GULF POWER COMPANY

Before the Florida Public Service Commission

Prepared Direct Testimony of

R. Scott Teel

Docket No. 110138-EI

In Support of Rate Relief

Date of Filing: July 8, 2011

Q. Please state your name and business address.

A. My name is Scott Teel. My business address is One Energy Place, Pensacola, FL 32520.

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

A. I am employed by Gulf Power Company (Gulf or the Company) as Vice President and Chief Financial Officer (CFO).

Q. What are your responsibilities as Vice President and CFO?

A. I am responsible for maintaining the overall financial integrity of the Company. My areas of responsibility include the Accounting, Corporate Secretary, Treasury, Regulatory Matters, Corporate Planning, and Supply Chain Management departments. I am also responsible for maintaining the overall financial and accounting records of the Company. Gulf maintains its books and records in accordance with Generally Accepted Accounting Principles in the U.S. (GAAP) and the rules and regulations prescribed for public utilities in the Uniform System of Accounts published by the Federal Energy Regulatory Commission (FERC), and adopted by the Florida Public Service Commission (FPSC or the Commission).

Our books and records are audited by Deloitte LLP, independent public accountants, and a copy of their latest audit opinion is included in the Company’s 2010 Annual Report to Stockholders, which is filed as MFR F-1 in this case. Gulf’s books and records are also subject to periodic review by the FERC and the FPSC.

Q. Please state your prior work experience and responsibilities.

A. Prior to moving to Gulf in 2010, I served as the Vice President and CFO for Southern Company Operations. In that role, I was responsible for the financial services of the Power Generation and Transmission organizations, which included budgeting and reporting, wholesale generation contract services, Open Access Transmission Tariff (OATT) administration and billings, and internal controls. I was also responsible for the Fleet Operations and Trading functions. Other roles that I have filled at Southern Company include Energy Trading Manager in Fleet Operations and Trading, and Assistant to Southern Company’s Executive Vice President and CFO. Prior to joining Southern Company, I held various positions at Ernst & Young and Sonat.

Q. What is your educational background?

A. I graduated from the University of Alabama in 1992 with a Bachelor of Science in Commerce and Business Administration and a major in Accounting.

Q. Do you hold a professional license or certification?

A. I am currently an inactive member of the Alabama Society of Certified Public Accountants.

Q. What is the purpose of your testimony?

A. My testimony begins with an explanation of the actions Gulf has taken to avoid a base rate increase for almost a decade, particularly over the last several years during an especially difficult economic period for our customers. I then explain the Company’s decision to use a projected 2012 test year for ratemaking purposes and the drivers behind the request for rate relief. I discuss the importance of the rate relief Gulf is requesting to Gulf’s financial integrity and credit quality. I also discuss Gulf’s capital structure and cost of capital. Finally, I explain why it is not appropriate to make a parent debt adjustment to Gulf’s income tax expense in determining our revenue requirement.

Q. Are you sponsoring any exhibits?

A. Yes. I am sponsoring Exhibit RST-1, consisting of Schedules 1 to 11. Exhibit RST-1 was prepared under my supervision and direction, and the information contained in that exhibit is true and correct to the best of my knowledge and belief.

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

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

**I. GULF’S EFFORTS TO AVOID A BASE RATE INCREASE**

Q. When was Gulf’s last base rate increase?

A. Gulf’s last base rate adjustment became effective on June 7, 2002. By the time this proceeding is complete, it will have been almost ten years between Gulf’s base rate increases. The Commission’s decision granting Gulf’s last base rate increase was in Order No. PSC-02-0787-FOF-EI in Docket No. 010949-EI.

Q. What major events and challenges has Gulf had to address in the decade since its last rate case?

A. Over the last decade Gulf has weathered a number of events and met significant challenges while continuing to provide reliable service to a growing customer base without increasing base rates.

