GULF POWER COMPANY

Before the Florida Public Service Commission

Prepared Direct Testimony of

Constance J. Erickson

Docket No. 110138-EI

In Support of Rate Relief

Date of Filing: July 8, 2011

Q. Please state your name and business address.

A. My name is Constance J. Erickson. My business address is One Energy Place, Pensacola Florida, 32520.

Q By whom are you employed?

A. I am employed by Gulf Power Company (Gulf or the Company). I serve as Gulf’s Comptroller.

Q. What are your responsibilities as Gulf’s Comptroller?

A. I am responsible for the financial and regulatory accounting functions of the Company. My duties include maintaining Gulf’s corporate accounting records in accordance with Generally Accepted Accounting Principles in the U.S. (GAAP) and in accordance with the Uniform System of Accounts as prescribed by the Federal Energy Regulatory Commission (FERC) and adopted by the Florida Public Service Commission (FPSC or the Commission). I have responsibility for the preparation of Gulf’s financial statements and various financial reports required by the U.S. Securities and Exchange Commission and the FPSC.

Q. Please state your prior work experience and responsibilities.

A. From 1987 to 1992, I was employed with the audit division of Arthur Andersen & Co. From 1992 to 2002, I held various senior financial positions with GNB and Exide Technologies and with Graco Inc. In 2002, I accepted employment with Southern Company and have held various financial positions, including Comptroller and Director of Customer Operations and Information Technology with Southern Company Gas and Director of Financial and Contract Services with Southern Company Services, until being named Comptroller of Gulf effective January 14, 2006.

Q. What is your educational background and professional certification?

A. I graduated from the University of North Dakota in 1987 with a Bachelor of Accountancy degree. Also, I am a licensed Certified Public Accountant and a member of the American Institute of Certified Public Accountants.

Q. What is the purpose of your testimony?

A. My testimony (a) sets forth and justifies Gulf’s 2012 Operations & Maintenance (O&M) budget within the Administrative & General (A&G) function, (b) justifies Gulf’s 2012 A&G benchmark variance for expenses other than employee benefits, (c) supports the need to increase Gulf’s property damage reserve, (d) discusses the depreciation and tax expenses included in the test year, and (e) explains Gulf’s projected test year expense for uncollectibles.

Q. Are you sponsoring any exhibits?

A. Yes. I am sponsoring Exhibit CJE-1, Schedules 1 through 5. Exhibit

CJE-1 was prepared under my direction and control, and the information contained therein is true and correct to the best of my knowledge and belief.

Q. Are you sponsoring any of the Minimum Filing Requirements (MFRs) filed by Gulf?

A. Yes. The MFRs that I sponsor or co-sponsor are listed on Schedule 1 of Exhibit CJE-1. The information contained in the MFRs I sponsor or co-sponsor is true and correct to the best of my knowledge and belief.

Q. How are the Company’s accounting records maintained?

A. Gulf maintains its books and records in accordance with GAAP and the rules and regulations prescribed for public utilities in the Uniform System of Accounts published by the FERC and adopted by the FPSC.

**I. GULF’S 2012 ADMINISTRATIVE AND GENERAL EXPENSES**

Q. What is Gulf’s A&G O&M expense budget for 2012 test year?

A. Gulf projects an O&M expense level for the A&G function of $78,453,000 in the test year.

Q. Is Gulf Power’s projected level of A&G expenses of $78,453,000 in 2012 reasonable and prudent?

A. Yes. The projected level of A&G expenses is both reasonable and prudent. Gulf’s 2012 A&G O&M expenses are based on the extensive budget preparation and review process that each planning unit follows. This process ensures that every item included in the budget is based upon the most accurate and up-to-date assumptions.

The A&G expense budget consists of a wide range of corporate expenses that are not associated with any particular operating function. There are a number of planning units within the A&G function: Accounting, Finance, Treasury, Human Resources, Information Technology (IT), External Affairs, and Corporate Services. Each planning unit within the A&G function is responsible for developing budgets for employees as well as office supplies and expenses within its unit.

The remaining A&G expenses - insurance, employee benefits, and other miscellaneous expenses - are budgeted at a corporate level using the latest assumptions for the projected period.

Q. Is Gulf’s projected level of A&G expenses of $78,453,000 in 2012 representative of a going forward level of A&G expense beyond 2012?

A. Yes. As noted above and discussed by Gulf Witness Buck, the Company’s budget process is very thorough, and O&M projections are prepared at a detailed level for a five year period. Schedule 2 of Exhibit CJE-1 compares total A&G expenses, including the net operating income adjustments, for the 2012 test year with the projections for 2011 and the three years 2013 through 2015. A&G expenses identified in the budget process for the years 2011 and 2013 through 2015 are in line with the 2012 A&G expenses, with the exception of employee benefit expenses in 2013 through 2015.

Q. Please address the primary factors that have driven Gulf’s overall A&G expenses up since Gulf’s prior rate case.

A. Excluding employee benefits costs, which are addressed by Gulf Witnesses Twery and Crumlish, there are five primary factors that have resulted in significant increases in Gulf’s A&G expense over the decade since Gulf’s last base rate increase. Most of these cost drivers were beyond Gulf’s control, and even with attempts to mitigate the impact of these drivers, Gulf has experienced rising A&G expenses.

The first major driver of increased A&G costs was the passage of the Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act was the response of Congress to several well known corporate failures in which misleading financial data was reported to investors and regulators. The Sarbanes-Oxley Act not only significantly impacted the level of work required by the Company’s external auditors to issue an opinion on the Company’s financial statements, but also required Gulf’s management to assess the internal controls over financial reporting of the Company. Both of these developments have led to significantly increased levels of A&G expenses related to external audit fees and internal controls, as I discuss later in my testimony.

The second major driver of increased A&G expense since Gulf’s last rate case was the September 11, 2001 terrorist attack. As a result of unanticipated and unprecedented losses in the insurance markets and the prospect that there might be further terrorist related events and losses, Gulf’s premiums associated with its property and public liability insurance have increased dramatically.

