

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 110138-EI

TESTIMONY AND EXHIBIT
OF
CONSTANCE J. ERICKSON

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ADM	1
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GULF POWER COMPANY

Before the Florida Public Service Commission
Prepared Direct Testimony of
Constance J. Erickson
Docket No. 110138-EI
In Support of Rate Relief
Date of Filing: July 8, 2011

- Q. Please state your name and business address.
- A. My name is Constance J. Erickson. My business address is One Energy Place, Pensacola Florida, 32520.
- Q By whom are you employed?
- A. I am employed by Gulf Power Company (Gulf or the Company). I serve as Gulf’s Comptroller.
- Q. What are your responsibilities as Gulf’s Comptroller?
- A. I am responsible for the financial and regulatory accounting functions of the Company. My duties include maintaining Gulf’s corporate accounting records in accordance with Generally Accepted Accounting Principles in the U.S. (GAAP) and in accordance with the Uniform System of Accounts as prescribed by the Federal Energy Regulatory Commission (FERC) and adopted by the Florida Public Service Commission (FPSC or the Commission). I have responsibility for the preparation of Gulf’s financial statements and various financial reports required by the U.S. Securities and Exchange Commission and the FPSC.

1 Q. Please state your prior work experience and responsibilities.

2 A. From 1987 to 1992, I was employed with the audit division of Arthur
3 Andersen & Co. From 1992 to 2002, I held various senior financial
4 positions with GNB and Exide Technologies and with Graco Inc. In 2002,
5 I accepted employment with Southern Company and have held various
6 financial positions, including Comptroller and Director of Customer
7 Operations and Information Technology with Southern Company Gas and
8 Director of Financial and Contract Services with Southern Company
9 Services, until being named Comptroller of Gulf effective January 14,
10 2006.

11

12 Q. What is your educational background and professional certification?

13 A. I graduated from the University of North Dakota in 1987 with a Bachelor of
14 Accountancy degree. Also, I am a licensed Certified Public Accountant
15 and a member of the American Institute of Certified Public Accountants.

16

17 Q. What is the purpose of your testimony?

18 A. My testimony (a) sets forth and justifies Gulf's 2012 Operations &
19 Maintenance (O&M) budget within the Administrative & General (A&G)
20 function, (b) justifies Gulf's 2012 A&G benchmark variance for expenses
21 other than employee benefits, (c) supports the need to increase Gulf's
22 property damage reserve, (d) discusses the depreciation and tax
23 expenses included in the test year, and (e) explains Gulf's projected test
24 year expense for uncollectibles.

25

1 Q. Are you sponsoring any exhibits?

2 A. Yes. I am sponsoring Exhibit CJE-1, Schedules 1 through 5. Exhibit
3 CJE-1 was prepared under my direction and control, and the information
4 contained therein is true and correct to the best of my knowledge and
5 belief.

6
7 Q. Are you sponsoring any of the Minimum Filing Requirements (MFRs) filed
8 by Gulf?

9 A. Yes. The MFRs that I sponsor or co-sponsor are listed on Schedule 1 of
10 Exhibit CJE-1. The information contained in the MFRs I sponsor or co-
11 sponsor is true and correct to the best of my knowledge and belief.

12

13 Q. How are the Company's accounting records maintained?

14 A. Gulf maintains its books and records in accordance with GAAP and the
15 rules and regulations prescribed for public utilities in the Uniform System
16 of Accounts published by the FERC and adopted by the FPSC.

17

18

19 **I. GULF'S 2012 ADMINISTRATIVE AND GENERAL EXPENSES**

20

21 Q. What is Gulf's A&G O&M expense budget for 2012 test year?

22 A. Gulf projects an O&M expense level for the A&G function of \$78,453,000
23 in the test year.

24

25

1 Q. Is Gulf Power's projected level of A&G expenses of \$78,453,000 in 2012
2 reasonable and prudent?

3 A. Yes. The projected level of A&G expenses is both reasonable and
4 prudent. Gulf's 2012 A&G O&M expenses are based on the extensive
5 budget preparation and review process that each planning unit follows.
6 This process ensures that every item included in the budget is based upon
7 the most accurate and up-to-date assumptions.

8
9 The A&G expense budget consists of a wide range of corporate expenses
10 that are not associated with any particular operating function. There are a
11 number of planning units within the A&G function: Accounting, Finance,
12 Treasury, Human Resources, Information Technology (IT), External
13 Affairs, and Corporate Services. Each planning unit within the A&G
14 function is responsible for developing budgets for employees as well as
15 office supplies and expenses within its unit.

16
17 The remaining A&G expenses - insurance, employee benefits, and other
18 miscellaneous expenses - are budgeted at a corporate level using the
19 latest assumptions for the projected period.

20
21 Q. Is Gulf's projected level of A&G expenses of \$78,453,000 in 2012
22 representative of a going forward level of A&G expense beyond 2012?

23 A. Yes. As noted above and discussed by Gulf Witness Buck, the
24 Company's budget process is very thorough, and O&M projections are
25 prepared at a detailed level for a five year period. Schedule 2 of Exhibit

1 CJE-1 compares total A&G expenses, including the net operating income
2 adjustments, for the 2012 test year with the projections for 2011 and the
3 three years 2013 through 2015. A&G expenses identified in the budget
4 process for the years 2011 and 2013 through 2015 are in line with the
5 2012 A&G expenses, with the exception of employee benefit expenses in
6 2013 through 2015.

7
8 Q. Please address the primary factors that have driven Gulf's overall A&G
9 expenses up since Gulf's prior rate case.

10 A. Excluding employee benefits costs, which are addressed by Gulf
11 Witnesses Twery and Crumlish, there are five primary factors that have
12 resulted in significant increases in Gulf's A&G expense over the decade
13 since Gulf's last base rate increase. Most of these cost drivers were
14 beyond Gulf's control, and even with attempts to mitigate the impact of
15 these drivers, Gulf has experienced rising A&G expenses.

16
17 The first major driver of increased A&G costs was the passage of the
18 Sarbanes-Oxley Act of 2002. The Sarbanes-Oxley Act was the response
19 of Congress to several well known corporate failures in which misleading
20 financial data was reported to investors and regulators. The Sarbanes-
21 Oxley Act not only significantly impacted the level of work required by the
22 Company's external auditors to issue an opinion on the Company's
23 financial statements, but also required Gulf's management to assess the
24 internal controls over financial reporting of the Company. Both of these
25 developments have led to significantly increased levels of A&G expenses

1 related to external audit fees and internal controls, as I discuss later in my
2 testimony.

3
4 The second major driver of increased A&G expense since Gulf's last rate
5 case was the September 11, 2001 terrorist attack. As a result of
6 unanticipated and unprecedented losses in the insurance markets and the
7 prospect that there might be further terrorist related events and losses,
8 Gulf's premiums associated with its property and public liability insurance
9 have increased dramatically.

10
11 A third driver of increased A&G expenses since the last rate case was the
12 particularly severe hurricane seasons of 2004 and 2005. Once again, like
13 September 11, there were heavy losses in the insurance markets. This, in
14 turn, increased the premiums for property insurance. Gulf was affected by
15 three Category 3 storms during this period.

16
17 A fourth driver of A&G costs was the financial crisis beginning in 2008,
18 which affected many financial institutions. As a result of the near collapse
19 of the financial markets, Gulf was affected by rising costs associated with
20 obtaining adequate financing.

21
22 The last significant driver of increased A&G expenses since the last rate
23 case was necessary technology upgrades to Gulf's accounting,
24 purchasing, and work order management systems. These upgrades and
25 their necessity are addressed in greater detail later in my testimony.

1 Q. The Commission has historically employed an O&M benchmark
2 calculation in base rate proceedings. How does Gulf's 2012 A&G
3 expense forecast compare to the A&G O&M expense benchmark?

4 A. The A&G benchmark is \$57,736,000. This calculation is described in Gulf
5 Witness McMillan's testimony. Gulf's projected 2012 A&G expenses are
6 \$78,453,000. These A&G expenses exceed the A&G benchmark by
7 \$20,717,000. These values are shown on Exhibit CJE-1, Schedule 3.
8

9 Q. Previously, you mentioned that Gulf's proposed level of A&G expense was
10 reasonable and prudent. Please elaborate on this in light of the
11 benchmark variance.

12 A. Gulf's 2012 A&G expense budget is the product of a sophisticated and
13 demanding budget process that has been described at a corporate level
14 by Mr. Buck and at a functional level by me and other witnesses. This is
15 the budget process that Gulf employs year in and year out to manage its
16 business. In that process, Gulf does not use the Commission's O&M
17 benchmark approach. Gulf's budget process is very robust and considers
18 matters beyond the Consumer Price Index (CPI) and customer growth.
19 Gulf's projected A&G O&M expenses are reasonable, prudent, and
20 necessary.
21

22 Moreover, as the discussion below shows, a multitude of A&G expense
23 increases in the electric utility industry are totally unrelated to either
24 customer growth or inflation. In the A&G area, costs can be and are
25 driven by other outside factors. Examples of these include employee

benefits and property insurance increases in excess of the CPI, audit and compliance cost increases due to new governmental regulations, and treasury related cost increases due to the recent financial crisis.

Q. Please address how Gulf has justified its \$20,717,000 A&G benchmark variance.

A. Gulf's A&G benchmark variance is justified by Mr. Twery, Ms. Crumlish and by me. Mr. Twery and Ms. Crumlish justify Gulf's A&G O&M benchmark variance in the area of employee benefits. The employee benefits variance of \$10,116,000 is roughly half of Gulf's total A&G O&M benchmark variance. This amount includes the Net Operating Income (NOI) adjustment to pensions and other employee benefits included in Mr. McMillan's testimony. This variance consists primarily of a \$6,938,000 variance in retirement plan expense and a \$3,302,000 variance in medical benefits cost. The remaining employee benefit amounts are below the benchmark variance.

I justify the remaining A&G O&M benchmark variance of \$10,601,000 with justifications in the following areas addressed further in my testimony and on Exhibit CJE-1, Schedule 3:

Insurance	\$4,648,000
Duplicate Charges	1,689,000
External Auditing / Internal Controls	1,453,000
Treasury Costs	976,000
Joint Ownership	874,000

1	Accounting, Supply Chain, and Work	
2	Order Management Systems	546,000
3	Rate Case Expense	249,000
4	Rent	<u>247,000</u>
5	Total	\$10,682,000

6

7 A. Insurance

8 Q. What is the benchmark variance for Insurance expense on Exhibit CJE-1,
9 Schedule 3?

10 A. The 2012 level for Insurance expense is \$14,077,000, which is \$4,648,000
11 above the benchmark. The three components of insurance that are above
12 the benchmark and the associated variance amounts are property
13 damage insurance of \$2,389,000; injuries and damages (I&D) insurance
14 of \$457,000; and Gulf's property damage reserve accrual of \$1,802,000.

15

16 Q. Please explain what is included in Insurance expense on Exhibit CJE-1,
17 Schedule 3.

18 A. Insurance consists primarily of premiums for insurance policies, which
19 cover property damage and I&D costs, and the annual accruals to the
20 property damage and I&D reserves. The Company is self-insured for
21 costs not covered by external insurance policies.

22

23 Property damage insurance protects the Company against losses and
24 damages to owned or leased property used in operations. Gulf's property
25 damage insurance is provided through the Company's All-Risk property

1 damage policy. This policy generally covers damage to the Company's
2 property except for transmission and distribution (T&D) facilities.

3 Insurance for T&D facilities is not widely available, and what is available is
4 cost prohibitive; therefore, Gulf is self-insured for its T&D facilities. The
5 property damage reserve is Gulf's self-insurance mechanism used to
6 cover certain costs of restoration as allowed by the FPSC in Docket No.
7 070011-EI, Order No. PSC-07-0444-FOF-EI, which are not covered by
8 insurance (i.e., T&D facilities) and insurance policy deductibles.

9
10 Insurance related to I&D includes the cost of insurance and accruals to the
11 I&D reserve to protect the Company against I&D claims by employees or
12 others that are not covered by insurance. I&D costs also include the cost
13 of labor and expenses incurred in I&D activities. For example, expenses
14 for the Company's public liability policy are included in I&D costs. This
15 policy covers third party bodily injury and property damage resulting from
16 most company operations. The I&D reserve is used to cover I&D costs
17 not covered by insurance and insurance policy deductibles. This reserve
18 balance is based on an annual accrual of \$1,600,000 less charges against
19 the reserve. The annual accrual amount was approved by the FPSC in
20 Order No. PSC-04-0453-PAA-EI, Docket No. 040218-EI.

21
22 Q. Please address why Gulf's 2012 property damage insurance expense of
23 \$4,407,000 exceeds the property damage insurance benchmark by
24 \$2,389,000.

1 A. The increase in the Company's property insurance costs, excluding the
2 annual property damage reserve accrual, is primarily driven by the events
3 of September 11, 2001 and the natural disaster events (hurricanes) in
4 2004 and 2005, which caused major property damage in Gulf's service
5 area. Additionally, the particularly severe 2004 and 2005 hurricane
6 seasons highlighted to insurers the risk of the potential loss for coastal
7 companies who have assets exposed to wind and storm surge. As a
8 result, insurance premiums have surged. These increases far exceed
9 customer growth and the rate of inflation. They are impacted more by
10 actual losses and potential risks, which impact the property insurance
11 market in general.

