Gulf Power

Robert L. McGee, Jr.
Regulatory & Pricing Manager

One Energy Place
Pensacola, FL 32520-0780
850 444 6530 tel
850 444 6026 fax
rlmcgee@southernco.com

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 and Exhibit of Gulf Power Company Witness James M. Garvie.

(Document 5 of 16)

Sincerely,

Robert L. McGee, Jr.

Robert L. McGee, Jr.
Regulatory & Pricing Manager

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 160186-EI

Gulf Power

REBUTTAL TESTIMONY AND EXHIBIT

OF

JAMES M. GARVIE

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony of
James M. Garvie
Docket No. 160186-EI
In Support of Rate Relief
Date of Filing: February 8, 2017

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

A. My name is James Garvie. My business address is 30 Ivan Allen Jr. Boulevard, Atlanta, GA 30308. I am the Compensation, Benefits and Human Resources Operations Vice President for Southern Company Services (SCS).

Q. Have you previously filed testimony in this proceeding?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my testimony is to address the testimony of Office of Public Counsel (OPC) Witness Donna Ramas in which she inappropriately concludes that the Commission should disallow portions of Gulf's compensation and benefit expenses even though those expenses are currently paid at or below the median of the market. As I will show, not only are these expenses reasonable and appropriate costs of service for ratemaking purposes, but they are also a necessary part of Gulf's total package of compensation and benefits that allows Gulf to attract, engage, retain, and motivate a highly skilled workforce that focuses on the customers' interests.

Q. Are you sponsoring any rebuttal exhibits?

A. Yes. I am sponsoring Exhibit JMG-2, Schedules 1 and 2. The information contained in the schedules is true and correct to the best of my knowledge and belief.

- Schedule 1, Aon Hewitt Preliminary 2017 ASC 715-30 Tax-Qualified Pension Benefit Cost for Gulf Power Company
- Schedule 2, Gulf Power Tax-Qualified Pension Plan Scenarios

I. ANNUAL AND LONG-TERM AT-RISK COMPENSATION

Q. Do you agree with Witness Ramas's proposal to disallow $14,191,000 of Gulf's O&M expense for at-risk compensation in the 2017 test year?

A. No, I do not, for a number of reasons. Foremost, Witness Ramas's recommendation is fundamentally flawed because she seeks to disallow a substantial portion of Gulf's compensation expense despite the fact that Gulf's compensation expense is already below the median of the market. If the Commission were to disallow the expenses as she suggests, Gulf's compensation expense would be unfairly reduced significantly below the median of the market. Witness Ramas's proposal is not based on any market analysis or supporting data. Instead, her proposal focuses merely on the mechanism of pay, and how that mechanism should be treated in accordance with her personal beliefs. By ignoring the fact that the compensation expense Gulf requests in this case is market-competitive, she disregards best practice in compensation program design and management and exhibits a lack of understanding of how at-risk pay goals are used to drive employee behavior in ways that benefit our customers. Gulf's total compensation plan aligns employees' interests with customers' interests and is set at a reasonable, middle of the market amount.

In addition, I note that Gulf Witness Deason explains in detail a number of additional objections to Witness Ramas's proposal related to Commission policy and precedent. In this regard, Mr. Deason importantly points out that in Gulf's 2012 test year rate case, the Commission appropriately allowed all of Gulf's annual at-risk compensation expense in recognition that customers benefit from a financially healthy utility.

Q. Does Witness Ramas present any evidence that Gulf's total compensation costs are unnecessary or unreasonable or that the Company's total compensation program is not properly designed or competitive?
A. No, she does not. Witness Ramas does not contest the reasonableness of the total expense requested for compensation or the design and competitiveness of the program. She instead focuses on the mechanism that triggers payment. Relying on her own opinion, Witness Ramas argues that some portion of Gulf's (necessary and reasonable) total compensation should not be allowed for recovery through rates because it is at-risk and tied to the financial performance of Gulf's parent company, Southern Company.

Q. Do you agree with Witness Ramas's opinion?
A. No. The combination of operational and financial goals tied to the at-risk portion of Gulf's total compensation plan is vital to the interests of our customers. It is important for our customers that Gulf's total compensation plan includes financial goals in addition to operational goals.

