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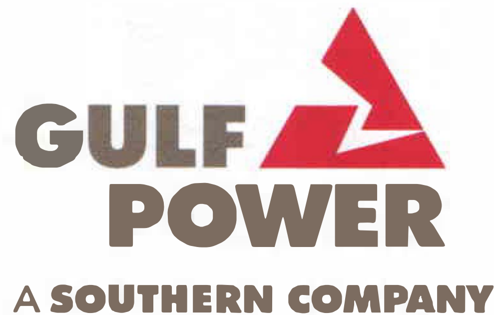
BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 130140-EI



TESTIMONY AND EXHIBIT

OF

R. SCOTT TEEL

1 GULF POWER COMPANY

2 Before the Florida Public Service Commission
Prepared Direct Testimony of
3 R. Scott Teel
Docket No. 130140-EI
4 In Support of Rate Relief
Date of Filing: July 12, 2013
5

6 Q. Please state your name and business address.

7 A. My name is Scott Teel. My business address is One Energy Place,

8 Pensacola, FL 32520.

9

10 Q. By whom are you employed?

11 A. I am employed by Gulf Power Company (Gulf or the Company) as Vice

12 President and Chief Financial Officer (CFO).

13

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

15 A. I am responsible for maintaining the overall financial integrity of the

16 Company. My areas of responsibility include the Accounting, Corporate

17 Secretary, Treasury, Regulatory Matters, Corporate Planning, Forecasting,

18 Pricing and Supply Chain Management departments. I am also responsible

19 for maintaining the overall financial and accounting records of the Company.

20 Gulf maintains its books and records in accordance with Generally

21 Accepted Accounting Principles in the U.S. (GAAP) and the rules and

22 regulations prescribed for public utilities in the Uniform System of Accounts

23 published by the Federal Energy Regulatory Commission (FERC), and

24 adopted by the Florida Public Service Commission (FPSC or the

25 Commission).

1 Our books and records are audited by Deloitte & Touché LLP, independent
2 public accountants, and a copy of their latest audit opinion is included in the
3 Company's 2012 Annual Report to Stockholders, which is filed as MFR F-1
4 in this case. Gulf's books and records are also subject to periodic review by
5 the FERC and the FPSC.
6
7 Q. Please state your prior work experience and responsibilities.
8 A. Prior to moving to Gulf in 2010, I served as the Vice President and CFO for
9 Southern Company Operations. In that role, I was responsible for the
10 financial services of the Power Generation and Transmission organizations,
11 which included budgeting and reporting, wholesale generation contract
12 services, Open Access Transmission Tariff (OATT) administration and
13 billings, and internal controls. I was also responsible for the Fleet
14 Operations and Trading functions. Other roles that I have filled at Southern
15 Company include Energy Trading Manager in Fleet Operations and Trading,
16 and Assistant to Southern Company's Executive Vice President and CFO.
17 Prior to joining Southern Company, I held various positions at Ernst &
18 Young and Sonat, a natural gas holding company in the pipeline,
19 exploration and production, and energy marketing businesses.
20
21 Q. What is your educational background?
22 A. I graduated from the University of Alabama in 1992 with a Bachelor of
23 Science in Commerce and Business Administration and a major in
24 Accounting.
25

1 Q. Do you hold a certification?
2 A. I am currently an inactive member of the Alabama Society of Certified
3 Public Accountants.
4
5 Q. What is the purpose of your testimony?
6 A. My testimony begins with an overview of Gulf's need for rate relief. I then
7 explain the Company's decision to use a projected 2014 test year for
8 ratemaking purposes, provide a summary description of Gulf's financial
9 performance since our last base rate increase, identify the drivers behind
10 the request for rate relief and explain why an increase is necessary at this
11 time. I discuss the importance of the rate relief Gulf is requesting to Gulf's
12 financial integrity and credit quality. I also discuss Gulf's capital structure
13 and cost of capital. I then discuss the reasons that the financial goals in
14 Gulf's employee compensation package are important to Gulf and its
15 customers. Finally, I explain why it is not appropriate to make a parent debt
16 adjustment to Gulf's income tax expense in determining our revenue
17 requirement.
18
19 Q. Are you sponsoring any exhibits?
20 A. Yes. I am sponsoring Exhibit RST-1, consisting of Schedules 1 through 8.
21 These schedules were prepared under my control and supervision, and the
22 information contained therein is true and correct to the best of my
23 knowledge.
24
25

1 Q. Are you sponsoring any of the Minimum Filing Requirements (MFRs) filed
2 by Gulf?
3 A. Yes. The MFRs that I sponsor in their entirety or that I jointly sponsor are
4 listed on Schedule 1 of my Exhibit RST-1. The information contained in the
5 MFRs that I sponsor or co-sponsor is true and correct to the best of my
6 knowledge and belief.
7
8
9 **I. NEED FOR RATE RELIEF**
10
11 Q. Why is Gulf seeking rate relief at this time?
12 A. Gulf has an obligation to provide safe and reliable service to customers
13 throughout the area we serve. We take this obligation seriously and put our
14 customers at the center of everything we do. At the same time, we have an
15 obligation to our investors to provide a fair return on their investment in Gulf
16 so that we can attract the capital needed to support continued investment in
17 the assets required to serve customers. Gulf can be successful in providing
18 the service that our customers expect and deserve only if we remain
19 financially strong – and that requires maintaining the appropriate balance of
20 the interests of all our stakeholders.
21
22 Gulf needs rate relief at this time because our current rates do not produce
23 sufficient revenues for us to continue adequately serving our customers
24 while maintaining the Company's financial integrity. We need additional
25 revenues to cover our operating expenses, to provide a fair return on our

1 existing assets, and to enable us to fund the significant capital expenditures
2 that are required to continue to provide reliable electric service and to
3 comply with federal regulations.
4
5 Q. What is the amount of base rate relief that Gulf is requesting in this case?
6 A. Gulf is requesting an annual increase of $74.4 million in base revenues.
7 This is the amount necessary for Gulf to continue to provide quality service
8 to its customers and provide its investors the opportunity to earn a fair rate
9 of return of 11.5 percent on the Company's common equity, as supported
10 by the testimony of Gulf Witness Dr. Vander Weide.
11
12 As discussed by Gulf Witness Ritenour, the requested increase would be
13 adjusted downward by $637,000 if the Commission determines that Gulf
14 can recover through the Environmental Cost Recovery Clause (ECRC)
15 certain transmission investments made in 2014 and beyond in order to
16 comply with environmental requirements. If the Commission determines
17 that such compliance-related transmission costs should be recovered
18 through base rates, then Gulf requests an additional step increase in base
19 rates of $16,392,000 effective July 1, 2015.
20
21
22 **II. TEST YEAR**
23
24 Q. What test year has Gulf used to calculate its proposed rate increase?
25 A. Gulf has chosen a 2014 projected test year. The test year projections were

1 developed as part of Gulf's 2013 budget process. As described in more
2 detail by Ms. Ritenour, Gulf's annual budget process produces a budget for
3 the current year and a budget forecast for the four subsequent years. The
4 2013 "prior year" shown in the MFRs is also the result of the 2013 budget
5 process, while the 2012 "historical year" reflects actual results for that year.
6
7 Q. Please explain why 2014 was chosen as the test period.
8 A. The 2014 test year is an appropriate representation of Gulf's expected
9 future operations. The 2014 test year properly matches Gulf's projected
10 revenues with the projected costs and investment required to provide
11 service to customers during the period following the effective date of the
12 new, permanent rates in this case. The use of a projected test year that
13 includes information related to rate base, net operating income, and capital
14 structure for the time new rates will be in effect benefits all stakeholders by
15 helping to reduce the impact of regulatory lag. Gulf's use of a projected test
16 year is also consistent with the Commission's long-standing practice to
17 approve projected test years.
18
19 The most recent historic year of 2012 is not representative of Gulf's
20 expected revenues and expenses in the future. In order to achieve modest
21 improvement in its returns, Gulf made significant efforts during 2012 to limit
22 operations and maintenance spending levels. However, those levels cannot
23 be sustained in the long term. Furthermore, whereas sales declined in
24 2012, the 2014 revenue forecast reflects the expectation of sales growth
25 beginning in 2013 and continuing into the test year.

