GULF POWER COMPANY

Before the Florida Public Service Commission

Prepared Direct Testimony of

Raymond W. Grove

Docket No. 110138-EI

In Support of Rate Relief

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Q. Please state your name and business address.

A. My name is Ray Grove. 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 am the Manager of Power Generation Services.

Q. What are your responsibilities as Manager of Power Generation Services?

A. I am responsible for Generation Planning, including the Ten Year Site Plan and the Renewable Standard Offer Contract, reporting plant performance through the Generation Performance Incentive Factor, supply side renewable energy development, Operations and Maintenance (O&M) budgeting for Production, and capital budgeting for Production.

Q. Please state your prior work experience and responsibilities.

A. I was hired by Gulf in January 1982 as a district accountant responsible for accounting and budgeting for the Western District. In 1984, I transferred to Internal Auditing, with primary responsibility for auditing

Power Generation and Fuel. I transferred to Power Generation in 1998, with responsibility for accounting and budgeting for Power Generation. I assumed the additional responsibility for Generation Planning in 2002 and supply side renewable generation in 2008.

Q. What is your educational background?

A. I graduated with a Bachelor of Arts in Accounting from the University of West Florida in 1981.

Q. What are the purposes of your testimony?

A. My testimony discusses Gulf’s generation resources used and useful in the provision of electric service to our customers. These resources include Gulf-owned resources, jointly-owned generation resources, the Southern electric system (SES) resources available pursuant to the Intercompany Interchange Contract (IIC), and power purchase agreements (PPAs) with independent generators, including renewable generators. My testimony also addresses Gulf’s resource planning process, Production investment, and 2012 Production O&M budget.

Q. Are you sponsoring any exhibits?

A. Yes. I am sponsoring Exhibit RWG-1, Schedules 1 through 12. Exhibit RWG-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. A list of MFRs I sponsor or cosponsor is included on Exhibit RWG-1, Schedule 1. The information contained in the MFRs I sponsor or co-sponsor is true and correct to the best of my knowledge and belief.

**I. GULF’S GENERATION RESOURCES**

Q. Please describe Gulf’s generating resources during the 2012 test year.

A. Gulf will generate or purchase electricity from a diverse group of resources in 2012. These resources will include: (a) units owned solely by Gulf, (b) units owned jointly with other operating companies within the SES, (c) units in the SES available to Gulf through the SES IIC, and (d) units available to Gulf under PPAs. The fuels used for the generation resources available to Gulf include coal, oil, natural gas, landfill gas and municipal solid waste.

Q. Please describe Gulf’s projected capacity mix by fuel type for 2012.

A. In the summer of 2002 at the beginning of the test year in Gulf’s last rate case, Gulf had 2,625 megawatts (MW) of capacity available to serve our customers, as shown on Schedule 2, page 1 of 2, of Exhibit RWG-1. The resources available to Gulf were primarily coal generation, which made up 75.7 percent of the resources owned or available through PPAs. For the summer of 2012, Gulf will have 3,852 MW of capacity available for our customers. Exhibit RWG-1, Schedule 2, page 2 of 2, shows that the resources available to Gulf will be made up of 48.4 percent coal, 50.4 percent gas, 0.8 percent oil, and 0.4 percent renewable. Since our last rate case, Gulf has increased its fuel diversity and reduced its reliance on coal.

Through an effective planning process, Gulf has a generation mix which will allow us to provide our customers energy from whichever resources are most economical. When coal prices are high, more gas resources can be utilized; when gas prices are high, more coal resources can be utilized. In addition, as a party to the SES IIC, Gulf takes advantage of making purchases or sales through the Southern Company Power Pool (the Pool) that further benefit our customers.

Q. Please describe the generation resources forecasted to be owned, operated and used by Gulf to serve its retail customers in 2012.

A. Exhibit RWG-1, Schedule 3 provides a list of the units owned and operated or co-owned by Gulf and used to provide retail service. The list includes Gulf’s ownership in Plant Daniel located in Mississippi. A summary of these units, fuel type, and capacity is as follows:

* + Plant Crist has four coal units totaling 906 MW;
  + Plant Smith has two coal units, a gas fired Combined Cycle (CC), and an oil fired Combustion Turbine (CT) totaling 945 MW;
  + Plant Scholz has two coal units totaling 92 MW;
  + Plant Daniel has two coal units of which Gulf owns 510 MW;
  + Pea Ridge has three gas fired units totaling 12 MW; and
  + Perdido has two landfill gas units totaling 3.2 MW.

Q. What PPAs will Gulf have in place and use to provide electric service in 2012?

A. Exhibit RWG-1, Schedule 4 provides a list of the power purchase resources available to Gulf during 2012 and information regarding the fuels and technologies used by these generating resources.

Q. You mentioned the SES Intercompany Interchange Contract, or IIC. Please summarize that arrangement.

A. The IIC is a contract among Alabama Power Company, Georgia Power Company, Mississippi Power Company, Gulf Power Company and Southern Power Company (collectively the Operating Companies).The IIC is designed to provide for the continued operation of the electrical system of the Operating Companies in such a manner as to achieve the maximum possible economies consistent with the highest practical reliable service, the reasonable utilization of natural resources, and the equitable sharing among the Operating Companies of the costs associated with the operation of facilities that are for the mutual benefit of the Operating Companies and their customers.

Q. How does the SES IIC work to the benefit of Gulf’s customers?

A. Gulf’s customers benefit tremendously from Gulf’s participation in this pooling arrangement. Benefits include, but are not limited to, the following:

1. Economic dispatch production cost savings,
2. Economic sharing of generating reserve capacity,
3. Lower reserve margin requirements,
4. Ability to install large, efficient generating units,
5. Reduced requirements for operating reserves,
6. Pool market for temporary surpluses of capacity and energy on Gulf’s system,
7. Ready supply of energy for purchase when Gulf is short,
8. Peak-hour load diversity, and
9. Opportunity energy sales and purchases.

In summary, Gulf’s decision to enter into and participate in the SES IIC was reasonable and prudent, and the benefits justify that Gulf’s participation in the IIC is in the best interest of our customers.

Q. Besides the environmental capital projects addressed through Gulf’s Environmental Cost Recovery Clause (ECRC), what major changes have been made to Gulf’s generation resources since Gulf’s last base rate proceeding?

A. Since our last rate case, there have been five major changes to Gulf’s generating fleet unrelated to ECRC projects.

1. Plant Crist Units 1, 2, and 3 (80MW) were retired as part of an agreement with the Florida Department of Environmental Protection (FDEP). The retirement of Plant Crist Units 1, 2, and 3 was approved in Docket No. 020943-EI, Order No. PSC-02-1396-PAA-EI.
2. In 2006, Gulf signed two PPAs for a total of 488 MW of peaking capacity that took effect in June 2009 and will last for five years through May 2014. The contracts are with Shell Energy North America for the electrical output from four units at the Coral Baconton facility and with Southern Power Company (an affiliate) for the electrical output from four units at their Dahlberg facility. These PPAs were approved in Docket No. 060811-EI, Order No. PSC-07-0329-PAA-EI. In addition, the contract with Southern Power Company was approved by the Federal Energy Regulatory Commission (FERC).
3. In 2008, Gulf signed a 6-year PPA with Bay County in Florida to purchase the electrical output from its 11 MW waste-to-energy facility. The PPA with Bay County was approved in Docket No. 080612-EI, Order No. PSC-09-0012-PAA-EI.
4. In 2009, Gulf signed a 14-year PPA with Shell Energy North America for 885 MW of intermediate capacity from its Central Alabama facility. The contract took effect in November 2009. This PPA was approved in Docket No. 090169-EI, Order No. PSC-09-0534-PAA-EI.
5. In 2010 Gulf finished construction of a 3.2 MW landfill gas-to-energy facility (Perdido) in Escambia County, Florida.

Each of these changes to Gulf’s generating resources is discussed later in my testimony.

**II. GULF’S RESOURCE PLANNING PROCESS**

Q. Please provide an overview of Gulf’s resource planning process.

A. The resource planning process utilized by Gulf to determine its future needs is coordinated within the SES Integrated Resource Planning (IRP) process. Gulf participates in the IRP process along with the other SES retail operating companies (Alabama Power, Georgia Power, and Mississippi Power). Gulf receives a number of benefits from being part of a large system planning process. Since Gulf comprises only about 6.9 percent of the total SES summer peak demand, its needs are relatively small compared to the entire system. This collaborative planning allows Gulf to coordinate its capacity additions to meet its demand and reserve requirements in a manner that utilizes the temporary surpluses of capacity available on the SES or shares our temporary surpluses of capacity with the other retail operating companies.

This ability to coordinate capacity additions and rely temporarily on any surplus system reserves also allows Gulf to defer capacity addition decisions until the timing allows consideration of (a) larger blocks of need that might justify less costly addition alternatives, (b) emerging technologies that might not have been available earlier, and (c) emerging environmental requirements that might affect unit addition choices. Another benefit to Gulf is the advantage gained from planning a large system such as the SES without the costs of a large planning staff of its own.

As discussed in Gulf’s Ten Year Site Plan (TYSP), the SES IRP process employs a 15 percent reserve margin target for long range planning. Gulf, as a member of the SES, has access to all the reserves of Southern Company, which at a 15 percent reserve margin represents approximately 5,000 MW. A 15 percent reserve margin in 2012 for Gulf represents 396 MW. If Gulf were required to carry a 20 percent reserve margin (as other Florida utilities are required to carry) Gulf would need to add 132 MW of capacity. Assuming Gulf purchased or constructed CT capacity to meet this increased reserve requirement, Gulf’s customers would be subjected to, at least, an additional $12.5 million in annual revenue requirements. As I discussed earlier in my testimony, the ability for Gulf to carry lower reserve margins is one of the many benefits of Gulf’s participation in the IIC.

The generation mix process employed by the SES uses PROVIEW (a computer model) to screen available technologies in order to produce a listing of preferred capacity resources from which to select the most cost-effective plan for the system. The resulting SES resource needs are allocated among the operating companies based on reserve requirements. Each operating company then determines the resources that will best meet its capacity and reliability needs.

