BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
TALLAHASSEE, FLORIDA

IN RE: Investigation into the earnings and authorized return on equity for Gulf Power Company.

DOCKET NO. 990250-EI

IN RE: Petition by Gulf Power Company for approval of proposed plan for an incentive revenue sharing mechanism that addresses certain regulatory issues including a reduction to the company's authorized return on equity.

DOCKET NO. 990244-EI

COPY

BEFORE:	CHAIRMAN JOE GARCIA COMMISSIONER J. TERRY DEASON COMMISSIONER SUSAN F. CLARK COMMISSIONER JULIA A. JOHNSON COMMISSIONER E. LEON JACOBS
PROCEEDING:	AGENDA CONFERENCE
ITEM NUMBER:	10**
DATE:	March 16, 1999
PLACE:	4075 Esplanade Way, Room 148 Tallahassee, Florida

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APPEARANCES:

JEFF STONE, Esquire, representing Gulf Power Company

STAFF RECOMMENDATION

Issue 1: Should the Commission approve GPC's petition for approval of proposed plan for an incentive revenue sharing mechanism that addresses certain regulatory issues including a reduction to the Company's authorized ROE (Attachment C of staff's March 4, 1999 memorandum)?

Recommendation: No. The Commission should not approve GPC's petition.

Issue 2: Should the Commission order GPC to place money subject to refund?

Recommendation: Yes. Pursuant to Section 366.071, Florida Statutes, the Commission should order GPC to place $2,772,085 of annual revenue under corporate undertaking subject to refund, including interest, pending final disposition in this proceeding. Consistent with Section 366.071(2)(b), Florida Statutes, GPC is authorized to continue to collect the previously authorized rates, subject to the appropriate corporate undertaking.

Issue 3: Should the Commission approve the plan listed in Attachment B of staff's memorandum?

Recommendation: Yes. The Commission should approve the sharing of earnings plan in Attachment B for Gulf Power Company.

Issue 4: Should the Commission initiate a proceeding to investigate Gulf Power Company's earnings and authorized ROE?

Recommendation: Yes. If Issue 3 is not approved, staff believes that an investigation should be initiated and a limited proceeding hearing should be held to determine the appropriate ROE and range.

Issue 5: Should the Commission order GPC to file Minimum Filing Requirements (MFRs)?

Recommendation: Yes. If Issue 3 is not approved, staff recommends that the Commission order the Company to file MFRs, by June 15, 1999, using 1998 as the base year, and 1999 as the projected test year.

Issue 6: Should the Commission initiate a review of GPC's executed Contract Service Agreements (CSA) under its Commercial/Industrial Service Rider tariff (CISR)?

Recommendation: Yes. For the twelve-month period ending December 31, 1998, GPC reported an achieved ROE of 12.99%. The top of GPC's currently authorized ROE range is 13.00%.

The addition of the revenues that would have been produced by GPC's otherwise applicable tariff and the revenues that are produced under the CISR (revenue shortfall) cause GPC's ROE to exceed the top of its authorized range. Order No. PSC-96-1219-FOF-EI requires the Commission to review each CSA if the addition of the revenue shortfall causes GPC to exceed the authorized top of its range. In addition to the amount of revenue identified in Issue 2, the amount of the revenue shortfall over the top of the range should be held subject to refund pending the completion of the review.

Issue 7: Should Docket No. 990244-EI be closed?

Recommendation: Yes. Docket No. 990244-EI should be closed if no person whose interests are substantially affected by the proposed action files a protest within the 21-day protest period.

Issue 8: Should Docket No. 990250-EI be closed?

Recommendation: No. Docket No. 990250-EI should not be closed.

P R O C E E D I N G S

CHAIRMAN GARCIA: All right. We go now to Item Number 10.

COMMISSIONER JOHNSON: MR. Chairman, for the record on Item 4, show me voting with the majority.

COMMISSION STAFF: Commissioners, Item Number 10 is staff's recommendation concerning two related dockets. The first docket is a petition filed by Gulf Power Company for a proposed incentive plan. The second docket is a docket opened by staff as an investigation into Gulf Power's earnings and authorized return on equity. I believe the company would like to speak.

CHAIRMAN GARCIA: Mr. Stone.

MR. STONE: Thank you, Commissioners. As a preliminary matter, Commissioners, we have -- in an effort to help facilitate reference to materials that I may make comments about, we have prepared a version of our petition with its attachments that has a consecutive number stamped from front to back in the lower right-hand corner that we would like to distribute at this time. So that if I can refer to it by that page numbering rather than by the attachment page numbers it may help people find them as I refer to them.

I appreciate your indulgence while we handed out that document. I think it will speed things along as we go through the presentation. Thank you for the time certain this afternoon, Commissioners, and we appreciate the opportunity to speak to you and discuss our proposal.

I have with me several individuals from the company that will have answers to particular questions if you have them, but I would like to make a presentation to you to discuss our plan. And I will have four outline points that I will cover in my presentation. First, I would like to present an overview of the plan itself and a summary of our petition. I then will go into some greater detail about the sharing plan itself.

