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GULF POWER
A SOUTHERN COMPANY

January 29, 2002

Ms. Blanca S. Bayo, Director
Division of the Commission Clerk and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee FL 32399-0870

Dear Ms. Bayo:

RE: Docket No. 010949-EI

Enclosed are an original and fifteen copies of Gulf Power Company's revised Rebuttal Testimony to be filed in the above docket consisting of the witnesses listed below. Please completely replace the previous rebuttal testimony filed on January 22, 2002, by these witnesses with this copy.

Charles A. Benore 01130-02
Robert G. Moore 01131-02

Sincerely,

Susan D. Ritenour (lw)

Susan D. Ritenour
Assistant Secretary and Assistant Treasurer

lw

Enclosure

cc: Beggs and Lane
Jeffrey A. Stone, Esquire

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Request for rate increase by)
Gulf Power Company)
_____)

Docket No. 010949-EI

Certificate of Service

I HEREBY CERTIFY that a copy of the foregoing has been furnished this 29th day of January 2002 by U.S. Mail to the following:

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BEFORE THE

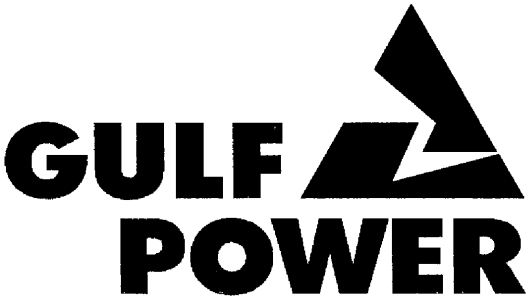
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 010949-EI

REBUTTAL TESTIMONY AND EXHIBIT

OF

CHARLES A. BENORE



A SOUTHERN COMPANY

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony Of
Charles A. Benore
Docket No. 010949-EI
Date of Filing: January 22, 2002

Q. Please state your name, address and occupation.

A. My name is Charles A. Benore and my business address is 125 West Street, Bar Harbor, Maine 04609. I am President of Benore Financial Consulting, Inc., a financial consulting company.

Q. Are you the same Charles A. Benore who provided direct testimony on Gulf Power's behalf in this docket?

A. Yes.

Q. What is the purpose of this testimony?

A. The purpose of my testimony is to respond to the testimony of Mr. James A. Rothschild.

Q. Have you prepared an exhibit that contains information to which you will refer in your rebuttal testimony?

A. Yes. I have prepared Exhibit (CAB-2) consisting of 24 schedules numbered Schedule 12 through Schedule 35.

Counsel: We ask that Mr. Benore's Exhibit (CAB-2) consisting of 24 schedules numbered 12 through 35 be marked for identification as Exhibit ___.

COMMENTS ON THE DIRECT TESTIMONY OF MR. ROTHSCHILD

Q. Do you have any fundamental concerns about the return on common stock equity recommended by Mr. Rothschild?

A. Yes, there are several.

1. Mr. Rothschild's return on common stock equity recommendation to the Commission will not produce the growth rate and return that he testifies investors require. By definition, therefore, his recommendation is contradictory and flawed.
2. He ignored the comparable earnings test, which shows the return on common stock equity expected by investors and embedded in their growth and return expectations.
3. He did not recognize the relatively small size of Gulf Power Company and its associated higher business risk in his recommended return on common stock equity.
4. He ignored flotation costs even though such costs are real and need to be recognized.
5. His schedules contain a number of errors, inconsistencies, and misrepresentations of reasonable investor expectations. These problems with his DCF and CAPM analyses are described in detail later in my rebuttal testimony.

BROAD ISSUES

Mr. Rothschild Made a Contradictory Recommendation to the Commission

Q. Why is there a contradiction between Mr. Rothschild's recommended return on common stock equity for Gulf Power Company (or the investor required market return), and the return that his recommendation will produce for investors?

A. Mr. Rothschild used a definition of the cost of common stock which he does not fulfill in the return he recommends to the Commission. He notes on page 21 beginning on line 4 that the cost of common stock is "the rate of return that must be offered to a common equity investor in order for that investor to be willing to buy the common stock." Common sense and investment theory indicate that the return required by investors is the return available to them from other comparable risk investments. Moreover, as indicated by the DCF model, investors expect to have a reasonable opportunity to earn their required market return through a combination of growth in the common stock price that tracks the growth in earnings/dividends plus the dividend yield on the stock.

Mr. Rothschild's recommendation stops short of fulfilling investor expectations because he does not provide investors with an opportunity to earn the 10.0% market return he testifies they require. For example, the achievable market return for investors using Mr. Rothschild's 10.0% regulatory return recommendation is only 7.3%. Data supporting this calculation is shown on Schedule 12 of my rebuttal exhibit.

This is clearly an untenable outlook for investors. The achievable

market return of 7.3% is less than the yield on Moody's "A" rated utility bonds of 7.66% (1/10/02), which are lower in risk. Mr. Rothschild's recommendation of a regulatory return of 10.0% will produce a market return to investors (7.3%) that is lower than the market return (7.7%) on lower risk bonds with a rating comparable to Gulf Power Company. This is an untenable investment prospect for investors.

Q. What are the expected consequences of adopting Mr. Rothschild's 10.0% return on common stock equity recommendation for Gulf Power Company?

A. Mr. Rothschild's 10.0% return on common stock equity recommendation, if adopted by the Commission, would likely drive the stocks toward book value. Based on data shown in Mr. Rothschild's Exhibit JAR 3, the stock price of companies on the list of companies comparable to Gulf Power would need to drop by 39% to reach book value. His recommendation would therefore deprive investors of a reasonable return on their capital and, therefore, repel rather than attract investors. This would in turn jeopardize the ability of Gulf Power Company to attract capital and fulfill its customer responsibilities. Clearly such a result is contrary to the public interest.

Q. What regulatory return on common stock equity is necessary to fulfill Mr. Rothschild's 10.0% achievable market return for investors?

A. The necessary regulatory return in order for investors to have an opportunity to earn in the market the 10.0% return that Mr. Rothschild

testifies they require is 12.7%, before consideration of flotation costs, and 12.9% with flotation costs. Data supporting this calculation is shown in the lower table on Schedule 12 of my rebuttal exhibit, and on Schedule 27 for flotation costs.

Mr. Rothschild Wrongly Ignores the Comparable Earnings Test

Q. Please explain why you believe Mr. Rothschild erred by ignoring the comparable earnings analysis in determining his recommended return on common stock equity for Gulf Power Company.

A. Mr. Rothschild employed the sustainable growth rate method for determining investor expected growth rates. In its simplest form, this consists of multiplying the expected return on common stock equity ("r") times the retention rate ("b"), which represents the earnings retained to support future growth. It should be clear from the sustainable growth rate formula (r times b) that one of the two elements necessary to determine the growth rate is the expected return on common stock equity. Mr. Rothschild uses the expected return on common stock equity (comparable earnings) for determining the earnings growth of the comparable companies. Yet after concluding his DCF analysis, he ignores the fact that his DCF recommendation relies on comparable earnings to provide the rate of growth used in that analysis.

From another perspective, there is a difference between book and market returns. Book returns, such as the return on common stock equity, are generally not the same as market returns (the sum of the growth rate and yield produced by the DCF model) except when stock prices are

comparable to book value. Nonetheless, the growth rate in the DCF model is functionally related to the book return on common stock as shown by the sustainable growth rate formula used by Mr. Rothschild. The return allowed by regulators, which is represented by "r" (return on common stock equity) in the sustainable growth rate model, is also a book return. Therefore, the comparable earnings model provides an apple-to-apple method of determining the appropriate regulatory return. The return shown by the comparable earnings model is the return on common stock equity expected by investors and embedded in their expected market return (price growth that tracks "br" plus the yield on the stock).

Q. What are the strengths of the comparable earnings method?

A. The comparable earnings model provides a direct rather than indirect method for assessing the investor expected return on common stock equity. Market based models, such as the DCF model, calculate the investor expected market return, which is different from the book return on common stock equity (except when price and book value are comparable). When stock prices are different from book value, as they are under current market conditions, it is necessary to determine the appropriate book regulatory return on common stock equity to produce the expected rate of growth, and to provide investors with an opportunity to earn their required market return. The comparable earnings method provides this information.

From another perspective, the cost of common stock is not the market return shown by the DCF, ERP, and CAPM models, but is the

book return the firm must earn in order to produce the investor required market return. "Basic Financial Management," as cited on page 24 of my direct testimony, notes:

> The cost of common stock: The rate of return the firm must earn in order for the common stockholders to receive their required return.

Mr. Rothschild Failed to Recognize that Gulf Power Company's Small Size Increases Its Risk Relative to the Comparable Companies

Q. Please explain why size is important in determining the cost of common stock for companies like Gulf Power Company.

A. Smaller companies generally lack the resources of larger companies and, therefore, are generally less able to cope with unforeseen events. Further, experience shows that investor returns are materially higher for smaller than larger companies, which is consistent with the proposition that their risk is higher.

Ibbotson Associates, which has developed size premiums based on market values, notes on page 107 of its "Valuation Edition, 2001 Yearbook," that:

> One of the most remarkable discoveries in modern finance is that of a relationship between firm size and return. The relationship cuts across the entire size spectrum but is most evident among smaller companies, which have higher returns on average than larger ones.

Q. What is an appropriate size premium for Gulf Power Company?

A. Gulf Power Company's common stock equity is equal to about 4% of that of its parent, Southern Company. Southern Company's market value according to Value Line is $15.8 billion, and at 4% Gulf Power Company's is approximately $630 million. The average market value of the companies on the list of companies comparable to Gulf Power is $5.3 billion, as shown on Schedule 23 of my rebuttal exhibit. Based on the Ibbotson size premium study, the higher return indicated for Gulf Power Company is approximately 0.7%. It is my judgment, nonetheless, that the higher business risk associated with the Company's smaller size is mitigated to a substantial extent by constructive adjustment clauses for fuel, purchase power, capacity, and environmental costs provided by the Florida Public Service Commission. Consequently, the size premium for Gulf Power Company is probably closer to 0.25% than 0.75% in quarter point increments.

Although substantially mitigated by constructive regulatory policies, size is still an important consideration, especially since Mr. Rothschild suggests that his 10.0% recommended return would be closer to 9.75% if the Commission chooses to consider the risk mitigation impact of its adjustment clauses.

Mr. Rothschild Ignored Flotation Costs Which Are Legitimate Costs That Should Be Recognized

Q. Did Mr. Rothschild recognize and make an adjustment for flotation costs?

A. No. Because monies invested by investors are reduced by the amount of

issuance costs, the amount shown on the balance sheet of Gulf Power Company is less than the amount actually invested by investors. Therefore, a higher return on the reduced amount of investment is necessary in order for investors to have an opportunity to earn the return considered fair by the Commission on the full amount of their investment.

Justification for a flotation cost adjustment is provided, and its amount is shown, in Schedule 11 of the exhibit to my direct testimony, and in the lower table on Schedule 27 of my rebuttal exhibit. The adjustment is 0.19%, or 0.2% rounded.

SINGLE-STAGE DCF ISSUES

Q. Please describe the single-stage DCF model used by Mr. Rothschild.

A. The single-stage DCF model used by Mr. Rothschild employed a sustainable growth rate (br + sv), with a yield based on the indicated dividend per share adjusted by one-half of the growth rate. Flotation costs and transformation were ignored. Using the average stock prices for the year ending 11/30/01, Mr. Rothschild's result for the comparable group of companies identified in my direct testimony was 8.86%, and his result for Southern Company was 9.60%. Using stock prices for 11/30/01, his results were 9.63% and 9.64% respectively.

Q. Please summarize the problems you found in Mr. Rothschild's single-stage DCF analysis.

A. I found three categories of problems: data errors, inconsistencies, and

misrepresentations of reasonable investor expectations.

Q. Please identify the data errors you found in his analysis.

A. Using the latest Value Line reports (9/7/01 and 10/5/01) before the 11/30/01 prices shown in his study, I found the following data errors in Mr. Rothschild's single-stage DCF calculations:

1. JAR 3, Page 1: The average price to book value using average prices for the comparable group is 1.87 not 1.92.
2. JAR 3, Page 1: The 11/30/01 market to book value ratio for Southern is 1.45 times instead of 1.71 times.
3. JAR 3, Page 1: The market to book value ratio for Southern based on average for the year prices is 1.81 instead of 1.90.
4. JAR 8: The common shares outstanding are incorrect for Progress Energy and TECO Energy.
5. JAR 8: The growth rate for common shares is incorrect.
6. JAR 8: Footnote [A] states that 0.40 was used for "s" but footnote [J] on JAR 4 states that 0.30 was used for calculating the sustainable growth rate.

Q. What inconsistencies did you find in Mr. Rothschild's analysis?

A. I found the following inconsistencies:

1. Mr. Rothschild used Southern Company for this single-stage version of his DCF analysis, but not for his two-stage DCF model analysis.

2. His two-stage DCF analysis used returns on common stock equity of 12.0%, 13.0%, and 13.5% compared to 13.0% for his single-stage, comparable company analysis.

Q. Why do you say that Mr. Rothschild's model contains misrepresentations of reasonable investor expectations?

A. I say that because:

1. Mr. Rothschild used a book value for Southern Company that apparently includes Mirant, a company that was spun-off from Southern Company in April 2001, well before the preparation of his testimony.

2. He based his analysis in part on an average of prices over the twelve months ending 11/30/01, despite the efficient market theory that indicates new information is reflected in stock prices almost immediately.

3. He ignored investor return on common stock equity expectations based on Value Line (13.5%) and Zacks' (14.85%) information and substituted his own lower numbers.

4. He concluded that the investor required market return is 9.63% based on 11/30/01 prices on JAR 4, page 1. This result cannot be replicated using the DCF model with a sustainable growth rate, which suggests that there may be errors or improper modeling on JAR 4 page 1.

Use of Southern Company

Q. The errors and inconsistencies that you identified are straightforward. Would you be more specific in your comments about the misrepresentations of reasonable investor expectations that you found in Mr. Rothschild's analysis?

A. In light of the fact that Mr. Rothschild used Southern Company data which preceded the spin-off of Mirant in performing his single-stage DCF analysis, I did not review his analysis of Southern Company. Another reason for not including Southern Company in my review is that Mr. Rothschild did not include Southern Company in his two-stage DCF or CAPM analyses.

Representative Stock Prices

Q. Please explain why you believe it is inappropriate to use stock prices that go back as far as December 1, 2000 to measure the cost of common stock for Gulf Power Company in 2002.

A. Mr. Rothschild used average prices for the year-ending 11/30/01 for one of his single-stage DCF analyses. It is generally conceded in this electronic age that investors reflect new information into stock prices almost instantaneously with its release. To assume that average prices over the year ending 11/30/01 are representative of current investor expectations is unreasonable, especially as the electric utility industry incurs distortions associated with the structural change from monopoly to competition. It is my judgment that the 11/30/01 price is the only one of the two he used that is representative of investor expectations for his

single-stage DCF analysis.

Furthermore, Mr. Rothschild used the price-to-book ratio of 1.7 based on 11/30/01 prices for determining the investment cost of the cash flows in his two-stage DCF analysis. It is inconsistent to use average year prices in one part of the analysis and year-end prices in another part.

Use of Investor Expected Returns on Common Stock Equity Versus Those of Mr. Rothschild

Q. You expressed a concern that Mr. Rothschild ignored investor expectation data from Value Line and Zacks and substituted his own judgment about the investor expected return on common stock equity in his sustainable growth rate calculations. Please explain your concern.

A. Mr. Rothschild's single-stage DCF model is not based on the investor expectations he shows on JAR 4, page 1. He developed his sustainable growth rate using a return on common stock equity of 13.0% for the comparable company group instead of using the 13.5%, 2004-06 normalized level shown by Value Line, and the 14.85% shown by Zacks (footnote [A] on JAR 4, page 1). Presumably the 13.0% represents his judgment after considering the lower returns on average common stock equity for the comparable group in 1999 (12.4%) and 2000 (12.9%) that are also shown on JAR 4, page 1.

The problem with Mr. Rothschild's choice of 13.0% is that it is unrepresentative of investor expectations. Whatever informational value investors find in short-term historical data is already embedded in their projected returns on common stock equity. Therefore, weighing historical

and projected results essentially double-counts short-term historical guidance. Moreover, short-term historical data adds little value to determining longer-term expectations during abnormal conditions such as those which exist today when the industry is progressing from a monopoly to a more competitive industry structure, and material distortions to earning assets, earnings, and dividends occur.