The day after Gulf’s last rate case filing was made, the mindless destruction of the World Trade Center occurred. Our government responded by heightening security, including security associated with critical infrastructure like the power grid. In order to increase security for critical pieces of infrastructure, Gulf has taken measures to improve physical security at substations and generation plants, including security checkpoints, cameras and other monitoring equipment. Additional measures have also been taken to improve cyber security.

The years 2004 and 2005 brought a number of major hurricanes to the continental United States and the Gulf Coast, including several in Gulf’s service area. Gulf was recognized for its prompt response in restoring service and hope in the aftermath of these disasters. In both 2004 and 2005, the Edison Electric Institute awarded Gulf the Emergency Response Award for hurricane restoration in our service area and the Emergency Assistance Award for the Company’s assistance to other companies who suffered hurricane damage. Gulf’s efficiency and cost consciousness minimized the financial impact on its customers. These storms, however, have had lasting impacts on Gulf’s distribution system as described by Gulf Witness Moore in his testimony. In addition, mandated storm hardening requirements have been enacted. These requirements are designed to benefit customers in terms of mitigating service interruptions, but they have imposed additional costs on Gulf and our customers.

In 2008, the United States experienced a near complete meltdown of its financial system, triggering a deep economic recession more severe than any since the Great Depression. This economic downturn affected Gulf on many levels. Thousands of jobs were lost in Gulf’s service area, making it difficult for customers to pay their bills and increasing Gulf’s bad debt expense. The impacts to the local economy stalled sales growth and resulted in a decline in Gulf’s base revenues. At the height of the financial crisis, the availability of commercial credit was severely limited; however, due to its strong financial position and credit ratings Gulf’s access to the capital markets was not disrupted.

Then, to finish the decade, the entire Gulf Coast experienced an unprecedented environmental catastrophe in the form of an enormous oil spill. Prior to the oil spill, the tourism and recreation industry in Northwest Florida showed signs of recovery from the recession. The oil spill interrupted this recovery and resulted in significant reductions in tourism and associated recreational activities.

During this momentous decade, Gulf Power has successfully undertaken and performed its duty to serve the public. Despite these major challenges and associated rising costs, Gulf has maintained system reliability and customer satisfaction.

Q. How has Gulf managed to avoid requesting base rate relief for almost a decade?

A. There are a number of factors that have contributed to Gulf’s ability to maintain the same base rates for nearly ten years. The combination of stable economic growth in its service area for most of this period and Gulf’s effective management of its resources are primary factors. The regulatory framework in Florida has also been effective in allowing for the recovery of certain prudent costs without a costly and lengthy base rate proceeding. Finally, Gulf has taken additional steps over the past several years to avoid a rate increase during the recession. All of these factors have allowed Gulf to provide reliable service at a reasonable cost to its customers without a base rate increase for close to ten years.

Q. What additional steps has Gulf undertaken to avoid asking for a base rate increase during the recession?

A. The Company has taken a number of actions over the last several years in an effort to avoid a base rate increase to customers. As Gulf Witness Buck discusses in his testimony, Gulf employs a rigorous annual planning and budgeting process which prioritizes resources and assures that customer needs are met in a cost-effective manner. As discussed by Gulf Witnesses Grove, Moore, and Caldwell, spending for production, distribution, and transmission has been closely managed. At the same time, concentrated efforts have been made to continue to provide reliable electric service to our customers. Gulf’s excellent performance statistics are an indication that our system has been well maintained and is operating efficiently and cost-effectively.

As Mr. Grove describes in his testimony, through Gulf’s effective ongoing maintenance practices, the Company has been able to extend the expected useful life of many of its generating units by as much as twenty years. This reduces annual depreciation expense and postpones the next need for additional generation resources.

In 2009, Gulf made further efforts to control costs during the economic recession by implementing restrictions on hiring and granting no merit raises to non-union employees.

The Company has done its best to reduce expenses during the difficult economic times that have faced us all the last few years. Now, Gulf finds that additional revenues are necessary to continue to provide quality service and maintain our financial integrity.