An element of our sharing plan contemplates a change to Gulf's authorized return on equity, and I will discuss the rationale behind the proposed change Gulf has made. And then finally my fourth point will be to discuss how Gulf's plan builds on and improves upon the incentives that are available under the existing regulatory framework.

Commissioners, we believe that the company -- well, first of all, the company has formulated this plan that has been presented to you in order to directly address staff's stated concerns regarding the current level of Gulf's authorized return on equity and the outstanding balance of certain regulatory assets. Gulf has developed a positive plan that addresses staff's stated concerns in a reasonable manner and provides opportunities for significant benefits to customers and shareholders alike.

We appreciate you allowing us the time to speak to you and to carefully explain our plan and to discuss why it should be approved and is in the public interest. The foundation for Gulf Power's proposal is the company's sustained performance on three key indicators that are of importance to the Commission: Rates, reliability, and level of customer complaints.

Our proposal properly takes into account significant differences between Gulf and the other Florida electric utilities in regards to five year trends in these key indicators. The data on the key indicators is shown on Attachment B to our petition, and that would be found at Pages 11 and 12 if you use the consecutive number stamping that's in the lower right-hand corner of the document we handed out to you.

There are a number of tables there, and I will highlight some information that are on those tables.

The data on these key indicators show sustained superior performance by Gulf Power, both in absolute numbers and in general trends on prices for residential customers, on the number of minutes of interruption per customer per year, and we refer to that as the System Average Interruption Duration Index, or SAIDI is the abbreviation. And then the third chart shows the level of customer complaints to the Commission, justified complaints. And I will take those in turn.

First, Gulf's customers presently benefit from the fact that Gulf Power has the lowest electric rates in Florida and among the lowest in the nation. Gulf's cost of $62.06 for 1000 kilowatt hours is the 58th lowest of the 60 utilities across the nation that were included in the October 1998 JEA survey. And the JEA survey is the generally recognized industry survey instrument to compare electric rates.

The December 1998 cost of 1000 kilowatt hours for Florida's largest electric utility was $76.40. This compared to Gulf's cost of $62.06. That $76.40 is 23 percent higher than the comparable cost for Gulf. Nearly one and a quarter times the cost paid by Gulf customers.

Excluding Gulf Power, that 76.40 is the lowest among the four major investor-owned utilities of such utilities in Florida. So you can see that Gulf has sustained -- shown sustained superior performance with regard to rates and price.

Gulf's customers also benefit from Gulf's high reliability. As shown on Exhibit B, Page 12 of the overall document, the annual minutes of interruptions per customer in 1996, the most recent published data from the PSC, were 38.6 minutes for Gulf compared to a range of 134 minutes to 158.39 minutes for Florida's two largest electric utilities. More importantly, the five year average for 1992 to 1996 for Gulf was 46.8 compared to a range of 100.4 to 125.724 for Florida's two largest electric utilities. Again, Gulf's reliability shows superior performance in the state.

COMMISSIONER DEASON: Mr. Stone,, is 1996 the last available data?

MR. STONE: Commissioner, that was the last published available data. We may have some later data available, and we are happy to share that with you if there is a particular year you are concerned about. But we were referring --

COMMISSIONER DEASON: Well, I'm not so much concerned as just curiosity as to why you stopped in '96. And my question is -- that's the last published data available?

MR. STONE: That was the last published data that had all of the utilities together in one document, yes, Commissioner. I'm not sure -- I'm not aware of another publication since then, and that's why we are going back to that document.

Among the four major investor-owned utilities in Florida, Gulf has the lowest annual rate of justified customer complaints per 1000 customers. As the chart shows on Page 12, the number of justified complaints to the Commission regarding Gulf Power for calendar year 1998 was 0.006 per 1000 customers, compared to a range of 0.010 to 0.016 for Florida's two largest electric utilities.

In previous years, the difference between companies is even more dramatic on a per 1000 customer basis. Gulf's performance in these areas reflects the company's long-term focus on issues related to customer satisfaction and values. Gulf is highly ranked among leading electric utilities across the country in regards to customer satisfaction. There is a chart in Attachment C of our petition. It's found on Page 17 of the document. And it shows Gulf's outstanding overall customer satisfaction and perceived values, relative ranking based on the most recent 1998 benchmark survey. I would like to review those results with you briefly.

We have taken that chart and shown it on a poster over there to your right. But the information shows that for residential customers, Gulf's overall satisfaction showed that it was ranked six out of twenty-one leading utilities. On perceived value for the residential class, it was fifth out of twenty-one leading utilities. In the general business class, third out of twenty-one leading utilities for overall satisfaction. And second out of twenty-one leading utilities on perceived values. With regard to our large accounts comparing to all eighty-eight utilities surveyed, we were second in the category of overall satisfaction, and fourth on perceived value.

Gulf's low rates, its high reliability, and its high customer satisfaction clearly reflect management's focus on these areas. In Attachment C to our petition, Pages 13 through 19, summarize some of the initiatives we have undertaken in that regard. Fuel cost reduction, reliability initiatives, and customer satisfaction initiatives that all reflect the company's management focus on customer satisfaction initiatives. And the outstanding results are an indication that something is working.