12
13 Q. What, if anything, has Gulf done in the face of surging property damage
14 insurance costs to mitigate their impact?

15 A. Gulf used and continues to use insurance brokers to search the insurance
16 market for premium savings. As a result, Gulf made changes in our panel
17 of insurers in pursuit of premium savings. Additional steps Gulf has taken
18 to ensure the competitiveness of property damage insurance costs
19 include:

- 20 • Benchmarking with industry peers;
- 21 • Broker reports on current market conditions, recent placements and
- 22 coverage cost comparisons with other client companies;
- 23 • Competitive bids among insurers;
- 24 • Benchmark comparison of broker compensation; and

25

- 1 • Periodic evaluation of program structures to explore possible
2 premium savings.

3
4 Even with these significant efforts to mitigate costs, Gulf has experienced
5 property damage insurance expense growth in excess of the O&M
6 benchmark. This is simply an area where the O&M benchmark does not
7 capture the causes underlying the growth of the expense.

8
9 Q. Why is the cost for I&D contributing to the benchmark variance?

10 A. The increase in Gulf's insurance costs related to I&D is primarily driven by
11 the events of September 11, 2001. This event highlighted the risk with
12 insurers of the potential public liability. As a result, I&D insurance
13 premiums have increased. These increases do not track customer growth
14 and the rate of inflation, as premiums are impacted more by actual losses
15 and potential risks which impact the insurance market in general. The
16 cost for I&D insurance has exceeded the O&M benchmark by \$457,000.

17
18 Q. What actions has Gulf undertaken to mitigate the cost of its I&D insurance
19 coverage?

20 A. Gulf has taken the same steps for I&D coverage as it has taken for
21 property damage coverage. However, even with these significant efforts,
22 the cost of this insurance has outpaced the combined rate of customer
23 growth and inflation.

1 Q. Of Gulf's \$4,648,000 Insurance expenses O&M benchmark variance, what
2 portion is associated with the property damage reserve accrual?

3 A. The projected cost for the Company's annual accrual to the property
4 damage reserve is \$6,800,000, which exceeds the benchmark by
5 \$1,802,000. As I discuss later in my testimony, this annual accrual level is
6 the level of the expected average annual loss to be covered by the
7 reserve as determined in Gulf's 2011 Hurricane Loss and Reserve
8 Performance Analysis. Maintenance of a property damage reserve that
9 can handle a significant but not catastrophic storm spreads the cost of
10 storms out to each generation of Gulf's customers and helps avoid the
11 situation in which customers who happen to be served during a storm
12 event or shortly thereafter have to absorb all or the bulk of a storm's cost
13 through a storm surcharge.

14

15 B. Duplicate Charges

16 Q. Your next category of A&G O&M benchmark justification is in the area of
17 Duplicate Charges. Please explain Duplicate Charges and the benchmark
18 variance in that account.

19 A. FERC Account 929, duplicate charges, is a credit A&G expense account
20 used as an offset to other A&G expense accounts. FERC defines this
21 account in the Code of Federal Regulations as an account that "shall
22 include concurrent credits for charges which may be made to operating
23 expenses or to other accounts for the use of utility service from its own
24 supply. Include, also, offsetting credits for any other charges made to
25 operating expenses for which there is no direct money outlay." The credit

1 included in the test year is \$1,095,000. This exceeds the benchmark
2 calculation by \$1,689,000. There are two reasons for this variance: a
3 decline in office space used by non-Gulf employees and an accounting
4 change implemented in May 2010.

5
6 Q. Can you provide an example of credits charged to the duplicate charges
7 account?

8 A. When Gulf provides assistance to another electric utility in a storm
9 situation, the costs are billed out to the other utility. Some of those costs
10 are A&G costs. When the other utility pays Gulf for the costs of its crews,
11 these payments are not treated as revenues; they are treated as a credit
12 to expenses. The credit to A&G expenses is booked to FERC Account
13 929.

14
15 Q. Can you explain what you mean by the decline in office space used by
16 non-Gulf employees?

17 A. When non-Gulf employees use Gulf's office space, they are charged an
18 occupancy expense based on actual costs. The 929 account gets
19 credited for this charge. Since 2002, billings for the use of space in Gulf's
20 offices have declined due to a decrease in the amount of space being
21 used by others from 38,000 square feet to 17,000 square feet. Billings for
22 office space included in the 2002 test year were \$1,239,000. Actual
23 billings for office space credited to the 929 account were \$591,000 in
24 2010. In 2012, Gulf expects to bill \$612,000 for office space. This is
25

1 reasonable based on the actual billings from 2010. This decline in space
2 occupied by others accounts for \$1,158,000 of the benchmark variance.
3

4 Q. Earlier you mentioned there had been an accounting change in May 2010
5 for Account 929. Please explain that accounting change.

6 A. Prior to May 2010, the benefits costs associated with the billings of the
7 Gulf employees working on storm restoration for another utility were
8 credited to the duplicate charges account, Account 929. Since May 2010,
9 these benefits, including pensions and employee insurance, are now
10 being credited to the benefit accounts rather than to duplicate charges.
11 This accounting change results in an equal offset between these
12 accounts.
13

14 Q. How has this accounting change impacted the duplicate charges account?

15 A. The credits going to the duplicate charges account are now less than they
16 were prior to May 2010. Since the credit to duplicate charges in 2012 is
17 smaller than the benchmark credit, this appears as an increase to non-
18 employee A&G expenses, when it is merely an accounting change. This
19 accounting change accounts for \$505,000 of the benchmark variance.
20

21 Q. Is the total amount of the duplicate charges credit Gulf has in this test year
22 reasonable?

23 A. Yes.
24
25

1 C. External Audit / Internal Controls

2 Q. Please address the A&G benchmark variance for the External Audit /
3 Internal Controls expense.

4 A. The projected cost for external audit fees is \$1,301,000 in 2012, which
5 exceeds the benchmark by \$1,031,000. The projected internal controls
6 expenses of \$422,000 are necessary for the Company to comply with the
7 financial reporting and internal controls components of the Sarbanes-
8 Oxley Act. There is no benchmark amount for the projected internal
9 controls expenses since the Sarbanes-Oxley Act was passed subsequent
10 to the Company's last base rate case. Both benchmark variances total to
11 \$1,453,000 and are predominately due to new compliance requirements
12 resulting from the passage of the Sarbanes-Oxley Act.
13

14 Q. Please discuss the key requirements mandated by the passage of the
15 Sarbanes-Oxley Act.

16 A. Sections 302 and 404 of the Sarbanes-Oxley Act of 2002 (the Act) directly
17 impacted the Company's financial reporting and internal control
18 requirements. Section 302 requires the Company's Chief Executive
19 Officer (CEO) and Chief Financial Officer (CFO) to certify in the
20 Company's periodic Securities and Exchange Act filings that the
21 information material to the Company's filing has been properly disclosed
22 and the effectiveness of the Company's internal controls have been
23 evaluated and properly communicated. Section 404 requires the
24 Company's CEO and CFO to attest to the design and effectiveness of the
25 Company's internal controls over financial reporting.

1 Q. What has been the impact on Gulf of Sarbanes-Oxley Act compliance?

2 A. Compliance with the Act has increased costs for Gulf Power. External
3 audit hours and resulting fees have increased as the Act, along with other
4 regulatory requirements, increased the amount of work required by the
5 Company's external auditors to issue an opinion on the Company's
6 financial statements. Since 2001, auditors have lowered materiality
7 thresholds and put an increased focus on internal controls and
8 requirements to comply with new auditing standards. The creation of the
9 Public Company Accounting Oversight Board (PCAOB) has increased the
10 cost of external audits as auditors now must comply with additional
11 regulatory requirements based on standards issued by PCAOB. Finally,
12 when performing audits, the Company's external auditors must consider
13 numerous complex accounting standards that have been issued since
14 2001. As previously noted, these significant additional outside auditor
15 requirements associated with Sarbanes-Oxley compliance have resulted
16 in an O&M benchmark variance of \$1,031,000. This compliance results in
17 additional assurance regarding financial data for customers, regulators,
18 and investors. These additional costs above the O&M benchmark are
19 entirely justified.

20

21 Additional resources, primarily labor, have been put in place at Gulf to
22 ensure compliance with the Act. These resources are used to determine
23 compliance requirements of the Act, provide guidance and assistance in
24 monitoring to meet those requirements and provide an overall evaluation
25 of the design and operating effectiveness of Gulf's internal controls over

1 financial reporting as required under the Act. As previously noted, these
2 additional Gulf resources associated with Sarbanes-Oxley compliance
3 have resulted in an O&M benchmark variance of \$422,000. These
4 additional costs above the O&M benchmark are entirely justified.
5

6 D. Treasury Costs

7 Q. Please address the A&G benchmark variance for Treasury Costs.

8 A. The projected Treasury Costs for 2012 is \$1,077,000, which is \$976,000
9 above the benchmark. Treasury Costs include rating agency fees and
10 commitment fees for lines of credit. Rating agency fees are assessed by
11 each of the three major rating agencies, Moody's, Fitch, and Standard &
12 Poor's. Each of the rating agencies has a different formula for the
13 calculation of fees, but essentially they are based on annual debt issuance
14 activity (both bonds and commercial paper) and total outstanding debt.
15 Commitment fees are charged by banks for entering into a credit facility
16 agreement with the Company (a committed line of credit). Commitment
17 fees are market driven and based on the amount of the line of credit.
18

19 Q. What is the benchmark variance associated with rating agency fees?

20 A. The projected cost for rating agency fees is \$227,000, which is \$205,000
21 over the benchmark.
22

23 Q. Why are rating agency fees contributing to the benchmark variance?

24 A. The rating agencies' services are essential for Gulf to be able to raise
25 capital. All three rating agencies have increased their fees significantly in

1 recent years. Since 2003, their fee rates have grown between 50 and 75
2 percent. The rating agencies' services, and therefore the fees, are
3 necessary for Gulf to be able to raise capital. These fees have risen faster
4 than the combined rate of CPI plus customer growth.

5
6 In addition, in 2010 Gulf made an accounting change in its treatment of
7 rating agency fees. Prior to that time, most of the rating agency fees were
8 capitalized and then amortized to interest expense over the life of debt
9 issues. After a review of the FERC classification of accounts, it was
10 determined that the part of the fees that are related to commercial paper
11 activity and total outstanding debt should be expensed as incurred.

12
13 Q. What is the A&G benchmark variance associated with commitment fees?

14 A. The projected cost for commitment fees is \$850,000, which is \$771,000
15 over the benchmark.

16
17 Q. Why are commitment fees contributing to the benchmark variance?

18 A. The increase in commitment fees is a result of two factors. These factors
19 include an increase in the total lines of credit and an increase in the fees
20 charged by banks for the lines of credit.

21
22 Q. Please explain why Gulf has increased the total lines of credit since the
23 prior test year.

24 A. Gulf currently has \$240 million in committed lines of credit. In April 2003,
25 Gulf had \$66 million in committed lines of credit. This is an increase of

1 \$174 million since 2003. The Company has obtained additional lines of
2 credit for three reasons.

3
4 First, lines of credit are required to provide back-up support for
5 \$65.4 million in daily rate Pollution Control Revenue Bonds (PCBs) that
6 were issued in 2009. These PCBs are marketed daily at rates that are
7 considerably less than Gulf's fixed rate outstanding long-term debt. These
8 lower interest rates more than offset the commitment fees associated with
9 the lines of credit, resulting in lower overall capital costs which benefits
10 customers.

11
12 Second, Gulf's commercial paper program has increased in size from
13 \$60 million when it was originally established in 2001 to \$150 million in
14 2010. The commercial paper program allows Gulf to borrow funds for the
15 short-term at competitive rates, and lines of credit are required as back-up
16 support for the program. Gulf's total capitalization has increased from
17 \$1.4 billion in the previous test year to \$3.2 billion in the 2012 test year.
18 With this increase in total capitalization comes the need for an increase in
19 the amount of short-term debt that the Company may issue, and thus a
20 larger commercial paper program. Including an appropriate amount of
21 short-term debt in the capital structure results in lower overall interest
22 costs compared to the use of only debt with longer maturities.

23
24 Third, due to the instability in the financial markets since 2008, Gulf has
25 increased its liquidity protection by obtaining additional lines of credit.

1 Q. How are commitment fees calculated and priced?

2 A. Commitment fees are generally comprised of two components, an upfront
3 fee for entering into the agreement and an unused fee (a fee for the
4 bank's commitment to make the credit available). Both components are
5 typically calculated as a percentage of the committed line of credit.

6

7 Commitment fees are market driven, and since the financial crisis they
8 have been volatile, reaching 1.0 percent at one stage compared with
9 0.075 percent in 2003. Gulf's current expectation for the test year is that
10 commitments fees will be approximately 0.33 percent, an almost five fold
11 increase.