Gulf’s long-range goal is to have economical, reliable generating capacity available to meet our customers’ needs. In order to meet the anticipated demand that often develops irregularly and in increments much smaller than the capacity of a large, efficient generating unit, and to realize the economies of scale inherent in large units, most electric utilities will construct “blocks” of generating capacity which are temporarily in excess of the requirements anticipated at the time the unit is initially brought on line. If the utility were to satisfy only the annual increase in demand, these small blocks would be much higher in cost on a per unit basis and much lower in efficiency.

In planning generating capacity additions, Gulf has certain advantages that greatly benefit its customers. Gulf Power, Alabama Power, Georgia Power, and Mississippi Power operate as an integrated generation and transmission network over a four-state area. Coordinated planning with our Southern system affiliates allows for the staggered construction of larger, more efficient generating units spread throughout the Southern electric system.

Q. Is this the same planning process used in Gulf’s last rate case and the same process described in Gulf’s TYSP?

A. Yes.

Q. Please address the relationship of Gulf’s major generating resource changes since its last rate proceeding to Gulf’s generation resource planning process.

A. Since Gulf’s last rate case, Gulf entered into four PPAs, which were the result of Gulf’s effective resource planning process. Each of these agreements has been reviewed and approved by the Florida Public Service Commission (FPSC or the Commission). In addition, Gulf constructed a 3.2 MW landfill gas-to-energy facility which began operation in 2010, and this resource addition was evaluated within Gulf’s generation resource planning process. The retirements of Plant Crist Units 1, 2 and 3 were the result of an agreement negotiated with the FDEP. While the retirement decision was not the product of Gulf’s resource planning process, the effect of the retirements was incorporated into Gulf’s resource planning process.

Q. Please address Gulf’s decision to retire Plant Crist Units 1, 2 and 3.

A. In 2002, Plant Crist Units 1, 2, and 3 were the oldest units on Gulf’s system and were scheduled for retirement in 2011. On August 28, 2002, Gulf entered into an agreement with the FDEP for the purpose of ensuring compliance with new air quality standards for ozone. The agreement required Gulf to undertake various activities at Plant Crist in order to reduce overall plant-wide air emissions of nitrogen oxides. The Commission approved this settlement with the FDEP, including the early retirement of Crist Units 1, 2, and 3, in Docket No. 020943-EI, Order No. PSC-02-1396-PAA-EI.

Q. Please address Gulf’s decision to enter into 488 MW of five-year power purchase contracts from June 2009 through May 2014.

A. In the 2005 TYSP, Gulf forecasted that its reserve margins in 2009 would, absent construction or purchase of resources, be below its reserve margin criterion of 15 percent. The forecasted reserve deficiency was approximately 400 MW.

Confronted with a need for additional peaking capacity, Gulf determined, for a variety of reasons, to look to the market rather than self-build alternatives to meet its additional short-term needs. First, Gulf’s assessment of the competitive wholesale market suggested there was likely capacity available that could be obtained through a Request for Proposals (RFP) process. Second, Gulf desired, if the costs were appropriate, to diversify its portfolio of resources. Third, Gulf desired the flexibility associated with deferring a decision that would involve consideration of a self-build alternative. Deferring consideration of a self-build alternative at this time of great uncertainty about prospective environmental compliance costs provided several advantages. The type and timing of Gulf’s 2009 need suggested an addition of CT capacity if Gulf’s need were to be met by a self-build option in 2009. However, deferring that need to 2014 would allow Gulf to consider other types of technologies and allow Gulf to defer capital investment. As a result, the deferral allowed more time for the emergence of technology improvements that might enhance performance and/or reduce costs.

To meet its projected 2009-2014 reserve margin shortfall, Gulf conducted a capacity solicitation in 2005. The RFP was conducted consistent with the Commission’s rule regarding capacity solicitations, even though the rule was inapplicable because Gulf was not considering a self-build option.

Gulf received three bids in response to the RFP, and after careful analysis, Gulf selected two bids that best fit Gulf’s needs. The contract negotiations resulted in Gulf submitting two executed PPAs to the Commission for approval. The contracts were approved by the Commission in Docket No. 060811-EI, in Order No. PSC-07-0329-PAA-EI. In addition, because one of the contracts was with an affiliate (Southern Power), that contract was reviewed and approved by the FERC.

Q. Please address Gulf’s decision to enter into a power purchase agreement with Bay County for the electrical output from its Municipal Solid Waste Facility.

A. Bay County owns and operates a Solid Waste Facility in Panama City, Florida. Gulf is committed to obtaining cost-effective energy supplies for our customers and to obtaining the benefits of fuel diversity wherever practical. Gulf is also committed to encouraging and promoting renewable energy pursuant to several sections of Chapter 366, including Sections 366.82, 366.91, and 366.92, Florida Statutes. This negotiated contract provides renewable energy produced by an existing in-state facility with a proven performance record. It also enhances Gulf’s fuel diversity. The resulting contract between Gulf and Bay County was reviewed and approved by the Commission in Docket No. 080612-EI, Order No. PSC-09-0012-PAA-EI.

Q. Please address Gulf’s decision to enter into the 14-year PPA with Shell Energy North America (SENA) for the capacity and energy from its Central Alabama facility.

A. The PPA with SENA was also the result of Gulf’s generation resource planning process. Anticipating the expiration of the 2009 PPAs, Gulf began the process of developing an RFP for 2014. The primary drivers of Gulf’s need to add generation resources in 2014 were the expiration of two PPAs totaling 488 MW and projected load growth. Gulf’s 2009 TYSP indicated that Gulf’s 2014 generation resource need was expected to be 976 MW, and Gulf anticipated issuing an RFP with a self-build option.

Just prior to the date scheduled for issuing the final RFP, Gulf learned that SENA desired to enter into a bilateral negotiation for a PPA with Gulf for the output of its facility located in Central Alabama. Initial review indicated that the SENA resource might be an extraordinary opportunity for Gulf’s customers. Therefore, Gulf decided not to proceed with its RFP.

Further cost-benefit analysis revealed a net present value (NPV) cost savings to customers of $587 million in 2014 dollars associated with the PPA compared to the self-build resource. Therefore, Gulf entered into a PPA with SENA.

The resulting contract between Gulf and SENA was reviewed and approved by the Commission in Docket No. 090169-EI, Order No. PSC-09-0534-PAA-EI. It should be noted that the forecasted $587 million NPV savings to customers did not reflect the additional benefits of having the capacity and energy of the unit available to Gulf prior to 2014. Every time the unit is dispatched prior to June 2014, Gulf’s customers benefit from additional energy savings.

Q. Please address Gulf’s decision to construct a landfill gas-to-energy facility at the Perdido landfill.

A. In July 2008, Escambia County, Florida issued an RFP for the sale of landfill methane gas from its Perdido landfill. Landfill gas is defined as a renewable energy resource pursuant to Section 366.91(2), Florida Statutes. The Florida Legislature has repeatedly recognized that it is in the public interest to promote the development of renewable energy resources in the state in order to, among other things, reduce dependence on natural gas, minimize volatility of fuel costs, encourage investment in the state and improve environmental conditions. Given these facts, Gulf began to evaluate the possibility of developing a project to utilize the gas being offered through this RFP.

In order to minimize or negate any impact to our customers, Gulf used the avoided cost of the unit contained in its Renewable Standard Offer Contract (RSOC) as the basis for determining the price Gulf would be willing to pay to Escambia County for its landfill methane gas. Using the established avoided cost concepts, Gulf submitted a bid for the procurement of the gas being offered under this RFP.

After submitting a winning bid in response to the RFP, Gulf entered into a twenty-year agreement with Escambia County to purchase landfill gas necessary to fuel a 3.2 MW landfill gas to energy facility to be located adjacent to the Perdido landfill. The total price to construct the project was $5.5 million, including the associated connection to Gulf’s distribution system.

The facility’s investment and expenses are included in Gulf’s base rate request. The O&M expense included in the test year is $770,000. The fuel savings associated with this project are already being passed to customers through the fuel clause. At the time Gulf conducted its analysis of the Perdido project, Gulf estimated that it would result in approximately $23.5 million in fuel savings to Gulf’s customers over its twenty-year life.

As Gulf continues to evaluate technologies available to provide renewable energy, it has become clear that the ability for a renewable energy provider to develop a project at or below avoided cost will be very challenging. Landfill gas may be the most cost-effective renewable resource available at this time. This confirms that Gulf’s decision to develop this project was prudent and in the best interest of our customers.

Q. Are the major changes to Gulf’s generating resources since its last rate case proceeding reasonable and prudent?

A. Yes. The changes in Gulf’s generating fleet since our last rate case were driven by Gulf’s desire to provide economical and reliable generating capacity to our customers. The retirement of Crist Units 1, 2 and 3 was required by an agreement that Gulf entered into with the FDEP as part of a plan to ensure compliance with new air quality standards for ozone. These retirements accelerated Gulf’s projected need to add capacity to meet our customers’ rising demands.

Gulf’s subsequent decision to solicit intermediate-term PPAs to defer its 2009 capacity need was also reasonable and prudent. Indeed, the Commission determined the reasonableness of that capacity solicitation in approving the contracts that were the products of the RFP. Gulf went beyond legal requirements in soliciting alternatives and ultimately purchased power at a cost less than the cost of a self-build option.

As noted in the Commission order approving the agreement, the contract between Gulf and Bay County provides Gulf with a viable source of electric energy from a renewable fuel source. It also meets all the requirements and rules governing Qualified Facilities and small power producers, including purchases at or below avoided cost. It was reasonable and prudent for Gulf to enter into the Bay County agreement consistent with the Commission’s policy to encourage Qualifying Facilities.

Gulf’s decision to enter into a 14-year PPA with SENA for the output of gas-fired combined cycle units from 2010 through 2023 was also reasonable and prudent, as the Commission determined in Order No. PSC-09-0534-PAA-EI. Gulf seized the opportunity to use a market resource which was available at a cost well below the cost at which Gulf could have built comparable combined cycle units. These cost savings will flow entirely to Gulf’s customers, who at the same time avoid having to pay carrying costs on an additional investment. This decision also forestalled Gulf from having to make other generating addition decisions at a time of great uncertainty about prospective environmental compliance costs.

