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Gulf Power

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October 12, 2016

VIA ELECTRONIC FILING

Ms. Carlotta Stauffer
Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Petition for an increase in rates by Gulf Power Company, Docket No. 160186-EI

Re: Petition for approval of 2016 depreciation and dismantlement studies, approval of proposed depreciation rates and annual dismantlement accruals and Plant Smith Units 1 and 2 regulatory asset amortization by Gulf Power Company, Docket No. 160170-EI

Dear Ms. Stauffer:

Attached is the Direct Testimony and Exhibit of Gulf Power Company Witness Xia Liu.

(Document 11 of 29)

Sincerely,

Robert L. McGee, Jr.

Robert L. McGee, Jr.
Regulatory & Pricing Manager

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 160186-EI

Gulf Power

TESTIMONY AND EXHIBIT

OF

XIA LIU

GULF POWER COMPANY

Before the Florida Public Service Commission
Prepared Direct Testimony of
Xia Liu
Docket No. 160186-EI
In Support of Rate Relief
Date of Filing: October 12, 2016

Q. Please state your name and business address.

A. My name is Xia Liu. My business address is One Energy Place, Pensacola, FL 32520.

Q. By whom are you employed?

A. I am employed by Gulf Power Company (Gulf or the Company) as Vice President and Chief Financial Officer (CFO).

Q. What are your responsibilities as Vice President and CFO?

A. I oversee all financial matters and decisions for Gulf and am responsible for maintaining the overall financial integrity of the Company. My areas of responsibility include the Accounting, Corporate Secretary, Treasury, Regulatory, Corporate Planning, Forecasting and Pricing departments. I am responsible for financial planning and for maintaining the Company's financial and accounting records. I also maintain strong relationships with the financial community, including the rating agencies, and serve as a member of Gulf's Management Council. Additionally, I represent Gulf Power as a member of the Southern Company Accounting, Finance and Treasury (AFT) Management Council, which is comprised of CFOs from Southern Company and all sister operating companies.

Q. Please state your prior work experience and responsibilities.

A. I have been employed with the Southern Company system since 1998. I have lived in three of the four states where the Southern electric system of which Gulf is a part serves retail customers. In my career, I have held positions working with Southern Company, Southern Company Services (SCS), Alabama Power and now Gulf Power.

Prior to moving to Gulf in 2015, I served as senior vice president of finance of SCS and treasurer of Southern Company. In that role, I had responsibilities overseeing the overall finance and treasury functions of Southern Company including strategic development, mergers and acquisitions, financial analysis, corporate planning and budgeting, treasury, enterprise risk management, insurance management, and pension and trust finance management. I oversaw rating agency, fixed income investor, investment banking and commercial banking relations and had regular meetings with all these financial institutions both domestically and internationally.

Prior to 2010, I served in various roles at various business units. I was the director of financial planning and assistant treasurer for Alabama Power Company, where I testified on behalf of Alabama Power before the Alabama Public Service Commission. I was the environmental and compliance manager for fuel services at SCS from 2005 to 2007, where I had responsibilities developing fuel procurement strategies including coal, natural gas, environmental commodities and emission allowances.

Q. What is your educational background?

A. I graduated from Renmin University of China, one of the nation's top universities located in the capital city of Beijing, with bachelor's and master's degrees in finance. I also hold an MBA from Emory University's Goizueta Business School in Atlanta, Georgia. Additionally, I spent two years in the Ph.D. in Economics program at Emory University and completed preliminary Ph.D. course work.

Q. Do you hold any certifications?

A. Yes. I have been a Chartered Financial Analyst (CFA) since 2001. The CFA designation is a professional credential offered internationally by the American-based CFA Institute to investment and financial professionals. It measures the competence and integrity of financial analysts. Candidates are required to pass three levels of exams covering areas such as accounting, corporate finance, economics, ethics, money management and security analysis.

Q. What is the purpose of your testimony?

A. My testimony begins with an overview of Gulf's need for rate relief. I then explain the Company's decision to use a projected 2017 test year for ratemaking purposes and provide a summary description of Gulf's financial performance since our last base rate increase. I discuss the rededication of a portion of Plant Scherer Unit 3 and related common facilities (collectively, Scherer 3) to serve our retail customers and explain that it is critical for the Florida Public Service Commission (Commission) to recognize and approve the reintegration of Scherer 3 into the retail jurisdiction and to authorize base rate recovery of the associated non-clause costs. Next, I identify the drivers behind the request for rate relief. I then discuss the importance of the rate relief Gulf is requesting to Gulf's financial integrity and credit quality. I also discuss Gulf's capital structure and cost of capital. Finally, I explain why it is not appropriate to make a parent debt adjustment to Gulf's income tax expense in determining our revenue requirement.

Q. Are you sponsoring any exhibits?

A. Yes. I am sponsoring Exhibit XL-1, consisting of Schedules 1 through 8. These schedules were prepared under my control and supervision, and the information contained therein is true and correct to the best of my knowledge and belief.

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

A. Yes. The MFRs that I sponsor in their entirety or that I jointly sponsor are listed on Schedule 1 of my Exhibit XL-1. The information contained in the MFRs that I sponsor or co-sponsor is true and correct to the best of my knowledge and belief.

I. NEED FOR RATE RELIEF

Q. Why is Gulf seeking rate relief at this time?

A. Gulf is a capital-intensive, regulated electric utility which has an obligation to provide reliable service to its customers at a reasonable cost. We take this obligation seriously and put our customers at the center of everything we do. We also take seriously the need to provide our investors a fair return on their investment in Gulf, commensurate with its risk, so that we can attract the capital needed to support the continued investment required to serve customers. Gulf can continue providing the quality service that our customers expect and deserve only if we remain financially strong—and that requires maintaining the appropriate balance of the interests of all our stakeholders.

Gulf needs rate relief at this time because our current rates will not produce sufficient revenues for us to continue adequately serving our customers while maintaining the Company's financial integrity. We need additional revenues to cover our expenses, to enable us to fund the significant capital expenditures that are required to continue to provide reliable electric service, and to provide a fair return on the assets serving our customers.

Q. What is the amount of base rate relief that Gulf is requesting in this case?

A. Gulf is requesting an annual increase of $106.8 million in base revenues. This is the amount necessary for Gulf to continue to provide quality service to its customers and provide its investors the opportunity to earn a fair rate of return of 11.0 percent on the Company's common equity, as supported by the testimony of Gulf Witness Vander Weide.

II. TEST YEAR

Q. What test year has Gulf used to calculate its proposed rate increase?

A. Gulf has chosen a 2017 projected test year. The projections for 2017 are based on Gulf's 2016 budget process. As described in more detail by Gulf Witness Mason, Gulf's annual budget process produces a budget for the current year and a budget forecast for the four subsequent years. The 2016 "prior year" shown in the MFRs is also the result of the 2016 budget process, while the 2015 "historical year" reflects actual results for that year.

Q. Please explain why 2017 was chosen as the test period.

A. The 2017 test year is the appropriate representation of Gulf's expected future operations. The 2017 test year properly matches Gulf's projected revenues with the projected costs and investment required to provide service to customers during the period following the effective date of the new base rates in this case. The use of a projected test year that includes information related to rate base, net operating income, and capital structure for the time new rates will be in effect benefits all stakeholders by helping to reduce the impact of regulatory lag. Gulf's use of a projected test year is also consistent with the Commission's long-standing practice of approving projected test years.

III. FINANCIAL PERFORMANCE

Q. When was Gulf's last rate case?

A. Gulf's last rate case was filed in July 2013 and was based on a 2014 test year. This case was resolved via a settlement agreement among all parties to the proceeding. The Stipulation and Settlement Agreement (2013 Settlement Agreement or Settlement) was unanimously approved by the Commission in Order No. PSC-13-0670-S-EI issued December 19, 2013 in Docket No. 130140-EI.

Q. Please provide a general overview of the major elements of the Settlement.

A. The Settlement covers a term of 42 months beginning with the first billing cycle of January 2014 and ending on the last billing cycle of June 2017. Gulf's base revenue was increased by $35 million in January 2014 and by an additional $20 million in 2015, for a total increase of $55 million. Gulf's authorized return on equity (ROE) was maintained at 10.25 percent, which is the same as the midpoint ROE set by the Commission in Gulf's previous rate case. The Settlement declared certain transmission projects with in-service dates ranging from 2013 to 2018 to be prudent for cost recovery purposes. Gulf was permitted to accrue a special Allowance for Funds Used During Construction (AFUDC)-like charge for these projects past their in-service dates until January 1, 2017. At that time the transmission investment will be included in rate base for ratemaking purposes. The Settlement also allowed Gulf to credit up to $62.5 million to depreciation expense over the 42-month term of the agreement.