12

13 E. Joint Ownership

14 Q. Your next area of A&G O&M benchmark variance justification on Exhibit
15 CJE-1, Schedule 3 is shown as "Joint Ownership." Please explain what is
16 included in Joint Ownership and address the associated A&G benchmark
17 variance.

18 A. Joint Ownership refers to Gulf's share of the A&G expenses associated
19 with Mississippi Power's coal-fired units at Plant Daniel. The Plant Daniel
20 units, which are located in Mississippi, are jointly owned by Mississippi
21 Power and Gulf Power. Mississippi Power operates the jointly owned
22 Plant Daniel units, and Gulf shares the cost of the units' operation. The
23 2012 projected costs of Joint Ownership, Gulf's share of the A&G
24 expenses associated with the operation of Plant Daniel, is \$4,184,000,
25 which exceeds the benchmark by \$874,000. The A&G benchmark

1 variance for Joint Ownership is primarily associated with employee
2 benefits. Mr. Twery and Ms. Crumlish will address the benchmark
3 variances associated with employee benefits.
4

5 F. Software Systems

6 Q. Your next A&G benchmark justification shown on Exhibit CJE-1, Schedule
7 3 is shown as accounting, supply chain, and work order management
8 systems. Please explain what is included in accounting, supply chain, and
9 work order management systems and address the related A&G
10 benchmark variance.

11 A. Gulf has implemented new software upgrades to its accounting, supply
12 chain and work order management systems since its last rate case.
13 These upgrades were made under the project name Enterprise Solutions.
14 The variance for the software upgrades represents ongoing operating
15 expenses such as licensing fees, maintenance, and support costs
16 associated with Gulf's recently implemented accounting, supply chain, and
17 work order management systems. The 2012 operational costs associated
18 with these new systems are \$1,959,000, which is \$546,000 above the
19 benchmark. Technology replacements or upgrades are not tied to
20 customer growth or inflation.
21

22 Q. Can you describe the Enterprise Solutions project?

23 A. The Enterprise Solutions project consisted of the installation of Oracle, an
24 integrated business software, and Maximo, an asset management
25 software, to replace the aging accounting, supply chain, and work order

1 management systems that were in use. Oracle and Maximo replaced
2 several IT applications in the accounting, supply chain, and generation
3 areas that were used to input, process, and summarize accounting
4 information, procure and pay for materials and services, and manage work
5 orders.

6
7 Enterprise Solutions leveraged technology to continue providing high
8 reliability and customer service. These new tools provide increased
9 automation and use of electronic routing and approvals to reduce the
10 likelihood of human error. They also facilitate the use of automated
11 internal controls.

12
13 Many of the previous systems were very old and highly customized. They
14 were becoming increasingly difficult to maintain. Some of the application
15 systems had been in place since 1985. The previous General Ledger
16 System was no longer supported by the vendor. Gulf delayed
17 implementing new technology for as long as reasonably possible. Further
18 delaying the implementation of the new system would have prolonged
19 Gulf's dependence on old, unsupported technology, which would have led
20 to increased risk associated with the timely procurement of essential
21 materials and services, and the accurate booking of related costs.

22
23 In today's world, changes in our industry are occurring much faster than
24 ever before. Gulf's goal is to provide a high level of customer service and
25

1 to operate in an efficient manner. Accomplishing this goal requires
2 appropriate technology for the long term.

3
4 Q. Please describe the process that was used to arrive at the solutions that
5 Gulf chose to implement.

6 A. A diverse team of IT, accounting, supply chain, and generation personnel
7 was formed to make a recommendation to executive management on the
8 software to replace the systems that were outdated and unsupported.
9 The team contacted twelve utilities to review the systems they used and
10 discuss their experience with those systems for work management,
11 materials management, procurement, general ledger and accounts
12 payable. The team also sought the advice from vendors and consultants,
13 as well as hosting vendor demos for their products.

14
15 Three alternatives were chosen to evaluate replacing our materials
16 management, procurement, accounts payable and general ledger
17 systems. The three alternatives were:

- 18 1. A combination of Maximo for materials and procurement with
19 Oracle for accounts payable and general ledger.
- 20 2. Oracle for all applications.
- 21 3. Systems, Applications, and Products in Data Processing (SAP)
22 for all applications.

23
24 There were pluses and minuses for all three alternatives, but functionality,
25 cost and strategic fit were the drivers that led to the decision to replace our

1 systems with a combination of Maximo and Oracle. Maximo also provided
2 a work order management solution that was also included in the scope of
3 the project. Oracle also has a customer service module that may be
4 viable for our needs if a decision is made in the future to replace our
5 Customer Service System (CSS) system.

6
7 G. Rate Case Expense

8 Q. The next category of A&G expense that you have shown as an A&G O&M
9 benchmark justification on Exhibit CJE-1, Schedule 3 is rate case
10 expense. Please explain what is included in rate case expense and justify
11 the benchmark variance for this category of expense.

12 A. The Company did not include rate case expenses in its 2012 budget;
13 therefore, Mr. McMillan has made adjustments to net operating income
14 and rate base in his exhibit necessary to include the 13-month average
15 unamortized balance of 2011 rate case expense in rate base and the
16 amortization of these rate case expenses in O&M expense in the test
17 year. The majority of the incremental expenses associated with this rate
18 case will be incurred in 2011, but will be deferred and amortized to better
19 match a longer period of time that new rates will be in effect.

20
21 The Company estimates rate case expenses to be \$2,800,000. Gulf is
22 proposing to amortize these rate case expenses over a four-year period
23 beginning in 2012. The jurisdictional net operating income adjustment is
24 an increase in 2012 expenses of \$700,000. This is \$249,000 above the
25

1 benchmark. The jurisdictional rate base adjustment for working capital to
2 reflect the unamortized balance is an increase of \$2,450,000.

3
4 In the decade since Gulf's last rate case, the cost of rate cases has
5 increased markedly. A review of the recent rate case experience of other
6 Florida investor owned electric utilities indicates more intervenors, more
7 discovery, more contested issues and more witnesses than Gulf
8 experienced in its last rate case. When putting together its anticipated
9 rate case budget, Gulf assumed it would have a similar experience. To
10 address these additional anticipated demands, Gulf will have to spend
11 more on incremental internal resources as well as additional outside
12 consulting and legal fees than it did in its last rate case as escalated by
13 CPI and customer growth. The \$2,800,000 level of expenses budgeted
14 and amortized over four years at \$700,000 per year is both reasonable
15 and prudent, even though it exceeds the A&G O&M benchmark
16 calculation by \$249,000 annually.

17
18 H. Rent

19 Q. Your last category of A&G O&M benchmark justification is rent. Please
20 explain what is included in rent on Exhibit CJE-1, Schedule 3 and address
21 the associated benchmark variance.

22 A. Rent includes the rental costs for property that Gulf does not own but
23 uses, occupies, or operates in connection with electric operations of the
24 Company. Gulf is requesting \$294,000 in the test year for the ongoing rent
25 expenses for facilities the Company leases. This exceeds the benchmark

1 calculation by \$247,000. This entire benchmark variance is related to the
2 Pensacola Customer Service Office facility discussed below.

3
4 Q. What has changed since the last rate case to create a need for additional
5 rent expense?

6 A. In 2008, we moved out of our Pace Boulevard building that housed,
7 among other departments, our Pensacola Customer Service Office –
8 where customers come in to pay their bills, sign up for energy efficiency
9 programs and do other business with the Company. We relocated the
10 Pensacola Customer Service Office to a new location selected with
11 customer convenience and access in mind. It is next to a public bus route
12 stop; it has 100 parking spaces; and it is accessible on the ground floor.

13
14 The new rental property required improvements to make it suitable for the
15 customer operations. These leasehold improvements were capitalized
16 and are being expensed over the life of the lease. The lease payments
17 and the additional amount for the leasehold improvements are charged to
18 A&G expense in the rent category. The total expense for this facility in the
19 test year is \$252,000.

20
21 Q. What led to the decision to move out of the Pace Boulevard building?

22 A. One of the departments located at the Pace Boulevard building was Gulf's
23 Distribution Operations Center (DOC). In 2004 the Pace Boulevard facility
24 incurred damage that included blown out windows and minor water
25 damage as a result of Hurricane Ivan. After Hurricane Katrina, Gulf

1 assessed the likelihood of a flooded building if a similar storm surge was
2 experienced like the one in Mississippi during Hurricane Katrina. Gulf
3 decided to relocate the DOC to a more inland Company owned facility.
4

5 In addition, the Pace Boulevard building was built in 1957 and had
6 increasing O&M costs associated with its upkeep. The majority of the
7 remaining departments in the building were relocated to other Company
8 facilities; however, none of these other Company facilities had the parking,
9 bus route proximity and customer access attributes necessary for
10 convenient Customer Service functions.
11

12 Q. Is the amount included in the test year 2012 for the rent of the Customer
13 Service Office facility reasonable?

14 A. Yes. The \$18 per square foot rental fee is reasonable. Gulf compared
15 rents in the downtown area for class "A/B" space. The comparable rents
16 were in the \$16 to \$24 per square foot range.
17
18

19 II. PROPERTY DAMAGE ACCRUAL 20

21 Q. What property damage accrual has been included in the projected test
22 year?

23 A. Gulf has included a property damage accrual of \$6,800,000 in the 2012
24 test year. This represents an increase from Gulf's current accrual of
25 \$3,500,000 per year as approved by the FPSC in the Company's last rate

1 case and results in an NOI adjustment of \$3,300,000 for the test year as
2 discussed in Mr. McMillan's testimony. If the \$3,500,000 annual expense
3 allowed in Gulf's last rate case were escalated for CPI and customer
4 growth, that accrual would be approximately \$5,000,000 per year.
5 However, Gulf proposes an annual accrual of \$6,800,000 per year.
6

7 The \$6,800,000 represents the expected average annual storm loss to be
8 charged to the reserve according to Gulf's 2011 Hurricane Loss and
9 Reserve Performance Analysis (Storm Study). Gulf's Storm Study, which
10 is required pursuant to FPSC Rule 25-6.0143, is attached to my testimony
11 as Exhibit CJE-1, Schedule 5. The expected average annual loss to be
12 covered by the reserve is shown on page 20 of the Study.
13

14 Q. What is the current balance in Gulf's property damage reserve?

15 A. The balance of the property damage reserve as of December 31, 2010
16 was \$27,593,000. With the current accrual of \$3,500,000 per year, this
17 balance will grow to \$31,093,000 by the beginning of the test year,
18 assuming that no property damage is charged to the reserve during 2011
19 (an optimistic assumption). However, as shown on page 5 of Exhibit
20 CJE-1, with the current accrual level of \$3,500,000 and estimated annual
21 charges of \$6,800,000, the expected fund balance in five years will decline
22 to \$11,000,000, and there is a 29 percent probability that the fund balance
23 will become negative within the next five years.
24
25

1 Q. What are the key policy considerations relating to the recovery of property
2 damage costs?

3 A. The Commission has recognized that storm restoration is a cost of
4 providing electric service in Florida and, therefore, is properly recoverable
5 through rates and charges of the Company. While the exact timing of
6 storms cannot be predicted, it is certain that tropical storms and
7 hurricanes will affect Gulf's system over time, and the Company will incur
8 costs for restoring power.

9
10 All customers should contribute to the cost of storm restoration, even if no
11 storm strikes in a particular year. Since storms will occur and only their
12 timing is uncertain, the true cost of providing electric service should
13 include an allowance for a level of restoration activity that approximates at
14 least the average expected annual storm costs over time.

15
16 Q. Please provide a brief history of Gulf's and the Commission's approach to
17 property damage cost recovery.

18 A. Prior to Hurricane Andrew in 1992, Gulf Power maintained commercial
19 insurance coverage for its T&D network. The cost of carrying this
20 insurance was recovered through base rates. The cost of storm
21 restoration, therefore, was spread out to customers over time, largely
22 through the cost of insurance included in the Company's base rate
23 charges.

24

25

1 Following Hurricane Andrew, commercial insurers withdrew from the T&D
2 insurance market. In the absence of commercial coverage, the Company
3 established, and the Commission consistently endorsed, an overall
4 framework which acknowledges that the costs associated with restoring
5 service after storms are a necessary cost of providing electric service in
6 Florida and as such, are properly recoverable from customers. The
7 framework consists of three main parts:

- 8 a. an annual property damage accrual adjusted over time as
- 9 circumstances change,
- 10 b. a reserve adequate to accommodate most but not all storm years,
- 11 and
- 12 c. a provision for utilities to seek recovery of costs that exceed the
- 13 reserve.

14
15 Q. How do these mechanisms enable Gulf Power to recover the costs of
16 storm restoration while balancing customer interests?

17 A. These mechanisms allow for on-going recovery of reasonable amounts to
18 provide for the costs of future storms. By spreading the costs over a
19 number of years, rate shock to our customers is minimized. The reserve
20 accrual also ensures that all customers contribute to the cost of recovering
21 from storms, whose timing is unknown.

22
23 Q. What is the appropriate level for the property damage accrual?

