TOWERS WATSON

Memorandum

Date:	June 13, 2013
To:	Jeffrey A. Stone, Esq. — Beggs & Lane
From:	David Wathen — Towers Watson/Atlanta Kevin Stiefler — Towers Watson/Atlanta
Subject:	Audit of Gulf Power's Pay Programs

Gulf Power Company (Gulf Power) is filing a request with the Florida Public Service Commission (FPSC) for a base rate adjustment. In preparation for this request, Gulf Power asked Towers Watson to review the competitiveness of its current pay programs relative to utility industry market practices.

In performing this review, Towers Watson analyzed the following plans, programs and processes for Gulf Power:

- Pay philosophy
- Annual merit increases
- Pay benchmark process
- Competitive market positioning of total pay (base salary and at-risk pay)
- At-risk pay programs
  - Performance Pay Program – the company's annual at-risk pay program
  - Stock Option and Performance Shares – the company's long-term at-risk pay programs

Summary Findings

Based on our review, we find:

- Gulf Power's total pay philosophy of targeting the 50th percentile of similarly sized utilities is consistent with the majority of utility peer companies examined and our consulting experience suggests it is the most prevalent practice across general industry

- Historical merit increases at Gulf Power have typically been below market levels over the last 13 years

- Gulf Power's pay benchmarking process is consistent with utility industry and general industry market best practices

- When compared to available published survey data, Gulf Power's pay levels are competitive with market levels based on the company's stated pay philosophy for base salary and target total direct compensation (Target TDC = base salary + at-risk pay)

- Gulf Power's strategy to provide at-risk pay (both annual and long-term) is consistent with the majority of publicly-traded utility peers examined. While specific design elements of at-risk pay programs may differ among utility peers, Gulf Power's design differences are limited. Overall, we find the

Company's at-risk pay program designs to be comparable to and competitive with designs of utility peers

- Based upon our review, we find Gulf Power's overall pay plans, programs and processes to be comparable to and competitive with utility peer practices

Pay Philosophy

Gulf Power's pay philosophy is to target base salary, annual at-risk and long-term at-risk pay at the 50th percentile of similarly sized utilities.

Towers Watson reviewed current proxy disclosures for the following two market perspectives to assess how Gulf Power's pay philosophy compares to market practice:

- Large Utility Peer Group – 15 publicly-traded, comparably-sized electric utilities with revenues in a range of approximately ½ to 2 times the revenues of Southern Company (see Exhibit 1 for the list of Large Utility Peer Companies)

- Small Utility Peer Group – Since comparably-sized subsidiary utilities like Gulf Power do not generally disclose pay program data, a peer group of 15 publicly-traded, comparably-sized electric utilities with revenues in a range of ½ to 2 times the revenues of Gulf Power were used for comparison (see Exhibit 2 for the list of Small Utility Peer Companies)

When developing peer groups for comparison, assessing companies with revenues in a range of ½ to 2 times company revenues is standard practice in compensation consulting and is also a guideline utilized by Institutional Shareholder Services (ISS), a prominent proxy advisor firm.

Pay Philosophy Review Findings

Based on our review, Gulf Power's pay philosophy aligns well with both market perspectives. Most peers (14 of the 15 Large Utility Peer Group and 14 of the 15 Small Utility Peer Group) target the market 50th percentile for some or all pay elements. For those companies that do not target the market 50th percentile, 1 small utility does not disclose a pay philosophy and 1 large utility targets the market 75th percentile for selected roles/critical positions. Likewise, Gulf Power's target pay positioning of the market 50th percentile aligns with the more common market practice found in the general industry.

Annual Merit Increases

Towers Watson was provided the actual average merit increase rates provided to all employees at Gulf Power from 2001 to 2013.

The WorldatWork Salary Budget Survey (a nationally renowned salary budget survey) was used by Towers Watson to assess the competitiveness of base salary merit increases at Gulf Power. The competitiveness of Gulf Power's merit increases were determined by using both the utility and general industry data cuts available in the WoldatWork survey.

