001?

A I think if you're asking me -- Did the test-year amount increase over 2001?

Q Yes.

A For Customer Accounts Expense total?

Q Right.

A Yes, sir, I can give you that.

(WITNESS REVIEWED DOCUMENTS).

A The actual for Customer Accounts Expense for 2001 was $16,694,000. The test-year amount is 16 thousand six thousand -- I'm sorry, $16,605,000 for a reduction of 89 thousand dollars.

Q Thank you, Mr. Saxon. That's all I had for you.

A Thank you, Mr. Harris.

COMMISSIONER DEASON: Commissioners?

(NO RESPONSE).

COMMISSIONER DEASON: Redirect?

MR. BADDERS: No redirect.

COMMISSIONER DEASON: Okay. Exhibits.

MR. BADDERS: Yes, we would like to move Exhibit 49 into the record.

COMMISSIONER DEASON: Without objection, show that Exhibit 49 is admitted. Thank you, Mr. Saxon.

I believe our next scheduled witness is Witness Moore.

ROBERT G. MOORE

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

EXAMINATION

BY MR. MELSON:

Q Would you state your name for the record, please?

A Robert G. Moore.

Q Mr. Moore, let me remind you, you're still under oath from yesterday.

A Yes, sir.

Q Have you prefiled revised rebuttal testimony, in this docket, consisting of 18 pages?

A Yes, sir, I have.

MR. MELSON: And, Chairman, that is testimony that was revised on January 28th, I believe.

BY MR. MELSON:

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

A No, sir, I do not.

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

A Yes, sir, they would.

MR. MELSON: Chairman Jaber, I would ask that Mr. Moore's revised rebuttal testimony be inserted into the record as though read.

CHAIRMAN JABER: The prefiled rebuttal testimony of

Robert G. Moore dated January 28th, 2002, shall be inserted into the record as though read.

GULF POWER COMPANY
Before the Florida Public Service Commission
Rebuttal Testimony and Exhibit of
Robert G. Moore
Docket No. 010949-EI
In Support of Rate Relief
Date of Filing: January 22, 2002

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

A. My name is Robert Moore, and my business address is One Energy Place, Pensacola, Florida 32520. I am Vice President of Power Generation and Transmission at Gulf Power Company.

Q. Are you the same Robert G. Moore who provided testimony on Gulf Power's behalf in this docket?

A. Yes.

Q. What is the purpose of your rebuttal testimony in this proceeding?

A. The purpose of my rebuttal testimony is to address the testimony of Mr. Helmuth W. Schultz, III, and the position taken by him with respect to the issues raised concerning the production function.

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

A. Yes. Schedule 1 is an index to the other schedules in my exhibit. Each schedule of this exhibit was prepared under my supervision and direction.

Counsel: We ask that Mr. Moore's Exhibit, comprised of seven schedules, be marked for identification as Exhibit ______(RGM-2).

Q. Mr. Moore, on page 6 of his testimony, Mr. Schultz suggests that production plant additions are overstated because some projects did not start on time or the projects are over or under budget. Do you agree?

A. No. The two documents that Mr. Schultz apparently uses to reach this conclusion are Schedule 9 of the exhibit to my direct testimony and Gulf's response to Citizens' Interrogatory No. 22. Schedule 9 of my direct testimony is the production construction budget for the period January 1, 2001 through May 31, 2002. The schedule provides individual descriptions for 77 construction projects totaling $238,059,660. This schedule reflects only the portion of the projected budget for the period January 1, 2001 through May 31, 2002, leading up to Gulf's proposed test year. It does not include dollars budgeted for these projects before January 1, 2001 or after May 31, 2002. Citizens' Interrogatory No. 22 provides the total actual dollars spent on each project through October 2001, including the dollars spent prior to January 1, 2001. As a result, although some projects may appear to be over budget when doing a comparison using these two documents, they actually are not.

Q. How do the actual results for 2001 compare to the budget for production projects?

A. Schedule 9 of my direct testimony includes $200,942,724 of budgeted expenditures for the year ended 2001. Schedule 6 of my rebuttal exhibit shows that actual construction expenditures for production for 2001 were $199,910,034, which is only 0.5% under the original budget. The results of 2001 clearly support that Gulf has not overstated the production construction budget.

Q. Are the benefits of construction projects reflected in the O & M expense budget?

A. Yes. As stated on page 15 of my direct testimony, Gulf uses the Project Evaluation and Prioritization System model to determine the economic viability of a project. The benefit from construction projects will not always appear as a reduction in the O & M expenses. Some projects are performed to avoid increases in O & M expenses. Other construction projects are designed to improve the efficiency (i.e. heat rate) of our units, which results in fuel savings that are passed directly to customers through the fuel clause. A significant number of construction projects are justified because of a reduction in Equivalent Forced Outage Rate (EFOR). EFOR reductions benefit the customer through reduced off system purchases, especially during peak periods when the cost of electricity is highest. Any impact to the O & M expense associated with a construction project has already been reflected in the O & M budget.

Q. Mr. Moore, is the construction budget you have included on Schedules 9 and 10 of the exhibit to your direct testimony reasonable?

A. Yes. As I have previously stated, the amount requested in the production construction budget is necessary to continue to improve heat rate, prevent forced outages, control O & M, address environmental and safety requirements, and otherwise help ensure the availability of efficient, low-cost generation to our customers.

Q. How did the Commission establish the allowable amount of coal inventory in the last rate case?

A. In its last rate case, Gulf requested an inventory level equal to 105 days burn. The Commission did not approve this amount, but agreed to allow 90 days projected burn or the amount of inventory projected at each plant site during the projected 1990 test year, whichever was less. The record in that case indicates that the Commission determined that Gulf projected at least 90 days of inventory at Plants Crist and Daniel but less than that amount at Plants Smith and Scholz. The allowed amount of 784,887 tons at a value of $37 million was therefore based on 90 days burn for Plants Crist and Daniel, 64.9 days burn for Smith Plant and 57.6 days burn for Scholz Plant.

Q. How does the amount requested by Gulf in this case compare with the amount allowed by the Commission in the last case?

A. In this case, Gulf is requesting 695,829 tons, or 52 days projected burn compared to the previously allowed amount of 784,887 tons. Gulf is asking for $26.8 million in coal inventory as compared to the previously authorized amount of $37.0 million

Q. Is Gulf's request in this case consistent with the methodology applied by the Commission in the prior case?

A. Yes. In the last case, Gulf and the Commission used the projected test year “fuel issued to generation” to determine tons per burn day. Gulf has used the same methodology in this case. However, Gulf has applied sound analytical methods to determine the appropriate amount of coal inventory needed in the test year, and has not simply requested what was previously approved.

Q. Please comment on Mr. Schultz's position that the Commission should disallow approximately 20 percent of the Company's fuel inventory request.

A. Mr. Schultz bases his position on the amount of inventory actually maintained by Gulf during the 13 month average historical year ending December 2000, reported in the current rate case filing. This is not the methodology applied by the Commission in the previous case, as Mr. Schultz asserts. In addition to looking at the wrong time frame, Mr. Schultz has not properly considered factors which made 2000 an unrepresentative year in terms of coal inventory and resulted in dangerously low year-end inventory levels. In this rate case filing, Gulf has already reduced total tons of inventory being requested by 11 percent from the amount allowed in the last rate case. I believe that to further reduce this amount simply to lower carrying costs would be reckless and would ultimately result in higher fuel and/or replacement power costs for the customer.

Q. What made 2000 an unrepresentative year?

A. The year 2000 was a challenging year for Gulf Power from a coal supply standpoint. Gulf's inventory levels dropped significantly in the last quarter of 2000 due to very early and prolonged winter conditions, unprecedented high natural gas prices, and the resulting increase in demand for coal fired generation. The winter conditions affected coal production at the mines and deliveries. Coal supplies were extremely tight throughout the country due to widespread coal production problems, which affected three of Gulf's eleven suppliers.

Q. What impact did these unusual conditions have on Gulf's coal inventory levels?

A. Gulf's inventories at Plants Crist, Smith and Daniel, reached 14.7, 14.8, and 14.6 normal full load burn (NFL) days, respectively. The adverse market conditions described and the unusually low inventory levels experienced during the year 2000 resulted in an average actual ending inventory level much lower than desired. The 476,481 tons used by Mr. Schultz as the basis for his recommendation is equivalent to only 24.8 NFL days. This would be a dangerously low target level for Gulf.

