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GULF POWER
A SOUTHERN COMPANY

July 6, 2001

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COMMISSION CLERK

The Honorable E. Leon Jacobs, Chairman
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Test Year Notification Pursuant to Rule 25-6.140 F.A.C.

Dear Chairman Jacobs:

Given current financial projections for Gulf Power Company ("Gulf Power", "Gulf" or the "Company") during and after the first twelve months after the projected in-service date of the new Smith Unit 3 combined cycle generating plant, it is the intent of Gulf Power to file a petition to change the Company's retail base rates effective the later of June 1, 2002 or the commercial in-service date of Smith Unit 3. The purpose of this letter is to comply with notice requirements of the Florida Public Service Commission set forth in Rule 25-6.140, Florida Administrative Code. Gulf has selected the projected twelve months ending May 31, 2003 as the Company's test year for the anticipated rate case filing that we presently plan to file on or about September 4, 2001. The target filing date is at least 60 days after the date of this letter.

As part of this notification of the projected test year, Gulf submits the following information:

Test Year

The projected twelve-month period ending May 31, 2003 is the appropriate test year to be used in setting Gulf's rates for the future. As indicated earlier in this letter, Gulf is seeking an effective date for new rates of June 1, 2002 or the commercial in-service date of Smith Unit 3, whichever date is later. The date of June 1, 2002 corresponds with the anticipated in-service date of the new Smith Unit 3 combined cycle generating plant currently under construction. The chosen test year is the first twelve months after this major new investment goes into service. As a result, the chosen test year will match projected revenues with the projected costs of service and investment required to provide customers with service during the period following the effective date of the anticipated final order in this case. The Company believes that the chosen test year will more accurately depict the conditions Gulf

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Power will face during the first twelve months new rates will be in effect than would a test year that is based on a historical period that does not include the new investment associated with the Smith Unit 3 generating plant addition. The chosen test year is also more representative of the actual revenues, costs of service and investments during the initial twelve months new rates will be in effect and beyond than would be the case with a test year based on a calendar year period that includes months prior to the in-service date of the new generating plant. For the same reasons, the chosen test year is more appropriate than one based on Gulf Power's fiscal year because the Company's fiscal year is a calendar year.

Major Factor Necessitating a Retail Base Rate Increase

The Company's chosen test year will reflect several conditions and one major factor that necessitates the filing of this case. In the 12 ½ years from 1990 through mid-2003, numerous factors will have increased the cost of providing electric service. Among these factors are: the cumulative effect of inflation; the addition of over 100,000 new customers; the addition of over 1400 miles of new distribution lines and over 120 miles of new transmission lines; replacing and repairing the electrical infrastructure associated with the double-digit customer growth that occurred in the mid–1980's; and increased spending to counter a trend of increased customer outages. While all of these and other conditions contribute to the need for rate relief, the major factor which necessitates a rate increase at this time is the completion of Smith Unit 3.

Smith Unit 3 is a 575 megawatt ("mW") combined cycle generating unit being constructed at Gulf's Lansing Smith generating plant near Panama City. This new generating unit is being constructed after having been permitted pursuant to the Florida Electrical Power Plant Siting Act found in Chapter 403 of the Florida Statutes. Pursuant to Section 403.519, Florida Statutes, and Rule 25-22.081, Florida Administrative Code, on March 15, 1999, Gulf petitioned the Commission for a determination of need for an electrical power plant, Smith Unit 3, to be located at Gulf's Lansing Smith facility in Bay County, Florida. Smith Unit 3 is a combined cycle gas unit with a net capacity of 519 mW. In an augmented power mode, the proposed power plant can produce 575 mW. Gulf proposed the unit to fulfill a 427 mW need beginning in the summer of 2002.

Pursuant to Rule 25-22.082, Florida Administrative Code, Gulf issued a Request for Proposals ("RFP") for capacity alternatives to the proposed Smith Unit 3. Although there were several competing proposals submitted through the RFP process by third party providers, upon evaluation of the alternatives it was determined that Smith Unit 3 was more cost-effective when compared to the closest alternative unaffiliated third party proposal submitted by an unaffiliated third party provider. On June 7, 1999 in Docket No. 990325-EI, this Commission held a hearing regarding the need for the 575 mW of capacity from the Smith Unit 3 pursuant to the Florida Electrical Power Plant Siting Act. After consideration of the evidence, the arguments of the parties, and Commission Staff's recommendation, the Commission voted unanimously to grant Gulf's petition for a determination of need. The Commission concluded that Gulf's proposed Smith Unit 3 was the most cost-effective alternative available to Gulf Power's customers. The Governor and members of the Florida Cabinet, sitting as the Power Plant Siting Board, approved site certification for Smith Unit 3 in July 2000 and construction commenced shortly thereafter.

The estimated investment in Smith Unit 3 will be more than $220 million when the unit goes into commercial operation. Gulf's estimated revenue requirements for this investment and the associated costs of depreciation, taxes, insurance, operation and maintenance related to the unit will be $45 million on a total company basis.

Actions and Measures Implemented to Avoid a Retail Base Rate Increase

Gulf's last retail rate case presented to the Florida Public Service Commission was filed in December 1989 in Docket No. 891345-EI. Docket No. 891345-EI was resolved by final order entered in September 1990. The revenue requirements were determined in that case based on a projected test year ending December 31, 1990. Since that time, the Company has made substantial efforts to effectively control expense levels to help avoid the need for future rate relief.