TOWERS WATSON

The table shown below identifies the actual average base salary merit increase provided to all employees at Gulf Power and compares this to the median total salary budget increases for all employees using the utility and general industry data from the WorldatWork survey.

Year	Gulf Power Average Increase as % of salary	Utility Median Actual Salary Budget Increase	General Industry Median Actual Salary Budget Increase
2013	2.8%	3.0%[1]	3.0%[1]
2012	2.9%	2.9%	3.0%
2011	2.6%	3.0%	3.0%
2010	2.7%	2.8%	2.7%
2009	0.0%	3.0%	2.5%
2008	3.5%	4.1%	3.9%
2007	3.3%	3.7%	3.9%
2006	3.4%	3.8%	3.8%
2005	3.3%	3.6%	3.7%
2004	3.1%	3.4%	3.6%
2003	3.7%	3.3%	3.6%
2002	3.9%	3.8%	3.9%
2001	4.2%	4.4%	4.6%

[1]Market data represents projected salary budget increases.

Overall, Gulf Power's historical merit increases have typically been at or below market levels for 11 of the last 13 years compared to other utilities and 12 of the last 13 years compared to general industry. It is important to note that given the severe economic decline experienced in 2009, several companies, like Gulf Power, did not provide merit increases.

Pay Benchmarking Process

Towers Watson reviewed the benchmarking process at Gulf Power. The review was conducted by analyzing a sample of positions from the following groups:

- Management employees
- Professional employees
- Non-exempt employees
- Employees covered under a collective bargaining agreement (Covered Employees)

In conducting the review, we analyzed over 110 of Gulf Power's positions, which covered 53% of employees.

Outlined below is the Gulf Power benchmarking process that was reviewed to determine if it was consistent with market norms and best practices:

- Select appropriate benchmark positions
- Review and define each position's duties and responsibilities
- Determine relevant labor market for position
- Use compensation surveys reflective of relevant labor market
- Use multiple compensation survey sources, when available
- Match company positions to compensation survey benchmarks reflective of each position's duties and responsibilities
- Develop a "market rate" for each company position matched to compensation survey benchmark jobs
- Assess competitiveness of Gulf Power's positions to the "market rate"

Pay Benchmark Process Findings

Based on our review, the benchmarking process that Gulf Power utilizes is consistent and aligned with utility industry and general industry market best practices.

Competitive Market Positioning

After reviewing Gulf Power's pay benchmarking process, Towers Watson assessed the competitiveness of Gulf Power's current pay levels to the Company's 50th percentile pay philosophy. To conduct this analysis, we utilized published energy services and general industry compensation surveys available to Towers Watson, including our proprietary 2012 Energy Services and General Industry Compensation Databases, reflecting over 125 and 450 survey participants, respectively.

Our analysis finds that for the positions examined, on average, base salaries at Gulf Power fall 6.1% below the market 50th percentile and target total direct compensation (base salary + at-risk pay) falls 6.2% below the market 50th percentile.

Competitive Market Positioning Findings

Based on our assessment, we have determined that Gulf Power's pay is competitive with the market for base salary and target total direct compensation (target TDC = base salary + at-risk pay), as it falls within a reasonable range of the market. The competitive positioning of pay aligns with Gulf Power's stated pay philosophy of targeting the 50th percentile of similarly sized utilities.

At-risk Pay Programs

Towers Watson reviewed Gulf Power's annual at-risk and long-term at-risk pay programs which include:

- Performance Pay Program – the company's annual at-risk program
- Stock Option and Performance Share Programs – the company's long-term at-risk programs

At-risk pay programs (both short-term and long-term) are used by most investor owned utilities and publicly-traded general industry companies to help attract, motivate and retain critically skilled employees needed to successfully run the business. These programs focus employees on both short- and long-term goals. Therefore, Gulf Power's strategy to provide at-risk pay (both short-term and long-term) is consistent with the market perspectives examined.

