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February 8, 2017

VIA ELECTRONIC FILING

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

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

Dear Ms. Stauffer:

Attached is the Rebuttal Testimony of Gulf Power Company Witness J. Terry Deason.

(Document 3 of 16)

Sincerely,

Robert L. McGee, Jr.
Regulatory & Pricing Manager

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 160186-EI

Gulf Power

REBUTTAL TESTIMONY

OF

J. TERRY DEASON

1 GULF POWER COMPANY

2 Before the Florida Public Service Commission
Rebuttal Testimony of:
3 J. Terry Deason
Docket No. 160186-EI
4 In Support of Rate Relief
Date of Filing: February 8, 2017

5

6 Q. Please state your name, business address and occupation.

7 A. My name is Terry Deason. My business address is 301 S. Bronough Street,

8 Suite 200, Tallahassee, FL 32301. I am a Special Consultant for the Radey

9 Law Firm specializing in the fields of energy, telecommunications, water and

10 wastewater, and public utilities.

11

12 Q. Have you previously filed testimony in this proceeding?

13 A. Yes.

14

15 Q. What is the purpose of your rebuttal testimony?

16 A. The purpose of my rebuttal testimony is to respond to certain assertions and

17 recommendations made by intervenor Witnesses Dauphinais, Mosenthal,

18 and Ramas. The issues I address in rebuttal to these witnesses are: Plant

19 Scherer Unit 3 (Scherer 3), At-Risk Compensation, and the Deferred Return

20 on Transmission Investment.

21

22 Q. Are you sponsoring any rebuttal exhibits?

23 A. No.

24

25

1 **I. SCHERER 3**

2

3 Q. What is Office of Public Counsel (OPC) Witness Dauphinais's
4 recommendation concerning Gulf's investment in Scherer 3?
5 A. He recommends that the Commission reject Gulf's proposal to rededicate
6 Scherer 3 to retail service and to recognize Scherer 3 costs in retail rates.
7
8 Q. What is the basis for Witness Dauphinais's recommendation?
9 A. He believes that Gulf, by its actions over the past 10 to 15 years, has
10 broken any regulatory compact with respect to Scherer 3. He further opines
11 that Scherer 3 should be subjected to another need assessment before its
12 costs can be recognized in retail rates. He also implies that Gulf has
13 earned excessive "profits" and has not shared those "profits" with retail
14 customers.
15
16 Q. Do you agree with these bases for his recommendation?
17 A. No, I do not. Witness Dauphinais shows either a lack of understanding of
18 the regulatory compact or a disregard of its importance in providing cost-
19 effective and reliable service to customers of regulated utilities. Witness
20 Dauphinais's positions and recommendation can be succinctly
21 characterized as a "heads I win, tails you lose" proposition that introduces
22 elements of 20-20 hindsight, which is inconsistent with the most basic
23 tenets of the regulatory compact.
24
25

1 Q. What are these basic tenets of the regulatory compact to which you refer?
2 A. I identified these tenets in my direct testimony. It is important to emphasize
3 some of the most salient points to illustrate how Witness Dauphinais's
4 recommendation is inconsistent with them:

5 - A regulated utility has the obligation to provide reliable and cost-
6 effective service to its customers and to deploy capital to meet this
7 obligation. Inherent in this obligation is a responsibility to manage
8 costs and mitigate risks where reasonably possible.
9 - All investments are subject to a determination of prudence, based on
10 the reasonably anticipated costs, risks, and benefits of said
11 investment that are known or reasonably known at the time that the
12 investment is made. Concomitant with this principle is that future
13 changed circumstances that can be known and applied only in
14 hindsight are not a valid basis to reverse a previous determination of
15 prudence.
16 - All prudently incurred investments that are used and useful in
17 providing service are to be afforded rate recovery treatment, both in
18 the form of a reasonable return on the investment and a reasonable
19 return of the investment, generally over the useful life of said
20 investment.
21 - The reasonable rate of return is a necessary cost to provide service
22 and should be set at a level to adequately compensate investors for
23 the risk of their investment and to be fair to customers on whose
24 behalf the capital is deployed. Inherent in this principle is the
25 expectation that customer and investor interests are balanced in a

1 fair and symmetrical manner.

2 • While the reasonable return on investment is not guaranteed, there is
3 an expectation that rates will be set to afford a utility a reasonable
4 opportunity to actually earn its authorized rate of return. Without that
5 reasonable opportunity, the allowed return would have to be
6 substantially higher, and over time this would result in higher electric
7 rates for customers.

8 • The reasonable rate of return is set and monitored to fall within an
9 established band, so that the return is neither excessive nor deficient.

10

11 Q. Was Gulf's decision to invest in Scherer 3 consistent with its obligations
12 under the regulatory compact?

13 A. Yes. Consistent with its obligation to serve customers reliably and cost-
14 effectively, Gulf identified a lower cost option in Scherer 3 to meet customer
15 needs. In further effort to manage costs and mitigate risks (in this case the
16 risk of matching capacity with uncertain customer growth and capacity
17 needs), Gulf identified the ability to relieve retail customers of immediate
18 cost responsibility by using wholesale contracts to provide temporary cost
19 recovery. After thoroughly explaining the options and the uncertain
20 dynamics involved, the Commission agreed that cancelling Caryville and
21 purchasing an interest in Scherer 3 was the prudent course of action (based
22 on the reasonably anticipated costs, risks, and benefits that were known or
23 reasonably known at that time) and took subsequent action to encourage
24 the consummation of Gulf Power's purchase of an interest in Scherer 3. All
25 of this is consistent with the regulatory compact. It is precisely the type of