The Company continues to review its Operation & Maintenance ("O&M") expenses on an as needed basis – at a minimum on an annual basis – in an effort to keep the expenses at reasonable levels. It is important to note that the number of customers Gulf serves will have grown by approximately 33% since the 1990 test year that was the basis of the Company's last rate case. In that same period, the CPI has grown by 37%. The resulting compound rate for both customer growth and inflation is 83%. Although the level of O&M that must be supported by base rates has increased significantly over the 12 ½ years between the 1990 test year of Gulf's last rate case and the proposed test year set forth in this notice, this growth in O&M level is well below the compound rate for customer growth and inflation in the same period. The resulting difference is a strong indicator of the success Gulf has achieved in controlling its expenses.

The Company continues to emphasize efficiency and working smarter. At the end of 1990, Gulf had 1626 employees. For the test year, Gulf is budgeting 1382 Gulf employees, and 85 Southern Company Service employees on site for a total of 1467. This is nearly a 10% reduction in the Company's work force since the last rate case. This reduction was accomplished through numerous efficiencies that have allowed us to keep our rates low and, based on our quality of service, achieve high customer satisfaction ratings.

Other Matters

Pursuant to Rule 25-6.140, this letter must contain a statement indicating that Gulf Power either is or is not requesting that the Commission process the Company's petition for rate increase ". . . using the proposed agency action process authorized in Section 366.06(5), Florida Statutes." Since Section 366.06(5) no longer exists in the statute, Gulf does not request use of the proposed agency action process formerly authorized by such section. If the Company cannot meet a filing date of September 4, 2001 as presently planned, the Company will notify the Commission in writing prior to that date. Such letter will include an explanation as to why the Company will not meet the filing date as well as a revised target filing date.

In October 1999, Gulf and various intervenors led by the Office of Public Counsel stipulated to an incentive program that included a rate reduction and a plan that results in revenues over certain base rate revenue levels being shared between customers and shareholders. In a separate filing, Gulf voluntarily agreed to lower its authorized ROE during the life of the stipulation to a 200 basis point range with a midpoint of 11.5%. The stipulation and Gulf's agreement regarding authorized ROE both expire with the in-service date of our new unit at Plant Smith that is on schedule for June 1, 2002. Pursuant to the stipulation approved by the Commission in Order No. PSC-99-2131-S-EI, the effective date for new rates resulting from Gulf's planned petition in the rate case to be filed pursuant to this notice may not take effect until the earlier of the commercial in-service date of Smith Unit 3 or January 1, 2003. As stated earlier in this letter, Gulf anticipates that the commercial in-service date of Smith Unit 3 will be June 1, 2002. Gulf's rate petition will affirmatively seek an effective date for new rates that is the later of June 1, 2002 or the commercial in-service date of Smith Unit 3. As a result, Gulf's petition will be both consistent and in full compliance with the stipulation approved by the Commission in Order No. PSC-99-2131-S-EI.

On June 8, 2001, Gulf filed a petition seeking approval of a proposed purchased power arrangement with regard to Smith Unit 3. Simultaneously, Gulf filed a request for an expedited review and decision regarding that petition. The results of that case clearly will have an impact on the rate filing noticed by this letter, both with regard to timing and amount. As noted during Commission consideration of Gulf's request for expedited treatment on June 25, 2001, if the Commission is not able to reach a final decision approving the proposed purchased power arrangement consistent with Gulf's request for expedited treatment, then Gulf will withdraw the earlier petition in order to make the full rate filing contemplated by this notice. The timing of Gulf's full rate filing is affected by the need to ensure a final decision on the rate case in time to have new rates in effect no later than June 1, 2002 or the commercial in-service date of Smith Unit 3, whichever comes last. If Gulf's proposed purchased power arrangement is approved by the Commission, the Company's actual rate filing pursuant to this notice will be re-evaluated to reflect that approval. Even without the revenue requirement impact of Smith Unit 3, Gulf's average return on common equity will fall below its allowed range for ROE during the proposed test year.

Gulf's rates have historically been and are currently among the lowest in Florida and the nation. Gulf presently has customer satisfaction ratings that are among the best in the nation. Gulf will present testimony justifying the expense level identified in the proposed test year as necessary to enable the Company to maintain a high level of customer satisfaction and quality of service. We cannot continue to achieve these levels with the revenues produced by current rates. Although we will be seeking to increase Gulf's base rates, it is expected that even with the increase that will be requested Gulf's rates will remain among the lowest in Florida and the nation.

As I hope is evident from this letter, we are planning to file a request for rate relief only after long and serious deliberation. We strongly believe that pricing our product properly, thereby producing revenues sufficient for us to continue to achieve and maintain our traditional high quality of service and also maintain a reasonable level of financial integrity is in the best long-term interest of our customers.

Respectfully submitted,

GULF POWER COMPANY

By: Travis J. Bowden
Travis J. Bowden, President and CEO

cc: <u>Florida Public Service Commission</u>

Hon. J. Terry Deason, Commissioner
Hon. Lila A. Jaber, Commissioner
Hon. Braulio L. Baez, Commissioner
Hon. Michael A. Palecki, Commissioner
William D. Talbott, Executive Director
Harold McLean, General Counsel
Dr. Mary A. Bane, Deputy Executive Director
Timothy J. Devlin, Director of Economic Regulation
Blanca S. Bayo, Director of the Commission Clerk and Administrative Services

<u>Office of Public Counsel</u>
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