

**BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION**

DOCKET NO. 130140-EI



**TESTIMONY AND EXHIBIT
OF
RICHARD J. MCMILLAN**

1 GULF POWER COMPANY

2 Before the Florida Public Service Commission
3 Prepared Direct Testimony of
4 Richard J. McMillan
5 Docket No. 130140-EI
6 In Support of Rate Relief
7 Date of Filing: July 12, 2013

8 Q. Please state your name and business address.

9 A. My name is Richard McMillan. My business address is One Energy Place,
10 Pensacola, Florida 32520.

11 Q. By whom are you employed?

12 A. I am employed by Gulf Power Company (Gulf or the Company) as the
13 Forecasting, Budgeting and Corporate Performance Manager.

14 Q. What are your responsibilities as Gulf's Forecasting, Budgeting and
15 Corporate Performance Manager?

16 A. My primary responsibilities are to ensure that Gulf's sales, customer,
17 demand, and revenue forecasts are accurate; coordinate the preparation,
18 review, and reporting for the Company's operation and maintenance (O&M)
19 budget; and ensure that management is provided timely and accurate
20 reporting of results.

21 Q. Please describe your educational and professional background.

22 A. I graduated from Louisiana State University in 1976 with a Bachelor of
23 Science in Accounting. Immediately following graduation, I was employed
24 by Gulf as an Internal Auditor. I have held various accounting positions of
25

1 increasing responsibility, including Staff Internal Auditor, Staff Financial
2 Analyst, Staff Accountant, Coordinator of Internal Accounting Controls,
3 Supervisor of Financial Planning, General Accounting Manager, Assistant
4 Comptroller, and Corporate Planning Manager. I have held my current
5 position since September 2012. Also, during my employment, I graduated
6 from the University of West Florida in 1983 with a Master of Business
7 Administration.

8

9 Q. What is the purpose of your testimony?

10 A. I will present and support Gulf's O&M expense Benchmark calculations and
11 will provide an overview of Southern Company Services (SCS) and the
12 services and benefits Gulf receives from the service company and other
13 affiliates. I will also address Gulf's employee complement and present the
14 calculation of a hiring lag adjustment that quantifies the O&M labor impact
15 of normal employee turnover.

16

17 Q. Are you sponsoring any exhibits?

18 A. Yes. I am sponsoring Exhibit RJM-1, Schedules 1 through 5. Exhibit
19 RJM-1 was prepared under my supervision and direction, and the
20 information contained in that exhibit is true and correct to the best of my
21 knowledge and belief.

22

23 Q. Are you also sponsoring any of the Minimum Filing Requirements (MFRs)
24 filed by Gulf?

25 A. Yes. The MFRs that I sponsor in their entirety and that I jointly sponsor

1 are listed on Schedule 1 of my Exhibit RJM-1. To the best of my knowledge
2 and belief, all of the information presented in the MFRs that I sponsor or co-
3 sponsor is true and correct.

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6 **I. O&M BENCHMARK ANALYSIS**

7
8 **Q. Has the Company prepared an O&M Benchmark variance by function?**

9 **A. Yes. The Benchmark variance by function is included in MFR C-41, and**
10 **Schedule 2 of Exhibit RJM-1 shows the functional summary for the test**
11 **year. As shown on Schedule 2, the Company's total adjusted O&M of**
12 **\$295,916,000 for the test year is \$2,505,000 over the Benchmark. The**
13 **justifications for each functional variance are included in MFR C-41 and are**
14 **addressed by the appropriate Company witnesses.**

15
16 **Q. Please explain how the Benchmark variances were calculated.**

17 **A. The first step in the calculation of the Benchmark variances is to determine**
18 **the base year O&M amounts. These are the adjusted 2012 test year O&M**
19 **expenses allowed in Gulf's last rate case. The derivation of the 2012**
20 **allowed amounts by function is included in MFR C-39 and Schedule 3 of**
21 **Exhibit RJM-1. The adjustments in columns 4 through 7 include the system**
22 **amount of the Company and Florida Public Service Commission (FPSC or**
23 **the Commission) adjustments, column 8 restates the Federal Energy**
24 **Regulatory Commission (FERC) functional classification for certain**
25 **approved 2012 test year activities which the Company is now recording and**

1 budgeting to different accounts, and column 9 reflects the system allowed
2 O&M by function. This amount is included in column 3 of Schedule 2 of my
3 Exhibit.