1 forward-looking and innovative solution seeking that the regulatory compact
2 is designed to facilitate and encourage.
3
4 Q. Does Witness Dauphinais agree that the Commission encouraged Gulf to
5 consummate the purchase of an interest in Scherer 3?
6 A. This is unclear. Witness Dauphinais states that Gulf was "supposedly"
7 encouraged to acquire an interest in Scherer 3. If the tone of his answer is
8 intended to convey doubt as to whether the Commission did in fact
9 encourage Gulf to acquire an interest in Scherer 3, I can unequivocally state
10 that the Commission strongly encouraged Gulf to consummate a purchase
11 of an interest in Scherer 3.
12
13 Q. On what basis can you so unequivocally state?
14 A. There are two bases for my statement. First, the Commission placed the
15 recovery of the Caryville cancellation charges subject to refund pending the
16 consummation of the Scherer 3 purchase. This was clearly reaffirmed by
17 the Commission in its Order No. 11498. (Order at p. 15 and Exhibit JTD-2,
18 RC-308)
19
20 Q. What is the second basis for your unequivocal statement that the
21 Commission encouraged the purchase of a portion of Scherer 3?
22 A. It is my personal knowledge and firsthand experience concerning that
23 decision. Order No. 11498 set forth the Commission's decision in Gulf's
24 1982 rate case. This case was decided by three Commissioners, one of
25 whom was Commissioner Gerald L. Gunter. At that time I served as

1 Commissioner Gunter's Aide and knew of the Commission's strong belief
2 that the Scherer 3 acquisition was the best course of action to serve Gulf's
3 customers. At that time, the Commission used a term to describe its efforts
4 to strongly encourage utilities to do the right thing within its legal authority
5 and the terms of the regulatory compact. I am hesitant to use the term in
6 today's world because it could be viewed as insensitive and as trivializing
7 the horrific realities that exist post-9-11. Nevertheless, the term used back
8 then was "amiable terrorism," which did not hold the negative connotations
9 that use of this term would carry today. That term was freely used by the
10 Commission to describe its efforts to encourage Gulf to do the right thing
11 and consummate the purchase of an interest in Scherer 3.
12
13 Q. Did Gulf rely on the assurances and encouragement it received from the
14 Commission before investing in Scherer 3?
15 A. Without question, Gulf did so rely. Based on this reliance, Gulf invested in
16 Scherer 3 as the more cost-effective option to reliably serve its retail
17 customers. An integral part of this reliance was the understanding that the
18 capacity from Scherer 3 was not immediately needed and that cost recovery
19 (pursuant to the regulatory compact) would be temporarily achieved by
20 marketing the Scherer 3 capacity on the wholesale market. It was believed
21 that the ability to market the Scherer 3 capacity at wholesale would provide
22 Gulf a reasonable opportunity to earn a reasonable return pursuant to the
23 regulatory compact while not immediately placing this responsibility on retail
24 customers.
25

1 Q. Was Gulf successful in marketing the Scherer 3 capacity?
2 A. Yes. Gulf was successful in selling the majority of the capacity in contracts
3 initially designed to span the gap between the unit's initial in-service date
4 and when the Scherer 3 capacity was expected to be needed to meet retail
5 requirements. Gulf Witness Burleson explains this in greater detail in his
6 rebuttal testimony.
7
8 Q. Does Witness Dauphinais take issue with this initial decision to market the
9 Scherer 3 capacity in the wholesale market?
10 A. No. Instead, he opines that Gulf broke the regulatory compact by "its
11 actions over the past 10 to 15 years." (Page 5) In another section of his
12 testimony, he opines that the regulatory compact was "broken by the course
13 of action Gulf actually chose to follow in the ensuing 35 years which
14 followed." (Page 22)
15
16 Q. What specific event or place in time does Witness Dauphinais allege that
17 Gulf broke the regulatory compact?
18 A. This is unclear. There appears to be no issue with the initial set of off-
19 system wholesale contracts.
20
21 Q. What followed the initial set of off-system wholesale contracts?
22 A. As explained in greater detail by Mr. Burleson, Gulf found itself in a position
23 of not immediately needing the Scherer 3 capacity to reliably serve its retail
24 customers. In essence, Gulf was in the same position that existed at the
25 time the initial set of wholesale contracts was signed. Even though Scherer

1 3 had been determined to be the more cost-effective alternative and a
2 prudent investment, its capacity was not then immediately needed to meet
3 retail requirements. A viable alternative existed in the form of the wholesale
4 market to provide needed cost recovery of a prudent investment.
5 Therefore, consistent with the regulatory compact, Gulf entered into two
6 other sets of wholesale contracts to provide a reasonable opportunity to
7 earn a fair return without placing cost responsibility on retail customers.
8
9 Q. Does Witness Dauphinais take issue with these succeeding wholesale
10 contracts?
11 A. Again, this is unclear. What is clear is that the succeeding sets of contracts,
12 like the first, were totally consistent with the regulatory compact and the
13 Commission's initial decision to pursue Scherer 3 as the prudent, more
14 cost-effective alternative and to delay cost responsibility for retail
15 customers.
16
17 Q. Was it contemplated that the first set of wholesale contracts would span the
18 gap until the Scherer 3 capacity was needed for retail requirements?
19 A. Yes, this was the belief, based on the best estimates of growth in customers
20 and demand at that time.
21
22 Q. Is the fact that this growth did not materialize a basis to determine that the
23 regulatory compact was broken?
24 A. No. The determination that Scherer 3 was prudent and the more cost-
25 effective option was based on the reasonably anticipated costs, risks, and

1 benefits known or reasonably known at that time. The fact that the growth
2 in customers and demand did not materialize could not have been
3 reasonably anticipated. Furthermore, it is a basic tenet of the regulatory
4 compact that such changes, which can be known and applied only in
5 hindsight, are not a valid basis to reverse a previous determination of
6 prudence.
7
8 Q. Did the Commission ever use hindsight to make a finding that either of the
9 two new sets of wholesale contracts were not prudent or somehow broke
10 the regulatory compact?
11 A. No. The Commission was aware of the first set of new wholesale contracts
12 and acknowledged them in its Order No. 23573 (Order at p. 12 and Exhibit
13 JTD-2, RC-12). In this order, the Commission recognized that the Scherer
14 capacity would not be needed to serve Gulf's customers until the year 2010
15 and that wholesale contracts (unit power sales (UPS)) were being used to
16 relieve customers of cost responsibility. Likewise, in its Orders Nos. PSC-
17 05-0084-FOF-EI (Order at p. 3 and Exhibit JTD-2, RC-368) and PSC-05-
18 0699-FOF-EI (Page 8), the Commission addressed Gulf's interest in
19 Scherer 3 as part of larger wholesale sales to Florida Power & Light (FPL)
20 and Progress Energy Florida (PEF). These wholesale purchases by FPL
21 and PEF were thoroughly reviewed by the Commission, and they were
22 determined to be prudent and to provide many strategic benefits to
23 customers throughout Florida. At no time did the Commission determine
24 that the continued use of wholesale contracts was imprudent or somehow
25 broke the regulatory compact.