A third driver of increased A&G expenses since the last rate case was the particularly severe hurricane seasons of 2004 and 2005. Once again, like September 11, there were heavy losses in the insurance markets. This, in turn, increased the premiums for property insurance. Gulf was affected by three Category 3 storms during this period.

A fourth driver of A&G costs was the financial crisis beginning in 2008, which affected many financial institutions. As a result of the near collapse of the financial markets, Gulf was affected by rising costs associated with obtaining adequate financing.

The last significant driver of increased A&G expenses since the last rate case was necessary technology upgrades to Gulf’s accounting, purchasing, and work order management systems. These upgrades and their necessity are addressed in greater detail later in my testimony.

Q. The Commission has historically employed an O&M benchmark calculation in base rate proceedings. How does Gulf’s 2012 A&G expense forecast compare to the A&G O&M expense benchmark?

A. The A&G benchmark is $57,736,000. This calculation is described in Gulf Witness McMillan’s testimony. Gulf’s projected 2012 A&G expenses are $78,453,000. These A&G expenses exceed the A&G benchmark by $20,717,000. These values are shown on Exhibit CJE-1, Schedule 3.

Q. Previously, you mentioned that Gulf’s proposed level of A&G expense was reasonable and prudent. Please elaborate on this in light of the benchmark variance.

A. Gulf’s 2012 A&G expense budget is the product of a sophisticated and demanding budget process that has been described at a corporate level by Mr. Buck and at a functional level by me and other witnesses. This is the budget process that Gulf employs year in and year out to manage its business. In that process, Gulf does not use the Commission’s O&M benchmark approach. Gulf’s budget process is very robust and considers matters beyond the Consumer Price Index (CPI) and customer growth. Gulf’s projected A&G O&M expenses are reasonable, prudent, and necessary.

Moreover, as the discussion below shows, a multitude of A&G expense increases in the electric utility industry are totally unrelated to either customer growth or inflation. In the A&G area, costs can be and are driven by other outside factors. Examples of these include employee benefits and property insurance increases in excess of the CPI, audit and compliance cost increases due to new governmental regulations, and treasury related cost increases due to the recent financial crisis.

Q. Please address how Gulf has justified its $20,717,000 A&G benchmark variance.

A. Gulf’s A&G benchmark variance is justified by Mr. Twery, Ms. Crumlish and by me. Mr. Twery and Ms. Crumlish justify Gulf’s A&G O&M benchmark variance in the area of employee benefits. The employee benefits variance of $10,116,000 is roughly half of Gulf’s total A&G O&M benchmark variance. This amount includes the Net Operating Income (NOI) adjustment to pensions and other employee benefits included in Mr. McMillan’s testimony. This variance consists primarily of a $6,938,000 variance in retirement plan expense and a $3,302,000 variance in medical benefits cost. The remaining employee benefit amounts are below the benchmark variance.

I justify the remaining A&G O&M benchmark variance of $10,601,000 with justifications in the following areas addressed further in my testimony and on Exhibit CJE-1, Schedule 3:

Insurance $4,648,000

Duplicate Charges 1,689,000

External Auditing / Internal Controls 1,453,000

Treasury Costs 976,000

Joint Ownership 874,000

Accounting, Supply Chain, and Work

Order Management Systems 546,000

Rate Case Expense 249,000

Rent 247,000

Total $10,682,000

A. Insurance

Q. What is the benchmark variance for Insurance expense on Exhibit CJE-1, Schedule 3?

A. The 2012 level for Insurance expense is $14,077,000, which is $4,648,000 above the benchmark. The three components of insurance that are above the benchmark and the associated variance amounts are property damage insurance of $2,389,000; injuries and damages (I&D) insurance of $457,000; and Gulf’s property damage reserve accrual of $1,802,000.

Q. Please explain what is included in Insurance expense on Exhibit CJE-1, Schedule 3.

A. Insurance consists primarily of premiums for insurance policies, which cover property damage and I&D costs, and the annual accruals to the property damage and I&D reserves. The Company is self-insured for costs not covered by external insurance policies.

Property damage insurance protects the Company against losses and damages to owned or leased property used in operations. Gulf’s property damage insurance is provided through the Company’s All-Risk property damage policy. This policy generally covers damage to the Company’s property except for transmission and distribution (T&D) facilities. Insurance for T&D facilities is not widely available, and what is available is cost prohibitive; therefore, Gulf is self-insured for its T&D facilities. The property damage reserve is Gulf’s self-insurance mechanism used to cover certain costs of restoration as allowed by the FPSC in Docket No. 070011-EI, Order No. PSC-07-0444-FOF-EI, which are not covered by insurance (i.e., T&D facilities) and insurance policy deductibles.

Insurance related to I&D includes the cost of insurance and accruals to the I&D reserve to protect the Company against I&D claims by employees or others that are not covered by insurance. I&D costs also include the cost of labor and expenses incurred in I&D activities. For example, expenses for the Company’s public liability policy are included in I&D costs. This policy covers third party bodily injury and property damage resulting from most company operations. The I&D reserve is used to cover I&D costs not covered by insurance and insurance policy deductibles. This reserve balance is based on an annual accrual of $1,600,000 less charges against the reserve. The annual accrual amount was approved by the FPSC in Order No. PSC-04-0453-PAA-EI, Docket No. 040218-EI.

Q. Please address why Gulf’s 2012 property damage insurance expense of $4,407,000 exceeds the property damage insurance benchmark by $2,389,000.

A. The increase in the Company’s property insurance costs, excluding the annual property damage reserve accrual, is primarily driven by the events of September 11, 2001 and the natural disaster events (hurricanes) in 2004 and 2005, which caused major property damage in Gulf’s service area. Additionally, the particularly severe 2004 and 2005 hurricane seasons highlighted to insurers the risk of the potential loss for coastal companies who have assets exposed to wind and storm surge. As a result, insurance premiums have surged. These increases far exceed customer growth and the rate of inflation. They are impacted more by actual losses and potential risks, which impact the property insurance market in general.