1 **III. GULF'S FINANCIAL PERFORMANCE AND RATE REQUEST**

2

3 Q. When was Gulf's last rate case?

4 A. Gulf's last rate case was filed in July 2011 and was based on a projected

5 2012 test year. The Commission's decision granting Gulf's last base rate

6 increase was in Order No. PSC-12-0179-FOF-EI issued April 3, 2012 in

7 Docket No. 110138-EI.

8

9 Q. How has the rate relief granted in 2012 impacted Gulf financially?

10 A. Prior to the last rate decision in 2012, our Return on Equity (ROE) had

11 deteriorated to a low of 4.75 percent in January 2012. While the

12 Commission did provide some rate relief with our previous case in 2012, it

13 was, unfortunately, not sufficient to cover our costs of service, including a

14 reasonable ROE. While the approved rate relief was designed to give Gulf

15 the opportunity to earn a fair ROE of 9.25 to 11.25 percent, Gulf's achieved

16 ROE never reached the anticipated level. It improved to a high of only 9.14

17 percent in April 2013 and is projected to decline from this level in the

18 remainder of 2013. In fact, Gulf's achieved ROE has been below the

19 bottom of the currently authorized range since the beginning of 2011 and,

20 without rate relief, is projected to be below that range for the entire four-year

21 period of 2011-2014.

22

23 Q. Why hasn't Gulf been able to achieve the level of return anticipated when

24 rate relief was granted in April 2012?

25 A. First, while Gulf's rates were increased, our base revenues have fallen far

1 short of the expectations in our filing. Our sales in 2012 were 7.7 percent
2 below those forecasted for that test year in our last case. Sales in each
3 customer segment failed to meet our forecasted growth. In the residential
4 and commercial sectors, customer growth rates continue to lag, and we
5 continue to see declines in average use per customer. As a result, base
6 revenues in 2012 were $32.5 million less than expected. That revenue
7 shortfall represents more than 50 percent of the annual rate relief
8 authorized in 2012. Schedule 2 of my exhibit depicts the differences
9 between the 2011 sales forecast used to project revenues in our last rate
10 case and our actual experience in 2012, as well as our current forecast for
11 2013-2015. In our proposed 2014 test year, this difference in sales
12 forecasts is projected to result in a revenue variance of over $50 million.
13 The schedule shows that under our current sales forecast, sales by 2015
14 will still be below the level projected for 2012 at the time of our last rate
15 case.
16
17 Second, as forecasted during our last case, Gulf has continued to invest
18 heavily, particularly in transmission assets. After an eight-year period
19 (2002-2009) of averaging approximately $96 million a year of capital
20 expenditures (excluding non-jurisdictional and clause-related investment),
21 Gulf has invested an average of $195 million a year over the three-year
22 period of 2010-2012. The associated increase in rate base has outpaced
23 our relatively flat sales and customer growth. Schedule 3 of my exhibit
24 shows our actual and projected base rate capital expenditures for 2002-
25 2014.

1 Third, Gulf's rates, approved by the Commission in 2012, did not provide for
2 the necessary recovery of certain costs that Gulf is still incurring and cannot
3 avoid.
4
5 The essential investments in our systems and the failure of projected sales
6 and revenues to materialize are the primary drivers of the need for our
7 current rate request.
8
9 Q. Are operating and maintenance expense increases a major rate case
10 driver?
11 A. No. While our operating and maintenance (O&M) expenses have increased
12 since our last rate case, a certain level of increases is expected over time in
13 the normal course of providing service. On an aggregate basis, our
14 requested test year O&M expenses are only $2.5 million above the
15 Commission's O&M Benchmark. Gulf's other witnesses justify the overages
16 in specific functional areas, but the overall benchmark variance could be
17 explained either by our requested increase of $5.5 million in the annual
18 property damage accrual described by Gulf Witness Erickson or by the $5.9
19 million overage in pension expense described by Gulf Witness Garvie. The
20 pension expense variance primarily results from factors in the financial
21 markets beyond Gulf's control.
22
23 Our revenue requirements associated with O&M expenses have increased;
24 however, the other factors discussed above far outweigh the impact of
25 those increases.

1 Q. Has Gulf taken any action to mitigate the impact of this revenue shortfall?
2 A. Yes. We sought and have achieved cost reductions to mitigate the impact
3 of the shortfall across the Company. For example, in 2012 and 2013 we
4 were able to extend the outage cycles of coal fired generating units, as their
5 output has been less than anticipated due to market conditions favoring
6 natural-gas-fired generation. While we were able to extend the outage
7 cycles during this period, the coal unit outages in the test year are
8 necessary, are planned, and cannot be delayed indefinitely.
9
10 Additionally, we have limited our labor costs by holding positions vacant.
11 We have found it necessary to do this over the past several years in order
12 to control costs; however, this is another form of cost containment that is not
13 sustainable in the long run. We cannot continue to operate at these staffing
14 levels, and we intend to fill the positions that are currently vacant.
15
16 We also have reduced our debt costs by taking advantage of the current
17 interest rate environment to refinance long-term debt at lower interest rates,
18 as well as financing new issuances at favorable rates. These savings not
19 only helped us offset some of the revenue shortfall but also will benefit
20 customers by reducing our overall cost of capital into the future.
21
22 Our actions did, to a degree, mitigate the impacts of the revenue deficiency
23 on our financial performance. Gulf's cost reductions enabled it to achieve
24 an actual return of 8.63 percent in 2012, which is still 162 basis points below
25 the ROE our authorized rates were designed to produce. Absent our cost

1 reduction efforts, Gulf's ROE for 2012 would have been approximately 6.4
2 percent, well below Gulf's authorized ROE range. While we were able to
3 achieve that modest improvement without affecting service to our customers
4 in 2012, neither that low level of earnings nor those spending levels are
5 sustainable.
6
7
8 **IV. GULF'S RATE REQUEST**
9
10 Q. Will Gulf's financial situation improve without rate relief?
11 A. No. Schedule 4 of my exhibit illustrates the relationship between the
12 projected growth in our rate base, O&M expenses, and revenues from 2012
13 to 2014.
14
15 As projected in our previous case, Gulf continues to invest significant
16 amounts of capital in our generating plants, transmission infrastructure and
17 distribution systems. The Rate Base line on Schedule 4 shows the resulting
18 growth in our rate base. These investments are required and cannot be
19 delayed if Gulf is to continue to reliably serve our existing customers and
20 support forecasted demand growth. Meanwhile, as discussed above, our
21 O&M expenses were restricted in 2012 and are not representative of our
22 needs in the test year. The non-clause O&M line on Schedule 4 represents
23 the growth in our O&M expenses from that low level in 2012 back to normal
24 levels in 2014. In contrast, as depicted by the weather-normalized
25 revenues line on Schedule 4, the growth in sales and associated revenues

1 have not and are not forecasted to offset these increasing costs to serve
2 customers. Our approved rates do not currently reflect the full cost of
3 providing service and the resulting revenue deficiency is only projected to
4 grow.
5
6 Q. What are the implications for Gulf's customers and investors of this
7 increasing revenue deficiency?
8 A. The result of the increasing revenue deficiency is that the Company's
9 earned rate of return will continue to fall. As shown on Schedule 5 of my
10 exhibit, after almost making it into the bottom of Gulf's currently authorized
11 range in April 2013, Gulf's earned ROE is projected to begin another
12 descent and to fall to 8.15 percent by the end of 2013 and to 5.14 percent
13 by the end of our 2014 test year. By the time of a decision in this case,
14 Gulf's ROE will have been below our authorized range for more than three
15 years despite all our efforts to control costs.
16
17 Base rate relief is necessary to allow Gulf an opportunity to cover its
18 reasonable and necessary operating expenses while at the same time
19 providing its investors with a fair return. That opportunity is essential to
20 attracting the capital that is required, not just for our current capital
21 expenditure program, but to sustain Gulf's ability to continue to provide the
22 service that our customers expect and deserve in the years to come at fair,
23 just and reasonable rates.
24
25

1 **V. FINANCIAL INTEGRITY**

2

3 Q. What does financial integrity mean to Gulf Power?

4 A. Financial integrity means maintaining a strong financial position that is
5 sufficient to meet our current financial obligations and to sustain the
6 confidence of investors in order to attract capital – continuously and on
7 reasonable terms.