Q. Why would this be a dangerously low target level?

A. Some of the offshore coal supplies that are currently economic for our plants are over a month away under normal conditions. The best case, Illinois Basin coal, is approximately ten days away under favorable weather conditions. A target inventory level of 24.8 NFL days would provide very little reserve for interruptions, and could result in reliability issues if Gulf were to face the type of supply reductions and delivery delays that we experienced in 2000.

Q. What has happened to inventory levels since the winter of 2000?

A. Gulf managed to recover from the winter of 2000 and rebuild inventories for the summer of 2001. Gulf's month-ending actual inventory for May 2001 was 873,992 tons, or 45.3 NFL days.

Q. What is the appropriate coal inventory for Gulf during the projected test year?

A. Based on my experience, it is prudent and in the customers' best interest to maintain an average inventory level of 36 NFL days, which is equivalent to 52 projected burn days. During the test year, this translates to the 695,829 tons that Gulf requested in its MFRs. The coal market is dynamic, and Gulf utilizes stockpile modeling, significant operating experience, market intelligence and sound judgement to set target inventory levels that are sensitive to market conditions, will assure reliability and provide adequate price protection to the customer. It would not be advisable to arbitrarily use historical data in setting inventory targets for the future, as Mr. Schultz suggests. Inventory levels should reflect not only historical trends, but also experience-based knowledge such as operational and capacity factors, changes in economic conditions, fuel markets, weather patterns, reliability, and other additional risks, including those arising out of the events of September 11, 2001.

Q. Are there any other reasons to support Gulf's requested inventory level?

A. Yes. Gulf believes that it would not be in the customers' best interest to further lower the authorized inventory level. Such action would result in higher fuel costs, especially during periods when fuel supplies are scarce. Although Gulf's primary purpose for maintaining an adequate fuel inventory is reliability, it must be recognized that a healthy inventory level provides some price protection to the customer from adverse market conditions. Gulf's stockpile modeling and inventory target setting efforts are prudent and well thought out, and are designed to achieve an optimum inventory level that measures the cost of replacement fuel and/or energy against the holding cost of inventory. The level of inventory suggested by Mr. Schultz does not take these dynamics into account.

Q. Is Mr. Schultz's working capital adjustment to in-transit coal appropriate?

A. No. Mr. Schultz's arbitrary 20 percent reduction of in-transit coal demonstrates his lack of knowledge of how coal-fired power plants operate. The purpose of in-transit coal is to assure an adequate supply of coal to meet burn requirements. In order to maintain a desired stockpile level, the amount of coal in-transit must approximate the burn. Furthermore, the importance of maintaining an adequate inventory and a sufficient flow of fuel to the power plants has become even more acute since the events of September 11, 2001. The increased risk of a disrupting event occurring in either the fuel supply and transportation sector or the power generation and transmission sector has placed new emphasis on the need to assure the availability of each and every generation facility in the country. Gulf has requested an amount of fuel inventory and in-transit coal that we believe will minimize these kinds of risks at a reasonable cost.

Q. Mr. Moore, do you have any concerns relating to the exhibit prepared by Mr. Schultz (HWS-6)?

A. Yes. The comparison made by Mr. Schultz on lines 16 through 19 of Schedule 6 of his exhibit is inaccurate. The basis for Schedule 6 was Gulf's response to Citizens' Interrogatory No.18 that read,

> Production O & M. Provide a summary by year, by category, of planned outages and other maintenance costs, as described on page 6 of Mr. Moore's testimony, for the years 1995-2000, 2001 to date and projected 2001 to 2003. Also include a breakdown for the test year.

The baseline, outage and special project designations described on page 6 of my direct testimony are generally used within the power plants and apply to all accounts used within the plants. Therefore, the information provided in Gulf's response to this interrogatory included only those items budgeted or incurred within the plants, which includes Production Steam, Production Other, Other Power Supply, and Production Related A & G. The response to Interrogatory No. 18 did not include charges to production expenses that occur outside the plant (i.e. corporate functions). Mr. Schultz apparently took the total dollars included in our response to Interrogatory No. 18 and made a comparison to the Benchmark for

Production Steam, which does include these amounts. Based on this misunderstanding, the resulting adjustment discussed on page 24 of his testimony is inaccurate.

Q. Have you prepared a schedule that outlines actual Production Steam, Production Other, and Production Other Power Supply for the period included in Mr. Schultz's exhibit?

A. Yes. Schedule 2 of my rebuttal exhibit reflects the actual expenses for 1996 through 2000, the 5-year average for that period, the actual expenses for 2001, and the test year budget. The test year budget dollars reflected on this schedule are consistent with Schedule 7 of the exhibit to my direct testimony.

Q. On page 23 of his testimony Mr. Schultz indicates that he does not know why there is a difference between the benchmark variance of $5.8 million for production steam referred to on Schedule 7 of your direct testimony and his Schedule 6. Can you explain the difference?

A. Yes. As I indicated earlier, Schedule 6 of Mr. Schultz's exhibit to his testimony did not include all dollars for Production Steam. Schedule 2 of the exhibit to my rebuttal testimony includes all expenses for Production Steam, Other Production, and Other Power Supply. The variance for Production Steam on Schedule 2 of my rebuttal exhibit is consistent with Schedule 7 of my direct testimony.

Q. Have you recalculated the recommended adjustments using Mr. Schultz's methodology for Production Steam?

A. Yes. Applying the logic used by Mr. Schultz, I have taken the amount included in the historical year of $63,562,361 and inflated that by the change in the compound multiplier for average CPI between 2000 and 2002 (.05165). The result is $66,845,356, which leaves a variance of $1,761,356 compared to the one calculated by Mr. Schultz of $8,930,618. The $1,761,356 variance calculated using Mr. Schultz's methodology is substantially under the $5,786,000 benchmark variance that I have already explained in my direct testimony.

Q. Is the amount Gulf has requested for planned outages in the test year representative of the amounts expected in the future years?

A. Yes. Schedule 5 of the exhibit to my direct testimony includes a planned outage schedule for the test year and for the five-year period from 2002 through 2006. This schedule clearly shows that the $13,979,818 requested for planned outages in the test year is below the projected five-year average of $15,749,008.

Q. On pages 22 and 23 of his testimony, Mr. Schultz expresses a concern regarding an increase in special projects to $3.0 million in 2001 and $2.7 million in the projected test year. Please comment.

A. In preparing my rebuttal testimony, I discovered an error on page 2 of our response to Citizens' Interrogatory No. 18. That response showed $2,650,000 projected for special projects for 2001. The correct amount should have been $952,879.

Q. Does this correction eliminate the concern expressed by Mr. Schultz?

A. No. Because the projected test year amount remains at $2.7 million, it simply shifts the major focus of his concern from 2001 to the projected test year.

Q. Please explain why Gulf is projecting an increase in special projects in the projected test year?

A. As I stated in my direct testimony, special projects expenses are for projects significant in cost that are tracked individually to enhance cost control and ensure acceptable performance. Although a particular special project may not occur annually, there will be special projects that have to be completed each year. The level of special projects costs included in the test year is representative of costs that will be incurred in future years. In the past, special projects would have been included as baseline. We now break these out separately. This change in our process has helped Gulf better manage costs. We have continually looked for ways to improve so that we can continue to provide low cost reliable generation. Breaking out special projects from baseline provided Gulf with a means by which to better manage those dollars, to ensure that the right dollars were spent on the right issues to maximize the benefit in terms of performance, reliability, and efficiency.

Q. Mr. Moore, can you give us an example of an item that Gulf has included as special project?

A. Yes. In 2002, Gulf has money budgeted to rebuild coal chutes. In Gulf's definition, this is not a one-time event, but recurs frequently and is directly related to the tons of coal processed through that conveyor system.

Q. Mr. Moore, have the requirements for maintaining Gulf's fleet of generating units changed since 1996 and is the maintenance amount requested for the test year consistent with the amount required in the future for production expenses?

A. Yes. Schedule 2 of my rebuttal exhibit clearly shows that in 1996, Gulf's actual expenses for Production were $55,260,698 and had increased to $66,258,414 by the year 2000. This increase supports our conclusion that the increasing age of our units and the increased generation requirement on those units is resulting in an increase in required O & M dollars. Schedule 4 of my rebuttal exhibit shows that the request for the test year is below the five-year average of 2002 through 2006 by $9,571,874.

Q. Mr. Moore, on page 21 of his testimony Mr. Schultz begins to make comparisons of the historical year to the test year; do you have any concerns with the basis for this comparison?