Q. What, if anything, has Gulf done in the face of surging property damage insurance costs to mitigate their impact?

A. Gulf used and continues to use insurance brokers to search the insurance market for premium savings. As a result, Gulf made changes in our panel of insurers in pursuit of premium savings. Additional steps Gulf has taken to ensure the competitiveness of property damage insurance costs include:

* Benchmarking with industry peers;
* Broker reports on current market conditions, recent placements and coverage cost comparisons with other client companies;
* Competitive bids among insurers;
* Benchmark comparison of broker compensation; and
* Periodic evaluation of program structures to explore possible premium savings.

Even with these significant efforts to mitigate costs, Gulf has experienced property damage insurance expense growth in excess of the O&M benchmark. This is simply an area where the O&M benchmark does not capture the causes underlying the growth of the expense.

Q. Why is the cost for I&D contributing to the benchmark variance?

A. The increase in Gulf’s insurance costs related to I&D is primarily driven by the events of September 11, 2001. This event highlighted the risk with insurers of the potential public liability. As a result, I&D insurance premiums have increased. These increases do not track customer growth and the rate of inflation, as premiums are impacted more by actual losses and potential risks which impact the insurance market in general. The cost for I&D insurance has exceeded the O&M benchmark by $457,000.

Q. What actions has Gulf undertaken to mitigate the cost of its I&D insurance coverage?

A. Gulf has taken the same steps for I&D coverage as it has taken for property damage coverage. However, even with these significant efforts, the cost of this insurance has outpaced the combined rate of customer growth and inflation.

Q. Of Gulf’s $4,648,000 Insurance expenses O&M benchmark variance, what portion is associated with the property damage reserve accrual?

A. The projected cost for the Company’s annual accrual to the property damage reserve is $6,800,000, which exceeds the benchmark by $1,802,000. As I discuss later in my testimony, this annual accrual level is the level of the expected average annual loss to be covered by the reserve as determined in Gulf’s 2011 Hurricane Loss and Reserve Performance Analysis. Maintenance of a property damage reserve that can handle a significant but not catastrophic storm spreads the cost of storms out to each generation of Gulf’s customers and helps avoid the situation in which customers who happen to be served during a storm event or shortly thereafter have to absorb all or the bulk of a storm’s cost through a storm surcharge.

B. Duplicate Charges

Q. Your next category of A&G O&M benchmark justification is in the area of Duplicate Charges. Please explain Duplicate Charges and the benchmark variance in that account.

A. FERC Account 929, duplicate charges, is a credit A&G expense account used as an offset to other A&G expense accounts. FERC defines this account in the Code of Federal Regulations as an account that “shall include concurrent credits for charges which may be made to operating expenses or to other accounts for the use of utility service from its own supply. Include, also, offsetting credits for any other charges made to operating expenses for which there is no direct money outlay.” The credit included in the test year is $1,095,000. This exceeds the benchmark calculation by $1,689,000. There are two reasons for this variance: a decline in office space used by non-Gulf employees and an accounting change implemented in May 2010.

Q. Can you provide an example of credits charged to the duplicate charges account?

A. When Gulf provides assistance to another electric utility in a storm situation, the costs are billed out to the other utility. Some of those costs are A&G costs. When the other utility pays Gulf for the costs of its crews, these payments are not treated as revenues; they are treated as a credit to expenses. The credit to A&G expenses is booked to FERC Account 929.

Q. Can you explain what you mean by the decline in office space used by non-Gulf employees?

A. When non-Gulf employees use Gulf’s office space, they are charged an occupancy expense based on actual costs. The 929 account gets credited for this charge. Since 2002, billings for the use of space in Gulf’s offices have declined due to a decrease in the amount of space being used by others from 38,000 square feet to 17,000 square feet. Billings for office space included in the 2002 test year were $1,239,000. Actual billings for office space credited to the 929 account were $591,000 in 2010. In 2012, Gulf expects to bill $612,000 for office space. This is

reasonable based on the actual billings from 2010. This decline in space occupied by others accounts for $1,158,000 of the benchmark variance.

Q. Earlier you mentioned there had been an accounting change in May 2010 for Account 929. Please explain that accounting change.

A. Prior to May 2010, the benefits costs associated with the billings of the Gulf employees working on storm restoration for another utility were credited to the duplicate charges account, Account 929. Since May 2010, these benefits, including pensions and employee insurance, are now being credited to the benefit accounts rather than to duplicate charges. This accounting change results in an equal offset between these accounts.

Q. How has this accounting change impacted the duplicate charges account?

A. The credits going to the duplicate charges account are now less than they were prior to May 2010. Since the credit to duplicate charges in 2012 is smaller than the benchmark credit, this appears as an increase to non-employee A&G expenses, when it is merely an accounting change. This accounting change accounts for $505,000 of the benchmark variance.

Q. Is the total amount of the duplicate charges credit Gulf has in this test year reasonable?

A. Yes.

C. External Audit / Internal Controls

Q. Please address the A&G benchmark variance for the External Audit / Internal Controls expense.

A. The projected cost for external audit fees is $1,301,000 in 2012, which exceeds the benchmark by $1,031,000. The projected internal controls expenses of $422,000 are necessary for the Company to comply with the financial reporting and internal controls components of the Sarbanes-Oxley Act. There is no benchmark amount for the projected internal controls expenses since the Sarbanes-Oxley Act was passed subsequent to the Company’s last base rate case. Both benchmark variances total to $1,453,000 and are predominately due to new compliance requirements resulting from the passage of the Sarbanes-Oxley Act.