Therefore, Mr. Rothschild should have used investor expected returns on common stock equity of 13.5% and 14.85% in his sustainable growth rate calculations.

Inability to Replicate Mr. Rothschild's Single-Stage DCF Model Results

Q. Using the "br+sv" DCF model, were you able to replicate the 9.63% investor required return shown for Mr. Rothschild's 11/30/01 single-stage DCF growth analysis?

A. No. The numbers don't add up. Using stock prices on 11/30/01, Mr. Rothschild claims that the investor required market return is 9.63%. However, when running the 13.0% return on common stock equity, with 2001 book value of $22.76, dividends per share (DPS) of $1.85, and yield of 5.32% on the forward dividend with an external growth rate of 0.14%, the indicated investor required market return is 10.3%. The calculations supporting this result are shown in the upper table on Schedule 13 of my rebuttal exhibit. Of course, as I explained earlier, the 13.0% return that Mr. Rothschild inputs into his model is not representative of investor expectations in any event.

Alternative Measures of the Investor Required Return for Gulf Power Company's Comparable Companies

Q. If Mr. Rothschild had used the average of the Value Line and Zacks' projected returns on common stock equity of 14.2% (13.5% and 14.85%) for his sustainable growth rate approach, what would Mr. Rothschild's single-stage DCF analysis show as the investor expected market return?

A. Using a 14.2% return on common stock and the book value for 2001, which better corresponds with the 11/30/01 common stock prices than 2000 book value, the indicated investor required market return is 11.5% before flotation costs and transformation. Supporting data is shown in the table at the bottom of Schedule 13 of my rebuttal exhibit.

Q. If Mr. Rothschild had used the average of the five-year earnings growth rates provided by four vendors, and recent, representative stock prices, what investor required market return is shown?

A. As noted in the response to Staff Production of Document Request Item No. 55, which requested updated information on the cost of equity, the indicated investor required market return using the most recent data is 12.1%, before flotation costs and transformation. This calculation is shown in Schedule 27 of my rebuttal exhibit.

TWO-STAGE DCF MODEL ISSUES

Q. Please describe the two-stage DCF model used by Mr. Rothschild.

A. Mr. Rothschild's two-stage DCF model determined the present value of

investor cash flows, or dividends per share plus the terminal price 40 years after initiating the investment. For the first five years, he used the dividends projected by Value Line, and for the next 35 years he essentially used the sustainable growth rate method (br+sv) employing returns on common stock equity of 12.0%, 13.0%, and 13.5%. He then determined the discount rate that equated the cash flows with the purchase price. The discount rate is the market rate of return required by investors.

Q. Did you find any problems with his two-stage DCF analysis?

A. Yes. Again I have categorized the problems as data errors, inconsistencies, and misrepresentations of reasonable investor expectations.

Errors:

1. Mr. Rothschild did not use either the year-to-date average price, or the 11/30/01 price for his analysis, but instead used an artificial price (approximately the ratio of 1/30/01 prices to 2000 book value times 2001 book value).
2. He used an incorrect 2005 book value for Ameren which caused the average book value for that year to be incorrect.
3. The previously cited data errors on his Schedule JAR 8 also affected his second-stage DCF analysis.
4. He erroneously used the retention rate for the first year of the stage-one analysis (41.33%) rather than the retention rate for the last year of that analysis (47.39%) as the rate carried forward into

stage two.

Inconsistencies:

1. He used Southern Company for his single-stage version of his DCF analysis but not for his two-stage DCF model analysis.
2. His two-stage DCF analysis used returns on common stock equity of 12.0%, 13.0%, and 13.5%, compared to 13.0% for his single-stage analysis.

Misrepresentation of Reasonable Investor Expectations:

1. He used his expected returns on common stock equity rather than those of investors.

Q. Please explain the fourth item that you identified in your list of errors.

A. The first stage portion of Mr. Rothschild's analysis used Value Line investor expected data inputs that resulted in a terminal retention rate of 47.39% for 2005. In 2006, however, when Mr. Rothschild begins his second stage, he drops the retention rate to the 2001 level of 41.33%. This error effectively institutes a new dividend policy for the comparable companies.

Mr. Rothschild Used His Own Expected Returns on Common Stock Equity Instead of Those of Investors

Q. Did Mr. Rothschild use his interpretation of investor expected returns on common stock equity instead of those provided by investors, as shown by Value Line and Zacks?

A. Yes. Mr. Rothschild used expected returns on common stock equity of

12.0%, 13.0%, and 13.5% in his analysis in lieu of those provided by investors of 13.5% by Value Line and 14.85% by Zacks. He notes that historical returns were lower and that analysts' estimates have an upward bias in justifying the write down of investor expectations. This is clearly wrong, because in concluding what future returns on common stock equity are expected to be, whatever guidance is provided by short-term historical results would already be embedded in investors' future expectations. Moreover, it is unlikely that investors would pay much heed to short-term historical results as the industry undergoes a structural change from monopoly to competition. Further, investors invest based on their expectations and not on after-the-fact results.

Q. If Mr. Rothschild had used the correct values for actual current stock prices, investor expected returns on common stock equity provided by Value Line and Zacks, and investor expected dividend policy, what would his two-stage DCF analysis show the investor expected market return to be?

A. Using the 13.5% investor expected return on common stock equity provided by Value Line, the indicated market return expectation by investors using a combined internal and external growth rate of 6.54% is 11.4% before flotation costs and transformation. Supporting data is shown on Schedule 14 of my rebuttal exhibit.

Using Zack's 14.85% investor expected return on common stock equity indicates an investor required market return of 12.4%, using a combined internal and external growth rate of 7.18%. Supporting data is

shown on Schedule 15 of my rebuttal exhibit.

DCF MODEL CONCLUSIONS

Q. What are your conclusions about Mr. Rothschild's single-stage DCF analysis for the list of companies comparable to Gulf Power?

A. Mr. Rothschild's single-stage DCF analysis contained a number of factual errors, misrepresentations of investor expectations, and the numbers shown on his JAR 4, page 1 for 11/30/01 stock prices do not add up. This analysis is badly flawed, and I recommend it not be considered in determining the regulatory return on common stock equity for Gulf Power Company.

Using the average sustainable growth rate based on Value Line and Zacks' expected returns on common stock equity, the investor expected market return is 11.5% as shown on Schedule 13 of my rebuttal exhibit.

Using an alternative measure based on projected five-year growth rates and representative stock prices, Mr. Rothschild's single-stage DCF, based on the update to my DCF analysis, would show an investor expected market return of 12.1% (see Schedule 27 of my rebuttal exhibit).

The 11.5% (Schedule 13) to 12.1% (Schedule 27) investor market return expectations are substantially higher than the 9.63% shown on Mr. Rothschild's JAR 4, page 1, for the list of companies comparable to Gulf Power.

Q. What are your conclusions about Mr. Rothschild's two-stage DCF analysis for the list of companies comparable to Gulf Power?

A. Mr. Rothschild's two-stage DCF analysis contained a number of errors, and misrepresented investor expectations. The most serious of the problems with his analysis is the use of his judgment about expected returns on common stock equity rather than those of investors, artificial rather than actual stock prices for the comparable companies, and the use of an erroneous dividend policy for the second stage of the analysis rather than a continuation of one already in place determined by investors.

After correcting these problems, and using the appropriate investor expected returns on common stock of 13.5% from Value Line, and 14.85% from Zacks, the two-stage DCF model indicates an investor expected market return of 11.4% (Schedule 14) and 12.4% (Schedule 15) respectively, before flotation costs and transformation. These expected market returns that are representative of investor expectations are materially higher than the 9.80% shown by Mr. Rothschild on his Schedule JAR 2.

Q. What is your overall conclusion about Mr. Rothschild's DCF analysis?

A. Mr. Rothschild's DCF analysis is badly flawed primarily because he chose to use his judgments about investor expected returns on common stock equity rather than those of investors. Had he used investor expected returns on common stock equity and several other assumptions consistent with reasonable investor expectations, he would have found that the required investor market return was considerably higher than shown in his

testimony.

Corrected for infirmities, his DCF analysis shows an investor required market return of 11.5% for his single-stage DCF, and a range of 11.4% to 12.4% (with a midpoint of 11.9%) for his two-stage DCF analysis, before flotation costs and transformation.

Q. What regulatory return is necessary so that investors can earn the 11.9% market return indicated by the recalculated two-stage DCF analysis?

A. In order for investors to have a reasonable opportunity to earn the 11.9% market return, a regulatory return of 14.2% is necessary. Supporting data is shown on Schedule 16 of my rebuttal exhibit.

EQUITY RISK PREMIUM ISSUES

CAPM, Version One

Q. Please explain the first of two versions of the CAPM used by Mr. Rothschild.

A. Mr. Rothschild's first version of the CAPM determined the investor expected rate of inflation (2.0%) to which he added the historic, real market return (6.6% to 7.2%) to determine the investor expected nominal market return of 8.9%, the midpoint of 8.6% to 9.2%.

Schedule JAR 9 extends the analysis beyond the stopping point in JAR 2 using the standard form of the CAPM. The real market return of 6.6% to 7.2% (not the nominal market return of 8.9%) is reduced by the nominal debt return of 1.33% (not the real debt return of –0.67%) to

determine the market equity risk premiums of 5.27% to 5.87%. The 5.27% to 5.87% market equity risk premiums were adjusted for the lower risk of the list of companies comparable to Gulf Power compared to the market by using the Value Line beta of 0.52, which indicated an equity risk premium of 2.75% to 3.06%, or what Mr. Rothschild describes as the risk adjusted equity premium. Normally this risk adjusted equity risk premium is added to the debt return to show the market return required by investors. Had this been done, his analysis would show a required market return for the list of companies comparable to Gulf Power of 4.08% to 4.39% (2.75% plus 1.33% and 3.06% plus 1.33%), which is of course unreasonable on its face.

From another perspective, the last line on his Schedule JAR 9 shows a midpoint risk premium applicable to electric companies of 6.23%. To this one would add the debt return, which he shows as 1.33%. The sum, or investor required market return, is 7.56%. In either event, the results are untenable since single A rated utility bonds, which are lower in risk, currently yield 7.66% (Moody's 01/10/02).

Q. What problems did you observe on his Schedule JAR 9?

A. There are several.

1. Mr Rothschild was inconsistent on line 9 of his analysis on Schedule JAR 9 when he adjusted the *real* market return by the *nominal* interest rate. It is not appropriate to mix apples and oranges (real and nominal rates) in developing the investor expected, nominal equity risk premium.

2. He shows a different conclusion on Schedule JAR 2 than on his Schedule JAR 9.

3. He produced untenable results using the standard version of the CAPM.

Q. What is your overall conclusion about Mr. Rothschild's inflation adjusted, real return method to determine the investor expected market return for the CAPM?

A. The analysis is seriously flawed and, therefore, should not be used for determining the investor required market return for Gulf Power Company.

CAPM, Version Two

Q. Please describe the second CAPM used by Mr. Rothschild.

A. Mr. Rothschild's second CAPM method determined that the historical equity risk premium for common stocks versus long-term Treasury bonds was 4.0%, instead of the 7.3% shown by Ibbotson using the arithmetic average for 1926-2000. Using geometric average returns, he showed 1926-1999 returns for various debt securities. He then adjusted these returns by subtracting the long-term Treasury bond return and another amount which he calculated was required to maintain consistency with his equity risk premium of 4% over long-term Treasury bonds.

Mr. Rothschild properly acknowledged the problems using Treasury bond yields (flight to quality and perhaps scarcity premiums in Treasury note and bond yields) and therefore used long-term corporate bonds for his analysis. His analysis showed an investor required market return for

the list of companies comparable to Gulf Power of 8.94%, before flotation costs and transformation, and a required return of 10.62% for the market. It is not clear why Mr. Rothschild uses the market return for the upper end of his analysis.

Q. Did you note any errors, inconsistencies, or misrepresentations of reasonable investor expectations, which you believe are present in Mr. Rothschild's CAPM analysis?

A. I did not note any errors in Mr. Rothschild's CAPM analysis, but there are some inconsistencies and misrepresentations of investor expectations which are noted below.

Inconsistencies:

1. Mr. Rothschild's yield on JAR 9 for Treasury bills is 1.33% versus 1.60% on JAR 10.
2. He used short-term Treasury bills for his CAPM Version One versus long-term corporate bonds for his Version Two.

Misrepresentations of Reasonable Investor Expectations:

1. Mr. Rothschild inappropriately used the geometric average instead of the arithmetic average Ibbotson Associates' data to determine investor expectations.
2. He inappropriately used a 4 percentage point equity risk premium relative to long-term Treasury bonds to represent investor expectations.
3. He failed to recognize that empirical studies show the standard CAPM model understates the investor expected return for low beta

stocks and also for small stocks, both of which apply to Gulf Power Company.

4. He improperly represented data from the Credit Suisse First Boston (CSFB) study in supporting his analysis.

The Arithmetically Derived Equity Risk Premium Provides the Correct Assessment of Investor Expected Returns

Q. Why is it wrong to use geometric measures of historical returns to reflect investor future return expectations?

A. Ibbotson Associates, the source of Mr. Rothschild's data, states on page 61 of its "Valuation Edition 2001 Yearbook":

> The equity risk premium data presented in this book are arithmetic average risk premia as opposed to geometric average risk premia. ***The arithmetic average equity risk premium can be demonstrated to be most appropriate when discounting future cash flows.*** For use as the expected equity risk premium in either the CAPM or the building block approach, ***the arithmetic mean or the simple difference of the arithmetic means of stock market returns and riskless rates is the relevant number.*** This is because both the CAPM and the building block approach are additive models, in which the cost of capital is the sum of its parts. The geometric average is more appropriate for reporting past performance, since it represents the compound average return. [Emphasis added.]

Morin in "Regulatory Finance," page 298, states:

> This appendix shows why arithmetic rather than geometric means should be used for forecasting, discounting, and estimating the cost of capital. Similar treatments and demonstrations are available from Brealey and Myers (1991), Ibbotson Associates (1993), and Litzenberger (1984). This appendix draws from the three aforementioned sources, particularly the latter.
>
> By definition, the cost of equity capital is the annual discount rate that equates the discounted value of expected future cash flows (from dividends and the sale of the stock at the end of the investor's investment horizon) to the current market price of a share in the firm. The discount rate that equates the discounted value of future expected dividends and the end of period expected stock price to the current stock price is ***a prospective arithmetic***, rather than a prospective geometric mean rate of return. Since future dividends and stock prices cannot be predicted with certainty, the "expected" annual rate of return that investors require is an average "target" percentage rate around which the actual, year-by-year returns will vary. ***This target rate is, in effect, an arithmetic average.*** [Emphasis added.]

From still another perspective, if the utility was expected to earn 10% on its common stock equity, after two years one would expect (assuming no dividends or external financing) that its common stock

equity would have grown by 21%. However, if the actual rate of growth were 0% in the first year and 20% in the second year, its common stock equity would have increased by only 20%, not 21%.

The geometric rate of growth in the second outcome (0% and 20%) is 9.54%. Had one wanted the utility to earn 9.54%, therefore, one would have had to allow a return of 10.0%. Therefore, it is essential that arithmetic returns be used to set returns on common stock equity. Use of the geometric mean return will produce a downward bias in the return on equity necessary to fulfill investor expectations.

Q. Nonetheless, Mr. Rothschild's position is that the arithmetic mean overstates actual returns received by investors (page 82, lines 4-5), and cites numerous examples (page 83 - 85) that he alleges support the use of the geometric mean to measure the cost of common stock for Gulf Power Company. Please comment.

A. Mr. Rothschild is right as far as his supporting evidence goes, but all that evidence relates to the use of geometric returns for presenting historical results, not for estimating expected future results.

In my three decades of experience in working with individual and institutional investors, I have never talked to an individual investor who asked me about geometric averages on either a historic or prospective basis. I cannot recall an institutional investor that looked at historical returns calculated with the geometric mean to determine expected future returns. This experience is supported by Value Line which shows even historic returns based on the arithmetic mean.

