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June 14, 1999

Blanca S. Bayo, Director
Division of Records and Reporting
Public Service Commission
4750 Esplanade Way, Room 110
Tallahassee, FL 32399

Re: Docket Nos. 990250-EI and 990244-EI

Dear Ms. Bayo:

Enclosed is an original and fifteen (15) copies of The Coalition's Petition on Proposed Agency Action in the above dockets. We have also enclosed a copy of the document on diskette, prepared in Microsoft Word 7.0 on a Windows 95 operating system. The diskette is a "2HD" density and 1.44 MB.

Please acknowledge the receipt of the above on the extra copy enclosed herein and return it to me. Thank you in advance for your assistance.

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Sincerely yours,

Seann M. Frazier

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STATE OF FLORIDA
PUBLIC SERVICE COMMISSION

IN RE: INVESTIGATION INTO THE EARNINGS AND AUTHORIZED RETURN ON EQUITY OF GULF POWER COMPANY — PSC 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 — PSC Docket No. 990244-EI

Order No. PSC-99-1047-PAA-EI
Issued: May 24, 1999

______________________________________/

THE COALITION'S PETITION ON PROPOSED AGENCY ACTION

Petitioner, the COALITION FOR EQUITABLE RATES ("Coalition") petitions for formal administrative proceedings to review Order No. PSC-99-1047-PAA-EI (the "Order under challenge") issued in Docket Nos. 990250-EI and 990244-EI, pursuant to §§ 120.569(1) and 120.57, Florida Statutes and Rules 25-22.029 and 28-106.201, Florida Administrative Code. In support of this Petition, The Coalition states:

The Parties

1. The Coalition is the Petitioner. The Coalition is an association of entities which pay Gulf Power for power at rates approved by the Florida Public Service Commission and an association of entities which represent such ratepayers. Representative examples of those entities within the Coalition include the Florida Health Care Association (which consists of most skilled nursing facilities and many

assisted living facilities in Florida), Florida Retail Federation (which represents major retailers in Florida) and the Florida Hotel and Motel Association. The Coalition is a "person" as defined by §1.01 and §120.52(13), Fla. Stat.

2. The Coalition maintains offices at 2300 N Street, Northwest, Washington, DC 20037, telephone number 202/663-9097. However, for purposes of this Petition, The Coalition may be contacted through its counsel, Ronald C. LaFace, Greenberg Traurig, P.A., 101 East College Avenue, Tallahassee, FL 32301, telephone number 850/222-6891.

3. The agency affected by this Petition is the State of Florida, Public Service Commission ("PSC"), located at 2540 Shumard Oak Blvd., Tallahassee, FL 32399-0850, telephone number 850/413-6248.

4. The "Order under challenge" is Order No. PSC-99-1047-PAA-EI which concerns Gulf Power Company's ("Gulf Power"), located at 500 Bayfront Parkway, Pensacola, Florida 32501-6101. Gulf Power may be contacted through its counsel, Beggs and Lane Law Firm, Jeffrey Stone/Russell Badders, P.O. Box 12950, 700 Blount Building, Pensacola, Florida 32576-2950, telephone number (850) 432-2451, facsimile number (850) 469-3330.

Order under Challenge

5. Gulf's currently authorized return on equity ("ROE") range is from 11.00% to 13.00%. When Gulf's return on equity reached levels consistently at or near the top of its authorized range, Public Service Commission Staff requested that an investigation into the earnings and authorized return on equity of Gulf be conducted.

Thus, Docket No. 990250-EI was opened in order to investigate Gulf's earnings and ROE.

6. In early 1999, Gulf filed a request to approve a proposed plan for an incentive revenue sharing mechanism which attempted to address certain regulatory issues including a reduction to the Company's authorized ROE. That matter was assigned Docket No. 990244-EI.

7. Staff recommended that Gulf's Petition for an approved incentive revenue sharing mechanism be denied. The PSC Commissioners deferred that matter, along with Docket No. 990250, in order to allow PSC Staff and Gulf to negotiate a compromise.

8. Deadlines on that negotiation were established and when no accord was reached, were reestablished. Eventually both dockets reappeared before the PSC commissioners and the Commissioners themselves suggested a compromise settlement. When Staff and Gulf could not agree as to the specific terms suggested by PSC, they approached the Commissioners again.

9 The results of this extended negotiation and attempt at settlement is Order No. PSC-99-1047-PAA-EI, the Order which is the subject of this Petition. That Order is attached to this Petition.

10. Eventually, the Order under challenge proposed its own regulatory incentive plan, a copy of which accompanies the Order under challenge as Attachment A.

11. The Order under challenge included a "Notice of Further Proceedings or Judicial Review" which would allow substantially affected parties to file a petition challenging the Order on or before June 14, 1999. Representatives of the Coalition received news of the Order under challenge through review of the Commission's Docket, after its publication on May 24, 1999.

12. This Petition is timely filed as a challenge to Order No. PSC-99-1047-PAA-EI by the Coalition, a person whose substantial interests are affected by the actions in the Order under challenge.

Substantial Effect Upon The Coalition

13. The Coalition is an association of entities which purchase electricity from Gulf. In all, The Coalition members pay approximately $80 million to Gulf annually for electric power.

14. As described in the Argument below, The Coalition and its members object to the Order under challenge and believe it would not provide rate relief to ratepayers, such as the Coalition and its members.