1 Q. Was Gulf's decision to enter into new wholesale contracts the only
2 alternative available?
3 A. No, but it was the best alternative to be consistent with the regulatory
4 compact and the precedent established by the Commission. Even though
5 this better option existed by virtue of the existence of a viable wholesale
6 market for the Scherer 3 capacity, Gulf could have simply sought to include
7 Scherer 3 in retail rates. The issue for the Commission then would have
8 been to either allow recovery in retail rates of a prudent investment or to
9 once again encourage Gulf to seek temporary cost recovery by means of
10 the wholesale market. Gulf's decision to pursue these wholesale contracts
11 cannot reasonably be interpreted as violating the regulatory compact, as
12 Witness Dauphinais implies.
13
14 Q. Within the context of the Commission's review of the most recent set of
15 wholesale contracts was the issue of Gulf acting improperly or breaking the
16 regulatory compact ever raised?
17 A. No. The Commission and Commission Staff were fully aware that the
18 proposed wholesale purchases by FPL and PEF included capacity from
19 Gulf's interest in Scherer 3. This was not an issue that was raised by the
20 Commission or its Staff.
21
22
23
24
25

1 Q. Did the Office of Public Counsel or any other intervenor in the Commission's review of FPL's and PEF's wholesale purchases raise the issue of Gulf breaking the regulatory compact by virtue of including its interest in Scherer 3 as part of these transactions?

5 A. No.

7 Q. Do you consider an issue of breaking the regulatory compact to be a significant one?

9 A. Yes. The regulatory compact is the very foundation of regulation and balances the interests and risks of all stakeholders.

12 Q. You earlier stated that a basic tenet of the regulatory compact is that changes which can be known and applied only in hindsight are not a valid basis to reverse a previous determination of prudence. Is this relevant in considering Witness Dauphinais's positions and recommendation?

16 A. Yes. Witness Dauphinais's allegation that Gulf has broken the regulatory compact is based on these changed circumstances that were not known or reasonably anticipated at the time the Commission endorsed Gulf's investment in Scherer 3. He is attempting to use hindsight to question the ongoing prudency of Gulf's investment in Scherer 3 and thereby undermine the very essence of the understanding that was reached by Gulf and the Commission at the time.

1 Q. How is Witness Dauphinais undermining the essence of the understanding
2 between Gulf and the Commission?
3 A. He is now attempting to introduce a new standard of review applicable to
4 Gulf's investment in Scherer 3. He would have the Commission subject
5 Scherer 3 to a new assessment of need, even though the Commission had
6 previously determined that Scherer 3 was both needed (by virtue of
7 replacing Caryville) and the more cost-effective option to meet the needs of
8 Gulf's retail customers.
9
10 Perhaps a hypothetical would elucidate this situation. Let's hypothetically
11 assume that at the time that Gulf approached the Commission with the
12 Scherer 3 option in lieu of Caryville, the Commission or an intervenor
13 responded that, despite Scherer 3 having a cost advantage, Gulf would not
14 be entitled to cost recovery unless there was a secondary determination of
15 need at some point in the future after the wholesale contracts expire. (Of
16 course, at the time when the Commission encouraged Gulf to purchase
17 Scherer 3 instead of building Caryville, no one at the Commission made
18 such a "second bite of the apple" argument, so this is truly hypothetical.)
19 This hypothetical scenario would have fundamentally altered the balancing
20 and sharing of risks contemplated under the regulatory compact. If that had
21 been the scenario contemplated, I do not believe that Gulf would have
22 pursued the Scherer 3 option. This outcome would have been unfortunate
23 for Gulf's customers, but it would have been the only logical decision for
24 Gulf under that hypothetical scenario.
25

1 This would also be true in any such business transaction outside the world
2 of regulation and the regulatory compact. For example, it is understood and
3 required that when a person buys a home and enters into a mortgage to pay
4 for it, that the obligation to pay exists regardless of circumstances that arise
5 later that were not anticipated at the time of purchase. It does not relieve
6 the buyer's obligation to pay should the buyer later determine that the house
7 is not the perfect match for his or her present needs. It does not relieve the
8 buyer's obligation to pay if the buyer is unable to find a tenant to lease the
9 house during a time when the buyer temporarily does not need the house.
10 It does not relieve the buyer's obligation to pay should the market value of
11 the house fall below the remaining unpaid balance on the mortgage. If such
12 circumstances were justification to relieve an obligation to pay a mortgage,
13 it would fundamentally change the balance between risks and rewards that
14 exist in the market for mortgages. Mortgage lenders would be unwilling to
15 make such loans, and if they did make such loans, they would be at interest
16 rates so high that it would prevent the vast majority of prospective home
17 purchasers from qualifying for a mortgage. Such results would be
18 disastrous for our economy. Yet this is the type of hindsight that Witness
19 Dauphinais would apply to the "mortgage" that is Scherer 3.
20
21 Q. Witness Dauphinais states that Gulf chose to enter into wholesale contracts
22 at market rates and did not share profits with retail customers. Does this
23 have any relevancy to the issue before the Commission?
24 A. No. His assertions are both irrelevant and misleading. He implies that
25 Gulf's decision to enter into market-based contracts under authority from the