Q. What has been the impact of the Settlement on Gulf's financial performance?

A. As noted in the Commission's order approving the Settlement, allowing Gulf to accrue the AFUDC-like treatment for the identified transmission projects and to credit depreciation expense was intended to provide a means for Gulf to adjust and stabilize its earnings throughout the 42-month Settlement term and neither over- or under-earn its allowed ROE of 10.25 percent with a range of plus or minus 100 basis points. The availability of the tools provided by the Settlement has helped the Company to earn within its authorized range for much of the period covered by the Settlement.

Q. Does Gulf need additional rate relief beginning July 1, 2017, when the 2013 Settlement Agreement expires?

A. Yes. All other things being equal, the termination on January 1, 2017 of Gulf's ability to accrue AFUDC-like charges on the transmission projects and the depletion prior to the end of the Settlement period of the allowable depreciation credits would trigger the need for rate relief to replace these non-cash earnings with base rate revenues to cover our expenses and provide a fair return on our investment.

However, all other things are not equal. For example, the sales growth that Gulf projected in our 2012 test year rate case has failed to materialize, while at the same time we continue to grow rate base through capital investment in order to continue to provide reliable service to our customers. Additionally, with the expiration of wholesale contracts covering approximately 76 percent of Gulf's investment in Scherer Unit 3, the non-clause portion of the related revenue requirement must be included in base rates.

Q. What is Gulf's projected ROE without rate relief?
A. Based on our current projection, the depreciation credits allowed under the 2013 Settlement Agreement will be fully utilized by the end of the first quarter of 2017. As shown on Schedule 2 of my exhibit, Gulf's ROE will fall to approximately 7.30 percent, well below the bottom of its authorized range, before rates from this case can be put into effect on July 1, 2017. Without rate relief, Gulf's return would continue to drop.

IV. SCHERER 3

Q. In your view as Chief Financial Officer of Gulf, is it critical that the Commission allow recovery through retail rates of the portion of Scherer 3 that has been rededicated to serving retail customers?
A. Yes. One of the primary differences between Gulf and many other businesses is that Gulf has the obligation to provide reliable service to our native load customers and to deploy capital well in advance to ensure we meet the long-term needs of these customers. Our business is capital intensive, our capital assets are long lived, and generating units in particular have a long planning and construction lead time. Thus, we must constantly make long-term investment decisions based on the best information

available to us at the time in order to meet the current and future needs of the customers we are obligated to serve.

As a regulated utility, once a prudent investment such as Scherer 3 has been made to serve our customers, we must be afforded the opportunity to earn a fair return on that investment. Under the regulatory compact that Gulf Witness Deason describes in more detail, utilities need the assurance that they will be allowed to recover the cost of prudent investments over the life of the asset, regardless of future changes in circumstances. It is important to ensure fair regulatory treatment of utilities' past long-term investments in order to preserve the ability to make future long-term investments. Without the assurance that prudent costs will be recovered, utilities would find it difficult to continue to consistently make the long-term investments that are required by their obligation to serve.

Q. When and why did Gulf make its investment in Scherer 3?

A. As described by Gulf Witnesses Burleson and Deason, Gulf acquired its interest in Scherer 3 in the mid-1980s as a cost-effective alternative to a generating unit then being planned for construction at Gulf's Caryville site for the purpose of serving Gulf's native load customers. At that time, Gulf had the opportunity to enter into interim long-term wholesale contracts in order to provide a bridge that would temporarily relieve Gulf's native load customers of the obligation to support the Scherer 3 revenue requirements. As discussed by Mr. Deason, the Commission encouraged Gulf to proceed with the purchase of an interest in Scherer 3 and to enter into the interim long-term wholesale contracts for the ultimate benefit of Gulf's retail customers.

Q. Did Gulf in fact make long-term off-system sales to temporarily relieve native load customers of the obligation to support Scherer 3?

A. Yes. Gulf entered into Unit Power Sales (UPS) contracts that initially committed most of the unit's capacity to the wholesale market through 1995. Subsequently, Gulf entered into other wholesale contracts that ultimately continued to commit the Scherer 3 capacity to the wholesale market through December 31, 2015 (110 MW), May 31, 2016 (50 MW) and December 31, 2019 (50 MW).

Q. What is the status of Scherer 3 today?

A. For the first time since Scherer 3 began commercial operation, a substantial majority (76 percent) of Scherer 3 is not committed to long-term wholesale contracts. The first of the last vintage of three wholesale contracts, covering 52 percent of Gulf's interest in Scherer 3, expired on December 31, 2015. The second contract of that vintage, covering 24 percent of Gulf's interest in Scherer 3 expired on May 31, 2016. The final of the three contracts will expire at the end of December 2019. As these wholesale contracts expire, Gulf's Scherer 3 investment is being rededicated to serving the native load customers for whom it was originally planned, acquired and ultimately built.

Q. Please explain the impact on Gulf of the expiration of the long-term wholesale contracts.

A. The costs of the rededicated portion of Scherer 3 are not currently being recovered through any rates despite the fact that it is now serving Gulf's native load customers.

Q. Does your current request in this case include all costs of the portion of Scherer 3 dedicated to serving retail customers?

A. No. Gulf has also filed a petition and testimony in the Environmental Cost Recovery Clause (ECRC) docket (Docket No. 160007-EI) requesting that the portion of Scherer 3 costs eligible for recovery through the ECRC be authorized for recovery in that docket. The ECRC portion of the Scherer 3 revenue requirement currently represents more than 40 percent of the total revenue requirement for the portion of the unit that serves retail customers. That request is still pending as of the date this testimony is being filed.

Q. What action is Gulf currently asking the Commission to take with respect to Scherer 3 in this docket?

A. We are asking the Commission to approve the rededication of Scherer 3 as a retail asset by allowing Gulf to recover in base rates the jurisdictional portion of the Scherer 3 revenue requirement that is not eligible for recovery through the ECRC. Specifically, we are asking the Commission to 1) reconfirm Gulf's ownership of Scherer 3 as a resource intended for and serving our native load customers, and 2) allow the jurisdictional portion of

Scherer 3 non-clause costs to be recovered in base rates as reflected in the testimony and exhibits of Gulf Witness Ritenour.

These actions will make it clear that the costs associated with the portion of the investment in Scherer 3 not committed to long-term off-system sales should be recovered from the retail customers being served by that investment. The Commission contemplated this result when it encouraged Gulf to market the Scherer capacity off-system as a temporary bridge of responsibility for supporting the revenue requirements associated with this investment. The Scherer 3 investment that was prudently made to serve retail customers will now be supported by those customers, although at its depreciated net book value. This treatment is consistent with the regulatory compact discussed by Mr. Deason.

Q. Why is this treatment critical to Gulf's customers and investors?

A. As I stated earlier, Gulf must continually evaluate and make long-term investments in order to fulfill its obligation to serve. It is critical to both Gulf and our customers that the utility be assured that it can recover through rates the cost of the prudent investments it undertakes to meet that obligation. That is the essence of the regulatory compact described by Mr. Deason. If Gulf were denied the ability to recover its investment in Scherer 3 from the customers for whom it was planned, acquired and ultimately built, that decision would make it difficult for Gulf to continue to consistently take a long-term view when making future investment decisions. Such a decision could also harm the current perception of a constructive regulatory environment in Florida, which would negatively impact Gulf and other Florida utilities.

V. RATE CASE DRIVERS

Q. What are the factors causing Gulf's need for rate relief?

A. At a high level, our need for rate relief is driven by the fact that Gulf's revenue growth since 2012 has not kept pace with our increased level of investment and expenses needed to serve our customers, despite the additional base rate relief we received under the 2013 Settlement Agreement beginning in 2014. In fact, as shown on Schedule 3 of Exhibit XL-1, Gulf's weather-normalized annual GWh sales have never reached the level that we originally projected to achieve in 2012, and sales are not currently projected to reach that level in 2017. This means that Gulf's current rates will not produce sufficient revenues to meet our need to continue to spend and invest to serve our customers.

Q. Have you performed an analysis to determine the specific drivers behind Gulf's need for rate relief?

A. Yes. Because our 2014 test year rate case was resolved by settlement, Gulf's 2012 test year case (Docket No. 110138-EI) is the last time that the Commission specifically reviewed and approved all the elements that make up our revenue requirement. In order to determine the major rate case drivers, I started with Gulf's revenues, expenses and investments as approved by the Commission in the 2012 test year rate case. I then compared the 2012 Commission-approved figures to our 2017 test year request in order to identify the changes that contribute to our need for a $106.8 million base rate increase.