15. If proper earnings and ROE limits were applied to Gulf, ratepayers such as the Coalition and its members would receive a reduction in rates paid to Gulf. Thus, the Order under challenge has the effect of a rate *increase* from amounts which should otherwise be paid to Gulf.

16. If the Order under challenge is adopted and made final agency action, The Coalition and its members will sustain losses of at least $2.5 million and as much as $5 million.

Argument

I. The Authorized Midpoint Return to Equity of 11.5% Is Too High.

A. It is inappropriate to Use the ROE applied to FP&L in Gulf Power's Case

17. The Order's justification for approving an 11.5% midpoint return on equity for Gulf Power is that Gulf Power has a higher equity proportion than Tampa Electric Company or Florida Power & Light, which justifies a higher equity return, and that the FP&L Settlement adopted an 11.0% return.

18. These general benchmarks do not provide an adequate basis for a establishing the earnings level against which all other elements of the incentive plan will be based, including particularly the sharing threshold.

19. First, it is not at all clear that the equity proportion for Gulf Power is comparable to those of Tampa Electric Company and FP&L. Gulf Power is a subsidiary of a much larger corporation, the Southern Company, which includes regulated utilities in Georgia, Alabama, Mississippi and Louisiana. Tampa Electric Company and FP&L are subsidiaries of companies of which they are they the only utility elements, and of which they represent by far the largest component. With its powerful corporate backing, Gulf Power can sustain a somewhat more levered capital structure than Tampa Electric Company and FP&L without any significant increase in risk.

20. Additionally, the FP&l ROE was not the result of any administrative finding of adequacy or propriety. Rather, it was a component package of provisions covering not just rate of return but agreed rate reductions, sharing levels, and other measures, the composite of which were found by the signatories, and confirmed by the

Commission, to be reasonable. It is inappropriate later to take one isolated element of this package, the rate of equity return, and declare it to be a reasonable benchmark against which the ROE of another utility should be measured.

b. The 11.5% ROE is Higher than ROEs Recently Found by Other Commissions.

21. In its October 22, 1998 report in Docket No. 981390-EI, the equity ratio and rate of return investigation of FP&L, PSC Staff cited the following recent ROEs set by regulatory commissions:

Company	Order Date	ROE
Empire District Electric	July 21, 1998	9.50%
Metropolitan Edison	June 26, 1998	10.00%
Rochester Electric L &P	June 24, 1998	11.00%
Green Mountain Power	June 8, 1998	11.25%
Concord Electric Company	May 11, 1998	10.20%
PacifiCorp	May 5, 1998	10.00%

22. These rates of return range from 25 to 200 basis points lower than the rate of return approved in the PAA for Gulf Power. While this comparison does not prove that the Order's ROE is too high, it does suggest that the Commission should examine the ROE issue with more care.

c. Capital Costs Have Declined Much More than Implicitly Assumed by the Revised ROE.

23. The Order's PAA notes that the ROE found appropriate in the last Gulf Power rate case was 12.55%. The Order in that case was dated October 3, 1990. By adopting a 11.5% return, the Order under challenge implicitly assumes that Gulf Power's ROE has declined by 105 basis points since the beginning of October 1990.

24. During September 1990, the month preceding the Commission's last rate case order, the yield on the benchmark 30-year Treasury bond was 9.03% (according to the Federal Reserve Bank, Annual Statistical Digest, 1990, Table 21). The most recent Federal Reserve Statistical Release reports that during the week ending April 30, 1999, these same 30-year bonds were yielding 5.58%, for a decline since September 1990 of 345 basis points.

25. Arguably, a more appropriate interest rate benchmark might be the yields on public utility bonds. In September 1990, the average yield of S&P rated AA utility bonds was 10.11 percent. In March 1999, the average yield on these same bonds was 7.69%, for a decline of 242 basis points (Standard & Poors).

26. While the trend in the ROEs required by equity investors does not necessarily follow in lock step the trend in interest rates on long-term debt, there clearly is some relationship. That is because debt and equity compete with each other. If perceived equity returns increase significantly relative to bond yields, then investors will shift to the stock market, causing stock prices to increase, which reduces the dividend yield, and consequently the return to equity. Similarly, if bond yields increase relative to expected equity returns, then investors shift to the bond market, driving up bond prices and causing the stock market to decline. Because of these shifts, the yields on the two types of instruments, debt and equity, tend to maintain some degree of stability over time.

27. Given these self-correcting mechanisms, it is unreasonable to assume, as the Order under challenge implicitly does, that the decline in the ROE for Gulf Power since 1990 has been less than half the decline in utility bond yields and less than a third the decline in long-term Treasury bond yields. Given the extraordinary performance of the stock market in recent years, it is more reasonable to assume that the decline in equity return requirements has been much closer to the decline in bond yields than the Order has implicitly assumed.

d. A limited Discounted Cash Flow analysis suggests a ROE much lower than 11.5%.

28. The most commonly accepted measure of return to equity is the discounted cash flow ("DCF") model. This model holds that the return investors require from a stock is the sum of the two components of return an investor can expect from that stock: the dividend he can expect in the immediate period and the likely increase in dividends he can expect by holding the stock. Since the ultimate determinant of any company's ability to pay dividends is its earnings, the second of these two components is conventionally expressed as the prospect for long-term growth in earnings.