**II. TEST YEAR**

Q. What test year has Gulf used to calculate its proposed rate increase?

A. Gulf has chosen a 2012 projected test year. The test year projections were developed as part of Gulf’s 2011 budget process. As described in more detail by Mr. Buck, Gulf’s annual budget process produces a budget for the current year and a budget forecast for the four subsequent years. The 2011 “prior year” shown in the MFRs is also the result of the 2011 budget process, while the 2010 “historical year” reflects actual results for that year.

Q. Please explain why 2012 was chosen as the test period.

A. The 2012 test year is the best representation of Gulf’s expected future operations. The 2012 test year properly matches Gulf’s projected revenues with the projected costs and investment required to provide service to customers during the period following the effective date of the new, permanent rates in this case. Gulf’s use of a projected test year is also consistent with the Commission’s long-standing practice to approve projected test years.

The most recent historic year is 2010, which is not representative of expected revenues and expenses on a going forward basis. During 2010, Gulf made significant efforts to curb capital and O&M spending levels to avoid having to request base rate relief during the recession. Also in 2010, base revenues were still in decline from peak levels in 2007. The 2012 revenue forecast is more representative of the revenues for the period the new rates will be in effect. The operating conditions experienced by the Company during the depths of the economic downturn simply are not indicative of future operating conditions.

**III. GULF’S RATE REQUEST**

1. What is the amount of base rate relief that Gulf is requesting in this case?
2. Gulf is requesting an annual increase of $93,504,000 in base revenues. This is the amount necessary for Gulf to continue to provide quality service to its customers and give Gulf the opportunity to earn a fair rate of return of 11.7 percent on its common equity, as supported by the testimony of Gulf Witness Dr. Vander Weide.

Q. Why is it necessary for the Company to seek rate relief at this time?

A. As shown on Schedule 2 of my exhibit, since 2007 Gulf’s rate base and O&M expenses have increased substantially while base rate revenue growth has stagnated.

During this period Gulf has made significant investment in production assets and transmission and distribution facilities. By 2012 Gulf’s rate base will have increased by more than $375 million since 2007. These investments are necessary to maintain system reliability and to meet demand growth.

Similarly, despite extraordinary efforts to hold the line on spending in order to avoid a base rate increase during a recession, Gulf has experienced significant increases in O&M expenses. As Gulf’s witnesses testify, many of these O&M cost increases are explained by new regulatory requirements, broader work scope associated with aging equipment, and the replacement of outdated computer applications. Meanwhile, the costs of materials and employee benefits are increasing at rates far in excess of the rate of inflation as measured by the Consumer Price Index (CPI). Gulf has undertaken significant efforts to control insurance, retirement and medical benefit costs, yet all of these necessary expenses have far outpaced the growth of CPI.

The result is a precipitous decline in the Company’s earned rate of return. Gulf’s currently authorized range for return on equity is from 10.75 percent to 12.75 percent. As shown on Schedule 3 of my exhibit, Gulf’s earned rate of return on equity has been below the bottom of the range since mid-2010. As of March 31, 2011, Gulf’s earned rate of return on equity had fallen to 6.83 percent. It is projected to fall to 2.83 percent by year-end 2012, absent base rate relief. Base rate relief is essential for Gulf to sustain its financial integrity, preserve its ability to raise capital on reasonable terms and continue to provide the reliable service that our customers expect.

**IV. CREDIT QUALITY & FINANCIAL INTEGRITY**

Q. Mr. Teel, please describe the strength of Gulf’s financial position since the last rate case and currently.

A. Gulf has maintained a strong financial position, as evidenced by the credit ratings of the three major credit rating agencies. Gulf has sustained long-term debt ratings in the “A” category and short-term debt ratings in the correlating categories since 2002. Schedule 4 of my exhibit is a table depicting Gulf Power’s current credit ratings from each of the rating agencies for both long-term and short-term debt.