Despite the combined effects of customer growth, inflation, and the effects of several hurricanes since base rates were last set for Gulf, management has been able to find ways to consistently meet the expectations and needs of its customers. Low rates, high reliability, high satisfaction, and at the same time still satisfy shareholders by achieving earnings near the top of the authorized range. And all of this has been done with no increase in the company's base rates. Gulf's sharing plan starts from this positive point and builds towards something even better.

With that, I'd like to turn to the next point that I mentioned at the beginning, and that is I'm going to talk to you about our sharing plan itself. A key point of Gulf's sharing plan is the fact that it does reduce the authorized midpoint for the company's return on equity 20 basis points. And this reduction under Gulf's proposal would be retroactive to the first of the year as part of the package that we have submitted to you for approval.

We are reducing Gulf's authorized midpoint ROE, if the plan is approved, from 12.0 percent to 11.8 percent. And there will be a corresponding shift in the authorized range. If this is approved, our range would be from 10.8 percent to 12.8 percent instead of the current 11.0 percent to 13 percent. I realize that's a lot of numbers, but that information is found on Page 8 of our document I handed out to you today, which is the first page of the sharing plan itself.

Adoption of Gulf's sharing plan sends a proper signal to management and the company's shareholders. This incentive is designed to achieve good financial results while maintaining a high level of performance on key customer service indicators of rates, reliability, and customer satisfaction. It builds on the existing framework rather than tearing down the structure and changing direction.

There are certain elements of our plan I want to talk to you about. First, it covers three calendar years: 1999, 2000, and 2001. And I point out again that our proposal, if accepted, would be retroactive back to the first of the year.

The second plan element is that there are two regulatory concepts that were established in Gulf's last rate case that are being readdressed. The first is the deferred return on the investment related to the third floor of the corporate office and the second is the effect of merchandising operations of the company and how they are taken out of the company's capital structure.

The third element of our plan is the sharing mechanism itself, and under that element the earnings above the newly established top of the authorized range, the 12.8 percent, will operate to the benefit of customers and shareholders alike. Both in the short-term through credits, a 40 percent credit to customers and 40 percent retained by shareholders, and in the long-term by taking the remaining 20 percent and using it to accelerate the amortization of the three identified regulatory assets. And also to supplement the accruals to the property insurance reserve.

I mentioned to you Gulf's proposed ROE adjustment, and that adjustment under our plan again is part of the package, is from the current 12.0 percent midpoint to 11.8 percent, a 20 basis point reduction that is a part of our overall proposal. And some discussion on why we chose that number, I think, is in order.

First, we believe that return on equity should not be set in a cookie cutter fashion. One size clearly does not fit all. And a hasty or ill-advised decision on the company's ROE today when major capital costs for new generating capacity are just around the corner -- and as an aside, yesterday we filed a petition for a need determination with regard to 532 megawatts of combined cycle capacity to be located at Plant Smith in Panama City. If we were to make a hasty decision today, it could cost our customers in the long-run if as a result of concern over the regulatory environment here at the Commission and in Florida if rating agencies were to downgrade Gulf's credit worthiness.

In Attachment D to our petition, Pages 20 through 27, we provide a detailed discussion of the basis for the ROE component of our proposal. In that document, we discuss key points of difference between Gulf and other Florida electric utilities in terms of leverage, electric rates, reliability, customer complaints, and business risk.

I want to highlight some of the elements of that discussion for you today. The relative differences in leverage between the utilities justify relative differences in authorized return on equity. This conclusion was reached in two separate studies that were conducted nearly twelve years apart. And actually in the course of those studies, they quantified that difference. In Gulf's case, that quantified difference, when you measure the difference in capital structure between what Gulf has and what was approved today for Florida Power & Light in their settlement, there is a 47 basis point difference above the range and midpoint.

Turning next to the issue on customer cost, the comparative reliability and customer complaints, clearly it is within the discretion of the Commission to take those matters into account in establishing the return on equity. This has been established both by statute and by controlling decisions of the Supreme Court and your own opinion. Section 366.041 says, in essence, in fixing the just, reasonable, and compensatory rates or charges to be observed and charged for service by utilities under your jurisdiction, the Commission is authorized to give consideration, among other things, to the efficiency, sufficiency, and adequacy of the facilities provided and the services rendered, the costs of providing such service and the value of such service to the public.

In several cases, the Commission has acknowledged and the Supreme Court has approved the discretion to make adjustments to the authorized return on equity to account for such things as accretion, inflation, and management efficiency. There are several cases cited in our petition, and I would be happy to go into some of those in more detail, but United Telephone Company versus Mann, Gulf Power Company versus Wilson, Gulf Power Company versus Cresse, and there are others.

I have already discussed Gulf's superior performance in the area of rates, reliability, and the level of customer complaints. We submit to you that Gulf's sustained performance on these three key indicators of customer service are sufficient magnitude that they should be recognized explicitly in establishing Gulf's authorized return on equity. The differences between Gulf and other Florida electric utilities warrant the exercise of your discretion to establish a different, higher midpoint than 11.0 percent, which was approved when you approved the stipulation today for use in FP&L's case.