29. Since Gulf Power has no publicly traded stock, the closest surrogate for its stock is that of its parent, the Southern Company. Attached to this Petition are two pages from the reports on the Southern Company by Zack's Investment Research, Inc. The first page contains the current dividend yield, shown at 5.4%, and the second shows the "consensus" of investment analysts as to the long-term growth in earnings. The 5-year forecast growth rate is shown as 4.7%. The sum of these two factors, dividend

yield and forecast growth, is 10.1%, which is 140 basis points below the 11.5% found appropriate in the Order under challenge.

30. Again, this very limited information does not prove that the ROE approved in the Order will be inappropriate after further analysis. It does, however, suggest that the 11.5% appears on the high side. It certainly suggests that further scrutiny of the Company's ROE is required.

II. The Accruals to the Property Insurance Reserve Are Excessive.

31. The Commission has adopted as its first priority an increase in the Company's Property Insurance Reserve to a target level of $25 million. To achieve this objective, the Commission has added a 1999 accrual of $2.9 million and a 2000 and 2001 annual accrual of $2 million to an already approved accrual of $3.5 million in the Property Insurance Reserve. In addition, the Commission would allocate one third of any earnings in excess of 12.5% to the Property Insurance Reserve until that reserve is at a level of $25 million.

32. The effect of these provisions is to divert into the Property Insurance Reserve a minimum of $6.4 million in 1999 and $5.5 million in 2000 and 2001. These funds might alternatively have flowed to ratepayers in the form of rate reductions. In all likelihood, the annual diversions will be greater yet, because one third of all excess earnings will be allocated to this reserve.

33. To the Coalition's knowledge, no public hearing has been held on the need to divert these sums to the Property Insurance Reserve. Apparently, the $25 million is based on a Company study which the Commission's Staff and the Commission itself

have accepted without public review. Since ratepayers are being required to fund this reserve, they should at least be accorded the opportunity to examine the basis for its adoption.

34. Superficially, the need for a large reserve fund against the possible damage wrought by possible natural disasters is questionable. Gulf Power is a subsidiary of one of the nation's largest public utility holding companies, the Southern Company, which should have ample resources to cover the cost of any storm damage to the Gulf Power facilities. Even if it did not, Gulf Power's Property Insurance Reserve fund would be a poor vehicle for ensuring the availability of cash for storm damage repairs because, unlike FP&L's reserve fund, Gulf Power's reserve is not "funded." That is, Gulf Power's fund is not isolated from the rest of the Company's assets so as to ensure that the money will be available when needed. The fund exists on the Company's books, but the actual cash is incorporated into the overall cash flow.

35. Even accepting that $25 million is the minimum reserve that should be set aside in a Property Insurance Fund, it is extraordinarily costly to fund this reserve by diverting a portion of the Company's net income, *because net income is taxable*. In order to add one dollar to the Property Insurance Fund, the Company must earn on the order of $1.60 in pretax income. If the same protection could be realized through tax-deductible insurance premiums, or even if the costs were recovered after the fact in repair expense amortization, the cost to ratepayers would be substantially less. For this reason, the Commission should explore alternative, less costly ways to fund the Property Insurance Fund.

III. There Is No Justification for Accelerating the Write-off of Losses on Reacquired Debt.

36. After building the Property Insurance Reserve to the target level of $25 million, the Order under challenge proposes to divert earnings to write off the balance of the loss on reacquired debt. Neither the Order nor the plan (Attachment A) identify the amount of these losses, nor do they provide any supporting rationale for this write-off.

37. Reacquisition losses occur when the Company pays premiums to reacquire high-cost debt prior to its maturity so that it can reduce its fixed capital service costs. Conventionally, this reacquired debt is replaced with lower-cost new debt and the losses are amortized over the life of the new debt issues. It appears that the Order under challenge would accelerate this amortization.

38. Regulatory theory generally accepts that the revenue requirement recognition of any long-term cost should be distributed over time in accordance with the realization of the benefit resulting from that cost. In the case of reacquired debt, the benefit from the losses is the lower cost of the new debt issues. The recognition, or amortization, of those losses is thus distributed over the lives of the replacement debt. Each year, ratepayers benefit from the lower cost of the new debt, but each year, that lower cost is offset to some degree by the cost of reacquiring the old debt.

39. There must be some valid reason for departing from this generally accepted regulatory practice. It is not adequate to state, as does the Order, that "past costs" should be reduced by 2002 because the Company will have to add generating

capacity. These costs are not "past costs." They are present costs incurred in the past in order to realize present benefits. It is flatly inappropriate to withhold rate reductions from ratepayers so that the recognition of these costs can be accelerated.

IV. Earnings Over 14% Should Be Flowed through to Ratepayers.

40. The sharing plan proposes that "the Commission will retain jurisdiction over any and all earnings over 14.0% after sharing." Apparently, this means that the Commission will relegate to itself total discretion as to the disposition of these overearnings.

41. If Gulf Power earns more than 14% on equity after sharing, it is clearly overcharging ratepayers. That is, the Company is charging its ratepayers far more than its costs to produce and deliver electricity. These excess earnings belong to ratepayers, not to the Commission. The plan should recognize that fact by explicitly by committing to flow those earnings through to ratepayers in the form of rate reductions.

42. The Order cites the desirability of maintaining incentives for the Company to improve its efficiency and reduce its costs. For this reason, the plan allows Gulf Power to retain one third of its earnings between 12.5% and 14.0%. It may be desirable to continue that incentive even when the Company is earning in excess of 14.0%. If so, then the one third retention should have no cap. But most important, the remaining two thirds of all earnings over 14.0% should flow to ratepayers immediately, without interference from the Commission.