We assessed the design of both annual at-risk and long-term at-risk pay programs against the Large Utility Peer Group, the Small Utility Peer Group as well as the following proprietary Towers Watson surveys:

- Annual at-risk pay program: Towers Watson's 2010 Annual Incentive Plan Design (AIPD) Survey energy services cut, reflecting 15 energy services industry participants. This survey is typically updated every three years and is expected to be updated at the end of 2013.
- Long-term at-risk pay programs: Towers Watson's 2012 Energy Services Long-term Incentive Plan (LTIP) Report reflecting 114 energy industry participants (survey conducted by Towers Watson for over 20 years)

Below are the findings of Tower Watson's assessment of the competitiveness of both annual at-risk and long-term at-risk pay programs.

Annual At-Risk Pay Program (Performance Pay Program)

Overall, our review indicates Gulf Power's Performance Pay Program is comparable to and competitive with designs of utility peers. Key design aspects are noted below:

- Eligibility – all regular full-time and part-time Gulf Power employees (with some limited exceptions) are eligible to participate in the Performance Pay Program, which aligns with market practice among utility peers

- Performance Measures – the Performance Pay Program assesses performance using a balanced scorecard approach, incorporating both financial (EPS and business unit ROE) and operational (safety, reliability, availability, and customer satisfaction) metrics. The use of a balanced scorecard approach is the most prevalent practice among the utilities examined
  - The use of EPS among all market perspectives examined is very common as 80% of large utility peers, 57% of small utility peers and almost two-thirds of the energy services peers incorporate EPS as part of their annual at-risk pay program
  - Like Gulf Power, the inclusion of business unit metrics in the annual at-risk program is common among large utilities (60% of the Large Utility Peer Group and almost half of Energy Services peers), but Return on Equity (ROE) is not a common metric among utility or energy services peers as only one large and one small utility peer and no energy services industry peer use this metric in their annual at-risk program

- Performance Weightings – all Performance Pay Program participants, from bargaining unit employees to senior management, have similar performance goal weights (33% Corporate EPS, 33% Business Unit Financial Performance and 33% Operational Performance), as the Company wants to emphasize the equal importance of all performance measures
  - Typical market practice applies different goal weights based on organizational level within the company. For example, business unit management employees would typically have greater weight applied to business unit performance than corporate performance to emphasize their stronger "line of sight" (i.e., ability to influence or impact the performance measure)

Long-Term At-Risk Pay Program

Like the annual at-risk pay program, our review of Gulf Power's long-term at-risk pay program indicates the program is comparable to and competitive with utility peer designs. We outline below key design aspects:

- Eligibility – Gulf Power grants long-term at-risk awards deeper into the organization than most utility peers with awards granted to employees in Grade 7 or a base salary midpoint of $106,140. This award level is lower than the median base salary of the lowest eligible recipient at both large and small utility proxy peers and energy services industry peers. Broader long-term at-risk award eligibility at Gulf Power is intended to facilitate a stronger long-term focus for award recipients
- Long-term At-Risk Awards – Gulf Power grants two types of equity awards (stock options and performance shares) when making annual long-term incentive (LTI) grants, which is the majority practice at the three market perspectives examined (60% of the large utility peers, 60% of the small utility peers and over 40% of the energy services industry peers utilize two award types). However, Gulf Power's long-term at-risk program reflects a stronger performance focus than utility peers as all grants are performance-based (stock options require the current stock price to exceed the stock price at the time of grant to have value and performance shares are only earned if relative Total Shareholder Return (TSR) goals are achieved). Most utility peers grant time-based restricted stock and performance shares where time-based restricted stock has no performance focus as the stock is typically awarded after a defined period of employment has lapsed

- Performance Measures – consistent with Gulf Power, most peers (93% of large utility peers, 87% of the small utility peers and over two-thirds of the energy services industry peers) tie some portion of performance share awards to relative total shareholder return (TSR).