Value Line shows the arithmetic and not the geometric total return in its reports to investors. Value Line notes:

> We are adding a new box to show "Total Return." On every report, in a box in the lower right hand corner of the stock price chart, we will now show total return for each stock (appreciation or depreciation of the stock plus cash dividends) for the past 1 year, 3 years, and 5 years. We will also show the total return of the stock market for the same time periods. The market measure used will be the ***Value Line Arithmetic Index***, which is representative of the stock market as a whole, and is an equally weighted price index of all stocks covered in The Value Line Investment Survey. [Emphasis added.]

Mr. Rothschild Erred by Selecting the Lowest, Round Number Equity Risk Premium Possible Over 1926-2000

Q. Mr. Rothschild determined that the equity risk premium was declining based on a 30 year moving average of historic equity risk premiums, and provided alleged supporting citations from Federal Reserve Chairman Greenspan and a Credit Suisse First Boston report to investors. Please explain why you believe he erred in using a 4% equity risk premium.

A. A review of arithmetic, historical equity risk premiums shown in Ibbotson's "Valuation Edition 2001 Yearbook," pages 208-209, for long-term government bond total returns, and pages 198-199, for large company stocks total returns, shown on Schedule 17 of my rebuttal exhibit, indicates that the time period used by Mr. Rothschild for his equity risk

premium is the lowest, using the 30 year moving average, for 1926-2000.

It is clear that a 4% geometric average return (the chart shows higher equity risk premiums based on arithmetic returns) is not representative of the thirty year moving average over 1926-2000, and Mr. Rothschild should not expect investors to make a similar conclusion. The range of equity risk premiums is 3% to 13% with a range midpoint of 8%. The range midpoint of about 8% is a more reasonable investor expectation. It is also reasonably close to the average of the arithmetic equity risk premiums for 1926-2000 of 7.3% based on total return, and 7.8% based on the income return.

Mr. Rothschild Failed to Observe that Empirical Studies Show that the Standard CAPM Understates Investor Required Returns for Low Beta Stocks and Small Companies Like Gulf Power Company

Q. Why do you conclude that the standard CAPM understates investor required returns for companies like Gulf Power?

A. Virtually all empirical studies of standard CAPM model results show that the CAPM understates the investor required market return for low beta stocks like Gulf Power Company. Additionally, empirical research indicates that the standard CAPM understates expected market returns for small company stocks, which also includes Gulf Power Company. Please see citations on Schedule 9, pages 3 and 4, of the exhibit to my direct testimony.

Additionally, electric utility stocks have detached themselves from the market since regulatory restructuring concerns surfaced in 1993.

Electric utility stocks have moved sideways as selling pressures overwhelmed buying and caused the stocks to dramatically under-perform the market on a risk adjusted basis. The resulting lower beta does not reflect lower risk, but the adjustment for higher risk. This can be viewed on Schedule 22 to my rebuttal exhibit. This is confirmed by the rising risk assessment for single A utility bonds shown on Schedule 3, page 2 of the exhibit to my direct testimony.

Therefore, the beta used by Mr. Rothschild understates the relative risk of the list of companies comparable to Gulf Power compared to the market, and therefore understates the indicated investor required market return.

<u>The Credit Suisse First Boston Report Does Not Support Mr. Rothschild's Claim that the Market's Expected Equity Risk Premium is 3.7%.</u>

Q. Mr. Rothschild cites a Credit Suisse First Boston (CSFB) report to investors that shows an equity risk premium relative to government bonds of 3.7%. Please comment.

A. The CSFB report identifies a current market risk premium of 5.3%. The 3.7% figure cited by Mr. Rothschild is based on a CSFB "stress test" which assumes that earnings per share growth returns to the post 1948 trend, which is described as a conservative assumption. CSFB does not state whether or not it has adjusted for the flight to quality and Treasury buy-back premiums in the yields for Treasury securities at this time, or the unprecedented efforts by the Federal Reserve to mitigate the recession in the U.S. economy through lower interest rates.

Accordingly, insufficient information is available from the study to assess whether or not the 5.3% market equity risk premium is representative of reasonable investor expectations. Other issues that are important to assessing the reasonableness of the 5.3% estimate is CSFB's use of the earnings yield as part of the estimation process, an input that CSFB describes in another section of its report as a flawed model, and their assumption that earnings per share will grow after five years at only a 5% rate. This is roughly one-half the rate over the last economic cycle, and investor expectations for the next five years.

Q. Mr. Rothschild also notes that Federal Reserve Chairman Greenspan expects the equity risk premium to decline. Please comment.

A. Because the equity risk premium is volatile from year to year, it is reasonable to consider that Chairman Greenspan may have been thinking of an average of several years. For example, if one thought of the equity risk premium as the average over the last five years, and then moved backward in time adding one year to each new measurement period (5 years, then 6 years, etc.), the results show an equity risk premium for the last five years of about 11%. This method of measurement gives the most recent data more weight than earlier data. It is also clear from the chart showing this method for calculating the equity risk premium that the equity risk premium has been sharply increasing in the 1990s. Perhaps Chairman Greenspan's reference was to these equity risk premiums. Supporting data is shown in Schedule 18 of my rebuttal exhibit.

Nonetheless, had he been referring to the equity risk premiums for

1998 or 1999 (his comments were made in 1999 according to Mr. Rothschild), the Ibbotson equity risk premium for 1999 was 30.0% and for 1998 was 15.5%. I agree that equity risk premiums were likely to decline, and that is why I have used a much lower level to reflect reasonable investor expectations in my testimony.

Q. What equity risk premium do you believe investors are using at this time?

A. Based on Value Line projections for the Value Line Composite of about 1,700 common stocks, the projected total return is 16.9%. Using three different investor growth rate estimates, the expected total return for the S&P 500 is 14.4%. The normalized yield on long-term governments is currently 6.2%. These inputs indicate an expected equity risk premium that averages 9.5%. Supporting data is shown on Schedules 31 and 33 of my rebuttal exhibit.

Q. If Mr. Rothschild had used Ibbotson's long-term, arithmetic equity risk premiums using both the total return and income return, as well as the projected market returns you noted, what would his CAPM test show the investor required return to be for the list of companies comparable to Gulf Power Company?

A. The standard CAPM result would be 10.6% before flotation costs and transformation. It would also be necessary to consider the disconnect of electric stocks from the market which I referenced earlier, and the empirical research that shows beta understates risk for low beta stocks and stocks of small companies.

Accordingly, it is appropriate to use the empirical CAPM shown in my testimony that indicates a required market return by investors of 11.6%, before flotation costs and transformation. Supporting data for the CAPM results are shown on Schedule 33 of my rebuttal exhibit.

CAPM CONCLUSIONS

Q. Please state your conclusions about Mr. Rothschild's CAPM analyses.

A. As stated earlier, Mr. Rothschild's CAPM Version One is seriously flawed and, as presented, does not provide useful guidance for determining the investor required return for Gulf Power Company. His CAPM Version Two is biased downward for the reasons previously stated. When corrected to show representative investor expectations, the standard CAPM shows an investor required market return of 10.6% before consideration of the understatement by beta of risk for low beta stocks and stocks of small companies, both of which apply to Gulf Power Company. The empirical CAPM, which partially adjusts for the beta understatement, shows an investor required return of 11.6% before consideration of flotation costs and transformation.

Q. What regulatory return is necessary to produce the average return of 11.1% shown by the standard and empirical CAPMs in your updated testimony?

A. The necessary regulatory return to yield or produce an 11.1% market return to investors is 13.4%. Supporting data is shown in Schedule 19 of

my rebuttal exhibit.

OVERALL CONCLUSIONS ABOUT THE RESULTS OF MR. ROTHSCHILD'S DCF AND CAPM RESULTS

Q. What are your overall conclusions about the results of Mr. Rothschild's DCF and CAPM analyses for Gulf Power Company?

DCF and CAPM Conclusion

A. Mr. Rothschild's DCF and CAPM analyses are flawed from an investor perspective for the reasons noted in the foregoing analysis. Using investor expected returns on common stock equity, his single-stage DCF analysis shows an investor required market return of 11.5%. His two-stage DCF model, with appropriate modifications, shows the investor required market return using Value Line's expected return on common stock equity is 11.4%, and Zacks' 12.4%. My updated DCF analysis for Gulf Power Company using the investor projected five-year growth rate shows an investor required market return of 12.1%. These estimates are before flotation costs and transformation.

In order for investors to have a reasonable opportunity to earn the range midpoint of his two DCF model results shown above, or 11.9%, the necessary regulatory return is 14.2%, as shown on Schedule 16 of my rebuttal exhibit.

Mr. Rothschild's CAPM Version One has serious fundamental flaws. Therefore, I recommend it not be considered for determining the

cost of common stock for Gulf Power Company. His CAPM Version Two when corrected for its infirmities shows an investor required market return of 11.1% before flotation costs and transformation. The necessary regulatory return to produce an 11.1% market return for investors is 13.4% as shown on Schedule 19 of my rebuttal exhibit.

Overall, Mr. Rothschild's testimony when amended to reflect reasonable investor expectations, supports an allowed regulatory return for Gulf Power Company of 13.4% to 14.2%, or an average of 13.8%.

RESPONSE TO MR. ROTHSCHILD'S COMMENTS ON MY DIRECT TESTIMONY

Transformation, or the Process of Providing Investors with an Opportunity to Earn Their Required Return so that Capital Attraction and Reliable Customer Service Can Reasonably Occur

Q. Do you agree with the rationale stated in FERC and FCC decisions cited by Mr. Rothschild at page 17 of his testimony for rejecting the use of transformation in setting regulatory returns?

A. No. FERC's argument assumes an ability to control the price-to-book value ratio, and that doing so is in the customers' interest. Controlling the price-to-book ratio would be difficult, and would require frequent rate adjustments and administrative costs.

More importantly with respect to capital access, when interest rates decline, it reduces the cost of capital not only for electric power companies like Gulf Power Company, but for all securities. This causes prices for all securities to rise. If investors were confronted with two investment

opportunities -- one that was going to rise because interest rates are declining, while the other would not because the return and earnings would be reduced in response to the lower cost of capital - - it is clear what the investors' response would be. They would buy the stock expected to rise and reject the stock that is expected to decline in price to its book value. Since declines in interest rates can span several years, capital attraction for regulated utilities could be jeopardized for a considerable period of time.

From an investor perspective, this is not an attractive investment proposition. If interest rates are flat, the investor can earn the expected return and is not disadvantaged relative to other stocks. However, interest rates are seldom flat. If interest rates decline, the utility can seek rate relief, and after regulatory lag, presumably increase rates to compensate for the increase in the cost of common stock. Conversely, non-regulated companies can presumably raise prices to offset capital cost increases. On the other hand, if the cost of capital declines, the utility investor will suffer an opportunity cost loss because other common stocks benefit from the decline in interest rates, while it is taken away from investors in utility stocks. Utility stock investors could even experience negative returns if the price decline to book value exceeds the stock's yield.

Therefore, there is a serious capital attraction issue with FERC's argument. Because of the indispensable nature of electric service to commerce, jobs, and the quality of life for Gulf Power Company's customers, I believe it is important for the utility to have continuing access to the capital markets in both easy and difficult conditions. This is, I

believe, a prerequisite for reliable customer service at reasonable rates in the future. Setting rates at levels that would potentially repel rather than attract investor capital does not in my view serve the public interest.

Q. Mr. Rothschild's testimony indicates that when stocks are trading above book value, it is reasonable to drive the stocks downward in price to book value? Do you agree?

A. Definitely not. He notes on page 19 of his testimony that "If the stock price exceeds book value, a reasonable result of the new rate determination could be for the stock price to decline." Based on three decades of working with investors, I can safely report that investors will not buy a stock that is expected to decline in price.

Q. Do investors expect regulated utility stock prices to drop in price or to their book values?

A. No. If they did, the stocks would already be selling at the lower expected price, or at a price-to-book ratio of 1.0 times.

Q. Mr. Rothschild also cites a FCC decision on the same issue. Please comment.

A. The FCC decision cited by Mr. Rothschild essentially makes the same argument as FERC, and concludes that even though the price of the stock declines, that the Bluefield/Hope criteria are still met. Since interest rates can decline over a considerable period of time when investors would be attracted to stocks other than regulated companies, capital access could

be jeopardized which would be adverse to customer interests.

As noted in my response to the FERC order, denying investors an opportunity to earn a prospective return comparable to companies of similar risk will repel rather than attract investors, and jeopardize the ability of Gulf Power Company to attract capital and fulfill its customer responsibilities.

Q. Mr. Rothschild also quotes from the U.S. Supreme Court's Hope decision and notes that the common stock price is the end product of the rate making process, not the front end, and therefore, a reduction in value does not invalidate regulation. Please comment.

A. I do not believe the U.S. Supreme Court would sanction a method that would deprive investors on a prospective basis of a reasonable opportunity to earn their required return. To do so would impede the utility's ability to attract capital, ultimately harming the customers it serves.

Q. What has been the response of regulators to the argument presented by Mr. Rothschild?

A. As price-to-book value ratios have risen from about parity in 1985, regulators have been allowing higher returns on common stock equity than indicated by strict application of market-based models, as shown in Schedule 5 of the exhibit to my direct testimony. Over the last several years, the allowed regulatory returns have exceeded the DCF indicated return by 1 to 3 percentage points using the earnings-per-share growth rate version of the model. Regulatory commissions, by allowing higher

returns than indicated by market based models, do not appear to have followed Mr. Rothschild's recommendation to deny investors an opportunity to earn a fair market return on their investment by setting rates designed to drive stock prices down toward book value.

Q. Mr. Rothschild's remaining comments on your testimony begin with a summary on page 63. There he notes that your DCF analysis using the investor expected five-year growth rate is valid only if the growth rate for book value, earnings and dividends are constant. Please comment.

A. Mr. Rothschild assumes a degree of specificity that is beyond the normal scope of investor practice. Based on my experience, investors typically use a five-year earnings growth rate in assessing expected market returns.

The use of earnings versus dividends is confirmed by a survey of investor practices cited on page 6 of Schedule 7 of the exhibit to my direct testimony. The survey shows that earnings was the top choice among cash flow, book value, earnings, and dividends for the most important variable in valuing a security. Of 297 respondents, only three respondents chose dividends, and only five chose book value. Both dividends and book value were at the bottom of the list among the four choices. If constancy of book value and dividend growth was important to investors in their valuation process one would expect them to be as important as earnings to investors.

Moreover, if investors ignored the five-year earnings growth rate because of the lack of growth constancy, and relied instead on the

sustainable growth rate favored by Mr. Rothschild, one would reasonably expect that First Call, I/B/E/S, Value Line, and Zacks would all provide sustainable rates of growth. The fact of the matter is that they all supply five-year earnings growth rates. Only Value Line provides a sustainable growth rate, which is based on year-to-year data, and is, therefore, not meant to be applicable to the long-term future.

Based on my experience, the sustainable growth rate method, which in its simplest form, consists of just two variables, does not provide investors with the detail they require for making investment decisions.

Nonetheless, the difference between using the investor practice, or five-year earnings growth rate, versus the sustainable growth rate preferred by Mr. Rothschild using investor expected returns on common stock equity, is not substantial enough in my view to justify his objection to investor practice.

Q. If Mr. Rothschild had used the same method as investors for determining expected total return, or investor five-year earnings growth expectations plus the yield, what would the analysis show the investor required market return to be?

A. The indicated investor required return would be 12.1%, as shown in my updated DCF analysis on Schedule 27 of my rebuttal exhibit. This result is not substantially different from the 11.5% shown by Mr. Rothschild's single-stage DCF analysis using investor expected returns on common stock equity rather than his, and 11.4% to 12.4% for his two-stage DCF analysis when again using investor return on common stock equity

expectations.

Q. Mr. Rothschild states that use of the five-year growth rate can lead to ever increasing returns on common stock equity. Please comment.

A. Mr. Rothschild states that if the earnings per share grow more rapidly than book value, the return on common stock equity will increase. This is true, but the reverse is also true. Further, after determining the investor expected market return, I have used the sustainable growth rate method for the transformation process. Therefore, Mr. Rothschild's concern that the return on common stock equity would continually rise if earnings grow more rapidly than book value, and fall when earnings grow less rapidly than book value is not relevant. Moreover, when using a number of companies instead of just one, as Mr. Rothschild did, there is a chance for offsetting outcomes regarding this issue, since more rapid growth in earnings than book value by one company may be offset by the reverse in another company.