V. The Plan Should Address Rate Structure Issues.

43. Aside from allocating the $5.8 million annual credit to the environmental cost recovery clause, the plan is silent on how the ratepayer portion of any excess earnings amounts will be distributed. Presumably, these credits or reductions will be allocated among ratepayer classes on a per-kWh or a percentage basis.

44. The absence of direction on this issue is a serious void in the plan. If the ratepayer refunds are distributed on a per-kWh basis, then a disproportional amount of benefit flows to customers with high load factors and low transmission and distribution costs. On the other hand, if the ratepayer credits or reduction are allocated on a percentage basis, then the greatest benefits flow to customers with the highest per-kWh charges, quite regardless of their actual cost incurrence.

45. In either case, the Order under challenge does nothing to resolve any distributional inequities that might now be embedded into Gulf Power's rate structure. In light of the fact that Gulf Power has not had a rate case in almost a decade, it would be appropriate for the Commission to convene an inquiry into the propriety of the Company's rate structure relative to cost incurrence. The results of that inquiry could then be reflected in any rate adjustments that flow from the plan.

46. Disputed issues of material fact include those facts raised in the argument above and include, but are not limited to:

> (a.) Whether a more reasonable return on equity should be imposed upon Gulf Power by the PSC;
>
> (b.) Whether proposed accruals to Gulf Power's Property Insurance Reserve are excessive and are not needed;

(c.) Whether the proposed write-off of losses on reacquired debt are inappropriate and economically inefficient;

(d.) Whether Gulf's ratepayers are entitled to immediate rate relief; and

(e.) Whether any Order setting forth a plan of ROE distribution should explicitly set forth rate structure issues and division of revenues, without unlimited and undescribed further discretion retained by the PSC.

47. Disputed issues of law include, but are not limited to:

(a.) Whether a more reasonable return on equity should be imposed upon Gulf Power by the PSC;

(b.) Whether proposed accruals Gulf Power's Property Insurance Reserve are excessive and are not needed;

(c.) Whether the proposed write-off of losses on reacquired debt are inappropriate and economically inefficient;

(d.) Whether Gulf's ratepayers are entitled to immediate rate relief; and

(e.) Whether any Order setting forth a plan of ROE distribution should explicitly set forth rate structure issues and division of revenues, without unlimited and undescribed further discretion retained by the PSC.

48. As a matter of ultimate fact and law, The Coalition states that the Order under challenge should not be issued without further modification.

WHEREFORE, The Coalition respectfully requests the PSC to enter an order modifying the Order under challenge as proposed in this Petition, and such other relief as is available. The Coalition requests that this matter be heard by a full panel of five (5) Commissioners of the PSC pursuant to Rule 25-22.0355(4), Florida Administrative Code.

Respectfully submitted this 14th day of June, 1999.

GREENBERG TRAURIG, P.A.
101 East College Avenue
Post Office Drawer 1838
Tallahassee, FL 32302
904/222-6891

Ronald C. LaFace
Florida Bar Id. 098614
Seann M. Frazier
Florida Bar No. 971200

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the original, fifteen (15) copies, and a copy of the document on diskette has been furnished via Hand Delivery to Public Service Commission, Director, Division of Records and Reporting, 2540 Shumard Oak Blvd., Tallahassee, FL 32399-0850 and a copy has been furnished as indicated to the parties on the attached mailing list this 14^{th} day of June, 1999.

Seann M. Frazier

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Via Hand Delivery

127350

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into the earnings and authorized return on equity of 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 ORDER NO. PSC-99-1047-PAA-EI ISSUED: May 24, 1999

The following Commissioners participated in the disposition of this matter:

JOE GARCIA, Chairman
J. TERRY DEASON
SUSAN F. CLARK
JULIA L. JOHNSON
E. LEON JACOBS, JR.

NOTICE OF PROPOSED AGENCY ACTION
ORDER APPROVING REGULATORY INCENTIVE PLAN AND DENYING GULF POWER COMPANY'S REVISED REVENUE SHARING PROPOSAL

AND

ORDER INITIATING REVIEW OF CONTRACT SERVICE AGREEMENTS

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

I. CASE BACKGROUND

The Florida Public Service Commission staff met with Gulf Power Company (Gulf, or the Company) and the Office of Public Counsel (OPC) in December 1998 and January 1999, to discuss the Company's authorized return on equity (ROE) and the treatment of certain regulatory assets. The Commission, the Company, and OPC also had conference calls in January and February 1999. The meetings were initiated after our decision at the December 1, 1998, Agenda Conference, to accept Florida Power & Light Company's proposal to reduce its authorized ROE.

On March 2, 1999, Gulf filed a Petition for approval of an incentive revenue sharing mechanism. Commission staff also presented a proposal. At the March 16, 1999 Agenda Conference, we directed our staff, the Company and any other interested persons to continue to try to resolve the issues in this docket through negotiation. Also, the Company agreed to record an additional accrual of $3.0 million annually to its Property Insurance Reserve, effective January 1, 1999, to avoid the need to place revenue subject to refund. Commission staff, the Company and the interested persons met several times but did not reach an agreement.