8

9 Q. Why is financial integrity important?

10 A. Financial integrity is critical to Gulf because of our statutory obligation to
11 serve. Meeting that obligation requires on-going capital investments to both
12 maintain our electric system and expand to serve increasing demand. Such
13 capital improvements are non-discretionary, and the Company has limited
14 flexibility in the timing of the investments required to reliably generate and
15 deliver electricity. We must therefore at all times maintain access on
16 reasonable terms to both the long-term debt and equity markets.

17

18 Continuous access to short-term debt markets, including commercial paper,
19 is also critical to provide the liquidity Gulf requires to manage its day-to-day
20 operational cash needs. Those needs are highly variable in response to
21 things such as changes in fuel prices and variations in sales, and the short-
22 term debt markets are more cost-effective than longer term financings for
23 these purposes.

24

25

1 Q. Please describe Gulf's financial position.

2 A. Gulf is not in a position of strength with respect to attracting equity capital.
3 Equity investors have not been fairly compensated for their investment risk
4 for several years. The revenues produced by Gulf's current rates are
5 insufficient to cover our operating and maintenance expenses and at the
6 same time provide an adequate return to our investors. This revenue level
7 is clearly deficient and will not support equity investment in the future.
8
9 From the viewpoint of our debt holders, Gulf's current financial position
10 remains strong despite our poor equity returns. Our credit ratings have
11 been sufficient to allow us to maintain access to debt markets, in even the
12 worst periods of the financial crisis, and to finance that debt at favorable
13 rates. However, as I will discuss later, Gulf is concerned about the effect of
14 declining credit metrics and current return levels on its credit ratings.
15
16 Q. Does Gulf face business risks that could affect its ability to maintain its
17 financial strength and access to capital?

18 A. Yes. Gulf faces a number of significant risks. Some of these risks are at
19 heightened levels today that are not likely to subside anytime soon and
20 some pose greater risk to Gulf relative to other electric utilities.
21
22 Economic uncertainty is clearly one of the most concerning business risks
23 that Gulf faces. The stalled economic recovery not only negatively impacted
24 our sales but also resulted in more forecast risk and variances. The
25 prolonged effects of the recession were not anticipated by economists in

1 their forecasts for economic growth. Gulf was especially affected by the
2 stalled economic recovery at the time of our last rate case filing. Given
3 several events impacting the economy after our filing, each subsequent
4 economic forecast resulted in declines in our projected sales.
5
6 The effect of this economic uncertainty was aggravated by the effect of
7 regulatory lag. In the short time between the filing of our last rate case and
8 the hearings, Gulf's sales and revenue projections for the 2012 test year
9 suggested an additional revenue deficiency of $17 million compared to the
10 forecast on which the MFRs were based. However, there was no way to
11 get this information before the Commission without a serious risk of
12 delaying a final decision in the case. Ultimately, our actual sales in 2012 fell
13 short of even these lower projections. While we continue to have some
14 optimism that the economy in Northwest Florida will rebound, much
15 uncertainty remains and a return to historical growth rates is not expected
16 soon. In this uncertain economic environment, regulatory lag increases the
17 risks to Gulf.
18
19 Q. Beyond economic uncertainty and regulatory lag, what other significant
20 business risks does Gulf face?
21 A. Gulf also faces significant exposure to tropical storms, more than most
22 utilities. Gulf is a relatively small electric utility, with a service area that can
23 be and has been impacted significantly by a single storm. In the aftermath
24 of Hurricane Ivan, over 90 percent of Gulf's customers lost power. Due to
25 the destruction of homes and other property, nine months passed before

1 Gulf's customer counts returned to pre-Ivan levels. We are proposing to
2 increase our property damage accrual in order to build the balance in the
3 funded reserve and thereby mitigate the financial impacts of storm
4 restoration. However, the potential for lost sales due to hurricanes and
5 tropical storms remains a significant risk to Gulf.
6
7 Gulf continues to diversify its generation mix, with the addition of more
8 natural gas to our portfolio. Our customers have benefitted and will
9 continue to benefit from our ability to optimize our production between coal
10 and natural gas generation. However, our opportunities to diversify have
11 been limited primarily to those fossil fuels, which does expose Gulf to
12 potential cost increases in the future. In this respect, Standard & Poor's
13 noted the following:
14 A reasonably diverse asset base that includes coal,
15 natural gas, nuclear, and renewable energy sources can
16 provide some insulation when prices for a particular fuel
17 source increase, or when--as is the case for coal--a
18 resource must comply with tougher environmental
19 regulations. (Coal-To-Gas Switching: Opportunities and
20 Challenges For The U.S. Regulated Electric Utility
21 Industry, dated May 11, 2012).
22
23 Similarly, Gulf's exposure to environmental regulations is pronounced due
24 to our reliance on coal-fired generation. More than 75 percent of Gulf's
25 owned electric generation capacity is coal-fired and has or will require

1 investment to comply with existing environmental regulations. Over the past
2 10 years, Gulf has invested over $1 billion in response to more stringent
3 environmental regulations. This represents almost 50 percent of our total
4 capital expenditures during that period. Between now and 2015, we are
5 projected to invest approximately $640 million more to comply with
6 environmental regulations, including the new Mercury Air Toxics Standards
7 Act. With the potential approval of proposed water and coal combustion
8 byproducts regulations, Gulf's compliance costs will only continue to climb.
9
10 Finally, Gulf is in the midst of the largest capital expenditure program in its
11 history. In addition to the environmental compliance requirements, Gulf's
12 transmission infrastructure investment needs are at historic levels. In its
13 October 26, 2012 report entitled "High Capital Expenditures Adding to Rate
14 Pressure for Utilities," Moody's recognized that "capex often drive[s] rate
15 relief needs for utilities," that Gulf Power "could generate credit metrics
16 below the levels we expect for their existing rating," and that a "sustained
17 decline in credit metrics could create downward rating pressure."
18
19 All of these factors pose more risk to Gulf today than in the past, increasing
20 concerns about sustaining our financial integrity. Maintaining our financial
21 integrity has always been and will be a priority to Gulf, but given the need
22 for more flexibility and liquidity for operations and the size of our capital
23 expenditure needs, it has never been any more critical to Gulf than it is
24 today.
25

1 **VI. CREDIT QUALITY**

2

3 Q. What credit ratings does Gulf target?

4 A. Gulf targets ratings in the middle of the “A” range for its long-term debt for
5 all three of the major credit rating agencies – Standard & Poor’s, Moody’s
6 Investor Service, and Fitch Ratings. For Standard & Poor’s, this range is
7 defined as “Strong,” and we target an “A” rating. For Moody’s, this range is
8 defined as “Upper Medium Quality,” and we target an “A2” rating. For Fitch,
9 this range is defined as “High Quality,” and we target an “A” rating.
10 Gulf targets the equivalent ratings for its short-term debt.

11

12 Q. What are Gulf’s current credit ratings?

13 A. Despite the improvement in Moody’s rating factors, Moody’s long-term debt
14 rating for Gulf remains at A3, below our targeted rating of A2. Standard &
15 Poor’s and Fitch credit ratings are at the targeted levels.