From still another perspective, the DCF model results using either the investor return on common stock equity expectation (11.5% using his single-stage DCF, and 11.4% to 12.4% using his two-stage DCF results), or the investor five year earnings growth rate expectation (12.1% shown in the update on Schedule 27 to my rebuttal exhibit) are similar.

Q. Mr. Rothschild alleges that you failed to take into account a downward trend in risk premiums. Please comment.

A. Whether or not one finds a downward trend in risk premiums depends on

the data one chooses to examine. The 1926-2000 Ibbotson data shows that equity risk premiums have been rising from about 4 percentage points in the early 1970s to about 11% for the most recent five years ending in 2000. Supporting data is charted in Schedule 18 of my rebuttal exhibit. Mr. Rothschild, on the other hand, uses a 30-year moving average as shown in Schedule 17 of my rebuttal exhibit. The latter shows for the most recent 30 years an equity risk premium about 4% in the mid-1990s.

Overall, it is best to use the long-term, arithmetic equity risk premium results for the stock market versus long-term governments, which is 7.3% using total returns, and 7.8% using income returns. This is a less arbitrary method than Mr. Rothschild uses. The data go back in time as far as quality inputs are available, and includes many event types that could be considered by investors to the extent that they use long-term, historical data to determine expected equity risk premiums.

Q. Please respond to Mr. Rothschild's comments on the process that you call transformation in your testimony.

A. The problem with Mr. Rothschild's objection is that he does not recognize the difference between book and market returns and improperly equates the investor required market return to the return that the Commission should allow for regulatory purposes. The investor return is a market return and the regulatory return is a book return. When stock prices are materially above book value, as they now are, using the investor required market return as the book regulatory return will not produce the investor required market return. Accordingly, investor expectations will not be

fulfilled, and knowledgeable investors will invest their capital elsewhere. This in turn will jeopardize the ability of Gulf Power Company to attract capital and fulfill its customer responsibilities.

In fact, Mr. Rothschild is not true to his own analysis of investor required returns. For example, he determined that the investor required market return was 10.0%, but as shown on Schedule 12 of my rebuttal exhibit, a 10.0% return on common stock equity will produce only a 7.3% achievable market return to investors. Therefore, his recommendation contradicts his analysis, since the return he recommends for Gulf Power Company will not enable investors to have an opportunity to earn the return he testifies they require. This is explained in greater detail along with a mathematical example on pages 13-20 of my direct testimony.

Q. Do you agree with Mr. Rothschild's claim that when transformation is used the higher the stock price, the higher the return on common stock equity that would be recommended?

A. No. Mr. Rothschild's claim is wrong, and illustrates that he either does not understand the transformation process, or is unwilling to provide investors with an opportunity to earn their required market return. This is clearly shown in the side-by-side example on Schedule 20 of my rebuttal exhibit, which shows why transformation is necessary. In the first of two examples, or "Price Up-Constant ROE," the expected market return is 10.7% based on a return on common stock equity expectation of 13.0%, a price of $35 for the stock, and a book value of $25, as shown in Column A.

If the price of the stock rises from $35 to $40, the investor required

market return declines to 10.0% as shown in Column B. The investor expected return on common stock equity in this example does not change, and the required regulatory return continues at 13.0%, instead of increasing as indicated by Mr. Rothschild.

Concurrently, if the investor expected return on common stock equity declines to 12.5% from 13.0% in the second example in Column F, while the price also rises from $35 to $40, the investor expected market return becomes 9.5% and is consistent with the lower expected return on common stock equity of 12.5% as shown in Column H.

Q. Are earnings necessarily excessive when prices are above book value?

A. No. Mr. Rothschild assumes that earnings are excessive when prices are above book value, and that transformation perpetuates excessive earnings. Mr. Rothschild may think that earnings are excessive, but investors do not, or they would not pay more than book value for regulated utility stocks. Based on investor expectations, the stocks are fairly valued and fairly reflect future cash flows. Cutting the return and earning power, such that common stock prices are driven down to book value would damage investor confidence, repel rather than attract investors, and hurt Gulf Power Company's financial integrity and ability to serve its customers.

Q. Does transformation protect investors from stock price declines?

A. No, transformation does not insulate investors from market risks, but simply provides them with an opportunity to earn their required return.

Transformation avoids driving stock prices to book value, thereby enhancing the ability of investors to earn their required return, so that Gulf Power can attract the capital necessary to continue providing reliable electric service in the future.

CAPM Analysis

Q. On page 79, Mr. Rothschild raises five objections to your CAPM analysis. Please respond.

A. I have previously responded to all but one of these objections earlier in this rebuttal testimony. With regard to the appropriate bond return to use in the CAPM, Mr. Rothschild prefers to use Treasury bills rather than Treasury bonds. However, his CAPM analysis using the Treasury bill results in a return below that of single A utility bonds, which is an untenable conclusion. Investors favor the use of long-term not short-term debt for investment purposes. In my judgment, this is because the long-term Treasury bond better matches the perpetuity term of common stocks, is much more stable than Treasury bill yields, and is much less controlled by the Federal Reserve. The latter point is particularly relevant at this time. Treasury bill yields are very low at this time because of unprecedented rate reductions by the Federal Reserve to mitigate the recession underway in the U.S. economy.

Q. Mr. Rothschild objects to the use of a five year growth rate in the CAPM because he claims that the base year for establishing the growth rate was a recession year when earnings would be depressed. Please comment.

A. Mr. Rothschild fails to recognize that the year 2000 was not a recession year.

Q. Mr. Rothschild on page 90 reiterates his position that equity risk premiums have been declining using the 30 moving average of Ibbotson's 1926-1999 returns, and that your historic equity risk premium is too high. Please comment.

A. Equity risk premiums have been rising as previously noted in my testimony. Comparisons of one method versus that used by Mr. Rothschild are provided on Schedules 17 and 18 of my rebuttal exhibit, both of which employ the same data. Relevant to this issue is the investor expected, market equity risk premiums shown in the update to my testimony on Schedule 33. Investor expected equity risk premiums based on projected market returns for the Value Line Composite and S&P 500 (using three different growth rate estimates) average 9.5%, which is almost double the equity risk premium that Mr. Rothschild believes investors expect.

Q. On page 91, Mr. Rothschild states that Treasury bonds are not risk free since they do not have a zero beta. Do you agree?

A. Mr. Rothschild is correct that longer-term investments such as Treasury bonds have more risk than Treasury bills, or higher than a zero beta -- that is, if one can believe that there is no reinvestment risk for Treasury bill investors. Bill versus bond investors must continually roll over their investments, and when interest rates are declining so are bill rates.

Meanwhile, the value of the bond is rising as investor required returns decline. The reverse is also true.

Even if one assumes that Treasury bonds have more risk than Treasury bills, it is long-term bonds not short-term Treasury bills that investors primarily use. This is because investors prefer comparisons with long-term not short-term bonds because they better match the duration risk of stocks than short-term investments such as Treasury bills. Treasury bill yields are primarily controlled by the Federal Reserve and not investors, and therefore, are not always indicative of investor expectations. For example, not many months ago bill yields were 6% compared to less than 2% currently. Bill yields are also much more volatile than Treasury bond yields. From an investor perspective, therefore, Mr. Rothschild's criticism is without merit.

Q. Mr. Rothschild's next concern is that your CAPM analysis using a 5.4% yield on long-term Treasury bonds would show an investor expected market return of 9.3% to 10.2%. Do you agree?

A. I do not agree that the 9.3% to 10.2% is representative of investor expectations because of the flight to quality and scarcity premiums now present in long-term Treasury bond yields. This is covered in Schedule 8, pages 3 to 6 of the exhibit to my direct testimony.

Mr. Rothschild appears to agree. He notes on page 14 and 15 of his testimony:

> While I normally have made a specific adjustment to the lower the indicated cost of equity for risk specific reasons, in the current

marketplace the yields on long-term bonds already reflect the flight to quality caused by uncertain economic times and stimulating effects of the Federal Reserve Board.

Again, due to current economic conditions, there are temporarily problems with using treasury securities in a risk premium analysis based upon historic risk premium relationships. Therefore, I have only summarized the results of a risk premium analysis based upon long-term corporate bonds.

Comparable Earnings

Q. Mr. Rothschild states that you used higher risk industrial companies for your comparable earnings analysis. Do you agree?

A. No. Schedule 10, page 6, of the exhibit to my direct testimony clearly shows that this is not so.

Q. Please respond to Mr. Rothschild's suggestion that the comparable earnings method does not provide useful information to the Commission.

A. As previously noted in Schedule 10 of my direct testimony, and in my comments about transformation in this testimony, the growth rate used by investors is fundamentally tied to their return on common stock equity expectation. When denying the validity of comparable earnings, therefore, one is also denying the growth rate in the DCF model, or the results of the DCF model. Mr. Rothschild should not expect to have it both ways -- using the investor expected return on common stock equity, or "r" in his "br+sv" method for his DCF analysis while denying its validity in the

comparable earnings method. It is necessary for Gulf Power Company to have a regulatory return comparable to investor expectations so that its common stock can provide investors with the market return they require.

Q. Does your comparable earnings method overlook the capital attraction standard?

A. No. Mr. Rothschild argues that capital is raised at the price of common stock and not its book value, which is correct. However, the price of the stock reflects investor expectations of the cash flows (using the DCF model) they expect to receive. As Mr. Rothschild's testimony clearly shows, these cash flow expectations are driven by the return on common stock equity and the retention rate in the simple form of the sustainable growth rate model. This is clearly shown on Mr. Rothschild's Exhibit JAR 5.

Q. What is the linkage between the return on common stock equity and the growth rate in the DCF model?

A. Each of the transformation schedules accompanying my market based models show the relationship between the return on common stock equity and the growth rate ("br" growth rate, where "b" is the retention rate and "r" the return on common stock equity). The connection or interrelationship is also shown on Mr. Rothschild's JAR 5. Mr. Rothschild states that in implementing his two-stage DCF model on page 46 of his testimony, he "determined future earnings in the second stage of the non-constant DCF model by multiplying the future book value per share by the future

expected earned return on book equity." This statement is itself evidence of the linkage that he later claims does not exist.

Flotation Costs

Q. Mr. Rothschild states that any flotation costs are more than offset by the accretion to book value from the sale of common stock above book value. Do you agree?

A. No. The companies on the list of Gulf Power's comparable companies have not always sold above book value. Furthermore, the accretion to book value is part of the growth rate expected by investors according to the testimony of Mr. Rothschild, who uses the "br+sv" form of the sustainable growth rate method. Clearly, if it is part of growth rate expectations it cannot also be flotation costs.

Q. Do you agree that a 0.2% allowance for flotation cost must be excessive?

A. No. Mr. Rothschild develops an exaggerated example in an attempt to show that financing costs are almost 50% of the new equity raised. His example is flawed because his $984,000 relates to all previous stock issuances. The flotation cost for a $2 million new issuance at 3% would be only $60,000.

MODEL UPDATE

Q. Mr. Rothschild's testimony makes reference to a number of reports and sources of data that are more recent than those you relied on in your

direct testimony. Have you updated your analysis?

A. Yes. In response to Staff's Production of Documents Request No. 55, I have updated my DCF results, equity risk premium analysis, CAPM model and comparative earnings model using the most recent information on stock prices, bond yields, Value Line earnings and dividends projections and other data. Updated schedules reflecting this information are attached as Schedules 21 through 35 of my rebuttal exhibit.

Q. Did you make any other changes when you updated your schedules?

A. Yes. It came to my attention that the bond ratings provided by C.A.Turner in two instances were incorrect at the time my testimony was prepared. The senior, utility debt rating for Progress Energy by S&P is "BBB+" and for TECO Energy "A." The relevance of the incorrect bond ratings is that Progress Energy with a "BBB+" bond rating would not have met the selection criteria noted on Schedule 6, page 6, of the exhibit to my direct testimony for inclusion on the list of comparable companies. Further, the indicated risk of the comparable companies relative to Gulf Power Company, based on the bond rating comparison, would have been understated. My updated exhibits, therefore, exclude Progress Energy from the comparable company group.

Q. What was the impact of the change to your analysis?

A. There was a slight increase in the indicated cost of common stock when deleting Progress Energy from the comparable company group. This increase would be mitigated by the higher than previously acknowledged

risk of the comparable companies relative to Gulf Power Company based on a bond rating comparison.

Q. Do you believe that the change to your comparable group of companies, therefore, would have a meaningful impact on the cost of common stock estimate for Gulf Power Company?

A. No.

Q. What are the updated results of your recommended return on common stock equity for Gulf Power Company?

A. The updated results show a moderate increase in the cost of common stock for Gulf Power Company. The average of the four tests used show an average cost of common stock of 13.6%, and the midpoint of the 13.2% to 14.2% range is 13.7%. Supporting data is summarized on Schedule 21 and detailed supporting data appears on Schedules 22-35 of the exhibit to my rebuttal testimony. Recognizing the slightly higher risk difference between Gulf Power Company and its comparable companies than apparent in my direct testimony, its lower financial risk, all electric revenue derivation, higher regulatory ranking, and its relatively small size, it is my judgment that Gulf Power's cost of common stock is slightly higher than the 13.0% previously recommended. Nonetheless, basing my recommendation on the nearest one-quarter of a percentage point, the updated cost of common stock for Gulf Power Company continues to be at least 13.0%.

Q. Does that conclude your rebuttal testimony?

A. Yes, it does.

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Mr. Rothschild's 10.0% Recommended Regulatory Return Results in Only a 7.3% Return to Investors

1	Price	34.80	JAR-3
2	2001 Book Value	22.76	JAR 5
3	Regulatory Return	**10.00%**	
4	EPS (2X3)	2.28	
5	DPS	1.85	JAR 5
6	DPS Payout (5/4)	81.28%	
7	Retention Rate (1.0-6)	18.72%	
8	Internal Growth Rate (3X7)	1.87%	
9	External Growth (a)	0.14%	
10	Yield (5/1)	5.32%	
11	Investor Return (8+9+10)	**7.33%**	

(a) SV = 0.40*(1-BV/P)

A Regulatory Return of 12.7% is Necessary to Provide Investors with an Opportunity to Achieve the 10.0% Market Return that Mr. Rothschild Testifies Investors Require

1	Price	34.80	JAR-3
2	2001 Book Value	22.76	JAR 5
3	Regulatory Return	**12.70%**	
4	EPS (2X3)	2.89	
5	DPS	1.85	JAR 5
6	DPS Payout (5/4)	64.00%	
7	Retention Rate (1.0-6)	36.00%	
8	Internal Growth Rate (3X7)	4.57%	
9	External Growth (a)	0.14%	
10	Yield (5/1)	5.32%	
11	Investor Return (8+9+10)	**10.03%**	

(a) SV = 0.40*(1-BV/P)

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A 13.0% Return on Common Stock Equity of the Comparable Companies' Book Value Shows an Investor Expected Market Return of 10.3%

1	Price	34.80	JAR-3
2	2001 Book Value	22.76	JAR-5
3	Regulatory Return	**13.00%**	
4	EPS (2X3)	2.96	
5	DPS	1.85	JAR-5
6	DPS Payout (5/4)	62.53%	
7	Retention Rate (1.0-6)	37.47%	
8	Internal Growth Rate (3X7)	4.87%	
9	External Growth (a)	0.14%	
10	Yield (5/1)	5.32%	
11	Investor Return (8+9+10)	**10.33%**	

(a) SV = 0.40*(1-BV/P)

Investor Expected Market Return Is 11.5% Using Investor Expected Returns on Common Stock Equity

1	Price	$ 34.80	JAR-3
2	2001 Book Value	22.76	JAR-5
3	Regulatory Return	**14.20%**	
4	EPS (2X3)	3.23	
5	DPS	1.85	JAR-5
6	DPS Payout (5/4)	57.24%	
7	Retention Rate (1.0-6)	42.76%	
8	Internal Growth Rate (3X7)	6.07%	
9	External Growth (a)	0.14%	
10	Yield (5/1)	5.32%	
11	Investor Return (8+9+10)	**11.53%**	

(a) SV = 0.40*(1-BV/P)

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With a 13.5% Return on Common Stock Equity
the Investor Expected Market Return is 11.4%