4
5 The second step is to escalate these base year amounts by the compound
6 multipliers noted in column 4 of Schedule 2 in order to derive the Test Year
7 Benchmark amounts included in column 5.

8
9 The third step is to calculate the adjusted 2014 test year O&M expense
10 request by function included in column 6 of Schedule 2. The derivation of
11 these figures is shown on MFR C-38 and Schedule 4 of Exhibit RJM-1.

12
13 The final step is to compare the test year requested O&M in column 6 of
14 Schedule 2 to the Test Year Benchmark in column 5 in order to calculate
15 the variance shown in column 7.

16
17 Q. Please explain the functional adjustments you made in column 8 of
18 Schedule 3 of Exhibit RJM-1.

19 A. These adjustments reflect the fact that two categories of costs are now
20 being recorded in different FERC functional accounts than in Gulf's 2012
21 test year rate case. Based on an evaluation of Automated Metering
22 Infrastructure (AMI) support costs, the Company decided to charge more of
23 these costs to Customer Accounting accounts (and reduce the amount
24 being charged to Distribution and Customer Service and Information
25 accounts) since these costs are primarily related to obtaining and evaluating

1 the electronic meter readings. The second change was a result of moving
2 the Forecasting and Pricing functions under the Chief Financial Officer from
3 the Customer Operations Business Unit. When this organizational change
4 was made and the new accounts for these areas were established,
5 management decided that the related costs would be charged to A&G
6 rather than to the Customer Service and Information accounts in which they
7 were formerly recorded.

8
9 I identified the total amounts approved in Gulf's last rate case for these
10 functions and have simply reclassified those costs to the functional
11 accounts currently being used to record these expenses. As shown in
12 Column 8, these adjustments net to \$0, and the adjustments are necessary
13 to accurately reflect the benchmark variances based upon the current
14 accounting for these costs.

15
16 Q. How is the Benchmark used to evaluate the reasonableness of O&M
17 expenses?

18 A. The Benchmark methodology escalates the base year approved expenses
19 for each function by customer growth (except for Production) and inflation,
20 as measured by the Consumer Price Index (CPI). If the projected test year
21 expenses for any function exceed the Benchmark, this triggers a
22 requirement that the Company explain the reasons for the variance. The
23 Benchmark is thus a tool used to identify specific expense amounts that
24 warrant further explanation and justification of the reasonableness of the
25 test year request during the course of a rate case.

1 Q. What types of factors can cause test year expenses to exceed the
2 Benchmark for a particular functional area?

3 A. Benchmark variances may be explained by a variety of factors. For
4 example, an O&M increase in pension costs due to the performance of the
5 financial markets, an increase in the requested storm damage reserve
6 accrual, or an increase in transmission vegetation management costs
7 necessary to ensure compliance with North American Electric Reliability
8 Corporation (NERC) requirements are unrelated to either customer growth
9 or inflation. As shown in Schedule 2 of Exhibit RJM-1, the Company's total
10 adjusted O&M expense of \$295,916,000 is \$2,505,000 above the
11 Benchmark. The witnesses for each functional area that had O&M
12 expenses over its Benchmark explain the reasons for that variance.

13
14 Q. Does the fact that the adjusted O&M expense exceeds the Benchmark
15 provide any basis to adjust the Company's test year O&M request?

16 A. No. The Benchmark simply identifies areas that may require additional
17 explanation. The testimony of the Company's functional witnesses provides
18 that explanation. That testimony demonstrates that the projected test year
19 expense is reasonable and prudent to continue to provide reliable electric
20 service to our customers, and it is representative of the level of expenses
21 that will be incurred in the future.

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1 **II. SOUTHERN COMPANY SERVICES**

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Q. Please provide an overview of SCS and its relationship to Gulf.