16

17 Q. What factors are considered in Gulf’s credit risk profile?

18 A. The rating agencies consider both qualitative and quantitative factors in
19 assessing a company’s credit risk.

20

21 For a utility, the regulatory environment and framework in which it operates
22 is the most important qualitative factor. In determining a utility’s credit
23 rating, Moody’s applies 25 percent of its weighting to the score of its
24 “Regulatory Framework.” Additionally, another 25 percent weighting is

25

1 assigned to the company's "Ability To Recover Costs And Earn Returns,"
2 which is largely a function of the regulatory environment.
3
4 The quantitative factors used by the rating agencies assess the company's
5 ability to meet its debt obligations considering its cash flow from operations,
6 interest expense, and levels of debt.
7
8 Q. How does Gulf rate on these factors?
9 A. At the time of our last rate case filing, the ratings agencies were concerned
10 about the regulatory environment in Florida. Specifically, Moody's
11 referenced "[a] decline in the historically supportive Florida regulatory
12 environment" (Moody's Credit Opinion dated August 13, 2010) and had
13 lowered its score from "A" to "Baa."
14
15 In its most recent report on Gulf dated August 10, 2012, Moody's stated:
16 the political and regulatory environment for investor-
17 owned utilities in Florida has largely stabilized and
18 appears to be improving...Because of these
19 constructive developments, we have returned Gulf
20 Power's score on Factor 1 of our Regulated Electric
21 and Gas Rating Methodology grid, Regulatory
22 Framework, to the "A" or above average category from
23 the "Baa" or average category.
24
25

1 Meanwhile, the rating agencies have also reported improvement for
2 Gulf in our quantitative financial metrics.
3
4 Q. Do you have concerns about Gulf's current credit ratings?
5 A. I do. While the agencies' opinions of the Florida regulatory environment
6 have improved, Gulf's financial metrics could deteriorate to levels that would
7 adversely impact our ratings. The Company's cash flow coverage metrics,
8 which measure, among other things, the amount of cash flow available to
9 service our debt, will be pressured due to our large capital expenditure
10 program and the expiration in 2014 of the bonus depreciation tax incentives.
11 Without further rate relief, those metrics will deteriorate even further and
12 pose greater risk to Gulf's ability to attain our targeted credit ratings.
13
14 As noted earlier, we are not at our targeted rating level of A2 with Moody's.
15 Moody's has already stated that Gulf's "cash flow coverage metrics are
16 weak for its A3 credit rating." (Opinion dated August 10, 2012)
17 Gulf's metrics are expected to decline from current levels, and Moody's
18 cites the metrics as an important factor that could lead to either a
19 rating upgrade or downgrade.
20
21 The metrics are certainly our biggest concern regarding our credit quality
22 today. However, if the outcome of this case is not sufficient to recover our
23 cost of service including fairly compensating investors, not only will our
24 credit metrics suffer more damage but the credit rating agencies'
25

1 assessment of our regulatory environment could also come into question
2 again.
3
4 Without adequate rate relief, the Company's ability to attain the targeted "A"
5 credit ratings with all three agencies would certainly be jeopardized and the
6 risk of further downgrades would also increase.
7
8 Q. Why is it necessary to maintain these targeted credit ratings?
9 A. Maintaining these targeted credit ratings for both long-term debt and short-
10 term debt is critical for Gulf and its customers. An electric utility's obligation
11 to serve requires continuous access to capital markets to fund the
12 maintenance of and investment in the assets needed to reliably generate
13 and deliver electricity. The targeted credit ratings help ensure access to
14 capital on reasonable terms and conditions. This is especially important
15 now for Gulf, as we remain in the midst of a significant capital investment
16 period and will be issuing new long-term debt.
17
18 Schedule 6 of my exhibit illustrates our actual capital expenditures,
19 including both base rate and clause investment, for the period since our
20 preceding rate cases in 2002 and 2012. It also shows our projected capital
21 expenditures in 2013 and 2014. During the period of 2002 through 2006
22 (pre-recession), Gulf's capital expenditures averaged approximately $130
23 million a year. Due to the combination of environmental compliance
24 requirements and the need for infrastructure investment in all other areas of
25 our system, our capital expenditures averaged approximately $310 million a

1 year between 2007 and 2012. With the investment needed to comply with
2 environmental regulations, along with other infrastructure requirements, our
3 capital expenditures will peak in 2014 at a projected level over $460 million.
4
5 Gulf also requires continuous access to short-term debt markets,
6 specifically the commercial paper market. The ability to access the
7 commercial paper markets is critical to financing our operations. Short-term
8 debt offers value to customers, as it is less expensive than long-term debt
9 and offers flexibility in financing. The ability to access the commercial paper
10 markets at any time is crucial to Gulf, since our short-term funding needs
11 are difficult to predict and can vary dramatically with volatile fuel prices,
12 seasonal changes in customer demand, and the effects of continued
13 economic uncertainty.
14
15 Strong credit ratings are necessary to ensure access to the commercial
16 paper markets. Companies with credit ratings lower than those targeted by
17 Gulf may experience difficulty in securing short-term funding. Some buyers
18 of commercial paper are restricted to buying the commercial paper of only
19 those companies with high quality ratings, potentially adversely affecting the
20 liquidity, or the ability to access cash quickly, of companies with lesser
21 ratings. During the height of the financial crisis, some companies with lower
22 credit ratings were unable to access the commercial paper markets. Credit
23 ratings below those targeted by Gulf could restrict access to those short-
24 term debt markets, particularly during times of economic or financial
25 uncertainty.

1 Gulf's ability to maintain strong credit ratings has benefitted customers
2 through lower debt costs and the ability to access capital through the most
3 difficult economic periods. Between the economy and sales growth
4 uncertainties – and the certainty of our capital expenditure requirements –
5 maintaining our targeted credit ratings is essential. Allowing our credit
6 quality to be threatened due to declining returns and cash flow coverage
7 metrics will expose our customers during a most critical period.
8
9
10 **VII. CAPITAL STRUCTURE AND COST OF CAPITAL**
11
12 Q. What capital structure does Gulf target?
13 A. Gulf targets a capital structure of 45 percent common equity and 55 percent
14 debt and preference or preferred stock. After regulatory adjustments, this
15 results in a test year equity ratio of approximately 47.5 percent for
16 ratemaking purposes.
17
18 Q. Is this a typical capital structure for electric utilities?
19 A. No. Gulf has a lower equity ratio than most electric utilities, including
20 the other electric utilities regulated by the Commission. In the most recent
21 rate decisions not involving stipulations, the Commission approved equity
22 ratios of 59.1 percent for Florida Power & Light in 2010, 50.3 percent for
23 Progress Energy Florida in 2010, 54 percent for Tampa Electric in 2009,
24 and 50.4 percent for Florida Public Utilities in 2008. These range from
25

1 approximately three to twelve percentage points higher than Gulf's equity
2 ratio.
3
4 Q. What are the implications of a company having a lower equity ratio?
5 A. With a lower equity ratio and more debt, a company's financial risk is
6 higher. While the additional debt is at a lower cost than equity, equity
7 investors will require compensation for the additional risk through a higher
8 return.
9
10 Q. Why does Gulf target a lower equity ratio than other electric utilities?
11 A. This mix of debt, preference stock and equity has proved to be in the best
12 interest of our customers. First, Gulf has been successful in maintaining its
13 financial integrity and access to the capital markets with this capital
14 structure, even during the most difficult economic times. Furthermore, this
15 capital structure has resulted in a low weighted average cost of capital,
16 which directly benefits our customers through lower rates.
17
18 Q. What cost of equity is the Company seeking in this case?
19 A. As Dr. Vander Weide indicates in his testimony, a fair rate of return on
20 common equity is 11.5 percent.
21
22 Q. Has Dr. Vander Weide considered Gulf's higher financial risk relative to
23 other utilities?
24 A. Yes. Dr. Vander Weide considers the relative financial risk in the capital
25 structures of his proxy group and adjusts Gulf's required return to ensure

1 that equity investors are compensated for Gulf's higher financial risk.

2

3 Q. Has Gulf's business risk relative to other utilities also been considered?

4 A. With respect to the cost of equity, Dr. Vander Weide does not attempt to

5 differentiate the utilities in his proxy group based on business risk.

6 Business risk is more of a subjective consideration than financial risk and

7 not as easily measured. For his purposes, Dr. Vander Weide assumes the

8 utilities in his proxy group have comparable business risk.

9

10 However, as discussed earlier, Gulf faces substantial business risks,

11 some of which are greater than other utilities – most notably, our exposure

12 to tropical storms and environmental regulations. Given these factors, it is

13 reasonable to conclude that Gulf's overall business risk is at least as high

14 as other electric utilities.

15

16 Q. What is Gulf's cost of debt?

17 A. As shown on Schedule 21 of Ms. Ritenour's Exhibit SDR-1, Gulf's

18 embedded cost of long-term debt is 4.96 percent. For the test year, we

19 project that our cost of short-term debt will average 0.82 percent.