		Book Value	EPS	DPS	Disc. Rate 11 4%	Cash Flow Present Value	ROE
Stage One	2001	22 76	3 11	1 83		-34 80	
	2002	24.03	3 36	1 85	1 1140	1.66	13 98%
	2003	25.48	3.53	1 92	1 24	1.55	13 85%
	2004	26.93	3 70	1 98	1 38	1 43	13 74%
	2005	28 64	3 88	2 04	1 54	1.32	13.55%
Stage Two	2006	30 51	4.12	2 17	1 72	1.26	13.50%
	2007	32.51	4.39	2 31	1 91	1.21	13 50%
	2008	34 63	4.68	2.46	2.13	1.16	13 50%
	2009	36.90	4.98	2.62	2.37	1.10	13 50%
	2010	39 31	5.31	2 79	2 64	1.06	13 50%
	2011	41.88	5 65	2.97	2.94	1 01	13.50%
	2012	44.62	6.02	3 17	3 28	0.97	13.50%
	2013	47.54	6 42	3 38	3.65	0.92	13.50%
	2014	50.65	6 84	3 60	4 07	0 88	13.50%
	2015	53.96	7 29	3 83	4.53	0.85	13.50%
	2016	57.49	7 76	4 08	5.05	0.81	13 50%
	2017	61.25	8 27	4 35	5 63	0.77	13 50%
	2018	65 26	8.81	4 63	6 27	0.74	13 50%
	2019	69.53	9 39	4.94	6.98	0.71	13.50%
	2020	74.07	10.00	5 26	7 78	0.68	13.50%
	2021	78.92	10.65	5.61	8.66	0 65	13.50%
	2022	84.08	11.35	5 97	9.65	0.62	13.50%
	2023	89.58	12.09	6.36	10.75	0.59	13.50%
	2024	95 44	12.88	6 78	11.98	0 57	13.50%
	2025	101.68	13.73	7 22	13.34	0.54	13.50%
	2026	108 33	14.62	7.69	14.86	0.52	13.50%
	2027	115.41	15.58	8.20	16.56	0 50	13.50%
	2028	122 96	16 60	8.73	18.45	0 47	13.50%
	2029	131.00	17.69	9.30	20.55	0.45	13.50%
	2030	139.57	18.84	9.91	22 89	0.43	13.50%
	2031	148.70	20.07	10 56	25.50	0 41	13.50%
	2032	158.42	21.39	11 25	28 41	0.40	13.50%
	2033	168 78	22.79	11.99	31.65	0.38	13.50%
	2034	179.82	24.28	12 77	35.25	0 36	13.50%
	2035	191.58	25.86	13.61	39 27	0.35	13.50%
	2036	204.11	27 55	14.50	43.75	0.33	13.50%
	2037	217.46	29.36	15.44	48.74	0.32	13.50%
	2038	231.68	31.28	16.45	54 29	0.30	13.50%
	2039	246.83	33.32	17.53	60.48	0 29	13.50%
	2040	262.98	35.50	18.68	67 38	0.28	13.50%
	2041	280 18	37.82	19.90	75.06	0.27	13.50%
	2042	298.50	40.30	21.20	83.62	0.25	13.50%
	2043	318 02	42.93	22.59	93.15	0.24	13.50%
	2044	338.82	45.74	24 06	103.77	0.23	13.50%
	2045	360 98	48.73	25.64	115.60	0.22	13 50%
	2046	384.59	51.92	27.31	128.78	0.21	13.50%
	2047	409 74	55.31	29.10	143.46	0.20	13.50%
	2048	436 53	58.93	31.00	159.81	0.19	13.50%
	2049	465.08	62.79	33 03	178.03	0.19	13.50%
	2050	495.50	66.89	35 19	198.32	0.18	13.50%
	2051	527.91	71.27	37 49	220.93	0.17	13.50%

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	Book Value	EPS	DPS	Disc. Rate 11 4%	Cash Flow Present Value	ROE	
2052	562 43	75.93	39.95	246 12	0.16	13 50%	
2053	599 21	80 89	42.56	274 18	0 16	13 50%	
2054	638 40	86.18	45 34	305.43	0 15	13.50%	
2055	680 15	91 82	48 31	340.25	0 14	13.50%	
2056	724.64	97.83	51 47	379.04	0.14	13.50%	
2057	772.03	104.22	54.83	422.25	0 13	13 50%	
2058	822.52	111.04	58 42	470 39	0.12	13.50%	
2059	876.31	118.30	62 24	524.01	0.12	13 50%	
2060	933 62	126.04	66 31	583.75	0.11	13 50%	
2061	994.68	134.28	70 65	650.30	0 11	13.50%	
2062	1059.73	143.06	75 27	724 43	0.10	13.50%	
2063	1129.04	152.42	80 19	807.02	0.10	13.50%	
2064	1202.88	162.39	85 43	899.02	0 10	13.50%	
2065	1281.55	173 01	91 02	1001.50	0.09	13.50%	
2066	1365.36	184.32	96 97	1115 67	0 09	13.50%	
6267	1454.65	196 38	103.31	1242 86	0 08	13.50%	
6068	1549 79	209.22	110 07	1384 55	0.08	13.50%	
2069	1651 15	222.90	117.27	1542.39	0 08	13.50%	
2070	1759 13	237.48	124.94	1718.22	0.07	13.50%	
2071	1874.18	253.01	133.11	1914.09	0.07	13.50%	
2072	1996.75	269.56	141.82	2132.30	0.07	13.50%	
2073	2127.34	287.19	151.09	2375.38	0 06	13.50%	
2074	2266 46	305.97	160.97	2646.18	0.06	13.50%	
2075	2414.69	325.98	171 50	2947 84	0.06	13.50%	
2076	2572.61	347.30	182.72	3283.90	0.06	13.50%	
2077	2740.86	370.02	194 67	3658.26	0.05	13.50%	
2078	2920.11	394.22	207.40	4075.30	0.05	13.50%	
2079	3111 09	420.00	220.96	4539 89	0.05	13.50%	
2080	3314.55	447 46	235.41	5057.43	0.05	13 50%	
2081	3531.32	476 73	250.81	5633 98	0.04	13.50%	
2082	3762.27	507.91	267.21	6276.25	0.04	13.50%	
2083	4008.33	541 12	284.69	6991.75	0.04	13.50%	
2084	4270 47	576.51	303 30	7788.81	0.04	13 50%	
2085	4549.76	614.22	323.14	8676.73	0.04	13.50%	
2086	4847.31	654 39	344.27	9665.88	0.04	13.50%	
2087	5164.33	697 18	366 79	10767.79	0.03	13.50%	
2088	5502 07	742.78	390.78	11995.31	0.03	13.50%	
2089	5861.91	791.36	416.33	13362.78	0.03	13.50%	
2090	6245.28	843.11	443 56	14886.14	0 03	13.50%	
2091	6653.72	898.25	472.57	16583.16	0.03	13.50%	
2092	7088.87	957 00	503 48	18473 64	0.03	13.50%	
2093	7552.49	1019.59	536.40	20579.63	0.03	13.50%	
2094	8046.42	1086.27	571.48	22925.71	0.02	13.50%	
2095	8572.65	1157.31	608.86	25539.24	0.02	13.50%	
2096	9133.31	1233.00	648 68	28450.71	0.02	13.50%	
2097	9730 62	1313.63	691.10	31694.09	0.02	13.50%	
2098	10367.01	1399.55	736 30	35307.22	0.02	13.50%	
2099	11045.01	1491.08	784 46	39332.24	0.02	13.50%	
2100	11767.35	1588.59	18839.81	43816.12	0.43	34.91	835.76
Price to Book	1.53						18004.05
Market Price	18004.05						18839.81

Sustainable Growth Rate: (13.5%*.474)+(0.4*.38)=6.54%

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With a 14.85% Return on Common Stock Equity
the Investor Expected Market Return is 12.4%

		Book Value	EPS	DPS	Disc. Rate 12 4%	Cash Flow Present Value	ROE
Stage One	2001	22 76	3.11	1 83		-34 80	
	2002	24.03	3.36	1.85	1 124	1 65	13 98%
	2003	25 48	3 53	1 92	1 26	1.52	13.85%
	2004	26 93	3.70	1.96	1 42	1 40	13.74%
	2005	28 64	3 88	2.04	1.59	1 28	13.55%
Stage Two	2006	30.70	4 56	2.40	1.79	1 34	14.85%
	2007	32.90	4 89	2.57	2 01	1 28	14.85%
	2008	35.26	5 24	2.75	2.26	1.22	14.85%
	2009	37.79	5.61	2.95	2 54	1.16	14.85%
	2010	40 51	6.02	3.16	2 86	1 11	14.85%
	2011	43.42	6 45	3.39	3 21	1.06	14 85%
	2012	46.53	6 91	3 64	3 61	1 01	14.85%
	2013	49 88	7.41	3.90	4.06	0.96	14 85%
	2014	53 46	7 94	4 18	4.56	0.92	14.85%
	2015	57 29	8.51	4.48	5.12	0 87	14.85%
	2016	61 41	9.12	4.80	5 76	0 83	14 85%
	2017	65.82	9.77	5.14	6.47	0 79	14.85%
	2018	70.54	10 48	5 51	7.27	0 76	14.85%
	2019	75.61	11.23	5.91	8.17	0.72	14.85%
	2020	81.04	12.03	6.33	9 18	0.69	14.85%
	2021	86 85	12.90	6.79	10 32	0.66	14.85%
	2022	93.09	13.82	7 27	11.60	0.63	14.85%
	2023	99 77	14.82	7 79	13 03	0 60	14.85%
	2024	106.94	15.88	8 35	14 65	0.57	14.85%
	2025	114 62	17.02	8.95	16 46	0 54	14 85%
	2026	122 85	18 24	9 60	18.50	0.52	14.85%
	2027	131.67	19.55	10 29	20.79	0.49	14.85%
	2028	141.12	20.96	11.03	23.36	0.47	14.85%
	2029	151 25	22 46	11 82	26 25	0.45	14.85%
	2030	162 11	24.07	12.67	29 50	0.43	14.85%
	2031	173 75	25.80	13 57	33.15	0 41	14.85%
	2032	186.23	27 65	14.55	37.26	0.39	14.85%
	2033	199.60	29 64	15.59	41.87	0 37	14.85%
	2034	213.93	31 77	16.71	47 05	0 36	14.85%
	2035	229.29	34 05	17.91	52.88	0.34	14 85%
	2036	245.75	36.49	19.20	59.42	0.32	14.85%
	2037	263 40	39.11	20.58	66.78	0.31	14.85%
	2038	282.31	41 92	22.06	75.04	0.29	14.85%
	2039	302.58	44.93	23 64	84.33	0.28	14.85%
	2040	324.31	48.16	25.34	94.77	0.27	14.85%
	2041	347.59	51.62	27.16	106.50	0.25	14.85%
	2042	372 55	55.32	29.11	119.68	0.24	14.85%
	2043	399.30	59.30	31 20	134.50	0.23	14.85%
	2044	427.97	63.55	33.44	151.15	0.22	14.85%
	2045	458.69	68 12	35.84	169.86	0.21	14.85%
	2046	491.63	73 01	38.41	190 89	0 20	14 85%
	2047	526.93	78.25	41.17	214.51	0.19	14.85%
	2048	564.76	83.87	44.12	241 07	0.18	14.85%
	2049	605.31	89.89	47.29	270 91	0 17	14.85%
	2050	648.77	96 34	50.69	304.44	0.17	14.85%
	2051	695.35	103.26	54.33	342.13	0.16	14.85%

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	Book Value	EPS	DPS	Disc. Rate 12 4%	Cash Flow Present Value	ROE
2052	745 28	110 67	58 23	384.48	0 15	14.85%
2053	798.79	118.62	62.41	432.08	0.14	14.85%
2054	856.14	127 14	66 89	485.56	0.14	14.85%
2055	917 62	136.27	71.69	545.67	0.13	14.85%
2056	983.50	146.05	76.84	613.21	0 13	14.85%
2057	1054.12	156.54	82.35	689.12	0 12	14.85%
2058	1129.80	167.78	88 27	774.42	0.11	14.85%
2059	1210.92	179 82	94.60	870.29	0.11	14.85%
2060	1297.86	192 73	101.40	978.02	0 10	14.85%
2061	1391 05	206.57	108.68	1099.08	0.10	14.85%
2062	1490.93	221 40	116.48	1235.14	0.09	14.85%
2063	1597 98	237 30	124 84	1388.03	0.09	14.85%
2064	1712.71	254 34	133.81	1559.85	0.09	14.85%
2065	1835.69	272.60	143.41	1752.94	0.08	14.85%
2066	1967.49	292.17	153 71	1969.93	0.08	14.85%
6267	2108.75	313.15	164 75	2213 78	0.07	14.85%
6068	2260 16	335 63	176.58	2487.81	0.07	14.85%
2069	2422 44	359 73	189.26	2795.77	0 07	14.85%
2070	2596 37	385.56	202.84	3141.85	0.06	14.85%
2071	2782.79	413.24	217.41	3530.77	0.06	14.85%
2072	2982 60	442.92	233.02	3967.83	0.06	14.85%
2073	3196 75	474.72	249.75	4458.99	0.06	14.85%
2074	3426.27	508.80	267 68	5010.96	0.05	14.85%
2075	3672.28	545 33	286.90	5631.24	0 05	14.85%
2076	3935.95	584.49	307.50	6328.32	0.05	14.85%
2077	4218.55	626.45	329.58	7111 68	0 05	14.85%
2078	4521 44	671.43	353.24	7992.01	0.04	14.85%
2079	4846.08	719.64	378.60	8981.31	0.04	14.85%
2080	5194 03	771.31	405.79	10093.08	0.04	14.85%
2081	5566.96	826 69	434 92	11342 47	0.04	14.85%
2082	5966.67	886.05	466.15	12746 51	0.04	14.85%
2083	6395.08	949.67	499.62	14324.36	0.03	14 85%
2084	6854.24	1017 86	535.49	16097.52	0.03	14.85%
2085	7346.38	1090 94	573 94	18090.18	0.03	14 85%
2086	7873.85	1169.27	615.15	20329 50	0.03	14.85%
2087	8439.19	1253.22	659.32	22846.02	0.03	14.85%
2088	9045.12	1343.20	706.66	25674.05	0.03	14.85%
2089	9694.56	1439 64	757.40	28852.15	0.03	14.85%
2090	10390.63	1543 01	811.78	32423.66	0.03	14.85%
2091	11136.68	1653.80	870.06	36437.27	0.02	14.85%
2092	11936 29	1772.54	932.53	40947.72	0.02	14.85%
2093	12793 32	1899.81	999.49	46016.50	0.02	14.85%
2094	13711.88	2036 21	1071.25	51712.72	0.02	14.85%
2095	14696.39	2182.41	1148 17	58114.07	0.02	14.85%
2096	15751.59	2339.11	1230.61	65307.81	0.02	14.85%
2097	16882.56	2507.06	1318.96	73392.04	0.02	14.85%
2098	18094.73	2687.07	1413.67	82476.99	0.02	14.85%
2099	19393.93	2880.00	1515 17	92686.53	0.02	14.85%
2100	20786.41	3086 78	33427.17	104159.88	0.32	34.75
Price to Book	1.53				2100 DPS	1623.96
Market Price	31803.21				2100 Price	31803.21
					2100 Cash	33427.17

Sustainable Growth Rate: (14.85%*.474)+(0.4*.38)=7.18%

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A 14.2% Return on Common Stock Equity
Provides Investors a Market Return of 11.9%