A. SCS is a subsidiary of Southern Company which provides various services to Gulf and the other subsidiaries of Southern Company. Gulf receives many professional and technical services from SCS, such as general and design engineering for transmission and generation; system operations for the generating fleet and transmission grid; and various corporate services and support in areas such as accounting, supply chain management, finance, treasury, human resources, information technology, and wireless communications.

All services provided by SCS are provided at cost. Costs are determined and billed in two ways. Costs are directly assigned to the company receiving the services when possible. Where direct assignment is not possible, costs are allocated among the subsidiaries receiving services based on a pre-approved cost allocator appropriate for the type of services performed. Typical allocators include employees, customers, loads, generating plant capacity, and financial factors. The methodology for developing the allocators is the same methodology used by Gulf and accepted by the Commission in Gulf's last rate case. The allocators are approved by SCS and by management of the applicable operating companies and are updated annually based on objective historical information.

1 Q. How often are the service company allocation factors updated?

2 A. The allocation factors are typically recalculated once a year based upon the
3 prior year's actual data, and the updated factors are used to develop the
4 budget amounts and subsequently to bill the actual costs for the following
5 year. For example, the 2013 budget allocators used in this case were
6 updated in 2012 based upon the 2011 actual data. The allocation
7 methodology used in the SCS budgeting and billing processes has
8 remained consistent for many years and is essentially the same
9 methodology previously reviewed and approved by the Commission in our
10 prior rate cases.

11
12 Q. What benefits does Gulf enjoy by obtaining services from SCS?

13 A. Gulf and its customers receive several benefits. The existence of SCS
14 facilitates the economic dispatch and sharing of generation resources,
15 avoids duplication of personnel in the various operating companies,
16 provides economies of scale in purchasing and other activities, and enables
17 Gulf to draw on shared experience from a centralized pool of professional
18 talent. As one of the smaller operating companies, access to these shared
19 resources is particularly valuable to Gulf, which otherwise would have to
20 employ additional professional and technical personnel who might not be
21 fully utilized on a continuous basis. The benefits received by Gulf include
22 but are not limited to the following: SCS administers the Intercompany
23 Interchange Contract and coordinates the economic dispatch of the
24 Southern System generating resources to minimize the energy costs to our
25 customers; SCS negotiates system-wide purchase agreements with

1 vendors to maximize volume procurement savings for our customers; Gulf
2 utilizes SCS engineering for the planning, design, and project management
3 related to large generation and transmission projects; and SCS manages
4 the centralized filing of income tax returns and provides review, instructions
5 and guidance to the subsidiaries to ensure compliance with IRS regulations
6 and requirements.

7
8 **Q. Are there other affiliate transactions included in your test year amounts?**

9 **A. Yes. As noted in MFR C-30, Gulf has included other utility related**
10 **transactions with Southern Company affiliates. All affiliate transactions are**
11 **for utility services such as production plant joint ownership billings,**
12 **transmission facility services, material transfers, and storm restoration**
13 **assistance. These transactions benefit our customers by enabling Gulf to**
14 **receive needed materials and services at cost from the other affiliates and**
15 **they are accounted for in accordance with Rule 25-6.1351, Florida**
16 **Administrative Code.**

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19 **III. Employee Complement**

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21 **Q. How many employees are included in Gulf's test year request?**

22 **A. Gulf's test year request includes a full complement of 1,463 employees for**
23 **2014. This is a net reduction of 26 positions compared to the complement**
24 **of 1,489 employees requested in our last rate case.**

1 Q. Did the Commission make an adjustment in Gulf's last case to labor
2 expense related to the number of employees requested?

3 A. Yes. In the last case, Gulf requested 159 additional positions compared to
4 the actual staffing level at the end of its 2010 base year. The Commission
5 found that 44 positions had not been filled at the time of the final hearing,
6 and made an adjustment to eliminate the labor expense associated with
7 those unfilled positions.

8

9 Q. Did the Commission find that any of Gulf's budgeted positions for the 2012
10 test year had not been justified by the Company?