24 A. The property damage reserve balance should be sufficient to protect
25 against most years' storm restoration costs but not the most extreme

1 years. This level should reduce the Company's dependence on relief
2 mechanisms such as a storm cost recovery surcharge. The annual
3 accrual should be set at a level to allow the reserve to build modestly in
4 years of no hurricane activity.

5
6 At year-end 2003, Gulf's property damage reserve balance stood at
7 \$26.2 million. In 2004 and 2005, Gulf's system was impacted by three
8 major storms. Hurricane Ivan, a strong Category 3 storm in 2004 caused
9 the reserve to be drawn down by \$97.7 million. In 2005, Hurricane
10 Dennis, another Category 3 storm, caused the reserve to be drawn down
11 by another \$51.7 million. These storms resulted in a deficit reserve
12 balance as high as \$94 million in September 2005. To eliminate this
13 deficit and begin rebuilding the reserve, the Commission authorized a
14 monthly residential storm surcharge between \$0.00257 and \$0.00271 per
15 kwh for 51 months.

16
17 Q. What is the current target level for the reserve?

18 A. The current target level for the reserve is \$25.1 million to \$36 million, as
19 approved by the Commission in Docket No. 951433-EI, Order No. PSC-
20 96-1334-FOF-EI, and affirmed in the Company's last rate case. The storm
21 study shows that with the current accrual level, the balance in the fund is
22 expected to decrease, rather than increase, over the next five years.
23 Increasing the annual accrual to \$6,800,000 with a targeted reserve
24 balance between \$52 million and \$98 million will provide our customers
25 with the best long term solution to storm restoration. This reserve band

1 replicates Gulf's expenses associated with most recent significant storm
2 damage charged to the reserve and would reduce the likelihood of a
3 significant storm cost recovery surcharge in the event of a large storm.
4

5 Q. Will an increase in the accrual to \$6,800,000 allow Gulf to reach its
6 targeted reserve?

7 A. It is possible but not likely. The requested accrual is only at the level of
8 the expected average annual loss to be covered by the reserve.
9 Therefore, if actual losses equal expected losses, the reserve will not
10 increase to its target. An annual accrual in excess of the expected
11 average annual loss would be required to have an expected increase in
12 the reserve balance over time.
13

14 Q. Why is Gulf not requesting an annual accrual in excess of the expected
15 average annual loss?

16 A. Gulf is aware of the impact that the requested accrual will have on rates
17 and has made a conscious decision to limit the requested accrual to the
18 expected average annual loss. While this will likely mean that the reserve
19 will not grow as large as our targets, it should be adequate to maintain the
20 reserve at or near existing levels, absent catastrophic storms or a series of
21 storms that exceed the average annual impacts. Gulf believes that the
22 requested annual accrual is a significant first step in reaching the targeted
23 reserve over the long term.
24
25

1 Q. Why is it important to maintain an adequate reserve?

2 A. There are numerous reasons for maintaining an adequate reserve. First,
3 an adequate reserve greatly diminishes (but does not eliminate) the
4 likelihood of having to impose surcharges on customers to pay for storm
5 losses. Avoiding surcharges in a post-storm period is greatly beneficial to
6 customers as they too have to struggle with the challenges of storm
7 recovery. Second, an adequate reserve acts like an effective insurance
8 policy. It allows “premiums” in the form of rates to be recovered from all
9 customers a little at a time to cover large losses of an infrequent nature.
10 Third, an adequate reserve assures that financial resources are available
11 to quickly and efficiently repair damages and restore service to customers.
12 Fourth, an adequate reserve diminishes the likelihood of the reserve going
13 negative as it did twice in the 2004-2005 time period. And fifth, an
14 adequate reserve allows for insurance deductibles to be met. The
15 deductible for the All Risk policy has increased from \$1 million to
16 \$10 million and \$25 million for named windstorm and wind driven water.

17
18
19 **III. DEPRECIATION**
20

21 Q. What are Gulf’s depreciation expense, dismantlement accruals, and
22 accumulated depreciation balances for the test year?

23 A. Gulf’s depreciation expense, including dismantlement, for the test year is
24 \$135,208,000, as shown on MFR F-8. Gulf’s 13-month
25

1 average accumulated depreciation balances for the test year, which total
2 \$1,412,339,000, is detailed on MFR B-9.

3
4 Q. What is the basis for Gulf's depreciation expense and dismantlement
5 accruals?

6 A. Gulf's depreciation expense reflects the depreciation rates approved by
7 the Commission in Order No. PSC-10-0458-PAA-EI, issued on
8 July 19, 2010 in Docket No. 090319-EI. Gulf's dismantlement accrual was
9 likewise approved in that same Order. Pursuant to that Order, these
10 newly approved rates were implemented effective January 1, 2010 and
11 will continue through the 2012 test year.

12
13 Q. How was the Advanced Metering Infrastructure (AMI) handled in Gulf's
14 last depreciation study?

15 A. During Gulf's last depreciation study, Gulf identified meter investments of
16 \$12,176,660 that would retire over the 2010-2013 period in connection
17 with its AMI program. The reserve associated with the near-term retiring
18 investments was estimated at \$4,352,459, with anticipated removal costs
19 of \$1,826,499. The resulting net investment of \$9,650,700 was withdrawn
20 from the meter account and placed in a separate account. A reserve
21 transfer of \$9,650,700 was made to cover the amortization related to
22 these meters.

23
24 Q. Does Gulf propose to change how AMI is handled with regard to
25 depreciation?

1 A. Yes. There have been significant changes to the AMI project since Gulf's
2 depreciation study. The move to AMI metering has progressed at a much
3 faster pace than projected in Gulf's Depreciation Study and is estimated to
4 be substantially complete by the end of 2012. This will leave an
5 unrecovered net investment of approximately \$7,088,000 as of
6 December 31, 2011. Gulf proposes a capital recovery schedule to
7 address the \$7,088,000 remaining investment, which will be amortized
8 over a four year period starting in 2012, resulting in \$1,772,000 of annual
9 expense and an increase in the 13-month average accumulated
10 depreciation reserve of \$886,000 as of December 2012. These amounts
11 were provided to Mr. McMillan and are discussed in his testimony.

12
13 Q. What is the depreciable life Gulf is proposing to use for AMI meters and
14 associated equipment?

15 A. Gulf is proposing a 15 year life with no net salvage value for the AMI
16 meters and associated equipment. The 15 year life was based on
17 discussions with project engineering personnel and consultation with our
18 depreciation expert, who agreed that a 15 year life was reasonable due to
19 the new technology involved. Using this proposed depreciable life results
20 in an increase of approximately \$1,327,000 in depreciation expense in
21 2012 and an increase in the 13-month average accumulated depreciation
22 reserve of \$616,000 as of December 2012. These amounts were
23 provided to Mr. McMillan and are discussed in his testimony. Gulf plans to
24 address the net salvage associated with AMI in Gulf's next depreciation
25 study when actual experience is available to analyze the data.

1 **IV. UNCOLLECTIBLE ACCOUNTS**

2

3 Q. Earlier you stated that your testimony would address Gulf's 2012 level of

4 Uncollectible Accounts expense. What level of Uncollectible Accounts

5 expense does Gulf project for 2012?

6 A. Gulf projects an Uncollectible Accounts expense in 2012 of \$4,143,000.

7

8 Q. Is Gulf's projection of 2012 Uncollectible Accounts expense reasonable

9 and prudent?

10 A. Yes.

11

12 Q Is Gulf's projection of 2012 Uncollectible Accounts expense representative

13 of Uncollectible Accounts expense on a going forward basis?

14 A. Yes. This is shown on Exhibit CJE-1, Schedule 4, which shows Gulf's

15 revenue and projected bad debt factor for every year, 2011 through 2015,

16 in the O&M budget that was the basis for the Company's 2012 test year

17 Uncollectible Accounts expense.

18

19 Q. In Gulf's last rate case, what approved write-off rate for Uncollectible

20 Accounts expense was allowed?

21 A. In 2002, the approved write-off rate was 0.24 percent. Write-offs as a

22 percent of revenue is an industry standard for measuring bad debt

23 performance.

24

25

1 Q. How does Gulf's bad debt expense compare to other utilities?

2 A. *{Words from original version removed by agreement between counsel for*
3 *OPD and Gulf.*

4 }

5 Gulf's 2009 net write-offs was 0.33 percent.

6

7 Q. What level of write-offs does Gulf project in 2012?

8 A. Gulf projects write-offs for 2012 to be 0.32 percent, which is slightly lower
9 than 2009 actual. *{Words from original version removed by agreement*
10 *between counsel for OPD and Gulf.* } Gulf made a \$206,000 NOI
11 adjustment, as discussed in Mr. McMillan's and Ms. Neyman's testimony,
12 to write-offs based on a plan for increased collection efforts by Gulf's Field
13 Service Representatives.

14

15 Q. What is driving the increased write-off rate?

16 A. As individuals are unemployed, under-employed, facing foreclosure, or
17 under other financial stress, utility bills can remain unpaid. The effect of
18 the weak economy has resulted in an increase in Gulf's actual write-offs
19 factor for 2008, 2009 and 2010 as reflected on MFR C-11.

20

21 Q. How does Gulf manage its collection process to minimize write-offs?

22 A. Gulf has worked diligently to minimize write-offs through the use of
23 consistent policies to assess and mitigate risk. Credit scoring is the
24 resource used to assist in the identification and risk assessment of a new
25 residential customer. Deposits are collected for residential, commercial

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1 and industrial classes of service based on creditworthiness. Pro-active
2 outbound calling is used to notify customers that payment is necessary to
3 avoid disconnection of service. Management monitors collection-related
4 statistics and has established performance indicators that prompt further
5 evaluation and action.

6
7 Q. Please summarize your justification of Gulf's Uncollectible Accounts
8 expense.

9 A. Uncollectible Accounts expenses do not track with CPI but are generally
10 determined as a percentage of revenues. Gulf's write-off percentage of
11 0.32 percent for the test year is slightly below the level experienced by
12 Gulf in 2009.

13
14
15 **V. INCOME TAX EXPENSE**

16
17 Q. What amount of income tax expense is included for the 2012 test year?

18 A. Total federal and state income tax provision for the test year is
19 \$63,241,000 as shown on MFR C-22.

20
21 Q. How was this amount calculated?

22 A. The income tax expense was calculated in accordance with GAAP.
23
24
25

1 **VI. SUMMARY**

2

3 Q. Please summarize your testimony.

4 A. The level of A&G expenses requested in this case is reasonable, prudent
5 and necessary to enable Gulf to continue to provide high quality, reliable
6 electric service to our customers. Although some of these costs have
7 grown more rapidly than the O&M benchmark, I, along with Mr. Twery and
8 Ms. Crumlish, have explained how these variances were influenced by
9 other factors outside the control of the Company and justified their levels.

10

11 Gulf's requested property damage accrual is an appropriate amount that
12 balances the interests of the Company and our customers in accordance
13 with established Commission policy.

14

15 The requested levels of uncollectible accounts and depreciation and
16 amortization expense are reasonable, prudent and necessary. The test
17 year income tax expense has been calculated appropriately.

18

19 Q. Does this conclude your testimony?

20 A. Yes.

21

22

23

24

25

AFFIDAVIT

STATE OF FLORIDA)
)
COUNTY OF ESCAMBIA)

Docket No. 110138-EI

Before me the undersigned authority, personally appeared Constance J. Erickson, who being first duly sworn, deposes, and says that she is the Comptroller of Gulf Power Company, a Florida corporation, and that the foregoing is true and correct to the best of her knowledge, information, and belief. She is personally known to me.

Constance J. Erickson

Constance J. Erickson
Comptroller

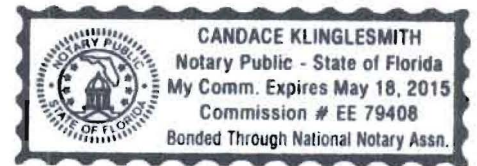
Sworn to and subscribed before me this 6th day of July, 2011.