		Book Value(a)	EPS(a)	DPS(a)	Disc. Rate 11.9%	Cash Flow Present Value	
Stage One	2001	22.76	3 11	1.83		-34 80	
	2002	24 03	3 36	1.85	1 1190	1 65	13.98%
	2003	25.48	3.53	1.92	1.25	1.53	13 85%
	2004	26.93	3 70	1.98	1.40	1.41	13.74%
	2005	28.64	3.88	2.04	1.57	1.30	13.55%
Stage Two	2006	30.61	4 35	2.29	1 75	1 30	14.20%
	2007	32.71	4.64	2.44	1.96	1 24	14 20%
	2008	34 96	4.96	2.61	2.20	1.19	14.20%
	2009	37.36	5.30	2.79	2.46	1 14	14.20%
	2010	39.93	5.67	2.98	2 75	1.08	14.20%
	2011	42 67	6.06	3.19	3.08	1 04	14.20%
	2012	45 60	6 48	3.41	3.44	0 99	14.20%
	2013	48 73	6 92	3.64	3.85	0 94	14.20%
	2014	52.08	7 40	3.89	4.31	0.90	14.20%
	2015	55.66	7.90	4.16	4.83	0.86	14.20%
	2016	59.48	8.45	4.44	5.40	0.82	14.20%
	2017	63.57	9.03	4.75	6.04	0.79	14.20%
	2018	67 94	9.65	5.08	6.76	0.75	14.20%
	2019	72.60	10.31	5.42	7.57	0.72	14.20%
	2020	77.59	11.02	5.80	8.47	0 68	14.20%
	2021	82.92	11 77	6 19	9.48	0 65	14.20%
	2022	88 62	12.58	6.62	10.60	0.62	14.20%
	2023	94 71	13.45	7.08	11.86	0.60	14.20%
	2024	101 21	14.37	7.56	13.28	0.57	14.20%
	2025	108.17	15.36	8 08	14.86	0.54	14.20%
	2026	115.60	16 41	8.64	16 62	0.52	14.20%
	2027	123.54	17 54	9.23	18.60	0.50	14.20%
	2028	132.03	18.75	9.86	20.82	0.47	14.20%
	2029	141.10	20.04	10.54	23.29	0.45	14 20%
	2030	150.79	21.41	11.26	26 07	0.43	14.20%
	2031	161 15	22 88	12.04	29.17	0.41	14.20%
	2032	172.22	24 46	12.87	32.64	0.39	14.20%
	2033	184.05	26 14	13.75	36.52	0.38	14.20%
	2034	196.69	27.93	14.69	40.87	0 36	14.20%
	2035	210.21	29.85	15.70	45.73	0.34	14.20%
	2036	224.65	31.90	16.78	51 17	0.33	14.20%
	2037	240.08	34.09	17.94	57.26	0 31	14.20%
	2038	256.58	36.43	19.17	64 08	0.30	14.20%
	2039	274.20	38.94	20.48	71.70	0.29	14.20%
	2040	293.04	41.61	21.89	80.24	0.27	14.20%
	2041	313.17	44.47	23 40	89.78	0.26	14.20%
	2042	334 69	47.53	25.00	100.47	0.25	14.20%
	2043	357.68	50.79	26.72	112.43	0.24	14.20%
	2044	382.25	54 28	28.56	125 80	0.23	14.20%
	2045	408.51	58.01	30.52	140.77	0.22	14.20%
	2046	436.58	61.99	32.62	157.53	0 21	14.20%
	2047	466.57	66.25	34.86	176.27	0.20	14.20%
	2048	498.62	70.80	37.25	197.25	0.19	14 20%
	2049	532.88	75.67	39.81	220.72	0.18	14.20%
	2050	569.49	80.87	42.54	246.99	0.17	14.20%
	2051	608.61	86.42	45.47	276.38	0.16	14.20%

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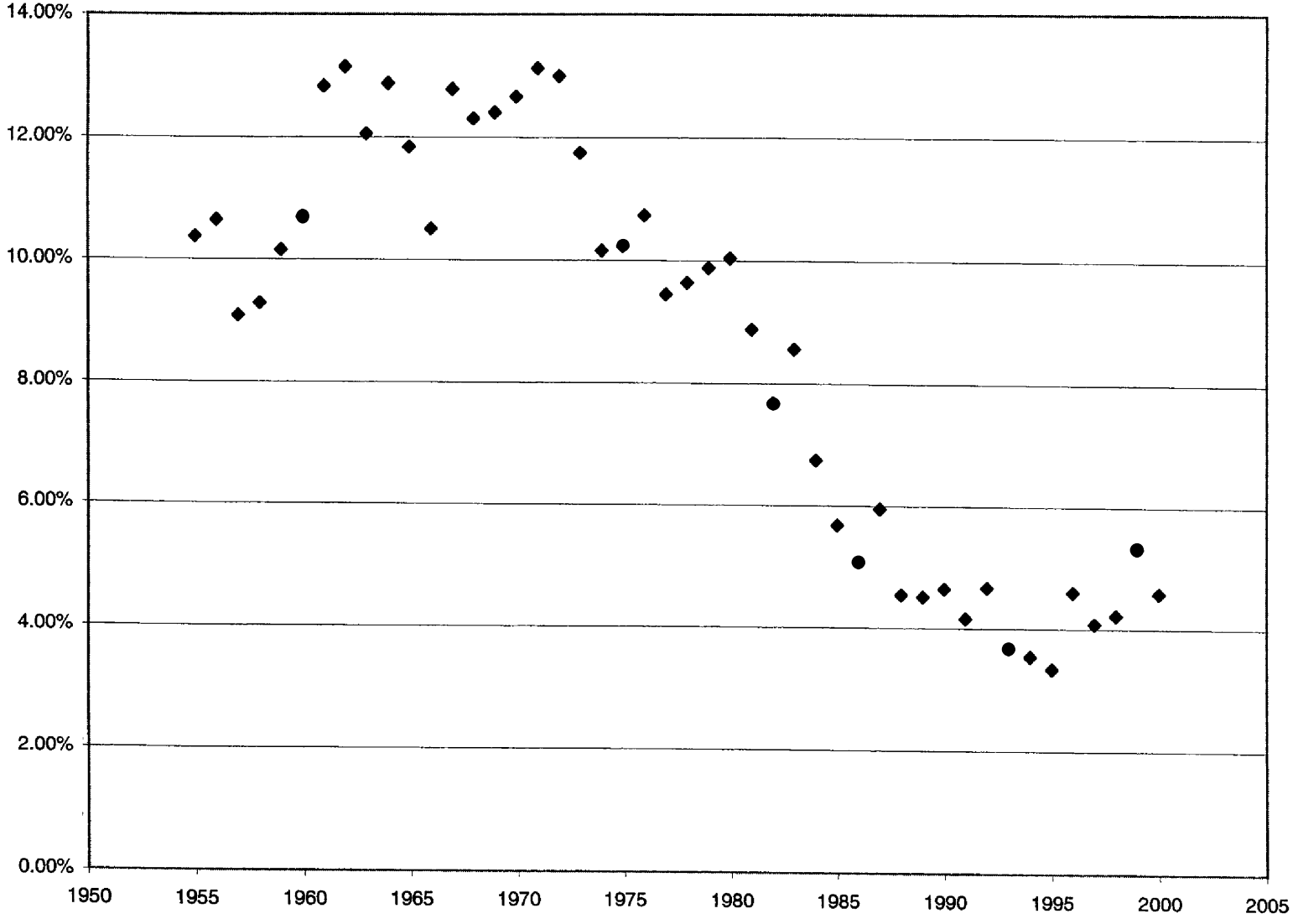
	Book Value(a)	EPS(a)	DPS(a)	Disc. Rate 11.9%	Cash Flow Present Value		
2052	650.42	92 36	48 59	309.27	0.16	14.20%	
2053	695 11	98 71	51 93	346.07	0.15	14.20%	
2054	742.86	105.49	55.50	387.25	0 14	14.20%	
2055	793.90	112.73	59.31	433.34	0 14	14 20%	
2056	848 44	120.48	63.38	484.90	0 13	14 20%	
2057	906 72	128.75	67.74	542.61	0.12	14.20%	
2058	969.02	137.60	72 39	607.18	0.12	14.20%	
2059	1035.59	147.05	77.36	679 43	0.11	14.20%	
2060	1106 73	157 16	82.68	760.28	0 11	14.20%	
2061	1182.76	167.95	88 36	850.76	0 10	14.20%	
2062	1264.02	179 49	94 43	952.00	0.10	14.20%	
2063	1350.86	191.82	100.92	1065 28	0 09	14 20%	
2064	1443.66	205.00	107.85	1192.05	0.09	14 20%	
2065	1542 84	219 08	115 26	1333.91	0.09	14 20%	
2066	1648 84	234 13	123 18	1492.64	0.08	14.20%	
6267	1762.11	250 22	131 64	1670.27	0.08	14.20%	
6068	1883.17	267.41	140.68	1869.03	0.08	14.20%	
2069	2012.54	285.78	150 35	2091.44	0 07	14.20%	
2070	2150 80	305 41	160 68	2340.32	0 07	14.20%	
2071	2298 56	326 40	171.72	2618.82	0 07	14 20%	
2072	2456.47	348 82	183.51	2930.46	0 06	14.20%	
2073	2625.23	372.78	196.12	3279.19	0.06	14.20%	
2074	2805.59	398.39	209.59	3669 41	0.06	14.20%	
2075	2998 33	425.76	223.99	4106.07	0 05	14.20%	
2076	3204.32	455.01	239.38	4594.69	0 05	14.20%	
2077	3424.45	486.27	255.83	5141.46	0.05	14 20%	
2078	3659 71	519.68	273.40	5753.30	0 05	14.20%	
2079	3911.14	555 38	292.19	6437.94	0.05	14.20%	
2080	4179.83	593.54	312 26	7204.05	0.04	14 20%	
2081	4466.99	634.31	333 71	8061.33	0.04	14.20%	
2082	4773.87	677.89	356 64	9020.63	0.04	14.20%	
2083	5101.83	724.46	381.14	10094.09	0 04	14.20%	
2084	5452.33	774 23	407.32	11295.28	0.04	14.20%	
2085	5826.90	827 42	435.31	12639.42	0.03	14.20%	
2086	6227.21	884.26	465.21	14143.51	0.03	14.20%	
2087	6655.02	945.01	497 17	15826.59	0 03	14 20%	
2088	7112.22	1009 94	531 33	17709 96	0.03	14.20%	
2089	7600.83	1079.32	567 83	19817.44	0.03	14.20%	
2090	8123 01	1153.47	606 84	22175.72	0.03	14.20%	
2091	8681.06	1232.71	648.53	24814.63	0.03	14.20%	
2092	9277.45	1317.40	693 08	27767.57	0 02	14.20%	
2093	9914.81	1407.90	740.70	31071.91	0.02	14.20%	
2094	10595.95	1504 63	791.58	34769.47	0.02	14.20%	
2095	11323.90	1607.99	845.97	38907.03	0.02	14.20%	
2096	12101.85	1718.46	904.08	43536.97	0.02	14.20%	
2097	12933 24	1836.52	966.19	48717.87	0.02	14.20%	
2098	13821.76	1962.69	1032.57	54515.30	0.02	14.20%	
2099	14771.31	2097.53	1103.51	61002.62	0 02	14.20%	
2100	15786.10	2241.63	25332.06	68261.93	0.37	34.88	1179.32
Price to Book	1.53						24152.74
Market Price	24152.74						25332.06

(a) Sustainable Growth Rate: (14.2%*.474)+(0.4*.35)=6.87% for Stage Two

Arithmetic S&P 500 Total Return Less Return Long-Term T-Bonds (30 Yr. Mov. Avg.)



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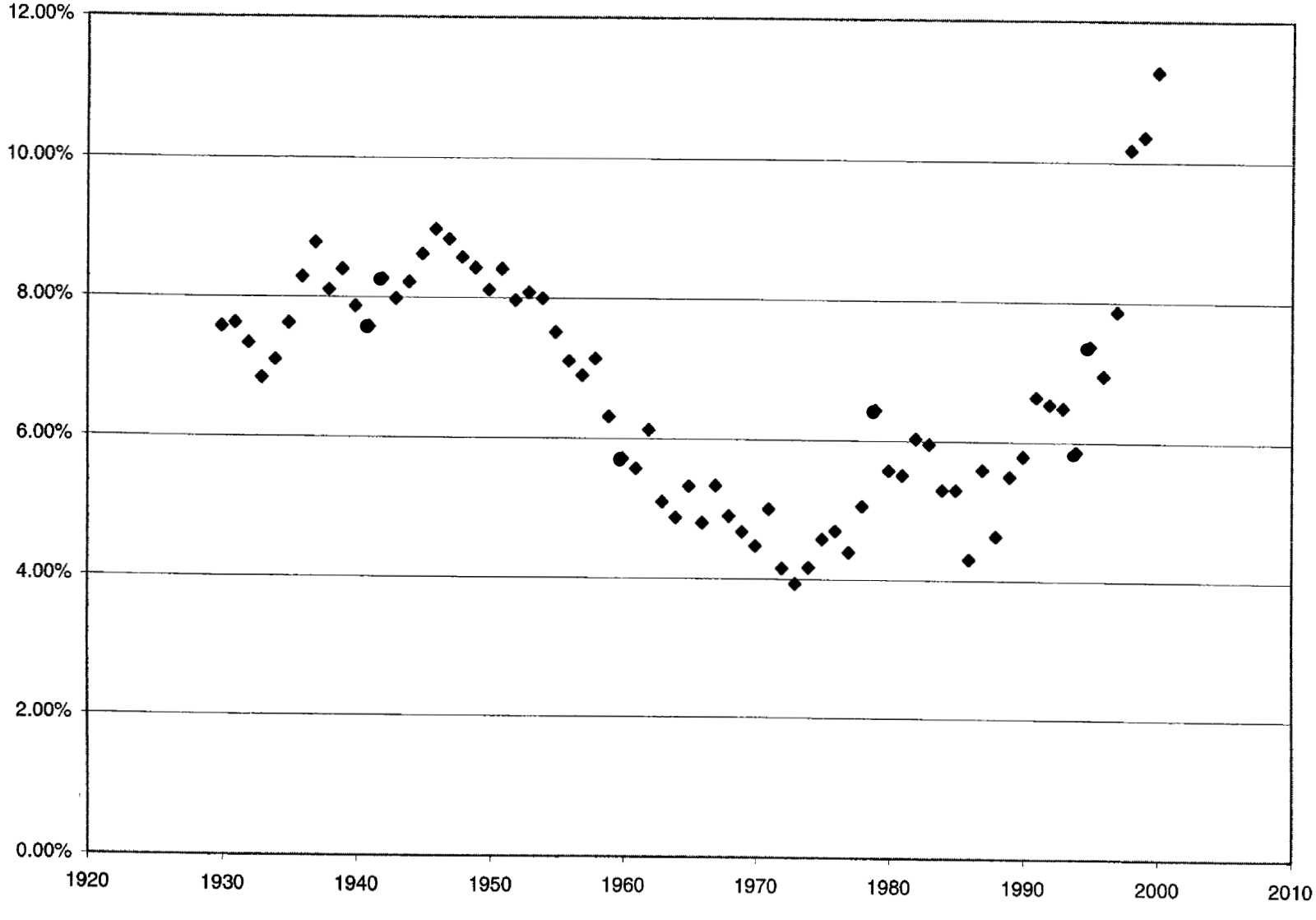
Equity Risk Premium for S&P 500 Versus Long-Term Treasury Bonds



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A 13.4% Return on Common Stock Equity
Provides Investors a Market Return of 11.1%