11 A. No. The disallowance was based on the fact that the positions were vacant,
12 not that they were unneeded.

13

14 Q. Has Gulf filled all of the positions included in the 2014 test year budget?

15 A. Not at this time. As discussed by Gulf Witness Teel, since the last rate case
16 Gulf's achieved return on equity has remained below the bottom of the
17 Commission authorized range. To minimize costs during this period in
18 hopes of avoiding the necessity of a further rate increase, Gulf refrained
19 from filling vacant positions whenever possible in addition to other
20 temporary cost containment efforts. This was a continuation of the efforts to
21 minimize costs that Gulf has been taking since the start of the Great
22 Recession.

23

24 While not filling vacancies is a short-term strategy for minimizing labor
25 costs, it is not possible to continue to operate at these artificially low

1 employee levels for the long-term without compromising the Company's
2 ability to provide efficient, high-quality service. The positions included in the
3 2014 test year budget are reasonable, necessary and representative of
4 future staffing levels under normal economic circumstances.

5

6 Q. Even if Gulf makes every effort to fill all employee positions, won't some
7 positions be vacant for part of the year due to voluntary and involuntary
8 separations, retirements, deaths, transfers within the Southern Company
9 system, and transfers within Gulf?

10 A. Yes. This type of hiring lag is found in any business.

11

12 Q. Since you acknowledge that some vacancies can be expected due to hiring
13 lag, should the Commission make a labor expense adjustment in this case
14 to account for that lag?

15 A. As I previously stated, the requested employee complement is an
16 appropriate staffing level for the Company. Furthermore, in normal
17 circumstances, any unspent payroll dollars resulting from hiring lag will most
18 likely be spent on contract labor, overtime, or other operational priorities.
19 Although the Company doesn't believe a labor adjustment is necessary or
20 appropriate, Gulf has included an adjustment to labor in the current
21 proceeding to be consistent with the prior Commission practice of making
22 labor expense adjustments related to hiring lag or vacancies.

23

24 Q. How did you calculate this adjustment?

25 A. The hiring lag adjustment takes into account Gulf's estimated employee

1 turnover, the average time it takes to fill a vacant position, and the average
2 salary for vacant positions. The calculation of the adjustment is shown on
3 Schedule 5 of Exhibit RJM-1. The average employee turnover (including
4 voluntary and involuntary terminations, retirements, and system transfers)
5 and the average time it has taken to fill positions were derived based upon
6 the Company's historical records for 2009 through 2012. The hiring lag
7 base salary amount was derived by multiplying the average turnover by the
8 time to fill positions times the salary level by employee classification as
9 shown on Schedule 5. This calculation resulted in a total base salary hiring
10 lag of \$519,191. Of this amount, \$373,818 represents the O&M portion,
11 which I then increased to include the estimated fringe benefits and variable
12 compensation, resulting in a total hiring lag adjustment of \$557,736. Gulf
13 Witness Ritenour has made an NOI adjustment to reduce test year
14 expenses \$557,736.

17 IV. SUMMARY

18
19 Q. Please summarize your testimony.

20 A. Gulf's total adjusted O&M for the test year is \$2,505,000 over the
21 Commission benchmark. Where the projected expenses for a particular
22 functional area exceed the O&M Benchmark, the functional witnesses
23 explain the reasons for that variance. As stated by the Company's
24 functional witnesses, the projected test year expense is reasonable and
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1 prudent to continue to provide reliable electric service to our customers, and
2 it is representative of the level of expenses that will be incurred in the future.

3

4 SCS is a subsidiary of Southern Company which provides numerous
5 professional and technical services at cost to Gulf and the other subsidiaries
6 of Southern Company. Gulf's ability to obtain these services from SCS
7 benefits our customers in a variety of ways, including cost savings due to
8 economies of scale and access to the shared experience of a group of
9 highly trained professionals that it would be impractical to try to replicate at
10 the Company level.

11

12 Gulf's test year request includes a full complement of 1,463 employees.
13 These positions are reasonable, necessary and representative of future
14 staffing levels under normal economic circumstances. Nevertheless, to be
15 consistent with the Commission practice of making labor expense
16 adjustments for some level of vacancies, Gulf is proposing a hiring lag
17 adjustment to our test year request which quantifies the reduction in O&M
18 labor costs resulting from normal employee turnover.

