BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 010949-EI

In the Matter of

REQUEST FOR RATE INCREASE BY
GULF POWER COMPANY.
_____________________________________/

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VOLUME 8

Pages 725 through 900

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN LILA A. JABER
COMMISSIONER J. TERRY DEASON
COMMISSIONER BRAULIO L. BAEZ
COMMISSIONER MICHAEL A. PALECKI
COMMISSIONER RUDOLPH "RUDY" BRADLEY

DATE: Tuesday, February 26, 2002

TIME: Commenced at 9:00 a.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: LINDA BOLES, RPR
Official FPSC Reporter
(850) 413-6734

APPEARANCES: (As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

NUMBER:		ID.	ADMTD.
40	(JIT-1)	730	755
41	(KHD-1)	756	756
42	(MJM-1 through MJM-5)	770	770
43	(HWS-1 through HWS-6)	786	850
44	(Appendix A and WMZ-1 through WMZ-5)	850	850
45	(RD-1)	858	858
46	(JEB-1 through JEB-4)	864	899

PROCEEDINGS

(Transcript follows in sequence from Volume 7.)

CHAIRMAN JABER: Good morning. I heard a rumor that last night you all settled the rest of the case.

MR. MELSON: We didn't hear that.

CHAIRMAN JABER: You're not hanging around the same circles.

Okay. Let's see. Where we left off, Mr. Stone, was with Mr. Thompson.

COMMISSIONER BRADLEY: Yes. Madam Chair, before we begin I would like to respectfully request that I withdraw, withdraw a request that I made yesterday regarding the complaints filed with the Consumer Affairs Department here at the Public Service Commission. I've decided to rely upon Staff testimony that is in the record, and I don't think there's a need to call any additional witnesses to address this issue.

CHAIRMAN JABER: Okay.

COMMISSIONER BRADLEY: And I would respectfully request concurrence from my fellow Commissioners.

COMMISSIONER DEASON: That's fine with me.

CHAIRMAN JABER: Thank you, Commissioner Bradley. That will take care of -- we can excuse Witness Durbin from the hearing. And who was it, Mr. Stone, you were saying was the rebuttal?

MR. STONE: That was Mr. Kilgore.

CHAIRMAN JABER: And we can excuse Mr. Kilgore from the hearing. So when it's time, we'll admit their testimony into the record. Thank you, Commissioner.

That brings us to Mr. Thompson, Mr. Stone.

MR. BADDERS: Mr. Thompson has taken the stand.

JAMES I. THOMPSON

was called as a witness on behalf of Gulf Power Company and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BADDERS:

Q Mr. Thompson, were you present yesterday when the witnesses were sworn in?

A Yes.

Q And you took that oath?

A I did.

Q Would you please state your name and your business address for the record.

A James I. Thompson. I'm employed by Gulf Power at One Energy Place, Pensacola, Florida 32520.

Q Have you prefiled testimony consisting of 22 pages?

A Yes.

Q Do you have any changes or corrections to that testimony?

A No, I do not.

Q If I were to ask you the same questions today, would your answers be the same?

A Yes.

MR. BADDERS: We ask that the prefiled direct testimony of Mr. Thompson be inserted into the record as though read.

CHAIRMAN JABER: The prefiled direct testimony of James Thompson shall be inserted into the record as though read.

MR. BADDERS: Thank you.

BY MR. BADDERS:

Q Mr. Thompson, do you have one exhibit attached to your testimony consisting of four schedules?

A Yes.

Q And at Schedule 3, is that the section that identifies the MFRs that you will be sponsoring?

A Yes.

Q Do you have any changes or corrections to that exhibit or to your portions of the MFRs?

A No.

MR. BADDERS: We ask that Exhibit JIT-1 be identified.

CHAIRMAN JABER: JIT-1 is identified as Exhibit 40.

(Exhibit 40 marked for identification.)

GULF POWER COMPANY

Before the Florida Public Service Commission
Prepared Direct Testimony and Exhibit of
James I. Thompson
Docket No. 010949-EI
In Support of Rate Relief
Date of Filing: September 10, 2001

Q. Please state your name, business address, employer and position.

A. My name is James I. Thompson, and my business address is One Energy Place, Pensacola, Florida 32520. I am employed by Gulf Power as Team Leader – Pricing and Load Research.

Q. Please describe your educational and professional background.

A. In December 1977, I graduated from Georgia Tech, earning a Bachelor of Science degree in Industrial Management. In early 1978, I joined the NCR Corporation as a sales representative out of that company's Atlanta office. I joined Gulf Power in 1980, as an analyst in the Company's Rate Department. In 1988, I became a member of Gulf Power's marketing organization. In 1997, I assumed the duties of Corporate Accounts Manager within Southern Company's Corporate Accounts organization and moved into my current position in 2000. Since joining the marketing organization, I have been involved with various marketing functional activities including program development and evaluation, market research, economic development, and market planning. Throughout most of my career, I have been involved in the pricing of Gulf Power's energy services.

Q. Have you previously testified before this Commission?
A. Yes, twice. I testified on behalf of Gulf Power in support of its Standby Service rate, Docket No. 931044-EI; and again in Docket No. 951161-EI, which was Gulf Power's request for approval of its Commercial/Industrial Service Rider.

Q. What is the purpose of your testimony?
A. The purpose of my testimony is to present Gulf Power's pricing/rates which are filed as a part of this proceeding. I will address the changes proposed, explaining how this specific set of rates and pricing programs will accomplish or move the Company toward accomplishing the corporate objectives.

Q. Do you have an exhibit to which you will refer in your testimony?
A. Yes.

Counsel: We ask that Mr. Thompson's Exhibit (JIT-1) consisting of four schedules be marked as Exhibit No. ____.

Q. Was this exhibit prepared by you or under your supervision and direction?
A. Yes.

Q. Are you the sponsor of certain Minimum Filing Requirements (MFRs)?
A. Yes. These are listed on Schedule 3 of my exhibit. To the best of my knowledge, the information contained in these MFRs is true and correct.

Q. Are there general or strategic purposes behind the proposed pricing?

A. Yes. This pricing package represents a move toward simplicity in our rates and continued recognition of the need for using pricing as a marketing tool to improve customer satisfaction. It seeks to create learning opportunities with our customers, to provide equity among customers, and to further Gulf Power's conservation efforts.

Q. Please describe the types of changes you have proposed to make to Gulf Power's current Tariff for Retail Electric Service.

A. The changes generally fall in three categories: (a) those made to simplify the pricing menu, (b) those made to meet customer expectations or improve the value of the rate or pricing program, and (c) a new pilot program, Gulf Power's FlatBill program, which will provide the Company important information about customer reaction to a new pricing structure. Additionally, the overall rate levels have been adjusted to achieve the target overall revenue level; and I will further discuss this important aspect of the Company's proposal after addressing the Tariff changes just mentioned.

Q. What changes have been made primarily to simplify Gulf Power's pricing?

A. There are five such changes. They are: (1) the elimination of Rates RST and GST, (2) the elimination of the Supplemental Energy (SE) Rate Rider, (3) merging subparts OS-I and OS-II of Rate Schedule OS, (4) simplifying the Standby and Supplementary Service Rate, Rate SBS, and (5) changing the applicability of the Budget Billing optional rider.

Q. Please describe the first of that category of changes you mentioned involving Rates RST and GST.

A. Rates RST and GST have been eliminated. These are traditional Time-of-Use rates that have existed for over 20 years as alternative rates for residential and small commercial customers. There has simply never been any significant interest in these rate structures by our customers. The number of customers on Rate RST has dwindled over the last several years. Gulf Power currently has only 13 residential customers on Rate RST. There is only one customer on Rate GST. There are better alternatives now for these customers, and we can improve efficiency by eliminating these two rates.

Q. Please describe the second change in this category.

A. Gulf proposes to eliminate the Supplemental Energy (SE) Rate Rider. This rider was developed in the mid-1980s, and its usefulness has been surpassed by more recent offerings such as Real Time Pricing (RTP). There are only a half dozen customers currently on this rate rider, and no (kWh) sales attributable to this rider are included in the test year sales forecast as part of this case. The SE Rider represented a good option in the 1980s, but technological capability and market needs have rendered it obsolete.

Q. What is the third change proposed to simplify Gulf's Tariff?

A. Gulf proposes to merge subparts OS-I and OS-II of Rate Schedule OS, which is the Company's Outdoor Service rate. Some of the same fixtures currently appear in both of those subparts, and merging the two serves to simplify the tariff and avoid unnecessary complication for customers and employees.

Q. Please describe the fourth change mentioned earlier.

A. The Standby and Supplementary Service Rate, Rate SBS, proposed here is a simplified and improved version of Gulf's current SBS Rate. The current rate is complicated, and it is difficult for our affected customers to be able to predict or understand the economic consequences of their operational decisions related to their on-site generation. The simplified version included in this proposal makes this easier for our customers and represents a better approach toward pricing this service.

Q. What is the fifth change proposed primarily to simplify Gulf Power's pricing?

A. Gulf has proposed changes to the Budget Billing (Rate Schedule BB) optional rider. In the "Applicability" section of that optional rider, we have added references to Rates RSVP, GSTOU, PX, PXT and RTP. RSVP is a residential rate that is associated with Gulf Power's **GoodCents** *Select* program. The Budget Billing optional rider should be applicable to this rate just as it is to our other residential rates. Rate GSTOU is a new, optional rate for customers currently on Rates GSD or GSDT, both of which are eligible for Budget Billing. Similarly, since BB is applicable to Gulf's other industrial and large commercial rates, we have proposed to extend its applicability to our Real Time Pricing Rate, schedule RTP, as well as our large, high load factor rate schedules PX and PXT. Budget Billing is not a price. It does not affect the rate that customers pay for retail electric service. Rather, it is intended to smooth the bill payment stream. The total amount owed for retail electric service is unaffected. A phrase in the "Billing" section has been deleted to make the section more understandable.

Q. You mentioned Outdoor Service rates. Are there other changes that the FPSC could consider, in addition to those already discussed?

A. As in the past, Gulf has included for approval all of the prices and terms for each of Gulf Power's various Outdoor Service lighting offerings. The Company currently offers street and highway lighting under subpart OS-I of Rate Schedule OS. General Area lighting, such as parking lot lighting, is currently covered by subpart OS-II of Rate Schedule OS. As part of this case, Gulf proposes to merge those two sets of prices into a single subpart for Outdoor Service – Lighting. Each time the Company introduces a new offering in this category, this has historically been filed with the Commission for approval. However, there may be a more efficient way to handle this in the future.

Gulf requests that the Commission approve a methodology, or approach, for modifying Outdoor Service lighting rates, rather than requiring specific approval of the new or revised product offering. Schedule 1 of my exhibit provides an example of the suggested methodology or approach. The rates for merged OS-I/II proposed in this case were developed using the methodology shown in Schedule 1. There are three sections in Schedule 1: Section A – Fixtures, Section B – Poles and Additional Facilities, and Section C – Relamping Service Agreement. In order to determine any of the three prices, the user would simply key in the values shown in the shaded areas of the appropriate section. The prices would then be determined as detailed in the unshaded areas of each section. As the Company adds to, or modifies, its products offered in this category, the pricing and terms would then be completed and the new product brought to market at lower transaction costs. Under the present system, the transaction costs associated with filing for specific approval of each new or modified Outdoor Service lighting product can be substantial and can even delay or inhibit the market introduction of such products.

Again, the tariff sheets accompanying this filing include all of our Outdoor Service lighting products and are submitted for specific approval as in the past. Included are the additions of three new decorative fixtures, one new pole type, the elimination of the coastal off-road luminaire, a provision for changing fixture types before contract expiration, and new kWh for high pressure sodium vapor and metal halide fixtures.

I encourage the Commission to refine the approval process for these products, and the attached schedule offers such an approach. We request the Commission approve this methodology for future use.

Q. What are the changes that you have proposed that are primarily intended to meet customer expectations or add value to a program?

A. There are four such changes included in this package. They are: (1) a modification to Rate RSVP, which is the rate accompanying Gulf's **GoodCents** *Select* Program, (2) the Term of Contract provision of Rate RTP, (3) a new optional rate schedule, and (4) retention of subpart OS-IV, which is for recreational lighting.

Q. Please describe the modification Gulf is proposing to Rate RSVP.

A. We are proposing a change to Rate RSVP, which is the rate accompanying our **GoodCents** *Select* Program. Gulf Power is proposing a reduction in the number of hours in the High (P_3) pricing period in the May through October season. The current P_3 pricing period in the May through October season is 11 a.m. to 8 p.m. Monday through Friday. The proposed P_3 pricing period in the May through October season is 1 p.m. to 6 p.m. Monday through Friday. This modification will result in four hours shifting from the P_3 pricing period to the Medium (P_2) pricing period. The new P_2 pricing period in the May through October season would be 6 a.m. to 1 p.m. and 6 p.m. to 11 p.m. Monday through Friday.

The Low (P_1) pricing period's hours would not be affected by the proposed change nor would the pricing periods in the weekends. The November through April season pricing periods also would not be affected by the proposed change.

Q. Have the prices themselves changed within Rate RSVP?

A. Yes. Prices have changed proportionally to reflect the change in the hours being shifted from the P_3 pricing period and to adjust the overall rate level for the proposed rate increase. All four prices have been adjusted. Also, the Customer Charge has been revised to correspond to the standard residential rate, Rate RS, Customer Charge of $12.00.

Q. Why is Gulf Power proposing these modifications to the RSVP rate?

A. The modifications will enhance the rate schedule and add customer value. This is expected to result in a greater number of customers choosing to participate in Gulf Power's **GoodCents** *Select* program.

Q. Why are you reducing the number of hours that the High (P_3) price is in effect?

A. While customers on the RSVP rate have responded to the prices, there has been specific customer feedback regarding the length of the P_3 pricing period in the summer season. This customer feedback, from both participants and non-participants, indicates that the P_3 period in the summer season is currently acting as a disincentive for participation. The proposed change modifies the P_3 period to effectively remove the disincentive while preserving the customer benefits.

The proposed modification to the P_3 pricing period is expected to increase the rate of customer participation and reduce the risk of current participants choosing to discontinue their participation. The overall conservation benefits associated with this program could be expected to improve with such increased participation results, since no adverse effects on peak demand reduction per customer participant are expected with the modification to the High (P_3) period.

Q. Are there any other changes to the RSVP rate that Gulf Power is proposing?

A. Yes. Gulf Power has reassessed the costs associated with the equipment that is installed and maintained in households participating in the **GoodCents** *Select* program. As a result, we are proposing an increase in the Participation Charge and in the Re-installation Fee that is charged to customers who resume participation at the same location for the second time. The increased Participation Charge, at $4.95 per month, reflects increases in the cost of the specific equipment associated with a customer's **GoodCents** *Select* participation. The increased Re-installation Fee, at $179.00, reflects increases in labor costs associated with installation of this equipment. All **GoodCents** *Select* customers are charged the monthly Participation Charge; but the Re-installation Fee, which is a one-time charge, is only charged to customers who discontinue **GoodCents** *Select* participation and subsequently resume participation at the same location.

Q. What is the second change proposed primarily to meet customer expectations or add value to a program?

A. The Company proposes to change the Term of Contract provision of Rate Schedule RTP, Real Time Pricing, from five years to one year. RTP was introduced as a pilot program at Gulf Power in early 1995. Following the successful four and one-half year pilot program, Gulf Power requested, and this Commission approved, RTP as an ongoing part of Gulf's Tariff. Also, at that transition in September of 1999, a few changes were made to

Rate RTP, one of which was to change the Term of Contract provision to five years, where it stands today.

Q. Why do you want to change the provision back to one year?

A. The pilot program worked well with no such five-year provision, and we have found in the two years since the transition that the perceived risk associated with the five year term inhibits customer participation in Rate RTP. We have gained only one RTP customer in this two year period, and several who have considered RTP and rejected this optional rate have stated that the five year commitment was the "deal breaker."

It would be to the advantage of all parties to contract for shorter time periods. Changes in our industry and the market require that we maintain more flexibility.

Q. Please describe the new optional rate schedule being proposed, which is the third change in this category.

A. We have included in the set of rates and prices accompanying this filing a new optional rate schedule, Rate GSTOU. In addition to meeting our customers' expectations, there are other benefits of this proposal.

One of the more frequently asked questions by Gulf's business customers is why Gulf doesn't have additional rate options from which to choose. Within the commercial class of customers, there is a broad range of customer types with varying energy usage patterns and different capabilities. By having choices in rates, these customers are more in control of their energy costs.

Because of this, Gulf is proposing a new, optional rate for customers between 20kW and 500kW. Rate GSTOU represents a different structure from the current options available to these customers, since it does not contain a distinct demand (kW) charge.

Q. What does the new rate structure look like?

A. It consists of a monthly Customer Charge, along with seasonal time-of-use energy-demand charges expressed in cents per kWh.

Q. What other benefits are expected from the addition of this new rate in addition to the customer satisfaction improvements associated with meeting customer expectations?

A. Other benefits include an improvement in simplifying our pricing structure available to these customers. Many of our business customers have difficulty in understanding the application of demand (kW) charges. As a result, our employees are frequently put in a position of explaining these complex rates to customers in a variety of situations. The new optional rate, without a distinct demand (kW) charge, is nearly as simple as our current residential rate and would allow our customers to more effectively manage energy costs.

Another benefit of this new offering is the load shifting potential. Since the new rate contains time-of-use features, customers have the opportunity to save money by shifting load.

Q. Is the fourth change in this category, your proposal to retain subpart OS-IV, really a change?

A. No. The fourth change proposed to meet customer expectations/improve value is not a change at all, but a proposal to retain a current offering. OS-IV is Gulf Power's recreational lighting rate. At the conclusion of Gulf's last rate case, Docket No. 891345-EI, the Commission ordered the Company to discontinue offering subpart OS-IV as part of Gulf's next rate case. However, Gulf's customers need continued access to this rate.

One of the Commission's significant areas of concern in Docket No. 891345-EI was the absence of research data to support the then new OS-IV provision. Following the conclusion and final order in Gulf's last rate case, the Company conducted research to obtain better load and usage information from OS-IV customers. A brief description of these efforts the Company would undertake was contained in Late Filed Exhibit No. 7 for Gulf's witness Tom Kilgore in Docket 891345-EI. Consistent with the Company's plans outlined in that exhibit, and after that case was concluded, a study was conducted on all OS-IV customers. This study indicated, among other things, that there was virtually no effect on any of the Company's monthly peak demands from any of these customers.

Gulf now has over ten years of experience with this pricing arrangement. It has worked well for these recreational lighting customers and for Gulf Power.

The research conducted subsequent to the Company's last rate case, the length of time that has passed since that case, and our market experiences with the affected customers all necessitate Gulf Power retaining subpart OS-IV of the OS rate.

Q. Please describe the new pilot program proposed by Gulf involving a new pricing structure.

A. The Company proposes to introduce Gulf Power's FlatBill pilot program. This is a pricing program which offers residential and small commercial customers the opportunity to purchase retail electric service at a fixed or flat monthly bill amount, customized for each customer. We believe this may be a valuable energy product/price optional package that will be well received by our customers. The pilot program will give us the opportunity to test this program.

Q. Has such a program been tested before?

A. Yes. Georgia Power's FlatBill pilot program began in June, 2000. That pilot program has proved successful for the participating customers and Georgia Power. Since the pilot proposed by Gulf Power is essentially the same as that conducted by Georgia Power, we have the advantage of having a preview of what we expect the pilot results will look like, unlike some other pilot programs.

Q. Do you have a detailed description of Gulf Power's proposed FlatBill pilot program?

A. Yes. Schedule 2 of my exhibit describes in detail the proposed Gulf Power FlatBill pilot program.

Q. In addition to the three categories of changes you have described, are there other enhancements proposed to Gulf's Tariff?

A. Yes. Gulf has proposed new or revised charges for eleven Service Fees. The cost data which supports these charges has been provided by Mr. Saxon on his Schedule 5. The amount of revenue increase associated with these new or revised charges serves as an adjustment, a reduction, to the amount of overall revenue increase needed from retail base rate schedules.

Q. Is the package of rates and prices that you propose designed to achieve the overall revenue level in the test year to which Mr. Labrato has testified?

A. Yes. Gulf's overall rates menu is designed to achieve a total target test year retail revenue increase of $69,867,000.

Q. Is the Company proposing to implement a change in how Florida Gross Receipts tax is billed?

A. Yes. Gulf Power's current retail base rates include 1.5 percent Florida Gross Receipts tax. This amount is included in the base rate charges shown on the Company's current retail tariff sheets. In addition to this amount included within Gulf's current base rates, customers are billed as a separate line item on the bill, 1 percent Florida Gross Receipts tax.

The Company is proposing, in this case, to extract the 1.5 percent Florida Gross Receipts tax from base rates and combine that amount with the 1 percent amount on the separate line item on our customers' bills.

That separate bill line item would then reflect the total Florida Gross Receipts tax of 2.5 percent.

Q. How has the removal of the Florida Gross Receipts tax from base rates been handled in this increase amount?

A. Florida Gross Receipts tax of $1,007,971 represents an adjustment, a reduction, to the amount of overall increase needed from retail rates.

Q. How did you determine which of the various rates to increase, and the amounts?

A. The total amount of annual revenue increase sought is $69,867,000, which represents a 20.2 percent increase over present base rate revenues for the test year. Two general limitations that have been followed in fairly allocating this amount of increase to the various classes of customers are: (1) that no class receive an increase greater than 1.5 times the overall retail increase in percentage terms – that is, that no class receive a base rate increase greater than 30.3 percent, which is 1.5 times the 20.2 percent overall retail base rate increase; and (2) that no class receive a rate level decrease. The largest portion of the overall rate increase is to Gulf's residential customer class.

Q. Why do you propose to collect most of the increase from Gulf Power's residential customer class?

A. There are several reasons for this. First, Mr. O'Sheasy's present rate summary of the cost-of-service study reveals a rate of return for Gulf's residential class that is significantly below the overall retail average rate of return. A larger increase is needed to bring the return on investment for this class closer to the overall retail average at the new proposed revenue level.

Another reason is the sheer size of Gulf's residential customer class. Over half of Gulf Power's base rate retail revenues come from sales to residential customers. By revenue volume alone, the bulk of the rate increase would gravitate to this group of customers, even if the total increase were apportioned equally among all customer classes.

Value of service also is a factor in the allocation of the increase among classes. Gulf Power has enjoyed a 40 percent increase in its number of residential customers since the Company's last rate case. New and additional in-home activities, such as banking, shopping, and satellite and cable television, all make those services delivered to the home, including electric service, more valuable. Additionally, the proliferation of telecommuting, home-based businesses, and home equipment such as personal computers, microwave ovens, icemakers, and second refrigeration units makes retail electric service a higher value purchase for residential customers.