20

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

22 A. As shown on Schedule 21 of Ms. Ritenour's Exhibit SDR-1, Gulf's weighted

23 average cost of capital is 6.47 percent when taking into account both

24 investor sources of capital (common equity, preference stock,

25

1 long-term-debt and short-term debt) and other sources considered for
2 ratemaking purposes (customer deposits, deferred taxes and investment tax
3 credits).
4
5 Q. How does this weighted average cost of capital compare to the other
6 electric utilities regulated by the Commission?
7 A. Even with a fair rate of return on equity of 11.5 percent, Gulf's proposed
8 weighted average cost of capital is lower than all of the other investor-
9 owned utilities in Florida, based on their most recent rate orders.
10
11 Q. Is the weighted average cost of capital proposed by Gulf appropriate in this
12 case?
13 A. Yes. The weighted average cost of capital of 6.47 percent proposed by Gulf
14 will provide debt and equity investors the opportunity to earn a fair return,
15 and allow Gulf's customers to continue to enjoy the benefit of the lowest
16 overall cost of capital among Florida IOUs.
17
18
19 **VIII. FINANCIAL GOALS AND EMPLOYEE COMPENSATION**
20
21 Q. What goals does Gulf's compensation package incorporate in the
22 determination of variable or at-risk pay?
23 A. As discussed by Mr. Garvie, Gulf's short-term performance based
24 compensation plan includes operational goals as well as financial goals
25 related to Gulf's ROE and Southern Company's earnings per share (EPS).

1 The long-term incentive compensation plan uses a goal related to Southern
2 Company's stock performance.
3
4 Q. Are these financial goals important to Gulf's customers?
5 A. Absolutely. Each of the financial goals measures performance that provides
6 a benefit to Gulf's customers. As the Commission recognizes, financial
7 strength and ROE are important to our ability to sustain safe and reliable
8 service to its customers. Just as our operational goals are essential to
9 ensuring that our employees provide high quality service, the financial goals
10 ensure that they do it cost effectively and also recognize the importance that
11 meeting our investors' expectations has in sustaining that service into the
12 future.
13
14 Q. Please explain how the ROE and EPS goals in the short-term incentive
15 compensation plan benefit customers.
16 A. As I have previously discussed, Gulf's ROE has a direct relationship to the
17 financial performance required to maintain Gulf's access to capital. That
18 access is important to our customers, who depend on Gulf to make the
19 investments required to serve them safely and reliably.
20
21 The second financial goal, Southern's EPS, is the measure used to gauge
22 the financial performance of Gulf's parent company. Just as Gulf's return to
23 its investors is critical to ensure access to capital and sustain the integrity of
24 our service to customers, Southern Company must also satisfy its investors
25 to maintain access to the capital markets.

1 As described in more detail by other witnesses, Gulf's customers derive
2 many benefits from being a part of the Southern Company system. These
3 include system reliability and generation optimization, as well as the
4 economies of shared services in areas such as system planning and
5 technical engineering expertise. Additionally, as Gulf's parent company and
6 sole common equity investor, we are dependent on Southern Company's
7 ability to access the capital markets for equity capital, when needed for
8 investment in our systems. Including a Southern Company goal in our
9 employees' compensation plan ensures our employees continue to
10 recognize both the direct benefits we receive from the system and the
11 importance of Southern Company's financial strength for Gulf and its
12 customers.
13
14 Our employees engage and work with counterparts across the system on a
15 daily basis in order to serve our customers better by drawing on the
16 expertise and best practices of both our shared services and sister
17 operating companies. But it is also important that our employees
18 reciprocate and share their own experiences and expertise. A shared goal
19 ensures that our employees recognize and realize the benefits we derive
20 from being part of the Southern system, and that we also contribute value to
21 the other companies in the system. Gulf's customers benefit by our
22 employees' engagement with and contributions toward the financial success
23 of our parent company.
24
25

1 The Commission recognized this very concept when approving the
2 Southern Company financial goal in allowing short-term at-risk
3 compensation costs in Gulf's last rate case:

4 We recognize that the financial incentives that Gulf
5 employs as part of its incentive compensation plans may
6 benefit ratepayers if they result in Gulf having a healthy
7 financial position that allows the Company to raise funds
8 at a lower cost than it otherwise could. (Order No. PSC-
9 12-0179-FOF-EI at 94)

10

11 The three components of the short-term performance based compensation
12 program strike the appropriate balance. Two of the three components are
13 tied directly to Gulf's performance and balance the operational and financial
14 measures. The last of the three components ensures that all employees of
15 the Southern Company work together to realize the benefits of being part of
16 the system.

17

18 Q. What about Gulf's long-term incentive compensation?
19 A. As discussed earlier, Gulf's customers benefit from being a wholly owned
20 subsidiary of the Southern Company and have a vested interest in its
21 success. The EPS measure in the short term incentive plan addresses the
22 Company's current year performance and is a part of all employees' at-risk
23 compensation.

24

25

1 The Company's management personnel, including most first line
2 supervisors, also have a portion of their at-risk compensation based on
3 Southern Company's stock price performance over a three year period. Just
4 as we must invest in and maintain our systems for the long-term, we must
5 also consistently satisfy our investors in order to attract the required capital.
6 The management employees covered by the long-term incentive
7 compensation plan have greater ability to influence the long-term
8 performance of the Company. This portion of Gulf's compensation program
9 provides the Company's management employees with the incentive to
10 ensure that their actions and decisions meet investor expectations not just
11 this year but on a sustainable basis.
12
13 Q. Would customers be served equally well if variable pay were tied only to
14 operational goals?
15 A. No. If variable (at-risk) pay were linked only to achievement of operational
16 goals, employees would be rewarded for meeting goals without regard to
17 the cost incurred to achieve them. By using a combination of operational
18 and financial goals, employees are provided the incentive to provide
19 outstanding customer service in a cost-effective manner that helps to
20 sustain a financially strong company.
21
22
23
24
25

1 ## IX. PARENT DEBT ADJUSTMENT

2

3 Q. What is the parent debt adjustment?

4 A. It is a regulatory adjustment to reduce the amount of income tax expense to

5 be included in rates, pursuant to Commission Rule 25-14.004.

6

7 Q. Please provide a brief overview of that rule.

8 A. The parent debt adjustment rule was adopted by the Commission in 1983.

9 For ease of reference, I have included a copy of that rule as Schedule 7 of

10 my exhibit. This rule applies in rate proceedings where (1) a parent-

11 subsidiary relationship exists, (2) the parent and subsidiary participate in

12 filing a consolidated tax return, and (3) funds provided by parent debt have

13 been invested in the equity of the regulated subsidiary. If all three factors

14 are present, the rule provides a formula for reducing the subsidiary utility's

15 income tax expense to reflect the tax effect of the parent debt that is

16 invested in the equity of the subsidiary.

17

18 Q. What is the basis for the rule's adjustment to income tax expense?

19 A. The premise is that parent debt has been invested in the equity of the

20 regulated subsidiary; thus, the income tax benefit of the interest deduction

21 for the debt should accrue to the regulated subsidiary.

22

23 Q. Are the interest costs associated with that parent debt included in rates?

24 A. No. The interest expense is not included in rates.

25

1 Q. Is the parent debt included in the regulated subsidiary's capital structure?
2 A. No. Only the debt issued by the regulated subsidiary is included in the
3 capital structure used to set rates.
4 Q. What are the financial implications of making a parent debt adjustment?
5 A. The parent debt adjustment results in an inconsistency between the federal
6 income tax interest deduction imputed for ratemaking purposes on the one
7 hand and the utility's actual interest expense and capital structure on the
8 other. This inconsistency would have two primary effects. First, imputing to
9 the subsidiary the tax benefits of parent company debt effectively assumes
10 that the Company has more debt in its own capital structure than actually
11 exists. The parent debt adjustment assumes there are tax benefits of
12 parent company debt accruing to the subsidiary without recognizing the
13 associated financial risk of having more debt in its capital structure.
14 Appropriately, the Commission does not impute parent company debt into
15 the subsidiary's capital structure. It would be inappropriate to impute any
16 tax benefits associated with such debt.
17
18 Second, by artificially reducing the federal income tax expense used to
19 establish the subsidiary's rates, the adjustment decreases the subsidiary's
20 effective return on equity. Making such an adjustment in this case would
21 reduce Gulf's effective ROE by approximately 18 basis points compared to
22 what the Commission otherwise determines is a fair rate of return.
23
24
25