Section II details our decision concerning the Company's revised proposal. In Section III, we approve, as proposed agency action, a regulatory incentive plan for Gulf. At the May 18, 1999, agenda conference, we clarified our decision to reflect that increasing the Property Insurance Reserve to a target level of $25 million is the first priority, and the write off of the balance of the loss on reacquired debt is the second priority. In Section IV of this order, we initiate a review of Gulf's Contract Service Agreements, consistent with our decision in Order No. PSC-96-1219-FOF-EI, issued September 24, 1996, in Docket No. 960789-EI.

II. Gulf Power Company's Revised Proposal for Incentive Revenue Sharing Mechanism that Addresses Certain Regulatory Issues Including a Reduction to the Company's Authorized Return on Equity

On March 2, 1999, Gulf filed a petition to implement a sharing plan and to address certain regulatory assets and its authorized ROE. On April 7, 1999, the Company filed a revised proposal. The revised proposal targets Gulf's earnings at a 12.2% ROE through the write down of a regulatory asset, the recording of an additional accrual to its Property Insurance Reserve, and a customer credit of $3.7 million. We believe that the Company's revised proposal does not adequately address its earnings, regulatory assets or authorized ROE. Our discussion is limited to the points of the revised proposal with which we disagree.

The Company proposes to reduce its authorized ROE from 12.0% to 11.6% and then to share any earnings in excess of 12.6% on a 40%, 20%, 40% basis. 40% is to be retained by the Company. 20% is to be applied to the write off of certain regulatory assets and to the Property Insurance Reserve. 40% is to be refunded to customers through a credit. The Company reported achieved earnings of 12.99% ROE on its December 1998 Earnings Surveillance Report (ESR) and is projecting a 12.85% ROE for 1999. Both of these earnings amounts include a discretionary $3 million accrual to the Property

Insurance Reserve. Without these discretionary accruals, Gulf would be earning in excess of its currently authorized ROE ceiling.

The plan proposes a new authorized ROE of 11.6% with a range of 10.6% to 12.6%. We believe that 11.6% for Gulf might be inappropriate, given current capital market conditions. In its original proposal, Gulf stated that it believes its ROE should be reviewed in light of its reliability and quality of service, its competitive rates, and its equity ratio.

Currently, Gulf has the lowest residential rates among the four largest investor-owned electric utilities in Florida. We believe this is caused by differences in cost conditions for Gulf and the other electric utilities, and efficiency could be part of these cost conditions.

Gulf's equity ratio is also significantly lower than that of Tampa Electric Company and Florida Power & Light Company. Presented below are Gulf's equity ratios for the past 6 years.

Gulf Power Company's Equity Ratios, 1993-1998

Date	Sep. 30, 1998	1997	1996	1995	1994	1993
Percent	49.3	46.8	47.2	45.4	45.3	44.9

Source: Standard & Poor's Financial Statistics, September 30, 1998; Standard and Poor's Utility Credit Report, Gulf Power Company, June 1997

Gulf's equity ratio has ranged from 44.9% to 49.3%. This equity ratio is within the range of equity ratios for electric utilities with A+ bond ratings. A low equity ratio may need to be compensated with a higher ROE.

Point 6 of Gulf's proposal requests that the Commission cease removing non-utility investment solely from common equity in reconciling the capital structure and rate base. The Proposal would have Gulf's merchandising operations and other non-utility investment removed from the capital structure either on a pro rata basis (instead of totally from equity) or based on a proxy capital structure of companies engaged in the financing of merchandise sales, whichever capital structure has the greater equity ratio.

Gulf's non-utility investment consists primarily of receivables arising from the sale of appliances to customers. Inventory is also part of this investment. This adjustment, from specific removal of non-utility investment from equity to pro rata removal, affects earnings by approximately 20 basis points. The annual revenue effect is approximately $1.2 million.

The current practice of removing non-utility investment from equity for surveillance purposes was approved in Order No. 23573 issued October 3, 1990 in Gulf's last rate case. In this Order, the Commission stated:

> Next, we believe all non-utility investment should be removed directly from equity when reconciling the capital structure to rate base unless the utility can show, through competent evidence, that to do otherwise would result in a more equitable determination of the cost of capital for regulatory purposes. In the case of Gulf, we believe that the non-utility investments should be removed from equity. This will recognize that non-utility investments will almost certainly increase a utility's cost of capital since there are very few investments that a utility can make that are of equal or lower risk. Removing non-utility investments directly from equity recognizes their higher risks, prevents cost of capital cross subsidies, and sends a clear signal to utilities that ratepayers will not subsidize non-utility related costs.

The adjustment to remove non-utility investments from equity has been made in several cases. In the matter of GTE Florida, Inc. in Docket No. 920188-TL, the Commission's decision to remove non-utility investments from equity was approved in Order No. PSC-93-0108-FOF-TL issued January 21, 1993, affirmed on reconsideration in Order No. PSC-93-0818-FOF-TL issued May 27, 1993, and upheld on appeal to the Florida Supreme Court.

We believe that we should continue our practice of removing non-utility investment from common equity. We do not agree with the methodology of using a proxy capital structure, as proposed by Gulf. This proposed method would provide Gulf with an incentive to finance riskier investments through the utility's capital structure. For these reasons, we reject this aspect of Gulf's proposal.

Point 7 of Gulf's proposal addresses the sharing point and sharing percentages, along with the disposition of any amounts to be shared. The Company proposes that it start sharing at 12.6% ROE and be allowed to retain 40% of earnings above the 12.6% ROE. We do not agree with the Company's proposal.