The number and scope of marketing programs and alternatives available to residential customers is another reason why it is appropriate to increase the overall rate level for this customer sector. Included in this filing, and discussed previously in my testimony, is a proposal to improve Gulf Power's **GoodCents** *Select* program by modifying Rate RSVP. Already a recognized successful and innovative program for residential customers, the modifications proposed will improve this program so that it offers even greater value to our customers. Also included in this filing is a proposal to initiate Gulf Power's FlatBill pilot program. This research will enable us to deliver and price energy services in ways that bring additional value to residential customers. Gulf Power's commitment to the residential market, and the opportunities, assistance, and choices offered these customers today and in the near future are factors in the allocation of the rate increase.

Q. Were the same types of considerations involved in allocating the remainder of the increase among the other classes of customers and rates?

A. Yes. A significant percentage increase is proposed for Gulf Power's Outdoor Service lighting customers. The rate of return from Mr. O'Sheasy's cost-of-service study, along with the product and service offerings for these customers, and the value of service are considerations which led to the increase allocated to this group of customers.

Subpart OS-III of the Outdoor Service class is the rate applicable to unmetered 24-hour-a-day facilities such as traffic signals and cable television amplifiers. We have allocated a small portion of the overall increase to this group of customers which, in relative terms, comprises a small portion of Gulf Power's annual revenues.

Portions of the overall rate increase have also been allocated to the rates for Gulf Power's small, medium, and large business customers. The percentage increases for these classes are lower than the overall retail average percentage increase. The rates of return for these classes, generally served by rates GS, GSD, and LP respectively, are above the retail average rate of return at present rate level as shown in the cost-of-service study.

Q. Is the allocation of the rate increase which the Company is proposing fair and reasonable?

A. Yes. It is a fair and reasonable allocation of the increase, all things considered.

Q. Has the Company proposed any changes to the Customer Charge?

A. Yes. The Customer Charge, which some might call a "base" charge, is a fixed monthly charge for each customer and is not related to the amount of electricity consumed during the month. Gulf is proposing increases to the Customer Charge rate components for two customer classes, residential and small commercial. The rates involved are rates RS, RSVP, and GS. Gulf proposes to increase the RS and RSVP Customer Charges to $12.00, and the GS Customer Charge to $15.00. Beyond this, there are no significant changes proposed to the Customer Charges of the other rates.

Q. Why are you proposing to increase the Customer Charge components of rates RS, RSVP, and GS?

A. The customer related costs from the cost-of-service study are significantly higher than our current Customer Charges for these rates and are actually even higher than the proposed Customer Charges. We have limited the increase in these Customer Charges to 50 percent above their current levels. There are important reasons for ensuring that, to the extent practical, costs of providing service to customers which are not related to the amount of consumption are recovered from fixed Customer Charges rather than including these amounts in the energy or demand charges. If these costs are included in the unit prices of energy consumed, then otherwise successful conservation efforts may result in revenue decreases for the Company which exceed the associated cost savings. This could lead to cost/benefit results which would render otherwise valid programs non cost-effective.

Also, each month Gulf Power has thousands of residential customer accounts whose monthly electric usage is zero. Customer related costs that are included in energy charges are not recovered at all from those customers.

The proposed Customer Charge levels are appropriate transitions from current Customer Charges and will help to avoid those results just mentioned. These Customer Charges are important rate components which recognize those costs that are not related to the amount of electricity consumed. Thus, the increased Customer Charges proposed for rates RS, RSVP, and GS are reasonable, and represent improvements in our pricing structure.

Q. What changes have been made to other rate components?

A. The overall levels of demand and energy charges have been increased in order to achieve the overall proposed revenue level for each rate class. As this has been done, the relationships between demand and energy charges, and between on-peak and maximum demand charges in Time-of-Use rates GSDT, LPT, and PXT have generally been preserved. We have designed our rates to ensure that the transitions from rate to rate, as consumption and load factor changes, are appropriate.

Q. Are the rates and charges proposed in this case fair and appropriate?

A. Yes. The rates, prices, and terms shown on the tariff sheets filed with this case will achieve the requested revenue level, represent fair and equitable pricing of Gulf Power's retail electric services, improve our pricing as a marketing tool, enhance conservation efforts, and provide opportunities to improve customer satisfaction with Gulf Power. I have included all of the revised Tariff sheets in Schedule 4 of my exhibit.

Q. Do you have any final comments with which you would conclude your testimony?

A. The changes and additions to Gulf Power's pricing menu proposed in this case are significant. These are very different times in the energy marketplace than what existed in 1989 when Gulf Power last came to this Commission with a general rate case. While some of what served us well in the 1980s is still applicable, some is not. We simply must be open to try new and diverse things. Pricing decisions, unlike capital or construction decisions, are not long-term decisions. Pricing tactics, even strategies, can be changed.

Q. Does this conclude your testimony?

A. Yes.

BY MR. BADDERS:

Q Mr. Thompson, will you please summarize your testimony.

A Yes. Good morning, Commissioners.

CHAIRMAN JABER: Good morning.

THE WITNESS: The purpose of my testimony is to present the set of rates filed by Gulf Power in this case. In addition to presenting the changes proposed to our pricing menu, my testimony explains that the proposed rates are designed to achieve the overall rate level, including the increase sought by Gulf Power in this case.

My testimony addresses the considerations that went into the allocation of the requested increase among the various customer rate classes and reasons for proposed increases to the monthly customer charges or, as some might call it, the base charges for two customer rate classes.

My testimony also describes the changes to demand charges and energy charges proposed which, A, achieve the overall revenue level for each rate class and, B, ensure that individual rate component modifications integrate cohesively across other related or affected portions of the overall rate package.

We have designed our standard and time-of-use rates to ensure that the transitions from current rates and the interactive effects among proposed rates are appropriate, and those are important considerations in developing a comprehensive rates package.

Finally, as I stated in the final lines of my prefiled testimony, these are very different times in the energy marketplace than what existed in 1989 when Gulf last came to this Commission with a general case. While some of what served us well in the 1980s is still applicable, some is not. We must be open to try new and diverse things.

Pricing decisions are important since they affect our customers directly; however, pricing decisions, unlike capital or construction decisions, are not necessarily long-term decisions. Pricing tactics, even strategies, can be changed. Thank you.

MR. BADDERS: Mr. Thompson is available for cross.

CHAIRMAN JABER: Thank you.

MR. ERICKSON: No questions.

MR. GROSS: No questions.

MR. PERRY: No questions.

MR. BURGESS: No questions.

CHAIRMAN JABER: Staff?

MS. STERN: No questions.

CHAIRMAN JABER: Well, now. Commissioners?

COMMISSIONER PALECKI: No questions.

CHAIRMAN JABER: Well, there will be no redirect. Mr. Thompson, I'm sorry. We wouldn't have made you do this, if

I would have known. We could have taken care of you last night. But it's their fault.

THE WITNESS: Thank you, Commissioner. Madam Chairman.

(Witness excused.)

MR. BADDERS: We'll move Exhibit, I believe, 40 into the record.

CHAIRMAN JABER: Exhibit 40 is admitted into the record without objection.

(Exhibit 40 admitted into the record.)

CHAIRMAN JABER: Okay. Mr. Burgess, I think we've got some of your witnesses.

MR. BURGESS: I think Mr. Schultz is, is next and our only remaining witness, Madam Chairman.

CHAIRMAN JABER: Let's, let's move, let's address Ms. Dismukes' testimony and her exhibit and Mr. --

MR. BURGESS: Oh, thank you. Thank you for the reminder.

We would ask that Ms. Dismukes' testimony be entered into the record as though read.

CHAIRMAN JABER: Okay. Hang on a second.

MR. BURGESS: Pursuant to agreement and stipulation accepted by the Commission that her testimony would be accepted without cross-examination.

CHAIRMAN JABER: Okay. The prefiled direct testimony of Kimberly H. Dismukes shall be inserted into the record as though read.

She had --

MR. BURGESS: She had --

CHAIRMAN JABER: -- KHD-1?

MR. BURGESS: That's correct, which would be a composite exhibit.

CHAIRMAN JABER: Is Composite Exhibit 41 for the hearing, and it shall be admitted into the record without objection.

(Exhibit 41 marked for identification and admitted into the record.)

MR. BURGESS: I'm sorry. That was 41?

CHAIRMAN JABER: What did you ask? What?

MR. BURGESS: I'm sorry. Would you tell me that exhibit number again?

CHAIRMAN JABER: Oh, 41.

MR. BURGESS: Thank you.

TESTIMONY
OF
KIMBERLY H. DISMUKES

On Behalf of the
Florida Office of the Public Counsel

Before the
Florida Public Service Commission

Docket No. 010949-EI

Q. **WHAT IS YOUR NAME AND ADDRESS?**

A. Kimberly H. Dismukes, 6455 Overton Street, Baton Rouge, Louisiana 70808.

Q. **BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?**

A. I am a partner in the firm of Acadian Consulting Group, which specializes in the field of public utility regulation. I have been retained by the Office of the Public Counsel (OPC) on behalf of the Citizens of the State of Florida to analyze portions of Gulf Power Company's (Gulf or the Company) application for a rate increase.

Q. **DO YOU HAVE AN APPENDIX THAT DESCRIBES YOUR QUALIFICATIONS IN REGULATION?**

A. Yes. Appendix I, attached to my testimony, was prepared for this purpose.

Q. **DO YOU HAVE AN EXHIBIT IN SUPPORT OF YOUR TESTIMONY?**

A. Yes. Exhibit__(KHD-1) contains 4 schedules that support my testimony.

Q. **HOW IS YOUR TESTIMONY ORGANIZED?**

A. My testimony is organized into two sections. In the first section, I address affiliate transactions between Gulf Power Company and its affiliates, focusing on the costs allocated to Gulf from Southern Company Services (SCS). In the second section, I address marketing expenses.

Section 1: Affiliate Transactions

Q. WHY IS IT IMPORTANT TO CLOSELY EXAMINE AFFILIATE TRANSACTIONS?

A. In a situation involving the provision of services between affiliated companies, the associated transactions and costs do not represent arms-length dealings. Cost allocation techniques and methods of charging affiliates should be frequently reviewed and analyzed to ensure that the company's regulated operations are not subsidizing the non-regulated operations. Because of the affiliation between Gulf and the affiliates that contribute to expenses included on the books of Gulf, the arms-length bargaining of a normal competitive environment is not present in their transactions. Although each of the affiliated companies is supposedly separate, relationships between Gulf and these affiliates are still close; they all belong to one corporate family.

In the absence of regulation, there is no assurance that affiliate transactions and allocations will not translate into unnecessarily high charges for Gulf's customers. Even when the methodologies for cost allocation and pricing have been explicitly stated, close scrutiny of affiliate relationships is still warranted. Regardless of whether or not Gulf explicitly establishes a methodology for the allocation and distribution of affiliate costs, there is an incentive to misallocate or shift costs to regulated companies so that the unregulated companies can reap the benefits.

Q. WOULD YOU PLEASE DESCRIBE THE SOUTHERN COMPANY ORGANIZATION?

A. Yes. Southern Company is a large, complex, and diverse organization, consisting of numerous affiliates that are engaged in regulated and nonregulated activities. The "Tier 1" affiliates, those owned or controlled directly by Southern Company, include the following companies:

<u>Operating Utilities</u>

Alabama Power Company ("APC")
Georgia Power Company ("GPC")
Gulf Power Company ("Gulf")
Mississippi Power Company ("MPC")
Savannah Electric and Power Company ("SEPCO")

<u>Service Companies</u>

Southern Company Services ("SCS")
Southern Nuclear Operating Company ("SNOC")

<u>Nonregulated Companies</u>

Southern Energy, Inc. ("SEI")
Southern Company Energy Solutions ("SES")
Southern Communications Services, Inc. ("SCSI")
Southern Telecom, Inc. ("STI")
Southern LINK Wireless ("SLW")
Southern Company Generation and Energy Marketing ("SCGEM")
Southern Electric Railroad Company ("SRC")
Southern Company Funding Corporation ("SCFC")
Southern Power Company ("SPC")
Southern Management Development, Inc.
Southern Information Holding Company, Inc. ("SIHCI")

In addition to these companies, there are numerous subsidiaries that exist below the first level of affiliates making up the Southern Company system.

Q. HAVE THE SOUTHERN COMPANY NONREGULATED ACTIVITIES CHANGED IN RECENT YEARS?

A. Yes there has been substantial growth in the Southern Company nonregulated activities in the last several years. Schedule 1 depicts the relationship of certain key statistics between the regulated electric companies and the nonregulated affiliates. As shown on this schedule, nonregulated assets have gone from comprising 3.87% of total assets in 1997 to 15.95% in 1999. Operating expenses show the same pattern, in 1997 nonregulated expenses comprised 19.15% of total expenses and in 1999 this had grown to 38.43%. Operating revenue of the nonregulated companies accounted for 15.06% of total revenue in 1997, compared to 27.54% in 1999. Officers and Directors of the nonregulated companies consisted of 27.82% of the total officers and directors in 1997; in 1999 they consisted of 40.31%. These statistics clearly demonstrate that there has been substantial growth in the nonregulated arena.

Southern Company intends to expand considerably in this area. According to a news release issued January 9, 2001, Southern Company received final approval from the Securities and Exchange Commission to form a new subsidiary that will own, manage and finance wholesale generating assets in the Southeast. The new subsidiary will market to wholesale customers in the fastest-growing wholesale electricity market in the nation.

According to the news release, Southern Company expects this new subsidiary to be one of its faster growing companies:

> "We expect that this will allow us to move faster and more aggressively in seizing wholesale opportunities throughout the South," said Charles McCrary, Southern Company chief production officer and president of Southern Company Generation. "We also believe this innovative approach to providing market-based wholesale generating assets continues to move our region toward competitive energy markets in a staged, orderly fashion. Our goal is to play a major role in serving the region's growth and to continue to expand our presence outside of our traditional core service territory."
>
> The new subsidiary, which will carry the legal name of Southern Power Company, will be the primary growth engine for Southern Company's market-based energy business. Energy from its assets will be marketed to wholesale customers under the Southern Company name.
>
> The current goal is to grow income from the new subsidiary by 15 percent annually so that in five years Southern Company earnings from wholesale market sales will more than double.
>
> By 2005, plans call for the new subsidiary to have developed or acquired more than 7,500 megawatts dedicated to the competitive wholesale business. Within 10 years, the new wholesale generating company is expected to own more than 15,000 megawatts.
>
> "But this is about more than growing our business," said McCrary. "It's also about doing it in a manner where we can minimize the environmental impact of our operations by using the most environmentally advanced generation technology available as we build and add new facilities. It's also about maintaining our reputation of high customer satisfaction."

Q. HOW DO THE AFFILIATES AFFECT THE COSTS GULF INCLUDED

IN THE TEST YEAR?

A. All SCS costs are allocated out to Southern affiliates. Gulf receives its allocated share of these costs. The SCS cost assignments (100% assigned to a specific affiliate) and allocations (allocated to various affiliates in accordance with numerous allocation factors) to Gulf are a function of the affiliates selected to receive services and/or charges and the factors used to allocate costs/charges. If the underlying data used to calculate the allocation factors is incorrect, this will cause either an under charge or an over charge to Gulf.

Q. **WHAT ALLOCATION FACTORS DID GULF USE DURING THE TEST YEAR TO ALLOCATE COSTS FROM SCS TO GULF?**

A. The allocation factors used to allocate costs to Gulf in the projected test year ending May 2003 were based upon data for 1999. In other words, if an allocation factor used revenue, the revenue data would have been for the year-ending 1999. As demonstrated on Schedule 1, given the rapid growth rate of the nonregulated affiliates, there is clearly an over allocation of costs to Gulf as a result of using 1999 allocation factors. In addition, in most instances, no costs were allocated to Southern Power Company, the new subsidiary the Southern Company expects to grow at a rate of 15% per year. According to the Southern Company's web site, under Investor Fact Sheet, Southern plans "to complete about 4,600 megawatts of additional competitive generation by the end of 2003 to serve the demand for growth in the 'Super Southeast' with 15,000 megawatts planned by 2010."

Although the costs of SCS for the test year reflect expectations for the year ending May 2003, there was no adjustment by Gulf to modify the allocation factors used to reflect what the year 2003 will look like relative to the data that make up the allocation factors. Schedule 2 shows the amounts allocated to each affiliate from SCS for the years 1999, 2000, 2001, and the projected test year. As can be seen on this schedule, no costs were allocated to Southern Power Company, despite the fact that it will have substantial investments in power plants during the test year. In fact, there are two subsidiaries that were formed in the year 2001 where no costs were allocated to these companies during the test year. These two companies are Southern Power Company and Southern Company Funding Corporation.

Q. IS GULF AND/OR SCS AWARE THAT SPC WILL BE OPERATING IN THE YEAR 2001?

A. Yes. In response to OPC's POD 40 Gulf produced certain documents related to costs and cost allocations from SCS. In a memorandum dated May 8, 2001 concerning 2001 Affiliate Billing Review, the memo addressed Southern Power Company. Specifically, it stated:

> As you are aware, Southern Power Company will begin operations this summer. In order to appropriately recognize the introduction of this new non-regulated affiliate, please pay particular attention to how your common costs are allocated. Recently, we received your preliminary indication of whether Southern Power should share in these costs, and the attached reports were built on this basis. This review will give you another chance to review the earlier decision...... (Response to OPC POD 40.)

In addition, there are forms that personnel fill out each year indicating whether or not allocation factors should be updated. One report dated May 22, 2001 indicated that the current allocations are correct recognizing that there may be issues regarding the incorporation of Southern Power Company on the insurance premium basis. Another respondent indicated that several allocation factors should be changed for 2001 to include SPC. In particular, the allocation factor entitled AOATL, which is Annual Operating Area Territorial Load, was changed from version 8, which did not include the load of SPC, to version 12, which did include the load for SPC. While some respondents indicated that for the year 2001 certain allocation factors should be changed to reflect SPC, many did not.

Q. **WHAT ABOUT SOUTHERN COMPANY FUNDING CORPORATION? WAS THERE ANY INDICATION THAT ALLOCATION FACTORS SHOULD CHANGE AS A RESULT OF THE ADDITION OF THIS NEW SUBSIDIARY?**

A. No. In the documents that I reviewed there was no indication that the allocation factors should be changed to reflect the allocation of costs to this new subsidiary.

Q. **WERE YOU ABLE TO CHANGE THE ALLOCATION METHODOLOGY USED BY GULF IN THE TEST YEAR TO REFLECT THE ADDITION OF THESE TWO NEW SUBSIDIARIES?**

A. I was able to modify the allocation factors for SPC, but I was unable to do the same for Southern Company Funding Corporation.

Q. **HOW DID YOU MAKE CHANGES TO THE ALLOCATION FACTORS FOR THE ADDITION OF SPC?**

A. In response to OPC Interrogatory 81, Gulf provided the allocation factors used for the test year. In this set of allocation factors there was data which contained information for

SPC, like KW load, revenue, expenses, investment, etc., for several allocation factors. While the data did not reflect the impact of this subsidiary for the year 2003, it reflected some level of activity for some allocation factors to be used in 2001. I modified the allocation factors used by Gulf for the projected test year to include additional allocations to SPC which reduced the allocation of costs to Gulf.

Q. DID YOU UTILIZE THE DATA PROVIDED IN INTERROGATORY 81 THAT INCLUDED SPC DATA TO DEVELOP THE ALLOCATION FACTORS?

A. Yes, I did, however, I modified the data for SPC to reflect what could be expected in the test year. In particular, the data supplied in response to OPC's Interrogatory 81 contained data for SPC that would appear to be relevant to the year 2001, not 2003. For example, for the allocation factor "fossil," which is based on the KW capacity of the various companies' plants, the figure used for SPS was 600,000 KW. As indicated above, Southern Company expects new generation from SPC to be 4,300,000 KW in the year 2003. Therefore, I modified the allocation factor to recognize that in the year 2003, there will be substantially more generation than reflected in the allocation factors for the year 2001. In addition, there were several other allocation factors where projected 2003 information was not readily available. For these factors I adjusted the amounts for SPC by increasing them by a factor of seven. This factor was derived based upon the relationship between the 2001 KW capacity of 600,000 KW compared to what is expected by the year 2003, which is 4,300,000 KW capacity at SPC. This comparison showed that the capacity in 2003 would be 7.167 times greater in 2003 than expected in 2001. Therefore, for allocation factors where there was data for 2001, I increased the amounts by seven.

There were some allocation factors where no information for SPC was included, in particular, allocation factors that use employees as the allocation basis. For these allocation factors I adjusted the factor for Gulf downward by average of the change in all other allocation factors where data was available. This resulted in a reduction in allocation factors of .45%. There were also some allocation factors that I did not modify, in particular, allocation factors that used customers as the basis for allocating costs.

I also modified two allocation factors used by the Company. There are two factors used to allocate SCS's costs which include revenue, expenses, and investment as the components that make up the allocation factor. I removed the revenue component from the allocation factor and used only investment and expenses. The two factors that used revenue are labeled "world-wide financial data" and "domestic financial data." Including revenue in these two allocation factors tends to under allocate costs to new nonregulated companies. Generally, new companies that are in the start-up phase of operations produce little revenue relative to investment and expenses. Therefore, I removed the revenue component from these two allocation factors.

Schedule 3 depicts the changes to the allocation factors that I recommend and the adjustment resulting from making these changes. As shown on this schedule, my recommended changes to the allocation factors result in a reduction to costs allocated to Gulf of $1.4 million.

Q. IS YOUR ADJUSTMENT CONSERVATIVE?

A. Yes. As explained above, I did not allocate any costs to Southern Company Funding Corporation and I did not reflect increases for growth in the other nonregulated companies. Therefore, the adjustment that I recommend is very conservative.

Q. DO YOU HAVE ANY OTHER ADJUSTMENTS RELATED TO COSTS ALLOCATED FROM SCS TO GULF?

A. Yes. During the test year, SCS allocated $1.6 million in costs to Gulf that are related to wholesale energy. In its MFRs, Gulf removed $304,000 of wholesale-related costs. I recommend removing the remainder of these costs which should not be passed on to retail customers. As shown on Schedule 4, my adjustment reduces test year expenses by $1.2 million.

Section II: Advertising Expenses

Q. WHAT IS GULF REQUESTING CONCERNING ITS ADVERTISING EXPENSES?

A. Gulf is requesting that it be allowed to recover advertising expenses in the amount of $1,144,952. In past proceedings, of this total amount, the Commission has disallowed advertising expenses related to enhancing the company's image and goodwill-type advertising. In the instant proceeding Gulf is requesting that it be allowed to include $550,221 of advertising expenses that have been previously disallowed. According to Ms. Neyman, it should be allowed to recover these costs because:

> Gulf Power Company depends on advertising as one of the primary methods of communication with our customers. This communication results in a greater awareness of the various products and services that

> are available to customers. These products and services are available to assist customer in making their home and businesses more enjoyable, comfortable and safe and provide for operation in a more energy efficient and, therefore, cost efficient manner. (Neyman Testimony, p. 14.)