Q. What did this analysis show?

A. Schedule 4 of Exhibit XL-1 is a waterfall chart that presents the results of the analysis. It shows that there are five primary groups of drivers that increase Gulf's overall revenue requirement in 2017 compared to 2012:

- $19.4 million base rate revenue requirement associated with the rededication of Scherer 3 to serve native load customers;
- $91.5 million revenue requirement associated with increases in rate base due primarily to infrastructure initiatives;
- $34.7 million from growth in non-clause O&M expenses;
- $17.7 million of sales deficiency related to the lagging economy and reduced use per customer; and
- $18.8 million from other changes in the cost of service, primarily driven by an increase in depreciation expense.

These upward pressures are offset by four primary items that reduce, or contribute to meeting, the increased revenue requirement:

- $2.0 million due to reduction in Gulf's weighted average cost of capital;
- $59.0 million of base rate increases since 2012;
- $9.3 million of increases in other operating revenues; and
- $5.0 million reduction in the annual dismantlement accrual.

Drivers of Rate Request

Q. Please explain the increase in revenue requirement associated with Scherer 3.

A. As I discussed above, 76 percent of Gulf's ownership in Scherer Unit 3 is no longer covered by wholesale contracts and has been rededicated to serve native load customers. The revenue requirement associated with the non-clause retail portion of Scherer Unit 3 is $19.4 million in the 2017 test period. This amount includes return on investment, depreciation, O&M expense and taxes.

Q. Please explain the increase in revenue requirement due to other rate base changes.

A. This $91.5 million is the revenue requirement associated with two other categories of increased non-clause investment.

First, it includes Gulf's investment in a group of specific transmission projects that all parties to the 2013 Settlement Agreement agreed were prudent for cost recovery purposes. The Settlement provided that the investment in these projects would be added to rate base no later than January 1, 2017. These investments are addressed in the testimony of Gulf Witness Smith. The revenue requirement for these projects is $28.7 million. This revenue requirement includes the amortization over four years of the transmission-related AFUDC-like regulatory asset created pursuant to the Settlement and discussed in the testimony of Ms. Ritenour.

Second, there is a $62.8 million revenue requirement for net rate base increases since 2012 for items other than the specific transmission projects and Scherer 3. This category primarily consists of investments in Gulf's power grid systems and Gulf's generating fleet that is used and useful in providing service to our customers. As discussed by Mr. Smith, in addition to the specific transmission projects discussed above, Gulf has continued to invest in its transmission infrastructure since Gulf's 2012 test year rate case. Gulf has also made additional investment in our distribution assets related to storm hardening, grid modernization, new business and other distribution infrastructure improvements. Furthermore, Gulf Witness Burroughs discusses the major non-ECRC production additions that contribute to an increase in Gulf's production investment. This category also reflects changes in working capital and other miscellaneous rate base items as supported by Ms. Ritenour.

Q. Please explain the increase related to growth in non-clause O&M expense.

A. Excluding amounts related to Scherer 3, Gulf's non-clause O&M expense has increased by $34.7 million since 2012 due to a variety of factors, including customer growth and inflation. Only $1.5 million of this amount reflects growth over and above the Commission's O&M benchmark. The benchmark overages in specific functional areas are discussed by other witnesses. As they explain, the requested O&M expenses are necessary to continue to provide our customers with the reliable service that they expect and deserve. It is important to note that the benchmark variance includes the effect of Gulf's requested $5.4 million increase in the annual accrual to the property damage reserve as explained by Gulf Witness Hodnett. Without this $5.4 million request, our O&M increase would be below the Commission's benchmark.

Q. Please explain the deficiency in 2017 projected sales revenues compared to the level originally projected for 2012.

A. The Commission-approved rates in Gulf's 2012 test year rate case were designed to meet Gulf's revenue requirement during the 2012 projected test year, based on Gulf's forecast of 2012 GWh sales. Due to a combination of slower than forecasted customer growth and a decline in usage per customer, Gulf's GWh sales have never reached the level originally projected for 2012, as shown on Schedule 3 of my exhibit. Instead, based on the 2016 forecast used for the test year projections, GWh sales for 2017 are forecast to be 6.3 percent below the originally projected level for 2012. At current rates, this produces test year revenues that are $17.7 million below the amount the rates approved in 2012 were designed to produce. This shortfall contributes to the 2017 revenue deficiency.

Q. Please explain the other changes in cost of service.

A. The other changes in cost of service consist of two items. The first is a $12.1 million increase in depreciation expense that results from applying the new depreciation rates included in the 2016 Depreciation Study filed on July 14, 2016, and corrected on September 20, 2016, in Docket No. 160170-EI to Gulf's 2017 test year rate base, rather than applying Gulf's currently approved rates to the same rate base. Gulf Witnesses Watson and Hodnett discuss Gulf's depreciation expense request in more detail.

The remaining $6.7 million is primarily the result of property tax and payroll tax increases.

Offsets to Rate Drivers

Q. Please explain the offset due to a reduction in Gulf's weighted average cost of capital.

A. Gulf's overall jurisdictional weighted average cost of capital (WACC) has declined from 6.39 percent as approved in the 2012 rate case order to a requested level of 6.04 percent for the 2017 test year. This change reduces Gulf's revenue requirement by $2.0 million. This reduction is the result of a combination of factors, including changes in the cost of debt and equity, and changes in the proportion of the various sources of capital in Gulf's overall jurisdictional capital structure.

Q. Please explain the offset provided by the $59.0 million in previously approved rate increases.

A. Up to this point, I have calculated a revenue requirement shortfall by comparing the Commission-approved investment and expenses from the 2012 test year to Gulf's projections for 2017. Since 2012, Gulf's base rates have changed on three occasions, namely: (1) a $4 million step increase effective January 1, 2013 pursuant to the 2012 test year rate case order; (2) a $35 million increase effective January 1, 2014 pursuant to the 2013

Settlement Agreement; and (3) a $20 million increase effective January 1, 2015 pursuant to that same Settlement. These rate increases offset a portion of the calculated revenue requirement shortfall.

Q. Please explain the $9.3 million offset provided by other operating revenues.

A. Since 2012, Gulf's other operating revenues have increased by $9.3 million. Like the base rate increases, these other operating revenues serve to reduce Gulf's revenue requirement shortfall.

Q, Please explain the offset provided by reduction in the annual dismantlement accrual.

A. Gulf has submitted an updated dismantlement study discussed in the testimony of Ms. Hodnett. This item represents the reduction in Gulf's annual dismantlement accrual compared to the amount included in the 2012 test year. As I previously discussed, the settlement agreement in Gulf's last rate case allowed Gulf to record up to $62.5 million in credits to depreciation expense as a method to adjust and stabilize its earnings. These credits were recorded to a regulatory asset account referred to as Other Cost of Removal. The Settlement provided that this regulatory asset would be considered and accounted for in conjunction with the accumulated cost of removal and the dismantlement reserve balances the next time the Commission establishes depreciation rates and dismantlement accruals. As described in the testimony of Ms. Hodnett, Gulf proposes to apply this regulatory asset to reduce the projected dismantlement reserve surplus shown in Gulf's 2016 Dismantlement Study filed on July 14, 2016 in Docket

No. 160170-EI. As discussed by Ms. Hodnett, Gulf proposes to reduce the annual dismantlement accrual in base rates to zero. This is a reduction of approximately $5.0 million from the current accrual level, and reduces the rate relief that Gulf would otherwise require.

Q. As a result of all these factors, what is the amount of Gulf's rate request?

A. As I stated earlier, Gulf is requesting an annual increase of $106.8 million in base revenues in order to cover our expenses and provide the opportunity for our investors to earn a fair rate of return. That opportunity is essential to attracting the capital that is required, not just for our current capital expenditure program, but to sustain Gulf's ability to continue to provide the service that our customers expect and deserve in the years to come at fair, just and reasonable rates.

VI. FINANCIAL INTEGRITY

Q. What does financial integrity mean to Gulf Power?

A. Financial integrity means maintaining a strong financial position that is sufficient to meet our current financial obligations and to sustain the confidence of investors in order to attract capital—continuously and on reasonable terms—so that we can consistently provide reliable service to our customers at a reasonable cost.

Q. Why is financial integrity important?

A. Financial integrity is critical to Gulf because of our obligation to serve our customers. As a capital-intensive regulated electric utility, Gulf must meet its obligation to serve at all times. We must continually make investments that are required to reliably generate and deliver electricity, even during challenging economic conditions or strained financial markets. Meeting that obligation requires on-going capital investments to both maintain our electric system and expand to serve increasing demand. We must therefore at all times maintain access on reasonable terms to all capital markets.