Q. What rating conventions are used by each of the credit rating agencies to distinguish companies’ credit quality?

A. Each credit rating agency has its own conventions; however, each uses a variation of “A” ratings for companies of the highest credit quality. The rating conventions and scales for long-term debt of all three agencies are shown on Schedule 5 of my exhibit.

Q. What credit ratings does Gulf target?

1. Gulf targets “A” ratings for its long-term debt, specifically A ratings by Standard and Poor’s and Fitch, and A2 by Moody’s. Gulf targets equivalent ratings for its short-term debt, A-1 by Standard & Poor’s and

F1 by Fitch. Moody’s does not rate Gulf Power’s short-term debt.

Q. Why is it necessary to maintain these targeted credit ratings?

A. Maintaining these targeted credit ratings for both long-term debt and short-term debt are critical for Gulf and its customers. Strong credit ratings ensure access to capital and allow Gulf to provide reliable service at the lowest financing costs possible. An electric utility’s obligation to serve requires continuous access to capital markets to fund the maintenance of and investment in the assets needed to reliably generate and deliver electricity.

Q. Please explain the importance of long-term and short-term debt.

A. Long-term debt is appropriate for the financing of long-lived assets. Strong credit ratings for long-term debt are especially important during a period of significant investment. As shown on Schedule 6 of my exhibit, Gulf’s capital expenditure requirements since 2008 are substantially above historic levels. In both 2012 and 2013, Gulf’s projected capital spending is

in excess of $400 million, which is larger than any other year in Gulf’s history.

Short-term debt, generally commercial paper, is typically used to meet shorter term funding requirements. Short-term debt is integral to financing Gulf’s operations, as it is less expensive than long-term debt and does not require a commitment to interest costs over an extended period of time. Thus, short-term debt lends flexibility in financing the business. Strong credit ratings for short-term debt ensure access to the commercial paper markets. The ability to access the commercial paper markets is crucial to Gulf, as short-term funding needs can vary dramatically with volatile fuel prices and seasonal changes in customer demand. Companies with credit ratings lower than those targeted by Gulf may experience difficulty in securing short-term funding.

Q. Please provide an example of the value to electric utilities of strong credit ratings.

A. The value of strong credit ratings was clearly demonstrated during the recent financial crisis. During the height of the credit crisis, access to capital markets was restricted.

In his report, “The A Rating” published in the May/June 2009 issue of Edison Electric Institute’s Electric Perspectives, Mr. Steven M. Fetter, President of Regulation UnFettered, former Chairman of the Michigan

Public Service Commission, and former head of the Global Power Group at Fitch Ratings, stated:

. . . the current economic turmoil has resulted in some utilities within the BBB category experiencing difficulty in accessing the capital markets. Even when capital is available, it is often at significantly higher costs and upon less favorable terms and conditions.

Due to our ability to maintain the targeted “A” ratings, Gulf did not experience these difficulties in accessing capital during this tumultuous period.

Q. What factors are considered by rating agencies in determining Gulf’s credit ratings?

A. The rating agencies consider both quantitative and qualitative factors in determining Gulf’s credit ratings. The quantitative factors, as expressed by financial metrics, generally assess a company’s ability to meet debt obligations considering its cash flows from operations, interest expense, and levels of debt. The qualitative factors consider operational and other business risks.

Of the three agencies, Moody’s Investors Service provides the most definitive explanation of the factors considered to determine a utility’s credit ratings. Moody’s lists four key rating factors in “Regulatory Frameworks – Ratings and Credit Quality for Investor-Owned Utilities”, published June 18, 2010. These factors are: (1) regulatory framework, (2) ability to recover costs and earn returns, (3) diversification of fuel sources, generating plants, regulatory regimes, and geographic regions, and (4) financial strength and liquidity.