1 Federal Energy Regulatory Commission allowed Gulf to earn a return on
2 equity in excess of what the Commission would have allowed and then did
3 not share those profits with retail customers. He then goes on to provide
4 some historical revenue numbers which he believes supports his
5 recommendation to not allow cost recovery of Scherer 3 in retail rates.
6
7 Q. How are his assertions misleading?
8 A. First, he fails to mention that market-based rates can generate revenues
9 that can either exceed costs or be insufficient to cover costs. It is part of the
10 risk profile of having market-based rates. Gulf chose to accept this risk
11 profile recognizing that market-based rates which exceed costs is a good
12 thing and provides benefits to both Gulf's investors as well as its customers.
13 If the market-based rates had been insufficient to cover costs, Gulf knew it
14 could not seek to be made whole from retail customers. I also doubt
15 Witness Dauphinais would be as eager to assert that retail customers
16 should cover that deficiency as he is eager to assert that retail customers
17 have been deprived by not sharing in market-based earnings.
18
19 Second, Witness Dauphinais provides a history of revenue-based metrics,
20 particularly the metric of Net Revenue per kW Sold. However, it is not
21 axiomatic that increases in revenue per kW equates to increases in
22 earnings. Information on both the level of operating costs and the amount
23 of investment is needed to conclude what level of earnings is achieved.
24 Witness Dauphinais fails to provide this information or acknowledge that
25 Gulf's Scherer 3 investment and operating costs grew as a result of

1 environment compliance measures that were required in close proximity to
2 the time that Gulf chose to charge market-based rates. It is also interesting
3 to note that two of the highest years for Net Revenue per kW Sold (including
4 the single highest year) occurred in the initial two years of the initial set of
5 cost-based wholesale contracts and that these revenue amounts decreased
6 in the intervening years, particularly those years in which the wholesale
7 contracts did not cover 100 percent of the Scherer 3 capacity. In addition,
8 Gulf's revenues in 2016 were materially insufficient to cover its costs.
9 Witness Dauphinais does not mention these dynamics. Nevertheless, the
10 historical level of revenues or earnings Gulf achieved from its Scherer 3
11 wholesale contracts is irrelevant to the issue of the prospective treatment of
12 Gulf's investment in Scherer 3.
13
14 Q. Why is the historical level of revenues and earnings irrelevant?
15 A. Simply put, the Commission has already considered and dealt with this
16 question. In so doing, the Commission declared them to be irrelevant. This
17 decision was made soon after Gulf entered into the first set of wholesale
18 contracts, and Gulf States Utilities subsequently defaulted on its contract
19 with Gulf. The Commission decided that all profits and losses from the UPS
20 (wholesale) contracts are the responsibility of Gulf's stockholders. Both
21 Witness Dauphinais and I quote this order in our respective testimonies.
22
23 Q. Is there another Commission order which addresses how the costs and
24 benefits of Gulf's wholesale contracts are to be treated for regulatory
25 purposes?

1 A. Yes. It is Order No. 11498 in Gulf's 1982 rate case, Docket No. 820150-
2 EU, to which I earlier referred. The issue addressed was the proper
3 regulatory treatment for UPS for Plant Daniel. Interestingly, in that case
4 OPC was seeking to have the entirety of the UPS costs and revenues fully
5 integrated into rate base and retail rates. Unfortunately, the Commission
6 disagreed with OPC and chose to allocate the costs determined to be
7 wholesale in nature out of the determination of retail rates.
8
9 Q. You stated that *unfortunately* the Commission rejected OPC's position. Do
10 you believe that the Commission erred in its decision?
11 A. No. I cannot say it was an error. However, the OPC was correct to point
12 out that wholesale revenues and costs associated with an asset which is
13 basically retail in purpose could be incorporated into retail rates. Under this
14 approach, any wholesale earnings in excess of Gulf's retail cost of capital
15 would benefit retail customers, just as any wholesale earnings below Gulf's
16 cost of capital would require retail rates to cover the difference. For an
17 asset like Scherer 3, which was acquired for retail customers but was
18 temporarily marketed at wholesale, following OPC's position would obviate
19 the issue we are currently addressing. After the wholesale contracts expire,
20 Scherer 3 would remain in rate base where it would have always been and
21 the retail jurisdiction would automatically be responsible for 100 percent of
22 the benefits and costs of Scherer 3. This would have accomplished the
23 eventuality that was originally intended.
24
25

1 Q. What is the eventuality to which you refer?
2 A. It is the eventuality that the portion of Gulf's investment in Scherer 3
3 uncovered by wholesale contracts would revert to the retail jurisdiction for
4 which it was originally acquired as the more cost-effective option to reliably
5 serve retail customers.
6
7 Q. Has the Commission previously recognized an uncovered portion of
8 Scherer 3 in retail rates?
9 A. Yes. It did so in Docket No. 890324-EI involving the determination of a tax
10 savings refund for Gulf. The Commission correctly found that 19 MW of the
11 Scherer capacity had not been subject to a contract and allowed the
12 associated costs of the 19 MW to be included in Gulf's rate base.
13
14 Q. Does Witness Dauphinais refer to this docket in his testimony?
15 A. Yes, but he discounts this decision because it was a tax savings refund and
16 did not involve the setting of base rates.
17
18 Q. Is Witness Dauphinais correct in his characterization?
19 A. He is factually correct that it was not a proceeding to prospectively set base
20 rates. However, his insinuation that the tax refunds were not important to
21 customers and the Commission is totally incorrect. The breadth of review
22 and the scrutiny of individual issues in the Commission's tax savings
23 dockets were comparable to a typical base rate proceeding, and the result
24 had a direct impact on Gulf's customers' bills.
25

1 Q. What would be the result of accepting Witness Dauphinais's
2 recommendation to not allow Gulf's uncovered investment in Scherer 3 in
3 retail rates?
4 A. There would be three extremely undesirable results. First, it would be
5 inconsistent with the regulatory compact. It would be altering a finding of
6 prudence based on considerations that were not known or reasonably
7 knowable at the time that the decision of prudence was originally made. It
8 would also violate the regulatory compact by denying Gulf a reasonable
9 opportunity to actually earn a fair return on its prudent investments made to
10 cost-effectively and reliably serve its customers.
11
12 Second, not allowing the uncovered investment in retail sales would foster
13 doubts about making long-term investments in a regulatory environment
14 that does not adequately support those investments. This is particularly
15 relevant in this case in that it could send a chilling message to Gulf and
16 other Florida utilities to not look for innovative ways to more cost-effectively
17 serve customers. The facts in this case clearly demonstrate that Gulf found
18 a way to more cost-effectively serve its customers, that doing so required a
19 substantial reliance on long-term wholesale contracts, and that Gulf went
20 forward with this approach based on encouragement and assurances from
21 the Commission. A decision to accept Witness Dauphinais's
22 recommendation would certainly cast doubt on the degree to which
23 Commission assurances can be relied upon in the future.
24
25