	Book Value(a)	EPS(a)	DPS(a)	Disc. Rate 11 1%	Cash Flow Present Value	
2001	22.76	3 11	1.83		-34.80	
2002	24.05	3 22	1.90	1.1110	1.71	13.40%
2003	25 41	3.40	2.00	1.23	1.62	13 40%
2004	26 85	3.60	2.12	1.37	1.54	13.40%
2005	28 37	3.80	2.24	1.52	1 47	13 40%
2006	29.97	4.02	2.36	1.69	1 40	13.40%
2007	31.67	4.24	2 50	1.88	1 33	13.40%
2008	33 46	4.48	2 64	2.09	1.26	13.40%
2009	35.36	4 74	2.79	2.32	1 20	13.40%
2010	37.36	5.01	2.95	2.58	1.14	13 40%
2011	39.47	5.29	3.11	2.87	1.09	13 40%
2012	41.71	5.59	3.29	3.18	1 03	13 40%
2013	44.07	5.90	3.47	3.54	0.98	13.40%
2014	46.56	6.24	3.67	3.93	0 93	13.40%
2015	49.19	6 59	3.88	4.37	0.89	13 40%
2016	51.98	6 97	4.10	4.85	0.85	13 40%
2017	54.92	7.36	4.33	5.39	0.80	13 40%
2018	58.03	7 78	4.58	5.99	0.76	13 40%
2019	61.31	8 22	4.83	6.65	0.73	13.40%
2020	64 78	8.68	5 11	7.39	0 69	13.40%
2021	68.45	9.17	5 40	8.21	0 66	13.40%
2022	72 33	9.69	5.70	9.12	0.63	13.40%
2023	76 42	10.24	6.03	10 13	0 59	13.40%
2024	80 75	10.82	6 37	11.26	0.57	13.40%
2025	85.32	11.43	6 73	12.51	0.54	13.40%
2026	90.14	12.08	7 11	13.89	0.51	13.40%
2027	95 25	12.76	7.51	15.44	0 49	13.40%
2028	100.64	13 49	7.94	17.15	0.46	13.40%
2029	106 33	14.25	8 38	19.05	0.44	13.40%
2030	112.35	15.06	8 86	21.17	0.42	13.40%
2031	118.71	15 91	9.36	23.52	0.40	13.40%
2032	125 43	16.81	9.89	26.13	0.38	13.40%
2033	132 53	17 76	10.45	29.03	0.36	13.40%
2034	140.03	18.76	11.04	32 25	0.34	13.40%
2035	147.96	19.83	11 67	35.83	0.33	13.40%
2036	156 33	20.95	12 33	39.81	0.31	13.40%
2037	165 18	22.13	13.02	44.23	0.29	13.40%
2038	174.53	23 39	13.76	49 14	0 28	13.40%
2039	184.41	24 71	14.54	54.59	0.27	13.40%
2040	194.84	26 11	15.36	60 65	0.25	13.40%
2041	205.87	27.59	16.23	67.38	0.24	13.40%
2042	217.52	29.15	17.15	74 86	0.23	13.40%
2043	229.84	30.80	18.12	83.17	0.22	13.40%
2044	242.84	32.54	19.15	92 41	0.21	13.40%
2045	256.59	34.38	20.23	102.66	0.20	13.40%
2046	271 11	36.33	21.38	114.06	0.19	13.40%
2047	286.46	38.39	22 59	126.72	0.18	13.40%
2048	302.67	40.56	23.87	140 79	0.17	13.40%
2049	319 80	42.85	25 22	156.41	0.16	13.40%
2050	337 90	45.28	26.64	173.78	0.15	13.40%
2051	357.03	47 84	28.15	193.06	0.15	13.40%

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	Book Value(a)	EPS(a)	DPS(a)	Disc. Rate 11.1%	Cash Flow Present Value		
2052	377.24	50.55	29 75	214.49	0.14	13 40%	
2053	398.59	53 41	31 43	238 30	0.13	13.40%	
2054	421 15	56.43	33 21	264.76	0.13	13 40%	
2055	444.98	59 63	35.09	294.14	0.12	13 40%	
2056	470.17	63 00	37.07	326.79	0.11	13.40%	
2057	496 78	66.57	39.17	363.07	0.11	13.40%	
2058	524.90	70.34	41.39	403.37	0.10	13.40%	
2059	554 61	74 32	43.73	448.14	0.10	13.40%	
2060	586.00	78.52	46.21	497.89	0.09	13.40%	
2061	619.17	82.97	48.82	553 15	0.09	13.40%	
2062	654 21	87.66	51.59	614 55	0.08	13 40%	
2063	691 24	92.63	54.51	682 77	0.08	13 40%	
2064	730.37	97.87	57.59	758.55	0.08	13 40%	
2065	771.70	103 41	60 85	842.75	0.07	13.40%	
2066	815.38	109.26	64 29	936.30	0.07	13.40%	
6267	861.53	115.45	67 93	1040.23	0.07	13 40%	
6068	910.30	121.98	71.78	1155.69	0.06	13.40%	
2069	961 82	128.88	75.84	1283.97	0.06	13.40%	
2070	1016 26	136.18	80.13	1426.49	0.06	13 40%	
2071	1073 78	143.89	84.67	1584.84	0.05	13 40%	
2072	1134.55	152.03	89.46	1760.75	0.05	13 40%	
2073	1198.77	160 64	94.52	1956.20	0.05	13 40%	
2074	1266.62	169 73	99.87	2173 33	0.05	13.40%	
2075	1338.31	179 33	105 53	2414.57	0.04	13.40%	
2076	1414.06	189.48	111.50	2682.59	0.04	13.40%	
2077	1494.10	200.21	117.81	2980.36	0.04	13.40%	
2078	1578.66	211.54	124.48	3311.18	0.04	13 40%	
2079	1668.01	223.51	131 52	3678.72	0.04	13 40%	
2080	1762 42	236.16	138.97	4087.06	0 03	13.40%	
2081	1862.18	249 53	146.83	4540 72	0.03	13.40%	
2082	1967.58	263.66	155 15	5044.74	0.03	13.40%	
2083	2078.94	278 58	163 93	5604.71	0 03	13.40%	
2084	2196.61	294.35	173.21	6226 83	0.03	13 40%	
2085	2320.94	311 01	183.01	6918.01	0.03	13.40%	
2086	2452.30	328.61	193 37	7685.90	0.03	13.40%	
2087	2591.10	347.21	204 31	8539.04	0.02	13.40%	
2088	2737.76	366 86	215.88	9486.87	0.02	13.40%	
2089	2892 71	387.62	228.09	10539.92	0.02	13.40%	
2090	3056.44	409 56	241.00	11709.85	0.02	13.40%	
2091	3229.44	432 74	254.64	13009.64	0.02	13.40%	
2092	3412.22	457.24	269.06	14453.71	0.02	13.40%	
2093	3605 36	483.12	284.29	16058 07	0.02	13.40%	
2094	3809.42	510.46	300.38	17840.52	0 02	13.40%	
2095	4025.03	539 35	317.38	19820.82	0.02	13.40%	
2096	4252.85	569.88	335 34	22020.93	0.02	13.40%	
2097	4493.56	602.14	354.32	24465.25	0.01	13.40%	
2098	4747.89	636.22	374.38	27180.89	0 01	13.40%	
2099	5016 63	672.23	395.57	30197 97	0.01	13.40%	
2100	5300.57	710.28	8527.83	33549.95	0.25	34.86	
Price to Book	1.53						417.96
Market Price	8109.87						8109.87
							8527.83

(a) Sustainable Growth Rate: (13.4%*.4116%)+(0.4*.35)=5.66%

When Interest Rates Decline, the Investor Expected Return is Likely to Decline. Since the Investor Expected Return is Lower, It Is Not Necessary to Increase the Regulatory Return on Common Stock Equity

	Price Up, Constant ROE				Price Up, ROE Down			
	A	B	C	D	E	F	G	H
	13 0% ROE Investor Expectation	Price Up Required Retn. Declines	10.0% Produces Only 7.0%	13.0% Produces 10 0%	13.0% ROE Investor Expectation	Price Up ROE Down 12.5% & $40	9.5% Produces Only 6.5%	12 50% Produces 9.50%
1 Current Price (Given)	$ 35.00	$ 40 00	$ 40.00	$ 40.00	$ 35 00	$ 40 00	$ 40.00	$ 40.00
2 Book Value (Given)	$ 25.00	$ 25.00	$ 25 00	$ 25.00	$ 25.00	$ 25.00	$ 25.00	$ 25.00
3 **Expected Return on Common Stock Equity**	13.00%	13.00%	10.00%	13.00%	13.00%	12.50%	9.50%	12.50%
4 Earnings Per Share (2 * 3)	$ 3.25	$ 3.25	$ 2.50	$ 3.25	$ 3.25	$ 3.13	$ 2.38	$ 3.13
5 Given; Dividends Per Share (4 * 6)	$ 2.00	$ 2.00	$ 2.00	$ 2.00	$ 2.00	$ 2.00	$ 2 00	$ 2.00
6 Dividend Payout Ratio (5 / 4)	61.54%	61.54%	80 00%	61.54%	61.54%	64.00%	84.21%	64 00%
7 Earning Retention Rate for Growth [1.0 - 6]	38.46%	38.46%	20.00%	38.46%	38.46%	36.00%	15 79%	36.00%
8 Sustainable Growth Rate (3 * 7)	5.00%	5 00%	2.00%	5.00%	5.00%	4 50%	1.50%	4.50%
9 Current Yield (5 / 1)	5.71%	5.00%	5.00%	5.00%	5.71%	5.00%	5 00%	5.00%
10 **Investor Achievable Market Return (8+9)**	10.71%	10.00%	7 00%	10.00%	10.71%	9.50%	6.50%	9.50%

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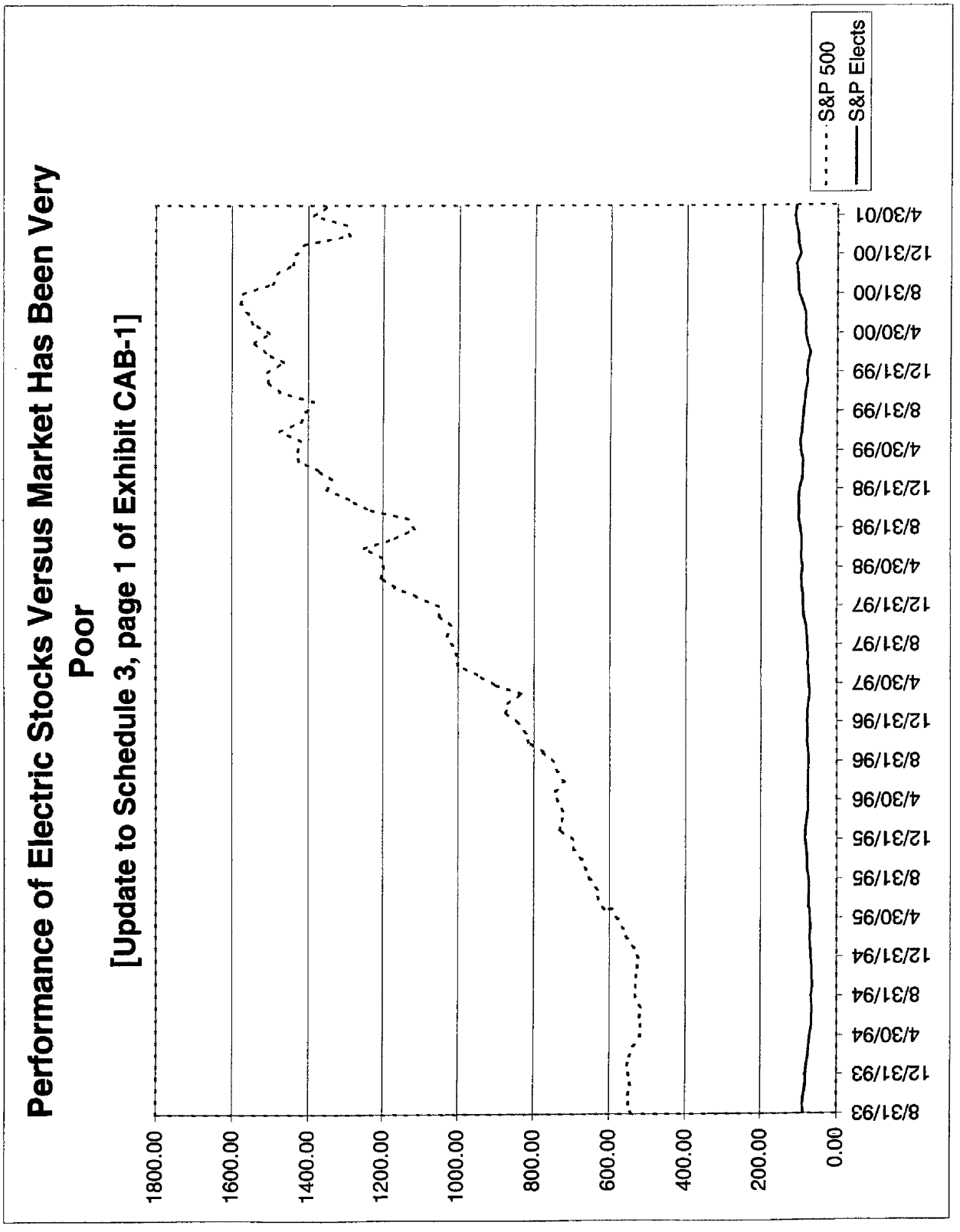
Summary of Test Results to Determine the Appropriate Regulatory Allowed Return for Gulf Power Company's Common Stock Equity [Update to Schedule 1a of Exhibit CAB-1]

Tests	Gulf Power Comparable Companies (a)	Reference
1. DCF		
Standard DCF (assumes 1.0 price/book)	12.1%	Schedule 27
Transformed DCF	**14.2%**	Schedule 28
2. Equity Risk Premium (assumes 1.0 price/book)	11.2%	Schedule 30
Transformed Equity Risk Premium	**13.3%**	Schedule 30
3. CAPM		
Average Standard CAPM (assumes 1.0 price/book)	10.6%	Schedule 33
Average Empirical CAPM (assumes 1.0 price/book)	11.6%	Schedule 33
Average Standard and Empirical CAPM's	11.1%	Schedule 33
Transformed CAPM	**13.2%**	Schedule 34
4. Comparable Earnings Test	**13.5%**	Schedule 35
Average of Four Tests	**13.6%**	
Range of Four Tests	**13.2% to 14.2%**	
Midpoint of Four Test Range	**13.7%**	
Recommended Return on Common Stock Equity for Gulf Power Company	**At Least 13.0%**	

(a) All estimates except for the "at least 13.0%" recommended return on common equity exclude flotation costs of 0.2%


Performance of Electric Stocks Versus Market Has Been Very Poor
[Update to Schedule 3, page 1 of Exhibit CAB-1]
S&P 500
S&P Elects
1800.00
1600.00
1400.00
1200.00
1000.00
800.00
600.00
400.00
200.00
0.00
8/31/93
12/31/93
4/30/94
8/31/94
12/31/94
4/30/95
8/31/95
12/31/95
4/30/96
8/31/96
12/31/96
4/30/97
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12/31/97
4/30/98
8/31/98
12/31/98
4/30/99
8/31/99
12/31/99
4/30/00
8/31/00
12/31/00
4/30/01

Risk Indicators for Gulf Power Company's Comparable Companies and Southern Company
[Update to Schedule 6, page 6 of Exhibit CAB-1]

Company	1 Predominately Regulated Company	2 S&P Business Profile	3 VL Safety Rank	4 VL Beta	5 S&P Bond Rating	6 Competitive Position	7 Val Line Regulation	8 Debt to Capital %	9 Mkt. Cap. $ Bil.
Allegheny Energy, AYE *	Yes	5	1.0	0.55	A+	Under $0.05 kWh	Avg.	57.0%	6.5
Alliant Energy, LNT	Yes	5	2.0	0.55	A+	Under $0.05 kWh	Avg.	51.0%	2.3
Ameren Corp., AEE	Yes	5	1.0	0.55	A+	Under $0.05 kWh	Avg.	46.0%	5.9
Cinergy Corp., CIN	Yes	5	2.0	0.55	A-	Under $0 05 kWh	Abv. Avg.	49.0%	5 4
FPL Group, FPL	Yes	5	2.0	0.40	AA-	Under $0.05 kWh	Abv. Avg.	39.0%	10.1
TECO Energy, TE	Yes	5	1.0	0.50	A	Under $0.05 kWh	Abv. Avg.	48.0%	4.3
Wisconsin Energy, WEC*	Yes	4	2.0	0.50	AA-	Under $0.05 kWh	Abv. Avg.	65.0%	2.8
Average	Yes	4.9	1.6	0.51	A/A+	Under $0.05 kWh	Avg/AbvAvg	50.7%	5.3
Gulf Power Company	Yes	4	NA	NA	A+	Under $0.05 kWh	Abv. Avg.	41.5%(b)	NA
Southern Company, SO	Yes	4	2.0	NA	A+(a)	Under $0.05 kWh	Avg.	38.0%	15.8

1. Predominately an Electric Company Followed by Bloomberg, C.A.Turner, and Value Line
2. S&P Business Profile 4 or 5, where integrated companies are generally expected to be 5 or 6 on a 1 is best scale of 1-10
3. Value Line Safety Rank 1 or 2 on a scale of 1 to 5 where 1 is lowest risk: Value Line recommends 1 or 2 for conservative investors
4. Value Line Beta 0.60 or less
5. S&P Credit Rating A- or better, C.A.Turner
6. Industrial Rates Under $0.05 as a Measure of Competitive Position
7. Value Line Regulation Ranking
8. Debt Ratio, Value Line, or 2001 Long-Term debt as a Percent of Total Capital
9. Market Value of Common Stock
10. Mergers were also considered; Potomac Electric Power was excluded because of proposed merger with Conectiv

* Allegheny and Wisconsin Energy were excluded because of non-representative results, and as a result, the DCF and other tests are based on a truncated average.