A. Yes. As I stated earlier, Mr. Schultz's Schedule 6 only includes total expense budgeted to Plants Crist, Smith, Scholz, and Daniel. An accurate comparison would include all of Gulf's production expenses.

Q. Have you prepared a schedule that breaks out all Production expenses as planned outage or baseline/special projects?

A. Yes. Schedule 3 of my rebuttal exhibit reflects the actual expenses for 1996 through 2000, the five-year average for that period, the actual expenses for 2001, and the test year budget.

Q. What is the cause of the increase in planned outage dollars from 2001 to the test year?

A. Earlier in my testimony I explained the increase from the Benchmark to the test year. The explanation for the increase from 2001 to the test year is the same. The increase in outage dollars is due, in part, to the additional maintenance costs associated with the increased amounts of generation required. Every generating unit on Gulf's system is at least 25 years old with the exception of Daniel Unit 2, which is 21 years old. Scholz Units 1 & 2 will celebrate their 50th anniversary of service in 2003. However, through effective maintenance practices, Gulf has been able to maintain all of the generating units in a manner that provides reliable low cost electricity to our customers. In addition, effective maintenance practices have allowed Gulf to avoid costly new construction of generating facilities to replace existing generating capacity. As Gulf's generating fleet ages, and as the cost to maintain these units increases, Gulf will continue to evaluate alternatives. In today's market, the cost of maintaining the units is the best alternative for our customers.

Generally, the changes in planned outage dollars from year to year are driven by the scope of the outage work. Original Equipment

Manufacturer's recommendations, unit history, unit efficiencies, and maintenance issues are all taken into consideration when determining the scope of a planned outage. Schedule 5 of my direct testimony provides a listing of the planned outages for the test year and the five-year period 2002 through 2006. Gulf's response to Citizens' Interrogatory No. 88 provided a detailed description of the outages scheduled for the test year.

Q. What is the increase from 2001 to the test year in baseline and special projects?

A. As shown on Schedule 3 of my rebuttal exhibit, the increase from 2001 to the test year for baseline and special projects is $7,631,478.

Q. What is the cause of the increase in baseline and special projects from 2001 to the test year?

A. The addition of Smith 3 resulted in an increase in O & M of $3,376,000 and is the major contributor to the increase. These dollars are necessary to operate and maintain the new unit. I have provided details associated with these dollars in my direct testimony.

The change in the compound multiplier from 2001 to 2002 would result in an increase to labor, materials and contract labor of $1,383,485.

In order to maintain compliance with environmental permitting, Plant Smith has increased costs associated with the ash handling system by $730,000.

To continue our support of Gulf's increased emphasis of employee effectiveness and comply with all OSHA requirements, Gulf has increased

O & M expenses associated with training and safety by $339,000.

As I have already stated, the remaining $1,802,993 is due to the additional maintenance costs associated with the increased amount of generation required from our existing fleet. In addition, we now use diagnostic tools that were not available in 1990 such as thermography, boiler mapping, tube sampling, non-destructive examination, and motor signature testing. These tools have enhanced our ability to identify maintenance issues that help reduce EFOR and provide reliable, low cost generation to our customers.

Q. Is the increase from 2001 to the test year for baseline and special projects a one-time increase?

A. No. As I discussed in my direct testimony, Gulf has been proactive in implementing several major preventive maintenance programs that have improved the overall effectiveness of scheduling and planning processes. One program is the Plant Reliability Optimization (PRO) program that was developed in partnership with the Electric Power Research Institute (EPRI). PRO is a maintenance process that seeks to produce the appropriate balance between corrective maintenance, preventive maintenance, and predictive maintenance. PRO combines all diagnostic, maintenance, financial, and process data into an effective decision-making tool. The ultimate goal is to perform maintenance at the least cost while maximizing equipment reliability. The EFOR for Gulf's units has declined significantly since 1997, in part, because of efforts that have more effectively targeted preventive maintenance costs to those preventive maintenance projects that have the greatest impact. These EFOR reductions have occurred even though total generation for Gulf's units has increased 25 percent from 1997 to 2000. This results in direct cost savings to the customers by minimizing replacement power costs. While some of the items discussed above will not occur annually, other projects will replace these items in subsequent years due to the dynamics of power plants.

Q. Mr. Moore, on page 24 of his testimony, Mr. Schultz states that Gulf has been underspending. Has Gulf's production function underspent?

A. No. In 1990 the Commission established rates that allowed Gulf to effectively serve our customers with reliable, low cost electricity. Through 1998, Gulf was able to operate within those rates through the effective management of the limited resources available. Gulf's high customer satisfaction ratings and low EFOR attest to the success of our strategy. Had Gulf underspent, customers would have suffered through higher fuel cost because Gulf would not have taken advantage of opportunities to improve unit efficiency. Customers would have suffered through higher forced outage rates which would have required Gulf to buy replacement power at a higher price. This higher price would have been passed on to the customers. Overall, such an erosion in the value of our product would have caused customer satisfaction to deteriorate. The reason we stand before this Commission today is because we have done all we can to operate under the current rate structure. The trend of spending beyond our benchmark for production, as documented in my Schedule 3, clearly demonstrates Gulf has not underspent. Rather, this trend supports Gulf's need for the additional funds requested in this proceeding. The low rates and reliable service our customers have enjoyed in the past clearly support Gulf's determination to spend prudently. The dollars we are asking for in the future are prudent and necessary to continue to efficiently and effectively serve our customers.

Q. Please summarize your testimony.

A. I have provided additional testimony that clearly demonstrates that the Production Construction budget is reasonable and, based on the results of 2001, accurately reflects the dollars that will be spent and should be included as production plant additions. Furthermore, I have provided additional clarification of the benefits associated with construction projects and how the customers benefit from these projects.

Gulf's stockpile modeling and inventory target setting efforts are prudent, designed to achieve an optimum inventory level that measures the cost of replacement fuel and/or energy against holding down cost of inventory. The amount Gulf has requested in working capital for fuel is prudent and reasonable.

We have clearly justified the maintenance dollars Gulf is requesting for Production Steam, Production Other and Other Power Supply relative to the Benchmark variance.

Q. Does this conclude your testimony?

A. Yes.

BY MR. MELSON:

Q And you had attached to your testimony one exhibit labeled RGM-2 consisting of seven schedules; is that correct?

A Yes, sir.

Q Any changes or corrections to the exhibit?

A No, sir.

MR. MELSON: I'd ask that that be identified as the next exhibit.

CHAIRMAN JABER: RGM-2 will be Exhibit 50.

BY MR. MELSON:

Q Mr. Moore, will you please summarize your testimony for the Commission?

A Yes, sir.

Good afternoon, commissioners. As I stated yesterday in my direct, in Gulf's last rate case, we requested 45.4 million dollars in total fuel to be included in working capital. Our current request is 42.4 million for total fuel, which includes natural gas. This is three million dollars below the amount approved in the last rate case in 1990.

Keep in mind, our current request includes 2.1 million for gas. No gas was included in the last rate case. The fact that Gulf is making this reduction in working capital, even though generation and fuel requirements are increasing, is an example in our approach to being proactive in managing our fuel inventory.

If I may, I must strongly disagree with Mr. Schultz's inventory levels that he has proposed. This would pose significant risk in terms of unit availability and potential exposure to off-system purchases to our customers. Gulf's request for working capital related to fuel inventories is prudent and designed to achieve an optimum fuel level which balances the carrying cost of fuel stock piles and the risk associated with interruptions in fuel supply.

As I stated in my direct testimony, the increased demand being placed on our aging fleet is a major cause for the need for additional O&M dollars. Witness Schultz has built his testimony on comparisons of the projected test year to five-year historical average. While it is important to understand the costs that have occurred in the past, it is not always representative of the future needs.

Three years ago, the demand of our units was 25 percent less than it is today. Over the past three years, the production expenses have exceeded the benchmark as a direct result of the increase in generation and the increased age of our fleet. Gulf's request for O&M expenses in the test year is 9.5 million dollars under the forecasted five-year average for the years 2002 through 2006.

As I stated in my direct testimony, the increased demand on our units and the increased need for O&M dollars to maintain our system reliability is the reason we stand before this Commission today. Gulf's request for 83.7 million dollars in production expenses for the May 2003 projected test year is an appropriate amount to effectively maintain and operate Gulf's fleet.