Q. Have Gulf’s credit ratings remained on target?

A. Gulf’s credit ratings by Standard & Poor’s and Fitch have remained on target; however, Moody’s downgraded Gulf’s long-term debt rating from A2 to A3 on August 12, 2010. While Moody’s does not rate Gulf’s short-term debt, this long-term debt rating could impact Gulf’s ability to access the commercial paper markets if one of the other rating agencies downgrades Gulf’s short-term debt rating.

Q. What factors were cited by Moody’s for the downgrade?

A. Moody’s stated “Gulf Power's A3 senior unsecured debt rating reflects cash flow coverage metrics that are weak for its rating, higher construction expenditures for environmental compliance, and a decline in the historically supportive Florida regulatory environment.” Gulf Power received an “A” rating on only one of the three primary qualitative factors and only one of the five financial metrics used by Moody’s in determining their credit rating for regulated electric and gas utilities. Moody’s cited additional debt leverage and further deterioration of metrics as risks to the

current rating. A copy of Moody’s Credit Opinion dated August 13, 2010 is attached as Schedule 7 of my exhibit.

Q. Are there any indications that either of the other two major credit rating agencies shares any of Moody’s concerns about Gulf’s credit quality?

A. Yes. With respect to the regulatory environment, Fitch stated in its report of October 5, 2010 on Gulf Power:

. . . political interference in the face of the economic slowdown led to a marked regulatory environment shift in 2010. Recent decisions for unaffiliated Florida utilities have been populist, with below average allowed return on equity and base rate increases that were significantly lower than amounts requested….Fitch expects the regulatory climate in Florida to slowly return to normal after this election year and as the state’s economy slowly begins to recover.

Copies of the most recent credit opinions by Fitch and Standard & Poor’s are attached as Schedules 8 and 9 of my exhibit.

Q. What would be the impact on Gulf’s credit quality without adequate rate relief?

A. The quantitative and qualitative factors considered by rating agencies would be adversely affected. The Company’s financial metrics would deteriorate. Furthermore, allowing the returns to remain at levels below those required by investors would likely increase the agencies’ concerns

about the regulatory environment in Florida. The Company’s ability to maintain the targeted “A” credit ratings would be jeopardized.

Q. How would eroding credit quality affect Gulf and its customers?

A. Credit quality is a key indicator of a company’s financial integrity. A weakened financial position will ultimately hinder Gulf’s ability to access capital at reasonable terms. In order to sustainably provide reliable service to its customers, a utility must maintain access to capital at all times. As discussed earlier, the Company is in the midst of a significant capital investment period. This heightens the importance of maintaining its financial integrity and access to capital.

**V. CAPITAL STRUCTURE AND COST OF CAPITAL**

Q. What capital structure is Gulf targeting?

A. Gulf is targeting a capital structure of 45 percent common equity and 55 percent debt and preference or preferred stock.

Q. Is this the same capital structure targeted in the last rate case filing?

A. Yes.

Q. Why is Gulf’s capital structure appropriate?

A. Gulf has been successful in maintaining its strong financial position and targeted credit ratings with this capital structure. Based on current projections, and with adequate rate relief, Gulf believes it will be able to sustain its financial integrity with this structure.

Q. What cost of equity is the Company seeking in this case?

A. As Dr. Vander Weide indicates in his testimony, a fair rate of return on common equity is 11.7 percent.

Q. What is Gulf’s cost of debt?

A. As shown on Schedule 12 of Mr. McMillan’s Exhibit RJM-1, Gulf’s embedded cost of long-term debt is 5.48 percent. For the test year, we project that our cost of short-term debt will average 2.12 percent.

Q. What is Gulf’s weighted average cost of capital for ratemaking purposes?

A. As shown on Schedule 12 of Mr. McMillan’s Exhibit RJM-1, Gulf’s weighted average cost of capital is 7.05 percent when taking into account both investor sources of capital (common equity, preference stock, long-term-debt and short-term debt) and other sources considered for ratemaking purposes (customer deposits, deferred taxes and investment tax credits).