Candace Klingsmith

Notary Public, State of Florida at Large

Commission No. EE79408

My Commission Expires 5-18-2015



Florida Public Service Commission
Docket No.: 110138-EI
GULF POWER COMPANY
Witness: C. J. Erickson
Exhibit No. _____ (CJE-1)
Schedule 1
Page 1 of 2

Responsibility for Minimum Filing Requirements

<u>Schedule</u>	<u>Title</u>
B-4	Two Year Historical Balance Sheet
B-21	Accumulated Provision Accounts- 228.1, 228.2 and 228.4
B-22	Total Accumulated Deferred Income Taxes
B-23	Investment Tax Credits – Annual Analysis
B-25	Accounting Policy Changes Affecting Rate Base
C-6	Budgeted Versus Actual Operating Revenues and Expenses
C-8	Detail of Changes in Expenses
C-9	Five Year Analysis – Change in Cost
C-10	Detail of Rate Case Expenses for Outside Consultants
C-11	Uncollectible Accounts
C-12	Administrative Expenses
C-13	Miscellaneous General Expenses
C-17	Pension Cost
C-19	Amortization/Recovery Schedule-12 Months
C-20	Taxes Other than Income Taxes
C-21	Revenue Taxes
C-22	State and Federal Income Tax Calculation

Florida Public Service Commission
Docket No.: 110138-EI
GULF POWER COMPANY
Witness: C. J. Erickson
Exhibit No. ____ (CJE-1)
Schedule 1
Page 2 of 2

Responsibility for Minimum Filing Requirements

<u>Schedule</u>	<u>Title</u>
C-25	Deferred Tax Adjustment
C-26	Income Tax Returns
C-27	Consolidated Tax Information
C-28	Miscellaneous Tax Information
C-29	Gains and Losses on Disposition of Plant and Property
C-30	Transactions with Affiliated Companies
C-31	Affiliated Company Relationships
C-35	Payroll and Fringe Benefit Increases Compared to CPI
C-41	O&M Benchmark Variance by Function
C-43	Security Costs
F-1	Annual and Quarterly Reports to Shareholders
F-2	SEC Reports
F-8	Assumptions

A & G Budgeted Expenses
(\$000's)

FERC Account	Description	2011	2012	2013	2014	2015
920	Administrative and General Salaries	13,613	14,175	14,117	14,539	15,014
921	Office Supplies and Expenses	3,903	3,992	4,036	4,093	4,145
922	Administrative Expenses Transferred - Credit	(324)	(332)	(341)	(349)	(358)
923	Outside Services Employed	19,678	18,718	18,549	18,740	18,916
924	Property Insurance	7,397	11,207	11,231	11,314	11,312
925	Injuries and Damages	2,869	2,914	2,930	2,968	3,008
926	Employee Pensions and Benefits	15,536	19,473	24,479	24,874	25,560
928	Regulatory Commission Expenses	1,284	2,014	2,047	2,082	2,118
929	Duplicate Charges - Credit	(1,065)	(1,095)	(1,122)	(1,147)	(1,173)
930	General Advertising / Miscellaneous General Expenses	5,862	6,554	6,381	6,716	6,195
931	Rents	307	313	318	322	327
935	Maintenance of General Plant	515	520	520	537	538
	Total	69,575	78,453	83,145	84,689	85,602

* These amounts include NOI adjustments discussed in Mr. McMillan's testimony for 2012.

A&G - Benchmark Variance

A&G

(\$000)

2002/2003 Allowed	40,432
Test Year Adjusted Benchmark	57,736
Test Year Adjusted Request	78,453
System Benchmark Variance	20,717

<u>Description</u>	<u>Variance</u>
1. Employee Benefits	10,116
2. Insurance	4,648
3. Duplicate Charges	1,689
4. External Auditing / Internal Controls	1,453
5. Treasury Costs	976
6. Joint Ownership	874
7. Accounting, Supply Chain, and Work Order Management System	546
8. Rate Case Expense	249
9. Rent	247
	<u>20,798</u>

Uncollectible Accounts
(000's)

<u>Description</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Revenue	1,307,587	1,307,803	1,378,382	1,455,758	1,556,340
Write-Offs*	4,352	4,137	4,186	4,448	4,852
Bad Debt Factor	0.33%	0.32%	0.30%	0.31%	0.31%

* These amounts include NOI adjustments discussed in Mr. McMillan's testimony for 2012.

Florida Public Service Commission
Docket No.: 110138-EI
GULF POWER COMPANY
Witness: C. J. Erickson
Exhibit No. _____ (CJE-1)
Schedule 4
Page 1 of 1

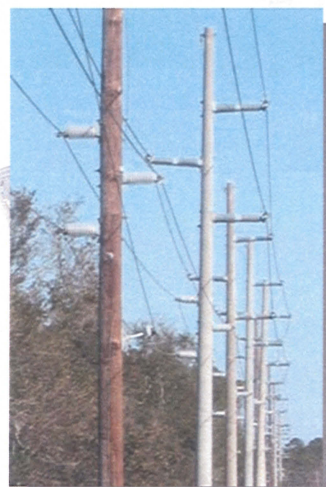
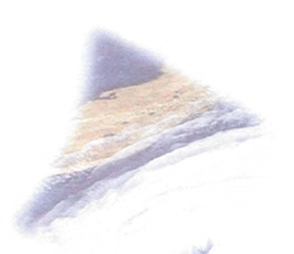
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Docket No. 110138-EI
GULF POWER COMPANY
Witness: C.J. Erickson
Exhibit No. ____ (CJE-1)
Schedule 5
Page 1 of 1

See Attached:

Gulf Power Company
Transmission and Distribution Hurricane Loss and Reserve Performance Analyses

Gulf Power Company

Transmission and Distribution Hurricane Loss and Reserve Performance Analyses



January
2011

Table of Contents

	<u>Page</u>
EXECUTIVE SUMMARY.....	iii
1. HURRICANE LOSS ANALYSIS.....	1-1
2. HURRICANE HAZARD	2-1
3. HURRICANE LANDFALL ANALYSES FOR SSI RANGES	3-1
4. HURRICANE LOSS ANALYSIS RESULTS	4-1
5. RESERVE PERFORMANCE ANALYSIS	5-1
6. REFERENCES	6-1

Tables

E-1	Gulf Power Company Transmission and Distribution Risk Profile.....	iv
1-1	Overhead Distribution Asset Replacement Values by County	1-2
1-2	Overhead Transmission Asset Replacement Value	1-2
4-1	Gulf Power Company T & D Assets Aggregate Damage Exceedance Probabilities.....	4-3
5-1	Gulf Power Company T & D Reserve Fund Accruals and Probability of Reserve Fund Performance	5-2

Figures

1-1	Overhead Distribution Asset Values by Zip Code	1-3
2-1	Atlantic Multidecadal Oscillation in Sea Surface Temperatures 1856-2010	2-2
3-1	Storm Landfall Mile Posts	3-3
3-2	Frequency Weighted Average Transmission & Distribution Damage from SSI 1 Landfalls	3-4
3-3	Frequency Weighted Average Transmission & Distribution Damage from SSI 2 Landfalls	3-5
3-4	Frequency Weighted Average Transmission & Distribution Damage from SSI 3 Landfalls	3-6
3-5	Frequency Weighted Average Transmission & Distribution Damage from SSI 4 Landfalls	3-7
5-1	Reserve Performance Analysis Results: \$27 million Initial Balance, \$3.5 million Annual Accrual	5-3

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A SIGNIFICANT AMOUNT OF UNCERTAINTY EXISTS IN KEY ANALYSIS PARAMETERS THAT CAN ONLY BE ESTIMATED. PARTICULARLY, SUCH UNCERTAINTIES EXIST IN, BUT ARE NOT LIMITED TO: HURRICANE SEVERITY AND LOCATIONS; ASSET VULNERABILITIES, REPLACEMENT COSTS, AND OTHER COMPUTATIONAL PARAMETERS, ANY OF WHICH ALONE CAN CAUSE ESTIMATED LOSSES TO BE SIGNIFICANTLY DIFFERENT THAN LOSSES SUSTAINED IN SPECIFIC EVENTS.

Executive Summary

Gulf Power (Gulf) transmission and distribution (T & D) systems are exposed to and in the past have sustained damage from hurricanes. The exposure of these assets to hurricane damage is described and potential losses are quantified. Loss analyses were performed by EQECAT, using an advanced computer model simulation program WORLDCATenterprise USWIND™.

The hurricane exposure is analyzed from a probabilistic approach, which considers the full range of potential hurricane characteristics and corresponding losses. Factors considered in the analysis include the location of Gulf's T & D assets, the probability of hurricanes of different intensities and landfall points impacting those assets, the vulnerability of those assets to hurricane damage, and the costs to repair assets and restore electrical service.

The frequencies and computed damage for all simulated hurricanes are combined to calculate the expected annual loss and the annual aggregate exceedance relations. The expected annual damage represents the average of all storm years over a long period of time. There is a 10% probability that damage to T&D assets from all hurricanes in one year could exceed \$22 million, and a 1% probability that damage could exceed \$140 million.

An analysis was also performed to simulate the performance of Gulf's reserve fund over a five year prospective period. This probabilistic analysis is based on the losses and frequencies of occurrence of hurricanes, and the current level of annual accruals to the reserve. This analysis shows the reserve fund balance is expected to decline from the current \$27 million to \$11 million at the end of five years. There is a 29% probability that the reserve could have inadequate funds to cover hurricane damage over the five year simulation period.

A summary of the analyses performed by EQECAT of Gulf's hurricane loss exposure and reserve performance are provided in the risk profile in Table E-1 below.

This report is intended to be used solely by Gulf and the Florida Public Service Commission for estimation of potential future Gulf losses to the reserve and the estimation of the performance of the reserve fund.

Table E-1
Gulf Power Company Transmission and Distribution Risk Profile

OWNER	Gulf Power Company	
ASSETS	Transmission and Distribution (T & D) System consisting of: Transmission towers, and conductors; Distribution poles, transformers, conductors, lighting and other miscellaneous assets	
LOCATION	All T & D assets located within State of Florida	
ASSET VALUE	Normal replacement value is approximately \$ 2.2 billion, of which approximately 21% is transmission and 79% is distribution	
LOSS PERIL	Hurricane Windstorm (SSI 1 to 5)	
EXPECTED ANNUAL DAMAGE	\$8.3 million	
10% AGGREGATE DAMAGE EXCEEDANCE VALUE	\$22 million (one year)	
1% AGGREGATE DAMAGE EXCEEDANCE VALUE	\$140 million (one year)	
	RESERVE PERFORMANCE	
Reserve Fund Initial Balance	Expected Fund Balance at 5 years	Probability of negative balances within 5 years
\$27 million	\$11 million	29%

1. Hurricane Loss Analysis

Gulf Power (Gulf) transmission and distribution (T & D) systems are exposed to and in the past have sustained damage from hurricanes. The exposure of these assets to hurricane damage is described and potential losses are quantified. Loss analyses were performed by EQECAT, using an advanced computer model simulation program WORLDCATenterprise USWIND™ developed by EQECAT, an ABS Group Company. All results which are presented here have been calculated using USWIND, and Gulf provided T & D asset portfolio data.

The hurricane exposure is analyzed from a probabilistic approach, which considers the full range of potential hurricane characteristics and corresponding losses. Probabilistic analyses identify the probability of damage exceeding a specific dollar amount. WORLDCATenterprise USWIND™ is a probabilistic model designed to estimate damage and losses due to the occurrence of hurricanes. EQECAT proprietary computer software USWIND is one of only four models evaluated and determined acceptable by the Florida Commission on Hurricane Loss Projection Methodology (FCHLPM) for projecting hurricane loss costs and approved for use in insurance rating (Reference 1).

Probabilistic Annual Damage & Loss is computed using the results of thousands of random variable hurricanes. Annual damage and loss estimates are developed for each individual site and aggregated to overall portfolio damage and loss amounts. Damage is defined as the Operations and Maintenance (O&M) portion of the cost, exclusive of capital and nominal labor, associated with repair and/or replacement of T & D assets necessary to promptly restore service in a post hurricane environment. This cost is typically larger than the costs associated with scheduled repair and replacement programs.

Factors considered in the analysis include locations of Gulf's overhead T & D assets, the probability of hurricanes of different intensities and/or landfall points impacting those assets, the vulnerability of those assets to hurricane damage, and the costs to repair assets and restore electrical service.

Transmission and Distribution asset data are provided in the Tables 1-1 and 1-2 below. Distribution asset values are shown in Figure 1-1.