Gulf’s decision to develop the landfill gas project in Escambia County was reasonable and prudent. The methodology employed to determine cost effectiveness was sound and in compliance with Gulf’s RSOC that was approved by the Commission.

In each instance, Gulf Power clearly had an eye on the future and considered the effect of these decisions on prospective Gulf Power capacity decisions. Each decision met Gulf’s long-range resource planning goal to have economical, reliable generating capacity available to

meet our customers’ needs. Each decision was reasonable, prudent and in the best interests of our customers.

**III. GULF’S PRODUCTION INVESTMENT**

Q. Mr. Grove, Gulf Witness McMillan shows a total of $2.6 billion of plant in service investment in Gulf’s 2012 rate base in this case. Other witnesses have testified that these costs are properly recorded consistent with the Uniform System of Accounts and generally accepted accounting principles. Are the Production assets associated with these costs used and useful in the provision of electric service to the public?

A. Yes. The Production assets, which comprise a total of $1,043,349,000 of plant in service in Gulf’s 2012 rate base in this case, are used and useful in Gulf’s provision of electric service.

Q. Were these Production costs reasonable and prudently incurred?

A. Yes. They were incurred pursuant to our capital budget process. I will discuss that process later in my testimony. They also were subject to cost controls used to govern budgeted expenditures. These cost controls are also discussed later in my testimony.

Q. What is Gulf’s projected Production Capital Additions Budget for 2011 and 2012 excluding Plant Scherer and items recovered through the ECRC?

A. Gulf’s Production non-ECRC Capital Additions Budget for 2011 is $68,334,000. As shown on Exhibit RWG-1, Schedule 5 page 1 of 2, there are 75 projects scheduled for 2011.

Gulf’s Production, non-ECRC Capital Additions Budget for 2012 is $43,738,000. The major items included in the Production non-ECRC Capital Additions Budget for the test year are:

* Crist Unit 6 Spring Boiler/Turbine Outage ($6,200,000);
* Crist Unit 7 Fall Boiler/Turbine Outage ($14,000,000);
* Static Exciter and Voltage Regulators on Crist Units 6 & 7 ($5,000,000)
* Smith Unit 2 & 3 Spring Boiler Outages ($3,400,000); and
* Daniel Unit 1 Spring Boiler Outage ($800,000).

All of these budgeted projects are needed to address safety issues, to maintain efficiency (heat rate), or to sustain reliability. As shown in Exhibit RWG-1, Schedule 5, page 2 of 2, there are 58 capital projects in 2012.

Q. Please address how Gulf’s Production Capital Additions Budget is formulated.

A. The Production Capital Additions Budget process is a multi-step process that begins at the plant level and is ultimately approved by Gulf’s Executive Management Team, which is made up of the CEO and the four Vice Presidents of Gulf. All capital projects are evaluated to ascertain the necessity of performing the work.

Plant personnel begin the Production budgeting process by evaluating existing plant equipment performance and maintenance costs. Where performance has degraded or is forecasted to degrade to an unacceptable level and maintenance costs are increasing, replacement of the equipment becomes necessary. As part of this evaluation process, plant personnel review the information provided by Gulf to the North American Electric Reliability Corporation Generation Availability Data System (NERC GADS) to evaluate events that have triggered unplanned outages or unit derates. Gulf develops plans to address GADS events that continue to be problematic and makes decisions to repair or replace existing equipment. Once plant personnel have identified specific projects, the Group Managers at each plant review the proposed project list to determine which projects will be submitted to the Plant Management Team (the Plant Manager and his direct reports). The Plant Management Team meets to discuss each proposed project to determine which projects will be submitted for the next level of review to be included for consideration in the final budget.

Each plant presents its proposed list of capital projects to the Power Generation Leadership Team (the Vice President of Power Generation and his direct reports). The Plant Managers then meet with the Power Generation Leadership Team to prioritize all projects at the Power Generation Level to ensure the most critical projects are included in the budget submitted for final review by Gulf’s executives.

Lastly, the Production Capital Additions Budget request is presented to Gulf’s executives. The Vice President of Power Generation is required to explain and justify the Production Capital Additions Budget, and the final Capital Additions Budget is ultimately approved by executive management.

Q. How does Gulf control capital costs after the Capital Additions Budget is developed?

A. Once the Capital Additions Budget is approved, each project is assigned a project manager who is responsible for all aspects of the project. The project manager will develop documentation outlining the scope of the project and work with Supply Chain Management to develop a bid package. From start to finish, the project manager is responsible for all on-site management, including contractor performance and invoice review. The plant manager receives a report from the Manager of Power Generation Services each month detailing capital project expenditures and any budget variance for all projects. The plant manager is responsible for explaining all budget variances. At the Company level, the Corporate Planning group requires a detailed explanation quarterly of all budget variances greater than 10 percent or $250,000 (whichever is lower). Variances less than $10,000 do not require a variance explanation.

Q. How are new capital projects or changes to existing projects incorporated in the current year budget?

A. In the event a new project or an increase in expenditures associated with an existing project is necessary, the planning unit must submit a justification letter to the Vice President with functional responsibility. If approved by the functional Vice President, the letter is also reviewed and approved by the Chief Financial Officer. Finally, the letter is sent to Corporate Planning where the change is documented and added to the financial plan.

Q. Was Gulf’s Production non-ECRC Capital Additions Budget of $68,334,000 in 2011 and $43,738,000 in 2012 developed by this budget and cost control process?

A. Yes. The projects included in Gulf’s Production Capital Additions Budget were approved pursuant to this rigorous evaluation and approval process. Gulf’s effective capital budgeting and spending program has helped ensure our generating fleet has continued to provide reliable and efficient generation. The dollars included in the test year non-ECRC Capital Additions Budget for Production are reasonable, prudent, and necessary. Gulf will continue to evaluate the benefits of additional capital projects in the future to ensure that we are able to provide our customers with reliable, cost-effective and efficient generating capacity.

**IV. GULF’S 2012 PRODUCTION O&M BUDGET**

Q. What are Gulf’s Production O&M budgets for 2011 and 2012?

A. Gulf’s Production O&M budget for 2012 is set forth on Exhibit RWG-1, Schedule 6 and Schedule 7. Gulf’s Production O&M budget for 2012 is $110,888,000, including Steam Production, Other Production, and Other Power Supply expenses.

Gulf’s Production O&M budget for 2011 is set forth on Exhibit RWG-1, Schedule 7. Gulf’s Production O&M budget for 2011 is $110,435,000, including Steam Production, Production Other, and Other Power Supply expenses.

Q. Are Gulf’s projected levels of Production O&M expenses of $110,435,000 in 2011 and $110,888,000 in 2012 reasonable and prudent?

A. Yes. My conclusion is based primarily on the fact that Gulf’s 2011 and 2012 Production O&M budget are the product of a rigorous budget process implemented by experienced employees who know their jobs and their facilities. Each year, Gulf’s Power Generation Organization develops a five-year O&M budget based on historical results, projected maintenance and outage planning. As we develop the budget request, we focus on planned outages and baseline expenses.

Over the years, Gulf’s plant personnel have gained valuable knowledge relating to the maintenance of our equipment. Our experience indicates that each unit should have a regularly scheduled planned outage to inspect and repair fuel handling equipment, boilers, turbine valves and auxiliary equipment every 18 to 24 months. In addition, a major planned outage is scheduled on each unit every 8 to 10 years, which includes work on the turbine and generator equipment in addition to the equipment listed above.

Baseline expenses are costs required to conduct the day-to-day operation and maintenance of the generating equipment and auxiliary equipment and facilities. Baseline expenses include all labor, material and other expenses, such as contracts for maintaining grounds, janitorial services, and other services.

The five-year O&M budgets are developed at the plant level with the goal of maintaining high reliability and efficiency. As discussed in Gulf Witness Burroughs’ testimony, Gulf has done an exceptional job of maintaining high unit reliability and efficiency while at the same time fostering an environment where employee safety is our number one priority.

As each plant develops a five-year O&M budget, the Plant Management Team seeks input from system owners and unit owners to ensure the most critical issues receive attention. Each plant assigns a system owner (expert) over major systems such as boiler, turbine or generator. In addition, each unit has an individual assigned as the unit owner with the expectation that the individual will be the coordinator of any work related to the assigned unit. As the O&M budget is developed, the Plant Management Team, which includes the plant manager and his direct reports, meets to discuss all aspects of the equipment maintenance requirements.

Once the Plant Management Teams are satisfied that their O&M budgets meet the plant’s needs, the Power Generation Leadership Team (the Vice President of Power Generation and his direct reports) meets to discuss the overall Power Generation O&M budget. In the event that there are resource (labor, physical, or financial) constraints, the Power Generation Leadership Team discusses risks associated with projects and prioritizes projects to help ensure the most critical activities are included in the budget. Lastly, the Power Generation budget is submitted to Gulf’s Corporate Planning group. Gulf Witness Buck discusses the budget process that takes place after Corporate Planning receives the Power Generation O&M budget request.

The $110,888,000 2012 Production O&M budget was developed using teams from the plants whose expertise and understanding of plant equipment and plant operations has been clearly demonstrated by the continued high performance indicators of the units. Their budgets were then reviewed and modified by Plant Management Team, the Vice President of Power Generation and his leadership team, and ultimately Gulf’s Executive Management Team. The 2012 Production O&M budget is the product of this robust budgeting process.

Q. Is Gulf’s projected level of Production O&M expenses of $110,888,000 in 2012 representative of a going forward level of Production O&M expenses beyond 2012?

A. Yes. As shown on Schedule 7 of Exhibit RWG-1, the average Production O&M budget for the five year period (2011 – 2015), which includes the prior year and the test year, is $113,223,000. The Production O&M expense for 2011 and the 2012 test period are consistent with this average, and they are representative of the ongoing level of expense necessary to maintain generation performance and reliability.

Q. Production O&M expenses in 2012 are higher than the five year historical average for the period 2006 through 2010. Why is the 2012 Production O&M Budget representative of the ongoing level of expenses necessary to maintain generation performance and reliability?

