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GULF POWER
A SOUTHERN COMPANY

August 12, 2016

The Honorable Julie Imanuel Brown
Chairman
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

RE: Test Year Notification Pursuant to Rule 25-6.140, F.A.C.

Dear Chairman Brown:

For many years, Gulf Power Company ("Gulf" or "the Company") has provided the people of Northwest Florida with safe and reliable electric service at reasonable rates. Gulf's commitment to invest in the long-term reliability of Northwest Florida's energy infrastructure is unwavering. This commitment is shown through Gulf's building, strengthening, operating and maintaining a secure electric system that relies upon a balanced energy mix and a smarter energy infrastructure, providing Gulf's customers the service they deserve and expect both now and into the future.

Based on our financial projections, our current rates do not produce sufficient revenues for us to be able to continue adequately serving our customers and maintain the Company's financial integrity. Accordingly, it is Gulf's intent to file a petition to change the Company's base rates on a permanent basis. The purpose of this letter is to comply with the notice requirements of the Florida Public Service Commission ("Commission") set forth in Rule 25-6.140 of the Florida Administrative Code. Gulf is proposing the projected twelve months ending December 31, 2017, as the test year for the planned rate case filing. In compliance with the Commission's notification rule, we presently anticipate filing the petition, testimony and minimum filing requirements necessary to initiate a rate case not sooner than October 11, 2016, and not later than October 28, 2016. These dates are all at least 60 days after the date of this letter.

This decision to prepare a new rate case filing has been reached only after thorough and careful consideration. Gulf's last base rate case before the Commission was filed on July 12, 2013, in Docket No. 130140-EI. That case was resolved via a Stipulation and

Settlement Agreement ("2013 Settlement Agreement") among all parties to the proceeding.

Because our 2014 test year rate case was resolved by settlement, Gulf's 2012 test year rate case, Docket No. 110138-EI, is the last time that the Commission specifically reviewed and approved all the elements that make up our base rate revenue requirement. The Company has successfully controlled growth in operation and maintenance (O&M) expenses since 2012, and has made and will continue to make every reasonable effort to avoid or limit the need for rate increases. Since that time, however, the Company continues to make significant and critical capital expenditures for infrastructure that are both reasonable and necessary in order to continue to provide reliable electric service. With continued increases in investment and expenses, coupled with the scheduled expiration of the 2013 Settlement Agreement, we must now seek an adjustment to the Company's base rates and charges in order to be able to continue fulfilling the public service requirements set forth in the statutes and the needs and expectations of our customers.

As part of this notification of the projected test year, Gulf submits the following information:

Test Year

The projected twelve-month period ending December 31, 2017, is the appropriate test year to be used in setting Gulf's rates for the future. The proposed test year is a calendar year that corresponds to the Company's fiscal year and largely corresponds with the first fiscal period that new, permanent rates could be in effect under the terms of the 2013 Settlement Agreement. As a result, the 2017 test year will provide a better match of projected revenues with the projected costs and investment required to provide customers with service than would a test year based on a historical period. In light of the impacts of the major factors necessitating a base rate increase discussed below, the chosen test year will also more accurately depict the conditions under which Gulf expects to operate during the initial period new rates will be in effect. Use of a projected test year that includes information related to rate base, net operating income, and capital structure for the time new rates will be in effect benefits all stakeholders by helping to reduce the impacts of regulatory lag.

Actions and Measures Implemented to Avoid a Base Rate Increase

The 2013 Settlement Agreement contained provisions that limited the amount of rate increases granted and provided several mechanisms that facilitated postponement of further changes in base rates. Gulf agreed not to seek a change in our base rates to be effective any earlier than meter readings for the first billing cycle of July 2017.

Throughout the settlement period, Gulf has continued to put emphasis on cost control and cost reductions. The Company regularly reviews our O&M budget and planned capital expenditures to keep expenses and investment at reasonable and adequate levels. Actual costs are tracked, monitored and evaluated to ensure expenditures incurred are prudent, reasonable and in the best interest of our customers. Our employees pursue cost efficiencies in all aspects of our business.

Since 2012, Gulf has been successful in limiting the growth in our O&M expenses to a level that is in line with the Commission's O&M benchmark. In addition to controlling our O&M expenses, Gulf has successfully reduced our interest expense since 2012 by refinancing debt at lower interest rates.