Table 1-1
Overhead Distribution Asset Replacement Values by County

County	Replacement Value (\$1,000)
Escambia	410,976
Bay	221,048
Okaloosa	206,440
Santa Rosa	188,933
Washington	45,271
Walton	39,078
Holmes	14,624
Jackson	9,136
Total	1,135,506

Table 1-2
Overhead Transmission Asset Replacement Value

	Replacement Value (\$1,000)
Total	463,579

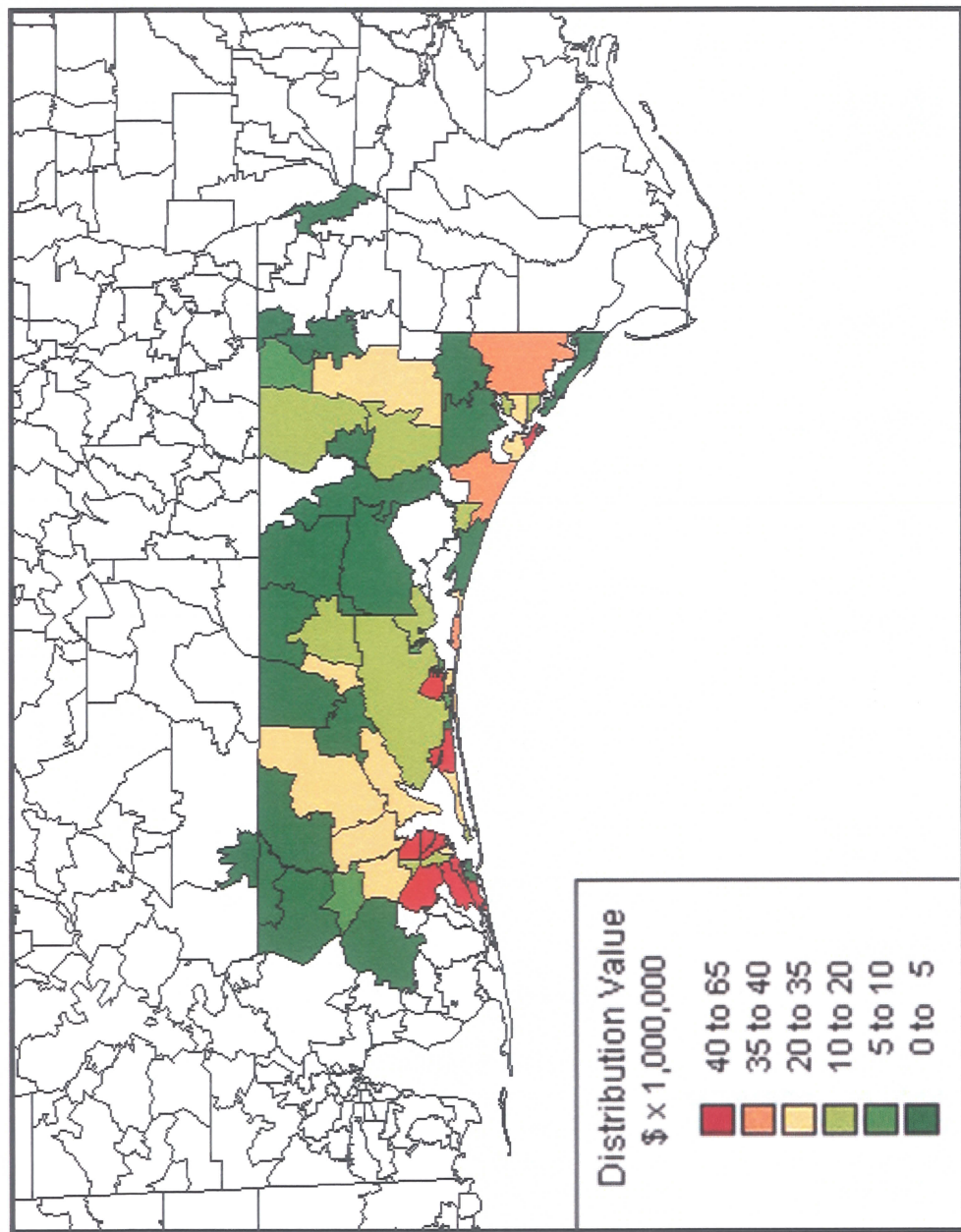


Figure 1-1: Overhead Distribution Asset Values by Zip Code

Transmission and Distribution Asset Vulnerabilities

The Gulf Power loss history from the 2004 Hurricane Ivan, 2005 Hurricane Dennis and Katrina were considered in the calibration of the hurricane loss model. These hurricanes provide data on recent hurricane recovery costs from moderate intensity events. The 2004-05 hurricane loss experience includes the effects of many factors including the post hurricane costs of labor, mutual aid and other factors associated with the hurricane restoration process utilized by Gulf Power. The 2004-05 loss history is believed to be most reflective of the current Gulf hurricane restoration practices and cost experience.

Loss Estimation Methodology

The basic components of the hurricane risk analysis include:

- **Assets at risk:** define and locate
- **Hurricane hazard:** apply probabilistic hurricane model for the region
- **Asset vulnerabilities:** severity (wind speed) versus damage
- **Portfolio Analysis:** probabilistic analysis -damage/ loss

2. Hurricane Hazard

Hurricane Exposure

The hurricane exposure is analyzed from a probabilistic approach, which considers the full range of potential hurricane characteristics and corresponding losses. Probabilistic analyses identify the probability of damage exceeding a specific dollar amount.

WORLDCATenterprise USWIND™ is a probabilistic model designed to estimate damage and losses due to the occurrence of hurricanes. EQECAT, Inc. proprietary computer software USWIND is one of only four models evaluated and determined acceptable by the Florida Commission on Hurricane Loss Projection Methodology (FCHLPM) for projecting hurricane loss costs and approved for use in insurance rating.

The historical annual frequency of hurricanes has varied significantly over time. There are many causes for the temporal variability in hurricane formation. While stochastic variability is a significant factor, many scientists believe that the formation of hurricanes is also related to climate variability.

One of the primary climate cycles having a significant correlation with Hurricane activity is the Atlantic Multidecadal Oscillation (AMO). It has been suggested that the formation of hurricanes in the Atlantic Ocean off the coast of Africa is related to the amount of rainfall in the Western African Sahel region. Years in which rainfall is heavy have been associated with the formation of a greater number of hurricanes. The AMO cycle consists of a warm phase, during which the tropical and sub-tropical North Atlantic basins have warmer than average temperatures at the surface and in the upper portion relevant to hurricane activity, and a cool phase, during which these regions of the ocean have cooler than average temperatures. In the period 1900 through 2005, the AMO has gone through the following phases:

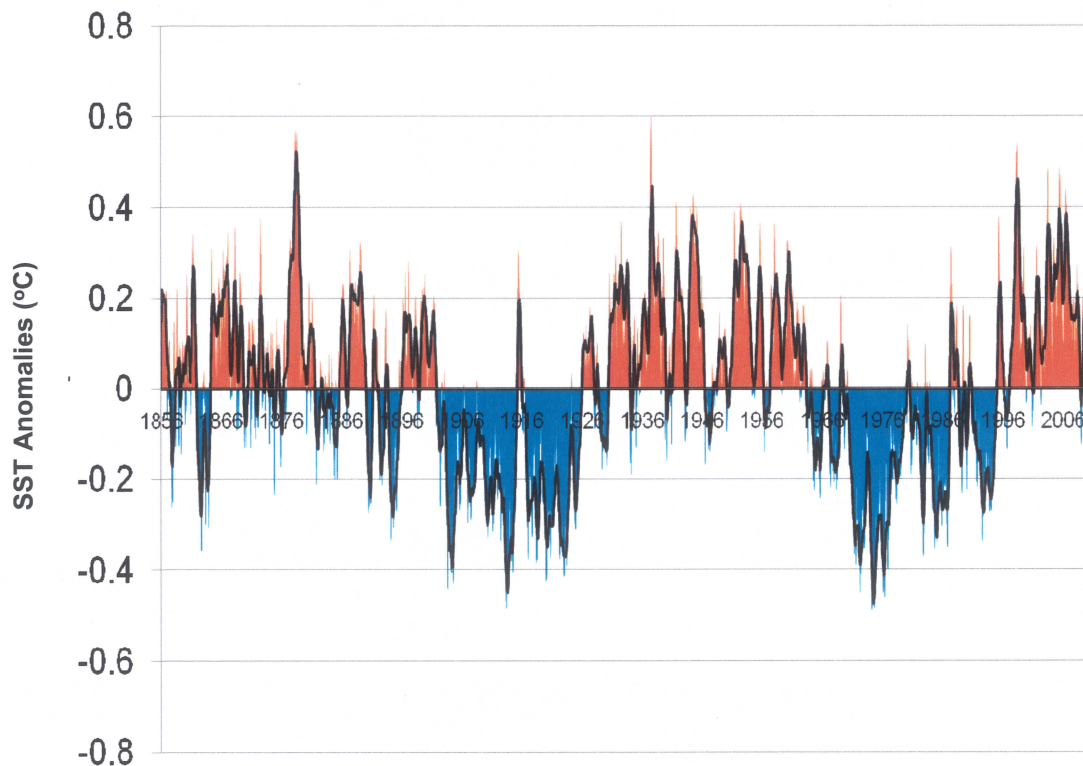
1900 through 1925	Cool	(Decreased Hurricane Activity)
1926 through 1969	Warm	(Increased Hurricane Activity)
1970 through 1994	Cool	(Decreased Hurricane Activity)
1995 through 2010	Warm	(Increased Hurricane Activity)

These AMO phases are illustrated by the plot of Sea Surface Temperature (SST) Anomalies (deviation from the mean) in the Atlantic Basin over the past 150 years in Figure 2-1.

The National Oceanic and Atmospheric Administration (NOAA) believes that we entered a warm phase of AMO around 1995 which can be expected to continue for at least several years; historically, each phase of AMO has lasted approximately 25 to 40 years.

Probabilistic Annual Damage & Loss is computed using the results of thousands of random variable hurricanes considering the long term 100 year hurricane hazard. Annual damage estimates are developed for each individual site and aggregated to overall portfolio damage amounts. Damage is defined as the total cost including the operations and maintenance (O&M) and capital components associated with repair and/or replacement of T & D assets necessary to promptly restore service in a post hurricane environment. This cost is typically larger than the costs associated with scheduled repair and replacement programs.

Primary factors considered in the analysis include the location of Gulf Power Company's overhead T & D assets, the probability of hurricanes of different intensities and/or landfall points impacting those assets, the vulnerability of those assets to hurricane damage, and the costs to repair assets and restore electrical service.



**Figure 2-1: Atlantic Multidecadal Oscillation in
Sea Surface Temperatures 1856-2010**

3. Hurricane Landfall Analyses for SSI Ranges

In order to provide further insight into Gulf's risk profile, the full set of stochastic hurricane events were analyzed by landfall for four storm intensities, SSI 1 through 4. The landfall locations are at mile posts 780 through 1010. Figure 3-1 illustrates the landfall locations. These mile posts extend east from Pascagoula, MS to Apalachicola, FL at approximately 10 mile intervals.

The full set of stochastic storms within each SSI category was analyzed on Gulf's T&D portfolio. For each milepost and SSI category, the frequency-weighted average damage was computed from all stochastic storms making landfall within 10 nautical miles of a given milepost and within that SSI category. Figures 3-2 through 3-5 provide these results graphically.