A. The historical average levels of Production O&M expense for the years 2006 through 2010 are not representative of Gulf’s going forward level of Production O&M expenses. If Gulf were held to such a level of expenses, necessary and essential maintenance would have to be foregone, and generation unit performance would likely suffer significantly. There are a number of factors that have led to the increase in Production O&M expenses for the period 2011-2015 relative to the period 2006-2010.

Q. Please address the factors that are driving Gulf’s Production O&M expense level up in the period 2011-2015.

A. There are at least five primary factors that are driving the Production O&M expense increase. First, despite the retirement of old units and the addition of new units, the age of Gulf’s generation fleet is increasing, and with age, greater levels of maintenance are necessary to maintain or improve generating unit performance. Second, there are a number of costs in the Production function that are simply increasing at a rate higher than the Consumer Price Index (CPI), the general measure of inflation. Third, Gulf has a generating unit (Smith Unit 3) that was relatively new in the 2006-2010 time-periods and required very little O&M expense. Fourth, Gulf has one new unit (Perdido) that was not constructed and operational until October 2010. Fifth, Gulf worked very hard during the 2009-2010 time frames to avoid asking for base rate relief when customers were struggling during the worst economic downturn since the Great Depression. The lower O&M expenses incurred during this historical period helped Gulf avoid asking for base rate relief without affecting the reliability or efficiency of our generating fleet. However, the historical level of expenses is not sustainable without affecting the reliability and efficiency of our fleet.

Q. Mr. Grove, please address the effect of Gulf’s aging generation fleet on its Production O&M budget in 2012.

A. This is best explained by comparing the ages of Gulf’s generating units at the time of its last rate case with the age of Gulf’s generating units in 2012, and comparing the amount of Production O&M expense allowed in

the last rate case with not only the levels of actual expenses in 2006-2010, but also the budgeted levels of Production O&M expense in 2011-2015.

All of Gulf’s generating units that were in-service at the end of 2002 are now 9.5 years older. Exhibit RWG-1, Schedule 8 shows the age of the fleet in 2002 compared to 2012.

When one examines the trend of Production O&M expenses over both the 2006-2010 periods and the projected 2011-2015 period, the trend is generally upward. This is shown on Exhibit RWG-1, Schedule 7. As the age of the generating fleet increases, so does the cost necessary to maintain and repair the fleet. There are only two years during this period in which that relationship has not held true: 2009 and 2013. In each of those years, factors other than age cause a slight deviation from this discernable trend of cost increases. In 2009, the Production O&M expense declined from the 2008 level because Gulf made a conscious decision to avoid requesting a rate increase during a severe economic recession. In 2013, the projected O&M level of expenses is only modestly below projected 2012 levels, due primarily to a decrease in planned outage expense from $23,149,000 in 2012 to $18,886,000 in 2013. This reduction in planned outage expense in 2013 is driven by a smaller scope of outages. When these differences are explained, the general relationship between aging units and levels of operation and maintenance

expenses is clear – as units age, more must be spent on maintenance to maintain or improve reliability.

Q. Since Gulf’s last rate case has the projected useful life of your generating fleet changed?

A. Yes. Based on Gulf’s effective ongoing maintenance practices, we have been able to extend the projected retirement dates on many of Gulf’s units by up to 20 years. Exhibit RWG-1, Schedule 9 shows the estimated retirement dates included in the 2002 TYSP and the 2012 TYSP.

Q. What are the expected benefits of extending the projected lives of these units?

A. There are two major benefits. First, extending the lives of the units reduces the effective depreciation rate of the assets. This, in turn, reduces the need for rate relief. In addition, extending the lives of units allows Gulf to postpone the procurement or construction of additional resources. That also reduces or defers Gulf’s need for rate relief.

Q. Mr. Grove, the second reason you gave for projected O&M expenses for 2011-2015 being higher than historical expenses in the 2006-2010 period was an increase of certain costs at a rate greater than the rate of inflation. Please explain your observation.

A All other things being equal, if the same work was performed in 2002 and in 2012, one would expect the cost of the work to have risen close to the rate of inflation. However, that has not been the case; costs for the same scope of work have risen much faster than inflation. For example, in 2005, Plant Crist replaced the Lower Economizer on Unit 6 at a cost of $1,127,667 for material. The same work was performed again in 2010, and the cost of the material was $2,050,120. That is an increase of 81 percent, or a 16.4 percent increase each year. In comparison, the CPI rose cumulatively by only 11.64 percent between 2005 and 2010.

In its O&M benchmark calculations, the Commission uses CPI, which is a general measure of inflation for consumers. However, the rate of inflation for the work performed on generating units is better captured in other measures of inflation. The Producer Price Index (PPI) is a better overall measure for inflation than CPI when it comes to addressing Production O&M expense inflation. From the test year in Gulf’s last rate case through the 2012 test year requested in this case, CPI has risen 25.34%, while:

PPI - Turbine & Generator set manufactures has risen 37.4%;

PPI - Commodities - Metals and Metal Products has risen 64.3%;

PPI - Commodities - Iron and Steel has risen 95.2%; and

PPI - Industrial - Valve Manufacturing has risen 48.8%.

These escalation rates, which are more closely tied to Production O&M expenses than CPI, explain some of the increase in Production O&M expense between test periods.

Q. The third reason you gave for the increase of Production O&M expenses between 2006-2010 historical periods and the 2011-2015 projected period was the aging of a generator (Smith 3) that was relatively new in the historical period. Please address how that affects the relative levels of Production O&M expenses in those time periods.

A. In our prior rate case, Plant Smith Unit 3 was in its first full year of operation. As discussed later in the benchmark variance justification for Production Other, the budget for Plant Smith has risen significantly since the last rate case. Similarly, the average projected cost associated with Smith 3 in the period 2011-2015 of $7.3 million is $1.7 million higher than the average cost in the historical period 2006 through 2010 of $5.6 million. Once again, this increase is being driven by an increase in maintenance expense that is directly related to repairing equipment that was relatively new in the historical period.

Q. The fourth reason you gave for the increase of Production O&M expenses between the 2006-2010 historical period and the 2011-2015 projected period was the addition of new generating units (Perdido). Please address how this affects the relative levels of Production O&M expenses in those time periods.

A. Gulf added new generation at Perdido in October 2010. There were no O&M expenses associated with this facility in the years 2005 through 2009. In addition, there was less than a full year of expenses in 2010; however, the years 2011 through 2015 fully reflect the annual O&M expense associated with the Perdido facility.

Q. The final reason you gave as to why the 2012 level of Production O&M expenses is more representative of ongoing levels of Production O&M levels than the levels of Production O&M levels during the period 2006-2010 relates to Gulf’s efforts to control expenses to avoid asking for a base rate increase at a time when Gulf’s customers were struggling through the worst economic downturn since the Great Depression. Please address that point in more detail.

A. This is best explained by looking at the allowed Production O&M expenses in the 2002/2003 test year, the actual Production O&M expenses in 2006 through 2010 and the budget levels of Production O&M expenses for 2011 through 2015. There was a clear trend of an increase in Production O&M expenses from the 2002/2003 test year level of $76,996,000 in Gulf’s last rate case through the actual level in 2008 of $88,424,000. (Actual Production O&M expense for 2006 through 2010 is shown on Exhibit RWG-1, Schedule 7). Then, in 2009, Gulf decreased its Production O&M expenses to $84,209,000. This $4,215,000 reduction in Production O&M expenses was part of the effort that Gulf undertook to defer its need to ask for base rate relief.

This reduction in Production O&M expenses in 2009 was not done without careful deliberation. We prioritized our maintenance decisions to address critical issues. We took the approach of trying to perform as much maintenance as we could on our larger units that are dispatched more often, and we did not perform selective maintenance on smaller units which, if they experienced forced outages, would not as severely impact overall reliability.

A similar effort was undertaken in 2010, but in that year we could no longer drive down Production O&M costs. They had to increase. Although our internal budget process had developed and submitted a Production budget of $94,665,000, we were able to hold actual expenses to $92,889,000. Once again, we prioritized maintenance, but we did it to avoid having to ask for a base rate increase during a time of weak economic recovery and high unemployment. We made calculated risk assessments of what maintenance had to be performed. Our EFOR performance indicator shows Gulf was able to make these reductions while we continued to maintain excellent performance.

Q. Does the level of Gulf’s actual expenses in 2009 and 2010 indicate that it is not necessary for Gulf to spend Production O&M at the levels suggested by its 2011 budget process?

A. Absolutely not. A well maintained system such as Gulf’s can forego some scheduled maintenance for a limited period of time without a severe risk of adverse consequences. However, it cannot forego scheduled maintenance over an extended period of time without predictable adverse consequences in unit performance, system reliability and ultimately customer satisfaction. Gulf has no prudent choice other than to increase Production O&M expenses to avoid these adverse consequences. Continued operation at these levels of Production O&M is simply too risky for our customers. It is time to increase Gulf’s Production O&M expenses and recognize those levels on a going forward basis.

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

A. The O&M benchmark for Production is $96,507,000, as provided to me by Mr. McMillan. Gulf’s projected 2012 Production O&M expenses for 2012 are $110,888,000, which results in a benchmark variance of $14,381,000. This is shown on Exhibit RWG-1, Schedule 10.

Q. Does Gulf’s O&M benchmark variance for 2012 undermine your conclusion that Gulf’s 2012 Production O&M expenses are reasonable and prudent?

A. No. The O&M benchmark has never been, nor is it meant to be, a budgeting tool. It is a regulatory mechanism used to provide a reference point to reflect CPI growth between rate cases. As discussed by Mr. McMillan, benchmark variations may be explained by a variety of different factors. For example, an O&M increase due to the cost of compliance with a new regulatory requirement would be totally unrelated to inflation. Gulf’s projected 2012 Production O&M budget is the result of a sophisticated and robust budgeting process, and it is that process that assures that those projected expenses are reasonable and prudent. Indeed, that process has been used to justify Gulf’s entire Production O&M budget, not just the O&M benchmark variance.

Q. Please break down the $14,381,000 Production benchmark variance into Production Steam, Production Other, and Production Other Power Supply.

A. As shown on Exhibit RWG-1, Schedule 10, Production Steam is $9,965,000 over the benchmark, Production Other is $2,940,000 over the benchmark and Production Other Power Supply is $1,476,000 over the benchmark.