In conclusion, as I stated earlier in this proceeding, we do not take this request lightly. We recognize that our customers trust Gulf Power to do the right thing, and the decisions we make and the expenditures we are requesting are in the long-term best interest of our customers. This concludes my summary. Thank you.

MR. MELSON: Mr. Moore is available for cross.

CHAIRMAN JABER: Major.

MR. ERICKSON: No questions.

MR. GROSS: No questions.

MR. PERRY: No questions.

MR. BURGESS: No questions.

CHAIRMAN JABER: Staff?

MS. STERN: No questions.

CHAIRMAN JABER: Commissioners?

COMMISSIONER PALECKI: I have one question.

CHAIRMAN JABER: Go ahead.

COMMISSIONER PALECKI: What is the philosophy of putting the fuel inventory in rates rather than putting it through the fuel clause?

WITNESS MOORE: Mr. Commissioner, I'm probably not the appropriate witness to testify to that. I'd probably defer that to Mr. Labrato.

COMMISSIONER PALECKI: All right. Thank you, .

WITNESS MOORE: I burn it. I don't account for it.

CHAIRMAN JABER: Commissioners, any other questions?

(NO RESPONSE).

CHAIRMAN JABER: No redirect?

MR. MELSON: No redirect. I move Exhibit 50.

CHAIRMAN JABER: Move Exhibit 50 into the record without objection.

Thank you, Mr. Moore.

WITNESS MOORE: Thank you.

CHAIRMAN JABER: Okay. We have Mr. Kilgore next?

MR. STONE: We'd ask that Mr. Kilgore's testimony be inserted into the record as though read.

CHAIRMAN JABER: Yes. The prefiled rebuttal testimony of J. Thomas Kilgore shall be inserted into the record as though read.

MR. STONE: May we have his Exhibit JTK-1 identified for the record?

CHAIRMAN JABER: JTK-1 will be identified as

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony and Exhibit of
J. Thomas Kilgore, Jr.
Docket No. 010949-EI
In Support of Rate Relief
Date of Filing: January 22, 2002

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

A. My name is J. Thomas Kilgore, Jr., and my business address is One Energy Place, Pensacola, Florida 32520. I am Gulf Power Company's General Manager of Customer Services.

Q. Please summarize your educational and professional background.

A. I graduated from Auburn University in 1980 with a Bachelor's degree in Industrial Engineering. I have been employed at Gulf since 1980 and have held various positions, including Supervisor of Forecasting and Marketing Planning, Manager of Marketing Planning and Research, and General Manager of Marketing. My entire career has been spent in areas devoted primarily to gaining a thorough understanding of customer expectations and finding ways in which those expectations can be effectively and efficiently met.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address statements contained in the direct testimony of witness Richard Durbin, specifically with regard to his observations relating to consumer complaints received by the Commission concerning Gulf Power Company.

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

A. Yes. Exhibit (JTK-1) was prepared under my supervision and direction.

Counsel: We ask that Mr. Kilgore's Exhibit (JTK-1) consisting of one schedule, be marked for identification as Exhibit ___.

Q. Do you have an overall reaction to Mr. Durbin's analysis of consumer complaints to the Commission against Gulf Power?

A. Yes, I do. It appears that Mr. Durbin's testimony is accurate and truthful, and I do not wish to take issue with the basic observations contained in his testimony. I believe, however, that it is important to expand upon his analysis of the complaint data in order to facilitate a better understanding of an increase in activity over the past two years, which he points to in his testimony. I will also expand upon Mr. Durbin's observations with regard to those complaints that indicate apparent violation of Commission rules or tariffs.

Q. Would you please address the increase in complaints cited by Mr. Durbin in each of the last two years?

A. Yes. Mr. Durbin indicates that he did not observe any specific cause for the increase in complaints during the years 2000 and 2001, and further states that the complaints were about evenly divided between billing and service complaints, with high bill concerns representing the single most common type of complaint. Further examination of the billing complaints during the January through May time frame for each of the years 1998 through 2001 indicates a strong correlation with winter weather conditions. Schedule 1 depicts this relationship between payment related complaint activity during and following the winter season with heating degree-hours recorded during the same winter season of each of these four years. Similarly, complaints related to payment arrangements and non-pay disconnects, which appear to have been categorized as service complaints in Mr. Durbin's analysis, are also more prevalent in months following extreme weather conditions. There were eight such complaints during 2001. Finally, two of the service related complaints included in Mr. Durbin's analysis, which total 18 for the year 2001, were actually withdrawn by the customers after they realized that Gulf Power was not at fault.

Q. What conclusions do you draw from your further examination of the complaint data?

A. While I agree with Mr. Durbin's observation that complaint activity increased in each of the last two years, it is important to search for and understand the underlying causes for these increases. Otherwise, one might draw the mistaken conclusion that Gulf Power's service level to our customers during the last two years has declined relative to previous years. The facts are that circumstances beyond our control, specifically weather conditions, explain the increase in complaint activity. The primary indicators that we use to gauge how well we are meeting our customers' expectations, including customer satisfaction, value and image surveys, all indicate that we have sustained exceptional performance with regard to providing service.

Q. Do you agree with Mr. Durbin's statement that Gulf Power Company was found to be in apparent violation of Commission rules or tariffs in fewer than two percent of the complaints filed against it?
A. While his testimony does not appear to reference a specific time period for this assertion, I agree that for the years 1998 through 2001 Gulf Power was found to be in apparent violation on two of the 101 complaints, representing 1.98 percent, in these four most recent years. It is important to further note that both of these apparent violations were during the first half of 1998, and that we have gone over three and a half years without any apparent violations.

Q. Please summarize your testimony.
A. My testimony is meant simply to place some of Mr. Durbin's observations in their proper context. As pointed out by Mr. Fisher in both his direct and rebuttal testimony, Gulf Power is committed to providing superior service to our customers. The increase in complaints, particularly during 2001, noted by Mr. Durbin in his testimony are due to external factors beyond our control and should not be interpreted in a manner that obscures our accomplishments with regard to providing customer value which is among the very best in our industry.

Q. Mr. Kilgore, does this conclude your testimony?
A. Yes.

MR. STONE: May we have his Exhibit JTK-1 identified for the record?

CHAIRMAN JABER: JTK-1 will be identified as Exhibit 51 and will be admitted into the record without objection.

And that brings us to Mr. Fisher, which would be the man that we have empowered. Now, you know, before Mr. Fisher gets on the stand, I'm assuming you all have questions.

MR. HARRIS: Yes.

MR. BURGESS: We have questions for Mr. Fisher.

FRANCIS M. FISHER, JR.

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

BY MR. STONE:

Q Mr. Fisher, I remind you, you're under oath from yesterday?

A Yes, counsel.

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

A My name is Francis M. Fisher, Jr. My business address is 1 Energy Place, Pensacola, Florida, 32520.

Q And you testified on direct yesterday in this proceeding?

A That is correct.

Q Have you prefiled rebuttal testimony consisting of 17 pages?
A Yes, I have.
Q Do you have any changes or corrections to your prefiled rebuttal testimony?
A No, I do not.
Q So if I were to ask you the same questions today, your answers would be the same?
A Yes, they would.
MR. STONE: We ask that Mr. Fisher's prefiled rebuttal testimony of 17 pages be inserted into the record as though read.
CHAIRMAN JABER: Prefiled rebuttal testimony of Francis M. Fisher, Jr. shall be inserted into the record as though read.

BY MR. STONE:
Q Mr. Fisher, you have one exhibit attached to your rebuttal testimony that consists of six schedules; is that correct?
A That is correct.
Q Do you have any changes to your exhibits?
A No, I do not.
MR. STONE: We ask that his exhibit, FMF-2 be identified for the record.

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony and Exhibit of
Francis M. Fisher, Jr.
Docket No. 010949-EI
In Support of Rate Relief
Date of Filing: January 22, 2002

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

A. My name is Francis M. Fisher, Jr., and my business address is One Energy Place, Pensacola, Florida 32520. I am Gulf Power Company's Vice President of Power Delivery and Customer Operations.

Q. Are you the same Francis M. Fisher, Jr., that provided direct testimony on Gulf Power's behalf in this docket?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address the statements contained in the direct testimony of witness Helmuth W. Schultz, III, with regard to his recommendation of certain disallowances and to provide additional information relating to the Company's construction budget and Operation and Maintenance (O & M) expenses in the distribution area. In addition, I will address the statements contained in the direct testimony of witness James E. Breman with regard to his recommendation to implement a program that provides an incentive to Gulf Power Company for maintaining reliable service and to address comments regarding Gulf's distribution tree trim program.