The next area of discussion in Attachment D, beginning on Page 22, are the differences in business risk faced by Gulf compared to other Florida electric utilities. Relative differences in business risk faced by different utilities should also be reflected in adjustments to the authorized return on equity. Gulf faces more business risk than other electric utilities in Florida due to its greater reliance on sales to the industrial sector, and the dominant role of the US military on the economy of the area served by Gulf. There is more detail about that in

Attachment D.

But as stated in the discussion, overall, based on the differences between utilities in regards to leverage in the capital structure, retail rates, the annual minutes of interruption, the number of justified customer complaints to the Commission, and relative business risk, Gulf's authorized return on equity should be higher than the authorized return on equity for other Florida electric utilities.

We have quantified at least a 47 basis point difference. And that is simply for the difference in leverage between us and FP&L. The differences between utilities in regards to the other areas, rates, reliability, customer complaints, and business risk also justify additional incremental increases above a baseline ROE when establishing the authorized ROE for Gulf. And although the value of these items individually may be difficult to quantify, they are not difficult to quantify in the sense that all we are asking for in asking that you set ROE at 11.8 percent, if you take the 47 basis points, all we need is 33 more basis points and you are at our 11.8. And that's what we suggest is reasonable.

But we didn't stop there. Our petition, in order to evaluate the reasonableness of our proposed midpoint, Gulf has examined the trends and returns that have been authorized for electric utilities across the nation. It's part of Attachment D on Pages 22 and 23. We have included data from a January 1999 report that's entitled Major Rate Case Decisions, January 1990 to December 1998. It was produced by Regulatory Research Associates, Incorporated.

According to this report, equity returns authorized for electric utilities across the nation averaged approximately 11.7 percent in 1998, compared to 11.4 percent in 1996 and 1997. For the fourth quarter of 1998, the return summarized in that report averaged 12.03 percent. When measured against these trends, Gulf's proposal of 11.8 percent is clearly reasonable, especially when you take into account the other aspects of our sharing plan and the fact that in Gulf's proposal the reduction would operate retroactively.

COMMISSIONER CLARK: Let me ask a question to be clear. Was that achieved rate of return or allowed rate of return that you --

MR. STONE: Those were allowed rate of returns, authorized returns.

COMMISSIONER CLARK: Okay.

COMMISSIONER DEASON: That's for all bond ratings, or just for a certain bond rating?

MR. STONE: As I understand the survey, and we can provide additional information for you, but as I understand the survey, it was for all rate decisions.

COMMISSIONER DEASON: Regardless of bond ratings?

MR. STONE: Yes.

COMMISSIONER DEASON: And regardless of capital structure.

MR. STONE: The next point that I wanted to raise to you in these comments was to talk about how Gulf's sharing plan builds on existing incentives. I mentioned to you that the existing framework provides limited incentive for management to seek out and achieve efficiencies and operations by allowing shareholders to keep a certain increment of earnings. That increment in the past has been measured as the difference between the authorized midpoint and keeping them up to the top of the authorized range.

Gulf's proposal builds on this existing framework by providing an incentive to seek out and achieve even greater efficiencies in order to grow shareholder value by entering into the sharing range above the top of the zone. The appropriate balance of customer and shareholder interest has been achieved by Gulf's plan because of the sharing mechanism that allows both constituencies to receive or retain the benefits resulting from these added efficiencies achieved in management effort.

It is important to note that a projected budget is simply a plan. By it's very nature it does not equate with actual results. And therein lies just one of the important attributes of Gulf's proposal. It ties rate reductions and write-offs or added accruals to earnings in the sharing zone. Gulf's proposal, therefore, bridges the gap between forecasts and actual results, and thereby protects the interests of all stakeholders, customers and shareholders alike.

If actual results during the calendar years covered by Gulf's plan showed Gulf to be earning above the top of the traditional authorized range, the sharing mechanism proposed as an integral part of our plan would operate. The effects would be credits to customers against already low rates, the lowest in Florida. The appropriate and reasonable levels of an accelerated amortization of the regulatory assets that are supported by earnings, not mandatory nondiscretionary added accruals or added amortizations, regardless of financial results.

And, finally, there is a reasonable incentive to shareholders to encourage management to pursue such extraordinary results. It would not be appropriate to drive earnings to the midpoint rather than the top of the range as part of this sharing proposal. I would like to compare this to Section 366.071, that if a utility was earning above the top of the zone, rate reductions pursuant to that statute should be calculated to bring the utility down to the top of the zone, not to the midpoint.

But more importantly, we are trying to build on the existing framework. The Commission has traditionally allowed Gulf to earn 100 basis points above the midpoint. This 100 basis point margin establishes the top of the range. If the sharing point was set at a point less than the normal top of the range, this would adversely affect the company's shareholders who are currently entitled to keep that 100 basis points.

Thus, the chosen sharing point in Gulf's proposal provides an incentive to achieve earnings above the traditional cap by allowing shareholders to retain a portion of those incremental earnings. The traditional range does not allow for such added incentives.