Q. Please justify Gulf’s $9,965,000 Production Steam O&M benchmark variance.

A. Gulf’s Production Steam O&M benchmark variance justification consists of two general categories. First, there are certain Production Steam O&M expenses in the 2012 test period that were not included in the test year of Gulf’s last rate case; therefore, these costs are not captured by the O&M benchmark calculation. These expenses total $3,559,000. Second, certain Production Steam expenses have grown faster than inflation since Gulf’s last rate case. This growth is explained both by increased scope of work and underlying costs that have risen faster than inflation as measured by CPI. This second group of Steam Production O&M expenses totals $7,565,000.

Q. Please justify the $3,559,000 of Production Steam O&M expenses that are new or incremental and therefore not captured in the O&M benchmark calculation.

A. None of the following Production Steam O&M expenses projected for 2012 were included in the Steam Production O&M expenses allowed in Gulf’s last rate case. Therefore, they are not captured in the O&M benchmark calculation. They are all new or incremental activities, and all of them are necessary for Gulf to provide continued reliable service to our customers.

* Genguard cyber security $ 550,000
* Research and Development (R&D) 370,000
* Renewable energy manager 150,000
* O&M improperly attributed to Scherer Unit 3 2,489,000

Total $3,559,000

Q. Please justify the $550,000 of O&M expenses associated with Gulf’s Genguard cyber security programs that were not projected to be incurred in Gulf’s last rate case.

A. The Genguard Cyber Security program is Gulf’s response to the need to ensure protection and reliability of the grid and to ensure compliance with the NERC Cyber Security policies of 2009. Gulf is required by law to comply with these policies, subject to penalties. Failure to comply with these policies would also expose Gulf’s system to reliability risks. The project improves cyber security and control for selected units whose loss potentially could impact the reliability of the grid. This is an entirely new activity that is necessary to meet requirements that have been imposed since Gulf’s last rate case.

Q. Please justify the $370,000 of O&M expenses associated with R&D projects that were not projected to be incurred in Gulf’s last rate case.

A. The test year of Gulf’s last rate case included $867,000 of R&D expenses. Escalating that amount by CPI (25.34 percent) results in an O&M benchmark for Steam Production O&M R&D expenses of $1,087,000. Gulf projects it will spend $1,457,000 on Steam Production O&M R&D expenses in 2012, resulting in a $370,000 benchmark variance.

This 2012 Steam Production O&M R&D expense benchmark variance is primarily due to Gulf’s participation in three ongoing projects: (1) Flue Gas Treatment, (2) the Power System Development Facility at Wilsonville, and (3) the 25 MW Carbon Capture center at Plant Barry in Alabama. As I discuss below, these projects are important to Gulf’s customers. Gulf, indeed the entire Southern system, relies heavily on coal generation, and efforts to control emissions in the face of new environmental emission regulations will be critical to keeping these units operating to serve customers.

The Flue Gas Treatment project screens, develops, and tests new technologies for more cost effective compliance with new and future power plant emission regulations. Power plant flue gas is treated with emissions control equipment, including the scrubber and Selective Catalytic Reduction system currently installed at Plant Crist. With proper development and testing, these technologies can be used to increase the collection of other emissions that are the subject of new regulations. These emissions include particulates, mercury and hydrochloric acid aerosols. However, other new technologies such as baghouses, activated carbon and wet electrostatic precipitation may still be required. Gulf’s customers benefit as a result of the knowledge gained through the program, which helps provide a foundation on which our decisions are made relative to the types of technologies that best suit our generating fleet. In our prior rate case, Gulf included $75,897 in our requested O&M expenses for this project. When escalated by CPI, the benchmark for this project is $95,000. Our request of $221,000 in the 2012 test year for Gulf’s share of the project creates a benchmark variance of $126,000.

Southern Company manages and operates the U.S. Department of Energy’s National Carbon Capture Center (NCCC), a focal point of the national effort to develop advanced technologies to reduce greenhouse gas emissions from coal-fired power plants. Working with scientists and technology developers, the NCCC, located at the Power Systems Development Facility in Alabama, screens, develops, and tests emerging technologies to capture carbon dioxide from coal-based power plants. The center accelerates carbon dioxide technology by offering infrastructure that bridges the gap between lab-scale research and large demonstration projects, providing a testing ground for the next generation of more cost effective, higher-performing carbon capture technologies. In 2012, Gulf’s portion of this R&D demonstration project is $178,000.

A portfolio of solutions is needed to provide timely and least cost reductions in carbon dioxide emissions from power generation sources. Accordingly, Southern Company, Mitsubishi Heavy Industries and the Electric Power Research Institute began construction of a 25 MW carbon dioxide capture and storage demonstration at Alabama Power’s Plant Barry. The demonstration involves the construction and operation of a 500 ton per day carbon capture plant. The captured carbon dioxide will be transported through an 11 mile pipeline and injected into a deep geologic formation near the Citronelle Oil Field. Extensive geologic formations like that found in the Citronelle area are common in the Southeast U.S. providing a large carbon dioxide storage capacity. In 2012, Gulf projects O&M R&D expenses of $219,000 for its portion of this demonstration project. If EPA’s carbon control rule is adopted or carbon control legislation is adopted, carbon capture and sequestration will become critically important and may be necessary for Gulf to preserve any coal fired generation.

Q. Please justify the $150,000 of 2012 Production Steam O&M expenses associated with Gulf’s Renewable Energy Manager that were not included in Gulf’s last rate case.

A. As I discussed earlier, Gulf is committed to obtaining cost-effective energy supplies for our customers and to obtaining the benefits of fuel diversity wherever practical. Gulf is also committed to encouraging and promoting renewable energy pursuant to several sections of Chapter 366, including Sections 366.82, 366.91, and 366.92, Florida Statutes. In order to effectively manage the continuous inquiries related to renewable energy projects and to develop cost effective supply side renewable projects, Gulf has created a Renewable Energy Manager position to deal with all issues associated with supply-side renewable energy. This position will play a critical role in developing Gulf’s overall renewable energy program in a manner that maximizes the benefits of emerging technologies while at the same time ensuring the impacts to our customers are minimized.

Q. You also mentioned that another $2,489,000 of 2012 Production Steam O&M expenses are projected for Gulf’s retail operations that were not included in Gulf’s Production Steam O&M expenses in the last rate case. Please explain.

A. In the 2012 test year, all expenses associated with Plant Scherer have been removed from the retail base rate calculation due to the fact that Gulf uses the output from Plant Scherer to serve wholesale contracts. In our prior rate case, Gulf also removed all expenses associated with Plant Scherer from our base rate calculation. However, in making that adjustment Gulf made an error and removed $1,986,000 of Steam Production expenses greater than the Steam Production expenses included in the financial projection for Plant Scherer. As a result of this error, Gulf’s request for Steam Production O&M expense in the prior rate case was $1,986,000 below what was actually needed for maintenance of Gulf’s territorial units. Since Gulf’s retail rates were set including this error, Gulf’s retail customers have received the benefit of this error for the past ten years. For 2012, only those O&M expenses specifically associated with Plant Scherer have been removed from Gulf’s request for Production Steam O&M expense.

The error discussed above accounts for $2,489,000 of the benchmark variance in 2012. Without this error in Production O&M expenses in Gulf’s last test year, Gulf’s 2012 Steam Production O&M benchmark would have been $91,098,000 million rather than $88, 609,000. Consequently, Gulf’s benchmark variance would have been $7,476,000 instead of $9,965,000. Gulf’s error, which has worked to the benefit of Gulf’s customers for almost a decade, should not be perpetuated into the future.

Q. Earlier you mentioned another type of Production Steam O&M expenses that was part of Gulf’s O&M benchmark justification – expenses that have grown faster than inflation as measured by CPI. Why have these expenses exceeded the O&M benchmark?

A. There are two reasons that these expenses (listed below) have exceeded inflation as measured by CPI. First, Gulf has expanded the scope of this work in 2012 relative to the scope of the work performed in the last test year of 2002/03 in Gulf’s last rate case. This expansion of scope is necessary and is representative of the expenses Gulf will incur on a going forward basis. Second, the costs associated with these types of expenses have escalated at a rate faster than the rate of inflation reflected in CPI, the measure of inflation used in the O&M benchmark calculation. These increases are beyond Gulf’s control.

The Production Steam O&M expenses that share these justifications are:

* Planned outage expenses $4,422,000
* Enterprise Solutions 587,000
* Fuels Management expenses 1,135,000
* Ash disposal and sales 1,421,000

Total $7,565,000

Q. Please discuss Gulf’s approach to planned outages.

A. Gulf has 12 generating units, and in 2012 there are 8 planned outages. A total of 40 planned outage weeks are scheduled across the fleet. The planned outage schedule varies from year to year based on the maintenance requirements of each generating unit and the need for adequate generating capacity in service to meet demand throughout the year. The planned maintenance forecast for 2012 is typical of the expected future planned outage requirements.

In general, Gulf plans outages on each unit every 18 to 24 months, unless conditions indicate a planned outage is needed sooner. Outage planning begins as soon as the previous outage is completed. Plant management, system owners, and unit owners continually evaluate unit performance and determine what items need to be addressed at the next outage. Prior to the unit outage the team meets to determine what specific items need to be addressed while the unit is off-line. The major equipment evaluated for each outage includes boilers, pulverizers, condenser systems, turbine valves and other auxiliary equipment.

Q. Please address why Gulf’s request for $22,016,000 for planned outages in Production Steam in the test year is representative of planned outage expenses in the future.

A. Exhibit RWG-1, Schedule 11 provides a detailed analysis of planned outage expense in Production Steam for the five-year period beginning with 2011. The planned outage expenses for the 2012 test year are $22,016,000. The prior year (2011) is budgeted for $21,923,000.

Q. How does Gulf’s 2012 Production Steam O&M planned outage expenses compare with Gulf’s planned outage expenses allowed in its last rate case?

A. Exhibit RWG-1, Schedule 11, page 2 of 2 shows the total outage expense requested for Production Steam in the last rate case was $14,037,000, which escalates to a benchmark amount of $17,594,000. The Gulf Production Steam request for the test year is $22,016,000, for a variance of $4,422,000.