Additionally, continuous access to short-term debt markets, including commercial paper, is critical to provide the liquidity Gulf requires in managing its day-to-day operational cash needs. Those needs are highly variable in response to things such as changes in fuel prices and variations in sales. The short-term debt markets provide a cost-effective source of financing for these purposes.

Q. Please describe Gulf's financial position.

A. As a result of the 2013 Settlement Agreement, Gulf has maintained a satisfactory level of financial strength since 2014. However, the Settlement contained mechanisms that increased Gulf's earnings without providing the corresponding cash flow. This negatively affects both the quality of Gulf's earnings and its key credit metrics. Upon expiration of the agreement, these non-cash earnings need to be replaced by an increase in base rate revenues. In addition, it is essential to maintaining Gulf's financial strength that the Commission allows recovery through retail rates of the portion of Scherer 3 that has been rededicated to retail service. Without rate relief, the revenues produced by Gulf's current rates will be insufficient to cover our expenses and at the same time provide an adequate return to our investors. This revenue level is clearly deficient and will create a challenge in supporting equity investment in the future.

From the viewpoint of our debt holders, Gulf's current credit ratings have been sufficient to allow us to maintain access to debt markets and to finance that debt at favorable rates. However, as I will discuss later, with insufficient cash revenues to cover its expenses and provide a fair return to investors, Gulf is concerned about the effect of declining credit metrics and credit ratings.

Q. Does Gulf face business risks that could affect its ability to maintain its financial strength and access to capital?

A. Yes. As discussed in broad terms by Dr. Vander Weide, Gulf faces a number of business risks that are common to electric utilities throughout the country. I will briefly discuss examples of a few specific risks, including: (1) risks associated with Gulf's regulatory environment and ability to recover costs; (2) risks related to sales uncertainty driven by weather, economic conditions and Gulf's customer mix; (3) risks associated with hurricane and tropical storm exposure; and (4) risks caused by evolution of the electric utility industry.

Q. Please explain risks related to Gulf's regulatory environment and ability to recover costs.

A. Investors and rating agencies all focus on the regulatory environment and ability to recover costs in a timely manner when they make investment and rating decisions. For example, Regulatory Research Associates (RRA) evaluates the regulatory climates of the jurisdictions on an ongoing basis. RRA's August 2016 Florida Regulatory Review publication states, "RRA continues to view Florida regulation as constructive from an investor perspective" and rates Florida regulation "above average." As I will discuss in detail later in the testimony, all the rating agencies comment on Florida's regulatory climate and Gulf's ability to recover costs.

Although Florida is currently considered a supportive regulatory environment, any change or perceived change to the environment could greatly impact Gulf's business risk. Additionally, the timeliness of cost recovery poses a significant risk to Gulf. Given the time necessary to prepare, file and process a rate case, Gulf is exposed to significant regulatory lag.

Q. Please describe Gulf's risks related to sales uncertainty.

A. Like other utilities, Gulf is exposed to economic uncertainty and sales risk. In Gulf's case this risk has been evidenced for an extended period of time by slow growth in sales and revenues, driven primarily by declines in use per customer. As a result, sales and revenues have not reached forecasted levels. This has posed a particular challenge to Gulf, as a small utility with a large concentration of its revenue in the residential and commercial sectors. Schedule 5 of my exhibit shows that Gulf's use per customer in both sectors has steadily declined over the past decade. As discussed by Gulf Witness Park, the factors leading to this decline in residential and commercial use per customer include the slow recovery of the economy and continuing energy efficiency measures adopted by our customers.

This sales risk is underscored by the fact, discussed by Mr. Park, that Gulf's most recent forecast of 2017 base revenues shows a $5.7 million shortfall compared to the forecast on which our test year calculations have been based, which has an impact of over 30 basis points on our retail return on equity.

Q. Please explain risks related to hurricane and tropical storm exposure.

A. Gulf faces significant exposure to tropical storms, more than most other utilities. Because of Gulf's size and location, its service area can be and has been impacted significantly by a single storm. In the aftermath of Hurricane Ivan in 2004, over 90 percent of Gulf's customers lost power. Due to the destruction of homes and other property, nine months passed before Gulf's customer counts returned to pre-Ivan levels. As discussed by Ms. Hodnett, we are proposing to increase our property damage accrual in order to build the balance in the funded reserve and thereby mitigate the financial impacts of storm restoration. However, the potential for lost sales due to hurricanes and tropical storms remains a significant risk to Gulf.

Q. Please explain risks associated with the evolution of the electric utility industry.

A. As the electric utility industry continues to evolve, new risk factors come into play. For example, cyber security threats are requiring utilities to increase their infrastructure investment. Mr. Smith discusses these impacts in his testimony. Additionally, technology is creating new customer expectations that the traditional regulated utility business model did not envision. To meet customers' evolving demand for enhanced services and to respond to an expanded range of customer service expectations, utilities need to make new investment in their customer service infrastructure as discussed by Gulf Witness Terry. These changed expectations will, at first, increase both costs and risks as utilities adapt to the new environment. These developments in the electric utility industry pose new challenges to which Gulf must respond.

Q. What is the impact on Gulf of these types of business risk?

A. All of these risk factors pose concerns about sustaining our financial integrity. Given continued sales uncertainty, Gulf's need for liquidity for operations, and the continuing need to support sizable capital expenditures, maintaining our financial integrity remains a top priority for Gulf.

VII. CREDIT QUALITY

Q. What credit ratings does Gulf target?

A. Gulf targets ratings in the middle of the "A" category for its long-term debt for all three of the major credit rating agencies – Moody's Investor Service (Moody's), Standard & Poor's (S&P), and Fitch Ratings (Fitch). Gulf targets comparable ratings for its short-term debt.

Q. What are Gulf's current long-term credit ratings?

A. Gulf currently has an "A2" rating from Moody's, an "A-" rating from S&P, and an "A" rating from Fitch.

Q. What factors are considered in Gulf's credit risk profile?

A. The rating agencies consider both qualitative and quantitative factors in assessing a company's credit risk. For example, Moody's rates electric utilities based on four categories of factors. They assign specific weight to each factor: 40 percent is assigned to financial strength, 25 percent to regulatory framework, 25 percent to ability to recover costs and earn returns, and 10 percent to diversification. Each of these broad areas has two or more sub-factors. Moody's considers all the factors and applies qualitative adjustment in producing its final rating.

Q. How does Gulf rate on these factors?

A. Florida currently has a supportive regulatory environment in the view of the rating agencies in their most recent reports. Moody's said that Gulf's "rating reflects a credit supportive regulatory environment in Florida." S&P said that Gulf operates "under a generally constructive regulatory environment." Fitch said that constructive regulation is "a key credit positive for Gulf Power." These are an improvement over views expressed several years ago and have a positive impact on their overall evaluation of Gulf, which was a major contributing factor to Moody's upgrade in Gulf's credit rating in 2014.

Moody's notes that Gulf ranks in the Baa range on "Sufficiency of Rates and Returns." Moody's also notes that Gulf's cash flow coverage metrics have been weak for its A2 credit rating. For example, Gulf ranks in the Baa range on certain cash flow from operations to debt coverage ratios. S&P views Gulf Power's financial risk profile as being in the "significant" category and expects the core ratios to weaken somewhat over the next few years as capital spending rises. Fitch indicates that Gulf's financial metrics are in line with its current rating category.

Q. Do you have concerns about Gulf's current credit ratings?

A. I do. As noted by the rating agencies, our financial metrics are important to maintain our targeted credit ratings. While the agencies' opinions of the Florida regulatory environment are now positive, Gulf's financial metrics could deteriorate to levels that would adversely impact our ratings. The Company's cash flow coverage metrics, which measure, among other things, the amount of cash flow available to serve our debt, will be pressured due to our continuing capital expenditure program. Without rate relief, those metrics will deteriorate even further and pose greater risk to Gulf’s ability to maintain our targeted credit ratings.

As noted earlier, while Gulf is currently at its targeted rating level of A2 with Moody’s, they have stated that Gulf’s cash flow coverage metrics have been weak for its A2 rating. They have also stated that metrics are an important factor that could lead to either a rating upgrade or downgrade in the future. Absent rate relief, Gulf’s metrics would decline from current levels and place this rating in jeopardy.

Q. Do you have any concerns beyond a decline in Gulf’s credit metrics?

A. Yes. The metrics are certainly our biggest concern regarding our credit quality today. However, if the outcome of this case is not sufficient to recover our cost of service including fairly compensating investors, not only will our credit metrics suffer more damage, but also the credit rating agencies’ assessment of Florida’s constructive regulatory environment could be affected. For example, I would be concerned about these impacts if the Commission did not authorize retail recovery for the portion of Scherer 3 that is now serving retail customers.