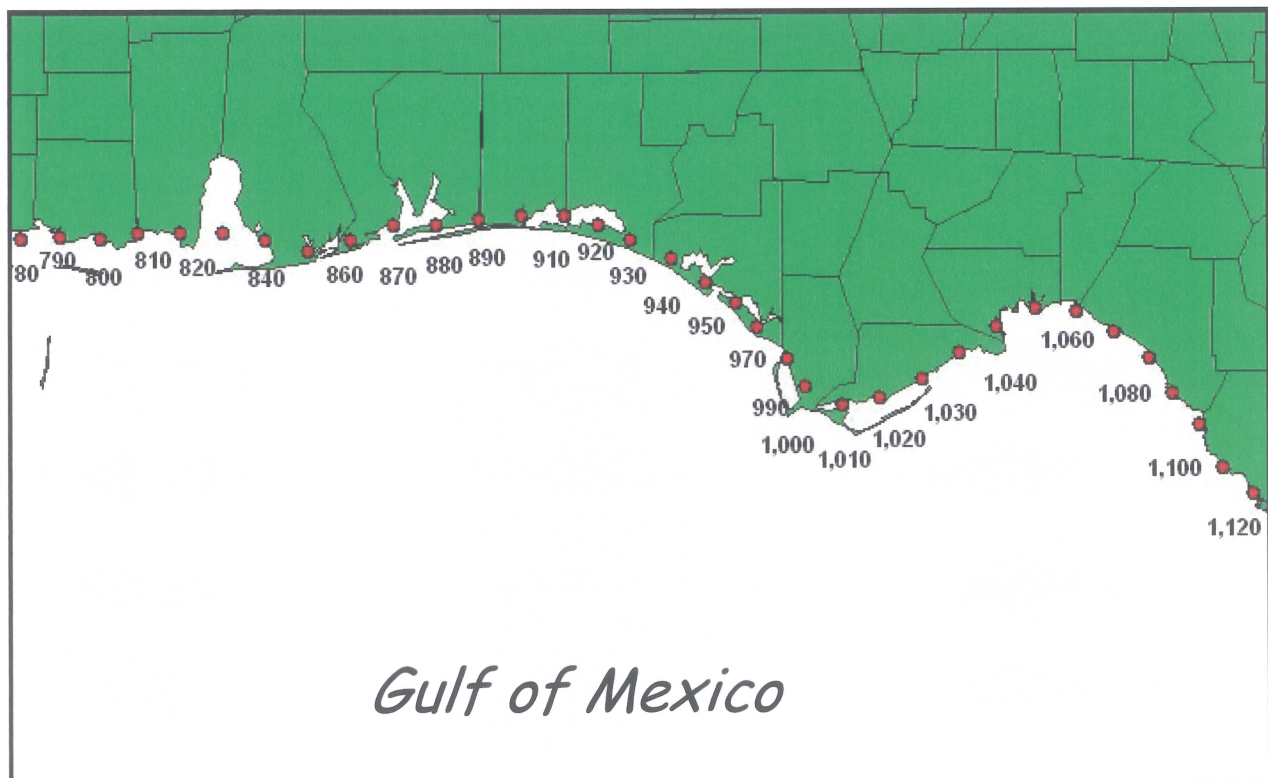


Figure 3-1: Storm Landfall Mile Posts

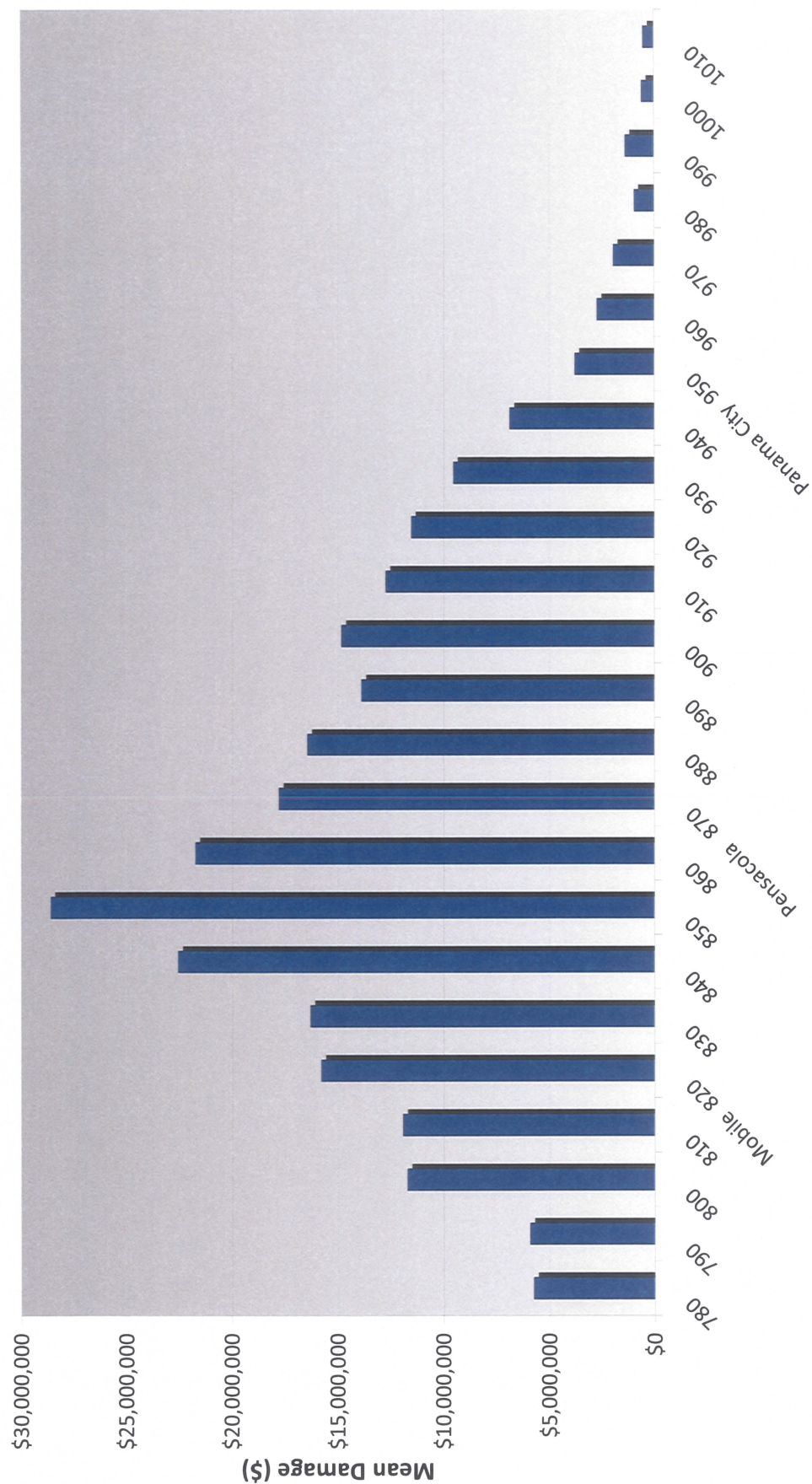


Figure 3-2: Frequency Weighted Average Transmission & Distribution Damage from SSI 1 Landfalls

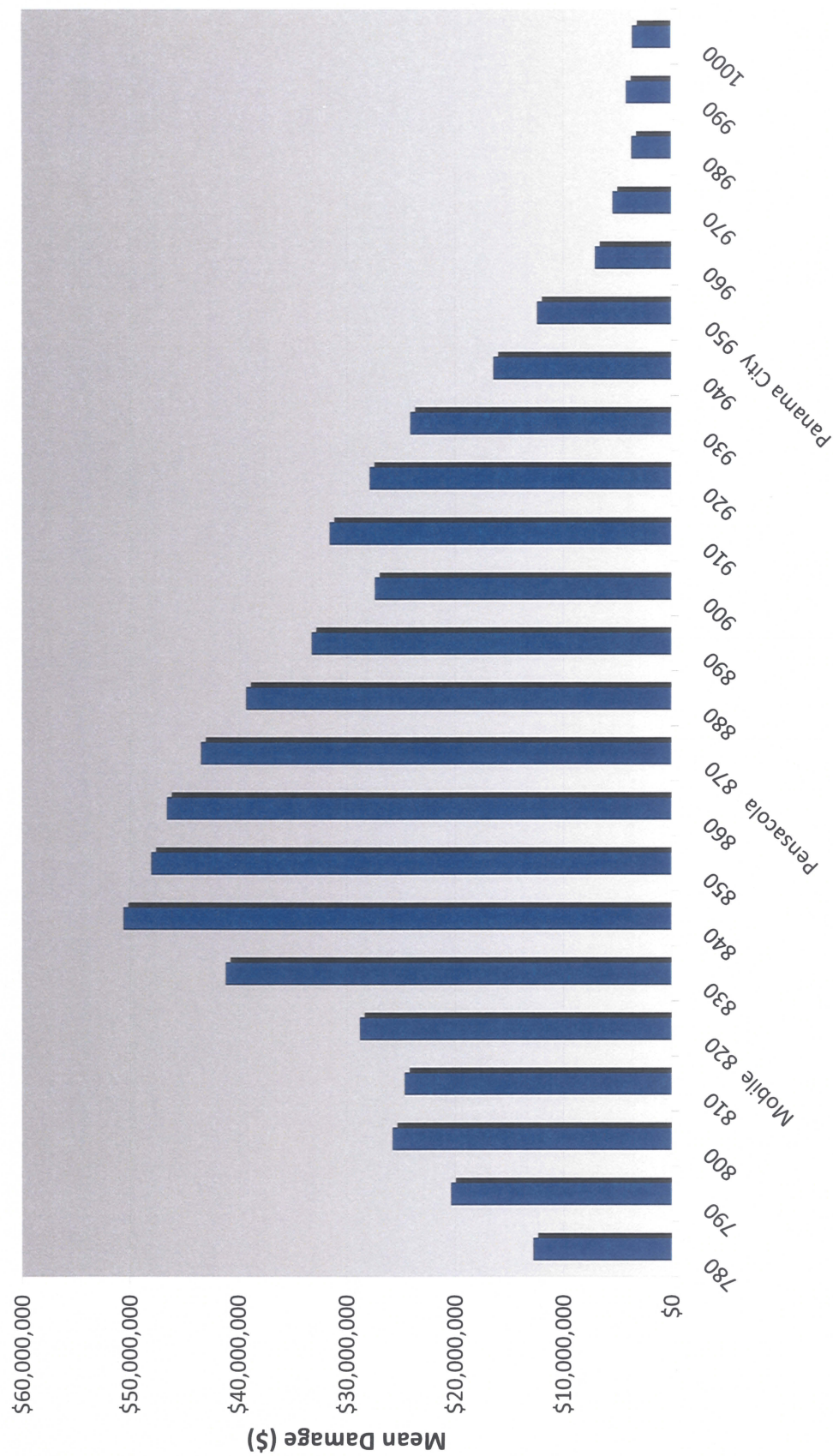


Figure 3-3: Frequency Weighted Average Transmission & Distribution Damage from SSI 2 Landfalls

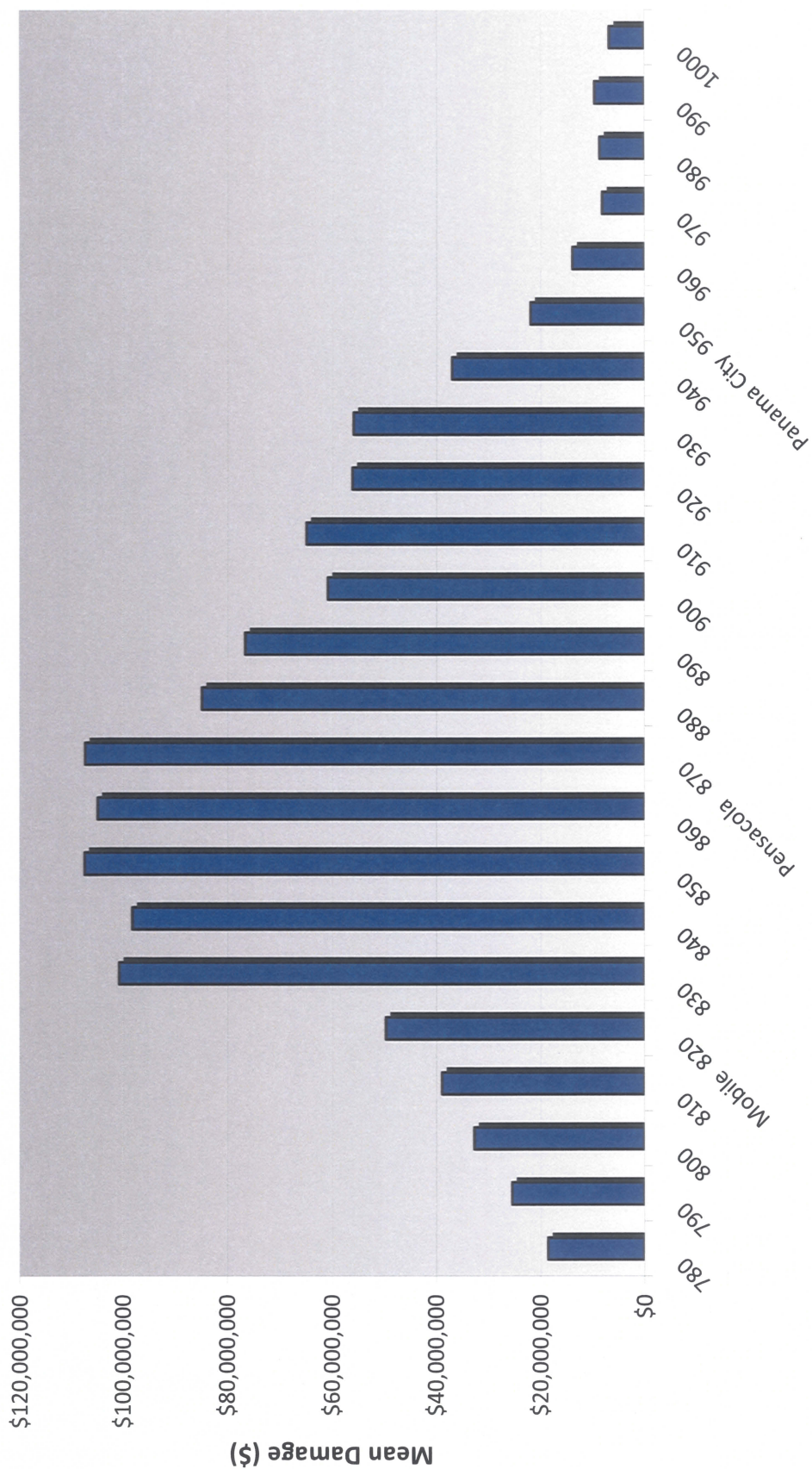


Figure 3-4: Frequency Weighted Average Transmission & Distribution Damage from SSI 3 Landfalls