What Ms. Neyman does not explain is that the advertising that has previously been disallowed by this Commission enhances the Company's image. For example, in response to OPC's POD 12, Gulf provided examples of the types of ads that have been disallowed in the past. The first example is an advertisement about reliability and talks about how different families use electricity. At the end it states, "A morning made possible by Gulf Power. Our proven reliability creates dependable relationships." The next example is similar, however, in it different families use electricity in the evening. At the end of the advertisement it states: "An evening made possible by Gulf Power. With some of the lowest rates in the country, it's what we call a valuable relationship." The third example, a TV ad, has a Gulf Power employee in a bucket truck, with a voice saying: "With the lowest rates in Florida, we make the power that puts you in control. Gulf Power and you. A valuable relationship. We stay on the go so you're not left standing still." A fourth example is similar to the third, and has a Gulf Power employee guiding a power pole into the ground, with a voice saying: "We go to great lengths so you don't have to. Gulf Power and you. A dependable relationship."

Of all of the examples provided by Gulf, not one addressed issues that inform the customer about products and services available to assist customers "in making their home and businesses more enjoyable, comfortable and safe and provide for operation in a more energy efficient and, therefore, cost efficient manner," as suggested by Ms. Neyman. These ads do nothing to inform the customers, they merely enhance Gulf's image with its customers. The Commission should disallow these costs as it has consistently done in the past. For example, in Order No. PSC-96-1320-FOF-WS, the Commission disallowed advertising costs related to image enhancement:

> We agree with OPC that advertising expense only for image enhancement purposes should not be borne by ratepayers because it only benefits stockholders. However, we also recognize that the utility's conservation efforts need to gain support and trust from its customers in order to be successful. Based on a review of the budget and the foregoing discussion, we do not believe that advertising expense for statewide communication can be separated between cost for informing customers and gaining public support for conservation and cost for image enhancement.

Gulf has provided no information to support its case that image enhancement advertising expenses should be borne by ratepayers. Accordingly, I recommend that the Commission remove $550,321 from test year expenses.

Q. DOES THIS COMPLETE YOUR TESTIMONY PREFILED ON DECEMBER 27, 2001?

A. Yes, it does.

CHAIRMAN JABER: The prefiled direct testimony of Michael J. Majoros shall be inserted into the record. And he had a number of exhibits, Mr. Burgess; correct?

MR. BURGESS: Yes. He had Exhibits 1 through 5, and they can be identified as a composite exhibit.

CHAIRMAN JABER: Okay. They look pretty comprehensive. Do you -- are you -- the parties are okay with identifying all five exhibits as one composite?

MR. STONE: Yes, Commissioner, since those issues have been stipulated.

CHAIRMAN JABER: Oh, okay. Composite Exhibit 42 will be MJM-1 through MJM-5.

MR. BURGESS: Thank you. And I --

CHAIRMAN JABER: And will be admitted into the record without objection.

(Exhibit 42 marked for identification and admitted into the record.)

GULF POWER COMPANY
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
PREPARED DIRECT
TESTIMONY OF MICHAEL J. MAJOROS. JR.
DOCKET NO. 010949-EL

INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Michael J. Majoros, Jr. I am Vice President of the economic consulting firm of Snavely King Majoros O'Connor & Lee, Inc. ("Snavely King"). My business address is 1220 L Street, N.W., Suite 410, Washington, D.C. 20005.

Q. PLEASE DESCRIBE SNAVELY KING.

A. Snavely King was originally founded in 1970 to conduct research on a consulting basis into the rates, revenues, costs and economic performance of regulated firms and industries. The firm has a professional staff of 10 economists, accountants, engineers and cost analysts. Most of the firm's work involves the development, preparation and presentation of expert witness testimony before Federal and State regulatory agencies. Over the course of the firm's 31-year history, its members have participated in over 500 proceedings before almost all of the state commissions and Federal commissions that regulate utilities, telecommunications companies and transportation industries.

Q. HAVE YOU PREPARED A SUMMARY OF YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. Appendix A is a summary of my qualifications and experience. It also contains a tabulation of my appearances as an expert witness before state and Federal regulatory agencies.

Q. FOR WHOM ARE YOU APPEARING IN THIS PROCEEDING?

A. I am appearing on behalf of the Florida Office of Public Counsel ("OPC").

Q. **WHAT IS THE SUBJECT OF YOUR TESTIMONY?**

A. Depreciation is the subject of my testimony.

Q. **DO YOU HAVE ANY SPECIFIC EXPEREINCE IN THE FIELD OF PUBLIC UTILITY DEPRECIATION?**

A. Yes. I and other members of my firm are specialists in the field of public utility depreciation. We have appeared as expert witnesses on depreciation before the regulatory commission of almost every state in the country. I have testified in over 80 proceedings on the subject of public utility depreciation and represented various clients in several other proceedings in which depreciation was an issue but was settled. I have also negotiated on behalf of clients in several of the Federal Communications Commissions' ("FCC") Triennial Depreciation Represcription conferences.

Q. **HAVE YOU EVER APPEARED BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION ("FPC")?**

A. Yes. In the late 1980's and early 1990's I appeared on behalf of the OPC and more recently I appeared on behalf of AT&T and MCI. All of those prior appearances addressed telephone depreciation rates.

Q. **DOES YOUR EXPERIENCE SPECIFICALLY INCLUDE ELECTRIC COMPANY DEPRECIATION?**

A. Yes. I have testified in twenty proceedings on the subject of electric company depreciation, and I have prepared testimony in six electric proceedings in which depreciation was ultimately settled.

OBJECTIVE OF TESTIMONY

Q. WHAT IS THE OBJECTIVE OF YOUR TESTIMONY?

A. OPC requested that I review the reasonableness of Gulf Power Company's ("GPC") proposal to reduce the depreciable life for its Smith Unit 3 from 30 to 20 years. I will also provide my observations concerning certain elements in GPC's May 29, 2001 depreciation study.

SMITH UNIT 3 LIFE CHANGE

Q. PLEASE EXPLAIN GPC'S SMITH UNIT 3 LIFE CHANGE.

A. Gulf Power is constructing a new 574-megawatt (MW) combined cycle unit at Plant Smith. Smith Unit 3 is expected to begin commercial operation on or before June 1, 2002.[1] Mr. Labrato, GPC's Chief Financial Officer and Comptroller, presents GPC's financial forecast which is the basis of the projected data for the test period which in turn results in a revenue deficiency.[2] The revenue deficiency is driven primarily by the commencement of service by Smith Unit 3.

Mr. Labrato's Schedule 4 is the projected Income Statement for the Twelve Months ended May 31, 2003.[3] The totals from Schedule 4 are carried forward to Mr. Labrato's Schedule 8 which is his Summary of Net Operating Income for the Twelve Months ended Many 31, 2003. Mr. Labrato then posts adjustments to the projected figures. Adjustments 17 and 20 were made to reflect the Company's proposed depreciation rates and dismantlement accruals which were filed on May 29, 2001 in

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[1] Direct Testimony of Ronnie R. Labrato, Docket No. 010949-EL ("Labrato"), p. 4.

[2] Id., p. 2-3.

[3] Id., p. 11.

Docket No. 010789-EL.[4] According to Schedule 8 these adjustments would increase jurisdictional depreciation by $795,000.[5]

The May 29, 2001 depreciation study proposed rates based on December 31, 2001 balances, and therefore did not include Smith Unit 3 which is expected to go in-service in the Spring of 2002.[6] According to Mr. Labrato, the original forecasted depreciation expense for Smith Unit 3, included as part of his Schedule 4, was calculated using a 30-year depreciable life for Smith Unit 3.[7]

GPC now proposes to change the life from 30 to 20 years, thus increasing depreciation expense and the revenue deficiency. Subsequent to the development of its original financial forecast GPC requested an opinion from Deloitte & Touche, the firm that conducted the May 29, 2001 depreciation study. Deloitte & Touche recommended a 20-year average service life.[8] Mr. Labrato's adjustment 21 reduces NOI consistent with Deloitte & Touche's recommendation.[9] This adjustment increases jurisdictional depreciation expense by $3,383,000.[10]

Q. WHAT WAS THE BASIS FOR THE ORIGINAL 30-YEAR LIFE MR. LABRATO USED FOR SMITH UNIT 3?

A. Exhibit___(MJM-1) is Mr. Labrato's response to Citizens 1-16 which states that "Mr. Labrato chose an estimated depreciable life of 30 years for Smith Unit 3 based on

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[4] Id., p. 19.

[5] Labrato Schedule 8, page 3.

[6] Labrato, p. 20.

[7] Id.

[8] Id.

[9] Id.

[10] Labrato Schedule 8, page 3.

estimated average service lives of other combined cycle projects within Southern Company."[11]

Q. HOW DOES THIS 30-YEAR AVERAGE LIFE COMPARE TO THE AVERAGE LIVES GPC USES FOR THE OTHER UNITS AT PLANT SMITH?

A. Exhibit___(MJM-2) is a two page exhibit taken from GPC's May 29, 2001 depreciation study. These two pages summarize the Deloitte & Touche's recommendations relating to the two steam units and the existing combustion turbine at Plant Smith.

Deloitte & Touche used the life-span method to calculate the depreciation rates. The life-span method is a procedure to calculate an average service life or average remaining life based on an assumed overall life span of a unit. A life span is the period between the commencement in service and final retirement of the unit. These life spans are then weighted for piece part interim retirements to calculate average service lives or average remaining lives.

Deloitte & Touche used 50-year life spans for the Plant Smith Steam Units 1 and 2 to calculate an overall 29-year average service life. The significant difference between the 50-year life spans and the 29-year average service life results from the assumption of a substantial amount of interim retirements in the future.

Deloitte & Touche assumed a 35-year life span for the existing combustion turbine unit at Plant Smith. This unit is included in the "Other Production" function (account nos. 340-346) on GPC's books.[12] Deloitte & Touche calculated a 30-year average service life based on the 35-year life span and assumed interim retirements for

[11] Labrato Response to Citizens' First Set of Interrogatories, Item No. 16 ("Citizens' 1-16'), attached as Exhibit___(MJM-1).

[12] Smith Unit 3 will also be recorded in Other Production function.

the combustion turbine. Hence, it is quite possible that Mr. Labrato was also aware of this 30-year average service when he originally prepared his Schedule No. 4 which included Smith Unit 3 depreciation expense based on a 30-year average service life.

Q. IS THERE AN OTHER EVIDENCE AVAILABLE RELATING TO THE SMITH UNIT 3 LIFE?

Confidential Information Follows

A. Yes. Exhibit____(MJM-3) is a copy of a confidential document titled Southern Company – System Design Lansing Smith Unit 3 Combined Cycle Plant Revision C." Section 2.2 addresses Design Life. Section 2.2.1 indicates that the selection of design options is based on an "economic life" of the combined cycle Plant of 20 years. However, sections 2.2.2 to 2.2.5 belie the 20-year economic life assumption. The Mechanical Design Life is typically 30-40 years, the Electrical Design Life is 30-40 years and the Civil Design Life is 30-40 years. Only Control Systems (which are subject to interim retirement) are 15-20 years. Hence, it is reasonable to assume that Southern Company would have selected a 30 year average service life from this set of Design Life specifications, just as Mr. Labrato says it does in his response to Citizens 1-16.

End of Confidential Information

Q. What is an economic life?

A. The conventional NARUC definition of economic life is the "total revenue producing life of an asset."[13] This definition would also suggest an average life of 30 to 40 years for Smith Unit 3, given the Design Life information described above. Smith Unit 3 is designed to last from 30 to 40 years and presumably will produce revenue throughout those years.

Q. AT THE BOTTOM OF HIS RESPONSE TO CITIZEN'S 1-16, MR. LABRATO STATES "HOWEVER, CONSIDERING THE FACT THAT COMBINED CYCLE UNITS ARE RELATIVELY NEW TECHNOLOGY AND THAT PERIODIC MAINTENANCE AND CAPITAL ADDITIONS ARE EXPECTED, THERE WILL BE INTERIM RETIREMENTS INDICATING A SHORTER AVERAGE LIFE." DO YOU AGREE?

A. No. Since, the 30-year life is an average life, interim retirements are already assumed in the 30-year life, just as Deloitte & Touche's 30-year life for the Other Production Function.

Q. WHAT DO YOU CONCLUDE?

A. I conclude that all available evidence within the Company supports a 30-year average service life for Smith Unit 3.[14] I also conclude that this is a minimum average service life. The Company's own design criteria suggests that an longer life could be used.

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[13] National Association of Regulatory Public Utility Commissioner's, Public Utility Depreciation Practices, August 1996 ("NARUC Manual") p. 318.

[14] For example, a 30-year average service life would assume a fairly long life-span, say 45-55 years, with a substantial amount of interim retirements.

NATIONAL LIFE STUDIES

Q. DO YOU HAVE ANY EMPIRICAL STUDIES FROM WHICH WE MAY DRAW INFERENCES CONCERNING THE REASONABLENESS OF GPC's 20-YEAR LIFE?

A. Yes. Exhibit___(MJM-4) is my firm's National Study of U.S. Steam Generating Unit lives – 50 MW and Greater ("National Study"). This study uses analytical techniques generally accepted in the utility industry and a data base maintained by the U.S. Department of Energy.[15] The study concludes that U. S. Steam Generating Units 50 MW or greater are experiencing in average life spans of approximately 55 years and that these spans are lengthening almost on a year-to-year basis.

Q. HAS YOUR FIRM ALSO CONDUCTED NATIONAL STUDIES OF OTHER PRODUCTION UNIT RETIREMENTS?

A. Yes. We have also studied national retirements of Other Production units. We employed Energy Information Administration Form 860 data from all units designated as Jet Engine (JE), Combustion Turbine (CT), Gas Turbine (GT) and Internal Combustion (IC). The following table shows the composition of the data base.

[15] The study is an actuarial retirement rate analysis, using the Energy Information Agency's Form 860 database of aged generating unit retirements and exposures. A full band (1918-99) and both rolling and shrinking analyses were conducted.

	Type of Peaking Unit				TOTAL
	JE	GT	IC	CT	
Operable	129	1354	2814	107	4407
Retired	1	116	1443	0	1559
TOTAL	130	1470	4257	107	5963

These technologies are in various stages of introduction as evidenced by the virtual lack of unit retirements in the JE and CT classifications. What they have in common, however, is the way that they are used. All are used primarily to meet short-term peaks in demand. Our study is included as Exhibit___(MJM-5). It is based on a full band (1899-1996) and a shrinking band analysis, and indicates lives of approximately 45 years at a minimum which have lengthened in recent years to as long as 55 years.

Q. WHAT ARE YOUR CONCLUSIONS BASED ON YOUR NATIONAL LIFE STUDIES?

A. I conclude that the Company's original 30-year average life is far below, by 15 to 25 years, the national average of life spans being experienced by the Steam Production and Other Production Plants in the United States. I recognize that the combined cycle units are considered to be new technology. That is why it is virtually impossible to conduct a National Study of Combined Cycle retirements. Smith 3 will not be used for the peaking function normally fulfilled by the units in the Other Production function but rather it will be used primarily as a base load unit.

Nevertheless, these national studies provide a range of reasonableness for the initial life assumptions for the state-of-the-art Smith 3 combined cycle unit.

One of the incentives to construct combined cycle plants is their relatively low capital costs compared to base load steam units. An arbitrary reduction from a 30-year life to a 20-year life effectively eliminates, from the customers perspective, any capital cost advantages of combined-cycle technology.

Q. HAVE YOU CONDUCTED ANY OTHER INVESTIGATIONS OF THE SMITH UNIT 3?

A. Yes. My associate, William M. Zaetz, has substantial experience in the building and maintenance of all types of steam and other production plants. Mr. Zaetz conducted research regarding combined cycle units and actually visited Smith Unit 3. Based on his experience, research and his physical observations, Mr. Zaetz concluded that he has found nothing that would lead him to assume that Plant Smith Unit 3 would have a shorter life than the 55 years resulting from our National Study of Steam Plants 50 MW and Greater.

Q. WHAT DO YOU RECOMMEND?

A. I recommend that the Company's original 30-year average life for Smith Unit 3 be retained. It is supported by the Company's own internal studies and planning, it is consistent with the proposals in the Company's depreciation study, it is quite conservative when considered in conjunction with our National Life Studies, and it is conservative based on Mr. Zaetz's experience, research and observations. To shorten the life merely creates an artificial increase to the Company's revenue requirements. If any changes are to be made, the 30 years should be lengthened, not shortened.

MAY 29, 2001 DEPRECIATION STUDY

Q. WHAT ARE YOUR OBSERVATIONS CONCERNING GPC'S MAY 29, 2001 DEPRECIATION STUDY?

A. In general it appears that the study results in excessive depreciation for at least two reasons. First, several of the production plant life spans assumed in the study are much shorter than the life spans indicated by my National Studies. Unless the Company can support these life spans with various kinds of studies including economic analyses, the life span study:

> … is analogous to a building which is structurally well built from the ground up but lacking in sound and proper foundation.[16]

Without this type of support, the results of my National Studies should be used. If they are, then depreciation rates will be substantially reduced.

Q. WHAT DO YOU RECOMMEND?

A. I recommend that the Commission establish a minimum 55 year life span for any steam production unit and a minimum 45 years life span for any unit to be included in the Other Production Function and require the studies identified at page 146 of the NARUC Manual for any reduction to those minimums.

Q. WHAT STUDIES DOES THE NARUC MANUAL REQUIRE?

A. The NARUC Manual requires:

- Economic studies
- Retirement plans
- Forecasts
- Studies of technological obsolescence
- Studies of adequacy of capacity

[16] NARUC Manual, p. 146.

- Studies of competitive pressure[17]

Q. HAVE YOU REQUESTED THESE STUDIES FROM GPC?

A. Yes, I requested the studies in OPC Interrogatory 92, however, I have not received a response.

Q. HAVE YOU QUANTIFIED THE IMPACT OF THESE LONGER LIFE SPANS?

A. No. Numerous calculations are required to quantify the impact of the longer life spans. In OPC POD 60 I requested the electronic data necessary to make these calculations, but I have not received a response. Nevertheless, I believe that such an adjustment would probably result in a decrease to the existing depreciation rates. Consequently, at a minimum the Company's depreciation study increase should be disallowed.

Q. WHAT IS THE SECOND REASON THAT THE MAY 29, 2001 DEPRECIATION STUDY RESULTS IN EXCESSIVE DEPRECIATION?

A. The May 29, 2001 depreciation study results in excessive depreciation because it assumes all of its existing plants will be decommissioned and dismantled. This assumption results in current charges to consumers.[18] However, it is unlikely that decommissioning and dismantlement will occur.

Q. DO YOU HAVE ANY CORROBORATION FOR THESE OBSERVATIONS?

A. Yes. The accompanying testimony of William Zaetz describes a survey he has conducted of steam generating units that have been retired since 1982. As of this writing, Mr. Zaetz has been able to determine the present status of 81 out of the 148 steam generating units that fit this description. He reports that only 13 of these plants have been dismantled, and

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[17] Id.

[18] The current rates include \$5.7 million and the proposed rates include \$5.6 million of dismantling costs. See Depreciation Study, May 29, 2001 Transmittal Letter to Blanca S. Bayo.

of these only five have been returned to their original "Greenfield" condition. Sixty-eight units, or 84 percent of the retired generating units remain in place without dismantlement.

Q. WHAT DO YOU RECOMMEND?

A. I recommend that the Commission reconsider the issue of dismantlement costs to determine whether such a liability actually exists. In the meantime the $5.7 million included in current depreciation rates is excessive and provides a substantial buffer for the Company.

Q. WHAT ARE YOUR OVERALL OBSERVATIONS CONCERNING THE COMPANY'S DEPRECIATION RATES?

A. Based on Our National Studies, the Company's depreciation rates are excessive. That means that they result in excessive charges to ratepayers for existing plant. Consequently, I do not believe that the Company's need for a revenue increase is as severe as Mr. Labrato claims, and I certainly do not believe that a depreciation expense increase relating to Smith Unit 3 or any other plant is required or warranted.

Q. DOES THIS CONCLUDE YOU TESTIMONY?

A. Yes, it does.

MR. BURGESS: All right. And then our final witness besides Mr. Schultz, who's here to testify, is Mr. Zaetz. And, again, this is that category of the issue that's been stipulated.

CHAIRMAN JABER: Okay.

MR. BURGESS: He has --

CHAIRMAN JABER: He's going to testify.

MR. BURGESS: He has Exhibits WMZ-1 through WMZ-5.

CHAIRMAN JABER: Okay. Let's take up Mr. Schultz first and then we'll come back.

MR. BURGESS: Thank you. We would call to the witness stand Mr. Schultz.

(Pause.)

MR. BURGESS: Madam Chairman, Mr. Schultz was not here yesterday when you swore in the people that were going to testify yesterday.

CHAIRMAN JABER: Good morning, Mr. Schultz.

THE WITNESS: Good morning.

CHAIRMAN JABER: Would you raise your right hand, please?

HELMUTH W. SCHULTZ, III

was called as a witness on behalf of the Citizens of the State of Florida and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BURGESS:

Q Would you state your name and business address, please, Mr. Schultz.

A My name is Helmuth W. Schultz, III. My business address is 15728 Farmington Road, Lavonia, Michigan.

Q Have you prefiled testimony in this docket on December 27th, 2001, on behalf of the Citizens of the State of Florida?

A Yes, I have.

Q Do you have any changes or corrections to make to that testimony?

A There is a typo on Page 5.

Q Would identify that, please?

A On Line 8 it says, "three," that should be "13." And the words "additions to" should be deleted and the word "of" inserted.

Q So it should read, "The Year 2000 13-month average of plant in service"?

A That is correct.

Q Would that change or those changes, if you were asked the questions posed herein, would your answers be the same today?

A Yes.

MR. BURGESS: Madam Chairman, we ask that Mr. Schultz' testimony be entered into the record as though read.

CHAIRMAN JABER: The prefiled direct testimony of Helmuth Schultz shall be inserted into the record as though read.

BY MR. BURGESS:

Q Mr. Schultz, did you also attach to that testimony various exhibits including a statement of qualifications and Exhibits HWS through, HWS-1 through HWS-6?

A Yes.

MR. BURGESS: Madam Chairman, I would ask that these be identified as a composite exhibit for this hearing, Composite Exhibit 44, I believe.

CHAIRMAN JABER: Yeah. No. Actually 43.

MR. BURGESS: I'm sorry.

CHAIRMAN JABER: The Appendix and HWS-1 through HWS-6 shall be identified as Composite Exhibit 43.