Q. Why is it important to your customers that Gulf employees have compensation goals that include both financial and operational components?
A. Our customers need safe and reliable service that is provided in the most cost efficient manner. A compensation plan that contained only operational goals might inappropriately drive employees to use more financial resources than necessary to achieve operational success. Similarly, a compensation plan that contained only financial goals might inappropriately drive employees to make decisions that sacrifice operational success for financial results. Witness Ramas's suggestion that the operational components should be separated from financial components and short-term goals from long-term goals is not in keeping with best practice of a well-designed compensation plan.

Q. Is the design and competitiveness of Gulf's total compensation program aligned with the external market and are the costs necessary and reasonable?
A. Yes. As previously demonstrated in my direct testimony, Gulf's total compensation of base pay and at-risk pay is managed to the median or

middle of the external market and is designed using sound compensation practice and principles. Through the use of compensation surveys published by recognized third-party sources, we determine the median total target compensation for each job. Based on the market, a portion of total target compensation is subtracted and allocated to at-risk pay focused on goals that benefit our customers. As illustrated in Exhibit JMG-1, Schedule 2 of my direct testimony, when assessing both our base pay and total compensation of base pay and at-risk pay, Gulf is slightly below the median of the market.

In addition, Gulf had Willis Towers Watson, a nationally recognized compensation and benefits firm, conduct a competitive assessment of the design of its total compensation program relative to external market prices. As shown in Exhibit JMG-1, Schedule 3 of my direct testimony, Willis Towers Watson's conclusion is that Gulf's compensation plans, programs, and processes are comparable to and competitive with the utility industry.

Q. Witness Ramas contends that Gulf's compensation plan design includes financial components that do not provide any benefit to customers. Do you agree?

A. No. By balancing both operational measures and financial measures in the at-risk pay plan, employees are driven not only to serve the customer by delivering safe and reliable service, but also to continue efforts to manage costs appropriately so that customers benefit from both excellent service and cost-effective management of the Company's resources. Customers benefit from employee efforts to set and work within budgets that improve efficiency and reduce costs, ultimately resulting in lower customer rates than would otherwise be the case.

Q. Regarding Gulf's annual at-risk program, in which every Gulf employee participates, Witness Ramas suggests that shareholders, not customers, should bear the costs attributed to the financial goal tied to Southern Company earnings per share. Is she right?

A. No. Witness Ramas is very wrong. As noted earlier, she is suggesting that a large portion of compensation expense be disallowed even though the Commission appropriately recognized that this expense was properly recovered in rates in Gulf's 2012 test year rate case. Addressing the financial goal tied to Gulf's parent company, the Commission specifically noted that customers benefit from a financially healthy utility.

Regardless of the particular goals in the annual at-risk plan, the compensation sought by Gulf is below the median of the market. Witness Ramas is basing her entire argument on singling out one of the goals that employees must meet to achieve market pay. In the case of the annual at-risk plan, she seeks to have one-third of the at-risk portion of compensation removed from rates merely because a goal of the program is tied to a financial metric that refers to Gulf's parent company. She presents no evidence that this goal harms a Gulf customer in any way. To the contrary, Gulf customers benefit when Gulf employees are motivated to manage the Company's money wisely as a part of a balanced compensation plan. In any event, her focus on one goal in the program is misplaced because the relevant question is whether the requested compensation is a reasonable cost of service for providing electric service to Gulf's customers. Nothing in Witness Ramas's testimony contradicts that the pay Gulf is requesting in base rates is reasonable in amount and reasonable as to its design.

Q. Witness Ramas suggests that the entire portion of Gulf's compensation expense associated with Gulf's long-term at-risk plan, $3,798,000, should also be disallowed because the goals in that program are tied to Southern Company. Mr. Garvie, why is it appropriate for the long-term portion of at-risk compensation to focus on Southern Company financial performance?

A. Foremost, the requested compensation expense is below the median of the market. Witness Ramas's suggestion that the entirety of the long-term compensation program be disallowed merely because the goals of the long-term at-risk program are tied to Southern Company demonstrates her unfamiliarity with sound compensation program design and her disregard of the benefits that such motivational goals bring to Gulf's customers. The compensation plan appropriately ties long-term goals to Southern Company financial performance for many reasons, each of which help our customers.