19

20 Q. Mr. McMillan, does this conclude your testimony?

21 A. Yes.

22

23

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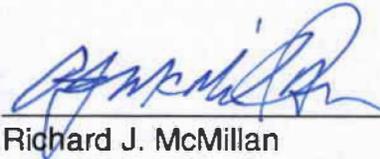
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AFFIDAVIT

STATE OF FLORIDA)
)
COUNTY OF ESCAMBIA)

Docket No. 130140-EI

Before me the undersigned authority, personally appeared
Richard J. McMillan, who being first duly sworn, deposes, and says that he is the
Forecasting, Budgeting, and Corporate Performance Manager of Gulf Power
Company, a Florida corporation, and that the foregoing is true and correct to the
best of his knowledge, information, and belief. He is personally known to me.



Richard J. McMillan
Forecasting, Budgeting, and
Corporate Performance Manager

Sworn to and subscribed before me this 8th day of July, 2013.



Notary Public, State of Florida at Large

Commission No. EE166803

My Commission Expires 2/6/16



Responsibility for Minimum Filing Requirements

<u>Schedule</u>	<u>Title</u>
C-6	Budgeted Versus Actual Operating Revenues and Expenses
C-7	Operation and Maintenance Expenses – Test Year
C-30	Transactions with Affiliated Companies
C-33	Performance Indices
C-35	Payroll and Fringe Benefit Increases Compared to CPI
C-36	Non-Fuel Operation and Maintenance Expense Compared to CPI
C-37	O&M Benchmark Comparison by Function
C-38	O&M Adjustments by Function
C-39	Benchmark Year Recoverable O&M Expenses by Function
C-40	O&M Compound Multiplier Calculation
C-41	O&M Benchmark Variance by Function
C-43	Security Costs

**OPERATION AND MAINTENANCE EXPENSES
BENCHMARK VARIANCE BY FUNCTION
2012 ALLOWED COMPARED TO TEST YEAR REQUEST EXPENSES**

(1)	(2)	(3)	(4)	(5)	(6)	(7)
Line No.	Description	2012 Allowed	Compound Multiplier	Test Year Benchmark (3) X (4)	Test Year Request	Variance
1	Steam Production	95,311	1.05007	100,083	91,723	(8,360)
2	Other Production	7,312	1.05007	7,678	11,142	3,464
3	Other Power Supply	4,312	1.05007	4,528	3,871	(657)
4	Total Production	<u>106,935</u>	1.05007	<u>112,289</u>	106,736	(5,553)
5	Transmission	11,320	1.07161	12,131	13,733	1,602
6	Distribution	39,877	1.07161	42,733	42,070	(663)
7	Customer Accounts	24,532	1.07161	26,289	25,795	(494)
8	Customer Service & Information	18,861	1.07161	20,212	16,644	(3,568)
9	Sales	945	1.07161	1,013	1,171	158
10	Administrative & General	<u>73,482</u>	1.07161	<u>78,744</u>	89,767	11,023
11	2012 Allowed O&M Compared to Test Year O&M Request	<u><u>275,952</u></u>		<u><u>293,411</u></u>	<u><u>295,916</u></u>	<u><u>2,505</u></u>

Note: Total O&M less Fuel, Purchased Power, ECCR, ECRC and Other Regulatory Adjustments

Florida Public Service Commission
 Docket No. 130140-EI
 GULF POWER COMPANY
 Witness: Richard J. McMillan
 Exhibit No. _____ (FJM-1)
 Schedule 2
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BENCHMARK YEAR RECOVERABLE O&M EXPENSES BY FUNCTION

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Line No.	Function	2012 System Per Books	Eliminate Recoverable Fuel and Purchased Power	Eliminate Recoverable ECRC	Eliminate Recoverable ECCR	Other Regulatory O&M Adjustments	Function Adjustments	2012 Adjusted System Amount
1	Production	882,030	(730,362)	(30,440)	0	(14,293)	0	106,935
2	Transmission	14,269	(2,657)	0	0	(292)	0	11,320
3	Distribution	43,781	0	(2,185)	0	(1,032)	(687)	39,877
4	Customer Accounts	24,723	0	0	0	(1,054)	863	24,532
5	Customer Service & Information	38,757	0	0	(18,070)	(465)	(1,361)	18,861
6	Sales Expense	1,097	0	0	0	(152)	0	945
7	Administrative & General	82,178	(300)	(706)	(1,241)	(7,634)	1,185	73,482
8	Total O&M Expenses by Function	1,086,835	(733,319)	(33,331)	(19,311)	(24,922)	0	275,952