The primary differences between the Company's proposal and the regulatory incentive plan approved in Section III of this order are:

1) the ROE at which earnings are targeted,

2) the ROE at which sharing begins,

3) the sharing percentages,

4) a productivity factor for 2000 and 2001, and

5) changing the treatment of non-utility investments from the last rate case.

Approving Gulf's revised proposal would begin the incentive sharing plan at a level of earnings which we believe is above the level indicated by current market conditions.

For these reasons, we find that Gulf's revised proposal should not be approved.

III. The Approved Regulatory Incentive Plan

After considering the Company's revised plan, and the proposals offered by staff and the Florida Industrial Power Users Group, we approve a regulatory incentive plan for Gulf for the years 1999, 2000, and 2001. This plan is included in this order as Attachment A and is incorporated by reference herein. This Commission implemented a sharing of earnings plan for BellSouth in Docket No. 880069-TL, by Order No. 20162, issued October 13, 1988. The sharing of earnings concept was applied to BellSouth from 1988 through 1997. We believe that the concept worked well for the ten-year period, providing significant benefits through rate reductions and refunds to the customers and allowing BellSouth the opportunity to earn higher rates of return.

In Order No. 20162, this Commission found that:

> Traditional utility regulation has historically taken the form of rate of return regulation (ROR) by independent regulatory authorities such as this Commission. Under this approach, privately-owned utilities such as Southern Bell are given the opportunity to collect rates which will cover operating costs and earn a reasonable rate of return on property devoted to providing the regulated service. In recent years in Florida, the Commission has

> calculated a rate of return as a mid-point and generally allowed a 100 basis point zone of reasonableness around that point.
>
> In our view, the disincentives of the present regulatory system are most likely to occur when the utility is earning at or near the top of its authorized range. Below this level, the company has the same incentive to raise productivity and offer new services as any other business. It is only when one sees no reward for doing what would otherwise be prudent that disincentives set in. No empirical evidence was offered to support the theory of disincentives under ROR regulation. However, this theory does have logical appeal. The analogy of the salesman working on commission selling more goods than the salesman working for a flat salary is instructive. The difference is that the one salesman has an incentive to sell more goods and will do so. A company's management and stockholders are no different. They make investment decisions based on the return they will receive. One can reasonably expect that given the opportunity to earn a higher return, even if it has to be shared, will encourage further investments and efficiencies as well as new services.

Order No. 20162 also notes that it was not a generic endorsement of the concept of sharing and expressed no opinion as to other companies or industries.

We believe that the conditions are appropriate to apply the sharing concept to Gulf. The Company is currently earning at its authorized ROE ceiling and disincentives may set in. Gulf is expected to bring additional generating capacity on line in 2002, which could increase revenue requirements. A plan which reduces future revenue requirements by writing off past costs before 2002 and encourages the Company to become more efficient by allowing it the opportunity to earn a higher ROE in 1999, 2000, and 2001 will mitigate the impact of this additional investment.

We find that the appropriate ROE midpoint for Gulf is 11.5%. We believe this is reasonable for Gulf, given the recent 11.0% midpoint for FPL, which the Commission approved as part of a stipulation by Order No. PSC-99-0519-AS-EI, issued March 17, 1999.

Item 3 of the regulatory incentive plan addresses two regulatory assets on Gulf's books and its Property Insurance Reserve. Each of the regulatory assets shall be written off in equal amounts per year during 1999, 2000, and 2001. The Commission previously approved the write off of the balance of the flow through portion of the FAS 109 regulatory asset for FPL.

Item 4 of the regulatory incentive plan requires a credit to the customers. We have calculated the amount based on targeting the Company's earnings at 12.0% ROE. In addition, we have included the effect of the write offs of the regulatory assets in item 3.

Item 5 of the regulatory incentive plan addresses earnings above the sharing point of 12.5% ROE. Since this Commission is proposing to target earnings at 12.0% ROE which is above the midpoint of 11.5% ROE, we are approving a sharing of the earnings divided into three equal shares. One 33.3% share will be used first to increase the Property Insurance Reserve to a target level of $25 million and second, to write off the balance of the loss on reacquired debt. The Company's shareholders will receive a 33.3% share. The last 33.3% will be refunded to the ratepayers, with any and all earnings over 14% after sharing subject to disposition by the Commission. In the case of BellSouth, the Commission required additional rate reductions each year of the plan to account for accretion or the normal improvement in earnings and productivity. In this case, we are not requiring additional rate reductions or credits be implemented for 2000 and 2001, but that the same amount ($5.8 million) of credit be applied each year. We are not certain of the amount of accretion or normal productivity gains that can be expected to occur. Therefore, we are approving a more conservative approach. The plan requires that additional amortization be recorded to the Property Insurance Reserve for 2000 and 2001 only if earnings exceed the 12.5% ROE sharing point.

Item 6 eliminates the flexibility previously granted by the Commission to Gulf for the recording of additional amounts of amortization to the Property Insurance Reserve. Item 5 specifies how any additional amortization to the Property Insurance Reserve is to be determined. In addition, we do not believe it is reasonable to allow Gulf the flexibility to reduce the amount of sharing to which the ratepayers may be entitled under this plan.

Item 7 of the regulatory incentive plan requires that the jurisdictional separations factors be updated based on 1998 data.