MR. BURGESS: Thank you, Madam Chairman.

(Exhibit 43 marked for identification.)

DIRECT TESTIMONY OF HELMUTH W. SCHULTZ, III

ON BEHALF OF THE CITIZENS OF FLORIDA

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

GULF POWER COMPANY

DOCKET NO. 010949-EI

INTRODUCTION

Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

A. My name is Helmuth W. Schultz, III. I am a Certified Public Accountant licensed in the State of Michigan and a Senior Regulatory Analyst in the firm of Larkin & Associates, PLLC, Certified Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan 48154.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES, PLLC.

A. Larkin & Associates, PLLC, is a Certified Public Accounting and Regulatory Consulting Firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). Larkin & Associates, PLLC, has extensive experience in the utility regulatory field as expert witnesses in over 400 regulatory proceedings including numerous water and sewer, gas, electric and telephone utilities.

Q. HAVE YOU PREPARED AN APPENDIX, WHICH DESCRIBES YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Appendix A, which is a summary of my experience and qualifications.

Q. BY WHOM WERE YOU RETAINED, AND WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. Larkin & Associates, PLLC, was retained by the Florida Office of Public Counsel (OPC) to review the rate increase requested by Gulf Power Company (Gulf or Company). Accordingly, I am appearing on behalf of the Citizens of Florida ("Citizens").

Q. ARE ANY ADDITIONAL WITNESSES APPEARING ON BEHALF OF THE FLORIDA OFFICE OF PUBLIC COUNSEL IN THIS CASE?

A. Yes. Kim Dismukes, of Acadian Consulting, is presenting testimony on several expense items in this case. Mike Majoros will be addressing depreciation issues on behalf of the OPC. Additionally, James Rothschild is presenting testimony on the OPC's recommended rate of return.

<u>OVERALL FINANCIAL SUMMARY</u>

Q. HAVE YOU PREPARED AN EXHIBIT IN SUPPORT OF YOUR TESTIMONY?

A. Yes. Attached to this testimony are several exhibits, which I will discuss in further detail throughout this testimony. The first exhibit, Exhibit__(HWS-1) consists of Schedules A-1, B-1 and C-1, with supporting schedule B-2 and C-2 through C-13. It is this first exhibit, Exhibit__(HWS-1), that presents the OPC's adjustments to the recommended revenue requirement sought by Gulf Power Company in this case.

Q. WHAT DOES SCHEDULE A-1, ENTITLED "REVENUE REQUIREMENT" SHOW?

A. Schedule A-1 presents the calculation of revenue requirement, at this time, giving effect to all the adjustments I am recommending in this testimony, along with adjustments recommended by OPC witnesses Kim Dismukes and Mike Majoros, and the overall rate of return recommended by OPC Witness James Rothschild. The adjustments presented on Schedule A-1 which impact rate base can be found on Schedule B-1. Schedule B-2 presents the detailed calculation supporting the adjustment to rate base. The OPC adjustments to net operating income are listed on Schedule C-1. Schedules C-2 through C-13 provide supporting calculations for the adjustments to operating income presented on Schedule C-1.

As shown on line 8 of Schedule A-1, the OPC's recommended adjustments at this time demonstrate that Gulf Power's rate increase request is excessive by at least $54,853,000. As discussed throughout this testimony, the OPC is still awaiting a significant level of support for the Company's projected test year. Consequently, the amount of increase recommended by the OPC may be revised after the additional supporting information is received. I will discuss each of the adjustments I am recommending in the remaining sections of this testimony.

RATE BASE - PLANT IN SERVICE

Q. WHAT ADDITIONS HAS THE COMPANY REFLECTED THROUGH THE PROJECTED TEST YEAR?

A. The Company has added $414,564,000 to plant in service. This represents a 22% increase over the year 2000 ~~three~~ 13 month average ~~additions to~~ of plant in service of $1,862,910,000. The major contributor to the budgeted additions is the $220,500,000 budgeted for Smith Unit 3.

Q. WHAT BUDGET INFORMATION WAS PROVIDED BY THE COMPANY?

A. Mr. Saxon provided a summary of the $413,891,000 construction budget on Exhibit___-(RMS-1), Schedule 2. The $251,069,000 of production related additions were listed by project by Company witness Moore, on Exhibit No.___(RGM-1), Schedules 9 and 10. Mr. Howell offered approximately two pages of testimony in support of the $56,035,000 of transmission construction costs budgeted. Also, Mr. Fishers provides two pages of testimony as justification for the distribution construction budget of $95,418,000 and five sentences as justification for $7,700,000 of general plant additions.

Q. DO YOU HAVE ANY CONCERNS WITH THE ADDITIONS TO PLANT AND

THE ASSOCIATED CONSTRUCTION BUDGET?

A. Yes. The Company has the burden of proof for the amount requested for plant. The information included in the Company's filing as justification for additions is not adequate. As mentioned above, the budgeted production additions are listed out by project. The summary provided some indication regarding what the additions are and specific inquiries were possible. The transmission, distribution and general plant additions are not identified by the Company. The Company's failure to provide a description of the $162,822,000 of distribution, transmission and general plant additions is an attempt to shift the burden of proof.

Q. WHAT INQUIRY DID YOU MAKE REGARDING THE PRODUCTION BUDGET?

A. An analysis was requested identifying the starting date of the project, current status of the project, estimated completion date and if there was a cost benefit analysis performed.

Q. WHAT DID YOU DETERMINE FROM YOUR INQUIRY?

A. Twenty-one projects that were scheduled to start prior to November 2001 did not start on time. A number of projects completed or near completion were under-budget. Five projects that appear to be significantly over-budget require further investigation. Tentatively, I believe the production plant additions are overstated.

Q. HAVE YOU MADE FURTHER INQUIRIES ON THE PRODUCTION PLANT ADDITIONS?

A. Yes. Each of the completed projects where the dollars expended significantly exceeded the budget were started before 2001. For each of the projects, I expect to find that the prior years budget amounts will eliminate or significantly reduce what appears to be an unfavorable budget variance. A request for additional information has been made.

Q. ARE THERE ANY OTHER CONCERNS FROM YOUR REVIEW OF THE PRODUCTION BUDGET?

A. Yes. A number of the projects indicate a benefit from the project. It is not clear whether that benefit has been reflected in the operations and maintenance expense budget. If the benefit is not reflected in the operations and maintenance expense budget, the shareholders will receive the benefit at ratepayers expense. This is not appropriate.

Q. HAVE YOU MADE ANY DETERMINATION ON THE TRANSMISSION AND DISTRIBUTION CONSTRUCTION BUDGETS?

A. Not at this time. A detailed listing of projects and the status of those projects has been requested. When the information is received, an evaluation of the information will be made to determine what adjustments are necessary.

Q. ARE YOU MAKING ANY ADJUSTMENT TO PLANT IN SERVICE AT THIS TIME?

A. Not at this time. After reviewing the responses on the information requests outstanding, I will determine whether an adjustment to plant in service is appropriate and necessary.

<u>WORKING CAPITAL</u>

<u>Coal Inventory</u>

Q. HAVE YOU REVIEWED THE COMPANY'S REQUEST FOR FUEL INVENTORY INCLUDED IN WORKING CAPITAL?

A. Yes. As a result of my review, I determined that the inventory is overstated by $8,130,000.

Q. IS THE COMPANY'S REQUEST FOR COAL INVENTORY WITHIN THE GUIDELINES PREVIOUSLY ALLOWED BY THE FLORIDA PUBLIC SERVICE COMMISSION IN GULF'S LAST RATE CASE?

A. No. Mr. Moore has suggested the inclusion of coal inventory based on 52 days of projected burn in the current filing is appropriate because it is less than the 90 projected burn days allowed in the last rate case. The Order in that case went beyond what Mr. Moore has stated. On page 18 of Order No. 23573, it states:

> We are of the opinion that Gulf has failed to justify this request and will allow a level equal to 90 days projected burn or the amount actually maintained in the test year at each plant site, <u>whichever is less.</u> (Emphasis added)

The "whichever is less" is the applicable terminology in this docket. The average amount of cost inventory actually maintained in the historic test year was 476,481 tons. The Company's request for 695,289 tons plus the in-transit exceeds what should be allowed. I recommend that the fuel inventory included in working capital be based on the historic test year average maintained of 476,481 tons, plus the Company's requested increase of 76,223 tons at Plant Smith, plus 80% of the Company's requested in-transit amount.

Q. WHY DID YOU UTILIZE 80% OF THE COMPANY'S REQUESTED IN-TRANSIT COAL AMOUNT?

A. The combination of the year 2000 average maintained of 476,481 tons, and the Company's requested increase of 76,223 tons for Plant Smith, results in an average maintained of 552,704 tons. That average of 552,704 tons is 79.5% of the Company requested coal inventory on hand of 695,289 tons. Assuming the Company requested in-transit amount was overstated by the same percentage that the maintained inventory was overstated, I applied the 80% to determine a reasonable level of in-transit coal.

Q. WHAT ADJUSTMENT TO THE COMPANY'S COAL INVENTORY IS REQUIRED?

A. As shown on Schedule B-2, the coal inventory is overstated by $8,130,346.

Deferred Return Third Floor

Q. WHY HAVE YOU MADE AN ADJUSTMENT FOR THE DEFERRED RETURN ON THE THIRD FLOOR?

A. The Company has elected to amortize the deferred return on the third floor of the corporate offices over three years, based on the stipulation adopted in Order No. PSC-99-2131-S-EI. The Order, which provided for a sharing of excess revenues, allowed Gulf at its "discretion to record an additional accrual...up to $1 million per year to reduce the accumulated balance of the deferred return on the third floor of the corporate offices." Gulf did not make such an election in the time frame established by the stipulated revenue sharing, or as part of the revenue sharing. The three-year amortization of $1,157,000 requested is for the test year as part of this proceeding. It is not consistent with the stipulation which allowed the write-off of "up to $1 million." The inclusion of the deferral in rate base, and the amortization period requested, are not appropriate.

Q. WHAT ADJUSTMENT ARE YOUR RECOMMENDING?

A. The working capital allowance should be reduced $2,893,000 and amortization expense should be reduced $1,157,000. If the Commission were to allow the deferral in rate base, the amortization should be based on the life of the building, not the three years proposed by the Company.

Third Floor Corporate Office

Q. WHAT ADJUSTMENT ARE YOU MAKING FOR THE THIRD FLOOR OF THE CORPORATE OFFICE?

A. I am removing the $3,800,000 of plant and $338,000 of accumulated depreciation discussed on page 14 of Mr. Labrato's September 10, 2001 prefiled testimony. The justification for Gulf's inclusion of the third floor in rate base is not sufficient.

Q. WHY IS GULF'S JUSTIFICATION INSUFFICIENT?

A. The third floor of the Corporate Office was purportedly a storage area in 1989, that was to serve as additional office space to accommodate Gulf Power's growth. Today, the third floor purportedly is still storage space. The Company had an employee complement of 1,626 in 1989. The year 2000 employee complement was 1,319. The referenced tour by the FPSC auditor provides no more justification for including the third floor in rate base today than did the claim by Gulf in 1989 that the same storage area was necessary in 1989.

<u>BUDGETED TEST YEAR EXPENSES</u>

Q. WHAT IS THE PROJECTED TEST YEAR USED BY THE COMPANY IN ITS MFRS?

A. Gulf Power Company selected a test year ended May 31, 2003. This test year consists of seven months of the 2002 budget and five months of the 2003 forecast.

Q. DO YOU HAVE CONCERNS REGARDING THE SELECTED TEST YEAR?

A. Yes. The test year is based entirely on a projection. A projection is an approximation or estimate of what resources are anticipated to be needed in the future or what the Company would like to have available for future operations. The fact that the Company's request is based on what it would like to have available initiates my first concern. Of even greater concern is the fact that it has not been possible to evaluate the amounts contained in the projections.

Q. WHY WERE YOU UNABLE TO EVALUATE THE REQUESTED AMOUNTS?

A. The budget detail and process at Gulf Power Company does not provide readily accessible information that can be evaluated. Citizens request for Production of Document (POD) No. 9, submitted early in the schedule, asked for the budget in the most detailed format available for five annual periods. The response was a single page, which I have attached as Exhibit___(HWS-2). The response identified five functions plus the category "other." The function totals were the sum of a select number of the Company's twenty-nine separate planning units, plus the "General To All" budget unit amount. Simply put, the response only identified extremely high level budgeted amounts with absolutely no detail.

Q. IS IT YOUR OPINION THAT A MORE DETAILED BUDGET EXISTS?

A. Yes. The Company was asked, in Citizens request for Production of Document No. 4, to provide "in the most detailed format available" budget to actual variance reports for 2000 and 2001 to date. The variance reports, a sample of which I have attached as

Exhibit ___(HWS-3), are prepared by function. However, the functions are not identical in title and/or amount as the functions provided in response to POD No. 9. I have prepared a side by side analysis of the two responses (i.e., POD 9 and POD 4) on Exhibit___(HWS-4). While the total budget for 2000 is the same, the reporting functions and/or planning units are different in description and/or amounts. The variance reports suggest a more detailed budget exists.

Q. IS THE VARIANCE REPORT AT A SUFFICIENT LEVEL OF DETAIL?

A. No. The variance reports do not provide explanations for the variances. Although there is a further identification of costs within the respective planning units, the variance reports do not provide anything specific. For example, the Corporate Planning Unit has $5,653,556 identified as Customer Accounts Expense. This does not identify the amount included for labor, employee expense, materials, etc. The information provided is not in the most detailed format available, it is a summary budget.

Q. WAS ADDITIONAL DETAIL REQUESTED?

A. Yes. A request for a more detailed response to POD No. 9 resulted in a nine page analysis of the budget by FERC account and sub account, which I have attached as Exhibit ___(HWS-5). Although more informative, it did not tie directly to any respective planning unit totals. Further inquiries were required.

Q. WHAT ADDITIONAL INQUIRIES WERE MADE?
A. First, I needed to identify how the 2002-2003 test year was developed. Based upon a response to On-Site Request No. 1, it was determined the test year was the respective monthly budgets amounts for the months of June 2002 through May of 2003, as opposed to being an allocation of 7/12 of 2002 and 5/12 of 2003. Next, I inquired as to why the cost detail by account by month consisted of more entries than planning units. I am still waiting for this information.

Q. WHY WAS THE NUMBER OF ENTRIES IMPORTANT?
A. In order to assess the costs budgeted, there must be an understanding of what the costs are for and how the costs are accumulated and rolled into the respective planning units. For example, Account 5000000 had a test year budget of $7,462,190. Based on the representation that the 29 planning units are the lowest level at which the budgeting is done, I would expect 29 budget amounts at most for Account 5000000. The monthly budget run provided in response to On-Site Request No. 1 identified 116 entries. Simply put, one of the questions that needs to be answered is why are there 116 entries for an account if there are only 29 planning units preparing the budget, as purported by Gulf Power.

Q. ARE THERE OTHER INQUIRIES THAT YOU ARE AWAITING RESPONSES TO?
A. Yes. In an attempt to assess the projected costs requested by the Company, I

identified a number of accounts and asked for identification of the different types of cost budgeted, along with an explanation regarding how each of the respective types of costs were determined. A response has not been filed as of the date this testimony was prepared.

Q. DOES THE COMPANY HAVE GUIDELINES FOR ITS BUDGET PROCESS?

A. Yes, to some degree. In response to Citizens' First Set of Interrogatories, Number 9, Gulf stated that the "Planning units use a modified zero base budgeting methodology." The response also stated the modified methodology: "Allows the planning unit the flexibility to build their budget program by program each year or use the prior year approved budget and adjust the dollars for escalation or new programs."

Specific guidelines are outlined in the annual budget message. The guidelines identify escalation rates, customer growth, how to retrieve labor escalation, and includes various directives including what is required to be maintained to support the planning units budget.

Q. WHAT IS REQUIRED FOR SUPPORT?

A. The budget message states: "Each Planning Unit is responsible for developing and maintaining supporting records and working papers for their budget and forecast requests. Please ensure that detail is maintained within in the Planning Unit in order to support <u>regulatory</u> and management requests." (Emphasis added) This is the level of detail that I sought to review, to no avail.

Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO EXPENSE AT THIS TIME?

A. Yes. While I am recommending several adjustments at this time, I may revisit my recommendation or make additional recommendations upon review of the outstanding information requests. It was impossible to make a thorough evaluation of the projected test year based on the extremely limited and incomplete support provided by Gulf Power Company to date.

PAYROLL, FRINGE BENEFITS AND PAYROLL TAXES

Q. WHAT AMOUNT OF PAYROLL EXPENSE IS INCLUDED IN THE COMPANY'S FILING?

A. The filing indicates that the projected test year gross payroll will be $78,328,343 for 1,367 employees. The portion of this that is expensed is not provided. In an attempt to identify payroll expense, the Company was asked to provide the O&M expense budget in the most detailed format available. The response, attached as Exhibit ___(HWS-2), was not detailed at all. Since the budget on which this entire rate proceeding is based is not very detailed, the amount of payroll expense could not be identified. Two additional attempts to secure more budget detail still did not provide sufficient information to identify the amount of payroll expense included. More specific information has been requested, since the level of budget detail provided was not as expected.

Q. DO YOU HAVE CONCERNS WITH THE PAYROLL FOR THE PROJECTED TEST YEAR?

A. Yes. Company testimony and benchmark schedules identify an increase in employees. To verify the increase identified, an interrogatory inquired as to the status of the 29 positions to be filled. The response to Citizens' Interrogatory No. 12 indicated 28 positions had been filled. The Company testimony failed to indicate that the projected test year payroll was based on an employee complement of 1,367, while the historic test year had an employee complement of 1,319. The increase of 48 employees has not been addressed in the testimony or in the benchmark justifications. In fact, the benchmark justifications refer to downsizing, not employee growth. It is not appropriate that the Company incorporate in its filing a significant increase in the employee complement without providing any justification for the increase.

Q. ARE YOU SATISFIED WITH THE PROJECTED INCREASE OF 29 POSITIONS FOR SMITH UNIT 3?

A. Yes. Those additions were identified in the filing, and there has been justification provided for the addition of the 29 employees. Furthermore, the Company has provided affirmation that 28 positions have already been filled.

Q. WHAT ARE YOU PROPOSING FOR THE REMAINING 19 POSITIONS?

A. Since the projected test year includes an increase of 48 employees, and the Company specifically identified 29 employees for Smith Unit 3, 19 positions remain as unsupported. The 19 unidentified positions should be removed from the filing. The Company has not provided testimony and/or justification for increasing the employee complement beyond that needed for Smith Unit 3. In fact, through 1998 it appears downsizing was the trend. In 1999, eight positions were added, and five more positions were added in 2000. The Company is now apparently claiming that in the next 17 months, 19 unexplained positions are needed.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING?

A. As shown on Exhibit ___(HWS-1), Schedule C-2, payroll expense should be reduced $701,420, fringe benefits should be reduced $131,177, and payroll tax expense should be reduced $58,475 in order to remove the 19 positions from the projected test year.

<u>INCENTIVE COMPENSATION</u>

Q. DO YOU HAVE ADDITIONAL PAYROLL-RELATED CONCERNS?

A. Yes. The Company's MFR Schedule C-33 provides a summary of gross payroll and fringe benefits. In reviewing this schedule, it was presumed to be inclusive of all compensation and benefits. *****Begin Confidential***** THIS INFORMATION DEEMED CONFIDENTIAL BY GULF POWER COMPANY. *****End Confidential*****

An accrual of this magnitude is significant in relation to the gross payroll in 2000 of $72.6 million and fringe benefits of $14.6 million. In an attempt to resolve my concern, additional detail has been requested for the years 2000-2003 regarding the amount of incentive compensation, the new incentive plan established in 2000, and how the costs are reported. No support for payment of any incentive compensation has been included in the Company's filing.

Q. ARE YOU RECOMMENDING AN ADJUSTMENT FOR INCENTIVE COMPENSATION?

A. Yes. The adjustment is tentative, pending receipt of the additional requested information. Without any indication as to what amount of incentive related costs have been expensed in the projected test year, and whether the cost is included in gross payroll and/or fringe benefits, I cannot make a final assessment of the plan or determination as to what amount may be reasonable. *****Begin Confidential***** THIS INFORMATION DEEMED CONFIDENTIAL BY GULF POWER COMPANY *****End Confidential*****

PRODUCTION OPERATION AND MAINTENANCE EXPENSE

Q. HAVE YOU REVIEWED THE COMPANY'S REQUEST FOR PRODUCTION

OPERATION AND MAINTENANCE EXPENSE?

A. Yes. The Company has requested $83,695,000 in the budgeted test year. The request of $83,695,000 is $9,367,000 higher than the test year benchmark of $74,328,000. The two major contributors to the benchmark variance are for production steam ($5,786,000) and production other ($3,840,000). The request is excessive and not justified by the information provided.

Q. HAS THE COMPANY EXPLAINED WHY THE REQUESTED AMOUNT IS NECESSARY?

A. The explanation for the $3,840,000 of production other costs is $3,376,000 for operation and maintenance at Plant Smith for Unit 3 and $450,000 for an extended service agreement at the Pea Ridge co-generation facility. At this time, I am not taking exception to this request.

The $5.8 million variance for steam production is purportedly due, in part, to additional maintenance costs associated with the increased amounts of generation and diagnostic tools not available in 1990 that increase the maintenance activities performed today.

Q. WHY IS ADDITIONAL MAINTENANCE ASSOCIATED WITH INCREASED GENERATION?

A. Company witness Moore explains that since the 1990 rate case, the Gulf "generating units have aged significantly and have been required to produce more electricity on an annual basis." The increased activity causes extremely high stress "due to the high temperatures and pressures" at which the units operate.

Q. ARE THE UNITS MAINTAINED IN A MANNER THAT A SIGNIFICANT INCREASE IN COSTS CAN BE AVOIDED?

A. That would be expected. Mr. Moore eluded to this on page 5 of his prefiled testimony, as follows:

> During the last 12 years, we have worked hard to maintain these units so that they have continued to provide reliable, low cost service to our customers.

Mr. Moore, however, then states that Gulf is now at the point where it must spend additional money on these units so that they can continue to provide reliable service in the future.

Q. BASED ON THE EXPLANATION GIVEN BY MR. MOORE, IS THERE ANY REASON WHY THE REQUEST MAY NOT BE APPROPRIATE?

A. Yes. The significance of the increase, accompanied by the suddeness, raises a concern. To illustrate this, I have prepared Exhibit ___(HWS-6). The Company summarized its maintenance expense into three classifications, baseline (i.e., normal maintenance), planned outages and special projects. As shown on Exhibit ___(HWS-6), lines 1-5, the normal maintenance costs remained relatively stable from 1996-2000, averaging $41.16 million. The Company budgeted $40.2 million for 2001, continuing the trend.