Q. Is the weighted average cost of capital proposed by Gulf appropriate in this case?

A. Yes. The weighted average cost of capital of 7.05 percent proposed by Gulf, including Dr. Vander Weide’s recommended return of 11.7 percent

on the common equity component, is cost efficient and fair for both investors and customers.

**VI. PARENT DEBT ADJUSTMENT**

Q. Please provide a brief overview of Commission Rule 25-14.004 relating to the parent debt adjustment.

A. The parent debt adjustment rule was adopted by the Commission in 1983. For ease of reference, I have included a copy of that rule as Schedule 10 of my exhibit. This rule applies in rate proceedings where (1) a parent-subsidiary relationship exists, (2) the parent and subsidiary participate in filing a consolidated tax return, and (3) funds provided by parent debt have been invested in the equity of the regulated subsidiary. If all three factors are present, the rule provides a formula for reducing the subsidiary utility’s income tax expense to reflect the tax effect of the parent debt that is invested in the equity of the subsidiary.

Q. In calculating Gulf’s income tax expense for the test year, Mr. McMillan does not make a parent debt adjustment under Commission Rule 25-14.004. Why isn’t such an adjustment required?

A. The rule does not require an adjustment in this case because only two of the three factors in the rule are met. Gulf is a subsidiary of Southern Company (Southern) and it participates in filing a consolidated income tax return; thus the first two factors are met. The third factor is not met because no funds provided by Southern Company debt have been invested in the equity of Gulf.

Q. Doesn’t subsection (3) of the rule create a presumption that Southern’s equity investment in Gulf is supported by debt based on the ratio of debt in Southern’s overall capital structure?

A. Yes, but the rule expressly states that the presumption is rebuttable. The presumption can be rebutted – and the rule does not require an adjustment – if the utility shows that the parent’s equity investment did not come from debt issued at the parent level. In this case, the facts surrounding Southern’s equity investment in Gulf are sufficient to rebut the presumption.

Q. What are the facts which rebut the presumption?

A. As shown on Schedule 11 of Exhibit RST-1, during the period from January 2003 (the middle of the test year in Gulf’s last rate case) to March 2011:

* Gulf has received $459.0 million in equity investment from Southern.
* Gulf has paid $655.8 million in dividends to Southern.

Gulf’s dividend payments are sufficient to support 100 percent of Southern’s equity investments, as represented in Gulf’s financial

statements, and still result in a net payment of $196.8 million from Gulf to Southern.

Gulf has been a net returner of capital to Southern, not a net recipient. Thus, Gulf itself has effectively provided the funding for Southern’s equity

investment in Gulf with its own internally generated funds.

Q. If Gulf’s internally generated funds have been the source of the common equity investment, why have both the common stock and paid-in capital portions of common stockholder’s equity increased?

A. The increases in common stock and paid-in capital result from the accounting effect of Gulf paying dividends while also accepting equity investment from Southern.

Q. Please explain the accounting effect.

A. The effect of Gulf paying dividends to Southern and Southern subsequently returning portions of those dividends through equity investments in Gulf is that the internally generated funds are moved from retained earnings to common equity or paid-in capital on the balance sheet. Assume, for example, that Gulf pays $10 million of dividends to Southern. This payment reduces Gulf’s retained earnings by $10 million. When that amount is subsequently reinvested by Southern, Gulf’s paid-in capital increases by $10 million. Gulf’s total common equity is the same as before the dividend, but the $10 million is now reflected as parent investment rather than retained earnings. However, this accounting treatment does not change the fact that Gulf’s internally generated funds, not Southern, are the underlying source of these common equity dollars. Because Southern is not the source of the funds, Southern’s debt cannot be a source of Gulf’s paid-in capital.

Q. What would be the effect under the parent debt rule if, rather than paying dividends to Southern out of internally generated funds that are then returned in the form of equity investment, Gulf had simply retained those internally generated funds?