Again, our goal is to build on the existing foundation and, therefore, it is important to add to whatever incentive exists within the traditional top of the zone framework. Gulf's proposal does this by adding an incentive based sharing opportunity to encourage efforts that may result in earnings above the top of the zone that can then be appropriately shared, earnings that are essentially discouraged under the current framework. With regard to achieving the goals and improved efficiency, the concept of a carrot is much more effective than a stick. We submit to you that Gulf's proposal offers that carrot and the alternatives that have been placed before you seem more of the stick variety.

This is probably a suitable breaking point in our presentation to move on to questions or other presentations. We do have people available to answer the Commissioner's questions, but after we hear from other parties, I would like to have an opportunity to make some brief closing remarks.

COMMISSION STAFF: Basically the company has, you know, outlined the reasons for approving it's plan. Staff in Issue 3 has essentially proposed our version of a sharing plan. You know, we can go through and discuss all of the differences and differences in ROEs and all of these other things, but I think really if we just focus on one or two of the biggest differences between their proposal and staff's proposal.

I think the major difference is that in initiating a sharing plan, staff believes that at the outset earnings should be targeted at some reasonable return on equity. The company doesn't propose any targeting earnings in their proposal. They simply -- okay, staff believes the company is already currently overearning, and the company's proposal is simply to start sharing those overearnings. There is no rate reduction, no write-offs, no nothing at the initiation of the plan.

This Commission over ten years ago found in the BellSouth case that it was appropriate to target earnings at some ratesetting point before initiating a sharing plan. Apparently, you know, Gulf Power does not have that in their proposal.

The other main factor that is different between our plan and the company's plan is that our plan includes what I would call a productivity factor. And what that is is we believe that through the normal course of business each year earnings would improve without extraordinary efforts of the company through normal growth in customers and all. And we think that's generally true throughout most of our utilities in Florida. So our plan has a productivity factor for the years 2000 and 2001. The company basically has no productivity factor.

You know, we can go into a lot of differences about why we think the ROE is different than their proposed ROE and all, but I just really wanted to highlight that the difference in our plan is that we think that upfront something should be done about the company's earnings. Our plan recommends over $13 million annually be passed back to the customer in benefits when the plan is initiated. The company proposes nothing in that area.

COMMISSION STAFF: Briefly over the ROE. Interest rates have come down probably 70 or 80 basis points since the last time that Gulf's ROE was established. And regarding business risks, they have identified a number of areas for business risk. A lot of that gets summed up in the bond rating. Gulf's bond rating was increased from an A rating to an A+ rating in March of '95.

So since their last ROE was established we've had an increase in the bond rating, and have had some increase in their equity ratios, and they've had a decline in interest rates of I would say at least 70 or 80 basis points. So these are factors that we think point to a lower ROE.

CHAIRMAN GARCIA: Commissioners.

COMMISSIONER DEASON: Commissioners, it seems to me that we have got two basic questions in front of us. We can either try to issue a PAA and if it gets protested take that to hearing, and we have two different PAAs in front of us, or proposals. We have the company's and we have staff's. And then there is also the alternative of basically going to the hearing on questions of return on equity and placing monies subject to refund. And I think staff even contemplates doing that even in conjunction with their issuance of a PAA, is that correct?

COMMISSION STAFF: Yes. We would say that Issue 2 should be approved no matter what with placing monies subject to refund.

COMMISSIONER DEASON: Excuse me, I'm losing my voice. My personal preference would be if we can to try to craft a PAA that we feel comparable with. A proposal that would be fair to the company and fair to its costumers. I believe that Mr. Stone makes some valid arguments as far as the performance of this company. It's in question that the company certainly has the lowest rate. And we presented the information concerning customer complaints, customer satisfaction, reliability, and those are all very critical factors.

I agree with that.

But it seems to me that -- I'll be real upfront and say I do not think that the company's proposal is acceptable. I would not be willing to issue it as a PAA. Likewise, I think that perhaps the staff's position is perhaps a little too aggressive, also. I think that perhaps there is some middle ground. And I would be willing to lay out some framework that I've thought about that perhaps would be workable, perhaps not.

In terms of ROE, I believe that the ROE should be set at a midpoint of 11.2 percent and a range that would likewise follow would be 10.2 to 12.2. However, I would not try to reach that earnings at 11.2. I think Mr. Stone makes some valid arguments in that regard.

I would reset earnings to a level of 12.2 percent. To achieve that, I think that there are a number of measures that should be taken. We already had discussions concerning the third floor of the office building. There has been concern about the adequacy of the storm damage reserve, there has been concerns about write-offs of loss on reacquired debt. There may be some other factors which staff has in mind which are of a key nature which I think could be done.

I think that there are opportunities in that area to get earnings down to a level of 12.2 percent. But I would have to rely upon staff to come up with the priorities of that and the actual dollar amounts which would be required to get it down to that level.

In terms of sharing, I think that is a valid concept, and I think the sharing point should be 12.2 percent. I, however, would differ from the company's percentages. I agree with the 40 percent per customer, but I would reverse the other. I would have 20 percent for stockholders and 40 percent for amortization.