One such reason is to motivate employees to act like owners of the company so that when they make management decisions with long-term impacts, they do so with long-term operational and financial considerations in mind. Through equity ownership they are invested in the business and the long-term success of Southern Company, which directly benefits the customers of Gulf Power Company.

Q. What is the logic of having a Southern Company financial goal as one of the goals that Gulf employees need to meet to secure their at-risk compensation?

A. Fifty-three percent of Gulf's capital provided by investors is equity capital. Gulf is a wholly-owned subsidiary of Southern Company. Gulf's access to the equity capital market is solely through its parent company, the Southern Company. Whether Gulf will be able to continue to provide reliable service to its customers at reasonable rates depends in part on the continued financial integrity of the Southern Company and its access to external equity investors. Therefore, employing Southern Company metrics in Gulf's at-risk compensation plan, in addition to operational goals, simply reflects the importance to Gulf's customers of the Southern Company being able to raise capital for Gulf's customers' benefit.

Q. In what other ways do Gulf's customers benefit from a goal tied to the Southern Company?

A. In addition to access to capital to fund projects that benefit Gulf's customers, Gulf's customers benefit from Gulf's relationship with Southern because it allows Gulf ready access to specialized expertise and savings from economies of scale. For example, due to the scale of Southern Company, Southern is able to negotiate lower contracts for many needed vendors and consultants that provide technical guidance and expertise to

Gulf. Similarly, customers benefit through cost savings on large purchases that are made possible due to Southern's bulk purchasing leverage. As addressed by Gulf Witness Hodnett in more detail, as a consequence of Gulf's relationship with Southern, Gulf has access, with no profit markup, to a myriad of specialized expertise that otherwise would be more costly to Gulf, either through having to pay more for third-party expertise that would necessarily include a profit mark-up or through having to hire more employees. The benefits Gulf receives from Southern are immense; motivational goals in the compensation plan that serve to keep Southern's financial integrity intact greatly benefit Gulf's customers.

Witness Ramas fails to recognize any of the benefits that Gulf's customers receive through Southern Company. She does not provide any evidence that including long-term financial goals as a part of a well-balanced compensation plan harms customers in any way. To the contrary, these financial goals benefit the customer. A total compensation plan without any long-term financial goals would not be in our customers' best interests. By designing the at-risk portion of the total compensation plan to include both annual goals and longer-term goals, an appropriate balance is achieved whereby employees are driven to deliver safe and reliable electric service to our customers in a manner that is economically efficient for our customers both now and in the years that follow.

Q. When you said earlier that Gulf's total compensation, which includes both base and at-risk pay, is appropriately market competitive and managed to the median of the external market, was the long-term portion of the at-risk pay plan included as a part of this analysis?

A. Yes. The amount of compensation sought in this rate case attributable to the long-term portion of at-risk compensation is only that amount required by Gulf to remain market competitive. Again, Witness Ramas does not contest the reasonableness of the total expense requested for long-term compensation, but instead she focuses on the mechanism that determines payment. If Witness Ramas's proposal is accepted, the total compensation of base pay and at-risk pay for the 30 employees in the plan would no longer be at the median of the external market, as stated in my direct testimony. To the contrary, the total compensation for this group of employees would be 22 percent below the external market median, which would put total compensation well below the market and not competitive with peers. To continue to provide market median compensation, Gulf would have to consider completely redesigning its compensation program such that the current program of base pay plus at-risk pay is eliminated in favor of a base pay only model. Gulf could conceivably request the same dollar amount of compensation expense for the 2017 test year as it currently seeks so as to remain market competitive from a dollar standpoint, avoiding Witness Ramas's argument that a portion of the compensation program should be disallowed in rates simply because it includes financial goals. However, increasing base pay and eliminating at-risk pay that through goals provide a focus on our customers both operationally and financially, is simply not in the best interests of customers. It would result in higher fixed costs and poor alignment of interests with customers.

Q. Mr. Garvie, how do you respond to Witness Ramas's argument that since Gulf has reduced the number of participants in the long-term at-risk pay plan, the Company does not view a significant reduction in participants as negatively impacting the ability to hire and retain employees?