A. There would be no additional parent investment on Gulf’s financial statements for the period January 2003 through March 2011. The presumption in subsection (3) would more clearly be rebutted. Under section (4) of the parent debt rule, the retained earnings balance would be treated as internally generated funds, not parent investment, and would not be a basis for imputing any additional income tax expense. The fact that Gulf’s dividend practice changes the accounting presentation should not trigger income tax imputation when Gulf has shown that its dividends more than support Southern’s equity investment; thus, parent debt cannot be a source of capital for Gulf.

Q. Schedule 11 of your exhibit shows that in 2007, 2009, and 2011 (through March) Southern made equity investments in Gulf that were not supported by dividends paid in those years. Does this mean that Southern’s capital contributions in those years came from some source other than Gulf’s internally generated funds?

A. No. This is merely a timing difference in cash flows. Gulf pays quarterly dividends to Southern. Southern only provides funds as necessary to fund Gulf’s business. These cash exchanges may or may not offset each other in any given calendar year. Most importantly, the cash generated by Gulf has been more than sufficient to cover all of Southern’s capital contributions since the last rate case and Gulf, on a cumulative basis, has been a net returner of cash to Southern at all points in time over this period.

Q. Does Gulf forecast additional dividends paid to Southern and additional equity investments in Gulf by Southern for the remainder of 2011 and 2012?

A. Yes; however, Gulf will also be a net returner of cash to Southern during this period.

Q. Isn’t it true that dollars are fungible, so Gulf cannot trace the exact dollars invested in Gulf back to dollars that resulted from dividends paid by Gulf?

A. This may be true as a purely theoretical matter, but the rule cannot properly be interpreted to require such an exact tracing. If exact tracing

were required, the presumption in the rule would be effectively irrebuttable. This cannot be what the Commission intended.

Q. You have focused on the period since Gulf’s last rate case. How can the Commission be assured that the Southern debt outstanding at the time of the last rate case did not support its equity investment in Gulf at that time?

A. First, prior to the last rate case, Southern issued long-term debt during the growth of Southern Electric International, which was ultimately spun-out of Southern in 2001 as Mirant Corporation. Second, Southern’s commercial paper borrowings, both now and at the time of the last rate case, are used to support parent-level expenditures. They are not used as a source of funds for investments in the operating companies. Finally, the Commission did not find it necessary to make a parent debt adjustment during Gulf’s last rate case.

Q. What are the financial implications to Gulf of making the parent debt adjustment?

A. The parent debt adjustment would have two primary effects on Gulf. First, imputing to Gulf the tax benefits of parent company debt would be effectively assuming the Company has more debt in its own capital structure than actually exists. The Company’s capital structure already has a relatively low equity ratio and includes as much debt as is practical to maintain its financial strength. The parent debt adjustment would assume there are tax benefits of parent company debt accruing to Gulf without recognizing the associated financial risk in Gulf’s capital structure. Gulf, appropriately, has not imputed parent company debt in its capital structure and it would be inconsistent to impute any tax benefits associated with such debt.

Second, by artificially reducing the federal income tax expense used to establish Gulf’s required rate relief, the adjustment would decrease the effective return on equity by approximately 25 basis points below the level the Commission otherwise determines to be appropriate.

The Commission should consider these impacts of applying the parent debt rule when weighing the evidence that Gulf has presented to rebut the presumption that Southern’s investment in Gulf is funded in part by parent debt.

Q. Has the Commission made a parent debt adjustment in any of Gulf’s prior rate cases?

A. No. The rule was adopted in 1983. Since that time Gulf has had three rate cases before the Commission, and the Commission has never made a parent debt adjustment pursuant to Rule 25-14.004.

**VII. SUMMARY**

1. Please summarize your testimony.

A. Gulf Power is committed to meeting the needs of our customers and investors and strives to maintain low rates, high quality service, and excellent customer satisfaction ratings. Despite Gulf’s continued efforts to control costs and keep expenses low to avoid the need for base rate relief, there has been an increase in the cost of providing electric service since the Company’s last base rate increase in 2002. These increases in costs are necessary to enable the Company to maintain reliability and meet the service expectations of our customers. Other witnesses address the details of the capital additions over the past ten years and the factors contributing to an increase in O&M expenses. Increases in both areas are necessary in order to ensure that Gulf can continue to provide dependable and reliable service to our customers. These increased costs have grown faster than Gulf’s base rate revenues, resulting in a declining net operating income.