Item 8 of the regulatory incentive plan requires interest on any amounts subject to disposition by the Commission. For the purpose of calculating interest, any amounts collected shall be assumed to be earned equally throughout the year.

We believe this plan fairly considers Gulf's performance, including Gulf's lower rates, reliability, customer satisfaction and its relatively low equity ratio. We believe that these factors indicate setting the authorized return on equity at a higher level. We note that in the past we have penalized this company for poor performance. Gulf Power Company's last rate case was in Docket No. 891345-EI. In that proceeding, this Commission set Gulf's authorized ROE at 12.55% by Order No. 23573, issued October 3, 1990. However, a 50 basis point reduction to the ROE based on evidence of mismanagement was ordered, and rates were set at 12.05%. After 2 years, the reduction no longer applied. At this point in time, Gulf's performance indicates a higher than otherwise appropriate ROE is warranted.

We believe the approved plan provides substantial benefits to customers, including credits via the environmental cost recovery clause, the earlier write-off of assets which would otherwise be included in rate base, and the possibility of additional earnings sharing in the future. We note that if the plan is not protested, these benefits will begin sooner, and without the expense of a full revenue requirements rate proceeding.

IV. Review of Gulf's executed Contract Service Agreements (CSA) under its Commercial/Industrial Service Rider (CISR) tariff

Gulf's CISR tariff allows the Company to enter into negotiated contracts with commercial/industrial customers. Order No. PSC-96-1219-FOF-EI (Order), issued September 24, 1996, in Docket No. 960789-EI. To receive service under the CISR, the customer has to demonstrate to Gulf that without the negotiated contract, the customer would leave Gulf's system, would not expand existing load, or, in the case of a new customer, would not locate in Gulf's territory (at-risk customer). If Gulf and the customer agree on the price and other terms and conditions, they would execute a CSA. The order does not require that the Commission review each CSA, however, the order specifies two triggering events that would result in a Commission review of each executed CSA. The first triggering event is a request by Gulf for a base rate increase. The second triggering event would result from conditions identified through the Commission's monthly surveillance reporting system discussed below. The Commission may also initiate a prudence review of any CSA upon its own motion.

Gulf provides a confidential supplement (Document No. 01906-99) to its monthly surveillance report that reports the difference between the revenues that would have been produced by Gulf's otherwise applicable tariff and the revenues that are produced under the CISR (revenue shortfall). If the revenue shortfall, when added to Gulf's achieved jurisdictional ROE, causes the ROE to exceed the top of its authorized range, this Commission will be required to review each CSA. For the twelve month period ending December 31, 1998, Gulf reported an achieved ROE of 12.99%. The top of Gulf's currently authorized ROE range is 13.00%. The addition of the revenue shortfall causes Gulf to exceed the authorized top of 13.00%. Therefore, review of each executed CSA is appropriate.

During the review of each executed CSA, we are to determine whether Gulf's decision to enter into any particular CSA was a prudent choice made in the best interests of Gulf's general body of ratepayers. Gulf has the burden of proof in demonstrating to the Commission that the CSAs were a prudent decision. For the review, Gulf will submit the CSA along with the supporting analyses and documents upon which Gulf relied in its determination that the CSA was a prudent decision. Gulf must specifically prove that any CSA customer was truly an at-risk customer as defined in the tariff. Pending completion of the Commission's review, the amount of the revenue shortfall that caused Gulf's ROE to exceed the top of Gulf's authorized range should be held subject to refund as possible over earnings. If at the conclusion of our review Gulf has not demonstrated to this Commission's satisfaction that the CSAs were a prudent decision, the revenue shortfall will be imputed.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Gulf Power Company's revised proposal for an incentive sharing mechanism be denied. It is further

ORDERED by the Florida Public Service Commission that the regulatory incentive plan for 1999, 2000, 2001 discussed in Section III of this order and included as Attachment A is approved. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a consummating order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings or Judicial Review" attached hereto. It is further

ORDERED by the Florida Public Service Commission that Docket No. 990244-EI be closed at the conclusion of the protest period, if no protest is filed. It is further

ORDERED by the Florida Public Service Commission that Docket No. 990250-EI remain open pending review of Gulf Power Company's contract service agreements executed pursuant to its Commercial/Industrial Service Rider tariff.

By ORDER of the Florida Public Service Commission this 24th day of May, 1999.

BLANCA S. BAYÓ, Director
Division of Records and Reporting

By: s/ Kay Flynn
Kay Flynn, Chief
Bureau of Records

This is a facsimile copy. A signed copy of the order may be obtained by calling 1-850-413-6770.

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NOTICE OF FURTHER PROCEEDINGS
SECTIONS II and III

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing that is available under Section 120.57, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on June 14, 1999.

In the absence of such a petition, this order shall become final and effective upon the issuance of a consummating order.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW
SECTION IV

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

Any party adversely affected by this order, which is preliminary, procedural or intermediate in nature, may request: (1) reconsideration within 10 days pursuant to Rule 25-22.0376, Florida Administrative Code, if issued by a Prehearing Officer; (2) reconsideration within 15 days pursuant to Rule 25-22.060, Florida Administrative Code, if issued by the Commission; or (3) judicial review by the Florida Supreme Court, in the case of an electric, gas or telephone utility, or the First District Court of Appeal, in the case of a water or wastewater utility. A motion for reconsideration shall be filed with the Director, Division of Records and Reporting, in the form prescribed by Rule 25-22.060, Florida Administrative Code. Judicial review of a preliminary, procedural or intermediate ruling or order is available if review of the final action will not provide an adequate remedy. Such review may be requested from the appropriate court, as described above, pursuant to Rule 9.100, Florida Rules of Appellate Procedure.