A. Witness Ramas again demonstrates her failure to understand sound compensation program design and management. As noted in my direct testimony, beginning in 2017, we are reducing the number of participants in the plan from over 100 to 30 to better align with the market as noted in the audit of our compensation program by Willis Towers Watson. To ensure that the total compensation for those removed from the plan remains at the median of the external market, it was necessary to increase their base pay to replace the portion of their total compensation which previously had been allocated to long-term at-risk pay. If base pay had not been increased, the total compensation of this group of employees would have been well below the market and created potential retention issues.

Notably, in order to remain market competitive, we continue to carve out a long-term at-risk portion of compensation for the remaining employees in the long-term plan. Our compensation plan is designed to the middle of the market. Gulf reduced the number of participants in the long-term plan in response to our consultant's market-based recommendation. The same consultant has not recommended that we reduce participation in the long-term plan any further. Gulf would not be market-competitive if it eliminated its long-term compensation plan.

Q. Witness Ramas argues that the relevant issue on the long-term at-risk pay plan is who should bear the cost burden of the plan expense – the shareholders or the rate payers. Do you agree?

A. No. In a base rate regulatory proceeding, the relevant issue is whether Gulf's total compensation expense of base pay and at-risk pay is reasonable and necessary. Witness Ramas has not provided any argument based on supporting data or analysis that Gulf's requested expense is unreasonable or unnecessary. Instead, her argument, also lacking in supporting data or analysis, is that some portion of at-risk pay should be disallowed based on goals within the pay program that motivate employees to wisely manage the Company's money both in the short and longer term.

My testimony has outlined how Gulf's total compensation program, including annual and long-term at-risk pay, is the best method for Gulf's customers because it allows Gulf to retain and attract qualified employees at market competitive compensation amounts, while allowing management to drive employee behavior so that employees continually keep the customers' interests at the center of their attention, serving the customers both in the short term and in the years to come.

Q. Witness Ramas also contends that short-term at-risk pay expenses for the 2017 test year should be reduced to the level associated with a "100 percent" performance level and not the "133 percent" performance level on which Gulf budgeted its short-term at-risk pay. Do you agree?

A. No, I do not agree. The expense requested for short-term at-risk pay is the amount needed to remain market competitive. The expense that Gulf is requesting is reasonable. The "100 percent" performance level is a function of the particular goal calibration for the short-term at-risk plan and does not reflect market median pay. If Gulf limited its payout to 100 percent for the short-term goals, Gulf's employees' payout would be below market.

Q. Would a 133 percent performance level for Gulf's short-term at-risk plan be within the market median?

A. Yes. Gulf's compensation is managed to the median of the external market with multiple checks throughout the process. Using multiple compensation surveys published by recognized third party sources, Gulf is assured that both the base pay and at-risk pay components of its total compensation plan are at the median of the market. As demonstrated by the audit performed by third party expert Willis Towers Watson, attached as Exhibit JMG-1 to my direct testimony, Gulf's compensation pay philosophy of targeting the 50^{th} percentile is the prevalent practice across the utility industry; our pay benchmarking process is consistent with industry market best practices; our pay levels are competitive with market 50^{th} percentile for base and at-risk compensation; our use of both annual and long-term at-risk pay components is comparable to industry peers; and our processes overall are confirmed to be competitive with industry peers. Witness Ramas's claim that any performance level over "100 percent" of our calibrated goal achievement would be above market is simply wrong. The compensation Gulf seeks is a reasonable and necessary expense.

Q. What benefits do Gulf's customers receive from the level of compensation that Gulf seeks in this case?

A. Simply put, Gulf is setting above average (top quartile) goals and paying employees market median compensation for reaching these goals. The goals drive employee behavior to achieve top operational performance and maintain a financially sound utility for compensation that is at the median of the market; this is a great deal for the customer. Gulf's compensation expense should be included as a necessary and reasonable expense.

II. SUPPLEMENTAL PENSION PLAN

Q. In her testimony, Witness Ramas proposes that the supplemental executive retirement plan expense be disallowed. Please describe the supplemental plans.

A. The Supplemental Benefit Plan (SBP) and Supplemental Executive Retirement Plan (SERP) were established to provide participants total retirement income benefits from company-sponsored sources, comparable to what other employees receive as a percent of base salary plus annual at-risk pay. The SERP has since been frozen with no new participants added after January 1, 2016.