1 The Commission should consider these impacts of applying the parent debt
2 rule when weighing the evidence to rebut the presumption that Southern
3 Company's investment in Gulf is funded in part by parent debt.
4
5 Q. In calculating Gulf's income tax expense for the test year, Ms. Ritenour
6 does not make a parent debt adjustment under Commission Rule 25-
7 14.004. Why isn't such an adjustment required?
8 A. The rule does not require an adjustment in this case because only two of
9 the three factors in the rule are met. Gulf is a subsidiary of Southern and it
10 participates in filing a consolidated income tax return; thus the first two
11 factors are met. The third factor is not met because no funds provided by
12 Southern debt have been invested in the equity of Gulf.
13
14 Q. Doesn't subsection (3) of the rule create a presumption that Southern's
15 equity investment in Gulf is supported by debt based on the ratio of debt in
16 Southern's overall capital structure?
17 A. Yes, but the rule also states that the presumption is rebuttable. The
18 presumption can be rebutted - and the rule does not require an adjustment -
19 if the utility shows that the parent's equity investment did not come from
20 debt issued at the parent level. Gulf rebutted this presumption in the 2012
21 case and the factors which were sufficient to rebut the presumption in 2012
22 still exist for the 2014 test year.
23
24 Q. How did the Commission rule on this issue in 2012?
25 A. The Commission did not make a parent debt adjustment in setting Gulf's

1 rates. In Order No. PSC-12-0179-F0F-EI, the Commission first found that:
2 "On its face, the Parent Debt Adjustment Rule is inconsistent with our long-
3 standing practice of determining allowable utility taxes on a stand-alone
4 basis." (Order at page 114)
5
6 After an extensive discussion of the testimony regarding the parent debt
7 adjustment, the Commission concluded that:
8 the preponderance of the evidence indicates Gulf
9 effectively has rebutted the presumption that Southern
10 Company invested debt dollars in Gulf's common equity
11 in direct proportion to the percent of debt in Southern
12 Company's parent only capital structure. Consequently,
13 we find that no debt adjustment shall be made in the
14 case. (Order at page 116)
15
16 Q. What was the basis of that rebuttal?
17 A. Gulf itself, not Southern debt, had effectively provided the funding for
18 Southern's equity investment in Gulf. Dividend payments made by Gulf to
19 Southern had exceeded the equity investments made by Southern in Gulf.
20
21 For the period between Gulf's previous rate case in 2003 and the 2012
22 case, Gulf had paid $655.8 million in dividends to Southern, while Southern
23 had made equity investments in Gulf of $459.0 million. Thus Gulf's dividend
24 payments had been sufficient to support 100% of Southern's equity
25 investments and still result in a net payment to Southern of $196.8 million.

1 This showed that Gulf itself, not Southern debt, had effectively provided the
2 funding for Southern's equity investment in Gulf.
3
4 Q. To rebut the presumption, did Gulf trace the dollars invested by Southern to
5 prove that the investment was sourced by the dividends paid by Gulf, as
6 opposed to Southern debt?
7 A. No. Dollars are fungible. Tracing dollars to prove that the third factor is
8 met - or not met - is simply not possible. However, the rule cannot properly
9 be interpreted to require an exact tracing. If exact tracing of dollars were
10 required, the presumption in the rule would be effectively irrebuttable. This
11 cannot be what the Commission intended.
12
13 Q. Did the Commission address tracing of dollars in the previous case?
14 A. Yes. In Order No. PSC-12-0179-F0F-E1, the Commission stated:
15 Although funds cannot be traced, it is more logical to
16 assume that Southern Company returned dividend dollars
17 to Gulf to maintain an appropriate level of equity in Gulf
18 than to assume Southern Company issued debt to invest
19 in Gulf's equity. (Order at page 116)
20
21 Q. Have the dividends paid by Gulf continued to exceed equity investments
22 made by Southern in Gulf?
23 A. Yes. Gulf has continued to pay more in dividends to Southern than the
24 amount of Southern's equity investments in Gulf. From January 1, 2011
25 through June 30, 2013, Gulf has paid dividends in the amount of $283.5

1 million while Southern has made equity investments in Gulf in the amount of
2 $130.0 million.
3
4 Q. Does Gulf forecast additional dividends paid to Southern and additional
5 equity investments in Gulf by Southern for the remainder of 2013 and 2014?
6 A. Yes. Schedule 8 of my Exhibit presents the actual and forecasted dividends
7 paid by Gulf and the equity investments from Southern for the period 2011
8 through 2014. Between July 1, 2013 and the end of 2014, Gulf is projected
9 to pay dividends to Southern in the amount of $178.3 million while Southern
10 is projected to make equity investments in Gulf of $120.8 million.
11
12 In aggregate, dividends paid to Southern are expected to exceed equity
13 investments in Gulf by $211 million from 2011 through the end of the test
14 year. Thus, Gulf will continue to be a net returner of capital to Southern, not
15 a net recipient. As in the last rate case, Gulf effectively provides the funding
16 for Southern's equity investment in Gulf with its own internally generated
17 funds.
18
19 Q. Has the Commission made a parent debt adjustment in any of Gulf's prior
20 rate cases?
21 A. No. The rule was adopted in 1983. Since that time Gulf has had three
22 rate cases before the Commission, and the Commission has never made a
23 parent debt adjustment pursuant to Rule 25-14.004.
24
25

1 **X. SUMMARY**

2

3 Q. Please summarize your testimony.

4 A. The rate relief authorized in 2012 has not provided Gulf with sufficient base
5 rate revenues to sustainably provide safe and reliable service to our
6 customers. While Gulf has invested in its systems to provide that service as
7 planned, the revenues required to support that investment have not
8 materialized. Gulf has made efforts and found opportunities to partially
9 offset the revenue deficiencies; however, the resulting level of spending in
10 2012 cannot be continued. Due to the need for continued investment as
11 well as expected increases in O&M expense, the cost to meet our obligation
12 to serve customers will continue to increase. Projected sales growth simply
13 will not cover that higher cost to serve.

14

15 Gulf's rates must be increased to sustain its financial strength to fund
16 investment and O&M expenses. Gulf has not provided its equity investors
17 with a fair return for over two years and those returns will only decline from
18 current levels without rate relief. A weakening financial position will
19 negatively impact the Company's ability to attract capital on reasonable
20 terms.

21

22 Gulf's capital structure is appropriate for ratemaking purposes. However,
23 Gulf maintains a lower equity ratio than most other electric utilities and the
24 increased financial risk associated with this capital structure should be
25 considered in establishing Gulf's authorized ROE. Dr. Vander Weide

1 makes an explicit adjustment for this increased financial risk in calculating a
2 fair rate of return for Gulf's shareholders. With Gulf's proposed capital
3 structure and returns, our customers will continue to enjoy the benefits of a
4 low weighted average cost of capital.
5
6 The inclusion of financial goals along with operational goals in determining
7 the variable pay portion of Gulf's compensation package benefits our
8 customers by ensuring that employees have the appropriate incentives to
9 act in the best interest of our customers by providing outstanding
10 operational performance while maintaining a financially strong company.
11
12 Finally, Gulf has shown that, as in its last rate case, the equity investments
13 by Southern are not funded by debt issued at the parent company level.
14 Gulf has thus rebutted the presumption in the parent debt adjustment rule
15 and demonstrated that no adjustment is necessary for ratemaking
16 purposes.
17
18 In summary, Gulf is committed not only to meeting the minimum
19 requirements of its obligation to serve, but also continuing to meet the
20 expectations of high quality service. Gulf is requesting an annual increase
21 of $74.4 million in its retail base revenues in order to do that. Further, if the
22 Commission determines that our transmission investments associated with
23 environmental compliance are more appropriately recovered in base rates
24 than the environmental clause rates, we also request an additional increase
25 of $16.4 million, effective July 1, 2015.

1 Q. Does this conclude your testimony?

2 A. Yes.

3

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AFFIDAVIT

STATE OF FLORIDA)
)
COUNTY OF ESCAMBIA)

Docket No. 130140-EI

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.

R. Scott Teel
R. Scott Teel
Vice President and Chief Financial Officer

Sworn to and subscribed before me this 8th day of July, 2013.