And there is also -- I agree with Item 7 and staff's proposal that we go ahead and upfront determine what interest rate is going to be applied to any revenues that would be deferred pending their determination. And there may be some other gaps in here, and in all honesty I have not gone through and tried to come up with a comprehensive plan that would fill all of those gaps, but that is the essence of a framework that I think that I, as one Commissioner, could live with.

Now, whether it is advisable to try to track all of that today, or kind of give that back to our staff, the company may find it totally unacceptable because it does deviate a great deal from their position. But I would anticipate that perhaps one thing the company is looking for is some guidance here today. They may not like what they are hearing. I have no idea.

And it may be that if we can't come to some type of an agreement that, you know, staff's alternatives for an ROE review, placing monies subject to refund in a rate case is the only alternative. But I am the optimist, and I think that there is some common ground that can be reached.

And I'm not saying that what I have proposed here is the correct answer. It may be that the company has some very valid alternatives or arguments as to why that is inappropriate. It could be that staff has some very -- and I'll be willing to listen to those. I don't know if we have the time today to go through all of that, but I wanted to be upfront about this and indicate what my -- first of all, my preference is to try to issue this as a PAA, to be fair to the customers, to be fair to the company. And I think that there is some middle ground. And right now I think that middle ground is between staff's position and the company's.

CHAIRMAN GARCIA: Well, let me just throw this out. It strikes me that perhaps -- because I feel comfortable with your suggestion, but you are absolutely right, it is difficult to craft from here and just sort of come to a consensus. But giving that as guidance, and I don't know what the rest of the Commissioners think, but we let the company come back here and we have given a framework.

Let the staff and the company get together and see if they can work towards that end and work out the details and we come back into agenda, and we approve Issue Number 2, which is to hold the money subject to refund, if I'm not mistaken, and then we let the company and staff give it one more try.

COMMISSIONER DEASON: I'm not sure -- I think before we take this step, it needs to be clear -- I've got some questions about staff's, but --

COMMISSIONER CLARK: Before we move off the notion of what might be an acceptable direction to head in, what does staff recommend, again, for their ROE?

COMMISSION STAFF: We have recommended that rates or earnings be targeted at 11.2 percent.

COMMISSIONER CLARK: Mr. Stone mentioned some items and I understood them to be perhaps business risk and leverage differences, the difference in how much they carry in their equity as opposed to other companies. What is their equity? 45, did he say? 49.3. What are the other ones at?

COMMISSION STAFF: (Inaudible, microphone not on.)

COMMISSIONER CLARK: High 50s, aren't they? Yes. How much of a basis point difference does that make to you all? I mean, there is -- customers pay a lot less because they carry a lot less equity, isn't that right?

COMMISSION STAFF: (Inaudible, microphone not on.)

COMMISSIONER CLARK: Okay. You're not going to go as far as what I -- I think Mr. Stone outlined some things that, you know, lends support to the notion of a higher midpoint than what was suggested.

COMMISSION STAFF: Commissioner Clark, we do believe in leverage, and there is an inter-relationship between equity ratio and general equity, and maybe there should be some recognition in this scenario here, but I have to point out over the last fifteen or twenty years in electric utilities, equity ratios have been all over the board, but the internal equity has been pretty standard throughout the industry. It's been sitting at 12 or so for the last five years.

COMMISSION STAFF: I think another important consideration is what Commission Deason suggested, is that even if we decided that 11.2 was a midpoint, that's not really what the suggested rate should be set at. I believe he suggested setting rates at 12.2.

COMMISSIONER DEASON: I am suggesting setting rates at 12.2. Realizing the company is now earning 12.99, it would be a significant reduction from current earnings. And in all honesty, I think the company makes a very good point that they have managed their company well. They have kept rates low and they have kept quality of service high, and I would hate to be punitive. Of course, they may think that 11.2 -- I mean, 12.2 is punitive, but --

COMMISSION STAFF: Commissioner Deason, could I ask you real quickly your sharing percentages again?

COMMISSIONER DEASON: Forty percent for customers, 40 percent for amortizations, 20 percent for shareholders. And I'm flexible on that, too, you know. And let me say I'm just trying to lay out a general framework from what I've thought about this. But the question is, how much -- I want there to be sufficient incentive for the company to continue managing this company as well as they have, to continue to earn a reasonable rate of return in spite of the fact that they have the lowest rates, and to continue their high customer satisfaction and their high level of reliability.

And my personal opinion, based upon what I know now is 20 percent is probably adequate to do that. If it's not, even in the company's opinion or the staff's position, I need to know that because I don't want to jeopardize that. I think that there is room in this plan for incentives. I do think that they work -- the question is is 40 percent the correct number. It strikes me as being high, and that's the reason I suggested 20 percent and still accomplish the same goals. Realizing that we would be targeting earnings to begin with at 12.2, not staff's suggested midpoint of 11.