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

A. Yes. Schedule 1 is an index to the subsequent schedules to which I will refer. Exhibit (FMF-2) was prepared under my supervision and direction.

Counsel: We ask that Mr. Fisher's Exhibit (FMF-2) consisting of six schedules, be marked for identification as Exhibit ___.

Q. Would you please address Mr. Schultz's concerns regarding the distribution construction budget of $95,413,000 and general plant budget of $7,700,000 for the period beginning January 1, 2001 through the end of the projected test year of May 31, 2003?

A. Yes. A general description of the distribution and general plant additions from my area of responsibility is provided on pages 10 - 12 of my direct testimony. A listing of additional detail for these capital additions is provided in Schedule 2 through Schedule 5 of my rebuttal exhibit, which summarize the distribution construction budget and general plant budget for the period from January 2001 through the end of the test year. Approximately two-thirds of these expenditures are dedicated to customer and load growth. The requested level for the distribution construction budget and general plant budget during the 17-month period and in the test year are reasonable, prudent and necessary to provide reliable service to Gulf's customers.

Q. Does Gulf's Minimum Filing Requirements (MFR) filing contain sufficient information related to its distribution construction projects for the January 2001 through May 2003 period?

A. Yes. The MFR schedules established the level of detail that Gulf is required to supply to support its distribution expenditures. Gulf provided all the required information on MFR Schedule B-10, Schedule B-13a, Schedule B-13b and Schedule F-17.

Q. Do you have an overall reaction to Mr. Schultz's analysis of distribution O & M expenses and the resulting recommended adjustments?

A. Yes. It appears that Mr. Schultz's general approach was to review the previous five years expense history, apply an inflation factor, calculate a five year average of the inflated costs and recommend disallowance of expenses over this average. This approach does not take into account the dynamic factors affecting the management of the total Company.

Q. Can you provide examples of the dynamic factors that have an impact on the management of the expense budget?

A. Yes. One example is the preparation that was necessary for the transition to the year 2000 (Y2K). This effort was one that was of paramount importance to our Company, our industry and to the regulatory community. There were thousands of individual systems, programs and pieces of equipment that had to be reviewed for compliance, and if necessary upgraded or replaced. Certain resources normally directed toward ongoing activities had to be redirected to accomplish this enormous task. These costs were managed by the Company in such a manner as to successfully accomplish this task without requesting a rate increase to cover the large cost of Y2K, while at the same time meeting the needs of our customers.

More recently, the terrorist events of September 11, 2001 put our country in a state of war. The electric utilities throughout the nation are an integral part of all Americans' lives and make a critical contribution to the economy. Consequently, Gulf incurred incremental security costs related to protecting the physical assets of our electric facilities, including power plants. These unusual and unprecedented security expenses were once again managed by the Company in such a manner as to successfully accomplish this task while meeting the needs of our customers.

Although these examples could be considered one-time occurrences, it has been our experience that new programs, events, and technologies will come up. Over the past few years as stated in my direct testimony, we have added new technologies and changed our work methods to keep up with the growth of our service territory and the changing expectations of our customers.

Q. Have such occurrences impacted the level of spending for normal maintenance activities?

A. Yes. The end result is that historical levels of spending on normal maintenance activities, such as tree trimming and pole inspections, are less than what is required on an ongoing basis. We cannot "keep robbing Peter to pay Paul."

Q. Are the adjustments to distribution expenses proposed by Mr. Schultz appropriate?

A. No. The proposed adjustments do not take into account the Company's efforts to effectively address situations such as those described above and other situations that arise without seeking a rate increase to recover the costs required. Mr. Schultz's proposed adjustments also potentially penalize efforts to reduce costs in a particular program.

Q. Do you have an example of a situation that could penalize an effort to reduce costs?

A. Yes. In my direct testimony regarding Gulf's efforts to control costs in its tree trimming program, I discuss how this has resulted in an increased dependence upon less efficient and less effective spot trimming. The result has been an increase in the annual minutes of interruption to our customers for tree related outages from 1,557,000 in 1997 to 5,988,000 in 2000. We have responded to this trend by increasing the budget for tree trimming on a going-forward basis. Mr. Schultz's methodology would penalize the tree trim program and would prevent the Company from meeting our customers' expectations regarding reliability. I will have more to say related to tree trimming later in my testimony.

Q. Would you like to address the statement made by Mr. Schultz that cable costs associated with extending the life of an asset are typically capitalized, not expensed?

A. Yes. The injection of silicone fluid into underground primary cable does not involve the addition or removal of a plant unit. It is maintenance of existing facilities; therefore, Gulf Power is expensing the cost associated with this procedure.

Q. Why is the cable injection program included in the test year when in the years 2000 and 2001, nothing was budgeted and nothing was expended?

A. In the past, the manufacturer's warranty for injected cable was only for three years. This was recently changed to an unconditional 20-year warranty. The cable injection program is now more cost-effective and Gulf's forecasted budget includes expenses related to this program.

Q. Is the $129,763 adjustment to cable injection proposed by Mr. Schultz appropriate?

A. No. The budgeted amount of $166,099 is not the entire cost of this project. It is the cost of injecting approximately 4.5 miles of cable in the test year only. Comparable amounts are budgeted in the forecast years for this ongoing project.

This project was reinstituted after the manufacturer extended the warranty period. The prior five-year historical average is therefore not an appropriate basis for establishing the budget since Gulf Power did not incur costs in this activity in three of the five previous years. The five-year historical period is not at all representative of future requirements because existing cable is aging and deteriorating.

Q. Is the $391,316 adjustment to substation maintenance proposed by Mr. Schultz appropriate?

A. No. The historical five-year period is not representative of future periods. The inflation adjusted historical five-year average contains two years (1999 and 2000) in which six substation electricians normally assigned to substation maintenance (O & M) were temporarily reassigned to substation plant construction due to the need for resources on several construction projects. Examples of substation construction completed by Gulf's electricians include converting Beulah Substation from 115 kV to 230 kV and installing a new 20 MVA transformer in Molino Substation with two new feeder bays in 1999. During 2000, examples of construction by Gulf's electricians include installing a new switchhouse and replacing all 115 kV and 230 kV breakers at Smith Plant and installing a 28 MVA transformer bank with two new feeder bays at East Bay Substation. The utilization of these six substation electricians in plant construction continued through calendar year 2001. Beginning January 1, 2002, these substation electricians have returned to their normal maintenance activities. This explains why the majority of the increase in expense appears in the test year.

In order to adhere to Gulf Power's Substation Maintenance Program and prevent increased failures of this aging substation equipment, it is necessary to keep these electricians assigned to maintenance, thus increasing O & M expenses by $755,000. Additionally, we have experienced insulator arching and outages at one of our distribution substations due to salt contamination. In order to prevent reoccurrence of this, approximately $60,000 will be expended each year to clean the insulators in this substation. The combination of these factors accounts for the additional $815,000 of O & M expenses needed to properly maintain our substation equipment, reduce failures and maintain reliable service to our customers. The amount requested for the test year is representative of future periods when new rates will be in effect.

Q. Please explain why Gulf Power's tree trim expense should not be reduced from $4,122,705 to $2,743,625 in the test year as suggested by Mr. Schultz.

A. As stated in my direct testimony, Gulf Power's attempts to control costs in this area have resulted in an increased dependency on less efficient and less effective spot trim. As shown in Gulf's response to Citizens' Interrogatory No. 33, the number of miles of line trimmed in our program has declined from 889 miles trimmed in 1998 to 241 miles trimmed in 2000. This has led to an increase in the annual minutes of interruption to our customers for tree related outages from 1,557,000 in 1997 to 5,988,000 in 2000. It is not appropriate to use the five-year historical average cost because it is not representative of future periods. The historical average does not take into account these factors of the increasing tree related outage time and a greater dependency on less effective spot trim.

The increase in outages and reduction in miles of cycle trim supports the fact that Gulf cannot maintain an adequate cycle of trim at the previous level of expenses. The distribution tree trim request of

$4,122,705 for the test year and corresponding amounts in the future periods will allow Gulf Power to transition to a more effective cycle and reduce tree related outages.