Under present retail rates, the projected return on average common equity for the test year is 2.83 percent, which is significantly below the 11.7 percent determined by Dr. Vander Weide to be appropriate for Gulf Power. Such a low return would leave the Company in a weakened financial position. In order for Gulf to attract capital on reasonable terms and continue to meet the needs of our customers, the Company must maintain its financial integrity. Therefore, based on the revenue deficiency calculated for the test period, Gulf is requesting an annual increase of $93,504,000 in our base rate retail revenues.

Q. Does this conclude your testimony?

A. Yes.

AFFIDAVIT

STATE OF FLORIDA ) Docket No. 110138-EI

)

COUNTY OF ESCAMBIA )

Before me the undersigned authority, personally appeared R. Scott Teel, who being first duly sworn, deposes, and says that he is the Vice President and Chief Financial Officer of Gulf Power Company, a Florida corporation, that the foregoing is true and correct to the best of his knowledge, information, and belief. He is personally known to me.

The original affidavit is attached to the

original testimony on file with the FPSC

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R. Scott Teel

Vice President and Chief Financial Officer

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

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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. S. Teel

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

Schedule 1

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## Responsibility for Minimum Filing Requirements

# Schedule Title

A-1 Full Revenue Requirements Increase Requested

C-24 Parent(s) Debt Information

D-2 Cost of Capital – 5 Year History

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D-8 Financing Plans – Stock and Bond Issues

D-9 Financial Indicators – Summary

F-1 Annual and Quarterly Reports to Shareholders

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F-3 Business Contracts with Officers or Directors

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Schedule 2

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Schedule 5

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Rating Agency Conventions and Scales

Senior Unsecured Notes (Long-Term Debt)



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Schedule 6

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Schedule 10

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**PARENT DEBT ADJUSTMENT RULE 25-14.004**

25-14.004 Effect of Parent Debt on Federal Corporate Income Tax.

In Commission proceedings to establish revenue requirements or address over-earnings, other than those entered into under Rule 25-14.003, F.A.C., the income tax expense of a regulated company shall be adjusted to reflect the income tax expense of the parent debt that may be invested in the equity of the subsidiary where a parent-subsidiary relationship exists and the parties to the relationship join in the filing of a consolidated income tax return.

(1) Where the regulated utility is a subsidiary of a single parent, the income tax effect of the parent’s debt invested in the equity of the subsidiary utility shall reduce the income tax expense of the utility.

(2) Where the regulated utility is a subsidiary of tiered parents, the adjusted income tax effect of the debt of all parents invested in the equity of the subsidiary utility shall reduce the income tax expense of the utility.

(3) The capital structure of the parent used to make the adjustment shall include at least long term debt, short term debt, common stock, cost free capital and investment tax credits, excluding retained earnings of the subsidiaries. It shall be a rebuttable presumption that a parent’s investment in any subsidiary or in its own operations shall be considered to have been made in the same ratios as exist in the parent’s overall capital structure.

(4) The adjustment shall be made by multiplying the debt ratio of the parent by the debt cost of the parent. This product shall be multiplied by the statutory tax rate applicable to the consolidated entity. This result shall be multiplied by the equity dollars of the subsidiary, excluding its retained earnings. The resulting dollar amount shall be used to adjust the income tax expense of the utility.

Specific Authority 350.127(2) FS. Law Implemented 366.05(1), 364.03, 364.035, 367.121(1)(a) FS. History–New 1-25-83, Formerly 25-14.04.

Florida Public Service Commission

Docket No. 110138-EI

GULF POWER COMPANY

Witness: R. S. Teel

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

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