Suddenly, in the projected test year, the budgeted cost increased $10.4 million to $50.6 million. The $50.6 million projection represents a 23% increase over the historical five-year average of $41.16 million. A sudden required increase of this magnitude raises a great deal of concern.

Q. WHAT ABOUT THE REQUEST FOR THE PLANNED OUTAGES?

A. The same scenario exists, with two exceptions. First, the overall costs, as shown on line 10 of Exhibit ___(HWS-6), were relatively steady except for a dip in expenditures in 1997. This dip in 1997 is consistent with a dip in expenditures in 1992 for the five-year period 1991-1995; therefore, it does not appear to be an anomaly. Second, the budget in 2001 did increase $2.1 million, or 24%, over the five-year average of $9 million. The 2001 budget of $11.1 million was only $193,807, or 1.8%, over the $10.9 million expended in 2000. However, the projected test year budget of $14 million is $2.9 million more than the 2001 budget; $3.1 million more than the year 2000; and $5 million more than the five-year historical average. The increase in costs is a concern due to the significance and abruptness of the purported need.

Q. DOES THE SAME CONCERN EXIST FOR SPECIAL PROJECTS?

A. Yes. The historical average of $1 million a year is suddenly transformed into a $3 million need in 2001 and a $2.7 million need in the projected test year. I would like to note that the Company's response to Citizens' Interrogatory No. 18 shows the actual September 2001 year-to-date expenditures for special projects is $47,579.

Annualized, that would amount to $63,439 of expenditures for 2001, which is $2,964,166 under-budget. It appears the 2001 budget is significantly overstated, which suggests that the projected test year budget is also overstated.

Q. ARE THERE OTHER CONCERNS WITH THE AMOUNT REQUESTED IN THE PROJECTED TEST YEAR?

A. Yes. Referring to Exhibit ___(HWS-6), you will notice that on line 18 I have calculated the benchmark amount for each of the historical years, the five-year average, the 2001 budget, and the projected test year. For each comparison of actual to benchmark, the actual expenditures are significantly less than the benchmark except in the projected test year. Over the last five-years, the Company expended, on average, $7.8 million less than the benchmark. Suddenly, the projected test year is over the benchmark.

Q. WHY IS THERE A DIFFERENCE BETWEEN THE BENCHMARK VARIANCE OF $5.8 MILLION FOR PRODUCTION STEAM REFERRED TO EARLIER AND YOUR EXHIBIT ___(HWS-6), WHICH SHOWS A $2.2 MILLION VARIANCE.

A. That is a question I do not have an answer for. I have requested that the Company explain the difference. What I can explain is that in the response to Citizens' Interrogatory No. 18, the Company indicated that the baseline budget for the projected test year is $50.6 million. Company Exhibit No. ___(RGM-1), Schedule 8, indicates the filing includes a baseline budget of $54.1 million. If the $3.5 million difference were reflected on my Exhibit ___(HWS-6), the difference between the historical benchmark variance and the projected benchmark variance would increase.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING?

A. The production steam expense should be reduced $10,251,700.

Q. HOW DID YOU DETERMINE YOUR ADJUSTMENT?

A. As shown on Exhibit ___(HWS-6), the amount historically expended has been relatively consistent, even though cost from year-to-year fluctuate either up or down. Taking that into consideration, on Exhibit___(HWS-1), Schedule C-4, I inflated the 2000 historic test year expenditures of $53,395,120 by the change in the Company's calculated compound multiplier between 2000 and 2002. The result is $56,152,991. I then assumed the Company would break from the historical trend of underspending and expend an amount closer to the $65,083,609 benchmark for the projected test year. Assuming a compromise between the adjusted historical spending of $56,152,991 and the test year benchmark of $65,083,609, I estimated that the Company will expend $60,618,300 in the projected test year for production steam operations and maintenance. The $60,618,300 is $10,251,700 less than the Company's request of $70,870,000.

<u>DISTRIBUTION EXPENSE</u>

Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO TEST YEAR DISTRIBUTION EXPENSES?

A. Yes. At this point, I am recommending several different revisions to Gulf's projected distribution expenses. I will discuss each of the distribution expense recommendations below.

Cable Inspection

Q. PLEASE EXPLAIN YOUR FIRST ADJUSTMENT TO DISTRIBUTION EXPENSE.

A. Company witness Fisher indicates in his testimony that before 1990, Gulf Power installed over 600 trench miles of underground primary cable. To extend the life of this cable, the Company proposes to inject a silicone fluid into the underground cable to remove water and fill voids. The projected cost of this program is $166,000. The entire cost of this program in the projected test year is questionable.

Q. WHY ARE YOU QUESTIONING THE COST ASSOCIATED WITH THE CABLE INSPECTION PROCESS DISCUSSED BY MR. FISHER?

A. First, Mr. Fisher indicates that the process will greatly extend the life of the cable. Costs associated with extending the life of an asset are typically capitalized, not expensed. Second, the Company has expended $229,435 since 1991 in the performance of this cable inspection process. That is less than $23,000 a year. In the year 2000, nothing was budgeted and nothing was expended. In 2001, again nothing was budgeted. The projected test year has $166,099 budgeted. The level of cost projected does not appear to be representative of costs on an annual, recurring basis.

Q. WHAT IS YOUR RECOMMENDATION?

A. As shown on Exhibit ___(HWS-1), Schedule C-5, the five-year average of cost associated with this cable inspection process is $36,336. A reduction of $129,763 is recommended to better reflect an annualized level of costs for this program.

Substation Maintenance

Q. WHY ARE YOU RECOMMENDING AN ADJUSTMENT TO SUBSTATION MAINTENANCE EXPENSE?

A. Mr. Fisher indicates increased maintenance is required due to the aging of the substation equipment. He indicates an increase of $555,000 annually for diagnostic procedures; $200,000 annually for transformer banks, breakers and capacitor banks; and $60,000 additional will be expended each year for cleaning. While Mr. Fisher suggests that the costs are required "during the 2001 to 2003 time period," the major portion of the increase occurs in the test year budget period. The request for $1,647,000, a 102% increase over the year 2000, is excessive, particularly when one considers that the costs expended in 1999 were $861,904; the costs expended in 2000 were $817,256; and the budget for 2001 is $1,150,811.

Q. HAS THE COMPANY PROVIDED ANY JUSTIFICATION FOR THE 102% INCREASE?

A. The Company's justification, in the testimony of Mr. Fisher and in Benchmark Variance explanations, is that it will incur $815,000 of additional costs on an annual basis during the 2001 to 2003 time period. The 2001 budget of $1,150,811 certainly does not reflect an annual increase of $815,000. This significant projected increase in spending raises a concern as to whether the sudden request for an additional $815,000 is rate case related. If the need for these expenditures exists, then one would think that the Company's actual historic costs would be closer to the 1999 benchmark of $1,196,666, instead of the $861,904 that was expended. The same applies to 2000 when the benchmark was $1,263,056 and only $817,256 was expended. The two years of under-spending the benchmark level, coupled with the required annual increase not being reflected in the 2001 budget (also below the benchmark), raises a concern regarding the sudden significant increase projected in the test year.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING?

A. The projected test year should be reduced $391,316. This adjustment is based on the most recent five year average (1996-2000) of actual costs grossed up to 2002 cost levels. The resulting recommended cost of $1,255,684 for the projected test year is $438,428 or 54% more than was actually expended in the year 2000. This adjustment is calculated on Schedule C-6, and results in a more than reasonable level of spending, particularly as the Company has only expended more than $1 million twice in the last ten years for substation maintenance.

<u>Tree Trimming</u>

Q. WHAT ADJUSTMENT ARE YOU MAKING TO TREE TRIMMING EXPENSE?

A. The Company's request for $4,122,705 for tree trimming expense should be reduced $1,379,080 to $2,743,625. The calculation of this recommended adjustment presented on Schedule C-7. Mr. Fisher once again indicates in his testimony that the need is there for improvements. Mr. Fisher states that a more proactive tree-trimming program is required due to the increase in the number of tree related outages. The increase requested is based on a proposed change from a seven-year trimming cycle to a three-year trimming cycle. This claim is not supported by either Company studies or actions.

Q. WHY DO YOU CONTEND THE CLAIM IS NOT SUPPORTED?

A. A review of recent customer surveys identifies maintaining reliable services as a strength of Gulf Power. While the percentage of customers who site reliability as a strength varies from period to period, the question of reliability consistently is Gulf Powers most favorable strength.

Gulf Power's action toward proactive tree-trimming speaks louder than words. In the year 2000, Gulf Power budgeted $3,010,997 and only expended $1,634,914. The 2001 budget was set at $1,639,694. Suddenly, the proactive position is determined to be the direction the Company must head toward, and a budget of $4,122,705 is established for the projected test year. The sudden need for a change to a three-year cycle and a significant increase of costs in the projected test year is suspiciously convenient.

Pole Inspections

Q. WHY IS THE ADJUSTMENT FOR POLE LINE INSPECTIONS NECESSARY?

A. Once again, the Company claims that due to the condition of aging equipment, an increase in expenditures is required. The request for the increase to $734,000 annually is not appropriate. The Company did not expend any funds in 1999 or 2000 for this type of maintenance. As with the distribution expenses discussed previously, the need for this increase was not reflected in the 2001 budget, but it does appear in the test year projections. According to the Benchmark Variance Justification, the Company began the inspection program in 1991 and has inspected 48,000 poles over the last ten years. Suddenly, Gulf claims there is a need to inspect the remaining 60,000 poles over the next five years. There also is no indication as to what period of time the $734,000 proposed annual level will continue for. Additional detail has been requested to better evaluate this request.

Q. WHAT ADJUSTMENT ARE YOUR RECOMMENDING?

A. Based on the fluctuating level of expenditures for this program from 1993 to 2000, the most appropriate level of costs would best be determined by averaging the historical costs. Inflating the average historical costs to a 2002 level results in a recommended annual cost level of $207,274. As presented on Schedule C-8, a reduction of

$526,726 is recommend to the Company's test year projection of $734,000.

Light Maintenance

Q. WHY IS AN ADJUSTMENT TO STREET AND OUTDOOR LIGHT MAINTENANCE EXPENSE NECESSARY?

A. The Company's request of $1,438,000 is excessive, and sufficient justification for the request, does not exist. Historically, the annual expense has been less than $1 million, with the exception of 1998, which was $1,090,648. The growth rate in lights is not an appropriate factor to be applied to the 1990 allowed expense in justifying the request. The annual maintenance expense per light has declined approximately 20%. Actual detail on the budgeting for the $1,438,000 has been requested for review. A response is still outstanding at this time.

Q. HOW DID YOU DETERMINE YOUR ADJUSTMENT?

A. The historical costs for the period 1996-2000 were totaled and divided by the number of lights maintained to arrive at an average cost per light of $7.86. This rate was multiplied by the estimated number of lights in the test year of 142,255, resulting in an expense of $1,117,857. The calculated expense is $320,143 less than the Company's $1,438,000 request for the test year. The adjustment, which is presented on Schedule C-9, is reasonable on a going-forward basis. It recognizes the historical growth and changes on the maintenance cost per light.

PROPERTY INSURANCE

Q. IS THE PROJECTED PROPERTY INSURANCE EXPENSE REASONABLE?

A. No. The Company had a negative reserve back in 1995. To compensate for the excess of costs over the annual expense provision, the Company was authorized, in Docket No. 951433-EI, to increase its annual accrual to a minimum of $3,500,000. Since 1996, the average annual charge against the reserve has been $1,536,600. The reserve has increased to $8,731,000 as a result of the increase in the annual provision and the lower amount of annual charges. If the Company continues to accrue at the current rate, the reserve balance will be $16,488,000 at May 31, 2003. The historical charges suggest the reserve is at a sufficient level to justify a reduction in the annual reserve accrual.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING?

A. As shown on Exhibit ___(HWS-1), Schedule C-10, the average annual charge to the reserve from 1996 to 2000 has been $1,536,600. Applying the change in the multiplier from 2000-2002, the annual cost would be $1,679,616. Due to the significant amount in the reserve as of December 2000, further increases are not justified. An annual accrual of $1,679,616 is considered reasonable to offset any charges and still maintain the current reserve balance. Adjusting the accrual from $3,360,000 to $1,679,616 results in a reduction to expense of $1,680,384.

CUSTOMER ACCOUNTS

Q. WHAT IS THE COMPANY REQUESTING FOR CUSTOMER ACCOUNTS EXPENSE?

A. The amount requested is $16,662,000. The adjusted benchmark is $14,160,000, and the year 2000 actual expense is $15,362,000.

Q. HAS THE COMPANY JUSTIFIED ITS REQUEST?

A. No. Explanations were provided for four benchmark variances. The explanations provided some functional variance explanations, but they do not provide a complete analysis of the changes in customer accounts.

Q. WHAT CHANGES ARE OF CONCERN?

A. Account 90300205-Postage was $1,114,054 in the year 2000. The projected test year includes $1,645,717 for this account, or an increase of $531,663 or 48%. There is no justification in the filing for an increase of postage expense of this magnitude. I recommend the projected postage expense be reduced by $427,975.

Q. DO YOU KNOW HOW THE COMPANY DETERMINED ITS POSTAGE EXPENSE REQUEST?

A. No. The filing does not provide any explanation for the increase in postage. A request has been made for budget detail to determine how the amount was determined and what caused the increase. That information has not been received at this time.

Q. HOW DID YOU DETERMINE YOUR ADJUSTMENT?

A. My adjustment of $427,975 is based on the difference between the year 2000 expense inflated by the change in the compound multiplier from the year 2000 to 2002 and the Company's request of $1,645,717. The calculation is shown on Exhibit ___(HWS-1), Schedule C-11.

CUSTOMER RECORDS

Q. WHY ARE YOU ADJUSTING CUSTOMER RECORD EXPENSE?

A. The requested Company Record's expense of $3,102,769 in the projected test year is $763,942 higher than the year 2000 expense of $2,338,827. The increase of 33% is not justified or supported in the filing. The benchmark justifications discuss changes implemented years ago, and they provide no insight as to why the cost in Account 90300020 increased so significantly between the year 2000 and the projected test year ending May 31, 2003.

Q. HAVE YOU INQUIRED AS TO WHAT THE DIFFERENCE COULD BE?

A. Yes. However, I have not received the requested budget detail for this account.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING?

A. The requested customer records expense should be reduced $546,261, as shown on Exhibit ___(HWS-1), Schedule C-12. The adjusted amount is based on the year 2000 expense, as adjusted by the compound multiplier.

RATE CASE EXPENSE

Q. ARE YOU RECOMMENDING AN ADJUSTMENT TO RATE CASE EXPENSE?

A. Yes. An adjustment is necessary for two reasons. First, the estimated cost is considered excessive; specifically, for the 219.13% increase in legal fees. Second, the four year amortization period is not appropriate.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING FOR LEGAL EXPENSES?

A. The estimated legal expense is overstated by $153,223. My estimate of $449,777, as presented on Schedule C-13, is based on the prior rate case actual of $188,953 indexed by the 2002 compound multiplier to $345,982. I then added a 30% increase of $103,795 for additional billable hours.

Q. WHAT AMORTIZATION PERIOD ARE YOU RECOMMENDING?

A. The last rate case, Docket 891345-EI, had a six-year time lapse between that case and Gulf's last rate case. The time between Docket 891345-EI and this rate case is eleven years. I recommend that a minimum six-year amortization period be utilized, reducing expense $140,829. My recommended adjustments to rate case expense are presented on Schedule C-13.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes, at this time. As discussed throughout this testimony, there are numerous interrogatories outstanding. Consequently, I reserve the right to supplement this testimony at a future time.

BY MR. BURGESS:

Q Mr. Schultz, could you provide a brief summary of your testimony for the Commission?

A Yes. The company originally requested an increase in rates of $69,867,000. Based on the information received by the Office of Public Counsel as of the filing date for this testimony in this proceeding, it was not possible to determine Gulf's actual level of revenue need.

The company's presentation of the rate year ended May 2003 was based on its budgeted amounts for the rate year. The use of budgeted information provides significant difficulty in determining what is an appropriate level of future plant and cost of operations. The difficulty arises because the budget is at best a guess as to what is anticipated or what is hoped for.

If the Commission is to rely on the budgets for the applicant in the establishment of rates, then the budget must be in sufficient enough detail to determine whether assumptions used by the company and the costs budgeted by the company are reasonable.

Exhibit HWS-2 is the company's response to a request for the O&M budget in the most detailed format available. The test year has $31,473,000 budgeted for Plant Crist that can be determined from a review of this document. What is not evident is how much is payroll, how much is training costs, how much is maintenance, et cetera. There is no detail.

I have a railroad client with a revenue of approximately $7 million that has a level of detail that overwhelms the company's most detailed format of budget information provided.

I recently reviewed budgeted costs of a major utility in another rate proceeding that provided far more detail than was provided by Gulf Power in response to my data request, and that information was part of the information actually supplied with the filing itself.

The company has the burden of proof in a rate proceeding, and the so-called detailed budget provided by the company, to me, does not appear to be sufficient support for $201 million of costs.

The company has requested significant increases in costs over the historical level of spending. It would appear that now that rates are being evaluated, that the budgets can be used as a better way of measuring results and what the costs are that are to be paid by ratepayers.

Historical trends seem to be ignored. This is not appropriate. The company made its choices over the years to spend on maintenance in a manner that they determined was best. They made efforts to contain costs, yet to provide a quality of service that was acceptable to the majority of their customers.

I have made a number of recommendations for adjustments based upon a historical level of spending that was considered sufficient over the past years to provide the quality of service that the company says its customers expect. It would only be appropriate to take into consideration the historical spending which established the rates, when establishing the rates on a going-forward basis, especially when considering the lack of detail in the company's budget. To ignore what the company determined to be sufficient historically would only suggest that the company has deferred expenses intentionally. By utilizing historical spending, I have taken the position that the historical spending was representative of what is necessary to provide the quality of service that the company has provided.

The company's request is excessive and should be reduced to reflect the unsupported increases in its budget. Thank you.

MR. BURGESS: We would tender the witness for cross-examination.

CHAIRMAN JABER: Thank you, Mr. Burgess. We should still start here, I believe. Major, do you have any questions?

MR. ERICKSON: No questions, ma'am.

CHAIRMAN JABER: Mr. Gross?

MR. GROSS: No questions.

MR. PERRY: No questions.

CHAIRMAN JABER: Okay. Gulf.

MR. MELSON: Commissioner Jaber, I neglected to talk with Ms. Stern this morning. We would prefer to go after Staff, if that's possible.

CHAIRMAN JABER: Staff?

MS. STERN: Yes, that's fine.

MR. HARRIS: And we do have some questions.

CHAIRMAN JABER: Go ahead.

MR. HARRIS: Thank you, Madam Chairman.

CROSS EXAMINATION

BY MR. HARRIS:

Q Mr. Schultz, my first question is relating to the underground cable expense, and I understand that your testimony is that it should be characterized as a capital expenditure and not an expense; is that correct?

A I alluded to that, yes, because it extends the life of the asset and it's -- technically from an accounting perspective when you extend the life of an asset, any procedures to do so should be capitalized.

Q So you're saying that because the procedure being asked for, the cable and the silicone injection would extend the life of the asset, that would be recharacterized as a capital improvement as opposed to an expense from an accounting perspective; is that correct?

A That is correct.

Q Okay. When you were looking at the level of expenses that Gulf has incurred over the past five years, did you or were you aware that the warranty for the cable injection process has recently changed to a 20-year warranty?

A No, I did -- was not.

Q If that fact were true, would that change your testimony about the correct amount of cost for Gulf?

A Well, essentially you still have the same scenario. As long as the costs incurred are extending the life of the asset, they should be capitalized.

Q But as to the amount requested by Gulf for repairing this cable, whether it's an expense or whether it's a capitalization, my understanding is that you believe a certain portion of that expense requested should be disallowed; is that correct?

A That is correct.

Q And that's based on the fact that this was not performed in a number of past years; is that correct?

A That is correct.

Q All right. If the company were to say the reason they didn't do it is because the warranty wasn't good enough but now it is, would that change your opinion about whether the entire expense should be allowed?

A It, it might have some impact on the level of spending. Although the -- you know, I'd still have some grave concerns about, you know, if this is a known procedure that does extend the life of these assets despite the warranty, why wouldn't they have taken, undertaken the effort to expend the money and do what's best, best to extend those assets for the company? I mean, the other alternative would be to replace it. And I think if this was cheaper to do this way, I would have thought that they would have made an all-out effort to do it this way.

Q My understanding is that in calculating the indexed average for the cable expense you used a certain number of years, is that correct, a certain, a certain choice of years between 1994 and the present?

A That -- I believe that's right.

Q Do you know why you chose the particular years you did?

A I'm sorry?

Q Why did you choose the particular years in calculating your average?

A It would have been the years that I, that I used in developing the historical average of the costs.

Q Okay. And are these the same years you used for all of the distribution expenses, Issues 64 through 69? Basically did you use, did you go back five years from present?

A Yes. I was using a five-year average.

Q Okay. And you used the previous five years for each of the expenses that you referred to: Tree trimming expense, cable injection expense, substation maintenance expense, et cetera?

A Yes, sir.

Q Okay. Would it be possible to use different averages for the different expenses? Say, for example, instead of the immediately prior five years, use, for example, for cable expense, say, 1994 through 1997 or 1995 through '98 or some combination, or would that yield inconsistent results?

A I believe, you know, you could. I mean, but generally speaking, in my experience you try to use the most historic five-year period or whatever is determined acceptable.

Q Would use of a different annual average, say, the years of 1994 through 1997, yield a result that was inconsistent with your premise, which is to yield a historical perspective of the costs Gulf has expended in order to justify their test year?

A Oh, that, that's definitely a possibility. For instance, in, let's say, 1994 they undertook a big effort to do that type of improvements to the, to the system, and then they didn't do anything in '95 but, and they had costs in '96, '97 and '98; whereas, in the period from, in '96, beginning in '96, let's say they didn't have any costs in '99, 2000, you'd have two years of zero cost. So, yeah, I mean, it would, it would have the possibility of giving you a different result. No question about that.

Q Okay. And you believe that for consistency, the same five years going back, the same previous five years should be used for all of the expenses so that we have a consistent result; is that correct?

A Generally speaking, yes. There are exceptions to that rule even on my part when there might be something really that's an anomaly that has caused a significant distortion and it can be explained away. How's that?

Q And could you briefly explain to me for your line pole, line pole inspection expense calculation? You did roughly the same type calculation, went back the previous five years, looked at what they had expended on an annual basis and then indexed that forward for the test year amount?

A Yes.

Q Okay. Do you know of any reason why it would be inappropriate to calculate that expense based on a 1994 through a 1998 average?