COMMISSION STAFF: Would you have a point for an absolute ceiling? I mean, in the past in sharing plans it has been say 200 basis points above sharing starts. I mean, so, for example, in your -- if you start sharing at 12.2, I believe staff's recommendation would be --

COMMISSIONER DEASON: Well, the 20 percent sharing, their earnings would have to go up a whole lot before we reach a cap that's unreasonable it seems to me. But I'm not -- I would be willing to listen to a position on that as to what could be considered fair.

COMMISSION STAFF: I mean, I think we would say, you know, 200 basis points above 12.2, I mean, would be in line with, you know, past plans.

COMMISSIONER DEASON: For them to achieve that of the 20 percent sharing, that would be, in essence, earning about 22 percent what they otherwise would have earned. So, I mean, I think that's highly unlikely, but --

COMMISSION STAFF: It's at least a known.

COMMISSIONER CLARK: Let me ask a question. Are the negotiations on-going, or -- OPC has not committed on the negotiations -- you attempted to reach a settlement?

COMMISSION STAFF: Yes. We've had, I would say, five meetings --

COMMISSIONER CLARK: Okay.

COMMISSION STAFF: -- starting in early January. OPC is invited to them as negotiations.

COMMISSIONER CLARK: Okay.

COMMISSION STAFF: That's kind of where we are at, and our positions have been laid on the table.

COMMISSIONER CLARK: They have not taken a position?

COMMISSION STAFF: OPC? No.

COMMISSIONER DEASON: Commissioner, let me say that I'm kind of reluctant to come out with this. It's not my nature to come out because I always try to keep an open mind on things, and I will still keep an open mind. I'm not saying that what I have suggested here is the absolute correct framework and that I'm not open-minded about hearing alternatives from the company and the staff and anyone else that participates in this process.

But it appeared to me that perhaps it would be conducive if we tried to lay out some middle ground and hopefully there may be some resolutions and agreement. And if not, I think that we do need to take some action. It seems to me, though, before we go through the measures of actually proceeding down the path of a rate case, it seems to me that there are some potential alternatives, and I wanted to make sure we explored those before we embarked upon that path.

COMMISSIONER CLARK: Are you talking about Issue 2?

COMMISSIONER DEASON: Yes, I am. And I'm concerned -- I'm not exactly sure -- first of all, I guess I need to ask the staff a question as to how they determined that amount. I need to ask that question first. How did you determine the amount to be held subject to refund?

COMMISSION STAFF: Okay. Basically, it's that calculation that was on Page 21 of Attachment A. In summary, what it is is the December '98 surveillance report --

COMMISSIONER DEASON: But you've made an adjustment for storm damage control?

COMMISSION STAFF: Right.

COMMISSIONER DEASON: Which troubles me, because here again, back to the amortization which I've suggested, I think that should be -- my personal idea is that should be one of the key factors. I think we've identified there should be a fund somewhere between 25 to $30 million, is that correct?

COMMISSION STAFF: Yes.

COMMISSIONER DEASON: And what is it at now?

COMMISSION STAFF: A little over a million dollars.

COMMISSIONER DEASON: One million?

COMMISSION STAFF: Yes.

COMMISSIONER DEASON: And, of course, we know that this utility has been hit by two hurricanes within the last, what, four years?

COMMISSION STAFF: Yes.

COMMISSIONER DEASON: I just -- and your suggestion to find money to place subject to refund is primarily attributable to the storm damage accrual, the $3 million, and it seems to me that's a reasonable thing given the current level they are at and the target should be, and I'm not sure that we should be placing money subject to refund based upon an adjustment to storm damage accrual.

COMMISSION STAFF: The argument is not that it's unreasonable. I mean, we think it's very reasonable. It's simply that that 3 million -- the company actually approved more than $3 million for storm damage. I believe it was closer to $6.5 million. The $3 million represents only that portion of the accrual that is totally subject to management discretion. The company doesn't have to record that 3 million. There is no guarantee they will report the 3 million during the interim period. And that's the only --

COMMISSIONER CLARK: Oh, so you're saying to ensure that it does get accredited in that way, you would have to capture it because if you don't it's within their jurisdiction to apply it or not.

COMMISSION STAFF: Right.

COMMISSIONER DEASON: Do they make the accrual monthly?

COMMISSION STAFF: On what?

COMMISSIONER DEASON: If the company guarantees that as we proceed through this PAA process that they would guarantee that amount being accrued every month and there will not be an adjustment at the end of the year reversing that, would that satisfy staff?

COMMISSION STAFF: Are we talking --

COMMISSIONER CLARK: Do you project that the amount they would accrue monthly would be equivalent to what they would be overearning?

COMMISSION STAFF: If they accrued one-twelfth each month, yes. I mean, one-twelfth of $3 million, if that was accrued each month. The problem that we ran into in the last calendar year was that the company had accruals during the year and then in December they reversed a portion of those.

COMMISSIONER DEASON: Well, that's why I said the agreement, it would be nonreversible depending on what earnings are. I mean, they would have to make the commitment that what they had booked, the one-twelfth would stay on the books until this matter is resolved either by ultimate disposition of a PAA or a rate case, the ultimate determination of final rates in a rate case. They would continue that monthly accrual at that level.