Q. Why does Gulf provide these types of plans?

A. Gulf provides these plans due to limitations imposed by the Internal Revenue Code (IRC) on the deductibility of benefits associated with annual compensation levels over $265,000. This annual compensation limitation exists solely for government revenue and tax policy purposes and has nothing to do with the level of benefits that should be provided.

Q. Are these plans intended to provide additional or greater benefits than other employees receive under the general pension plan of the Company?

A. No. The intent of these plans is to provide equivalent benefits (as a percentage of pay) across our employee population.

Q. How do you respond to Witness Ramas's argument that these pension costs are additional benefits that the Company has decided to provide that exceed IRS limitations and therefore are not necessary for the provision of utility service?

A. I disagree. Contrary to Witness Ramas's unsupported statement, the amounts needed to fund these retirement plans are in fact necessary for the provision of utility service. A company of Gulf's size and scope cannot operate effectively without experienced and qualified employees to lead and manage the organization. Gulf has a responsibility to deliver safe and reliable electric service to the hundreds of thousands of its customers in Northwest Florida. I do not think there can be any valid dispute that in order to carry out this responsibility, Gulf needs to be able to attract and retain individuals who are able to effectively lead and direct its employees. Customers benefit from the efforts of the leaders of the Company. In order to remain competitive, Gulf must be able to offer these employees competitive retirement benefits commensurate with their compensation.

Q. Do you agree with Witness Ramas's basis for her proposed disallowance?

A. No. The supplemental benefit plans are intended to provide fair and equitable benefits to all Gulf employees at all levels. They are reasonable and appropriate expenses that allow Gulf to provide benefits to employees at competitive levels. As such, these expenses should be included in base rates.

III. PENSION EXPENSE AND CONTRIBUTION

Q. Witness Ramas proposes to remove the ratemaking effects of the planned 2016 pension contribution discussed in your direct testimony unless Gulf demonstrates that the contribution was made and was cost effective for the company. Did Gulf make a pension contribution in 2016?

A. Yes, Gulf made a contribution to the pension plan in December 2016. The amount of the contribution was $55,816,000, consisting of $48,000,000 for Gulf and $7,816,000 as an allocation from SCS. The contribution was less than the projected amount as of the time I prepared my initial testimony in this case.

Gulf Witness Ritenour addresses the appropriate ratemaking adjustments to reflect this lower contribution level.

Q. Why was the actual pension contribution less than what was previously projected?

A. The original $81,000,000 contribution was prepared by the pension plan actuary, Aon Hewitt, based upon the assumptions as of the July 2016 measurement date. This amount was the estimated contribution needed to improve the pension plan's funded status to the desired target and to avoid Pension Benefit Guaranty Corporation (PBGC) variable-rate premiums. As noted in Exhibit JMG-2, Schedule 1, the discount rates increased from the date of the original estimated $81 million contribution. Prior to making the actual contribution of $55,816,000, the pension plan actuary provided updated information which reflected the most recent discount rate and assumption information available in mid-December. The discount rate used for preliminary December 31, 2016 disclosure is very close to the rate used for determining the actual $55,816,000 contribution made in December. As noted in the pension plan actuary's letter dated January 24, 2017, this contribution improved the funded status of the pension plan to 99 percent as of December 31, 2016.

Q. Was the December 2016 pension contribution cost effective for Gulf and its customers?

A. Yes. The contribution resulted in a revenue requirements savings of $100,000 for the 2017 test year and a $3,800,000 Net Present Value (NPV) over the next 10 years as seen in Exhibit JMG-2, Schedule 2. As noted in the attached letter dated January 24, 2017 from our pension actuary, the December 2016 contribution of $55,816,000 improved the funded status of the plan to a preliminary value of 99 percent that had the following positive impacts:

1. Reduced the 2017 pension expense by $3,860,000 from what it otherwise would have been had there been no contribution.
2. Eliminated projected PBGC variable-rate premiums which otherwise would have been incurred based on the funded status of the plan, with estimated savings of over $6,000,000 over a 10-year period.
3. Eliminated projected future minimum required contributions for the next 10 years.

Q. In her testimony, Witness Ramas recommends that the Company provide the current estimate of the 2017 pension expense (or income, if applicable). Is this information available?