A Not knowing what happened in '94 and '95 -- I mean, theoretically, no. But I think one of the ideas of looking at the period of '96 through 2000 in this proceeding is the fact that there were years where they didn't spend money. And that's one of the concerns because all of the sudden, you know, when you don't spend any money, now we have a rate proceeding in front of us and we're going to spend lots of money. So that's a concern as to showing the difference that's resulting to this as a result -- and that ratepayers are going to have to be paying a lot more because of the fact that, hey, we decided not to do anything for two years or something to that extent.

Q Is your -- with the line pole inspection expense is your concern mainly the amount of money they're asking for or the number of poles they're seeking to inspect or a combination of the two?

A It's a combination of the two and the historical trend. You can't ignore the historical trend as far as I'm concerned.

Q So my, my understanding is that your testimony is that you're concerned about what you see as a trend over the five-year average suddenly increasing for the rate, the test year; is that correct?

A Exactly.

MR. HARRIS: Okay. May I have a moment?

CHAIRMAN JABER: Uh-huh.

(Pause.)

BY MR. HARRIS:

Q I wanted to jump backwards a brief minute, going back to the cable injection process. Do you know whether the process requested by Gulf, that is, the injection with the silicone fluid, is being made to extend the life of those assets or merely to repair those assets so that they can fulfill their current expected life?

A My understanding is by injecting the solution into the cables is that it's going to actually extend the life because it, it'll slow the deterioration process down.

Q Okay. So it's not merely allowing the cable in the ground to last its budgeted life or its targeted life but to extend beyond that targeted life?

A That's, that's my understanding based on the response that I have received from the company.

MR. HARRIS: Thank you. I have nothing further.

CHAIRMAN JABER: Thank you, Mr. Harris.

Mr. Melson?

CROSS EXAMINATION

BY MR. MELSON:

Q Mr. Schultz, Rick Melson representing Gulf Power.

I'd like to start with your proposed adjustment to working capital for fuel inventory. And if you could, if you would turn to Schedule B-2 of your Exhibit HWS-1.

A Yes, sir.

Q And this is a schedule where you calculate a proposed $8.1 million adjustment to coal inventory; is that right?

A That's correct.

Q And you start on Line 1 of the schedule with the actual amount of coal inventory maintained during the Year 2000; is that correct?

A That's correct.

Q And the source of that is MFR Schedule B-17A. Would you accept that?

A That's correct.

Q And am I correct that your basis for recommending the use of 2000 actual as a starting point is a statement in the last rate case order saying that Gulf should be allowed 90 days projected burn or the actual, the amount actually maintained in the test year at each plant site, whichever is less?

A That's correct.

Q And that statement referred to the amount maintained by the company during the test year?

A That's my understanding, yes, sir.

Q What was the test year in the last rate case?

A I believe it was, it was either 1989 or 1990, the actual period.

Q Was the rate case -- was the test year in the last rate case a projected test year or a historic test year?

A I think it was based on an actual. I can't say for sure. My recollection, ten years ago, is a little hazy as to what was -- it was, I thought, actual with pro forma adjustments.

Q Let me represent to you that if you review the Commission order from the last rate case, that it was a projected test year. Will you accept that?

A I would accept that, yes, sir.

Q And, therefore, would you accept that the Commission's statement in the order allowing an actual level maintained during the test year, in fact, referred to the amount to be maintained during the projected test year?

A I'm not sure that it was referencing that. I mean, I understand that there can be some differences as to what's, what's considered the test year. I mean, the test year in this proceeding would have been 2000 adjusted, and the projection is the adjusted 2000 test year. That may be the case. But to my understanding and what I typically would, would have assumed was it was the actuals, and that's the way I interpreted it to be.

Q Okay. And based on the statement you just made, it's your understanding that the test year in this case is 2000.

A The test year itself is 2000, and then we have an adjusted test year as what -- is what's reflected in the rate request.

Q Have -- in suggesting the use of the 2000 figures, coal inventory figures as a basis for your recommendation, did you do any investigation to determine whether 2000 was a representative year in terms of level of coal inventory?

A Well, I was under the understanding that there were some impacts from it. I, I saw some notations. I don't know -- it referenced my review of the audit work papers. I mean, do you want me to identify that as being confidential or not? That's up to you.

Q Well, I guess I don't know what you intend to say.

A Well, let me put it --

Q Let me ask the question again because I think it's a simple yes-or-no question really.

Did you do any investigation to determine whether the inventory levels in Year 2000 are representative?

MR. BURGESS: Excuse me again. I understand that that is a yes-or-no question and, of course, the Commission allows explanation. And the witness is warning counsel that the explanation gets into areas that the company has sought confidentiality of.

CHAIRMAN JABER: Thank you, Mr. Burgess. We do allow elaboration after the yes-or-no answer. But in elaborating, if you so choose, it doesn't mean you have to, but if you so choose, do not reveal confidential information. Try to talk around it.

THE WITNESS: Okay.

BY MR. MELSON:

Q Do you recall the question?

A Yes. I was, I was aware that there were fluctuations in the inventory that were not typical of the year.

Q All right. Have you done any investigation to determine what actual coal inventory levels were during the Year 2001?

A I believe I saw some detail as to what coal inventory levels were in the Year 2001.

Q And was the average for 2001 -- what was the average for 2001?

A I can't say what it was in 2001 other than I know that it was higher.

Q But you don't know how much higher?

A No, sir, I don't.

Q And was the coal inventory level higher in 1999?

A I believe so.

Q So to the best of the information you've reviewed, you'd say Year 2000 was the lowest of the years?

A That's a good possibility, yes, sir.

Q On Line 2 of your Schedule B-2, you add to the historic level 76,000 tons for increase at Plant Smith; is that correct?

A That's correct.

Q What is the basis for treating Plant Smith differently?

A Well, Plant Smith was, is coming on-line and you're going -- there was the presumption that there was going to be an additional requirement there.

Q So that's for the Smith Unit 3 that's coming on-line in June?

A Yes, sir. I was trying to follow basically what my analysis showed the company was also projecting that there was going to be additional requirement for Plant Smith.

Q How much coal do you normally burn in a gas-fired plant?

A Well, it's a combining cycle so, I mean, you know, I don't know how much they're going to burn. I couldn't tell you.

Q But you're allowing 76,000 tons of coal to, to accommodate that unit?

A Yes, sir.

Q All right. On Line 3 you propose an adjustment to in-transit coal, and I've, if I've recalled the written part of your testimony correctly, essentially you've made a 20 percent reduction to the coal inventory and you make a corresponding 20 percent reduction to the amount of in-transit coal; is that correct?

A That's correct.

Q And in-transit coal is just the coal that's on barges or in railcars on its way from the mines to the plant; is that a fair description?

A That's coal that's heading towards -- yeah. It's not on location. How is that?

Q Okay. I want to use a little hypothetical to understand the implication of making an adjustment to in-transit coal, and I'd like you to make four assumptions for me.

First, assume that it just takes one day to get coal from the mine to the plant so that at any time you've got one day in transit. Are you with me?

A Yes, sir.

Q All right. Assume that the plant burns anywhere from 50 to 150 tons a day, but on an annual average basis it comes dead out on 100 tons a day. Are you with me on that assumption?

A Okay.

Q Okay. Assume that coal deliveries are 100 tons a day every day, assuming you don't have a rail strike or you don't have weather that prevents a train from moving. Are you with me on that?

A I'm following you.

Q Okay. And the final assumption is that we start the year and end the year with a coal stack of 5,000 tons. Are you with me there?

A You're starting to add up the numbers, but I'm still, I think I'm still on track.

Q Okay. And since you've got 100 tons a day coming into the stack and you've got burn of anywhere from 50 to 150, it varies day to day or season to season, but on an annual average it's 100 tons. So would you expect over the course of the year that the coal stack is on average going to stay at

5,000 tons?

A Yes.

Q All right. Now assume you reduce the size of that stack 20 percent, as you suggest, to 4,000 tons. Your adjustment to in-transit coal reduces the in-transit coal from 100 tons a day to 80 tons a day; is that right?

A That's correct.

Q If you've got a 4,000-ton stack and 80 tons a day coming in and 100 tons a day on average being burned, what's going to happen?

A In your hypothetical, you might run short of coal.

Q You'd run out of it, wouldn't you?

A Eventually you could possibly do that.

Q On Line 4 of your Schedule B-2, you show a $2.6 million adjustment for Plant Scherer; is that correct?

A That's correct.

Q And that is to remove, I guess, from Line 1 the amount of coal related to Plant Scherer; is that right?

A Yes, sir.

Q Okay. Do you have a copy of MFR Schedule B-17A handy?

A No, sir, I do not.

Q And I'm looking at MFR B-17A, Page 2 of 30.

A Yes, sir.

Q And would you tell me on Page 135, if we look over in the column "Ending Balance Units," that's the 476,481 tons that you carried forward on your schedule; is that correct? Are you with me on --

A Yes, I see that. Yes, sir.

Q And would you read the caption on that, "Which plants are included in that 467 tons?" That would be in the upper left-hand corner.

A It says, "Plants Crist, Smith, Scholz and Daniel."

Q And it doesn't say Scherer.

A No, sir.

Q So it appears, wouldn't you agree, that you were adjusting out coal for Plant Scherer that's not in the base to which you're making the adjustment?

A That's, that's what it would appear. I, I was basing my adjustment based on the company's Schedule B-14. And if it wasn't in there, then the adjustment shouldn't be made.

Q Thank you. Could you turn to Page 10 of your direct testimony where you were talking about adjustment for deferred return on the third floor of the corporate office? And I'm looking specifically at Lines 11 and 12 where you say, "Gulf did not make such an election in the time frame established by the stipulated revenue sharing or as part of revenue sharing." What is the basis for that statement?

A I was not aware of the fact of any amortization being made on the third floor, deferred return.

Q What investigation did you make to determine whether any amortization had been taken?

A I, I had reviewed the filing and reviewed responses. I believe there was some information that I was waiting for. Subsequently I, I did receive a response that said that they did amortize the Year 2000.

Q And do you know whether there's been an amortization for the Year 2001?

A Not according to the filing. And, in fact, the company indicated that they did not make an amortization in the Year 2001. And they, in the rebuttal, I believe, reflected a change to correct for the fact that it didn't do an amortization in the Year 2001. There also wasn't an amortization in 1999.

Q Let's turn for a moment to production O&M. You recommend disallowing $10,251,000 production-related O&M expense; is that correct?

A That's correct.

Q And a large part of the basis for your recommendation is that the test year expenses for steam production are above the historic expense level; is that right?

A That's correct.

Q And would you agree that if the figures you're using for historic levels are not apples to apples in terms of inclusiveness with the figure you're using for the test year level, the results you calculate would not be valid?

A If they were not totally comparative. However, we do have some -- I mean, you could say that they're not comparative right from the start because, first of all, the company didn't have the detailed records to provide what the real actuals were. In each of the responses the company says these are estimates. So for the earlier years -- I believe it was only the latter couple of years that they were purportedly real actuals.

So if you said that my use of estimates is not comparative to, to the other, to the number that the company has in the filing, you're correct. And it's also correct because those estimates, the, what is represented as the actual is actuals as opposed to budgets, you know.

Q Well, let me ask this. To the extent that you compared figures that included expenses incurred within specific power plants but did not include corporate level expenses and you compared that against a number that included the universe of those, if that were the case, would that be a valid comparison?

A It wouldn't be, it wouldn't be a valid comparison. And I understand that there is, there's been an indication that that isn't, that that's the problem with my analogy that I've done is that I've made a comparison of actual numbers to numbers that have these corporate costs included in and said they're way under.

The problem I have with that is the company has said within its testimony and in responses that our accounting has changed over the years, and we are no longer charging costs previously charged to A&G. We're charging them now to these plant accounts.

Now if they've changed their accounting over the years, then my presumption is the budget process changed, too. And the budget that was back then wouldn't have included those numbers that were corporate costs.

Q Okay. So that's a presumption you've made. But have you been able to confirm the adequacy, the accuracy of that presumption?

A Well, basically the responses in the testimony came afterwards, and I haven't seen any evidence that would either confirm or not confirm the fact that the benchmark numbers did, did include those corporate amounts.

Q Turn to Page 20 of your direct, if you would, please. And I'm looking at Line 7.

You'd agree that the company calculates that its test year production benchmark, that it's test year production is $9,367,000 above the benchmark; is that right?

A Yes.

Q And if I read the rest of that page correctly, you don't take issue with $3.8 million of that related to Smith

Unit 3 and Pea Ridge; is that correct?

A That's correct.

Q You do take issue with some $5.8 million related to steam production; is that right?

A Essentially, yes.

Q Okay. Page 21, Line 9. You're asked a question, "Are the units maintained in a manner that a significant increase in costs can be avoided?" And you say, "That would be expected," and go on to say that Mr. Moore talks in his testimony about the company's maintenance practices. Do you see that?

A Yes, sir.

Q Do you own a car?

A Yes, sir.

Q Would you agree that in general the older a car gets, the more you need to spend on maintenance?

A It depends, and it depends on how you maintained it during the years.

Q Even if you maintain it well, wouldn't you expect that in later years you're going to spend some more on maintenance than you did in earlier years?

A At some point in time you may incur -- I -- and I have -- I can give you a prime example. I have a pickup truck that is 12 years old, 310,000 miles on it. And until I hit 300,000 miles, I didn't really have to put any significant amount of expense into it. And that cost me $1,100, which, over ten years, that's pretty cheap.

Q And if you were to start driving that vehicle more now and at a faster pace than you drove it in the past, would you expect that because of the increased mileage and the increased age that you might spend more on maintenance in the future?

A I still drive it daily and it's, and the only maintenance I'm putting into it is getting my oil changed and having it checked and just your normal maintenance, but when you have to replace your brakes -- and those are due.

So I guess the bottom line is as long as you keep quality maintenance on it, you will minimize any significant maintenance in the future. Granted, there will be times where you will incur some significant maintenance. But that's all factored into your periodic planned outages and stuff when you have to make those repairs.

And those, it's not like this plant that's 20 years old didn't have a major repair done to it ten years ago, because I'm sure it did.

And so as long as you continually maintain it, you should be able to control the level of maintenance expense to some degree.

Q And it's your testimony that the appropriate level at which to control it is the historic average of the last five years?

A I think the last five years will reflect that, you know, the level of maintenance that you have put into it. As far as plant maintenance, I wouldn't have a problem even if you looked at a ten-year cycle and figured out what the average was because the ten-year will give it more over the life of the assets itself.

Q You didn't look at ten years, though.

A Well, I think I had the ten years of information.

Q But you --

A But for consistency purposes because if I don't, if I switch from one to the other, I'm usually criticized for it. So I tried to stay consistent.

Q Let me talk about your proposed adjustments to distribution expense, and that really covers several subtopics, and I'm just going to ask some general questions about your philosophy that really relates to cable inspection, substation maintenance, tree-trimming, pole inspections, light maintenance.

In each case you propose an adjustment to these categories of expenses, the effect of which is to reduce the test year amount to a historic five-year average; is that right?

A Essentially, yes, sir.

Q Okay. Would you agree that the purpose of using a test year to measure expenses is to establish an amount that's going to be representative of reasonable and prudent costs that can be expected in the future?

A Yes, sir.

Q And would you agree with me that historical information is valuable only to the extent that it provides evidence of what reasonable and prudent costs would be in the future?

A I would believe the historical gives a representation of what is believed to be an ongoing cost.

Q And, in fact, I -- let me see if I can get a yes or no to that.

Would you agree that historical information is valuable only to the extent that it is, provides evidence of what reasonable and prudent expenses would be in the future?

A I'm not sure. I'd have to say -- and I'm not sure that it's a real yes and no answer because of the fact that we don't know what's in the future. And it could be yes from the perspective that we anticipate that's what we should at least incur in costs to continue to maintain it at the quality that we have maintained it over the historic trend.

Q Let me ask it this way. Would you agree if a utility demonstrates that reasonable and prudent costs going forward are, will, in fact, be higher than historical levels, in that case you would not blindly apply historical levels; is that correct?

A I would not -- you better restate that for me, please.

Q Okay. Assume that if you -- assume that a utility has demonstrated that its reasonable and prudent costs in the future are going to be higher than they were in the past. If that demonstration was made, it would not be appropriate to adjust those simply based on a historical average. Would you agree with that?

A I would agree that would be the case. However, in this particular case I don't feel that I have been presented enough information to do such an analysis of what the company represents would be necessary over and above what they historically have spent. And that's one of the things that I alluded to earlier is that, you know, I want, I wanted to see some real budget detail that I could ask some real questions on specific issues, and I couldn't get to that level of detail.

Q Have you reviewed the rebuttal testimony that's been filed in this case?

A Yes, sir.

Q And how many of those rebuttal witnesses were deposed by Public Counsel, Office of Public Counsel? Do you know?

A I could not tell you.

Q Let me turn to property insurance. You proposed to reduce the property damage accrual so that the amount going into the reserve equals the inflation adjusted five-year historic average of what was charged against the reserve during the last five years; is that right?

A Essentially that's correct, yes, sir.

Q Are you aware of what the reserve target level is for that reserve?

A Yes.

Q What is --

A Basically the reserve target was to be somewhere in the range of $25 to $35 million. I'm just basically recommending that the Commission may want to take a second look at that and reconsider whether, you know, the level at $16 million will be sufficient come the rate year.

Q And when was that target reserve amount established?

A I'm sure you know the date. I can't say specifically, but --

Q Let me ask this. Would you agree that it was in 1996 by an order of this Commission?

A I would agree.

Q And are you aware that the target reserve level was established only after the Commission required this company to present a storm damage study?

A Yes, sir. And that's, I guess that's why I'm just asking the Commission to maybe reconsider what they might determine to be an appropriate level.

Q Have you presented any storm damage study or storm damage analysis that would show results different from what this Commission considered in 1996?

A No. The only thing I've presented is the fact that there's a history there, and they might want to take a look at the historical trend.

Q In fact, isn't the history of the charges against the reserve actually just a little higher than what the Commission or the company projected the annual charges would be at the time the target level was set?

A That, I believe, is correct.

Q And is it also correct that the order expected that the reserve would build up to the target over a 13- to 17-year period?

A It was, it was a lengthy period. I'm, I'm not sure exactly. It was a while ago since I looked at that, so.

MR. MELSON: That's all I've got.

CHAIRMAN JABER: Thank you, Mr. Melson.

Commissioners? Okay. Thank you.

MR. BURGESS: Ma'am?

CHAIRMAN JABER: Oh, redirect.

MR. BURGESS: Thank you.

REDIRECT EXAMINATION

BY MR. BURGESS:

Q Mr. Schultz, you were asked by Mr. Melson about some of the adjustments you made to distribution costs. Do you remember being asked whether your general approach was to take the five-year average and, and to derive some of your adjustments from that?

A That's correct.

Q Now the five-year average, when you took these historical amounts, actual amounts from the last five years, did you take the, the actual dollars that were spent and, and use those, use those nominal dollars to recommend the future amounts?

A No, sir. I was indexing them based on the company's filing.

Q You indexed each year then to bring it in to reflect test year value dollars?

A Yes, sir.

MR. BURGESS: Thank you. That's all I have.

CHAIRMAN JABER: Thank you, Mr. Burgess.

All right. Exhibits? That would be Exhibit 43, Mr. Burgess?

MR. BURGESS: I apologize.

CHAIRMAN JABER: That's okay.

MR. BURGESS: Yes. I would ask that Exhibit 43 be admitted into the record.

CHAIRMAN JABER: Exhibit 43 is moved into the record without objection.

MR. BURGESS: Thank you.

CHAIRMAN JABER: Thank you.

(Exhibit 43 admitted into the record.)

(Witness excused.)

CHAIRMAN JABER: And your next witness is Mr. Zaetz. And there was a stipulation regarding Mr. Zaetz; right?

MR. BURGESS: Yes, ma'am. So although, again, it's a stipulated issue, consistent with the others, I would ask that his testimony be entered into the record.

CHAIRMAN JABER: Okay.

MR. BURGESS: Along with his --

CHAIRMAN JABER: The prefiled direct testimony of William Zaetz shall be inserted into the record as though read. And it looks like Mr. Zaetz has five exhibits and an Appendix A.

MR. BURGESS: That's correct.

CHAIRMAN JABER: Okay. That will be Composite Exhibit 44.

MR. BURGESS: Thank you, Commissioner.

CHAIRMAN JABER: Appendix A and WMZ-1 through WMZ-5. Composite Exhibit 44 is admitted into the record without objection.

MR. BURGESS: Thank you, Madam Chairman.

(Exhibit 44 marked for identification and admitted into the record.)

DIRECT TESTIMONY OF
WILLIAM M. ZAETZ

INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is William M. Zaetz. I am a Senior Consultant with the economic consulting firm of Snavely King Majoros O'Connor & Lee, Inc. ("Snavely King"). My business address is 1220 L Street, N.W., Suite 410, Washington, D.C. 20005.

Q. WHAT IS YOUR PROFESSIONAL BACKGROUND?

A. Prior to joining Snavely King this year, I was a boilermaker for 33 years with Union Local No.193, headquartered in Baltimore, Maryland, rising eventually to the position of General Foreman. In the course of this career, I participated in or supervised the fabrication, installation, repair and dismantlement of boiler plant, fuel-handling equipment, and environmental abatement facilities in electric generating plants operated by both public utilities and private industrial and commercial enterprises. In the course of 180 separate projects, I participated in operations in most of the major power plants in Maryland, the District of Columbia, southern Delaware and the northern Virginia.

After leaving the Boilermakers' Union, I worked as a consultant and expert witness for the Department of Justice's Environmental Division in connection with their Power Plant Initiative. My duties consisted of analyzing and summarizing various "forced" and "scheduled" outage reports and providing the attorneys with contact lists from my association with the International Brotherhood of Boilermakers.

I joined Snavely King earlier this year. I have provided technical support and advice in connection with that firm's analyses of steam generation facilities and costs, principally in connection with depreciation proceedings.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. During my college years, I enrolled in the apprenticeship program of the International Brotherhood of Boilermakers and also served in the Naval Reserves as a boilermaker. In 1971, I received a Bachelor of Science degree in Business Management from the University of Baltimore.

Q. HAVE YOU ATTACHED A SUMMARY OF YOUR EXPERIENCE?

A. Yes. Appendix A is a brief summary of my qualifications and experience.

Q. FOR WHOM ARE YOU APPEARING IN THIS DOCKET?

A. I am appearing on behalf of the Florida Office of Public Counsel ("OPC")

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. First, I will explain the basic principles of the combined-cycle technology. Second, I will report on my December 14, 2001 tour of Plant Smith Unit 3. Third, I will describe my survey of the current disposition of retired electric generating units.