Q. Please discuss the key requirements mandated by the passage of the Sarbanes-Oxley Act.

A. Sections 302 and 404 of the Sarbanes-Oxley Act of 2002 (the Act) directly impacted the Company’s financial reporting and internal control requirements. Section 302 requires the Company’s Chief Executive Officer (CEO) and Chief Financial Officer (CFO) to certify in the Company’s periodic Securities and Exchange Act filings that the information material to the Company’s filing has been properly disclosed and the effectiveness of the Company’s internal controls have been evaluated and properly communicated. Section 404 requires the Company’s CEO and CFO to attest to the design and effectiveness of the Company’s internal controls over financial reporting.

Q. What has been the impact on Gulf of Sarbanes-Oxley Act compliance?

A. Compliance with the Act has increased costs for Gulf Power. External audit hours and resulting fees have increased as the Act, along with other regulatory requirements, increased the amount of work required by the Company’s external auditors to issue an opinion on the Company’s financial statements. Since 2001, auditors have lowered materiality thresholds and put an increased focus on internal controls and requirements to comply with new auditing standards. The creation of the Public Company Accounting Oversight Board (PCAOB) has increased the cost of external audits as auditors now must comply with additional regulatory requirements based on standards issued by PCAOB. Finally, when performing audits, the Company’s external auditors must consider numerous complex accounting standards that have been issued since 2001. As previously noted, these significant additional outside auditor requirements associated with Sarbanes-Oxley compliance have resulted in an O&M benchmark variance of $1,031,000. This compliance results in additional assurance regarding financial data for customers, regulators, and investors. These additional costs above the O&M benchmark are entirely justified.

Additional resources, primarily labor, have been put in place at Gulf to ensure compliance with the Act. These resources are used to determine compliance requirements of the Act, provide guidance and assistance in monitoring to meet those requirements and provide an overall evaluation of the design and operating effectiveness of Gulf’s internal controls over financial reporting as required under the Act. As previously noted, these additional Gulf resources associated with Sarbanes-Oxley compliance have resulted in an O&M benchmark variance of $422,000. These additional costs above the O&M benchmark are entirely justified.

D. Treasury Costs

Q. Please address the A&G benchmark variance for Treasury Costs.

A. The projected Treasury Costs for 2012 is $1,077,000, which is $976,000 above the benchmark. Treasury Costs include rating agency fees and commitment fees for lines of credit. Rating agency fees are assessed by each of the three major rating agencies, Moody’s, Fitch, and Standard & Poor’s. Each of the rating agencies has a different formula for the calculation of fees, but essentially they are based on annual debt issuance activity (both bonds and commercial paper) and total outstanding debt. Commitment fees are charged by banks for entering into a credit facility agreement with the Company (a committed line of credit). Commitment fees are market driven and based on the amount of the line of credit.

Q. What is the benchmark variance associated with rating agency fees?

A. The projected cost for rating agency fees is $227,000, which is $205,000 over the benchmark.

Q. Why are rating agency fees contributing to the benchmark variance?

A. The rating agencies’ services are essential for Gulf to be able to raise capital. All three rating agencies have increased their fees significantly in recent years. Since 2003, their fee rates have grown between 50 and 75 percent. The rating agencies’ services, and therefore the fees, are necessary for Gulf to be able to raise capital. These fees have risen faster than the combined rate of CPI plus customer growth.

In addition, in 2010 Gulf made an accounting change in its treatment of rating agency fees. Prior to that time, most of the rating agency fees were capitalized and then amortized to interest expense over the life of debt issues. After a review of the FERC classification of accounts, it was determined that the part of the fees that are related to commercial paper activity and total outstanding debt should be expensed as incurred.

Q. What is the A&G benchmark variance associated with commitment fees?

A. The projected cost for commitment fees is $850,000, which is $771,000 over the benchmark.

Q. Why are commitment fees contributing to the benchmark variance?

A. The increase in commitment fees is a result of two factors. These factors include an increase in the total lines of credit and an increase in the fees charged by banks for the lines of credit.

Q. Please explain why Gulf has increased the total lines of credit since the prior test year.

A. Gulf currently has $240 million in committed lines of credit. In April 2003, Gulf had $66 million in committed lines of credit. This is an increase of $174 million since 2003. The Company has obtained additional lines of credit for three reasons.

First, lines of credit are required to provide back-up support for  $65.4 million in daily rate Pollution Control Revenue Bonds (PCBs) that were issued in 2009. These PCBs are marketed daily at rates that are considerably less than Gulf’s fixed rate outstanding long-term debt. These lower interest rates more than offset the commitment fees associated with the lines of credit, resulting in lower overall capital costs which benefits customers.

Second, Gulf’s commercial paper program has increased in size from $60 million when it was originally established in 2001 to $150 million in 2010. The commercial paper program allows Gulf to borrow funds for the short-term at competitive rates, and lines of credit are required as back-up support for the program. Gulf’s total capitalization has increased from $1.4 billion in the previous test year to $3.2 billion in the 2012 test year. With this increase in total capitalization comes the need for an increase in the amount of short-term debt that the Company may issue, and thus a larger commercial paper program. Including an appropriate amount of

short-term debt in the capital structure results in lower overall interest costs compared to the use of only debt with longer maturities.

Third, due to the instability in the financial markets since 2008, Gulf has increased its liquidity protection by obtaining additional lines of credit.

Q. How are commitment fees calculated and priced?

A. Commitment fees are generally comprised of two components, an upfront fee for entering into the agreement and an unused fee (a fee for the bank’s commitment to make the credit available). Both components are typically calculated as a percentage of the committed line of credit.

Commitment fees are market driven, and since the financial crisis they have been volatile, reaching 1.0 percent at one stage compared with 0.075 percent in 2003. Gulf’s current expectation for the test year is that commitments fees will be approximately 0.33 percent, an almost five fold increase.

E. Joint Ownership

Q. Your next area of A&G O&M benchmark variance justification on Exhibit CJE-1, Schedule 3 is shown as “Joint Ownership.” Please explain what is included in Joint Ownership and address the associated A&G benchmark variance.