Q. Is the $526,726 adjustment to pole inspections proposed by Mr. Schultz appropriate?

A. No. Once again, the historical five-year average is not an appropriate basis for establishing the budget since it is not representative of future periods, particularly since Gulf Power did not make expenditures on this activity in two of the five previous years. Basing the test year expenses totally on five years of historical cost with an inflation factor also does not take into consideration other factors that could affect cost, such as the age of the poles being inspected. In this instance, all of the poles involved in this program are now over 20 years old.

Gulf's distribution poles are located in the worst of five wood decay zones (zone 5 "Severe") as defined in the American Wood Preservers Association Standard C-4-99. Due to the condition of this aging pole plant, Gulf Power has determined that the remaining 60,000 Creosote and Penta poles will be inspected and, as necessary, treated, repaired or replaced over the next five years. This will allow more of the remaining poles to be treated rather than waiting until more expensive repairs are required. The amount requested by Gulf Power for the test year is representative of future periods when new rates will be in effect.

Q. Would you please address Mr. Schultz's contention that the street and outdoor light request of $1,438,000 is excessive?

A. Yes. The-five year historical average cost is not representative of the test year expenses because this five-year period included only one area where group street light rebulbing and maintenance was conducted. During group rebulbing, all the bulbs and photocells are replaced and since street lights are closed units, the globes are cleaned or replaced as necessary. The average cost associated with accomplishing group street light rebulbing is estimated at approximately $38 per unit based on current cost, which greatly exceeds the historical five year average cost of $7.86 per unit as stated by Mr. Schultz in his testimony on page 30, lines 15 – 16. The test year expenses include $425,600 for group street light rebulbing of 11,200 lights. When this is added to the ongoing maintenance of street and outdoor lights, the $1,438,000 for the test year is justified. The amount requested in the test year related to street and outdoor lights is appropriate and is representative of future periods when new rates will be in effect.

Q. Please address Mr. Schultz's concern that there is a lack of justification for the significant increase in the employee complement during the test year.

A. Mr. Saxon has addressed Mr. Schultz's concern with an overview of the positions reflected in the test year. In my area of responsibility, there are 11 additional positions in the test year budget. The addition of 11 positions will be filled as a class of line and substation technician apprentices for Gulf's earned progression program during the test year. This class and subsequent ones are a proactive step towards preparing for the number of employees eligible for job changes such as promotions and retirements. This class of apprentices addresses a workforce issue and will also ensure a diverse competitive workforce for the future.

Q. You stated earlier that you would address statements in Mr. Breman's testimony. Do you agree with the proposal in Mr. Breman's testimony regarding a program of potential penalties to provide an incentive to maintain reliable service?

A. No. As stated on pages 12-14 of my direct testimony, Gulf is committed to providing superior service to our customers. Gulf has previously utilized the System Average Interruption Duration Index (SAIDI), the Public Confidence Surveys and Florida Public Service Commission (FPSC) infractions results as indicators of providing reliable electric service which meets our customer expectations.

Gulf has not previously utilized the Customer Experiencing More than Five Interruptions (CEMI5) indicator as a measure of reliability. As I will explain later in my testimony, I do not think it is appropriate to base refunds to customers on this one indicator, which could be greatly affected by weather and other conditions beyond the electric utility's control. Adopting this procedure would establish a penalty to the Company for not meeting this proposed standard without a reward for exceeding the standard. This is inappropriate, particularly when Gulf's customers are very positive about the quality and reliability of service they are receiving, and Mr. Breman concludes in his testimony on page 2, line 23 that, "Overall, Gulf Power Company's distribution reliability is good."

Q. Can you provide examples that demonstrate that your Company is maintaining or improving distribution reliability?

A. Yes. In 2001, SAIDI was reduced to 78.55 minutes, which represents a 19 percent reduction from the previous year. In addition, the Public Confidence Survey regarding "Providing Reliable Service" remained high at 93 percent favorable response and the FPSC infractions were zero.

Q. Would you comment on Mr. Breman's statement on page 5, lines 4-6 regarding various locations where tree conditions were not in compliance with the National Electric Safety Code (NESC)?

A. Yes. The NESC Part 2 Section 21.218 A. 1. states that "Trees that may interfere with ungrounded supply conductors should be trimmed or removed." Gulf's distribution tree trim program is designed to comply with this requirement. As stated on page 5 of my direct testimony, Gulf's attempts to control cost have resulted in an increased dependence on spot trim. Gulf is aware that it must increase its expenses for distribution tree trim to achieve a more effective tree trim cycle. The distribution tree trim budget of $4,123,000 in the test year and corresponding amounts in forecast years will allow this to occur.

Q. Is the estimate used by Mr. Breman of 4 percent for CEMI5 in the year 2000 accurate for Gulf Power?

A. No. The correct value for CEMI5 for Gulf in 2000 is 2.1 percent. An error was made in Gulf's original calculation for CEMI5 provided in our response to an April 2, 2001 PSC request. In that response, Gulf utilized customers that experienced five or more interruptions instead of six or more interruptions, which caused the CEMI5 indicator to be overstated. Schedule 6 to my rebuttal exhibit provides Gulf's original calculation and the correct calculation of CEMI5.

Q. What problems do you foresee with the two fundamental concepts for the programs proposed in Mr. Breman's testimony?

A. It is only reasonable to expect that customers would experience some variances in reliability over time. Reliability is a function of many variables that are under various degrees of the electric utility's control, and to initiate refunds based on a level established at one point in time does not take into account these natural variances.

Accountability comes willingly because reliability is integral to our business success. Quality of service is a key component of customer satisfaction and Gulf has clearly demonstrated a high commitment to satisfying its customers. Gulf has focused on providing reliable service because it is in our customers' best interest and it is integral to our business goals.

As documented on page 15 of my direct testimony, Gulf's performance in response to trouble events is among the best in the industry. In the residential segment of the customer value surveys, Gulf ranks second in handling emergencies and third in responding quickly to problems. In the general business segment, Gulf ranks third in restoring service quickly after an outage. It has been over three and a half years since we have had a reliability related infraction. This should provide additional assurance that Gulf will continue to maintain distribution reliability.

Q. Do you have any other concerns with Mr. Breman's proposal?

A. Yes. The method of how the penalty will be derived and the mechanics of how to determine refunds to individual customers are unclear. Depending on the structure of the program, the administrative costs could be substantial and these dollars can be better utilized in improving the distribution system.

Q. Has there been an effort to standardize reliability reporting requirements among investor owned electric utilities?

A. Yes. As the Commission is aware, the utilities have been working with the FPSC Staff to provide the Commission with information necessary to enhance the understanding and analysis of various reliability issues, such as managing, tracking and reporting and have also provided a proposed revision to Rules 25-6.044 and 25-6.0455, Florida Administrative Code. The collaborative efforts of the utilities and the FPSC Staff have fostered significant improvements in statewide reliability as indicated in the utilities' response filed in Docket No. 011351-EI. Many of the concepts and reporting requirements outlined in the FPSC Staff's proposed rules will serve to ensure a high level of reliability for customers of Florida's investor owned electric utilities.

The utilities' response to proposed rule changes provides for appropriate reporting requirements. These can lead to the development of fair standards and the appropriate mechanisms to ensure cost-effective reliability targets are developed. In addition, all utilities can implement the proposed rule changes without significant modifications to existing systems and without incurring additional on-going annual costs.

Q. Do you agree that Mr. Breman's proposed standard of 2 percent CEMI5 is appropriate?

A. No. Gulf does not have experience in dealing with this indicator and it is not clear how it will vary over time due to the effects of weather and other uncontrollable factors. To utilize the proposed standard of 2 percent to initiate penalties and to use one single indicator of reliability is not appropriate.

Q. Please summarize your testimony.

A. Gulf Power Company's management philosophy is to provide superior customer service and high reliability to our customers, keep its rates low, and meet the needs of its shareholders. As stated by Mr. Saxon in his direct testimony, the Company utilizes a budget review process to ensure that all projects we undertake are prudent, reasonable, and cost-effective. The requested level of $33,048,000 in distribution O & M expenses in the test year, $95,413,000 in distribution construction expenditures and $7,700,000 for general plant expenditures in my area of responsibility for the period from January 2001 through the end of the test year are reasonable, prudent, and necessary for Gulf to continue to maintain reliable services and meet the demand due to our customer growth.