1 Third, Gulf would have a substantial investment upon which it would not be
2 earning a return. As more fully explained in the testimony of Gulf Witness
3 Liu, Gulf's financial integrity would be threatened.
4
5 Q. What is Sierra Club Witness Mosenthal's recommendation for Scherer 3?
6 A. Witness Mosenthal recommends that Gulf's investment in Scherer 3 not be
7 allowed in retail rates based on his belief that there are better alternatives to
8 Scherer 3 at this time or when Gulf has a future need for capacity.
9
10 Q. What is your response to Witness Mosenthal's testimony?
11 A. Witness Mosenthal's testimony is inconsistent with the regulatory compact
12 for the same reasons that I gave for Witness Dauphinais's testimony, so I
13 will not repeat them. For those reasons alone, his recommendation should
14 be rejected.
15
16 Q. Is there another reason that his recommendation be rejected?
17 A. Yes. The vast majority of his testimony is simply irrelevant for this
18 proceeding. He attempts to engage in forward-looking planning in a rate
19 proceeding designed to provide cost recovery of historical investments and
20 those specific capital projects projected in the test year. A rate case is not
21 the appropriate vehicle to address forward-looking planning issues typically
22 reserved for need determinations.
23
24 Gulf's investment in Scherer 3 was made for the right reasons based upon
25 the best information available at the time and was determined to be prudent

1 by the Commission. The issue now is how best to provide for cost recovery
2 of real dollars already invested to serve customers.
3
4 Q. You earlier stated that it is inconsistent with the regulatory compact and an
5 inappropriate use of hindsight to evaluate the prudence of Gulf's interest in
6 Scherer 3 based on a new assessment of need. If such an assessment
7 were to be made, what costs should be considered?
8 A. In response to positions taken by Witnesses Dauphinais and Mosenthal, Mr.
9 Burleson explains that such an assessment should be based on incremental
10 costs and not sunk costs. I agree with Mr. Burleson on this point.
11
12 Q. Has the Commission previously considered the use of incremental costs
13 versus sunk costs when making forward-looking economic analyses?
14 A. Yes. The Commission has consistently recognized that incremental costs
15 are the appropriate consideration in performing such analyses and making
16 judgments based on them. A good example of this is the Commission's
17 decision in Docket No. 110009-EI, as expressed in its Order No. PSC-11-
18 0547-FOF-EI (Page 56). In this case, the OPC was questioning the amount
19 of nuclear uprate costs incurred by FPL that should be allowed for recovery
20 through the Nuclear Cost Recovery Clause. OPC's Witness Jacobs was
21 advocating the use of a breakeven analysis that relied on the use of sunk
22 costs. In rejecting OPC's position, the Commission stated:
23 While it appears that OPC witness Jacobs believes that
24 prudently incurred costs will not be subject to disallowance,
25 he nonetheless proposed that the final breakeven analysis

1 include sunk costs. OPC argued that we should disallow as
2 imprudent the difference between the actual EPU project
3 costs and the final breakeven value. Consequently, we are
4 confused regarding how OPC's proposal provides for
5 recovery of costs previously found prudently incurred
6 because the proposal requires inclusion of all costs, even
7 those previously deemed prudent, to determine the extent of
8 FPL's imprudently incurred costs.
9
10 Q. Is there anything else in this order that provides guidance for the correct
11 standard to apply when determining the recoverability of costs previously
12 determined to be prudent?
13 A. Yes. In Order No. PSC-11-0547-FOF-EI (Page 57), the Commission
14 rejected the use of hindsight review to test the reasonableness of costs
15 previously determined to be prudent. In this order the Commission stated:
16 Based on the above analysis, we find that, as asserted by
17 various FPL rebuttal witnesses, the methodology
18 recommended by OPC witnesses Jacobs and Smith may
19 result in hindsight review of prudence by use of future facts
20 and assumptions to determine the extent of current or past
21 prudently incurred costs. Moreover, the evolving nature of
22 OPC's proposal, the possibility of inappropriate use of long-
23 term planning, and the possibility of limiting FPL's ability to
24 recover costs previously deemed to be prudently incurred,
25 are aspects that lead us to question the adequacy of record

1 evidence in support of adopting the proposal. Accordingly,
2 we reject the proposal of the OPC witnesses.
3 This same rationale would equally apply to the positions of
4 Witnesses Dauphinais and Mosenthal concerning Scherer 3 in this
5 case.
6
7
8 **II. AT-RISK COMPENSATION**
9
10 Q. Please address OPC Witness Ramas's recommendation to disallow a large
11 portion of Gulf's total at-risk compensation.
12 A. Witness Ramas is recommending that $14.2 million, or over 60 percent, of
13 Gulf's total at-risk compensation be disallowed for ratemaking purposes. If
14 her recommendation were to be adopted in its entirety, it would mean that
15 Gulf would be making payments to employees consistent with its obligations
16 to those employees and yet not have sufficient revenues to cover over 60
17 percent of those obligations. Given this scenario, it would in essence
18 equate to an 89 basis point reduction in Gulf's allowed return on equity.
19
20 Q. On what basis is Witness Ramas recommending such a significant
21 disallowance?
22 A. She essentially identifies three reasons for her recommended disallowance.
23 First, she disallows all at-risk compensation associated with her assertion of
24 vacant positions. Second, she makes an adjustment to Gulf's budgeted
25 payout under its Performance Pay Plan (PPP) to disallow what she

1 mistakenly believes is in excess of the PPP target. Third, she disallows 100
2 percent of Gulf's Performance Share Plan (PSP) and then makes a further
3 33.33 percent disallowance of Gulf's PPP. These last two disallowances
4 are based on her incorrect personal belief that this amount of at-risk
5 compensation "is focused on benefiting the shareholders of Southern
6 Company and not Gulf's Florida ratepayers." (Pages 22-23) It is this third
7 disallowance that is tied to Southern Company performance metrics that I
8 address.
9
10 Q. Why should Witness Ramas's disallowances based on Southern Company
11 performance metrics be rejected?
12 A. These recommended disallowances are inconsistent with sound regulatory
13 policy and basic principles of ratemaking and, if accepted, would be
14 detrimental to the long-term best interests of Gulf's customers.
15
16 Q. How is Witness Ramas's recommended disallowance inconsistent with
17 sound regulatory policy and basic principles of ratemaking?
18 A. A fundamental tenet of sound regulatory policy is to provide recovery of all
19 reasonable and necessary costs expected to be incurred to provide service
20 to customers. And a basic principle of ratemaking is to include all such
21 costs as test year expenses in calculating a regulated company's net
22 operating income. Only if the Commission finds that the expenses in
23 question are unreasonable, unnecessary or not expected to be incurred,
24 should they be disallowed in calculating the company's revenue
25 requirement.