REGULATORY INCENTIVE PLAN

1. This plan covers calendar years 1999, 2000 and 2001.

2. Effective January 1, 1999, the following returns on equity (ROE) are set for Gulf Power:

   10.5% - Authorized Floor
   11.5% - Authorized Mid Point
   12.5% - Sharing Begins
   14.0% - Authorized Ceiling after Sharing

   The 11.5% ROE will be used as the equity return for other purposes as well, including but not limited to the equity portion of JDIC and calculating Gulf's allowance for funds used during construction (AFUDC) rate. After December 31, 2001, unless changed by the Commission, Gulf's authorized ROE mid point will be 11.5% with an authorized floor of 10.5% and an authorized ceiling of 12.5%.

3. Regulatory Assets and Liabilities-

   A. Effective January 1, 1999, Gulf Power will no longer accrue a deferred return on the cost of the third floor of the corporate office as authorized and identified in Order No. 23573 issued October 3, 1990 in Docket No. 891345-EI (Gulf Power's last full base rate adjustment proceeding). The accumulated balance of such deferred return together with the identified third floor investment amount shall be included in the Company's authorized jurisdictional rate base and be subject to depreciation and/or amortization for purposes of calculating the achieved jurisdictional return beginning January 1, 1999. The balance of deferred returns on the costs of the third floor of the corporate office (approximately $2.9 million) and the deferred depreciation associated with the corporate office third floor will be fully amortized in equal amounts per year during 1999, 2000, and 2001.

   B. The balance of the flow through portion of the FAS 109 regulatory asset (approximately $1.7 million) will be fully amortized in equal amounts per year during 1999, 2000, and 2001.

   C. For 1999, the Company shall record an additional accrual of $2.9 million to its Property Insurance Reserve. The

ATTACHMENT A

$2.9 million is in addition to its approved annual accrual of $3.5 million.

4. Customer credit - Customer bills will be credited by $5.8 million on an annual basis beginning July 1, 1999, through the environmental cost recovery clause. The Company shall file revised tariffs to reflect this credit, effective, July 1, 1999.

5. Sharing - After the close of each calendar year covered by this plan, the amount of any actual revenues contributing to earnings above 12.5% ROE will be determined by the Commission.

   A. For calendar year 1999, the amount of any actual revenues contributing to earnings above 12.5% ROE up to a net earned jurisdictional return (after sharing) of 14.0% will be divided into three equal shares. One 33.3% share will be used first to increase the Property Insurance Reserve to a target level of $25 million, and second, to write off the balance of the loss on reacquired debt. The Company's shareholders shall receive one 33.3% share. One 33.3% share will be refunded to the ratepayers. The Commission will retain jurisdiction over any and all earnings over 14.0% ROE after sharing. The disposition of these revenues will be determined in the future.

   B. For calendar year 2000, the first $2 million of revenues above 12.5% ROE will be added to the annual accrual to the Property Insurance Reserve. Any additional actual revenues contributing to earnings above 12.5% ROE up to a net earned jurisdictional return (after sharing) of 14.0% will be divided into three equal shares. One 33.3% share will be used first to increase the Property Insurance Reserve to a target level of $25 million, and second to write off the balance of the loss on reacquired debt. One 33.3% share will be refunded to the ratepayers. The Company's shareholders shall receive one 33.3% share. The Commission will retain jurisdiction over any and all earnings over 14.0% ROE after sharing. The disposition of these revenues will be determined in the future.

   C. For calendar year 2001, the first $2 million of revenues above 12.5% ROE will be added to the annual accrual to the Property Insurance Reserve. Any additional actual revenues contributing to earnings above 12.5% ROE up to a net earned jurisdictional return (after sharing) of 14.0% will be divided into three equal shares. One 33.3% share will be used first, to increase the Property Insurance Reserve to a target level of $25 million, and second, to write off the balance of the loss on reacquired debt. The Company's shareholders shall receive one 33.3% share. One 33.3% share will be refunded to the ratepayers. The Commission will retain jurisdiction over any and all earnings over 14.0% ROE after sharing. The disposition of these revenues will be determined in the future.

6. During 1999, 2000, and 2001, Gulf Power shall not have the flexibility, as approved in Order No. PSC 96-0023-FOF-EI, to increase its annual accrual to the Property Insurance Reserve above $3.5 million, except as provided for in this plan.

7. The jurisdictional separation factors used in the earnings surveillance report will continue to be based on a cost of service study prepared in accordance with the same methodology as the cost of service study used in Gulf's last full base rate adjustment proceeding (Docket 891345-EI). However, the Company will complete an updated study using the surveillance report for the calendar year 1998 as a base period. The updated study will be completed and new separation factors will be used for calculating the earnings for 1999, 2000 and 2001.

8. Any revenues deferred pending Commission jurisdiction as to final disposition will accrue interest at the 30 day commercial paper rate as specified in Rule 25-6.109, Florida Administrative Code. Such deferred revenues will be assigned a cost rate in the determination of the cost of capital based on the rate used in the interest accrual for deferred balances consistent with the Commission's decision on this issue in Docket No. 950379-EI for Tampa Electric Company.