Q. Why do Gulf’s 2012 planned outage O&M expenses for Production Steam exceed the O&M benchmark level of $17,594,000 based upon Gulf’s allowed level of planned outage expenses from its last rate case?

A. As I noted earlier in my testimony, there are two primary reasons. First, Gulf’s scheduled planned outages in the 2012 test year are much broader in scope than the planned outages in Gulf’s 2002/2003 test year. Even though Gulf will be performing fewer planned outages in 2012 than in the last test year, the dollars associated with the planned outages is much greater due to the increased scope of work needed to maintain reliability on an aging fleet.

Second, the cost of planned outages and the equipment and materials used in these outages have risen much faster than inflation as measured by CPI. These cost increases are beyond Gulf’s control and are not captured in the O&M benchmark calculation. For instance, turbine and generator set manufacturing costs, a critical part of the planned outages in 2012 at Plant Crist on Units 6 and 7, have risen 37.4 percent since the last test year, although CPI has risen only 25.34 percent. Similarly, industrial-valve manufacturing costs have risen 48.8 percent since Gulf’s last rate case whereas CPI has risen only 25.34 percent. Industrial valves are critical equipment in almost every outage. In each of Gulf’s planned outages in 2012, iron and steel will comprise component parts. The price of iron and steel commodities has risen 95.2 percent since Gulf’s last rate case, whereas the rate of inflation in the CPI benchmark calculation has risen only 25.34 percent. Similarly, the cost of metals and metal products, also used in Gulf’s planned outages in 2012, have risen 64.3 percent since Gulf’s last rate case, instead of the CPI increase of only 25.34 percent.

Q. Please address why the scope of planned outages assumed in the 2012 test year is appropriate.

A. As I have discussed throughout my testimony, Gulf has worked hard to maintain our fleet of generators in a manner that ensures high reliability. Our success is demonstrated in the testimony of Mr. Burroughs. We achieved this success while controlling cost to prevent Gulf from having to ask for a base rate increase at a time when our customers were recovering from a major hurricane and a major recession. However, we have reached a point where additional dollars are needed to maintain the reliability of our fleet. As one can see from the outages discussed below, the work we are planning simply includes the normal type of maintenance that is required to maintain our fleet of generation. Moreover, the work described below is indicative of the work we plan to continue on our entire fleet in the future. The following is a list of the outages planned for the test-year:

* Plant Crist Unit 6 has a 72-day planned outage to address turbine, turbine valves, generator, Selective Catalytic Reduction (SCR) tie-in, boiler inspection/repairs, fan/air preheater, pulverizers, and ash handling systems.
* Plant Crist Unit 7 has a 79-day planned outage to address turbine, turbine valves, generator, boiler inspection/repairs, fan/air preheater, condensate pumps, pulverizers, and ash handling systems.
* Plant Scholz Unit 1 has a 22-day planned outage to address off-line work orders and general boiler inspection.
* Plant Smith Unit 2 has a 23-day planned outage to address turbine valves, fans/ductwork, ash handling, boiler inspection/repairs, and boiler feed pumps.
* Plant Daniel Unit 1 has a 58-day planned outage to address turbine valves, fans/air preheater, pulverizers, ash handling, boiler inspection/repairs, and boiler feed pumps.
* Plant Daniel Unit 2 has a 9-day planned outage to address common equipment and install ductwork isolation blanks.
* Plant Daniel Unit 2 has an additional 7-day planned outage to address common equipment and remove ductwork isolation blanks.

Q. How do the planned outages scheduled in the 2012 test year compare to the prior test year planned outages?

A. The scope of the work on an outage has a direct impact on the cost of the outage. In the prior test year Gulf had outages scheduled on Crist Units 6 and 7, Smith Unit 2, and Daniel Unit 1. Gulf has scheduled outages on these same units in the current test year; however, the scope of the work in 2012 is much larger.

In the prior test year, the outage on Plant Crist Unit 6 included work on the boiler, pulverizers, precipitator and cooling towers. In 2012 Gulf will perform work on the boiler, pulverizers, and precipitator. However, Gulf will also perform significant work on the turbine ($2,400,000) and the generator ($2,200,000). The total benchmark variance for Plant Crist Unit 6 is $5,098,000.

In the prior test year, the outage on Plant Crist Unit 7 included work on the boiler, pulverizers, precipitator, turbine valves, and cooling towers. In 2012 Gulf will again perform work on the boiler, pulverizers, and precipitator. However, Gulf will also perform significant work on the turbine ($750,000) and the generator ($2,300,000). The total benchmark variance for Plant Crist Unit 7 is $3,899,000.

In the prior test year, the outage on Plant Smith Unit 2 included work on the boiler, ash handling, and pulverizers. In 2012 Gulf will again perform work on the boiler and pulverizers. However, Gulf will also perform significant work on the turbine valves ($750,000). The total benchmark variance for Plant Smith Unit 2 is $986,000.

In the prior test year, the outage on Plant Daniel Unit 1 included work on the boiler, pulverizers, generator and turbine. In 2012, Gulf will again perform work on the boiler and pulverizers. However, Gulf will also perform significant work on the nose arch of the boiler ($3,200,000). The total benchmark variance for Plant Daniel Unit 1 is $1,626,000.

Q. Mr. Grove, you justified Steam Production O&M outage expense benchmark variances totaling $11,609,000 for outages associated with four units due to increased scope of work and increased cost of materials since the last rate case. Why do you use only $4,422,000 of that benchmark variance in your benchmark variance justification?

A. All of the $11,609,000 of increased outage related Steam Production O&M expenses for these four units is justified by the increased scope of work and increased costs in 2012 relative to the last test year. However, there were some Steam Production outages in the last test year that are not scheduled again for 2012. So, to be conservative in my approach, I have netted the benchmark escalated costs of the projects that do not reoccur in 2012 against the $11,609,000 variance justification.

Q. Please justify the $587,000 of Production Steam O&M related to Enterprise Solutions forecast in 2012 that were not projected to be incurred in Gulf’s last test year and so are not in the O&M benchmark calculation.

A. As described by Gulf Witness Erickson, the Enterprise Solutions project consisted of the installation of Oracle and Maximo to replace the aging accounting, supply chain, and generation systems. Oracle and Maximo are used to input, process, and summarize accounting information. In addition, the system allows users to procure and pay for materials and services as well as manage work orders. Many of the previous systems were old, highly customized, and were becoming increasingly expensive to maintain. The expenses of $587,000 are the portion of Enterprise Solution expenses being charged directly to Production Steam that are above the level of expense charged for the old systems.

Q. Please address the $1,135,000 of Production Steam O&M fuels management expenses forecasted in the 2012 test year that are above the benchmark.

A. Gulf’s fuels management expenses have exceeded the benchmark as a result of a variety of changes in these activities:

* Railcar lease and management
* Fuel Services management and oversight
* Crist Scrubber limestone and gypsum management, and
* Plant Daniel fuel unloading expenses.

Since Gulf’s last rate case Plant Daniel has begun using Powder River Basin (PRB) Coal. This has increased the management oversight associated with this new coal supply and transportation requirement. Gulf has also changed the delivery mode for a majority of its coal supply from an exclusive barge transportation mode to rail and barge transportation. This shift in transportation mode has required Gulf to lease a fleet of open hopper railcars for the movement of coal from the coal’s origin to the Alabama State Docks in Mobile, Alabama. This fleet of railcars requires both logistic support and maintenance by our Fuel Services organization. Additional personnel were needed to perform these railcar management functions, and the labor, overhead, and expenses of these new employees are being included in Gulf’s O&M expenses. In 2012 these expenses will be $351,000 over the benchmark. The increased cost of managing the PRB coal is more than offset by associated fuel savings.

Since Gulf’s last rate case a new fuel accounting system (COMTRAC) was purchased to replace the original fuel accounting system (FAACS). This was necessary because the FAACS system software was no longer being technically supported due to outdated source code. In addition, more stringent accounting controls adopted as a result of Sarbanes-Oxley requirements made changes to the fuel accounting process necessary. As a result of accounting system upgrades and new accounting control requirements, additional O&M costs associated with management of software system and accounting oversight have been incurred by Fuel Services. Additional personnel were needed to perform these fuel accounting management functions, and the labor, overhead, and expenses of these new employees are being included in Gulf’s O&M expenses. In 2012 these expenses will be $355,000 over the benchmark.

Since the last rate case Gulf has added Flue Gas Desulfurization (scrubber) equipment at Plant Crist for the reduction of sulfur emissions. The scrubber uses limestone as a feedstock to react with sulfur in the gas stream which produces a synthetic gypsum product. The procurement and delivery of the limestone feedstock and the associated contract administration is being managed by Fuel Services, but it is not being recovered by Gulf in either the Fuel or ECRC clauses. In addition, the synthetic gypsum product is required to be disposed of in a beneficial use under an agreement between Gulf and the FDEP. This cost is not being recovered through ECRC. Fuel Services also manages the marketing and sales of Gulf’s synthetic gypsum to end users in the wallboard, cement, and agricultural industries. Additional personnel were needed to perform these limestone and gypsum management functions, and the labor, overheads, and expenses of these new employees are being included in Gulf’s O&M budget. In 2012 these expenses will be $264,000 over the benchmark.

Since our last rate case Mississippi Power Company (MPC) contracted with a third party to unload coal trains at Plant Daniel. This work was previously performed by MPC employees. Plant Daniel has leased additional equipment to handle the increased requirements of managing PRB coal inventory. In 2012 these expenses will be $367,000 over the benchmark. This increased cost is more than offset by fuel savings associated with burning PRB coal.

Other Fuel expenses increased at less than the O&M benchmark. Collectively, these expenses are $202,000 below the benchmark.

Q Please address why the cost of ash disposal and sales has increased beyond the benchmark.

A. In the prior test year, Gulf budgeted $918,000 for ash disposal and sales. Using the CPI adjustment, the benchmark for ash disposal and sales is $1,150,000. Gulf’s current request for ash disposal and sales is $2,571,000, resulting in a benchmark variance of $1,421,000.