Gulf takes great pride in being ranked at the very top of our industry in delivering value to our customers. The disallowances determined by Mr. Schultz's methodology would negatively impact Gulf's ability to meet the reliability needs of our customers. Gulf cannot maintain adequate programs at the previous levels of expenditures. Mr. Schultz's adjustments of $2,747,028 do not take into account the Company's efforts to effectively manage dynamic situations, implement new programs and maintain aging plant. Today's customers are becoming more sophisticated in their use of technology and require a higher level of reliability, and are thus becoming more demanding in what they expect from their electric utility. It is imperative that we continue to take steps to maintain the integrity of our electrical system and our responsiveness to service interruptions when they occur. The Company has exercised careful stewardship of its O & M and capital costs over the years, expending resources when reasonable and cost-effective to maintain acceptable levels of system reliability.

As I stated earlier, Gulf's customers are very positive about the reliability of service they are receiving as indicated in several surveys and indices. Gulf does not agree with the use of a single reliability indicator and method as proposed in Mr. Breman's testimony. The existing rulemaking Docket No. 011351-EI is a more appropriate forum for introducing his proposal than introducing it during a rate case. The proposal in Mr. Breman's testimony is not an incentive; it is a financial penalty to the Company. Gulf supports the recommended rule changes as submitted to the FPSC by the Committee of Florida investor owned electric utilities as filed in Docket No. 011351-EI. In addition, this committee, along with FPSC Staff, should continue with the current process underway.

Q. Mr. Fisher does this conclude your testimony?
A. Yes.

BY MR. STONE:

Q Mr. Fisher, you have one exhibit attached to your rebuttal testimony that consists of six schedules; is that correct?

A That is correct.

Q Do you have any changes to your exhibits?

A No, I do not.

MR. STONE: We ask that his exhibit, FMF-2 be identified for the record.

CHAIRMAN JABER: FMF-2 will be Exhibit 52.

BY MR. STONE:

Q Mr. Fisher, do you have a summary of your testimony?

A Yes, I do.

Good afternoon, commissioners. I have a very brief summary of my testimony.

During the last 12 years, Gulf has encountered outside factors in implementing new programs and technologies that have caused us to reallocate resources away from basic distribution programs, such as tree trimming and substation maintenance. Thus far, we've been able to accomplish this without adversely impacting our overall system distribution reliability; however, we cannot continue to do this. As stated yesterday, the warning signs are clearly present. Minutes of interruption due to tree-related outages have increased dramatically, and our substation testing and maintenance are behind schedule and will fall farther behind.

Mr. Schultz's analysis of these and other programs does not take these factors and warning signs into account. His proposed methodology of using a five-year inflated average ignores our customers' need for continued reliable electric service and would severely limit our ability to meet their basic expectations. In his testimony, Witness James E. Breman proposes a penalty to the company based on one piece of reliability data, CEMI5. This is proposed even in light of his testimony that Gulf's overall reliability is good. Our average customer minutes of interruption for the year 2001 of 78.55 is well below the last published national average.

I believe that it is inappropriate to base a penalty or reward on such a narrow, limited indicator. The emphasis on a financial penalty for such a narrow measurement could result in undue administrative expenses, dollars that could be better used to improve the distribution system, and it could cause focus to shift away from the more broad effective and recognized measures. Thank you very much.

MR. STONE: Mr. Fisher is available for cross examination.

MR. ERICKSON: No questions.

MR. GROSS: No questions.

MR. PERRY: No questions.

EXAMINATION

BY MR. BURGESS:

Q Mr. Fisher, if I could direct you to Page 3 of your rebuttal testimony, please?

A Yes, sir.

Q And beginning on Line 17 you begin addressing certain dynamic, let's say, adhoc circumstances that Gulf encounters and has to expend resources to deal with; is that correct?

A Yes, sir, it is.

Q And one is the Y2K. You say that was the preparation necessary for the transition to Y2K?

A Yes, that is correct.

Q Can you tell me any idea of the costs associated with that, the revenues expended? Do you have any notion as to the costs that were encountered by Gulf in dealing with that transition?

MR. STONE: Commissioner Jaber, may we approach the bench?

CHAIRMAN JABER: Is it information that might be confidential?

MR. STONE: Yes.

MR. BURGESS: Oh, okay. All right. I don't need that. I apologize. I did not realize.

BY MR. BURGESS:

Q And don't hesitate to either break in or, Mr. Fisher, let me know that.

A Thank you, Mr. Burgess.

CHAIRMAN JABER: Hang on. Let me give some direction here.

Mr. Fisher, if any answer requires or could get into confidential information, I'm going to leave it up to you to point that out to me before answering.

WITNESS FISHER: Thank you, Madam Chairman, I will.

MR. BURGESS: Thank you.

BY MR. BURGESS:

Q Mr. Fisher, can you tell me, again without violating any confidentiality issues, when the pattern of expenditures for this were the most prominent?

A Probably the greatest example is the Y2K example because it lasted from 1996 through the first quarter of 2000. That would probably be the greatest example.

Q Okay.

A And then of course the subsequent 9/11 events of last year is another example.

Q All right. And then with regard to the anti-terrorist steps, security steps that the company is dealing with, this is something that the company has asked for as a separate amount over and above the initial filing;

is that correct?

A That's correct.

Q All right. So when we see at the bottom of -- I'm sorry, let me take you then to Page 5 of your testimony, where, I think, you continue speaking of this, and you indicate that the proposed adjustments of Mr. Schultz -- I'm sorry, on Line 3, that the proposed adjustments of Mr. Schultz do not take into account the company's efforts to address the situation such as those described above. In those described above, I only see the two being the Y2K and the security cost; is that right? So I assume that's what you're referencing when you talk about the situations described above?

A As examples of the kinds of outside influences that we have to deal with. Also, in the year 2001, we have expended expense dollars that we have not sought recovery of for the terrorist attacks.

Q Now let's break them down. With regard to Y2K, given your statement that the -- most of the money was spent during the 1996 to 2000 range, wouldn't you agree that Mr. Schultz's adjustments, based on the 1996 to 2000 range, in fact, do take into account the Y2K specifically?

A Not in terms of looking at the distribution budget and maybe the other functional budgets where those funds would have been reallocated from to fund the Y2K effort.

Q I'm sorry, you're going to have to explain to me. Are you saying that the specific adjustments -- you're not complaining about the years 1996 to the years 2000 being used generally, are you, as not taking into account the Y2K expenditures?

A I'm a little unclear on your question, Mr. Burgess.

Q All right. I'm trying to --

COMMISSIONER DEASON: Let me see if I can help, and I'm only trying to help. I think what the witness is saying is that his budget was smaller for those years because those resources had to be redirected elsewhere.

MR. BURGESS: That's what I'm trying to get to.

COMMISSIONER DEASON: Oh, okay.

MR. BURGESS: I'm trying to find out what he is saying with regard to that.

BY MR. BURGESS:

Q Are you saying that the years 1996 to 2000 are unrepresentative of the effects of Y2K?

A No, they are not unrepresentative of the Y2K effort.

Q Now with regard to the anti -- with regard to the security efforts, did Mr. Schultz make any adjustments to remove the costs associated with that?

A No, sir, he did not.

Q Okay. So his adjustments would not affect that particular item, dynamic item that Gulf encounters?

A No, sir, that's correct. It was there as an example of the type of situations that come up.

Q If I could have you look back to Page 4, your last sentence on that page says, "You cannot keep robbing Peter to pay Paul." So does that mean that during the years 1996 to 2000 you were robbing Peter to pay Paul?

A That was meant to illustrate what we had discussed both on direct and rebuttal with respect to taking existing programs and funding activities that occur outside of the company's control such as Y2K, also, to improve the menu of reliability programs that we have by adding such programs as the pole line inspection program, the cable inspection program that were new programs. The funding had to come from someplace, and that's how we chose to do it.

Q Mr. Fisher, I'd like to ask you about the silicon solution injection into the distribution lines that you describe on Page 6, the cable injection program. What part did the change in the warranty period play in the decision? Am I correct in understanding from this that it would not have been -- you would not have considered the injection program to be cost beneficial if you had not received an extension of the warranty period?

A We would not have reinstituted the cable injection program had we not received that change in the warranty.

During this same period of time, we were experimenting with new technology in our industry with respect to directional boring, which is more cost effective than trenching, and it's less intrusive in existing neighborhoods to replace the cable. But when we got the 20-year unconditional warranty from the manufacturer, that, once again, placed cable injection on a better footing with the other technologies.

Q So is that saying if you had not received the extension of the warranty, that you would not have been interested, from a cost-benefit basis, in extending the life of these particular lines?

A Using that technology, no, sir, we would not have.