A. A copy of the most recent information provided by the pension actuary is attached based on preliminary December 31, 2016 disclosure results. As noted on page 2 of the letter dated January 24, 2017, the preliminary results reflect the most recent actuarial assumptions (discount rate, mortality, etc.)

Q. Witness Ramas states that pension expense in the filing is a negative amount which is indicative of pension income and implies that a large contribution to the plan was not needed. Is this accurate?

A. No. As previously noted, the contribution resulted in reduced costs to our customers. The $55,816,000 contribution made in December improved the funded status of the pension plan and eliminated future PBGC variable-rate premiums which would have been an added cost to the pension plan. The

2017 pension expense decreased $3,860,000 from what it otherwise would have been as a result of the contribution, which resulted in pension income (i.e. negative pension expense) projected for the 2017 test year. Both in the 2017 test year and overall for a projected 10-year period, the contribution reduced revenue requirements; therefore, it provided customers savings in the amounts of $100,000 for the 2017 test year and a $3,800,000 Net Present Value (NPV) over the next 10 years.

Q. When it filed this case, how was the Company able to determine the pension expense for the 2017 test year when the discount rate and other actuarial assumptions would not be known until the end of 2016 as Witness Ramas contends in her testimony?

A. The pension expense for the 2017 test year was determined using a discount rate and other actuarial assumptions available at the time of our original testimony. We have provided a letter dated January 24, 2017, from the pension plan actuary summarizing preliminary December 31, 2016, results using the updated 2017 test year discount rate and other actuarial assumptions. As noted above, the December 2016 pension contribution saved money for our customers.

IV. OTHER EMPLOYEE BENEFITS

Q. Please address Witness Ramas's suggestion that the expenses under the category of Other Employee Benefits should be reduced by $268,432 to reflect the 2015 actual expense level of $461,749.

A. Witness Ramas's recommendation that Gulf not be allowed the additional amount needed to cover these expenses for the 2017 test year should be rejected. Her stated ground for disallowing the expenses is that Gulf "has not supported" the increase in expense when comparing 2015 actual to the 2017 projection. However, Witness Ramas's claim is belied by Attachment 5 to her testimony, Gulf's Response to Citizens' First Set of Interrogatories Item No. 13(d), wherein the reasons for the cost increases are identified. The actual expenses for Other Employee Benefits in 2015 were less than the projected amounts for 2017 due to multiple factors. One such factor is the addition of a Functional Movement wellness program. This new wellness program involves employees participating in a "prehab" where at risk movement patterns are identified and corrected through daily corrective movement sessions. The purpose of the program is to enable employees to move with biomechanical efficiency, increasing performance, reducing injuries, and enhancing career longevity. Expenses under Other Compensation Benefits also necessarily increased due to Gulf having additional employees reaching service milestones in 2017, requiring an increase in the budget for Service Awards. An increase in the projected prime rate called for an increased expense for Interest on Deferred Compensation. The final category of Other Compensation Benefits, which

Gulf budgeted under the “Meals and Travel” accounting line item, included budgeting for meals related to Company-wide and smaller business unit gatherings to foster teamwork and the engagement of employees. “Other” employee benefits such as wellness programs, service awards, and employee gathering events should not be dismissed as unimportant, as they are cost-effective ways to increase the health and morale of the workforce. Witness Ramas’s claim that these expenses are “not supported” is wrong.

V. CONCLUSION

Q. Does Witness Ramas provide any evidence to challenge the overall reasonableness of Gulf’s total compensation and benefits package?

A. No, she does not. She has not provided any evidence that the costs of Gulf’s compensation and benefit programs are unnecessary or unreasonable. Instead she proposes to disallow a portion of compensation simply because she disagrees with the manner in which it is paid. Gulf’s projected expenses for the at-risk portion of total compensation, supplemental retirement benefits, and pension expenses are reasonable and appropriately included in rates.

Q. Does this conclude your rebuttal testimony?

A. Yes.

AFFIDAVIT

STATE OF GEORGIA)
)
COUNTY OF FULTON)

Docket No. 160186-EI

Before me the undersigned authority, personally appeared James M Garvie, who being first duly sworn, deposes, and says that he is the Compensation, Benefits and Human Resources Operations Vice President at Southern Company Services and that the foregoing is true and correct to the best of his knowledge, information, and belief. He is personally known to me.

s/ Jim M. Garvie
James M. Garvie
Compensation, Benefits and HR Operations VP

Sworn to and subscribed before me this 2 day of February, 2017.