A. Joint Ownership refers to Gulf’s share of the A&G expenses associated with Mississippi Power’s coal-fired units at Plant Daniel. The Plant Daniel units, which are located in Mississippi, are jointly owned by Mississippi Power and Gulf Power. Mississippi Power operates the jointly owned Plant Daniel units, and Gulf shares the cost of the units’ operation. The 2012 projected costs of Joint Ownership, Gulf’s share of the A&G expenses associated with the operation of Plant Daniel, is $4,184,000, which exceeds the benchmark by $874,000. The A&G benchmark variance for Joint Ownership is primarily associated with employee benefits. Mr. Twery and Ms. Crumlish will address the benchmark variances associated with employee benefits.

F. Software Systems

Q. Your next A&G benchmark justification shown on Exhibit CJE-1, Schedule 3 is shown as accounting, supply chain, and work order management systems. Please explain what is included in accounting, supply chain, and work order management systems and address the related A&G benchmark variance.

A. Gulf has implemented new software upgrades to its accounting, supply chain and work order management systems since its last rate case. These upgrades were made under the project name Enterprise Solutions. The variance for the software upgrades represents ongoing operating expenses such as licensing fees, maintenance, and support costs associated with Gulf’s recently implemented accounting, supply chain, and work order management systems. The 2012 operational costs associated with these new systems are $1,959,000, which is $546,000 above the benchmark. Technology replacements or upgrades are not tied to customer growth or inflation.

Q. Can you describe the Enterprise Solutions project?

A. The Enterprise Solutions project consisted of the installation of Oracle, an integrated business software, and Maximo, an asset management software, to replace the aging accounting, supply chain, and work order management systems that were in use. Oracle and Maximo replaced several IT applications in the accounting, supply chain, and generation areas that were used to input, process, and summarize accounting information, procure and pay for materials and services, and manage work orders.

Enterprise Solutions leveraged technology to continue providing high reliability and customer service. These new tools provide increased automation and use of electronic routing and approvals to reduce the likelihood of human error. They also facilitate the use of automated internal controls.

Many of the previous systems were very old and highly customized. They were becoming increasingly difficult to maintain. Some of the application systems had been in place since 1985. The previous General Ledger System was no longer supported by the vendor. Gulf delayed implementing new technology for as long as reasonably possible. Further delaying the implementation of the new system would have prolonged Gulf’s dependence on old, unsupported technology, which would have led to increased risk associated with the timely procurement of essential materials and services, and the accurate booking of related costs.

In today’s world, changes in our industry are occurring much faster than ever before. Gulf’s goal is to provide a high level of customer service and

to operate in an efficient manner. Accomplishing this goal requires appropriate technology for the long term.

Q. Please describe the process that was used to arrive at the solutions that Gulf chose to implement.

A. A diverse team of IT, accounting, supply chain, and generation personnel was formed to make a recommendation to executive management on the software to replace the systems that were outdated and unsupported.

The team contacted twelve utilities to review the systems they used and discuss their experience with those systems for work management, materials management, procurement, general ledger and accounts payable. The team also sought the advice from vendors and consultants, as well as hosting vendor demos for their products.

Three alternatives were chosen to evaluate replacing our materials management, procurement, accounts payable and general ledger systems. The three alternatives were:

1. A combination of Maximo for materials and procurement with Oracle for accounts payable and general ledger.
2. Oracle for all applications.
3. Systems, Applications, and Products in Data Processing (SAP) for all applications.

There were pluses and minuses for all three alternatives, but functionality, cost and strategic fit were the drivers that led to the decision to replace our systems with a combination of Maximo and Oracle. Maximo also provided a work order management solution that was also included in the scope of the project. Oracle also has a customer service module that may be viable for our needs if a decision is made in the future to replace our Customer Service System (CSS) system.

G. Rate Case Expense

Q. The next category of A&G expense that you have shown as an A&G O&M benchmark justification on Exhibit CJE-1, Schedule 3 is rate case expense. Please explain what is included in rate case expense and justify the benchmark variance for this category of expense.

A. The Company did not include rate case expenses in its 2012 budget; therefore, Mr. McMillan has made adjustments to net operating income and rate base in his exhibit necessary to include the 13-month average unamortized balance of 2011 rate case expense in rate base and the amortization of these rate case expenses in O&M expense in the test year. The majority of the incremental expenses associated with this rate case will be incurred in 2011, but will be deferred and amortized to better match a longer period of time that new rates will be in effect.

The Company estimates rate case expenses to be $2,800,000. Gulf is proposing to amortize these rate case expenses over a four-year period beginning in 2012. The jurisdictional net operating income adjustment is an increase in 2012 expenses of $700,000. This is $249,000 above the

benchmark. The jurisdictional rate base adjustment for working capital to reflect the unamortized balance is an increase of $2,450,000.

In the decade since Gulf’s last rate case, the cost of rate cases has increased markedly. A review of the recent rate case experience of other Florida investor owned electric utilities indicates more intervenors, more discovery, more contested issues and more witnesses than Gulf experienced in its last rate case. When putting together its anticipated rate case budget, Gulf assumed it would have a similar experience. To address these additional anticipated demands, Gulf will have to spend more on incremental internal resources as well as additional outside consulting and legal fees than it did in its last rate case as escalated by CPI and customer growth. The $2,800,000 level of expenses budgeted and amortized over four years at $700,000 per year is both reasonable and prudent, even though it exceeds the A&G O&M benchmark calculation by $249,000 annually.

H. Rent

Q. Your last category of A&G O&M benchmark justification is rent. Please explain what is included in rent on Exhibit CJE-1, Schedule 3 and address the associated benchmark variance.

A. Rent includes the rental costs for property that Gulf does not own but uses, occupies, or operates in connection with electric operations of the Company. Gulf is requesting $294,000 in the test year for the ongoing rent expenses for facilities the Company leases. This exceeds the benchmark calculation by $247,000. This entire benchmark variance is related to the Pensacola Customer Service Office facility discussed below.