NA: Not Available (a) Simple Average of Five Electric Subsidiaries--weighted by size A; (b) 2000 SO 10K
Sources: Latest Value Line Reports When Preparing Testimony

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Witness: C. A. Benore
Exhibit No. ____ (CAB-2)
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Stock Prices for Gulf Power Company's Comparable Companies
[Update to Schedule 7, page 13 of Exhibit CAB-1]

	AYE	LNT	AEE	CIN	FPL	TE	WEC
11/27/01	35.00	28.45	40.99	30.64	55.44	26.84	22.44
11/28/01	34.21	28.24	40.30	29.90	54.60	26.33	22.00
11/29/01	34.01	28.55	40.63	29.65	55.25	26.50	22.01
11/30/01	34.85	28.10	40.88	29.48	55.40	26.42	21.90
12/3/01	34.86	28.28	41.06	29.70	55.22	26.34	21.92
12/4/01	35.50	28.62	41.20	29.60	55.75	26.62	22.15
12/5/01	35.70	28.51	41.28	29.50	55.55	26.50	21.90
12/6/01	35.41	28.45	40.49	29.12	55.00	26.18	22.10
12/7/01	36.04	28.75	40.88	29.56	55.75	26.24	22.01
12/10/01	35.75	28.90	40.10	29.02	55.22	25.96	21.81
12/11/01	34.97	28.50	39.32	28.70	54.00	25.25	21.65
12/12/01	35.13	28.54	39.67	29.15	54.29	25.08	21.80
12/13/01	35.23	28.60	40.00	29.95	55.15	25.24	21.71
12/14/01	34.56	28.88	40.32	30.74	54.74	25.24	21.85
12/17/01	33.25	28.80	40.06	30.84	54.15	24.94	21.55
12/18/01	33.91	29.17	40.94	31.58	54.40	25.80	21.69
12/19/01	35.12	30.28	41.80	32.49	55.70	26.39	22.00
12/20/01	34.90	29.82	41.27	31.75	55.70	26.28	22.00
12/21/01	34.96	30.15	41.13	31.77	55.67	25.45	22.51
12/24/01	35.50	30.00	41.78	32.22	56.45	25.73	22.77
12/26/01	35.83	30.42	42.30	32.84	56.45	25.76	22.79
12/27/01	36.39	30.59	42.30	33.07	56.51	25.92	22.70
Average	35.05	29.03	40.85	30.51	55.29	25.96	22.06

Source: American Online

Projected First Year Dividend for Gulf Power Company's Comparable Companies
[Update to Schedule 7, page 14 of Exhibit CAB-1]

Company	Q4'01	Q1'02	Q2'02	Q3'02	DPS1	Growth Rate
	$	$	$	$	$	%
Allegheny Energy, AYE	0.4756	0.4756	0.4756	0.4756	1.90	10.6%
Alliant Energy, LNT	0.5245	0.5245	0.5245	0.5245	2.10	4.9%
Ameren Corp., AEE	0.6629	0.6629	0.6629	0.6629	2.65	4.4%
Cinergy Corp., CIN	0.4784	0.4784	0.4784	0.4784	1.91	6.3%
FPL Group, FPL	0.5958	0.5958	0.5958	0.5958	2.38	6.4%
TECO Energy, TE	0.3450	0.3736	0.3736	0.3736	1.47	8.3%
Wisconsin Energy, WEC	0.2108	0.2108	0.2108	0.2108	0.84	5.4%
Average					1.89	6.6%

Sources: Wall Street Journal and Value Line along with Schedule 26

Projected Growth Rates for Gulf Power Company's Comparable Companies
[Update to Schedule 7, page 15 of Exhibit CAB-1]

Company	Value Line Proj 5 Yr EPS Gwth	Projected IBES Growth	Projected Zacks Growth	Projected First Call Growth	Average Proj'ed Gwth
Allegheny Energy, AYE	14.0%	9.2%	9.0%	10.0%	10.6%
Alliant Energy, LNT	6.5%	4.0%	5.0%	4.0%	4.9%
Ameren Corp., AEE	4.0%	4.9%	3.8%	5.0%	4.4%
Cinergy Corp., CIN	6.0%	6.3%	5.7%	7.0%	6.3%
FPL Group, FPL	4.5%	6.8%	7.2%	7.0%	6.4%
TECO Energy, TE	7.0%	8.5%	8.8%	9.0%	8.3%
Wisconsin Energy, WEC	8.5%	4.7%	4.5%	4.0%	5.4%
Average	7.2%	6.3%	6.3%	6.6%	6.6%

Sources: Value Line; Bloomberg, Zacks Investment Research, and First Call

Standard, or P/B = 1.0, DCF Investor Required Market Return for Gulf Power Company's Comparable Companies [Update to Schedule 7, page 16 of Exhibit CAB-1]

Company	DPS1($)	Price ($)	Yield	Yld with 3% Flo. Costs	Proj. Gwth	DCF w/o FloC	DCF w Flo C
Allegheny Energy, AYE	1.90	35.05	5.42%	5.59%	10.6%	16.0%	16.19%
Alliant Energy, LNT	2.10	29.03	7.23%	7.46%	4.9%	12.1%	12.36%
Ameren Corp., AEE	2.65	40.85	6.49%	6.69%	4.4%	10.9%	11.09%
Cinergy Corp., CIN	1.91	30.51	6.26%	6.45%	6.3%	12.6%	12.75%
FPL Group, FPL	2.38	55.29	4.30%	4.44%	6.4%	10.7%	10.84%
TECO Energy, TE	1.47	25.96	5.66%	5.84%	8.3%	14.0%	14.14%
Wisconsin Energy, WEC	0.84	22.06	3.81%	3.93%	5.4%	9.2%	9.33%
Average	1.89	34.11	5.60%	5.77%	6.61%	12.21%	12.38%

Flotation Costs

	Gulf Pw. Comps.
Yield with Flotation Costs	5.77%
Yield without Flotation Costs	5.60%
Flotation Costs	0.17%

Standard, or P/B = 1.0, Truncated DCF Investor Required Market Return for Gulf Power Company's Comparable Companies [Update to Schedule 7, page 16 of Exhibit CAB-1]

Company	DPS1($)	Price ($)	Yield	Yld with 3% Flo. Costs	Proj. Gwth	DCF w/o FloC	DCF w Flo C
Alliant Energy, LNT	2.10	29.03	7.23%	7.46%	4.9%	12.1%	12.36%
Ameren Corp., AEE	2.65	40.85	6.49%	6.69%	4.4%	10.9%	11.09%
Cinergy Corp., CIN	1.91	30.51	6.26%	6.45%	6.3%	12.6%	12.75%
FPL Group, FPL	2.38	55.29	4.30%	4.44%	6.4%	10.7%	10.84%
TECO Energy, TE	1.47	25.96	5.66%	5.84%	8.3%	14.0%	14.14%
Average	2.10	36.33	5.99%	6.17%	6.06%	12.05%	12.23%

Flotation Costs

	Gulf Pw. Comps.
Yield with Flotation Costs	6.17%
Yield without Flotation Costs	5.99%
Flotation Costs	0.19%

Sources: Schedules 24-26

Transformed DCF Test for Gulf Power Company's Comparable Companies (a) [Update to Schedule 7, page 17 of Exhibit CAB-1]

Standard DCF Model Results:	**Gulf Pw. Comp. Co's**
Book Value	26.04
Regulatory Return	12.1%
Earnings Per Share	3.15
Dividend Per Share	$ 2.10
Dividend Payout Ratio	66.65%
Retention Rate	33.35%
Sustainable Growth Rate	4.04%
Current Yield	5.99%
Market Return to Investors	10.0%

Necessary Regulatory Return on Common Stock for Investors to Earn Required Market Return:	**Gulf Pw. Comp. Co's**
Book Value	26.04
Regulatory Return	14.2%
Earnings Per Share	3.70
Dividend Per Share	$ 2.10
Dividend Payout Ratio	56.79%
Retention Rate	43.21%
Sustainable Growth Rate	6.14%
Current Yield	5.99%
Market Return to Investors	12.1%

(a) Excludes flotation costs

Representative Yield for Long-Term U. S. Treasury Bonds
[Update to Schedule 8, page 12 of Exhibit CAB-1]

Date	Moody's Aaa Corporates
11/27/01	7.12%
11/28/01	7.12%
11/29/01	7.00%
11/30/01	7.02%
12/3/01	7.01%
12/4/01	6.98%
12/5/01	7.11%
12/6/01	7.20%
12/7/01	6.88%
12/10/01	6.88%
12/11/01	6.70%
12/12/01	6.63%
12/13/01	6.69%
12/14/01	6.73%
12/17/01	6.78%
12/18/01	6.66%
12/19/01	6.61%
12/20/01	6.59%
12/21/01	6.60%
12/24/01	NA
12/26/01	6.66%
Average	**6.85%**
Normalization Adj.	**-0.64%**
Norm. T-Bond Yield	**6.21%**

Source: St. Louis Federal Reserve, and
Schedule 8

P/B=1.0 Equity Risk Premium Results for Gulf Power Company's Comparable Companies [Update to Schedule 8, page 14 of Exhibit CAB-1]

Equity Risk Premium	5.0%
Long-term Interest Rates for Treasury Bonds	6.2%
P/B=1.0 ERP Investor Required Market Return	11.2%(a)

(a) Excludes Flotation Costs

Transformed ERP Test for Gulf Power Company's Comparable Companies (a) [Update to Schedule 8, page 14 of Exhibit CAB-1]

Standard ERP Model Results		**Gulf Pw. Comp. Co's**
Book Value	$	26.04
Regulatory Return		11.2%
Earnings Per Share	$	2.92
Dividend Per Share	$	$ 2.10
Dividend Payout		72.00%
Retention Rate		28.00%
Sustainable Growth Rate		3.14%
Current Yield		5.99%
Market Return to Investors		9.1%

Necessary Regulatory Return on Common Stock for Investors to Earn Required Market Return		**Gulf Pw. Comp. Co's**
Book Value	$	26.04
Regulatory Return		13.3%
EPS	$	3.46
Dividend Per Share	$	$ 2.10
Dividend Payout Ratio		60.64%
Retention Rate		39.36%
Sustainable Growth Rate		5.24%
Current Yield		5.99%
Market Return to Investors		11.2%

(a) Excludes flotation costs

Sources: Value Line, IBES, Zacks, and American Online

Investor Expected Market Returns for the Value Line Composite and S&P 500 Composite [Update to Schedule 9, page 12 of Exhibit CAB-1]

Value Line Composite

Growth Plus Yield:	
Value Line Projected EPS Growth Rate	15.5%
Current Yield on DPS1	1.4%
Required Return	16.9%

S&P 500 Composite

IBES Projected EPS Growth Rate	12.9%
Value Line Projected EPS Growth Rate	15.4%
Zacks' Projected EPS Growth Rate	10.3%
Average	12.9%
Current Yield on DPS1	1.5%
Required Return	14.4%

Sources: Value Line, First Call, IBES, Zacks, and Standard & Poor's

Value Line Betas for Gulf Power Company's Comparable Companies [Update to Schedule 9, page 14 of Exhibit CAB-1]

Company	Gulf Pw. Comp Co's	Truncated Gulf Pw. Comp Co's
Allegheny Energy, AYE	0.60	
Alliant Energy, LNT	0.55	0.55
Ameren Corp., AEE	0.55	0.55
Cinergy Corp., CIN	0.55	0.55
FPL Group, FPL	0.45	0.45
TECO Energy, TE	0.50	0.50
Wisconsin Energy, WEC	0.50	
Average	0.53	0.52

Source: Latest Value Line Reports

Standard and Empirical, P/B = 1.0, CAPM Cost of Common Stock for Gulf Power Company
[Update to Schedule 9, page 15 of Exhibit CAB-1]

Long-Term Historical Tests	Standard Gulf Pw. Comps	Emprical Gulf Pw. Comps
Ibbotson Long-Term Historical Total Return Premium	7.3%	7.3%
Beta	0.52	0.52
Equity Risk Premium	3.8%	3.8%
Empirical CAPM (.75* Miss. Pw. Comp's equity risk premium of 3.8%)		2.8%
Yield on 30 Year U.S. Treasury Bonds	6.2%	6.2%
Empirical CAPM (.25*market equity risk premium of 7.3%)		1.8%
Investor Required Market Return	10.0%	10.9%
Ibbotson Long-Term, Historical Yield Risk Premium	7.8%	7.8%
Beta	0.52	0.52
Equity Risk Premium	4.1%	4.1%
Empirical CAPM (.75* Miss. Pw. Comp's equity risk premium of 4.1%)		3.0%
Yield on 30 Year U.S. Treasury Bonds	6.2%	6.2%
Empirical CAPM (.25*market equity risk premium of 7.8%)		2.0%
Investor Required Market Return	10.3%	11.2%
Projected Tests		
Value Line Indicated Total Return (Growth plus Yield)	16.9%	16.9%
Yield on 30 Year U.S. Treasury Bonds	6.2%	6.2%
Market Equity Risk Premium	10.7%	10.7%
Beta	0.52	0.52
Equity Risk Premium	5.6%	5.6%
Empirical CAPM (.75* Miss. Pw. Comp's equity risk premium of 5.6%)		4.2%
Yield on 30 Year U.S. Treasury Bonds	6.2%	6.2%
Empirical CAPM (.25*market equity risk premium of 10.7%)		2.7%
Investor Required Market Return	11.8%	13.0%
S&P 500 Indicated Total Return (Growth plus Yield)	14.4%	14.4%
Yield on 30 Year U.S. Treasury Bonds	6.2%	6.2%
Market Equity Risk Premium	8.2%	8.2%
Beta	0.52	0.52
Equity Risk Premium	4.3%	4.3%
Empirical CAPM (.75* Miss. Pw. Comp's equity risk premium of 4.3%)		3.2%
Yield on 30 Year U.S. Treasury Bonds	6.2%	6.2%
Empirical CAPM (.25*market equity risk premium of 8.2%)		2.1%
Investor Required Market Return	10.5%	11.4%
Average of Historical CAPM Tests	10.1%	11.0%
Average of Projected CAPM Tests	11.1%	12.2%
Average of All CAPM Tests	10.6%	11.6%
Average of Standard and Empirical CAPM Tests	11.1%	

Sources: Value Line, IBES, S&P, Zacks and Federal Reserve

Transformed CAPM Test for Gulf Power Company's Comparable Companies (a) [Update to Schedule 9, page 16 of Exhibit CAB-1]

Standard & Empirical CAPM Model Results		**Gulf Pw. Comp. Co's**
Book Value	$	26.04
Regulatory Return		11.1%
Earnings Per Share	$	2.89
Dividend Per Share	$	$ 2.10
Dividend Payout		72.65%
Retention Rate		27.35%
Sustainable Growth Rate		3.04%
Current Yield		5.99%
Market Return to Investors		9.0%

Necessary Regulatory Return on Common Stock for Investors to Earn Required Market Return		**Gulf Pw. Comp. Co's**
Book Value	$	26.04
Regulatory Return		13.2%
EPS	$	3.44
Dividend Per Share	$	$ 2.10
Dividend Payout Ratio		61.09%
Retention Rate		38.91%
Sustainable Growth Rate		5.14%
Current Yield		5.99%
Market Return to Investors		11.1%

(a) Excludes flotation costs

Value Line Projected Book Values, and Returns on Year-End Common Stock Equity
[Update to Schedule 10 of Exhibit CAB-1]

Gulf Power Company's Comparable Companies	2004-2006 Book Value	Truncated 2004-2006 Book Value	2004-2006 ROE	Truncated 2004-2006 ROE
Allegheny Energy, AYE	36.10		16.0%	
Alliant Energy, LNT	29.25	29.25	10.0%	10.0%
Ameren Corp., AEE	28.25	28.25	13.5%	13.5%
Cinergy Corp., CIN	23.20	23.20	13.5%	13.5%
FPL Group, FPL	33.50	33.50	15.0%	15.0%
TECO Energy, TE	16.00	16.00	15.5%	15.5%
Wisconsin Energy, WEC	25.50		11.0%	
Average	27.40	26.04	13.5%	13.5%

Source: Latest Value Line Reports