Q. ON WHAT INFORMATION IS YOUR TESTIMONY BASED?

A. My testimony regarding the principles of combined–cycle technology is based on my individual research, my observation of other combined cycle plants that are under construction, and my 33 years of practical experience with the stages and entities of the steam cycle. I have condensed and simplified the principles in Exhibit___(WMZ-1). My report of the plant tour of Smith Unit 3 is attached as Exhibit___(WMZ-2). (At the time this testimony was prepared, Gulf Power had not released the photographs that were taken during the tour. Exhibit___WMZ-2 will be filed separately when I receive those photos.)

Q. DO YOU HAVE ANY PERSONAL EXPERIENCE WITH COMBINED-CYCLE PLANTS?

A. These plants are relatively new to the scene and none have been constructed so far in the Mid-Atlantic region that was part of my jurisdiction while I was working in the field. I have, however, worked on several "waste heat boilers" over the years. Recapturing exhaust heat is not a new concept. Steel mills and refineries have used the waste heat concept for many years.

Q. HAVE YOU RECENTLY OBSERVED ANOTHER COMBINED CYCLE PRODUCTION PLANT UNDER CONSTRUCTION?

A. Yes. On my tour of seven plants in the Georgia Power System conducted on September 26, 27, and 28, 2001, I observed the construction of four combined-cycle units under construction at Plant Wansley. Exhibit___(WMZ-3) contains a photo that I took during that tour. You can see the similarity between those units and Plant Smith Unit 3.

Q. PLEASE SUMMARIZE THE RESULTS OF YOUR RESEARCH.

A. The combined-cycle technology combines the thermodynamic principles of the gas turbine cycle and the steam cycle. The heat contained in the exhaust gases expelled by the gas turbine is used to heat the water used in the steam cycle.

There has been an increase in the use of combined cycle power generation because of its advantages in the overall efficiency and the relatively low cost of construction compared with other known energy sources.

Over the years, improvements in the Brayton (gas turbine) Cycle and the Rankine (steam) Cycle has resulted in an efficiency of over 60% in combined-cycle cycle plants now under construction, and efficiency ratings in excess of 70% are expected before the end of this decade. Historically, the average efficiency of electricity generation has progressed from under 5% in 1900, to its high of around 33% in the mid-1980s. When the use of combined-cycle techniques became a reality for commercial operation, the efficiency rating has progressed approximately 10% per decade.

Q. HOW DO THESE FACTS RELATE TO THE FINAL RETIREMENT OF A COMBINED-CYCLE PLANT?

A. For a plant to be considered for retirement, it must be determined that the plant has become economically unfeasible to continue power generation. If all predictions are true about the increase in future power requirements to the grid, then the development of the most cost-effective method for delivering the needed power would be the only prudent answer. At the present time, the combined-cycle technology is the state-of-the-art in power generation. At each stage of the development of the entities used in this technology, improvements have been made to increase the life span of various parts.

Exhibit___(WMZ-4) is a *GE Power Systems* brochure in which the manufacturer elaborates on the various improvements to the state-of-the-art turbines that are being installed at Smith Unit 3.

Q. HAVE YOU COME TO A CONCLUSION BASED ON YOUR ANALYSIS?

A. The current average life span of existing electric generating plants over 50 MW is approximately 55 years (Snavely-King's National Study 2000-01). I have found nothing in my research, or on the plant tour that would lead me to conclude that Plant Smith Unit 3 would have a shorter life span than these existing plants.

RETIRED PLANT SURVEY

Q. PLEASE DESCRIBE YOUR SURVEY OF RETIRED PLANTS.

A. The Energy Information Agency of the Department of Energy maintains a database, which identifies the status of steam plants generating electricity in the nation. From this database, I was able to identify all generating units that had been retired since 1982. The FERC database also identified the units' owner as of the time they were retired. I telephoned those owners and found that in many cases, the ownership had changed. I then telephoned as many current owners as possible to inquire as to the present state of the retired unit, that is, whether it is still in place or whether it has been dismantled and, if so, what has become of the site.

Q. WHAT WERE THE RESULTS OF YOUR SURVEY?

A. Exhibit___(WMZ-5) provides a summary of the result of my survey. It lists all of the **146** steam generating units 50 MW and above that has been retired since 1982. I was able to contact **28** owners of 86 units in **40** separate locations. Only

15 units in **9** locations have actually been dismantled, and of these only **6** units in **4** locations have been returned to "Greenfield" status, meaning that there is not remaining evidence of the site having been used for electric generation.

This leaves **68** units in **26** locations that have not been dismantled. Most of these units are essentially untouched, although some are being retained to be cannibalized for their parts. **Four** units in **2** locations have been recommissioned and put back in service. **Four** more units, at Hawthorn in Missouri, owned by Kansas City P&L CO. are about to be returned to service. These units have been listed as retired since 1984.

Q. WHAT IS THE RELEVANCE OF THESE SURVEY RESULTS IN THE ISSUES IN THIS PROCEEDING?

A. GPC has incorporated a $5.6 million dismantling charge in its depreciation request. My survey indicates that utilities do not necessarily dismantle generating units when they are retired for a number of reasons. It is highly unlikely that any owner would dismantle a unit if any other units sharing the same building were still in operation. First of all, asbestos removal would halt the operation of the working units because it would represent a safety hazard for any personnel performing normal plant duties. Furthermore, it is probably uneconomical to dismantle a single unit within a plant while leaving other, operational units in place.

Q. WHAT DO YOU CONCLUDE?

A. I conclude that the dismantlement of all of GPC's existing units is an unlikely event.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

CHAIRMAN JABER: And the next witness, Staff, is yours, and that's Mr. Durbin. And we have a stipulation on his testimony as well.

MR. HARRIS: Yes.

CHAIRMAN JABER: Okay. So the prefiled direct testimony of Richard Durbin shall be inserted into the record as though read.

MR. HARRIS: Yes, Commissioner.

CHAIRMAN JABER: And, Mr. Harris, he has, what, one exhibit?

MR. HARRIS: I believe Mr. Durbin does have one exhibit, RD-1.

CHAIRMAN JABER: Okay. RD-1 is identified as Exhibit 45, and that will be admitted into the record without objection.

(Exhibit 45 marked for identification and admitted into the record.)

DIRECT TESTIMONY OF RICHARD DURBIN

Q Would you please state your name and address.

A My name is Richard Durbin; 2540 Shumard Oak Boulevard, Tallahassee, Florida, 32399-0850.

Q By whom are you employed and in what capacity?

A I am employed by the Florida Public Service Commission as a Regulatory Consultant in the Division of Consumer Affairs.

Q Please give a brief description of your educational background and professional experience.

A I graduated from the University of Louisville in 1975 with a Bachelor of Science in Commerce degree.

I have worked at the Florida Public Service Commission since 1992 and have held various positions within the Division of Consumer Affairs since that time.

Q What are your present responsibilities with the Commission?

A I work in the Bureau of Complaint Resolution where I am primarily responsible for both initial and continuing education of the analysts. I identify, develop, and maintain training resources including the Division's Intranet. I also serve as the first point of contact when a customer requires a higher level of staff member intervention.

Q What is the purpose of your testimony?

A The purpose of my testimony is to advise the Commission of the number of consumer complaints received by the Commission concerning Gulf Power Company, the nature of the complaints received by the Commission, and the adequacy of the company's response to those complaints.

Q. What do your records indicate concerning the number of complaints filed against Gulf Power Company?
A. Attachment RD-1 is a chart showing the number of complaints filed on behalf of customers by the Public Service Commission's Division of Consumer Affairs against Gulf Power Company. The chart indicates a steady decline in the number of complaints from 1995 through 1999. Complaints have increased in each of the last two years.
Q. In your review of the complaints against Gulf Power Company, did you observe any specific cause for the increased complaints in the last two years?
A. No, the overall pattern of complaints stayed the same as in previous years. They were about evenly divided between billing and service complaints.
Q. What were the most commonly filed types of complaints filed against Gulf Power Company?
A. High bill concerns were the single most common complaint.
Q. Did complaints about service outages represent a large portion of the complaints?
A. No. Service outages represented a very small portion of the complaints. In the year 2001 we only filed two (2) electric outage complaints and in 2000 we only filed three (3).
Q. The Florida Administrative Code requires a utility to respond to a Commission complaint within fifteen (15) working days. Does Gulf Power Company provide responses to customer complaints in a timely manner?
A. Yes, they do. The company has not been late in responding to a

complaint since 1997.

Q. In how many of the complaints filed against Gulf Power Company was the company found to be in violation of Commission rules or tariffs?

A. Gulf Power Company was found to be in apparent violation of Commission rules or tariffs in fewer than two percent of the complaints filed against it.

Q. Does this conclude your testimony?

A. Yes, it does.

CHAIRMAN JABER: And that brings us to Jim Breman.

MR. HARRIS: Yes, Commissioner.

JAMES E. BREMAN

was called as a witness on behalf of the Staff of the Florida Public Service Commission and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. HARRIS:

Q Mr. Breman, have you been sworn previously?

A I have.

Q Okay. And could you state your name and your business address, please.

A Yes. My name is James E. Breman. I work at 2340 Shumard Oak Boulevard, Tallahassee.

Q And in what capacity are you employed by the Commission?

A I'm an engineer, and I believe the reorg has me in the Division of Economic Regulation today.

Q Okay. And have you prefiled, have you prefiled or have had cause to prefile direct testimony in this matter?

A I have.

Q Okay. Do you have any changes or corrections to your testimony?

A Yes, I do.

Q Okay. Could you enumerate what those changes are?

A Yes.

MR. HARRIS: Commissioners, Ms. Espinoza is handing out a handout which contains Mr. Breman's changes.

CHAIRMAN JABER: Thank you, Mr. Harris. Go ahead, though, for the record and just say where the changes are.

BY MR. HARRIS:

Q Mr. Breman.

A Okay. Starting on Page 3, delete the first full sentence on Line 5 through 9. On Page 8, delete the first full sentence on Line 5, and on Page 8, delete the last full sentence on Line 9.

Q And what are the reasons for these changes to your testimony?

A We received some information from Gulf Power subsequent to my filing of my testimony.

Q Okay.

MR. HARRIS: Madam Chairman, may we have Mr. Durbin's (sic.) testimony inserted into the record as though read with those corrections made?

CHAIRMAN JABER: The prefiled direct testimony of Mr. Breman shall be inserted into the record as though read.

MR. HARRIS: I apologize. Thank you, Commissioner.

CHAIRMAN JABER: That's okay.

BY MR. HARRIS:

Q And, Mr. Breman, did you also have exhibits to that testimony?

A I did. I do.

Q And those exhibits are marked as, I believe, JEB-1 through JEB-4; is that correct?

A Yes.

MR. HARRIS: Okay. May we have those marked for --

CHAIRMAN JABER: Composite is okay?

MR. HARRIS: Yes. I believe that would be okay.

CHAIRMAN JABER: Okay. Composite Exhibit 46 will be JEB-1 through JEB-4.

(Exhibit 46 marked for identification.)

BY MR. HARRIS:

Q And as a result of your changed testimony, do you have any changes or corrections to any of those exhibits?

A I guess the proper thing is to note that there's a figure that was presented to a June Internal Affairs that is now incorrect.

Q Okay. Is that figure reflected in any of your exhibits?

A It is.

Q Okay. Specifically which exhibits?

A Exhibit JEB-1, Figure 5.

Q And what should the correction be for JEB-1, Figure 5?

A The Gulf's corrected CEMI5 number is approximately

2.1.

Q Did you have any other changes?

A No, sir.

DIRECT TESTIMONY OF JIM BREMAN

Q. Please state your name and business address.

A. My name is Jim Breman; 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850.

Q. By whom are you employed and in what capacity?

A. I am employed by the Florida Public Service Commission as a Utility Systems Communications Engineer in the Division of Economic Regulation.

Q. Please briefly describe your educational background and professional experience.

A. From April 1980 through December 1981 I was an engineering technician with Peoples Gas System Inc., North Miami Division. I graduated from Florida State University in 1986 with a Bachelor of Science in Mechanical Engineering. I was also employed by the College of Engineering while pursuing my degree at Florida State University.

I began employment with the Florida Public Service Commission in 1988 and have held various positions since that time. In April 2000 I was promoted to my current position.

Q. What are your present responsibilities with the Commission?

A. My responsibilities include reviewing utility distribution reliability reports and then preparing reports to the Commission on staff's findings. I also analyze various other electric utility filings concerning the Ten-Year Site Plans, underground vs. overhead distribution differentials, storm damage issues, and the environmental cost recovery clause. My responsibilities also include addressing customer complaints related to electric service.

Q. Have you previously testified before the Commission?

A. Yes. I testified in Docket No. 910615-EU that resulted in Rule 25-6.115, F.A.C., Facility Charges For Providing Underground Facilities of Public Distribution Facilities Excluding New Residential Subdivisions. I testified in Docket No. 960409-EI, Prudence Review to Determine Regulatory Treatment of Tampa Electric Company's Polk Unit.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to show why the Commission should implement a program that provides an incentive to Gulf Power Company for maintaining reliable service. I also discuss why a minimum distribution reliability standard is appropriate and necessary.

Q. Have you prepared any exhibits to which you will refer to in your testimony?

A. Yes. I prepared four exhibits. In JEB-1, I've reproduced the various graphs of distribution reliability indices presented to the Commission in a June 2001 Internal Affairs report on distribution reliability. In JEB-2, I state responses provided by each of the four major utilities when questioned about the costs necessary to comply with the vegetation management requirements of the National Electric Safety Code. JEB-3 consists of recent photographs of utility distribution facilities that are not being maintained in compliance with the National Electric Safety Code. JEB-4 is a detailed presentation of my proposed distribution reliability incentive program.

Q. Is Gulf Power Company currently providing reliable distribution service?

A. Overall, Gulf Power Company's distribution reliability is good. As Staff's Witness Durbin's testimony indicates, the Commission has not recently received many complaints. Therefore, I would agree that most of Gulf Power

Company's customers receive reasonable service.

Q. Why are you proposing an incentive program if Gulf Power Company's customers are not complaining about service reliability?

A. Waiting for a large number of customers to complain about frequent service interruptions is reactive rather than proactive. ~~Last year, Gulf Power Company estimated that 4 percent of its customers experience more than five service interruptions. This is approximately double the amount reported by the other Florida investor owned companies. So we already know that some of Gulf Power Company's customers do not receive highly reliable service.~~ Also, it appears there is a potential for complaints to increase.

In recent years the Commission elevated its review of distribution reliability primarily because the level of customer complaints seemed high for Florida Power & Light and Florida Power Corporation. As a result of the Commission's intervention, all the utilities began various activities to improve distribution reliability. JEB-1 contains various graphs of indices used to assess changes in distribution reliability. The graphs demonstrate general reliability improvement trends relative to 1997 for the utilities as a group. However, there is little assurance that Gulf Power Company or the other utilities will either maintain or even continue to improve distribution reliability absent continual Commission intervention.

Q. Why do you believe the utility provides little assurance that it will maintain or improve distribution reliability?

A. The utilities have been relying on self-set goals. These internal goals are typically tied to financial performance. The desire to meet such financial goals creates a disincentive to make expenditures that would increase distribution reliability. Consequently, as in 1997, it is sometimes necessary for the Commission to intervene on behalf of the retail customers. The utilities do not have what I would call a minimum standard for distribution reliability because their current practice has not proven to be effective. Unless there is a change in the process, history is likely to be repeated.

Q. Do you have a specific example that demonstrates how your concerns apply to this rate case?

A. Yes. The test year budget includes a projection of all costs for planned activities including those affecting distribution reliability. There are certain causes of service interruptions that a utility has more ability to mitigate than others. Tree trimming or vegetation management is one of these. One would think that a utility would have a natural incentive to therefore promote vegetation management activities. The utility should also be motivated to promote vegetation management because Part 2, Section 21.218 of the National Electric Safety Code requires the utilities to maintain clearances between vegetation and utility distribution facilities. Yet, as you can see in JEB-1, vegetation continues to be a significant cause of service interruptions. Last year, staff asked the utilities to estimate the annual cost to be in continuous compliance with the National Electric Safety Code. Their responses are in JEB-2. Please note that some of the utilities characterized the tree trimming budget as the amount to most cost effectively comply with the National Electric Safety Code in 2001 while others simply stated the budgeted amount. Gulf Power Company responded with a budgeted 2001 amount of $2,599,198. Gulf Power Company's 2001 budget is at least $1.5

million less than the 2003 test year vegetation budget of $4.1 million.

Q. Did Gulf Power Company comply with the vegetation clearance requirements of the National Electric Safety Code during 2001?

A. No. JEB-3 is a catalog of recent photographs taken by Jerry Woodall, a PSC Safety Engineer. The pictures are of various locations where Gulf Power Company was not in compliance with the National Electric Safety Code.

Q. Gulf Power Company's test year budget is higher than the 2001 budget. If the vegetation management budget were doubled would your concern be addressed?

A. No. It is important to realize that vegetation management and other distribution reliability programs are expensive. However, I don't believe the Commission should be picking and choosing between distribution reliability activities. As I said earlier, vegetation management is just an example. Vegetation management is just one of many activities affecting distribution reliability. The vegetation management example highlights the incentives and dis-incentives a utility has to minimize the many causes of service interruptions shown in JEB-1. The example highlights current utility and Commission practices. The existing scheme relies primarily on customer complaints and is not proactive. A better approach would be one that ensures reliable distribution service.

Q. You appear to suggest a change from historical rate case reviews. What is wrong with performing a test year distribution budget review similar to what was done in prior rate cases?

A. In the past, a common method has been to review the previous five years and compare the test year budget levels to the five-year averages. However, the five-year period of distribution expenses includes the effects of direct Commission intervention. Consequently, I don't know what level of expense would have occurred under "normal" or "average" conditions. In addition, there are no minimum distribution reliability standards. Neither the Commission nor the utility can tell the customer what average service is or that next year the same level of service will be considered average. Consequently, I don't know what normal or average distribution expense levels are because I don't know what normal or average service means.

Q. How should the Commission address the situation?

A. The Commission should establish a program that allows the utility and retail customer interests to be reasonably balanced between rate cases. The program should be based on two fundamental concepts.

The first concept is that distribution reliability should not decline between rate cases. At a minimum, the retail customer should not be expected to endure less reliable service once the rate case is concluded. Making such a commitment is consistent with setting base rates for average service.

The second concept is simply that the company will be held accountable for declines in service in a timely manner. Timely accountability will provide an incentive for the company to consistently ensure that distribution reliability is appropriately maintained.

Q. Can you be more detailed in how the new program would be implemented?

A. Yes. In JEB-4 I've prepared a schedule reflecting the implementation of the new program for Gulf Power Company. Simply stated, the utility is required to make an annual refund to its retail customers when the number of retail customers experiencing more than five service interruptions exceeds an established standard in any consecutive 12 month period.

Q. Should there be a cap on the annual refund amount?

A. Yes. The total refund amount should be capped at the equivalent amount of 10 basis points of equity.

Q. Why do you recommend a cap of 10 basis points?

A. The intent of the refund is simply to provide sufficient incentive to cause the utility to manage distribution systems pro-actively between rate cases. It is not intended to be punitive.

Q. Why did you select the number of customers experiencing more than five interruptions as the index for the incentive program?

A. The number of Customers Experiencing More Interruptions than Five (CEMI5) is perhaps the best indicator of reliable service because CEMI5 is the number of customers who did not receive reliable service. By definition, CEMI5 provides the number of customers that have experienced six or more service interruptions. A prudent company should seek to minimize CEMI5. As seen in JEB-3, problems are likely to exist in areas where customers are experiencing many interruptions. In addition, as seen in JEB-1, CEMI5 is already used by the utilities and the Commission. Finally, the number of customers experiencing more than five interruptions is a measure that is easily understood.

Q. Do all utilities have similar abilities to report CEMI5?

A. Not as of June 2001. Gulf Power Company and Tampa Electric Company were implementing system changes that are expected to enable them to begin computerized reporting of CEMI5 in the near future. I believe the four largest companies will have similar abilities by the end of 2002 or sooner.

Therefore, Gulf Power Company should be able to begin implementing the program in 2003.

Q. How do you respond to the lack of computerized and historical data for Gulf Power Company?

A. ~~Gulf Power Company estimated a CEMI5 of 4 percent for year 2000.~~ Mr. Fisher's testimony highlights various service reliability improvement activities that are either new activities or expansions of year 2000 activities. Therefore, on a going forward basis, distribution reliability should improve. ~~Consequently setting CEMI5 to 4 percent is not appropriate.~~ I believe a CEMI5 of 2 percent is a reasonable standard primarily based on the expectation that Gulf Power Company's projected cost levels for activities are typical of future years. Continuation of similar budget levels should continue to improve retail service. In which case, at some future date, the Commission may need to adjust the incentive program.

Q. How do you propose Gulf Power Company implement the incentive program?

A. In 2003, they should include the necessary documentation in their final true-up testimony filed in an appropriate cost recovery clause where the refund amount can be allocated on a demand basis. The total refund amount, if any, would be a line item adjustment to the final true-up amount that Gulf Power Company would normally report for 2003. This way, a measure of the level of distribution reliability achieved during 2003 is used to set Gulf Power Company's retail cost recovery factors for 2004.

Q. Does this conclude your testimony?

A. Yes.

CHAIRMAN JABER: Do you tender the witness for cross?

MR. HARRIS: I was going to ask him to briefly summarize his testimony first, Chairman.

COMMISSIONER JABER: Okay. Go ahead, Mr. Breman.

THE WITNESS: Unless you don't want me to.

CHAIRMAN JABER: No, we want you to. Thank you for asking, Jim.

THE WITNESS: I was just trying to expedite this thing.

CHAIRMAN JABER: And where do you work, Jim?

THE WITNESS: I used to work here.

CHAIRMAN JABER: Just kidding.

THE WITNESS: Good morning, Commissioners, ladies and gentlemen. You have heard and read Gulf's claims of past superior service. My testimony directs your attention respectively towards incentives directed at future performance rather than retroactive assessments for past performance.

Rather than attempting to define what superior reliability is, I propose a definition of what poor reliability is for all customers. Defining poor reliability will aid distribution management to be effective in their internal budget debates. Distribution management will be better able to compete with the generation and transmission functions. Simply stated, if you can't keep it, you can't spend it. If you can't spend it, reliability will suffer.

The financial mechanism in JEB-4 provides an efficient regulatory tool to implement distribution reliability. Thank you.

MR. HARRIS: Madam Chairman, I'd like to tender Mr. Breman for cross-examination.

CHAIRMAN JABER: Okay. Thank you. Major?

MR. ERICKSON: No questions.

MR. GROSS: No questions.

MR. PERRY: No questions.

CHAIRMAN JABER: Public Counsel?

MR. BURGESS: Yes.

CROSS EXAMINATION

BY MR. BURGESS:

Q Mr. Breman, I look at the -- one of the changes you made, the first change from 4 percent to 2.1 percent and that took that sentence out of your testimony.