1 Another fundamental tenet of sound regulatory policy is to encourage
2 regulated utilities to be efficient and provide high quality service to their
3 customers. Sacrificing efficiency and quality of service in the long run to
4 achieve temporary rate reductions is not in the customers' interest. All
5 regulatory decisions have consequences, and good regulatory policy results
6 when these consequences are adequately considered. Witness Ramas's
7 recommendation violates both of these tenets of sound regulatory policy.
8
9 Q. How so?
10 A. First, Witness Ramas makes no allegation that the amount of overall
11 compensation paid to Gulf's employees, including at-risk compensation, is
12 unreasonable, unnecessary, or not expected to be incurred. In effect, she
13 abandons the "reasonableness standard." She has not presented any
14 analysis of the employment market to determine what amount of
15 compensation is reasonable and necessary to attract the workforce needed
16 to efficiently and reliably run an electric utility. Her complete lack of analysis
17 stands in stark contrast to the testimony of Gulf Witness Garvie. Mr. Garvie
18 explains in detail that the overall compensation, including the at-risk
19 compensation, is reasonable, that it is necessary to attract and retain a
20 qualified workforce, and that it is at or near the median of employee
21 compensation paid by other regulated utilities.
22
23 The primary basis for Witness Ramas's recommended disallowance is an
24 unfounded, personal belief that at-risk compensation tied to financial metrics
25 of the Southern Company benefits only shareholders. Notably, she does

1 not allege that such financial goals harm Gulf's customers. On the contrary,
2 customers do, in fact, benefit from a financially strong parent company, as I
3 will discuss later in my testimony.
4
5 Notably, neither does Witness Ramas provide any analysis of the net
6 amount of compensation to employees that would result from her
7 recommendations, and she fails to ascertain whether that net amount is
8 reasonable. Consequently, Witness Ramas's testimony is totally devoid of
9 any consideration of the reasonableness of the net amount that she
10 recommends or of the amount of compensation expected to be paid to
11 employees. Again, she is abandoning the reasonableness standard that is
12 universally applied to all other costs incurred to provide service to
13 customers.
14
15 Q. Why are Gulf's PPP and PSP goals tied to the Southern Company's
16 financial performance beneficial to Gulf's customers?
17 A. Fifty-three percent of Gulf's capital provided by investors is equity capital.
18 However, Gulf's access to the equity capital market is solely through its
19 parent company, the Southern Company. Gulf does not publicly issue
20 equity in the equity market. It is essential that the Southern Company have
21 the financial integrity necessary to be able to raise new equity capital in the
22 equity market and to enable Gulf to obtain equity capital so that it can, in
23 turn, invest in property, plant, and equipment necessary to provide reliable
24 service to Gulf's customers. Gulf's use of Southern Company financial
25 performance measures in its PPP and PSP programs simply mirrors

1 financial reality and, to the customers' benefit, properly focuses Gulf
2 employees on the financial performance of the Southern Company. Gulf's
3 customers benefit because it is the Southern Company that will be
4 responsible for more than half of the investor-supplied capital necessary to
5 serve them.
6
7 Q. What would be the longer-term consequences of accepting Witness
8 Ramas's recommendation?
9 A. Her recommendation would have longer-term consequences that could
10 affect efficiency and take away a valuable managerial tool that is effective in
11 increasing efficiency and maintaining or improving the quality of service
12 provided to customers.
13
14 Q. What do you mean by "take away a managerial tool"?
15 A. If the Commission were to accept Witness Ramas's recommendation, Gulf
16 would be justified in rethinking its long-standing approach to employee
17 compensation. If a significant amount of otherwise valid and reasonable
18 costs are disallowed not on the basis of the reasonableness of their amount
19 but rather simply because of the method by which they are paid, Gulf would
20 be justified in implementing a different pay structure that does not call into
21 question the method by which these costs are paid. While accepting
22 Witness Ramas's recommendation would deny Gulf the opportunity to
23 recover necessary costs currently, adopting a different compensation plan
24 with less at-risk pay and a greater reliance on base pay would presumably
25 eliminate the issue in future rate proceedings. By moving more salary to

1 base pay, employees would no longer have to re-earn that pay each year by
2 meeting goals that balance operational and financial measures both in the
3 short term and long term. A compensation structure that pays employees
4 regardless of performance diminishes management's leverage to motivate
5 and focus employees on appropriate goals. In essence, the Commission
6 would be substituting its judgment for that of Gulf's management as to how
7 best to motivate and compensate its employees. Consequently, the
8 incentive for Gulf's employees to be efficient and productive would be
9 diminished.
10
11 Q. You understand Witness Ramas is not recommending that Gulf not pay the
12 at-risk compensation, she is just recommending that a portion not be
13 recovered in rates.
14 A. Yes, I understand her recommendation. However, disallowing a reasonable and
15 necessary expense, or requiring the Company to pay part of the expense out of
16 the return component that is intended to compensate investors for the use of
17 their invested capital, is nothing more than a backdoor approach to reducing
18 the allowed Return on Equity (ROE). Funds that should go to shareholders as a
19 fair return on investment instead would be diverted to cover costs that should
20 otherwise be recovered in rates. The reduction to Gulf's ROE represented by
21 Witness Ramas's recommendation is significant—approximately 89 basis
22 points. This would significantly affect Gulf's opportunity to earn what the
23 Commission determines to be a fair rate of return.
24
25