Q. What has changed since the last rate case to create a need for additional rent expense?

A. In 2008, we moved out of our Pace Boulevard building that housed, among other departments, our Pensacola Customer Service Office – where customers come in to pay their bills, sign up for energy efficiency programs and do other business with the Company. We relocated the Pensacola Customer Service Office to a new location selected with customer convenience and access in mind. It is next to a public bus route stop; it has 100 parking spaces; and it is accessible on the ground floor.

The new rental property required improvements to make it suitable for the customer operations. These leasehold improvements were capitalized and are being expensed over the life of the lease. The lease payments and the additional amount for the leasehold improvements are charged to A&G expense in the rent category. The total expense for this facility in the test year is $252,000.

Q. What led to the decision to move out of the Pace Boulevard building?

A. One of the departments located at the Pace Boulevard building was Gulf’s Distribution Operations Center (DOC). In 2004 the Pace Boulevard facility incurred damage that included blown out windows and minor water damage as a result of Hurricane Ivan. After Hurricane Katrina, Gulf assessed the likelihood of a flooded building if a similar storm surge was experienced like the one in Mississippi during Hurricane Katrina. Gulf decided to relocate the DOC to a more inland Company owned facility.

In addition, the Pace Boulevard building was built in 1957 and had increasing O&M costs associated with its upkeep. The majority of the remaining departments in the building were relocated to other Company facilities; however, none of these other Company facilities had the parking, bus route proximity and customer access attributes necessary for convenient Customer Service functions.

Q. Is the amount included in the test year 2012 for the rent of the Customer Service Office facility reasonable?

A. Yes. The $18 per square foot rental fee is reasonable. Gulf compared rents in the downtown area for class “A/B” space. The comparable rents were in the $16 to $24 per square foot range.

**II. PROPERTY DAMAGE ACCRUAL**

Q. What property damage accrual has been included in the projected test year?

A. Gulf has included a property damage accrual of $6,800,000 in the 2012 test year. This represents an increase from Gulf’s current accrual of $3,500,000 per year as approved by the FPSC in the Company’s last rate case and results in an NOI adjustment of $3,300,000 for the test year as discussed in Mr. McMillan’s testimony. If the $3,500,000 annual expense allowed in Gulf’s last rate case were escalated for CPI and customer growth, that accrual would be approximately $5,000,000 per year. However, Gulf proposes an annual accrual of $6,800,000 per year.

The $6,800,000 represents the expected average annual storm loss to be charged to the reserve according to Gulf’s 2011 Hurricane Loss and Reserve Performance Analysis (Storm Study). Gulf’s Storm Study, which is required pursuant to FPSC Rule 25-6.0143, is attached to my testimony as Exhibit CJE-1, Schedule 5. The expected average annual loss to be covered by the reserve is shown on page 20 of the Study.

Q. What is the current balance in Gulf’s property damage reserve?

A. The balance of the property damage reserve as of December 31, 2010 was $27,593,000. With the current accrual of $3,500,000 per year, this balance will grow to $31,093,000 by the beginning of the test year, assuming that no property damage is charged to the reserve during 2011 (an optimistic assumption). However, as shown on page 5 of Exhibit

CJE-1, with the current accrual level of $3,500,000 and estimated annual charges of $6,800,000, the expected fund balance in five years will decline to $11,000,000, and there is a 29 percent probability that the fund balance will become negative within the next five years.

Q. What are the key policy considerations relating to the recovery of property damage costs?

A. The Commission has recognized that storm restoration is a cost of providing electric service in Florida and, therefore, is properly recoverable through rates and charges of the Company. While the exact timing of storms cannot be predicted, it is certain that tropical storms and hurricanes will affect Gulf’s system over time, and the Company will incur costs for restoring power.

All customers should contribute to the cost of storm restoration, even if no storm strikes in a particular year. Since storms will occur and only their timing is uncertain, the true cost of providing electric service should include an allowance for a level of restoration activity that approximates at least the average expected annual storm costs over time.

Q. Please provide a brief history of Gulf’s and the Commission’s approach to property damage cost recovery.

A. Prior to Hurricane Andrew in 1992, Gulf Power maintained commercial insurance coverage for its T&D network. The cost of carrying this insurance was recovered through base rates. The cost of storm restoration, therefore, was spread out to customers over time, largely through the cost of insurance included in the Company’s base rate charges.

Following Hurricane Andrew, commercial insurers withdrew from the T&D insurance market. In the absence of commercial coverage, the Company established, and the Commission consistently endorsed, an overall framework which acknowledges that the costs associated with restoring service after storms are a necessary cost of providing electric service in Florida and as such, are properly recoverable from customers. The framework consists of three main parts:

a. an annual property damage accrual adjusted over time as circumstances change,

b. a reserve adequate to accommodate most but not all storm years, and

c. a provision for utilities to seek recovery of costs that exceed the reserve.

Q. How do these mechanisms enable Gulf Power to recover the costs of storm restoration while balancing customer interests?

A. These mechanisms allow for on-going recovery of reasonable amounts to provide for the costs of future storms. By spreading the costs over a number of years, rate shock to our customers is minimized. The reserve accrual also ensures that all customers contribute to the cost of recovering from storms, whose timing is unknown.

Q. What is the appropriate level for the property damage accrual?

A. The property damage reserve balance should be sufficient to protect against most years’ storm restoration costs but not the most extreme years. This level should reduce the Company’s dependence on relief mechanisms such as a storm cost recovery surcharge. The annual accrual should be set at a level to allow the reserve to build modestly in years of no hurricane activity.

At year-end 2003, Gulf’s property damage reserve balance stood at $26.2 million. In 2004 and 2005, Gulf’s system was impacted by three major storms. Hurricane Ivan, a strong Category 3 storm in 2004 caused the reserve to be drawn down by $97.7 million. In 2005, Hurricane Dennis, another Category 3 storm, caused the reserve to be drawn down by another $51.7 million. These storms resulted in a deficit reserve balance as high as $94 million in September 2005. To eliminate this deficit and begin rebuilding the reserve, the Commission authorized a monthly residential storm surcharge between $0.00257 and $0.00271 per kwh for 51 months.