Monica A Williams
Notary Public, State of Florida at Large

Commission No. EE 166803

My Commission Expires 2/6/16

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
D-3	Short-Term Debt
D-7	Common Stock Data
D-8	Financing Plans – Stock and Bond Issues
D-9	Financial Indicators – Summary
F-1	Annual and Quarterly Reports to Shareholders
F-2	SEC Reports
F-3	Business Contracts with Officers or Directors
F-8	Assumptions
F-9	Public Notice

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GULF POWER COMPANY
Witness: R. Scott Teel
Exhibit No. ____ (RST-1)
Schedule 2
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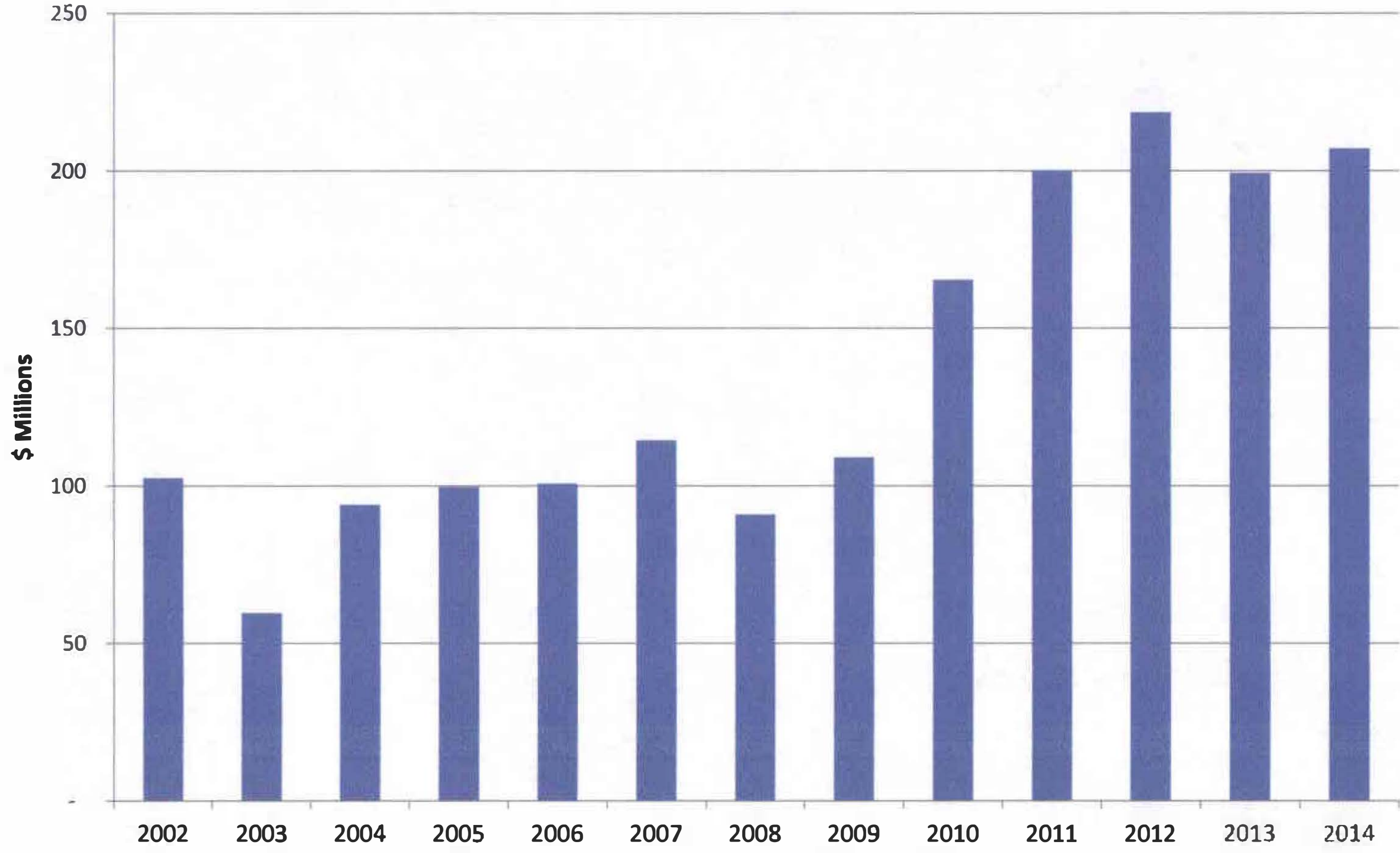
Base Rate Capital Expenditures *

(actuals through 2012)



* Capital expenditures shown on graph do not include wholesale, clauses and non-utility

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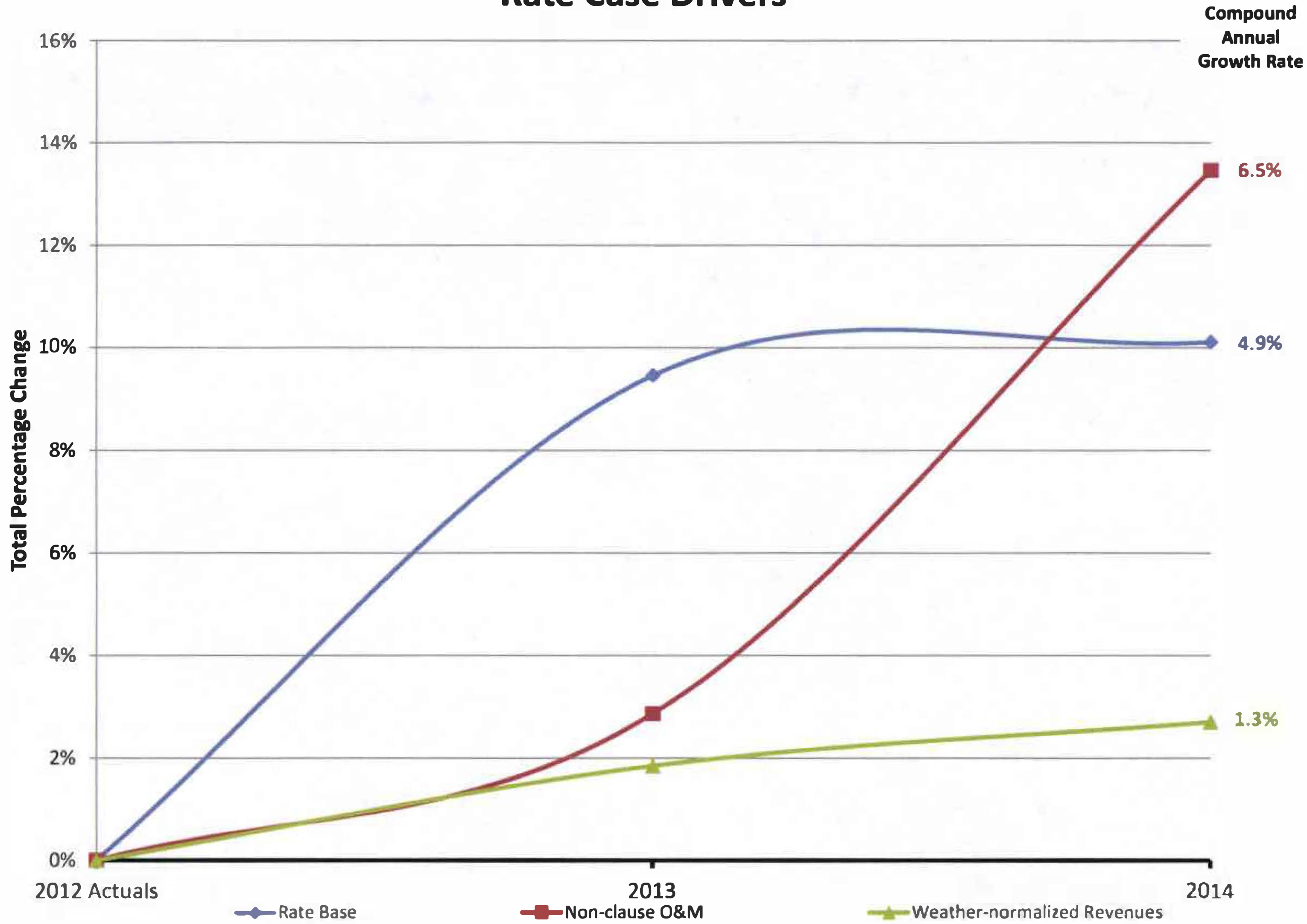