Q. Why is it necessary to maintain these targeted credit ratings?

A. Maintaining these targeted credit ratings is critical for Gulf and its customers. An electric utility’s obligation to serve requires continuous access to capital markets to fund the maintenance of and investment in the assets needed to reliably generate and deliver electricity. The targeted credit ratings help ensure access to long-term debt capital on reasonable terms and conditions. This is especially important now for Gulf, as we remain in the midst of an ongoing capital investment period. Over the period 2016-2020, our total retail capital investment is projected to average approximately $215 million per year.

Q. Are there similar credit concerns related to the short-term debt markets?

A. Yes. Gulf also requires access to short-term debt markets, including the commercial paper market, to meet our liquidity needs. The ability to access the commercial paper markets at any time is crucial to Gulf, since our short-term funding needs are difficult to predict and can vary dramatically with fuel price volatility, seasonal changes in customer demand, the effects of continued economic uncertainty, and the need for ready access to cash to respond to potential storm damage above the amounts in our property damage reserve. Short-term debt is less expensive and offers flexibility in meeting these needs of our customers.

Strong credit ratings are necessary to ensure continuing access to the commercial paper markets. Companies with credit ratings lower than those targeted by Gulf may experience difficulty in securing short-term funding. Some buyers of commercial paper are restricted to buying the commercial paper of only those companies with high quality ratings, potentially adversely affecting the liquidity, or the ability to access cash quickly, of companies with weaker ratings. During the height of the recent financial crisis, some companies with lower credit ratings were unable to access the commercial paper markets. Credit ratings below those targeted by Gulf could restrict access to those short-term debt markets, particularly during times of economic or financial uncertainty.

Q. Would there be any impacts if Gulf suffered a ratings downgrade?

A. There are several potential impacts depending on the severity of the downgrade. First, a downgrade would increase borrowing costs and, under certain economic conditions, a downgrade in short term ratings could limit or preclude Gulf's access to the commercial paper market, all to the detriment of our customers. In addition, Gulf is party to numerous contractual agreements, including power purchase agreements and fuel storage and transportation agreements, which require the parties to post performance security in certain circumstances. Downgrades by one or more agencies can trigger requirements to post security in the form of cash or letters of credit. Depending on the degree of the downgrade, Gulf could incur aggregate security posting obligations between $135 million and $525 million.

Q. Please summarize your views on the importance of maintaining strong credit ratings.

A. Gulf's ability to maintain strong credit ratings has benefitted customers through lower debt costs and has ensured the Company's ability to fulfill its obligation to serve by maintaining access to capital at all times, including through the most difficult economic periods. Maintaining our targeted credit ratings is essential to our ability to continue to provide reliable service at a reasonable cost for our customers.

VIII. CAPITAL STRUCTURE AND COST OF CAPITAL

Q. What capital structure has Gulf maintained in the past?
A. Over the past ten years, Gulf has maintained a corporate capital structure with approximately 47 percent common equity, 5 percent preferred or preference stock, and 48 percent debt for investor sources of capital.

Q. Is this a typical capital structure for electric utilities in Florida?
A. No. Gulf has previously maintained a lower equity ratio than the other electric utilities regulated by the Commission. As shown on Schedule 6 of my exhibit, in the most recent rate decisions that addressed capital structure, the Commission approved equity ratios (taking into account only investor sources of capital) for FPL, Duke, and TECO that range from approximately four to thirteen percentage points higher than Gulf's approved equity ratio. According to the June 2016 surveillance reports, the average equity ratio for these three Florida utilities was 56.7 percent, about ten percentage points higher than Gulf Power's equity ratio.

Q. What are the implications of a company having a lower equity ratio?
A. With a lower equity ratio, a company's financial risk is higher. Equity investors require compensation for this additional risk through a higher return. In addition, all rating agencies look at the equity ratio as a measurement in assigning the credit ratings. The lower the equity ratio, the more pressure a company has on its credit rating and therefore on its borrowing costs.

Q. Does Gulf have a higher authorized return to reflect this increased financial risk?

A. No. Despite its higher financial risk, and requests in prior rate cases for an ROE adjustment to reflect this higher risk, Gulf's authorized return of 10.25 percent is tied for the lowest among the major Florida investor-owned utilities (IOUs). FPL and Duke, with higher equity ratios of 59.1 percent and 50 percent, both have an authorized return of 10.5 percent. TECO has an authorized return of 10.25 percent with a 54 percent equity ratio. Gulf's lower equity ratio and higher financial risk suggest that its authorized ROE should be higher than the authorized ROEs for these other companies, yet its authorized return is tied for the lowest.

Q. What capital structure is Gulf using in this case?

A. Gulf is using a capital structure of 53 percent common equity, 42 percent debt, and 5 percent preference stock for its investor-supplied sources of capital. Under this capital structure, coupled with our proposed ROE, our customers still benefit from having a weighted average cost of capital that is among the lowest in the state.

Q, What action is Gulf taking to achieve this capital structure?

A. During 2016, Gulf has increased its equity from the level at year-end 2015 by retaining additional earnings. In addition to equity infusions for general business purposes, Gulf will take an equity infusion of approximately $150 million in or before January 2017 to achieve the 53 percent equity ratio.

Q. What is the effect of this planned increase in equity on Gulf's overall jurisdictional capital structure?

A. Gulf's jurisdictional capital structure includes both investor and non-investor sources of capital. While common equity was 46.3 percent of investor-supplied capital in Gulf's Commission-approved 2012 capital structure, it was 38.5 percent of total jurisdictional capital. This means that Gulf was earning an equity return on 38.5 percent of its retail rate base.

When the transition is complete, the percentage of equity in Gulf's jurisdictional capital structure for 2017 will increase to 40.1 percent. Gulf will thus earn an equity return on only a slightly higher portion of its rate base than what the Commission approved in 2012. Even with this change and Gulf's proposed ROE, the overall weighted average cost of capital reflected in Gulf's rates will decline from 6.39 percent in 2012 to 6.04 percent in 2017.

Q. How does this jurisdictional capital structure compare to the other Florida IOUs?

A. Gulf currently has a lower proportion of equity in its jurisdictional capital structure than the other Florida IOUs. As shown on Schedule 6 of my exhibit, the other Florida IOUs currently have jurisdictional equity ratios that are six to eleven percentage points greater than Gulf's. After taking into account the new capital structure, Gulf will still have the lowest jurisdictional equity ratio of the major Florida IOUs.

Q. Why is Gulf proposing a change in capital structure at this time?

A. There are several reasons. First, the increased equity ratio will improve Gulf's quantitative credit metrics, increasing the likelihood that Gulf will be able to maintain its targeted credit ratings during a period of continued large capital expenditures. Second, adjusting the equity ratio at this time brings us more in line with other utility peers in the state. This will allow investors to correctly see that the financial risk of investing in Gulf Power is similar to other Florida utilities, permitting them to focus on the quality of Gulf Power's operations. This will bring the total risk that equity investors face onto a level playing field with other Florida utilities, allowing Gulf to access capital on competitive terms. Third, the historic inability of Gulf to earn equity returns that reflected the higher financial risk of its previous capital structure makes it appropriate to adopt a capital structure that is more likely to produce returns that meet the expectations of equity investors.

Even with this capital structure and our proposed ROE, Gulf Power still provides its customers a weighted average cost of capital that is among the lowest of our Florida peers.

Q. What cost of equity is the Company seeking in this case?

A. As Dr. Vander Weide indicates in his testimony, a fair rate of return on common equity is 11.0 percent.

Q. Has Dr. Vander Weide considered the effect of Gulf's increased equity ratio and the resulting impact on its financial risk?

A. Yes. In Gulf's two prior rate cases, Dr. Vander Weide considered the relative financial risk in the capital structures of his proxy group and adjusted Gulf's required return to ensure that equity investors would be compensated for Gulf's higher financial risk. Because the increase in Gulf's equity ratio brings it more in line with the other members of his proxy group, the same analysis in this case results in a lower adjustment.

Q. What is Gulf's cost of debt?

A. As shown on Schedule 14 of Ms. Ritenour's Exhibit SDR-1, Gulf's embedded cost of long-term debt is 4.40 percent. For the test year, we project that our cost of short-term debt will average 3.02 percent.

Q. What is Gulf's weighted average cost of capital for ratemaking purposes?

A. As shown on Schedule 14 of Ms. Ritenour's Exhibit SDR-1, Gulf's weighted average cost of capital is 6.04 percent when taking into account both investor sources of capital (common equity, preference stock, long-term debt and short-term debt) and other sources considered for ratemaking purposes (customer deposits, deferred taxes and investment tax credits).