Q. What is the current target level for the reserve?

A. The current target level for the reserve is $25.1 million to $36 million, as approved by the Commission in Docket No. 951433-EI, Order No. PSC-96-1334-FOF-EI, and affirmed in the Company’s last rate case. The storm study shows that with the current accrual level, the balance in the fund is expected to decrease, rather than increase, over the next five years. Increasing the annual accrual to $6,800,000 with a targeted reserve balance between $52 million and $98 million will provide our customers with the best long term solution to storm restoration. This reserve band replicates Gulf’s expenses associated with most recent significant storm damage charged to the reserve and would reduce the likelihood of a significant storm cost recovery surcharge in the event of a large storm.

Q. Will an increase in the accrual to $6,800,000 allow Gulf to reach its targeted reserve?

A. It is possible but not likely. The requested accrual is only at the level of the expected average annual loss to be covered by the reserve. Therefore, if actual losses equal expected losses, the reserve will not increase to its target. An annual accrual in excess of the expected average annual loss would be required to have an expected increase in the reserve balance over time.

Q. Why is Gulf not requesting an annual accrual in excess of the expected average annual loss?

A. Gulf is aware of the impact that the requested accrual will have on rates and has made a conscious decision to limit the requested accrual to the expected average annual loss. While this will likely mean that the reserve will not grow as large as our targets, it should be adequate to maintain the reserve at or near existing levels, absent catastrophic storms or a series of storms that exceed the average annual impacts. Gulf believes that the requested annual accrual is a significant first step in reaching the targeted reserve over the long term.

Q. Why is it important to maintain an adequate reserve?

A. There are numerous reasons for maintaining an adequate reserve. First, an adequate reserve greatly diminishes (but does not eliminate) the likelihood of having to impose surcharges on customers to pay for storm losses. Avoiding surcharges in a post-storm period is greatly beneficial to customers as they too have to struggle with the challenges of storm recovery. Second, an adequate reserve acts like an effective insurance policy. It allows “premiums” in the form of rates to be recovered from all customers a little at a time to cover large losses of an infrequent nature. Third, an adequate reserve assures that financial resources are available to quickly and efficiently repair damages and restore service to customers. Fourth, an adequate reserve diminishes the likelihood of the reserve going negative as it did twice in the 2004-2005 time period. And fifth, an adequate reserve allows for insurance deductibles to be met. The deductible for the All Risk policy has increased from $1 million to $10 million and $25 million for named windstorm and wind driven water.

**III. DEPRECIATION**

Q. What are Gulf’s depreciation expense, dismantlement accruals, and accumulated depreciation balances for the test year?

A. Gulf’s depreciation expense, including dismantlement, for the test year is $135,208,000, as shown on MFR F-8. Gulf’s 13-month

average accumulated depreciation balances for the test year, which total $1,412,339,000, is detailed on MFR B-9.

Q. What is the basis for Gulf’s depreciation expense and dismantlement accruals?

A. Gulf’s depreciation expense reflects the depreciation rates approved by the Commission in Order No. PSC-10-0458-PAA-EI, issued on July 19, 2010 in Docket No. 090319-EI. Gulf’s dismantlement accrual was likewise approved in that same Order. Pursuant to that Order, these newly approved rates were implemented effective January 1, 2010 and will continue through the 2012 test year.

Q. How was the Advanced Metering Infrastructure (AMI) handled in Gulf’s last depreciation study?

A. During Gulf’s last depreciation study, Gulf identified meter investments of $12,176,660 that would retire over the 2010-2013 period in connection with its AMI program. The reserve associated with the near-term retiring investments was estimated at $4,352,459, with anticipated removal costs of $1,826,499. The resulting net investment of $9,650,700 was withdrawn from the meter account and placed in a separate account. A reserve transfer of $9,650,700 was made to cover the amortization related to these meters.

Q. Does Gulf propose to change how AMI is handled with regard to depreciation?

A. Yes. There have been significant changes to the AMI project since Gulf’s depreciation study. The move to AMI metering has progressed at a much faster pace than projected in Gulf’s Depreciation Study and is estimated to be substantially complete by the end of 2012. This will leave an unrecovered net investment of approximately $7,088,000 as of December 31, 2011. Gulf proposes a capital recovery schedule to address the $7,088,000 remaining investment, which will be amortized over a four year period starting in 2012, resulting in $1,772,000 of annual expense and an increase in the 13-month average accumulated depreciation reserve of $886,000 as of December 2012. These amounts were provided to Mr. McMillan and are discussed in his testimony.

Q. What is the depreciable life Gulf is proposing to use for AMI meters and associated equipment?

A. Gulf is proposing a 15 year life with no net salvage value for the AMI meters and associated equipment. The 15 year life was based on discussions with project engineering personnel and consultation with our depreciation expert, who agreed that a 15 year life was reasonable due to the new technology involved. Using this proposed depreciable life results in an increase of approximately $1,327,000 in depreciation expense in 2012 and an increase in the 13-month average accumulated depreciation reserve of $616,000 as of December 2012. These amounts were provided to Mr. McMillan and are discussed in his testimony. Gulf plans to address the net salvage associated with AMI in Gulf’s next depreciation study when actual experience is available to analyze the data.

**IV. UNCOLLECTIBLE ACCOUNTS**

Q. Earlier you stated that your testimony would address Gulf’s 2012 level of Uncollectible Accounts expense. What level of Uncollectible Accounts expense does Gulf project for 2012?

A. Gulf projects an Uncollectible Accounts expense in 2012 of $4,143,000.

Q. Is Gulf’s projection of 2012 Uncollectible Accounts expense reasonable and prudent?

A. Yes.

Q Is Gulf’s projection of 2012 Uncollectible Accounts expense representative of Uncollectible Accounts expense on a going forward basis?