1 Q. Mr. Garvie addresses the balanced nature of Gulf's at-risk compensation.
2 Is Witness Ramas's recommendation balanced?
3 A. No. Witness Ramas's rationale does not recognize that the Company's at-
4 risk compensation program is designed to provide a careful balance that
5 benefits all stakeholders, including its customers, employees and investors.
6 Gulf's at-risk compensation programs include operational and financial
7 goals designed to motivate employees to deliver quality services to
8 customers, to improve operational efficiency, and to provide a fair return to
9 investors, all of which benefit Gulf's customers. This balanced approach
10 helps to ensure that the Company is sustainable and it provides benefits to
11 each of the stakeholders, including in particular the customers.
12
13 Q. Is it your position that Commission precedent and policy supports the
14 recovery of at-risk pay tied to financial measures?
15 A. Yes. While the Commission reviews each utility's compensation costs on
16 the facts unique to that utility, the Commission has consistently recognized
17 that at-risk pay is an accepted and desirable way to simultaneously achieve
18 corporate goals and to control costs for the benefit of customers. The
19 Commission has also determined that at-risk compensation is an
20 appropriate component to include within overall compensation to judge
21 whether the overall compensation paid to employees is reasonable.
22
23 Q. Is there a Commission decision reflective of this policy?
24 A. Yes. There is a Florida Power Corporation rate case that provided for cost
25 recovery of incentive compensation. There, the Commission found:

1 “Incentive plans that are tied to the achievement of corporate goals are
2 appropriate and provide an incentive to control costs.” (Order No. PSC-92-
3 1197-FOF-EI, issued October 22, 1992, in Docket No. 910890-EI, In re:
4 Petition for a rate increase by Florida Power Corporation)
5 The Commission has also approved incentive compensation in three prior
6 rate cases for Gulf Power Company. The Commission’s finding in the 2001
7 Gulf rate case, Order No. PSC-02-0787-FOF-EI (Page 45), states:

> 8 To only receive a base salary would mean Gulf employees
> 9 would be compensated at a lower level than employees at
> 10 other companies. Therefore, an incentive pay plan is
> 11 necessary for Gulf salaries to be competitive in the market.
> 12 Another benefit of the plan is that 25% of an individual
> 13 employee’s salary must be re-earned each year. Therefore,
> 14 each employee must excel to achieve a higher salary. When
> 15 the employees excel, we believe that the customers benefit
> 16 from a higher quality of service.

17

18 Q. Why has this been the long-standing policy of the Commission?
19 A. I believe there are a number of reasons for this. First, the Commission’s
20 policy is consistent with the basic tenets of sound regulatory policy which I
21 described earlier. Second, the Commission has recognized that having
22 good management at utilities is essential for regulators to achieve their
23 mission of having safe, reliable, and reasonably-priced service delivered to
24 customers. The Commission has further understood that management
25 needs sufficient tools and incentives to achieve these goals and that

1 regulators should not attempt to "micro-manage" their regulated utilities.
2 Finally, the Commission has appropriately recognized that not all issues in a
3 rate proceeding are a simple situation of "us vs. them," where every issue
4 has a clear winner and a clear loser. By couching the issue in terms of who
5 should pay (customers or shareholders), Witness Ramas is attempting to
6 make it an "us vs. them" issue, when in reality it is not. Incentive
7 compensation is a good example of a "win-win" situation.
8
9 Q. What do you mean by a "win-win" situation?
10 A. At-risk compensation is a situation where all stakeholders win.
11 Shareholders get to invest in a company with employees motivated to
12 achieve appropriate corporate goals. Management gets to apply
13 compensation tools that they think are best to motivate and fairly
14 compensate employees. And most importantly, customers pay no more
15 than a reasonable amount in their rates and get a workforce that is
16 motivated to be efficient, to reduce costs where possible, and to maintain a
17 high level of safe and reliable service.
18
19 Q. The underlying rationale for Witness Ramas's recommendation is that at-
20 risk payments related to financial performance primarily benefit
21 shareholders and therefore should be excluded for ratemaking purposes.
22 Do you agree?
23 A. No, I do not. Financial goals also significantly benefit customers.
24 Regulated utilities are profit making entities (hopefully) and must make a
25 reasonable profit to be sustainable and to access capital when needed and

1 on reasonable terms. This is the means by which customers receive the
2 service that they expect and deserve. A utility earning a reasonable return
3 is beneficial for both its shareholders and its customers. A financially
4 healthy utility benefits all of its stakeholders – customers, employees and
5 investors – by delivering quality service and earning a fair return on
6 investment. A utility's ability to earn a fair return assists in attracting the
7 capital required to provide services to the customer. A financially healthy
8 utility provides access to capital on reasonable terms and provides the
9 ability to withstand financial adversity. Moreover, a financially healthy utility
10 will also provide a lower cost of funds for necessary infrastructure
11 investment, resulting in a lower price for the customer. These benefits are
12 consistent with the goals of the Commission. In Gulf's 2012 test year rate
13 case, the Commission specifically recognized that ratepayers benefit from
14 Gulf and Southern Company maintaining a healthy financial position.
15 (Order No. PSC-12-0179-FOF-EI, Pages 94-95)
16
17 Q. Are financial goals an important component of both the short-term and long-
18 term portions of Gulf's at-risk compensation?
19 A. Yes, they are. My testimony concerning the appropriateness and the
20 associated customer benefits of at-risk compensation based on financial
21 goals applies equally to both short-term and long-term compensation. Once
22 again, the test is whether the amount is reasonable. As Mr. Garvie states in
23 his testimony, the long-term portion of Gulf's at-risk compensation is part of
24 a balanced compensation plan, and when combined with short-term at-risk
25 compensation and base pay, the entire amount of compensation is at the