When did you find out about the change to 2.1 percent?

A I think it was on or about the 18th, about four days after my testimony was filed.

Q And how did you find that out?

A I received a phone call from a distribution reliability person at Gulf Power, Ed Battaglia, B-A-T-T-A-G-L-I-A.

Q And what was -- what -- did he simply tell you that the number that you had received was incorrect, or did you, had you drawn an erroneous number somewhere?

A Well, what we -- we had the dialogue. Ed has been part of the distribution reliability working group that we've been meeting with for, since '97, I suspect. And we talked about what he had reported. What, what the company really had calculated and reported was CEMI4. In other words, they reported the number of customers that had received five or more as opposed to more than five.

Q When I look at where the sentence was placed within your testimony, the sentence that has now been extracted or the sentences, I see that it's in response to the question on Page 3, "Why are you proposing an incentive program if Gulf Power Company customers are not complaining about service reliability?" Does this change in this data change your ultimate answer to that question at all?

A No, sir. You yourself and the Commissioners yesterday, I believe it was Mr. Palecki, questioned about some activities that Gulf Power elected not to pursue because of budget constraints. This is a concern of mine and it has been for some time. I've been advocating not cutting distribution budget and that's what this incentive is instructed to do.

Q And so you still would maintain that it would be better to be proactive than reactive to dealing with service interruption?

A Yes, I do.

Q If I could get you to turn to the next page, Page 4. You indicate that at the very, at the very top of the page, "It is sometimes necessary for the Commission to intervene on behalf of the retail customers." Can you -- why, why would you say retail and not wholesale in this context?

A Because the focus of my testimony is directed at the distribution functions. I believe distribution function has no incentive program offered by the Commission to date. I think generation does and I think transmission does. And as such, there is no need to embellish on those. The record of this case is evident that those programs have been successful.

MR. BURGESS: Thank you, Mr. Breman. That's all we have.

CHAIRMAN JABER: Gulf?

MR. STONE: Thank you, Chairman Jaber.

CROSS EXAMINATION

BY MR. STONE:

Q Good morning, Mr. Breman.

A Good morning.

Q In your testimony you described Gulf's overall distribution reliability as good; is that correct?

A Yes, I do.

Q You indicate on Page 3 that the Commission elevated its review of distribution reliability because the level of customer complaints seemed high for Florida Power Corporation, Florida Power & Light and Florida Power Corporation. Is there any indication that customer complaint levels are high for Gulf Power?

A Not today.

Q You indicate in your testimony -- your testimony indicates the use of one indicator, CEMI5, to determine if the company is required to make refunds to customers under your proposal; is that correct?

A Yes, sir.

Q And as we've indicated, that's the percentage of customers experiencing more than five service interruptions in a year?

A Yes, sir.

Q How would you compare CEMI5 to the System Average Interruption Duration Index, I think that's commonly referred to as SAIDI, as far as an overall measure of a company's service reliability?

A They measure two different things. Are you asking me for a dissertation on SAIDI versus CAIDI?

Q They measure two different things.

A Right. Okay.

Q And I was asking for the comparison of CEMI5 versus SAIDI.

A Okay. SAIDI, System Average Interruption Duration, we also say SAIDI, is exactly what it says. It's a system average. The best way to get a handle on what it means is sort of like saying system average fuel factor. No specific customer experiences it.

CEMI5 is the number of interruptions, more than five interruptions, so customers have had repeated interruptions. So it's very customer specific. So there's a strong difference between that.

CEMI5 is directed at looking at pockets, potential pockets of problem areas where there are systemic, possibly systemic problems that need specific attention.

SAIDI, on the other hand, is a system average. It's an overall picture. It doesn't represent anything specific. So the two variables measure two very different things. One is sort of overall average and the other is looking for something very specific.

Q In the determination and setting of rates, the company, the Commission looks at the average cost to all customers; isn't that correct?

A I think the struggle is to try to set the rate for each respective rate class and to try to get the pot right that you start cutting up into the respective pieces for those subcategories.

What, what you seem to be going at is in distribution, sort of akin to discrimination concerns. SAIDI is, is very concerned with the total number of customers. So if you have a population dense area, every dollar spent is going to have potentially a better effect in the higher population area than in the rural area. And so that creates a, a questionable practice that makes possibly customers in rural areas not have the, the benefit of improved distribution reliability because SAIDI is driving the investment activities in the higher, more urbanized areas.

Q I guess the point of what I was trying to get at is those are two different measures of system reliability and you've only focused on one; is that correct?

A Yes.

Q Okay. Now as I understand your example, the utility would pay a penalty for each of the first months under your, as shown on your Schedule JEB-4.

A Yes.

Q Okay. And there would be no penalty for the last four months of your schedule.

A Yes.

Q Now the numbers shown on your JEB-4, those are not actual numbers for Gulf, are they?

A That's correct. These are examples.

Q They're just numbers made up for purposes of your example?

A Yes, sir.

Q Okay. Now does your example calculate the variance from your 2 percent standard on an annual basis or on a monthly basis?

A On a 12-month moving period.

Q Okay. So each of those months represents the previous 12 months?

A That's correct.

Q Okay. The best the utility can do in your proposal is to avoid paying a penalty; is that correct?

A No. The best the utility could do is provide reliable service and minimize CEMI5.

Q But in terms of the incentive mechanism you have provided, the best it can do is avoid paying a penalty?

A I guess you could see it that way.

Q Okay. Are you familiar with the expression, "Use a carrot or a stick"?

A Yes.

Q Okay. Then would you characterize your program as using a carrot or a stick?

A You mean stop beating you with a stick?

The, the carrot is not in my proposal.

Q So it is a stick?

A This part is. The Commission's purview in this case is addressed in other areas. I believe the company has offered many other "give me stick" requests from the Commission and "give me carrot" requests from the Commission. I believe we heard it by the opening comments of your first witness.

So I believe the carrot is already being presented to the Commission. This is the stick part, I guess.

Q But your program as a stand-alone basis does not offer any opportunity for a reward.

A It operates as one of the various pieces and tools that the Commission has to promote incentive regulation.

Q But there is no opportunity for a reward under your program.

A Not on this schedule.

Q Is it possible that weather conditions could be a determining factor as to whether refunds are required by your CEMI5 proposal?

A Its' possible. Also, SAIDI is severely affected by weather. You could be very lucky and have great SAIDI.

Q Does your CEMI5 proposal take into account any other uncontrollables such as cars hitting power line poles, customers digging into underground cables, capitalism?

A Not in any great detail. If you notice in the sections where I do a weight, where I do Column 5, there's a weight that I put in there. And that sort of normalizes the causes. There's going to be a certain amount of noise in distribution reliability indices, they're going to go up and go down because of weather, and so there needs to be some sort of weighting scheme. And I took that into account to some extent in the weights.

Q But you don't take into account other uncontrollables besides weather in your weighting?

A Just generically I apply weight to account for all noise.

Q And there are a number of things that are outside the utility's control that might affect customer interruptions.

A Yes, sir.

Q Now make sure I understand your proposal. The refunds that you're talking about in your proposal, do those go to the customers who suffer the outages greater than five or do they go to all customers?

A They go to all customers.

Q Okay. Do you have any idea how much it would cost to administer such a program?

A I have not assessed the costs.

Q Would -- if you have customers that are experiencing frequent interruptions, the dollars spent to administer this program could actually be spent to cure the problem, could, could it not?

A Well, I guess anything can be argued theoretically. The facts that we have in this case was that I filed my testimony. Four days later I got a response about what the right number was from Gulf Power. Not only that, Gulf Power has filed a CEMI5 number for the past year of 2001 of, of

1 percent. So I don't know that it's extremely difficult for Gulf Power to calculate this number or that there's much expense involved at all.

Q But in terms of any of that money that's spent in terms of administering the program is money that's taken away from the ability to be spent on actually addressing the interruption?

A Sure. If the company spends the money at all.

Q Okay. At the bottom of Page 5, top of Page 6, you reference the effects of direct Commission intervention. What did you mean by that?

A The investigation that we've done into distribution reliability.

Q And that's where you're referring to where, where there was the high incidence of complaints at Florida Power & Light and Florida Power Corporation?

A Right. And it triggered sort of what I would call a road show. We did investigations into things as far afield as damage claims. We did investigations into lightening management and so on. There's been a lot of heightened investigation that, to my knowledge, is a little bit new in the way we've been doing business.

Q Okay. But in terms of your reference to direct Commission intervention, there was, there have been no orders entered directed at Gulf, there's been no direction specifically indicated by, by the Commission to Gulf with regard to its distribution reliability?

A I believe in general you're correct. The presentations have been through the Internal Affairs medium.

Q So would it be fair to say then at least with respect to Gulf Power Company the intervention by the Commission is indirect?

A No. I believe the presentations to the Commissioners are very detailed. I believe it's all inclusive. Even Florida Public Utility's two divisions have been included in those reports. So the Commission is making an assessment when we make our presentation to the Commission about how is the distribution reliability doing for the utilities. It is the utilities, it's not just FPL, it's not just Florida Power Corp. It's all five of the utilities.

Q But in terms of the intervention that you're referring to, it is simply a reporting. There have been no specific actions directed by the Commission.

A That's correct.

Q So in terms of the response the utilities and Gulf in particular have taken in reaction to those reports, those have not been by direct invention but rather indirect?

A I guess you could view it that way.

CHAIRMAN JABER: Mr. Breman, is your point that just by monitoring and reporting it really has incented the utilities to address the issues so that the Commission has not had to undertake any enforcement proceedings?

THE WITNESS: That's probably a lot more gently than I would say it. I would simply say the Commission --

CHAIRMAN JABER: I didn't hear you, Mr. Breman.

THE WITNESS: That's probably a lot more gently and politically correct than the way I would say it.

In my mind, any time the Commission asks a question, that's almost like a stick. It's a threat. If you don't fix it --

CHAIRMAN JABER: Some might call that incentive regulation.

THE WITNESS: Right. If you don't fix it, we're going to step in and fix it for you. It might be unwritten, it might be unspoken, and it might not be in an order, but I think the Commission's attention to something means that something rose to that level and, and some sort of mediation is necessary.

BY MR. STONE:

Q But, again, my understanding is that you agree that there was not the same situation at Gulf that would -- led to the Commission's action in response to complaints at Power Corp. and Power & Light?

A That's correct.

Q You indicate in your testimony that distribution reliability should not decline between rate cases.

A Yes.

Q Are you suggesting that Gulf Power's distribution reliability declined following the company's last rate case, which was Docket Number 89-1335-EI?

A I can't say what level of service was provided prior to 1997 with respect to distribution reliability. The quality of data was somewhat suspect. So relative to 1997 distribution reliability has in general improved.

Q And there's been no rate case since 1997.

A That's correct.

Q Until now.

A That's correct.

Q But you do not have any evidence that Gulf Power's distribution reliability declined after its last base rate increase some 12 years ago?

A I don't have any information that I can rely on prior to '97.

Q Now earlier you indicated a preference for a utility to be proactive rather than reactive; is that correct?

A That is correct.

Q If the utility spots an emerging trend of increasing tree-related outages or, or other specifically caused outages, would that utility be justified in spending additional dollars in a program that is designed to address that problem before it shows up in increased customer complaints?

A Yes.

MR. STONE: Thank you. I have no further questions.

CHAIRMAN JABER: Thank you, Mr. Stone.

Mr. Breman, I'm trying to understand the incentive program that you're recommending, and, candidly, you're going to have to walk me through it because I wasn't real clear on what it is you're recommending that we implement in the form of an incentive program.

Starting on Page 3 of your testimony, you're saying when a company has -- and you need to correct me if I'm wrong, because I don't want to characterize your testimony, but this is working up into a question. You say that there are sometimes forces and conflicts related to the company maintaining their financial posture because that's what they have to do, and, and sort of mitigating where improvements have to be made. And you want us to be more proactive in making sure things like distribution reliability are at the forefront of their decision making.

How is it -- what incentive program would accommodate that very admirable goal, but what incentive program can we implement to make sure that things like the vegetation management, you know, tree-trimming and all of those maintenance sorts of issues can be resolved?

THE WITNESS: The, the tool that you need to give the utilities is, is within their corporate structure.

Distribution managers like Mr. Fisher testified that they had to put certain projects on hold. The ability to elect, to put projects on hold, it needs to be considerably eroded. So you need to give Mr. Fisher a tool to argue for not cutting the distribution budget but increasing it when Mr. Fisher argues with the generation managers and the transmission mission managers. You've already provided internal management for generation with incentives and you've provided management of transmission with incentives through the clauses. You need to do similar things with distribution.

CHAIRMAN JABER: So would an ROE factor be consistent with your recommendation that an incentive program be implemented for distribution reliability?

THE WITNESS: An ROE factor like I have constructed or an ROE factor as constructed by the utility?

CHAIRMAN JABER: Both. Let's, let's have you comment on both. The company has proposed allowing the range to expand far away; you heard Mr. Bowden testify to that and some of the other witnesses. Comment on that and whether that sort of fits into your idea for an incentive program, and then tell me if you think your proposal would work.

THE WITNESS: I guess I'm, I'm very skeptical about the program proffered by Gulf Power. There's no assurance that Mr. Fisher's budget won't get cut. The company will be pursuing a higher ROE and then hand out their budget decisions, and so the tension between ROE and expenses will continue to exist.

CHAIRMAN JABER: Could we add -- do you remember Mr. Bowden testified that the PSC would actually establish the criteria and automatically a refund or a sharing mechanism would be made if the criteria were met? Could we add as a criteria certain expectations with respect to distribution reliability?

THE WITNESS: You could.

CHAIRMAN JABER: And that would satisfy your concern?

THE WITNESS: That would, that would help a lot, yes. But I don't know what the right sharing starting point is. I don't know how wide that is simply because the effective earnings could be substantial. And if distribution reliability isn't where it should be, I'm really kind of callous to where ROE goes.

CHAIRMAN JABER: Okay. Now how could your proposal be modified?

THE WITNESS: Well, I just stayed away from the ROE level itself. I'm not an ROE expert witness. I really don't know what number you should target or add to.

CHAIRMAN JABER: Okay. Thank you. Commissioners, any other questions?

COMMISSIONER PALECKI: Yes. On your penalty provision you recommend a cap of ten basis points. In order to have both a carrot and a stick, could you allow Gulf Power to retain earnings ten basis points over their allowed rate of return if they achieve some level of excellence so that you have a two-sided stick and carrot approach?

THE WITNESS: Well, if you modify your question to exclude the word "excellence," I would probably agree. But, but what you said and what Commissioner, the Chairperson said to me sound very, very similar. I can't distinguish the two programs.

COMMISSIONER PALECKI: Well, I guess what I'm asking you is if you were to take your program, which is relatively simple and it doesn't sound like it would be that difficult to implement, but wanted to add a carrot in the same ten basis point amount, how would you go about accomplishing that?

THE WITNESS: Oh, I see. A very similar format as, as what is here. You would have to have some sort of debate or expert witness offer what the standard would be for, for the respective indices like the ones that I have in my testimony on JEB-1. I'm not sure what the right level are for those indices.

For example, there's one that's specifically interesting. It's called CAIDI, C-A-I-D-I. It represents the average time it takes to restore service to an interrupted customer. I'm not sure that, that some number near 90 minutes is a reasonable level. And so when you start trying to set values for these things, it becomes a little bit subjective, probably argumentative. And I really don't know what the right level is for, for all the indices that are in JEB-1.

COMMISSIONER PALECKI: So it could be accomplished. It would just require a separate proceeding where we specifically addressed where we wanted to put those criteria.

THE WITNESS: I think it's doable, but I don't have the information with me to say what the right number is for the rest of the indices.

COMMISSIONER PALECKI: And you've put a cap of ten basis points on your penalty provision. Do you really call that a stick or is it more like a twig?

THE WITNESS: As I indicated in my testimony, sir, I was not intending to be punitive.

COMMISSIONER PALECKI: Wouldn't we -- I mean, could we look at a 25 basis point penalty and then a 25 basis point reward or some, something that might be a little bit more meaningful, 50 basis points maybe?

THE WITNESS: That's, that's totally within your discretion, sir. I would not be opposed to whatever number you selected.

COMMISSIONER PALECKI: Thank you.

CHAIRMAN JABER: Other questions, Commissioners? Okay. Staff, redirect?

MR. HARRIS: Thank you, Ms. Chairman.

REDIRECT EXAMINATION

BY MR. HARRIS:

Q Mr. Breman, are you familiar with Mr. Fisher's testimony regarding the distribution problems he faces due to tree-trimming activities?

A Yes, sir.

Q Okay. Are the issues Mr. Fisher is facing, that is, a reliance on a less effective spot trimming method, the type of problems you're referring to when you're referring to budget problems within Gulf Power?

A I think the answer to the question is yes.

Q Do you need me to repeat the question?

A Well, I think Mr. Fisher is trying to respond as best he can to address reliable distribution service with the tools he has at hand. While he may want to do other things, I'm not sure he's totally empowered to do it with the current scheme.

Q And you believe that your, your proposal would allow a tool that Mr. Fisher could use to do the things he needs to do to ensure distribution reliability?

A Yes.

Q And that would include the optimal tree-trimming cycle?

A Yes.

CHAIRMAN JABER: Mr. Breman, do you think just by virtue of the fact we've discussed this today at the hearing that we've sort of given Mr. Fisher some power?

THE WITNESS: I would agree with you, but Mr. Stone may not.

COMMISSIONER PALECKI: Well, Mr. Breman, the problem we're seeing is that in order to maximize earnings during a given time period -- and so quarterly reports look favorable. Sometimes utilities will defer maintenance schedules or maintenance functions in order to achieve those higher rates of earnings; correct?

THE WITNESS: I, I would agree with you. I don't think they defer the functions for generation as readily as they probably would distribution.

COMMISSIONER PALECKI: Because they can.

THE WITNESS: Because they can. And, similarly, they're not going to defer transmission as readily as they will distribution simply because they can. And I think we heard that customers in Florida demand higher reliability than they have in the past, and that trend is not going to go away.

COMMISSIONER PALECKI: So you have a situation where if there are going to be means for a, a utility to, to maximize their revenues and to, to see savings, it'll come from the distribution side generally.

THE WITNESS: I would hope, yeah.

COMMISSIONER PALECKI: And what you want to do is to put some incentive in place so that the savings won't come out of the, out of the distribution side. And if these expenditures are not made and the maintenance is not kept up to date, it will actually hurt the company financially?

THE WITNESS: Yes, sir. I think you've got a handle on it.

COMMISSIONER PALECKI: And have you seen any other utilities, without mentioning the names of the utilities, apart from Gulf Power that have deferred maintenance and their distribution systems have suffered because of it?

THE WITNESS: I'll refer to a publication I read that was filed with the IEEE. The distribution reliability is a fallout of budget expenses, not something that's proactive and planned. And that's a piece of information that, that is generic and historic and commonly accepted. And I read it back in 1997 when I started looking into distribution reliability and it concerned me greatly. That's why I propose this mechanism.

COMMISSIONER PALECKI: Thank you.

BY MR. HARRIS:

Q Mr. Breman, regarding the difference between the CEMI5 and the SAIDI index, I think you touched on this, but is it possible that a company could have, any company could have very, very good SAIDI numbers and still have very poor CEMI5 numbers?

A It's possible.

Q How would that situation occur?

A You could have customers being repeatedly put out of service for shorter periods of time. Not all outages have to last five hours, they could be short, and so there could be situations like that that occur.

Heavy vegetation areas, areas where vegetation grows quickly and aren't adequately maintained would probably be characteristic of where there's high CEMI5 but low overall SAIDI.

Q I believe you referred in your testimony to the issue of population density reflecting higher SAIDI numbers; the higher the population density, the more a small amount of investment pays off than in a lower population area; is that correct?

A Yes.

Q And would that be shown in CEMI5 numbers, also?

A CEMI5 is just simply the straight up number of, of, number of customers being affected more than five times. It doesn't really -- it's not concerned about whether it's in a rural area or an urban area. It doesn't discriminate.

Q So that would be a way for, that would be a way, that would be a tool that could prevent investment from being focused solely on high density areas?

A That's right. It treats customers in a uniform fashion.

Q All right. I understand that one of your major concern is, concerns is either budget cuts or just not spending budgeted amounts on distribution reliability issues; is that correct?

A Yes.

Q And at this point you believe that there is no prospective way to enforce that; is that correct?

A I'm not --

Q At this point there's no mechanism in place or tool in place that would assure that on a going-forward basis budgeted amounts are spent for distribution reliability expenses?

A I would agree that there's nothing that ensures it gets spent. That's correct.

Q And would it be correct to say that part of your proposal is an attempt to ensure that on a going-forward basis distribution reliability dollars will actually go for distribution reliability improvement?

A Yes.

Q Okay. And would it be fair to say that you're proposing this so that we won't have distribution reliability problems in the future such as Gulf through its witnesses is testifying to at this time, distribution type problems?

A Yes. It's very unlikely that distribution reliability would decline.

Q Will decline. All right.

As far as Commission involvement in the distribution reliability issue, do you know whether the Commission has conducted any type of management audits on the subject of electric service reliability since 1997?

A Yes, they have.

Q Okay. And do you know if that was instituted as a result of declining service by some investor-owned utilities?

A It was.

Q Okay. And do you know whether the Commission conducted a follow-up to the electric service reliability in the Year 2000?

A Yes, they did.

Q Okay.

CHAIRMAN JABER: Was Gulf Power part of those audits?

THE WITNESS: They were part of the first audit. I believe the first audit was published in December of '97. I'm working from memory here. I apologize.

I believe there's a subsequent one that came out something like two years, very close to two years later. I think it only addressed FPL and FPC.

I think recently there was a lightening audit, and it addressed, I believe, all four utilities. Florida Public Utilities was not part of the reports.

BY MR. HARRIS:

Q So would it be fair to say that although the Commission has not entered any orders on distribution reliability, it has, in fact, taken some type of direct action?

A Yes.

Q All right. And is one of the goals of your program to prevent the Commission from having to take future direct action regarding electric reliability?

A That's correct.

MR. HARRIS: That's all I have. Thank you.

CHAIRMAN JABER: Exhibit 46 is admitted into the record without objection.

(Exhibited 46 admitted into the record.)

CHAIRMAN JABER: Thank you, Mr. Breman.

(Witness excused.)

CHAIRMAN JABER: We're going to take a break until ten after 11:00.

(Transcript continues in sequence with Volume 9.)

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STATE OF FLORIDA)

: CERTIFICATE OF REPORTER

COUNTY OF LEON)

I, LINDA BOLES, RPR, Official Commission Reporter, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorneys or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 27TH DAY OF FEBRUARY, 2002.

Linda Boles

LINDA BOLES, RPR
FPSC Official Commissioner Reporter
(850) 413-6734