COMMISSION STAFF: At one-twelfth of $3 million?

COMMISSIONER DEASON: Yes.

COMMISSION STAFF: Yes. We believe that would, you know, adequately set the ratepayers -- I mean, in the same way that putting money subject to refund would in large part.

COMMISSIONER DEASON: Mr. Stone?

MR. STONE: (Inaudible, microphone not on.)

COMMISSIONER DEASON: The staff comment was that if you would agree upfront to a monthly accrual of one-twelfth of $3 million to storm reserve accrual with the commitment that there would not be a reversal at the end of the year, that that would be sufficient to protect customer interest without placing money subject to refund.

MR. STONE: (Inaudible, microphone not on.)

COMMISSIONER DEASON: It would be effective immediately until there was a disposition of a PAA settling this matter, or until, if it goes to a rate case, there is final rates determined at the end of the rate case.

MR. STONE: (Inaudible, microphone not on.)

COMMISSIONER CLARK: Mr. Thurber (phonetic), you need to turn your mike on.

MR. STONE: If I could have a moment to speak with Mr. Thurber.

COMMISSIONER JACOBS: What is the status of the credit the staff was just proposing?

COMMISSIONER DEASON: I'm sorry, the status of what?

COMMISSIONER JACOBS: Are you considering -- on Page 22 of the recommendation would be a description of staff's proposal. Item 4, is that a part of your proposal, as well?

COMMISSIONER DEASON: I think that's something to be considered, but I would leave that up to staff. If we can agree on some type of basic framework to come back with the priority as to what should be done to get earnings to the targeted level and what should be the priorities if there are to be amortizations as the result of this hearing above 12.2 percent.

COMMISSIONER CLARK: Commissioner Deason, I took -- when you talked about amortization, you are talking about things like storm accrual and those sorts, not strictly amortization as --

COMMISSIONER DEASON: There should be a priority set, and it would include such things as the storm damage reserve accruals, write-off of loss on reacquired debt, which I think does apply to this company. Measures that were taken to some of the things that Mr. Stone mentioned about the third floor of the office building to cease -- put that into rate base and cease accruing, I guess, AFUDC. I'm not sure what they were accruing. But anyway, there was an accrual based upon that because it was not in rate base. Get all of those things corrected, and basically the staff would come back with the quantification of those and the prioritization of those.

COMMISSIONER CLARK: May we go into that 40 percent thing again?

COMMISSIONER DEASON: It would go into the 40 percent if there is to be sharing, but it would also -- those things would need to be done to get rates -- I mean, not rates, but to get earnings targeted to 12.2. There would not be any change in customer rates. Those adjustments would be made to target earnings at the 12.2 percent. And they would not be discretionary with management. Those things would have to be done.

MR. STONE: Commissioners, I understand you have laid out a framework, and certainly we have a lot to digest from what you've laid out. We certainly want to consider them. There are some aspects of what you stated that give us some concern, but we would have to address them in --

COMMISSIONER DEASON: Well, I would be upset if there weren't some things that gave you some concern, so I'm glad to hear that. But I want -- as I said earlier, I'm going about this with an open mind, and if you can convince me there were things of this framework that are wrong, I'm more than willing to listen to that. But I think what we need now is to establish some framework and basically send you back for some more work and see if we can come with a PAA that can be issued that we know is not going to be immediately protested over here.

COMMISSIONER CLARK: I think the motion that you are suggesting is that we move to defer this, but it's with the understanding that with respect to the $3 million that Gulf Power will be accruing one-twelfth of that on a monthly basis starting in January 1999, and that that would not be later reversed absent it being part of what we decide in this docket.

CHAIRMAN GARCIA: Mr. Elias, would it be -- because of the complexity of this, but in an effort to avoid sort of getting it more difficult, would it be easier to set this for, you know, like a special agenda or something, a date and a time certain that --

no?

MR. ELIAS: I don't think so. I think that we've got some guidance here.

COMMISSIONER CLARK: If they agree.

MR. ELIAS: We do have a framework. We can see if we can --

COMMISSIONER DEASON: I think we've got protection for customers in the interim.

MR. ELIAS: With the --

CHAIRMAN GARCIA: I'm just trying to make it easier to work this out, because I think the company is trying to meet us halfway, and if staff does that, I think Commissioner Deason has given some good guidelines, and it sets some strong parameters, so -- all right, then. Give me a time frame, then. So we give you guys two agendas?

MR. ELIAS: Yes, two.

CHAIRMAN GARCIA: Two agendas. And I'd like to thank the staff and the company, and hopefully we can work this out. And maybe we'll have just a primary from staff on this one. All right. Thank you. We'll move on then.

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CERTIFICATE OF REPORTER

STATE OF FLORIDA)

COUNTY OF LEON)

I, JANE FAUROT, RPR, do hereby certify that the foregoing proceeding was transcribed from cassette tape, and the foregoing pages number 1 through 41 are a true and correct record of the proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor relative or employee of such attorney or counsel, or financially interested in the foregoing action.

DATED THIS 21st day of March, 1999.

Jane Faurot

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