Q. Is the weighted average cost of capital proposed by Gulf appropriate in this case?

A. Yes. The weighted average cost of capital of 6.04 percent proposed by Gulf will provide debt and equity investors the opportunity to earn a fair return and will allow Gulf's customers to continue to enjoy the benefits of an overall weighted average cost of capital that is among the lowest of the major Florida IOUs.

IX. PARENT DEBT ADJUSTMENT

Q. What is the parent debt adjustment?

A. It is a regulatory adjustment to reduce the amount of income tax expense to be included in rates, pursuant to Commission Rule 25-14.004.

Q. Please provide a brief overview of that rule.

A. The parent debt adjustment rule was adopted by the Commission in 1983. For ease of reference, I have included a copy of that rule as Schedule 7 of my exhibit. This rule applies in rate proceedings where (1) a parent-subsidiary relationship exists, (2) the parent and subsidiary participate in filing a consolidated tax return, and (3) funds provided by parent debt have been invested in the equity of the regulated subsidiary. If all three factors are present, the rule provides a formula for reducing the subsidiary utility's income tax expense to reflect the tax effect of the parent debt that is invested in the equity of the subsidiary.

Q. What is the basis for the rule's adjustment to income tax expense?

A. The premise is that parent debt has been invested in the equity of the regulated subsidiary; thus, the income tax benefit of the interest deduction for the debt should accrue to the regulated subsidiary.

Q. Are the interest costs associated with that parent debt included in rates?

A. No. The interest expense is not included in rates.

Q. Is the parent debt included in the regulated subsidiary's capital structure?

A. No. Only the debt issued by the regulated subsidiary is included in the capital structure used to set rates.

Q. What are the financial implications of making a parent debt adjustment?

A. The parent debt adjustment results in an inconsistency between the federal income tax interest deduction imputed for ratemaking purposes on the one hand and the utility's actual interest expense and capital structure on the other. This inconsistency would have two primary effects. First, imputing to the subsidiary the tax benefits of parent company debt effectively assumes that the Company has more debt in its own capital structure than actually exists. The parent debt adjustment assumes there are tax benefits of parent company debt accruing to the subsidiary without recognizing the associated financial risk of having more debt in its capital structure. Appropriately, the Commission does not impute parent company debt into the subsidiary's capital structure. It would be inappropriate to impute any tax benefits associated with such debt.

Second, by artificially reducing the federal income tax expense used to establish the subsidiary's rates, the adjustment decreases the subsidiary's effective return on equity. Making such an adjustment in this case would reduce Gulf's effective ROE by approximately 61 basis points compared to what the Commission otherwise determines is a fair rate of return.

The Commission should consider these impacts of applying the parent debt rule when weighing the evidence to rebut the presumption that Southern Company's investment in Gulf is funded in part by parent debt.

Q. In calculating Gulf's income tax expense for the test year, Ms. Ritenour does not make a parent debt adjustment under Commission Rule 25-14.004. Why isn't such an adjustment required?

A. The rule does not require an adjustment in this case because only two of the three factors in the rule are met. Gulf is a subsidiary of Southern and it participates in filing a consolidated income tax return; thus the first two factors are met. The third factor is not met because no funds provided by Southern debt have been invested in the equity of Gulf.

Q. Doesn't subsection (3) of the rule create a presumption that Southern's equity investment in Gulf is supported by debt based on the ratio of debt in Southern's overall capital structure?

A. Yes, but the rule also states that the presumption is rebuttable. The presumption can be rebutted—and the rule does not require an adjustment—if the utility shows that the parent's equity investment did not come from debt issued at the parent level. Gulf rebutted this presumption in its 2012 test year rate case, and the factors which were sufficient to rebut the presumption in 2012 still exist for the 2017 test year.

Q. How did the Commission rule on this issue in 2012?

A. The Commission did not make a parent debt adjustment in setting Gulf's rates. In Order No. PSC-12-0179-FOF-EI, the Commission first found that: "On its face, the Parent Debt Adjustment Rule is inconsistent with our long-standing practice of determining allowable utility taxes on a stand-alone basis." (Order at page 114)

After an extensive discussion of the testimony regarding the parent debt adjustment, the Commission concluded that:

> the preponderance of the evidence indicates Gulf effectively has rebutted the presumption that Southern Company invested debt dollars in Gulf's common equity in direct proportion to the percent of debt in Southern Company's parent only capital structure. Consequently, we find that no parent debt adjustment shall be made in the case. (Order at page 116)

Q. What was the basis of that rebuttal?

A. Gulf itself, not Southern debt, had effectively provided the funding for Southern's equity investment in Gulf. Dividend payments made by Gulf to Southern had exceeded the equity investments made by Southern in Gulf.

As shown on Schedule 8 of my exhibit, for the period between Gulf's previous rate case in 2003 and the 2012 case, Gulf had paid $655.8 million in dividends to Southern, while Southern had made equity investments in Gulf of $459.0 million. Thus, Gulf's dividend payments had been sufficient to support 100 percent of Southern's equity investments and still result in a net payment to Southern of $196.8 million. This showed that Gulf itself, not Southern debt, had effectively provided the funding for Southern's equity investment in Gulf.

Q. To rebut the presumption, did Gulf trace the dollars invested by Southern to prove that the investment was sourced by the dividends paid by Gulf, as opposed to Southern debt?

A. No. Dollars are fungible. Tracing dollars to prove that the third factor is met—or not met—is simply not possible. However, the rule cannot properly be interpreted to require an exact tracing. If exact tracing of dollars were required, the presumption in the rule would be effectively irrebuttable. This cannot be what the Commission intended.

Q. Did the Commission address tracing of dollars in the 2012 case?

A. Yes. In Order No. PSC-12-0179-FOF-EI, the Commission stated: "Although funds cannot be traced, it is more logical to assume that Southern Company returned dividend dollars to Gulf to maintain an appropriate level of equity in Gulf than to assume Southern Company issued debt to invest in Gulf's equity." (Order at page 116)

Q. Have the dividends paid by Gulf continued to exceed equity investments made by Southern in Gulf?

A. Yes. Gulf has continued to pay more in dividends to Southern than the amount of Southern's equity investments in Gulf. From April 1, 2011 through December 31, 2015, Gulf has paid dividends in the amount of $567.1 million while Southern has made equity investments in Gulf in the amount of $150 million.

Q. Does Gulf forecast additional dividends paid to Southern and additional equity investments in Gulf by Southern for 2016 and 2017?

A. Yes. As shown on Schedule 8 of my exhibit, between January 1, 2016 and the end of 2017, Gulf is projected to pay dividends to Southern in the amount of $240.7 million while Southern is projected to make equity investments in Gulf of $232.9 million.

In aggregate, dividends paid to Southern are expected to exceed equity investments in Gulf by $621.6 million from 2003 through the end of the test year. Thus, Gulf will continue to be a net returner of capital to Southern, not a net recipient. As in the prior rate cases, Gulf effectively provides the funding for Southern's equity investment in Gulf with its own internally generated funds.

Q. Has the Commission made a parent debt adjustment in any of Gulf's prior rate cases?

A. No. The rule was adopted in 1983. Since that time Gulf has had five rate cases before the Commission, and the Commission has never made a parent debt adjustment pursuant to Rule 25-14.004.

X. SUMMARY

Q. Please summarize your testimony.

A. The rate relief authorized in our last two rate cases does not provide Gulf with sufficient base rate revenues to sustainably provide safe and reliable service to our customers. While Gulf has invested in its systems to provide that service as planned, the revenues required to support that investment have not materialized. Due to the need for continued investment as well as increases in O&M expense, the cost to meet our obligation to serve customers will continue to increase. Projected sales growth simply will not cover that higher cost to serve.

Gulf's rates must be increased to sustain its financial strength to fund investment and O&M expenses. With the expiration of the support mechanisms contained in the approved Settlement from our last case, Gulf's returns will be well below the bottom of our authorized range by the time that new base rates can take effect, and the returns would only continue to decline without rate relief. A weakening financial position would negatively impact the Company's ability to attract needed capital on reasonable terms and would challenge our long-term ability to provide high quality services to our customers.

It is essential that the Company's investment in the portion of Scherer 3 that is now serving retail customers be recovered from those customers. Such recovery is not only required by the regulatory compact, but it is also necessary to allow Gulf to continue to consistently take a long-term view when making future investment decisions.

Gulf is in the process of increasing the proportion of equity in its capital structure to 53 percent of investor-supplied sources. This change will reduce Gulf's financial risk and bring our capital structure more in line with other utilities in Florida. With Gulf's proposed capital structure and returns, our customers will continue to enjoy the benefits of an overall weighted average cost of capital that is among the lowest of the major Florida IOUs.