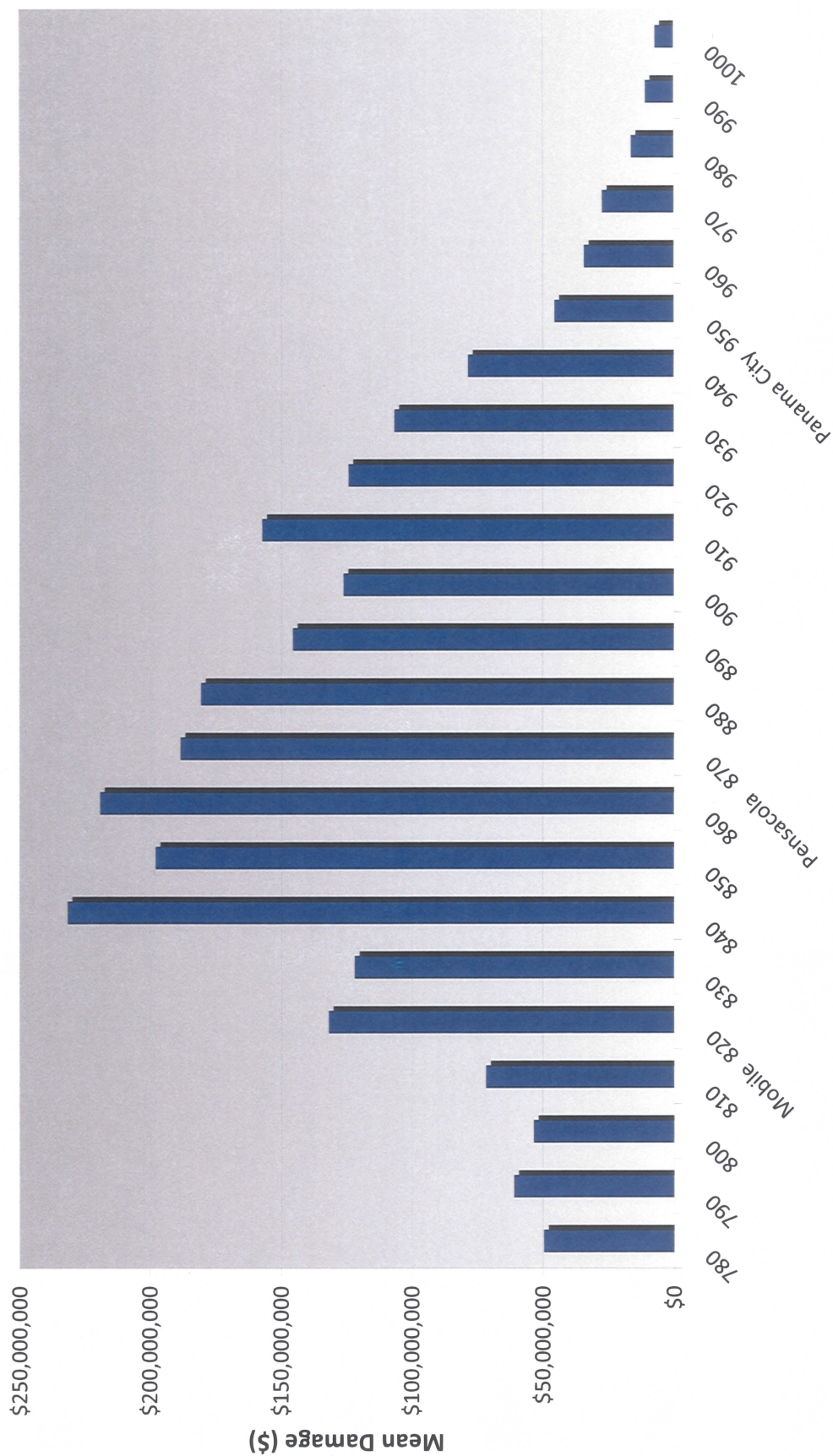


Figure 3-5: Frequency Weighted Average Transmission & Distribution Damage from SSI 4 Landfalls

4. Hurricane Loss Analysis Results

Aggregate Damage Exceedance and Expected Annual Damage

A probabilistic database of losses is developed using the hurricane hazard, assets at risk and their vulnerabilities. For each hurricane, the center, shape, geographical orientation, track and wind speeds were defined. The wind field for each hurricane is integrated with the asset vulnerability and the asset locations to compute the damage. The annual frequency and the portfolio damage for each simulated hurricane is determined. By querying this database of thousands of hurricane losses, various loss exceedance or non-exceedance distributions are generated. The frequencies and computed damage for all hurricanes are combined to calculate the expected annual loss and the annual aggregate exceedance relations.

Aggregate damage exceedance calculations are developed by keeping a running total of damage from **all possible events** in a given time period. At the end of each time period, the aggregate damage for all events is then determined by probabilistically summing the damage distribution from each event, taking into account the event frequency. The process considers the probability of having zero events, one event, two events, etc. during the time period. Each event within the EQECAT stochastic event set is unique, described by a frequency of occurrence, severity, azimuth of landfall, central track, radius to maximum winds, hurricane profile and other critical parameters.

A series of probabilistic analyses were performed, using the vulnerability curves derived for Gulf assets and the computer program USWINDTM. A summary of the analysis is presented in Table 5-1, which shows the aggregate damage (i.e. deductible is “0”) exceedance probability for damage layers between zero and over \$250 million dollars.

For each damage layer shown, the probability of damage exceeding a specified value is shown. For example, the probability of damage exceeding \$100 million in one year is 1.9%. The analysis calculates the probability of damage from all hurricanes and aggregates the total.

Table 4-1 provides the aggregate damage exceedance probabilities for the Gulf T & D assets analyzed for a series of layers. Each layer has a layer amount of \$10 million, except for the final layer which represents all damage \$250 million and greater. The value in the first column, labeled Damage Layer, is the attachment point for each layer, with the exception of the last layer, for which the attachment point is \$250 million.

The second column of the table, labeled 1 year Exceedance Probability, provides the 1-year modeled probability of penetrating each layer, i.e. the probability that the total damage from all events in a 1 year period will exceed the attachment point of the layer.

The expected annual damage (EAD) and exposure to Gulf's Reserve from hurricanes is \$8.3 million. This value represents the average damage from all simulated hurricanes over a long time horizon within the EQECAT stochastic event set. The EAD is not expected to occur each and every year. Some years will have no damage from hurricanes, some years will have small amounts of damage and a few years will have large amounts of damage.

Table 4-1
GULF POWER COMPANY T & D ASSETS
AGGREGATE DAMAGE EXCEEDANCE PROBABILITIES

Damage Layer (\$millions)	1 Year Exceedance Probability
0 (>0.5)	24.5%
10	15.4%
20	10.8%
30	8.03%
40	6.23%
50	4.96%
60	4.02%
70	3.30%
80	2.74%
90	2.29%
100	1.93%
110	1.63%
120	1.39%
130	1.18%
140	1.01%
150	0.87%
160	0.75%
170	0.65%
180	0.57%
190	0.49%
200	0.43%
210	0.38%
220	0.34%
230	0.30%
240	0.26%
>250	0.23%

5. Reserve Performance Analysis

A probabilistic analysis of losses from hurricanes was performed for Gulf Power (Gulf) to determine their potential impact on the Reserve fund.

Analysis

The Reserve performance analysis consisted of performing 10,000 iterations of hurricane loss simulations within the Gulf service territory, each covering an 8-year period, to determine the effect of the charges for damage on the Gulf Reserve. Monte Carlo simulations were used to generate damage samples for the analysis. The analysis provides an estimate of the Reserve assets in each year of the simulation, accounting for the annual accrual, expenses, fund earnings when balances are positive, borrowing costs when fund balances are negative and hurricane damage using a dynamic financial model.

Assumptions

The analysis performed included the following assumptions:

- An initial Reserve balance of \$27 million.
- Annual Reserve accruals of \$3.5 million were assumed in the analysis.
- Hurricane losses are assumed to increase by 4% per year as replacement values of T&D increase due to inflation and system growth.
- Negative Reserve balances are assumed to be financed with an unlimited line of credit costing 3.8%.
- Positive Reserve balances are assumed to earn at an annual rate of 3.6%.
- \$6.8 million of the \$8.3 million Expected Annual Loss, determined in the Loss Analysis, is assumed to be an obligation of the reserve annually.
- All results are shown in constant 2009 Reserve dollars.

The analysis results for the case analyzed are shown in Table 5-1 below. The results show the Annual Reserve Accrual amount, the mean (expected) Reserve fund balance as well as the probability that the Reserve fund balance will be negative in any one or more of the five years of the simulated time horizon.

Table 5-1
GULF POWER COMPANY T & D
RESERVE FUND ACCRUALS AND
PROBABILITY OF RESERVE FUND PERFORMANCE

Initial Reserve Balance	Annual Reserve Accrual	Expected Reserve Balance at end of 5 years	Probability of negative balance within 5 years
(\$ millions)	(\$ millions)	(\$ millions)	%
\$27	\$3.5	\$11	29%

Figure 5-1 below shows the results of the Reserve fund performance analysis. These results show the mean (expected) Reserve fund balance as well as the 5th and 95th percentiles.

For example, given an initial Reserve balance of \$27 million and an Annual Accrual of \$3.5 million, Figure 5-1 illustrates the expected performance of the Reserve. The Reserve has a mean (expected) balance of \$11 at the end of the five year period. The 5th percentile and 95th percentile 5 year ending Reserve balances are \$51 million and negative \$(111) million respectively. The Reserve fund has a 29% chance of having a negative balance in one or more years of the five year simulation.

The first year of each simulation begins with a \$27 million Reserve balance. The first year's annual accrual will bring the reserve balance to \$30.5 million. Table 5-1, shows that the likelihood of hurricane damage exceeding \$30 million in a single year is about 8%.

The accrual of \$3.5 million is less than the Reserve obligation of the Expected Annual Damage from hurricanes of \$6.8 million. Therefore with each passing year, the Reserve ending balance has a decreasing likelihood of accumulating surpluses. The expected (mean) Reserve balance declines gradually over the five year simulation to \$11 million at five years reflecting the annual accrual less than the expected annual damage. At the end of five years, the likelihood of annual hurricane damage in excess of \$11 million is approximately 15%, about double the likelihood at the beginning of the simulation.

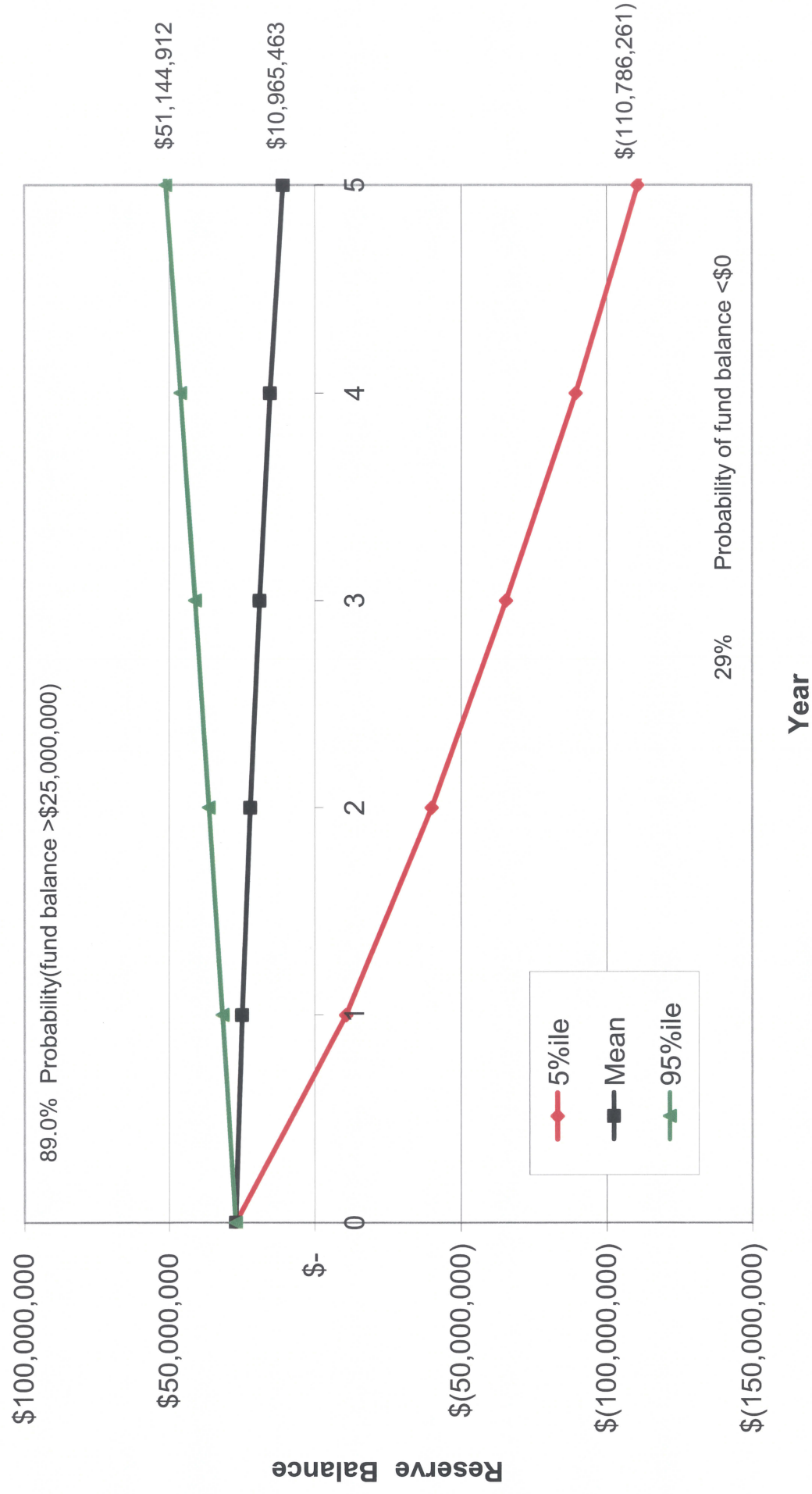


Figure 5-1: Reserve Performance Analysis Results: \$27 million Initial Balance, \$3.5 million Annual Accrual

6. References

1. "Florida Commission on Hurricane Loss Projection Methodology", EQECAT, an ABS Group Company, May 18, 2009.



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