TEST YEAR O&M ADJUSTMENTS BY FUNCTION

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Line No.	Function	Test Year System Per Books	Direct Fuel, Fuel-Related Expenses and Purchased Power	ECCR	ECRC	Tallahassee Liaison Expenses	Plant Scherer/ UPS	Marketing Support Activities	Management Financial Planning	Economic Development
1	Production									
2	Steam Production	431,622	(303,538)		(24,672)		(10,072)			
3	Other Production	321,851	(310,241)		(51)					
4	Other Power Supply	92,144	(88,018)							
5	Total Production	845,617	(701,797)	0	(24,723)	0	(10,072)	0	0	0
6	Transmission	27,386	(13,624)		(9)		(4)			
7	Distribution	45,738			(3,576)					
8	Customer Accounts	25,850								
9	Customer Service & Information	38,602		(21,931)						
10	Sales Expenses	1,391						(156)		(62)
11	Administrative & General	88,996	(100)	(1,589)	(769)	(306)	(2,616)		(41)	(1)
12	Total Adjustments	1,073,580	(715,521)	(23,520)	(29,077)	(306)	(12,692)	(156)	(41)	(63)

TEST YEAR O&M ADJUSTMENTS BY FUNCTION

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Line No.	Function	Wholesale Sales Expense	Advertising	Rate Case Expenses	Property Insurance Reserve	Hiring Lag	Perdido Unit 3	Plant Scholz	Subtotal Adjustments	Total Adjusted O&M
1	Production									
2	Steam Production					(142)		(1,475)	(339,899)	91,723
3	Other Production					(17)	(400)		(310,709)	11,142
4	Other Power Supply	(255)							(88,273)	3,871
5	Total Production	0	0	0	0	(159)	(400)	(1,475)	(738,881)	106,736
6	Transmission					(16)			(13,653)	13,733
7	Distribution					(92)			(3,668)	42,070
8	Customer Accounts					(55)			(55)	25,795
9	Customer Service & Information					(27)			(21,958)	16,644
10	Sales Expenses					(2)			(220)	1,171
11	Administrative & General		(30)	930	5,500	(207)			771	89,767
12	Total Adjustments	(255)	(30)	930	5,500	(558)	(400)	(1,475)	(777,664)	295,916

HIRING LAG

	<u>Average Turnover</u>	<u>Average # of Days to Hire</u>	<u>Average Salary</u>	<u>Average Hiring Lag</u>
Covered	20	45	\$ 27,402	\$ 67,567
Exempt	26	59	\$ 86,696	\$ 364,361
Non-Exempt	13	60	\$ 40,835	\$ 87,264
				<u>\$ 519,191</u>

Average Hiring Lag	\$ 519,191
O&M Percentage	<u>72.00%</u>
Average Hiring Lag - O&M	\$ 373,818
Benefits - 33.74%	\$ 126,126
Variable Compensation - 15.46%	\$ 57,792
Average Hiring Lag, incl. Benefits and Var. Comp.	<u>\$ 557,736</u>

Average Turnover and Average Days to Hire details are shown below.
Average Salary - based on average salaries for 2012.
Fringe Benefits and Variable Compensation rates calculated using MFR C-35.

Employee Turnover *				
Year	Covered	Exempt	Non-Exempt	
			NC	Total
2009	12	20	9	41
2010	25	42	12	79
2011	19	21	11	51
2012	24	19	18	61
Avg	20	26	13	58

* Includes voluntary and involuntary terminations, retirements and transfers within the Southern Company.

Average # of Days to Hire				
Year	Covered	Exempt	Non-Exempt	
			NC	Total
2009	53	45	62	55
2010	37	57	52	46
2011	50	65	63	60
2012	42	68	62	53
Avg	45	59	60	53