Finally, Gulf has shown that, as in its last rate case, the equity investments by Southern are not funded by debt issued at the parent company level. Gulf has thus rebutted the presumption in the parent debt adjustment rule and demonstrated that no adjustment is necessary for ratemaking purposes.

In summary, Gulf is committed not only to meeting the minimum requirements of its obligation to serve, but also to continuing to meet the expectations of high quality service. Gulf is requesting an annual increase of $106.8 million in its retail base revenues in order to do that.

Q. Does this conclude your testimony?

A. Yes.

AFFIDAVIT

STATE OF FLORIDA)
)
COUNTY OF ESCAMBIA)

Docket No. 160186-EI

Before me the undersigned authority, personally appeared Xia Liu, who being first duly sworn, deposes, and says that she is the Vice President and Chief Financial Officer of Gulf Power Company, a Florida corporation, that the foregoing is true and correct to the best of her knowledge, information, and belief. She is personally known to me.

s/ Xia Liu
Xia Liu
Vice President and Chief Financial Officer

Sworn to and subscribed before me this 5th day of October, 2016.

Melissa Darnes
Notary Public, State of Florida at Large

Commission No. FF 912698

My Commission Expires December 17, 2019

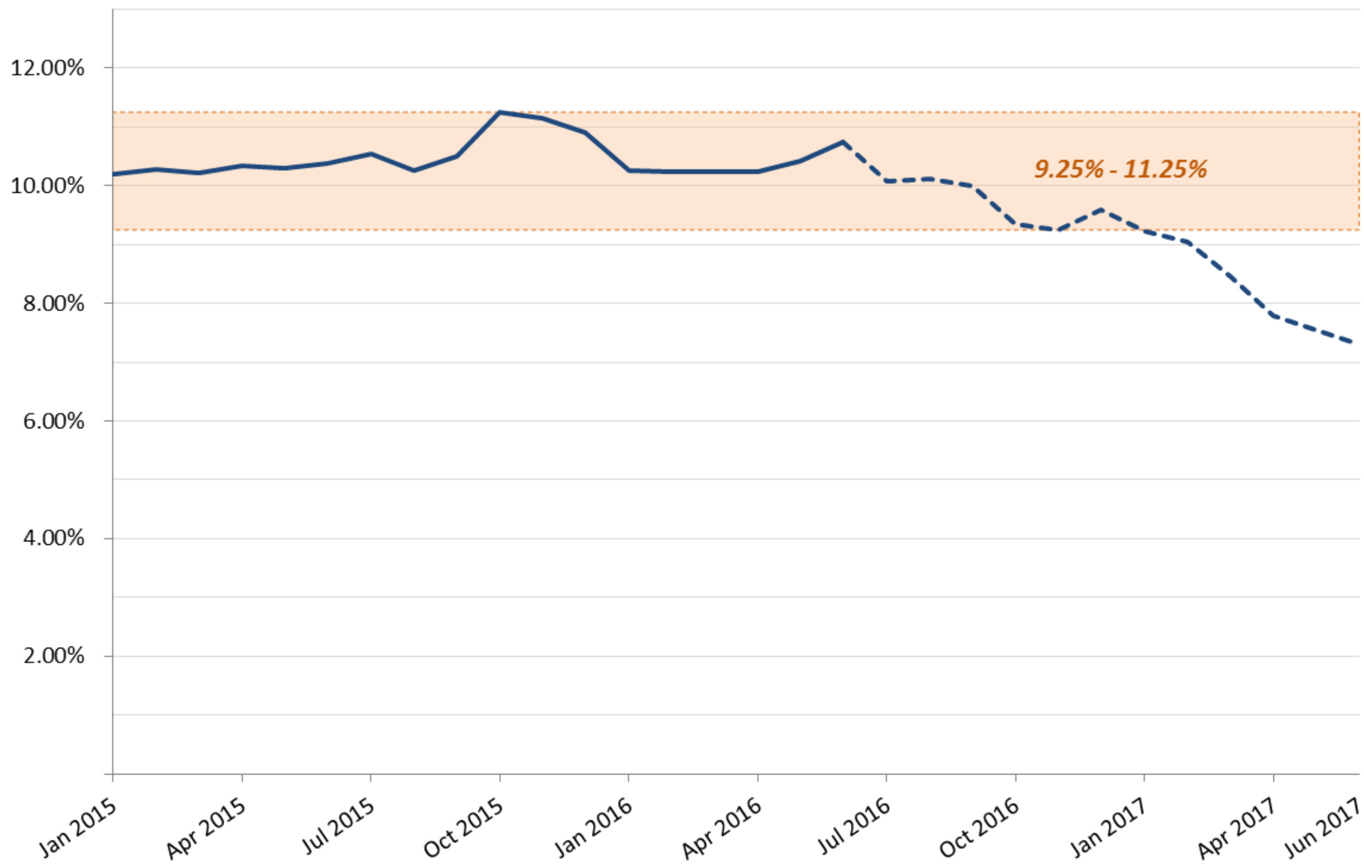
NOTARY PUBLIC STATE OF FLORIDA
MELISSA DARNES
MY COMMISSION # FF 912698
EXPIRES: December 17, 2019
Bonded Thru Budget Notary Services

Exhibit

Responsibility for Minimum Filing Requirements

Schedule	Title
A-1	Full Revenue Requirements Increase Requested
C-24	Parent(s) Debt Information
D-2	Cost of Capital – 5 Year History
D-7	Common Stock Data
D-8	Financial Plans – Stocks and Bond Issues
D-9	Financial Indicators – Summary
F-1	Annual and Quarterly Reports to Shareholders
F-2	SEC Reports
F-3	Business Contracts with Officers or Directors
F-8	Assumptions
F-9	Public Notice

Base Retail ROE



Note: Forecast period includes non-clause portion of Scherer 3 rededicated to retail service