1 median of the market. Therefore, customers get the benefits of motivated
2 and focused utility employees and are paying no more than the market level
3 of overall compensation. Including long-term financial-based goals as a
4 part of a total compensation plan is particularly important for customers.
5
6 Q. Why are long-term goals important for customers?
7 A. They balance the short-term perspective with a longer-term perspective.
8 This leads to better decision making which ensures that customer benefits
9 are obtained and maintained into future years. Successful utilities which
10 best serve the interests of customers are required to plan well into the future
11 and must obtain capital to invest in needed infrastructure with lives often
12 times exceeding 40 years. It is imperative that managers maintain their
13 focus on both the short term and the long term.
14
15 Q. Do you agree with Witness Ramas that the relevant issue is who should
16 bear the cost of at-risk compensation – shareholders or rate payers?
17 A. No. To me the most relevant issue is whether incentive compensation is a
18 cost of providing service to customers. It is, and as such, it is properly paid
19 for by customers in their rates just like any other cost of providing service
20 and should be based on its reasonableness. Witness Ramas abandons the
21 reasonableness standard and instead uses a strict standard of disallowing
22 an otherwise reasonable amount because of how it is paid. Following
23 Witness Ramas's logic to its illogical conclusion would illustrate the fallacy
24 of her position.
25

1 Q. Please explain.

2 A. Strictly as a hypothetical, if we were to assume that 100 percent of Gulf's
3 compensation was at risk and that 100 percent of the at-risk compensation
4 was based on Southern Company financial metrics, Witness Ramas's logic
5 would conclude that zero labor costs should be included in Gulf's rates.
6 This would be the untenable result based on her misguided belief that any
7 pay based on Southern Company's financial metrics only benefits
8 shareholders and should not be judged on its reasonableness. Granted,
9 this is an extreme hypothetical pay structure that would not be balanced and
10 not reflective of the labor market. Such an extreme pay structure would
11 never be used by Gulf. Nevertheless, it shows the fallacy of abandoning the
12 reasonableness standard that is applied to all other costs to provide service
13 and replacing it with the "who should pay" standard.

14

15

16 **III. DEFERRED RETURN ON TRANSMISSION INVESTMENT**

17

18 Q. What is the deferred return on transmission investment?

19 A. Pursuant to the settlement agreement in Gulf's last rate case, in lieu of
20 placing new transmission investment in rate base and earning a cash
21 return, Gulf was permitted to accrue non-cash earnings by means of an
22 Allowance for Funds Used During Construction (AFUDC) like mechanism.
23 This resulted in the creation of a regulatory asset. Gulf is now seeking to
24 amortize the resulting regulatory asset over four years as part of this rate
25 case.

1 Q. Does Witness Ramas dispute the amount of the regulatory asset associated
2 with the transmission investment?
3 A. No. She is taking issue with the length of the amortization period.
4
5 Q. What amortization period does Witness Ramas recommend?
6 A. She recommends an amortization period equal to the remaining life of the
7 transmission investment, or 40 years. She equates the accrual of the
8 deferred return to AFUDC, which is added to the cost basis of an asset and
9 then depreciated over the useful life of said asset.
10
11 Q. Is Witness Ramas correct?
12 A. No. Her conclusion is incorrect. She is correct that typical AFUDC is
13 capitalized during the construction phase of an asset and becomes a part of
14 the cost basis of an asset. By virtue of being part of the cost basis of the
15 asset, any AFUDC is then appropriately depreciated over the useful life of
16 the asset. The situation here with the deferred return is entirely different.
17
18 Q. Please explain how this situation is different.
19 A. The deferred return is not AFUDC. It was merely accrued consistent with
20 the Commission-approved AFUDC calculation. That does not mean that
21 the deferred return is AFUDC.
22
23 Q. If it is not AFUDC, what is it?
24 A. It is an approximation of the amount of return that would have been earned
25 through rates had the transmission assets actually been included in rate

1 base in the last rate case, hence the term "deferred return." Therefore, the
2 deferred return is not the same as typical AFUDC which is accrued during
3 construction.
4
5 Q. What does this have to do with the correct amortization period?
6 A. It means that the amortization period is not the remaining life of the
7 transmission asset, since the deferred return reflects dollars that under
8 normal ratemaking would have already been recovered from customers
9 through base rates.
10
11 Q. What should the amortization period be?
12 A. It is a matter of discretion of the Commission. The Commission has
13 generally had a policy of removing regulatory assets off the books of a utility
14 as quickly as possible to restore the economic positions of all parties to
15 what they would have been had the regulatory asset not been created.
16 However, this should be done within the constraints of not distorting
17 earnings in the short term and not placing undue burdens on the company
18 or its customers. A rate case is an opportune time to correctly use such
19 discretion. The general rule of thumb is to use an amortization period that
20 approximates what is believed to be the typical or expected time period
21 between rate cases. It was on this basis that Gulf proposed a four-year
22 amortization period.
23
24
25

1 Q. What is your recommendation?
2 A. I endorse Gulf's proposed four-year amortization period. However, the
3 Commission can use its discretion to use a slightly shorter or longer period.
4 For instance, Gulf has not been able to avoid a base rate proceeding every
5 four years as a result of its last two rate cases. This frequency might
6 suggest a shorter amortization period. On the other hand, five years, which
7 is typically used to amortize any gains or losses that may result from the
8 disposition of utility property, could be reasonable. Certainly 40 years is not
9 the correct amortization period. A 40-year amortization period would just
10 perpetuate amounts in rate base over a longer period of time and would
11 cause rates to be higher over the long term than they should be.
12
13 Q. Does this conclude your testimony?
14 A. Yes, it does.
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25

AFFIDAVIT

STATE OF FLORIDA)
)
COUNTY OF LEON)

Docket No. 160186-EI

Before me the undersigned authority, personally appeared J. Terry Deason, who being first duly sworn, deposes, and says that he is a Special Consultant for The Radey Law Firm, and that the foregoing is true and correct to the best of his knowledge, information, and belief. He is personally known to me.

s/ J. Terry Deason
J. Terry Deason
Special Consultant

Sworn to and subscribed before me this 3rd day of February, 2017.

Melissa Darnes
Notary Public, State of Florida at Large

Commission No. FF 912698

My Commission Expires December 17, 2019

MELISSA DARNES
MY COMMISSION # FF 912698
EXPIRES: December 17, 2019
Bonded Thru Budget Notary Services