As evidenced by our strong levels of customer satisfaction, Gulf continues to provide safe, reliable service to our customers. However, the fact remains that growth in base rate revenues has not kept pace with the cost of providing service to our customers. Adequate rate relief through an increase in base rates is necessary now in order for Gulf to have the capability to continue providing our customers with safe and reliable electric service at reasonable prices.

Major Factors Necessitating a Base Rate Increase

As mentioned above, Gulf's revenue growth since 2012 has not kept pace with our increased level of investment and expenses. Despite the additional base rate relief we received under the 2013 Settlement Agreement beginning in 2014 and 2015, the major factors below necessitate this request:

- Capital investments: Since 2012, Gulf's net investment in non-clause assets serving our retail customers will have increased by approximately $750 million from the level included in our Commission-approved rate base. This includes costs associated with Gulf's efforts to maintain a reliable and balanced energy mix as well as our efforts to modernize our transmission and distribution infrastructure. The following is a breakdown of the major components of the increase in capital investment:
    - Gulf's investment in a group of specific transmission projects that all parties to the 2013 Settlement Agreement agreed were prudent for cost recovery purposes,
    - Continued capital investments to maintain and expand our infrastructure to provide reliable service to our retail customers, and
    - The base rate portion of Gulf's ownership in Plant Scherer Unit 3 which has been rededicated to serve the native load customers for whom it was originally purchased and built.

- Slow sales growth: In addition to the increase in the cost of providing electric service noted above, Gulf's base rate revenues have not grown as expected. Due to a combination of slower than forecasted customer growth and a decline in usage per customer, Gulf's weather-normalized annual GWh sales have not reached the level originally projected for 2012, and sales are not currently projected to reach that level in 2017. Although Gulf has been successful in controlling the growth of O&M expenses, the growth in our base rate revenues has not been sufficient both to cover increased expenses and to provide a return on our increased investment.

- Depreciation expense: On July 14, 2016, Gulf filed depreciation and dismantlement studies. The depreciation study reflects new depreciation rates and recoverable lives for our depreciable assets. The resulting impact on annual depreciation expense is an increase of approximately $15 million. This increase is offset by a proposed decrease in Gulf's annual dismantlement accrual of approximately $5 million.

Gulf's test year capital structure reflects an increased level of common equity and a reasonable increase in our Commission-approved return on common equity (ROE). Even with these changes, however, Gulf's overall cost of capital will be lower than it was in 2012. Gulf's retail customers will continue to benefit from a weighted average cost of capital that is among the lowest of the major investor owned utilities in the state.

As a combined result of the increase in the cost of providing electric service and the slower than expected growth in base rate revenues described above, Gulf's return on equity is projected to fall below the range of reasonableness set by the Commission in Gulf's last rate case. Gulf presently estimates that an increase in annual revenues of approximately $115 to $125 million is necessary to produce sufficient revenues to allow us to continue to provide the electric service our customers require.

<u>Other Matters</u>

Pursuant to Rule 25-6.140, this letter must contain a statement indicating that Gulf either is or is not requesting that the Commission process the Company's petition for rate increase ". . . using the proposed agency action process authorized in Section 366.06(4), Florida Statutes." Since Gulf's annual sales to end-use customers exceeds the 500 gigawatt-hour threshold specified in that statutory section, Gulf is not requesting that the Commission process the Company's petition for a rate increase using the proposed agency action process.

The Company anticipates a filing date as soon as practicable following the required notification period (i.e., no earlier than October 11, 2016). If the Company cannot file by October 28, 2016, the Company will notify the Commission in writing prior to that date. Such letter will include an explanation as to why the Company will not meet the filing date as well as a revised target filing date.

As I hope is evident from this letter, we are planning to file a request for rate relief only after serious deliberation. An increase in base rate revenues is now necessary to maintain a reliable electric system and to preserve our financial integrity, which is in the long-term best interest of our customers.

Respectfully submitted,

GULF POWER COMPANY

By: ______________________________
S. W. Connally, Jr., Chairman, President and CEO

cc: Florida Public Service Commission

Hon. Lisa Polak Edgar, Commissioner
Hon. Art Graham, Commissioner
Hon. Ronald A. Brisé, Commissioner
Hon. Jimmy Patronis, Commissioner
Braulio L. Baez, Executive Director
Keith Hetrick, General Counsel
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