Q Let me ask you a couple of questions about -- on Page 8 of your testimony where you speak of the tree-trim expense. And as I understand it, you are -- the company is going to shift its emphasis from spot trimming to a more deliberate ongoing basis; is that right? Does that about capture the notion that you're changing to?

A Yes, sir, that's correct. The reason being is that the spot trimming is not as efficient as a routine preventive maintenance cycle trim. In the cost per mile, utilizing that technology, while you hold down total cost, the cost per mile is greater than what it should be.

Q Well, let me ask you bluntly. You've been serving north Florida for a long time. Is this something that you've just discovered?

A No, sir, after the last rate case, we were spending at those levels or above those levels on the benchmark for the first five years. And then as we began to deal with things like Y2K and institute new technologies and programs, about during that same period of time, in order to fund those things and to fund the new technologies, we made the decision to move towards spot trimming; or as some of our people call it, just-in-time-trimming.

Q So you switched to that in order to have funds to be diverted elsewhere; is that -- do I understand that correctly?

A We utilized funds from that program in order to help fund programs such as the Y2K effort, such as the pole line inspection program, such as trouble call management system, such as ARMS and those kind of programs, to add to our menu of reliability programs.

Q And what is the annual difference in cost between the spot tree trimming treatment that you've been engaging in and the new program that you intend to embark on?

A The difference would be approximately 1.9 million dollars comparing 2001 actuals to the test-year budget.

Q And am I not correct that for the last several years Gulf has been engaged in a stipulation involving revenue sharing with the customers pursuant to agreements that have been approved by the Commission?

A That is correct.

Q Well, what prevented you from simply continuing to, or embarking on the more appropriate tree-trimming program and at the same time dealing with the Y2K problems? In other words, why not -- why did the company not continue to, or why did the company not embark on the plan that would admittedly cost it an additional 1.9 million during the period of time at which it was engaging in stipulations for potential refunds above certain revenue levels?

A The reason would be is we were trying to fund new programs and activities that would add to our menu of distribution reliability programs during that same period of time, plus we were trying to hold our rates down and delay the need for filing for a rate increase.

Q But if in that period of time you were engaged in refunds anyway, then doesn't that suggest that you had enough revenues to fund the requirements at the time without the need for a rate increase?

MR. STONE: Commissioner, if I may, Mr. Burgess seems to be confusing revenues with earnings. And the type of stipulation we're operating under is simply a refund, revenues above a stipulated amount. It does not take into account the company's earnings.

MR. BURGESS: Commissioners, I appreciate Mr.

Stone's testimony in this case, but since it's not an objection to the question, I don't quite know how to respond. But, no, I'm not confused between revenues and earnings.

CHAIRMAN JABER: Okay. Well, now you both have had an exchange.

MR. STONE: Well, I'm sorry. I did mean to preface my comments with an objection.

CHAIRMAN JABER: Which would be what?

MR. STONE: That it's beyond the scope of his rebuttal testimony.

CHAIRMAN JABER: Okay. The objection is it's beyond the scope, Mr. Burgess.

MR. BURGESS: And his rebuttal testimony is about defending the tree-trimming expenditures and defending why the program was not engaged in earlier.

CHAIRMAN JABER: Okay. I'll allow the question. Mr. Burgess, to make sure the record is absolutely clear, why don't you go back and ask the question and clarify whether you're talking about revenues or earnings.

BY MR. BURGESS:

Q Is it your understanding that the company chose to agree to enter into a stipulation whereby refunds might be required based on revenues?

A Yes, sir, that's correct.

Q Is it your understanding that upon doing that the company then could obviate its requirement that would otherwise be imposed to serve its customers to the greatest extent possible?

A Would you mind restating that for me, please?

Q Is it your understanding that in agreeing to refunds based on revenues, that that allowed the company to avoid obligations it would otherwise have for service to its customers?

A I'm really -- I don't understand it, Mr. Burgess. I don't understand what you're trying to --

COMMISSIONER DEASON: Let me ask the question. Did the company make a decision to cut back on tree trimming to increase your earnings, realizing that you were not subject to an earnings cap any more, just a revenue sharing mechanism?

WITNESS FISHER: What we were trying to do is to manage the entire company throughout this period of time in order to fund all the activities that I have listed and to meet the needs of our customers and our company and our employees and our shareholders. That's what we were trying to do during this period of time.

CHAIRMAN JABER: Mr. Fisher, I don't think that answers the question.

WITNESS FISHER: I'm really trying to answer the question. Maybe I'm not the best --

CHAIRMAN JABER: I think the way that Commissioner Deason phrased it was really clear.

WITNESS FISHER: I think that we were trying to meet the needs of all of our stakeholders, including our shareholders. Is that responsive to your question, Commissioner?

COMMISSIONER DEASON: It's probably as responsive as I'm going to get, and no disrespect to you. I'll just be real up front with you. It appears that there was some decision by someone at management to make a decision to cut back on certain expense categories, and when you cut back in expense you're going to increase earnings. And apparently this was during a period of time where your earnings were not a limiting factor, but it was just the revenues were the limiting factor, and I just -- maybe it goes beyond the scope. And if you have any information about that, I'd like for you to share it with me. And if you don't, just say you're not aware of that.

WITNESS FISHER: I'm not the correct witness.

CHAIRMAN JABER: Who would be?

WITNESS FISHER: Mr. Labrato would be better prepared to answer that.

MR. BURGESS: Thank you. Thank you, Mr. Fisher. That's all I have.

CHAIRMAN JABER: Staff?

MR. HARRIS: Yes, commissioner -- or Chairman, thank you.

EXAMINATION

BY MR. HARRIS:

Q The first area I wanted to discuss with you was the outdoor and street lighting situation, which I believe you begin in your rebuttal testimony on Page 10 or so. And, specifically, I'm confused about the group re-lamping program, and I'm hoping you can explain it to me. And, specifically, I see on pages -- beginning on Page 8 -- I mean Line 8 of Page 10, that the average cost associated with accomplishing group street re-bulbing is estimated at approximately 38 dollars per unit which greatly exceeds the historical five-year average cost of $7.86 per unit. So I'm hoping you can explain for me why a program that costs 38 dollars per unit is more effective than one that historically has cost $7.86 per unit?

A All right, sir. In total, the street light maintenance program includes all the fixtures that we have. They're different type fixtures. They're what we call open-bottom fixtures, which are -- you know, there's no bottom on the luminary that surrounds the bulb, and so it doesn't get dirty under there and those kinds of things, so that doesn't have to be taken care of.

On street lights, street lights are closed fixtures, and in order to do a proper job of maintaining them, you have to do a lot more to them than you would an open-bottom fixture, such as, open the luminary up, clean the luminary, change the bulb, replace the photo cell, those kind of activities. We do those in a group fashion with the municipalities in our service territory. We will identify a municipality, and we will go in and group re-lamp that entire municipality. That by itself is 38 dollars per unit. That is cheaper than going to those units one at the time when they fail, and so that's the difference between the two programs.

Q So you're saying that to do a closed unit is 38 dollars per unit, to do an open unit is seven dollars and --

A It's less than the 38 dollars, yes.

Q It's less than 38. Well, where does the historical five-year average cost of $7.86 come from?

A That's lumping all of those fixtures together, and there was limited group re-lamping in the last five years.

Q But if you -- if the historical average lumps all of the different types together, and that's $7.86, and in your test year, I presume you're lumping all of the groups together as a group re-lamping project and saying that's 38 dollars, I still don't understand how the past five-year average of seven dollars could be so different from the current test year amount of 38 dollars.

(WITNESS REVIEWS DOCUMENTS).

CHAIRMAN JABER: Mr. Fisher, I have actually been looking for a good place to take a lunch break. Do you need more time to look at that?

WITNESS FISHER: Yes.

CHAIRMAN JABER: Okay. We're going to take --

WITNESS FISHER: Yes.

CHAIRMAN JABER: Thank you. Let's come back at 1:45. We'll take a lunch break until 1:45.

(WHEREUPON, THE TRANSCRIPT CONTINUES IN SEQUENCE IN VOLUME 10)

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CERTIFICATE

STATE OF FLORIDA)
COUNTY OF LEON)

I, NANCY S. METZKE, Certified Shorthand Reporter and Registered Professional Reporter, certify that I was authorized to and did stenographically report the foregoing proceedings and that the transcript is a true and complete record of my stenographic notes.

DATED this 26th day of February, 2002.

Nancy S. Metzke
NANCY S. METZKE, CCR, RPR