A. Yes. This is shown on Exhibit CJE-1, Schedule 4, which shows Gulf’s revenue and projected bad debt factor for every year, 2011 through 2015, in the O&M budget that was the basis for the Company’s 2012 test year Uncollectible Accounts expense.

Q. In Gulf’s last rate case, what approved write-off rate for Uncollectible Accounts expense was allowed?

A. In 2002, the approved write-off rate was 0.24 percent. Write-offs as a percent of revenue is an industry standard for measuring bad debt performance.

Q. How does Gulf’s bad debt expense compare to other utilities?

A. In the 2010 Edison Electric Institute (EEI) and American Gas Association (AGA) DataSource benchmarking study using 2009 data, the electric company average net write-off percentage of revenue was 0.61 percent. Gulf’s 2009 net write-offs was 0.33 percent.

Q. What level of write-offs does Gulf project in 2012?

A. Gulf projects write-offs for 2012 to be 0.32 percent, which is slightly lower than 2009 actual and considerably less than the EEI and AGA DataSource benchmarking electric company average. Gulf made a $206,000 NOI adjustment, as discussed in Mr. McMillan’s and Ms. Neyman’s testimony, to write-offs based on a plan for increased collection efforts by Gulf’s Field Service Representatives.

Q. What is driving the increased write-off rate?

A. As individuals are unemployed, under-employed, facing foreclosure, or under other financial stress, utility bills can remain unpaid. The effect of the weak economy has resulted in an increase in Gulf’s actual write-offs factor for 2008, 2009 and 2010 as reflected on MFR C-11.

Q. How does Gulf manage its collection process to minimize write-offs?

A. Gulf has worked diligently to minimize write-offs through the use of consistent policies to assess and mitigate risk. Credit scoring is the resource used to assist in the identification and risk assessment of a new residential customer. Deposits are collected for residential, commercial and industrial classes of service based on creditworthiness. Pro-active outbound calling is used to notify customers that payment is necessary to avoid disconnection of service. Management monitors collection-related statistics and has established performance indicators that prompt further evaluation and action.

Q. Please summarize your justification of Gulf’s Uncollectible Accounts expense.

A. Uncollectible Accounts expenses do not track with CPI but are generally determined as a percentage of revenues. Gulf’s write-off percentage of 0.32 percent for the test year is slightly below the level experienced by Gulf in 2009.

**V. INCOME TAX EXPENSE**

Q. What amount of income tax expense is included for the 2012 test year?

A. Total federal and state income tax provision for the test year is $63,241,000 as shown on MFR C-22.

Q. How was this amount calculated?

A. The income tax expense was calculated in accordance with GAAP.

**VI. SUMMARY**

Q. Please summarize your testimony.

A. The level of A&G expenses requested in this case is reasonable, prudent and necessary to enable Gulf to continue to provide high quality, reliable electric service to our customers. Although some of these costs have grown more rapidly than the O&M benchmark, I, along with Mr. Twery and Ms. Crumlish, have explained how these variances were influenced by other factors outside the control of the Company and justified their levels.

Gulf’s requested property damage accrual is an appropriate amount that balances the interests of the Company and our customers in accordance with established Commission policy.

The requested levels of uncollectible accounts and depreciation and amortization expense are reasonable, prudent and necessary. The test year income tax expense has been calculated appropriately.

Q. Does this conclude your testimony?

A. Yes.

AFFIDAVIT

STATE OF FLORIDA ) Docket No. 110138-EI

)

COUNTY OF ESCAMBIA )

Before me the undersigned authority, personally appeared Constance J. Erickson, who being first duly sworn, deposes, and says that she is the Comptroller of Gulf Power Company, a Florida corporation, and that the foregoing is true and correct to the best of her knowledge, information, and belief. She is personally known to me.

The signed original affidavit is attached to the

original testimony on file with the FPSC.

s/\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Constance J. Erickson

Comptroller

Sworn to and subscribed before me this \_\_\_\_\_\_ day of \_\_\_\_\_\_\_\_\_\_\_\_\_, 2011.

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Notary Public, State of Florida at Large

Commission No. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

My Commission Expires \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Florida Public Service Commission

Docket No.: 110138-EI

GULF POWER COMPANY

Witness: C. J. Erickson

Exhibit No. \_\_\_\_ (CJE-1)

Schedule 1

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Responsibility for Minimum Filing Requirements

Schedule Title

B-4 Two Year Historical Balance Sheet

B-21 Accumulated Provision Accounts- 228.1, 228.2 and 228.4

B-22 Total Accumulated Deferred Income Taxes

B-23 Investment Tax Credits – Annual Analysis

B-25 Accounting Policy Changes Affecting Rate Base

C-6 Budgeted Versus Actual Operating Revenues and Expenses

C-8 Detail of Changes in Expenses

C-9 Five Year Analysis – Change in Cost

C-10 Detail of Rate Case Expenses for Outside Consultants

C-11 Uncollectible Accounts

C-12 Administrative Expenses

C-13 Miscellaneous General Expenses

C-17 Pension Cost

C-19 Amortization/Recovery Schedule-12 Months

C-20 Taxes Other than Income Taxes

C-21 Revenue Taxes

C-22 State and Federal Income Tax Calculation

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Responsibility for Minimum Filing Requirements

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C-25 Deferred Tax Adjustment

C-26 Income Tax Returns

C-27 Consolidated Tax Information

C-28 Miscellaneous Tax Information

C-29 Gains and Losses on Disposition of Plant and Property

C-30 Transactions with Affiliated Companies

C-31 Affiliated Company Relationships

C-35 Payroll and Fringe Benefit Increases Compared to CPI

C-41 O&M Benchmark Variance by Function

C-43 Security Costs

F-1 Annual and Quarterly Reports to Shareholders

F-2 SEC Reports

F-8 Assumptions



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Schedule 3

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