Q. What has caused the cost of managing ash to increase beyond the CPI benchmark?

A. The ash disposal expense included in the test year, which is above the benchmark by $1,421,000, is necessary to manage ash and meet all environmental requirements at our four coal electric generating facilities. The major change in ash handling expense is not driven by an increase in volume as one might expect. The ash contracts (which are competitively bid) are renegotiated every three or four years, and the contract price to handle ash has exceeded CPI growth. As an example, in 2002 the contract for managing ash at Plant Crist was $339,000; in 2012 the contract is $800,000, or an increase of 136 percent. This is far beyond the 25.34 percent increase used in the benchmark calculation. Another contributing factor is that in the prior test period Plant Daniel was able to dispose of ash by selling the ash in the market. Such sales are no longer available. The change in the market for ash sales has reduced revenues which previously were credited against ash disposal costs.

Plant Crist has increased the budget for removing solids from the ash pond settling basins by approximately $250,000 in order to meet the more stringent water quality standards required by Gulf’s National Pollution Discharge Elimination System industrial wastewater permits. The stringent water quality-based copper effluent limitations included in Chapter 62 Part 302, Florida Administrative Code, became effective in May 2002.

The ash disposal expense included in the 2012 test year is necessary to manage ash and meet all environmental requirements at our four coal electric generating facilities.

Q. Please justify Gulf’s $2,940,000 Production Other O&M benchmark variance.

A. Expenses in this area relate mainly to the Plant Smith Unit 3 Combined Cycle and the Perdido Landfill gas to energy project. The following is a list of projects that have caused Gulf to exceed the benchmark calculation:

* Plant Smith Unit 3 planned outage $830,000
* Plant Smith Unit 3 maintenance 845,000
* Gas Fuel Management 593,000
* Perdido 770,000

Total Other Production $3,038,000

Q. How old was Smith Unit 3 at the time of Gulf’s last rate case?

A. Smith Unit 3 went into commercial service in April 2002, approximately two months earlier than projected. The test year for the last rate case was June 2002 through May 2003, which corresponded with the first twelve months that Smith Unit 3 was projected to be in service. At the end of 2002, Smith Unit 3 had been in service nine months.

Q. How old will Smith Unit 3 be at the midpoint of the 2012 test year?

A. At the midpoint of the 2012 test year, Plant Smith Unit 3 will be ten years old.

Q. How has the relative age of Smith Unit 3 affected the level of Production Other O&M expenses in the projected test year versus the test year in Gulf’s last rate case and the O&M benchmark calculation?

A. Because Smith Unit 3 was a new unit in Gulf’s last rate case and will be over a decade old in the 2012 projected test year in this case, there are far more O&M expenses projected for Smith Unit 3 in the 2012 test year. Since the O&M expenses associated with Smith Unit 3 comprise a significant portion of Gulf’s Other Production O&M expenses, a major portion of the O&M benchmark variance for Other Production is justified by examining the Smith Unit 3 O&M expenses.

Q. What is the O&M benchmark level of Smith Unit 3 planned outage expenses escalated from the last test year to 2012?

A. Exhibit RWG-1, Schedule 11, page 2 of 2 shows the total outage expense requested for Production Other in the last rate case was $242,000. That escalates to an O&M benchmark amount of $303,000. Gulf’s Smith Unit 3 planned outage expense for the test year is $1,133,000, which results in a benchmark variance of $830,000.

Q. Why is the 2012 Smith Unit 3 planned outage expenses of $830,000 over the O&M benchmark?

A. This is due to a combination of factors. First, Smith Unit 3 is no longer new. It has aged, and like other units, with the passage of time, more O&M expenses are required. Second, the scope of the planned outage at Smith Unit 3 in 2012 is appreciably larger than the scope of the Smith Unit 3 planned outage included in the 2002/03 test period. In Gulf’s last rate case, most of the $241,000 was budgeted for work on the turbine system and the heat recovery steam generator. In the current test year, the planned outage scope includes work on the gas supply system, generator system, cooling towers, condenser/hotwell system, boiler feed

pumps, air and gas system, combustion turbine system, heat recovery steam generator valves and piping, and the control system.

The scope of the planned outage at Smith Unit 3 in 2012 has been developed based upon the manufacturer’s recommended maintenance schedule, the expertise of the capable people at Gulf who operate and maintain Smith Unit 3 and Gulf’s Production Management Team. This scope of work is necessary to preserve the reliability and performance of this valuable generating asset.

Q. Please discuss the $845,000 O&M expenses over the benchmark for maintenance related to the Smith Unit 3.

A. There are three major systems at Smith Unit 3 that are causing maintenance to exceed the O&M benchmark. Those three systems are the feedwater system, the combustion turbine system and the heat recovery steam generator system.

The feedwater system includes a vast amount of transport piping, drains and valves. All of this is insulated and much of the piping is elevated above ground level. We have been steadily replacing components as needed to prevent reliability issues. The majority of the work requires scaffold and insulation removal and reinstallation. Components are being changed from carbon steel to stainless steel to increase longevity while helping to control future costs. This work represents $130,000 of the benchmark variance.

The combustion turbine system also contains piping, drains, and valves. Additionally, multiple platforms, enclosures, exposed motor and electrical boxes are being replaced. Where possible, components are being replaced with stainless steel to increase longevity while helping to control future costs. This work represents $370,000 of the benchmark variance.

The heat recovery steam generator requires the same type of ongoing maintenance as the feedwater and combustion turbine systems. Piping, valves, platforms, and handrails are commonly replaced. Various paint coatings are also being applied to assess their impact on longevity and the future cost control. This work represents $670,000 of the benchmark variance.

Other maintenance that will be performed on Smith Unit 3 will increase at less than the O&M benchmark. Collectively, these expenses are $325,000 below the benchmark.

Q. Please discuss the $593,000 of Production Other O&M expenses related to the gas procurement program.

A. Smith Unit 3 was Gulf’s first large scale gas asset, and in the prior rate case no dollars were requested to support the gas program. The $593,000 of Production Other O&M expenses for the gas procurement program covers procuring gas, managing the transportation contract, and managing the hedging program for Smith Unit 3. In addition, these dollars include the gas procurement program for Gulf’s three PPAs totaling over 1,350 MW.

Q. Please justify the $770,000 of 2012 Production Other O&M expenses associated with the Perdido landfill gas to energy facility that were not included in Gulf’s last test year.

A. As I discussed earlier, in July 2008, Escambia County, Florida issued an RFP for the sale of landfill gas from its Perdido landfill. Landfill gas is defined as a renewable energy resource pursuant to section 366.91(2), Florida Statutes. The Florida Legislature has repeatedly stated that it is in the public interest to promote the development of renewable energy resources in the state. They recognized that renewable energy reduces dependence on natural gas, minimizes volatility of fuel costs, encourages investment in the state and improves environmental conditions. To address these legislative concerns, Gulf began to evaluate the possibility of developing a project to utilize the gas being offered within this RFP.

In order to minimize or negate any impact to our customers, Gulf used the RSOC as the basis for determining the price Gulf would be willing to pay the County for its gas. Using the established avoided cost concepts, Gulf submitted a bid for the procurement of the landfill gas being offered under this RFP.

The O&M dollars used in this evaluation were part of the overall assessment of avoided cost for the Perdido project. As a result, the cost is prudent, necessary and reflective of expenses going forward.

Q. Please justify Gulf’s $1,476,000 Production Other Power Supply O&M benchmark variance.

A. Expenses in Production Other Power Supply that exceed the benchmark are related to the following:

* Energy Management Systems $486,000
* Resource Planning 79,000
* Fleet Operations and Trading 700,000
* Financial and Contract Services 277,000

Production Other Power Supply $1,542,000

Q. Please justify the $486,000 of 2012 Production Other Power Supply O&M expenses associated with the Energy Management Systems that are over the Benchmark calculation.

A. Energy Management System budget increases over the last 10 years are a reflection of expanding industry regulations as well as increasing complexities in managing the bulk electric system. Bulk Power Operations (BPO) is responsible for ensuring a reliable and economic operation of the bulk electric system and as such provides direct benefit to Gulf.  The Sarbanes-Oxley Act of 2002 and the Energy Policy Act of 2005 (along with the resulting establishment of the Electric Reliability Organization and mandatory reliability standards) have resulted in additional processes, procedures, application features, new tools, and resources to maintain and demonstrate compliance with the industry regulations.  In addition to the regulatory requirements, new business requirements related to power purchase agreements at Plant Dahlberg, Coral Baconton, and Central Alabama that directly benefit Gulf Power have been implemented.

The additional complexity related to the bulk electric system stems from a need to continuously improve our ability to collect and manage supervisory control and data acquisition assets in compliance with regulatory requirements and support business requirements. Over the past 10 years, BPO and Energy Management Systems (EMS) have continued to enhance current systems and implemented new systems, such as operator training simulators, N-1 contingency analysis, situational awareness, and transient stability analysis. Implementation of these technologies has a direct benefit to Gulf Power associated with operating the transmission system at an increased level of reliability due to the advancements of these technologies. The operator training simulators are a benefit because they afford our Power Systems Coordinators (PSCs) the opportunity to participate in training that provides Continuing Education Hours, thus helping the PSCs maintain their NERC Certification. Without such technology and training improvements, Gulf’s ability to manage its increasingly complex bulk electric system would decline, system reliability would deteriorate and customer satisfaction would drop. As a direct result of these additional technologies and business requirements, BPO and EMS have increased their need for resources and have increased their reliance on application/tools to increase efficiency and reduce risk of errors.

Q. Please justify the $79,000 of 2012 Production Other Power Supply O&M expenses associated with the Resource Planning that are over the Benchmark calculation.

A. The Resource Planning Organization is responsible for developing generation mix studies, Integrated Resource Planning, environmental compliance evaluations and supporting RFP development for supplying generation resources to meet our retail customers’ growing demands. In addition, they support the eventual development of contracts (PPAs) and contract negotiations that develop as a result of an RFP. The complexities associated with planning at a time with so much uncertainty related to potential environmental legislation have also resulted in additional expenses. Additional personnel are needed to support the overall planning process, and the labor, overhead, and expenses of these new employees are being included in Gulf’s O&M expenses.