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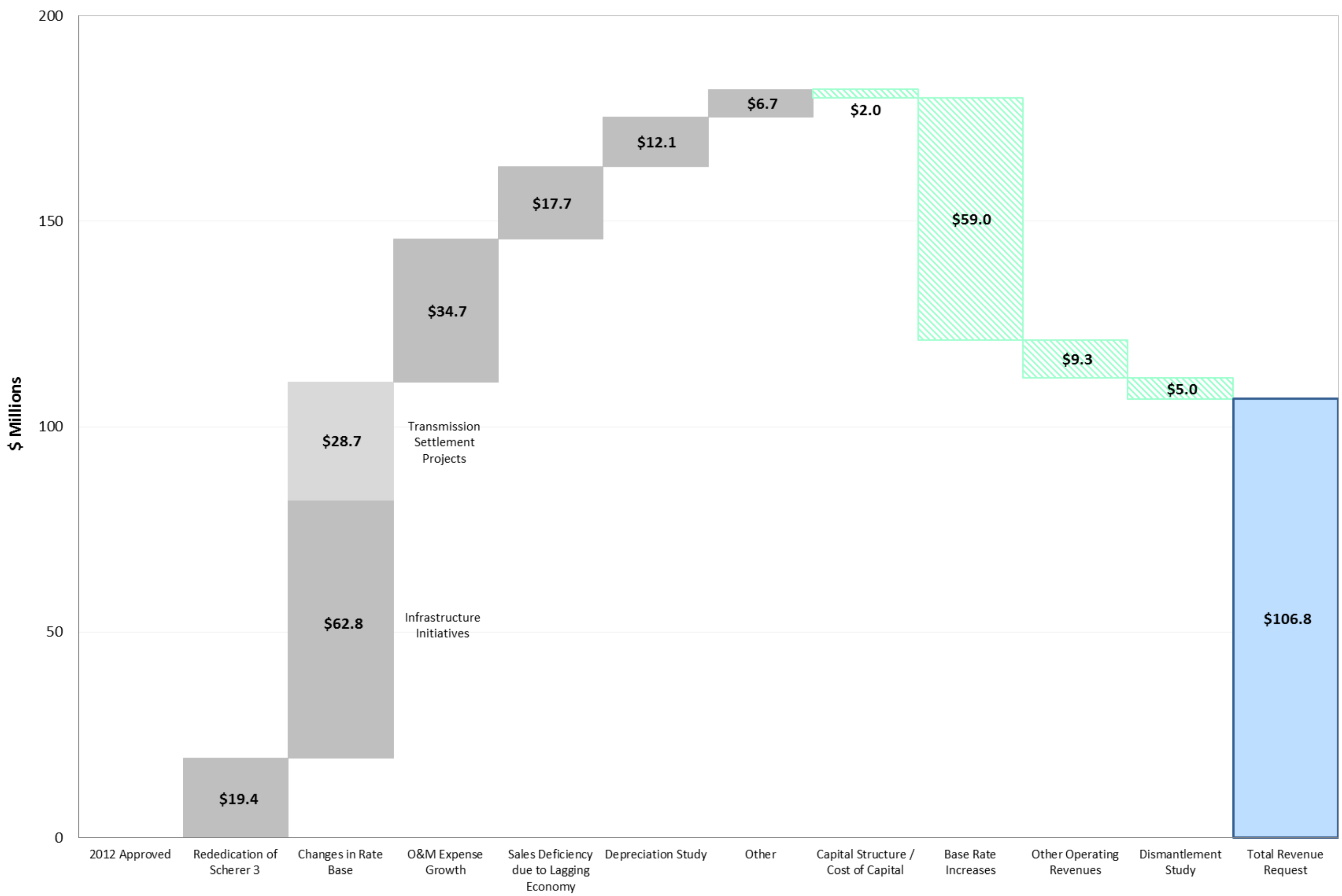
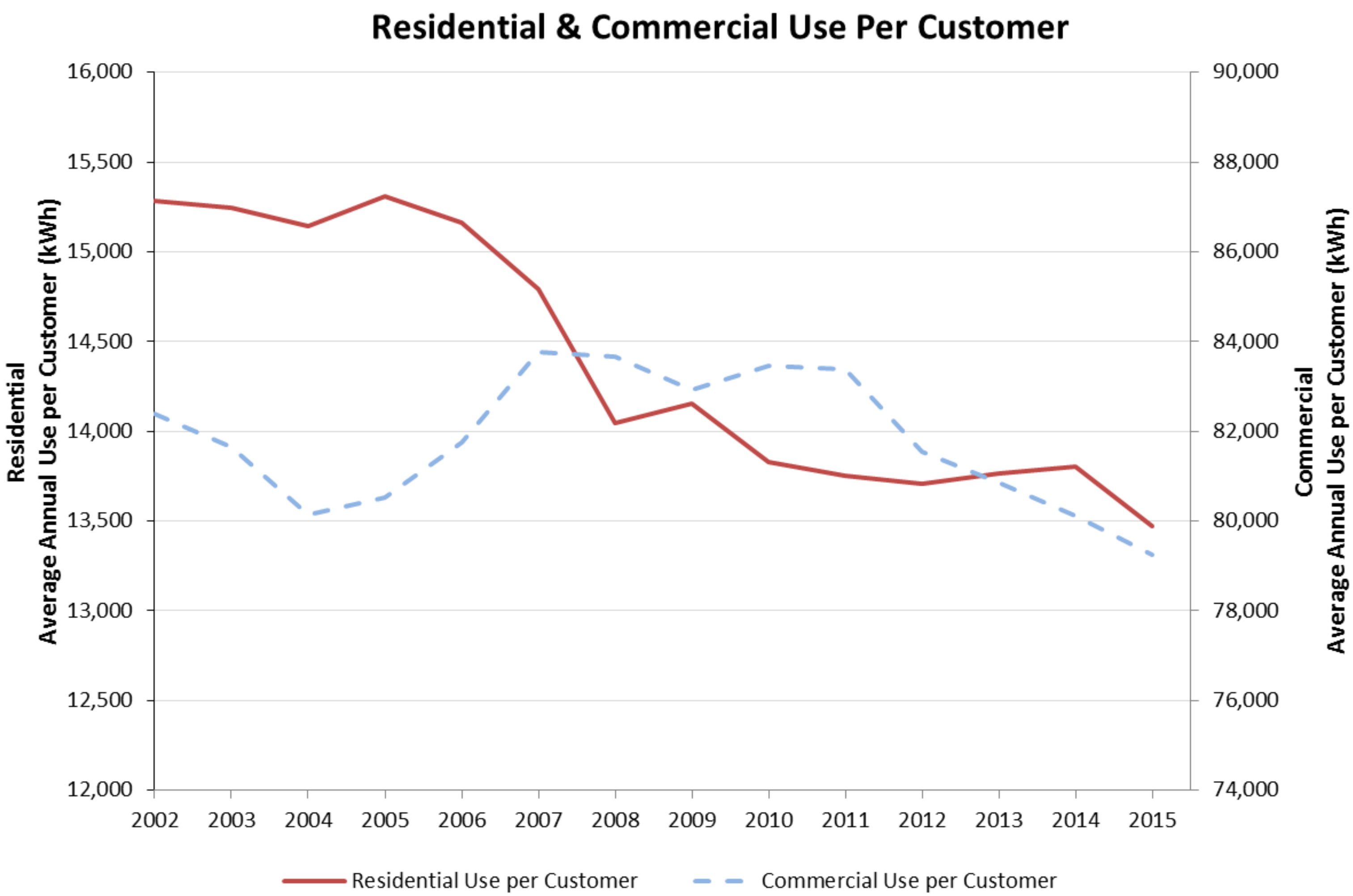
2017 Test Year Revenue Request



Amounts above represent jurisdictional revenue requirements, including NOI multiplier for bad debt expense and FPSC assessment fee as discussed by Witness Ritenour and shown on SDR-1 Sch. 17



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Equity Percentages & Return on Equity

Florida Investor-Owned Utilities

	Equity as % of Jurisdictional Total	Equity as % of Investor Sources Only	Weighted Average Cost of Capital	Equity as % of Investor Sources Only	Approved Return on Equity Midpoint
Company	June 2016 Surveillance Report			Most Recent Commission Approved	
Gulf Power	**36.1%**	**47.1%**	**5.52%**	**46.3%**	**10.25%**
Duke Energy Florida	46.1%	55.6%	6.74%	50.0%	10.50%
Florida Power & Light	46.6%	60.6%	6.30%	59.1%	10.50%
Tampa Electric	41.9%	54.0%	6.20%	54.0%	10.25%
Average excl. Gulf Power	**44.9%**	**56.7%**	**6.41%**	**54.4%**	**10.42%**
Gulf Power - 2017 Test Year	**40.1%**	**53.1%**	**6.04%**		

PARENT DEBT ADJUSTMENT RULE 25-14.004

25-14.004 Effect of Parent Debt on Federal Corporate Income Tax.

In Commission proceedings to establish revenue requirements or address over-earnings, other than those entered into under Rule 25-14.003, F.A.C., the income tax expense of a regulated company shall be adjusted to reflect the income tax expense of the parent debt that may be invested in the equity of the subsidiary where a parent-subsidiary relationship exists and the parties to the relationship join in the filing of a consolidated income tax return.

(1) Where the regulated utility is a subsidiary of a single parent, the income tax effect of the parent's debt invested in the equity of the subsidiary utility shall reduce the income tax expense of the utility.

(2) Where the regulated utility is a subsidiary of tiered parents, the adjusted income tax effect of the debt of all parents invested in the equity of the subsidiary utility shall reduce the income tax expense of the utility.

(3) The capital structure of the parent used to make the adjustment shall include at least long term debt, short term debt, common stock, cost free capital and investment tax credits, excluding retained earnings of the subsidiaries. It shall be a rebuttable presumption that a parent's investment in any subsidiary or in its own operations shall be considered to have been made in the same ratios as exist in the parent's overall capital structure.

(4) The adjustment shall be made by multiplying the debt ratio of the parent by the debt cost of the parent. This product shall be multiplied by the statutory tax rate applicable to the consolidated entity. This result shall be multiplied by the equity dollars of the subsidiary, excluding its retained earnings. The resulting dollar amount shall be used to adjust the income tax expense of the utility.

Rulemaking Authority 350.127(2) FS. Law Implemented 366.05(1), 367.121(1)(a) FS. History–New 1-25-83, Formerly 25-14.04.

Gulf Dividends Compared to Southern Company Capital Contributions 2003 - 2017

($000)

Year	Gulf Dividends to Southern	Gulf Equity from Southern	Net Cash To (From) Southern
2003	70,200	10,000	60,200
2004	70,000	25,000	45,000
2005	68,400	-	68,400
2006	70,300	21,000	49,300
2007	74,100	80,000	(5,900)
2008	81,700	71,000	10,700
2009	89,300	152,000	(62,700)
2010	104,300	50,000	54,300
1Q - 2011	27,500	50,000	(22,500)
Subtotal to 2012 Rate Case *	655,800	459,000	196,800
2Q - 4Q - 2011	82,500	-	82,500
2012	115,800	40,000	75,800
2013	115,400	40,000	75,400
2014	123,200	50,000	73,200
2015	130,160	20,000	110,160
Subtotal Since 2012 Rate Case	567,060	150,000	417,060
2016 & 2017 Projection	240,668	232,949	7,719
Total	**1,463,528**	**841,949**	**621,579**

* See Order No. PSC-12-0179-FOF-EI in Docket No. 110138-EI at page 113