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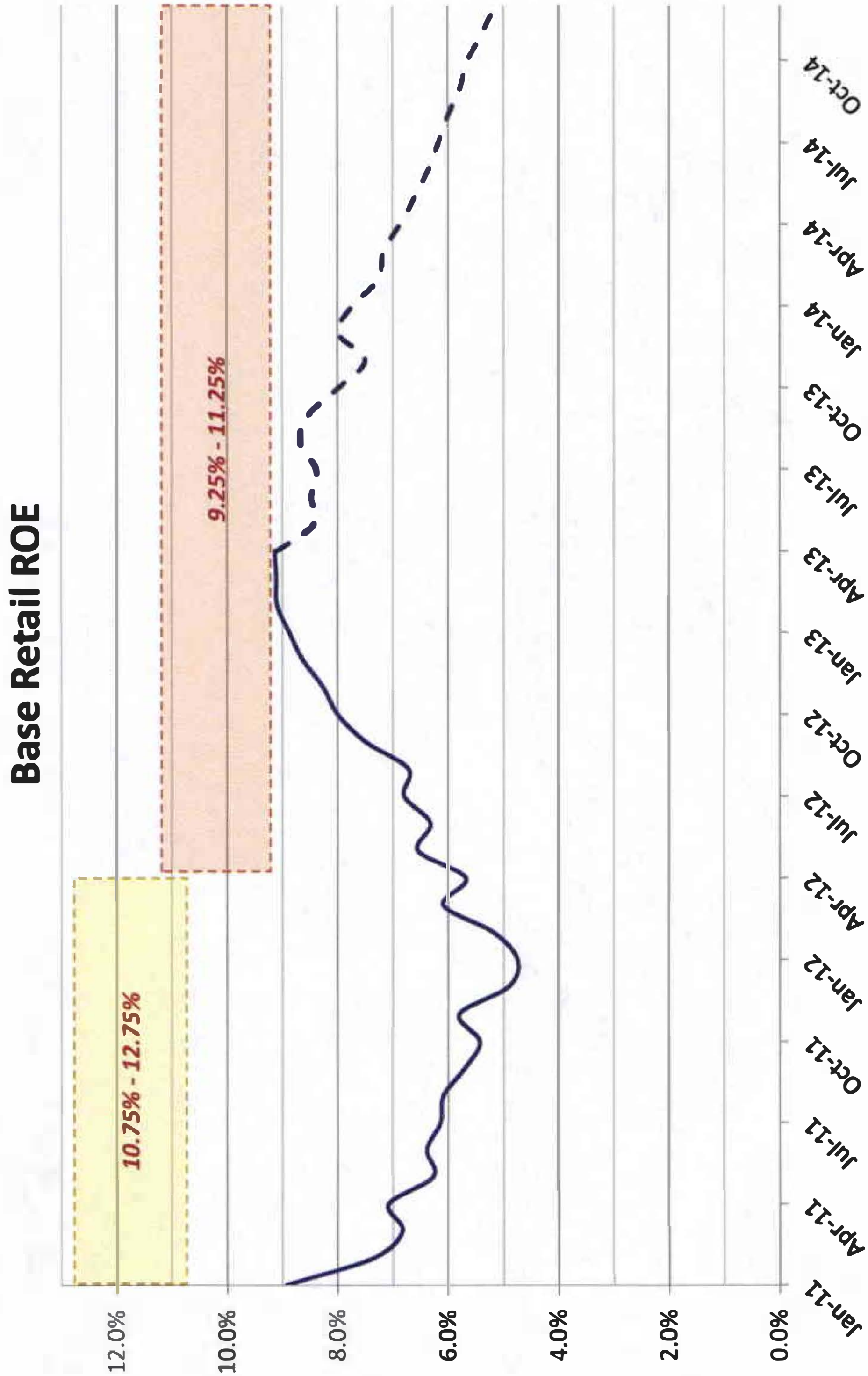

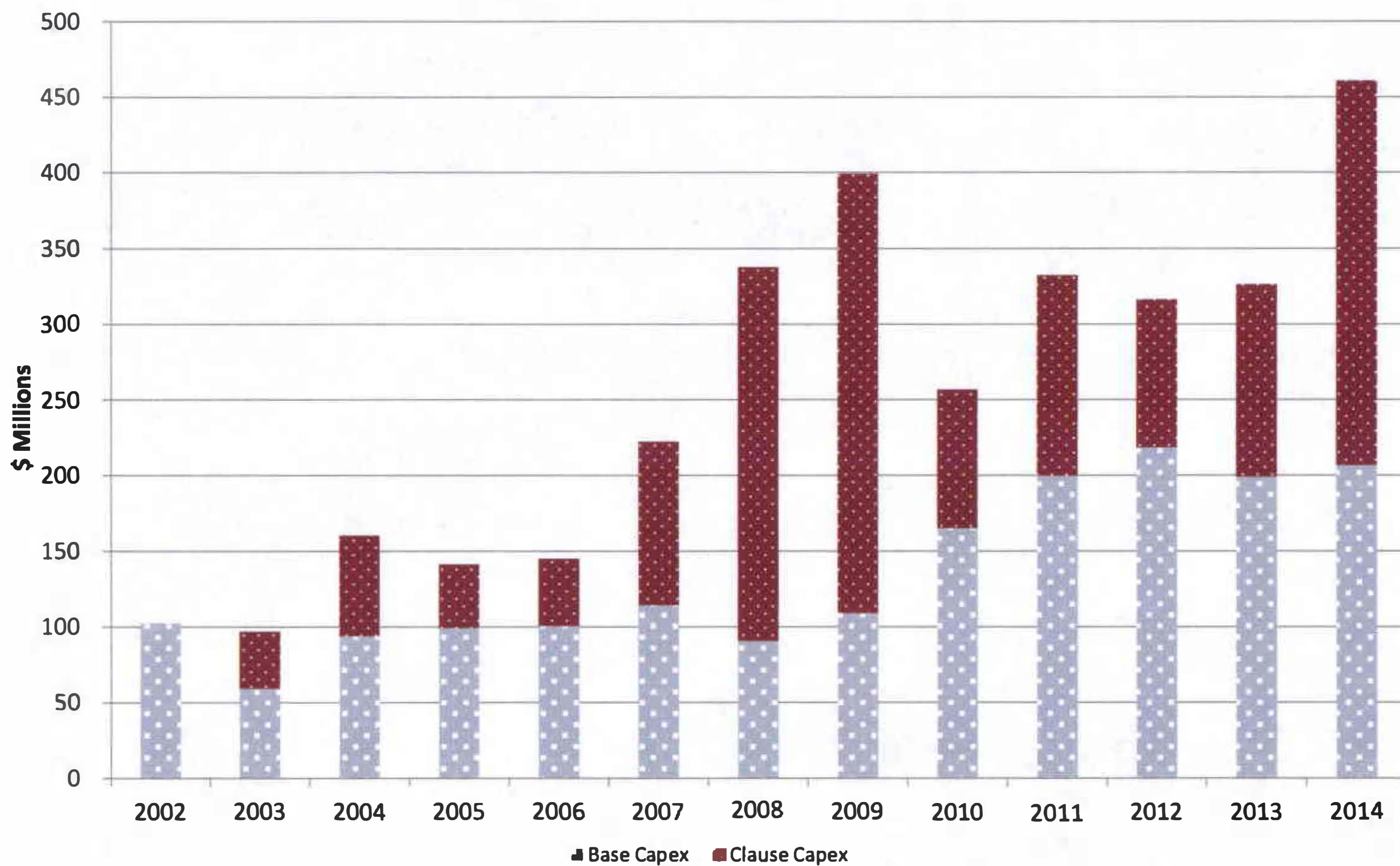

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GULF POWER COMPANY
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Schedule 6
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PARENT DEBT ADJUSTMENT RULE 25-14.004

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.

Gulf Dividends Compared To Southern Company Capital Contributions 2011 - 2014 ($0000)

Year	Gulf Dividends to Southern	Gulf Equity from Southern	Net Cash To (From) Southern
2011	110,000	50,000	60,000
2012	115,800	40,000	75,800
1Q & 2Q - 2013	57,700	40,000	17,700
Subtotal	283,500	130,000	153,500
3Q & 4Q - 2013 Projection	57,700	-	57,700
2014 Projection	120,560	120,798	(238)
Subtotal	178,260	120,798	57,462
Total	**461,760**	**250,798**	**210,962**

Note: Equity contributions typically occur during 1st quarter of each year.