The prior test year budget for planning was $124,000, resulting in a benchmark of $155,000. In the 2012 test year Gulf has budgeted $234,000 for Resource Planning. This results in a variance of $79,000. The O&M dollars budgeted for generation planning are prudent and necessary to insure the Company has adequate generation to meet our customers’ needs.

Q. Please justify the $700,000 of 2012 Production Other Power Supply O&M expenses associated with the Fleet Operations and Trading that are over the Benchmark calculation.

A. Fleet Operations and Trading (FOT) is responsible for ensuring a reliable and economic generation supply for the Pool.  Budget increases in FOT over the last 10 years reflect the ever-increasing complexity in managing the generation Pool and growing compliance requirements.

The additional complexity related to the Pool stems from an increased reliance on third-party generation and contract implementation for those resources, as well as managing new challenges in operations.  FOT has implemented numerous new contracts including Gulf’s PPAs for facilities located at Plant Dahlberg, Coral Baconton, and Central Alabama.

With respect to regulatory and compliance requirements, FOT responsibilities have increased in areas such as NERC requirements, energy auction, market based rates and generation dominance analysis.  As a direct result of these additional complexities, FOT has increased its reliance on application/tools to increase efficiency and reduce the risk of errors.

Q. Please justify the $277,000 of 2012 Production Other Power Supply O&M expenses associated with the Financial and Contract Services that are over the Benchmark calculation.

A. Financial and Contract Services manages the billings for capacity and energy purchases (PPAs), which ultimately provide energy to our retail customers. This includes Gulf’s PPAs for power from the facilities located at Plant Dahlberg, Coral Baconton and Central Alabama. The costs associated with these contracts are incremental to our prior rate case, and each of these contracts provides value to our retail customers. The other services provided by the Financial and Contract Services group include

(a) wholesale fuel and emission reconciliations which document the wholesale portions of these costs to ensure retail customers do not subsidize the wholesale customers, (b) administration of the Intercompany Interchange Contract, (c) and Pool Billing. The increase in expenses associated with the Financial and Contract Services group are a direct result of additional workload associated with an increase in the number and complexities of contracts used to support Gulf’s retail customers. The benchmark variance of $277,000 is prudent and necessary to effectively support Gulf’s PPAs.

**V. 2012 PRODUCTION WORKFORCE**

Q. Mr. Grove, at the end of 2010, Gulf had 342 full time equivalent (FTE) employees in the Production function. In the test year Gulf has budgeted labor costs equivalent to 394 FTE employees in Production. Why does Gulf need to add 52 FTEs in Production by 2012?

A. At the end of 2010, three years of holding the line on Production O&M expenses to help avoid asking for a base rate increase had taken a toll on Gulf’s Production labor force. It was clear that it was necessary to hire additional employees in the Production function to be able to perform not only baseline maintenance, but also a broader scope of unit outages. This increased personnel requirement was reflected in the 2011 O&M budget cycle.

Q. What is the status of Gulf filling the 52 FTE positions budgeted for 2012 that were vacant at the end of 2010?

A. We are in the process of filling the positions with the exception of the positions at Plant Scholz. We plan to have the majority of the positions filled by the end of 2011. I will discuss the status of the positions as they relate to the Power Generation Office, Plant Crist, Plant Smith and Plant Scholz.

Q. Please address the projected additional workforce at the Power Generation Office.

A. As of December 2010, there was one vacant position, the Renewable Energy Manager, at the Power Generation Office. The previous incumbent took a position at Alabama Power at the end of 2010, and Gulf hired a replacement in March 2011. I have previously justified this incremental position in the O&M benchmark justification section.

Q. Please address the projected additional workforce at Plant Crist.

A. At Plant Crist, there were 15 vacancies at the end of 2010 that we are in the process of filling. These 15 vacancies, as well as five new positions at Plant Crist, are set forth by position and budget type on Exhibit RWG-1, Schedule 12. Six of the positions at Plant Crist will either be charged to capital projects or the Environmental Cost Recovery Clause. Also note that five of the positions are for Utilitypersons. These are entry level positions that form the pool for future mechanics, electricians, or operators. It is our intent to fill all 20 of these positions. A complete work force capable of performing all necessary operation and maintenance at this site is in the best interest of Gulf’s customers.

Q. Please address the projected additional workforce at Plant Smith.

A. At Plant Smith, there were 23 vacancies at the end of 2010 that are included in Gulf’s 2012 O&M budget. These 23 vacancies are set forth by position and budget type on Exhibit RWG-1, Schedule 12. Gulf has filled or is in the process of filling all except 2 of these 23 vacancies. There are two positions that are open. An Instrument and Control (I&C) Specialist position is currently on hold pending resolution of uncertainty regarding environmental regulation. This open position is included in Gulf’s 2012 O&M budget. The second open position is for an Operations Team Leader, and that position is being used as a developmental position. That position will be filled by the end of 2011. Eight of the 23 positions are for entry level Utilitypersons. These are entry level positions that form the pool for future mechanics, electricians, or operators. With the exception of the I&C Specialist, all other positions at Plant Smith that were vacant at year end 2010 are scheduled to be filled.

Q. Please address the vacancies at Plant Scholz at year end 2010 and whether those positions are likely to be filled by 2012.

A. At year end 2010 there were 26 filled positions at Plant Scholz, and in 2012 Gulf has budgeted a full complement or 34 positions at Plant Scholz. The eight vacancies at Plant Scholz are set forth by position and budget type on Exhibit RWG-1, Schedule 12.

Due to current uncertainty associated with environmental regulations, Gulf has not begun to fill these eight vacant positions at Plant Scholz. Contract labor and temporary reassignments from Plant Smith have been used to supplement the workforce at Plant Scholz. Although Gulf has chosen not to fill those positions until there is more clarity about prospective environmental regulations, the labor expenses included in the 2012 test year are appropriate for the ongoing operation of this plant.

**VI. SUMMARY**

Q. Please summarize your testimony.

A. Gulf maintains and operates a diverse set of generation resources designed to serve our customers economically and reliably. Since our last rate case, Gulf has made sound generation planning decisions that were clearly in the best interest of our customers. In the case of the Central Alabama PPA, the Company was able to defer potentially large construction expenditures with a solid contract that is expected to provide over $500 million (NPV) in savings to our customers.

Gulf’s Production operation continues to provide low cost, reliable electric service to our customers to meet their increasing demand for electricity. The reliability of Gulf’s generating units and low EFOR are clear indications that Gulf has executed an effective maintenance program that continues to provide our customers with reliable service. Gulf is committed to maintaining our generating facilities through the effective use of resources that focuses not only on reliability but also efficiency.

Gulf’s entire Production, Other Production, and Other Power Supply investment should be included in Gulf’s rate base. This property is used and useful in providing service to Gulf’s customers. Moreover, the investment has been reasonably and prudently incurred and managed.

Gulf’s Production capital additions and O&M expenses are carefully controlled and utilized in a manner to ensure high availability and low EFOR. The $110,888,000 budgeted for Power Production O&M and $43,738,000 budgeted for Capital Additions in the test year are reasonable, prudent, and necessary expenditures and should be included in establishing Gulf’s base rates.

Q. Does this conclude your testimony?

A. Yes, it does.

AFFIDAVIT

STATE OF FLORIDA ) Docket No. 110138-EI

)

COUNTY OF ESCAMBIA )

Before me the undersigned authority, personally appeared Raymond W. Grove, who being first duly sworn, deposes, and says that he is the Manager of Power Generation Services for Gulf Power Company, a Florida corporation, and that the foregoing is true and correct to the best of his knowledge, information, and belief. He is personally known to me.

The signed original affidavit is attached to the

original testimony on file with the FPSC.

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

Raymond W. Grove

Manager of Power Generation Services

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: R. W. Grove

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

Schedule 1

Responsibility for

Minimum Filing Requirements

Schedule Title

B-11 Capital Additions and Retirements

B-12 Net Production Plant Additions

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-34 Statistical Information

C-41 O&M Benchmark Variance by Function

F-5 Forecasting Models

F-8 Assumptions

Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 2

Page 1 of 2

**Total Capacity 2,625 MW**



Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 2

Page 2 of 2

**Total Capacity 3,852 MW**



Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 3

**Owned and Operated or Jointly Owned Generating Capacity**

Commercial

Unit Description Net Generation Operation Date

(MW)

Crist Unit 4 75 July 1959

Crist Unit 5 75 June 1961

Crist Unit 6 291 May 1970

Crist Unit 7 465 Aug 1973

Smith Unit 1 162 June 1965

Smith Unit 2 195 June 1967

Smith Unit 3 556 Apr 2002

Smith Unit A 32 May 1971

Scholz Unit 1 46 Mar 1953

Scholz Unit 2 46 Oct 1953

Pea Ridge Unit 1 4 May 1998

Pea Ridge Unit 2 4 May 1998

Pea Ridge Unit 3 4 May 1998

Perdido Unit 1 1.6 Oct 2010

Perdido Unit 2 1.6 Oct 2010

Daniel Unit 1 255 Sep 1977

Daniel Unit 2 255 Jun 1981

Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 4

**Power Purchase Agreements**

Agreement Technology Fuel MW Start Date End Date

Bay County Steam MSW 11 July 2008 July 2014

Coral Baconton CT Gas/Oil 196 June 2009 May 2014

Dahlberg CT Gas/Oil 292 June 2009 May 2014

Central Ala. CC Gas 885 Nov 2009 May 2023

Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 5

Page 1 of 2

**2011 Production Capital Additions Budget**

($000)



Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 5

Page 2 of 2

**2012 Production Capital Additions Budget**

($000)



Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 6

2012 Production O&M Budget

($000’s)

2012

Test Year

Description Amount

Steam Production 98,574

Other Production 7,801

Other Power Supply 4,513

Total Production 110,888

Excludes Environmental Cost Recovery O&M and Plant Scherer

Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 7



Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 8

**Owned and Operated or Jointly Owned Generating Capacity**

**(Age of generating fleet in 2002 compared to 2012)**



Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 9

**Owned and Operated or Jointly Owned Generating Capacity**

**2002 Ten Year Site Plan Compared to 2012 Ten Year Site Plan**



Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 10



Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 11

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Florida Public Service Commission Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. W. Grove

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Schedule 11

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GULF POWER COMPANY

Witness: R. W. Grove

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

Schedule 12

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