- Performance/Payout Range − Gulf Power provides a maximum payout opportunity of 200% of target which is the majority practice among all three market perspectives examined. However, Gulf Power requires stronger relative TSR performance (90th percentile achievement against peers) than large utility peers which typically only require 75th percentile TSR performance for a maximum award to be earned. Small utility peers are almost evenly split between requiring the same/higher relative TSR performance level (90th, 95th or 100th percentile) or a performance level below Gulf Power's level (75th, 80th or 85th percentile) to receive a maximum award opportunity. Gulf Power's maximum relative TSR performance achievement level is consistent with the energy services industry peers market perspective

- Peer Groups – performance share awards at Gulf Power are measured against two peer groups to determine if awards are earned. Most utility peers use a single peer group as opposed to two. Gulf Power uses two peer groups to measure performance against a broad utility market perspective reflecting an independent third party index (Philadelphia Utility Index) and a custom peer group of utilities with similar business model and size

At-risk Pay Programs Findings

Our competitive market review indicates Gulf Power's at-risk pay programs are comparable to and competitive with plan designs of other similarly sized utilities.

Conclusion

In summary, we find the form, mix and levels of total pay at Gulf Power to align with the Company's stated pay philosophy and the market practices of utility peers. The market competitive pay program enables Gulf Power to attract, retain and motivate employees needed for continued success.

* * * *

We hope this information is helpful and would be happy to discuss this information in more detail at your convenience.

cc: Mike Butts – Southern Company Services

TOWERS WATSON

Exhibit 1

Large Utility Peer Group

Company	Ticker	Revenue ($000s)	Number of Employees
AES Corp.	AES	$18,141	25,000
American Electric Power Company	AEP	$14,945	18,513
Consolidated Edison	ED	$12,188	14,529
Dominion Resources	D	$13,093	15,500
DTE Energy	DTE	$8,791	9,900
Duke Energy	DUK	$19,158	18,249
Edison International	EIX	$11,862	16,593
Entergy	ETR	$10,302	14,625
Exelon	EXC	$23,489	26,057
FirstEnergy	FE	$14,848	16,495
NextEra Energy	NEE	$14,256	14,400
PG&E	PCG	$15,040	20,593
PPL Corp.	PPL	$12,286	17,729
Public Service Enterprise Group	PEG	$9,781	9,798
Xcel Energy	XEL	$10,128	11,113

25th Percentile	$10,259	14,497
Median	$12,690	16,544
75th Percentile	$14,969	18,315

Data source: Standard & Poor's Capital IQ. Company revenue and employee data reflect fiscal 2012 data.

TOWERS WATSON

Exhibit 1

Small Utility Peer Group

Company	Ticker	Revenue ($000s)	Number of Employees
ALLETE, Inc.	ALE	$961	1,342
Avista Corp.	AVA	$1,547	3,124
Black Hills Corporation	BKH	$1,174	1,925
CH Energy Group Inc.	CHG	$925	1,235
Cleco Corporation	CNL	$994	1,259
El Paso Electric Co.	EE	$853	1,000
Great Plains Energy Incorporated	GXP	$2,310	3,090
IdaCorp, Inc.	IDA	$1,081	2,090
Northwestern Corp.	NWE	$1,070	1,430
Otter Tail Corporation	OTTR	$859	2,286
PNM Resources, Inc.	PNM	$1,342	1,909
Portland General Electric Company	POR	$1,805	2,603
UIL Holdings Corporation	UIL	$1,487	1,865
UNS Energy Corporation	UNS	$1,462	1,979
Westar Energy, Inc.	WR	$2,261	2,313
25th Percentile		$1,013	1,539
Median		$1,258	1,952
75th Percentile		$1,532	2,306

Data source: Standard & Poor's Capital IQ. Company revenue and employee data reflect fiscal 2012 data.