Denise V. Watkins
Notary Public, State of Georgia

Commission No. ____________________

My Commission Expires 3/21/19

DENISE V. WATKINS
NOTARY PUBLIC
MY COMMISSION EXPIRES MARCH 21, 2019
COBB COUNTY, GEORGIA

Exhibit

AON
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January 24, 2017

Mr. Robert K. Beideman
Southern Company Services, Inc.
30 Ivan Allen Jr. Boulevard
Atlanta, GA 30308

Dear Bob,

Subject: Preliminary 2017 ASC 715-30 Tax-Qualified Pension Benefit Cost for Gulf Power Company

This letter provides and discusses the preliminary ASC 715-30 tax-qualified fiscal 2017 cost for Gulf Power Company. These results are based on preliminary year-end 2016 information provided to Southern Company on January 11, 2017. ***Final results are not yet available and will vary from the results included in this letter.***

Gulf Power Company's tax-qualified preliminary 2017 accounting cost (income) is ($0.05) million after reflecting the contribution made on December 19, 2016. The table below shows the preliminary 2017 tax-qualified cost along with a comparison to what the accounting cost would have been if the contribution was not made.

Preliminary 2017 ASC 715 Cost for Gulf Power Company, Tax-Qualified Pension

	Before Contribution	After Contribution
Reconciliation of Funded Status, December 31, 2016		
Projected Benefit Obligation	(494.81)	(494.81)
Market Value of Assets	441.93	489.93
Funded (Deficit) / Surplus	(52.88)	(4.88)
Funded Ratio	89.3%	99.0%
2017 ASC 715 Cost		
Service Cost	12.75	12.75
Interest Cost	18.61	18.61
Expected Return on Assets	(34.58)	(38.40)
Prior Service Cost Amortization	0.53	0.53
(Gain) Loss Amortization	6.50	6.46
Total Net Cost (Income)	3.81	(0.05)

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About Preliminary 2017 Costs

The preliminary 2017 costs were measured as of December 31, 2016 using preliminary benefit obligations, assets and other information as of December 31, 2016 provided by Southern Company. The correspondence with Brent Young at Southern Company dated January 13, 2017 includes additional information supporting these results.

The following are a few of the key assumptions and experience reflected:

- *Discount rate for benefit obligations*—4.46%
  - Prior projected December 31, 2016 results provided in July 2016 used a discount rate of 3.99% and projections provided in December 2016 used a discount rate of 4.42%
- *Expected long-term rate of return*—7.95% for pension trust (net of investment expenses)
  - Prior projected December 31, 2016 results provided in July 2016 used an expected return of 8.20% and projections provided in December 2016 used an expected return of 7.95%
- *Mortality rates*—updated mortality improvement factors (MP-2016) published by Society of Actuaries in October 2016, reflecting shorter projected life expectancies
  - Prior projected December 31, 2016 results provided in July 2016 did not anticipate this update as the Society of Actuaries had not yet released the new factors and projections provided in December 2016 reflected the estimated impact of these factors
- *Demographic experience*—Reflects 2016 census data used for year-end 2016 accounting measurement
  - Prior projected December 31, 2016 results provided in July 2016 anticipated demographic experience was the same as the underlying assumptions and projections provided in December 2016 reflected the estimated impact the 2016 demographic experience
- *Plan change*—primarily updated death benefits and optional form of payment conversion factors
  - Prior projected December 31, 2016 results provided in July 2016 and December 2016 anticipated the estimated impact of these plan changes

About the 2016 Pension Contribution

Gulf Power Company contributed to The Southern Company Pension Plan in December 2016. The contribution had the following impacts:

- Improved Gulf's tax-qualified accounting funded status by 9.7% (preliminary 12/31/2016 funded status of 99%)
- Reduced Gulf's tax-qualified preliminary 2017 ASC 715 cost by $3.86 million

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- Eliminated PBGC variable-rate premiums that were projected to be required beginning in 2017 for the Southern Company tax-qualified pension plan.

  PBGC variable-rate premiums are based on the funded status of the tax-qualified pension plan. Prior to the December 2016 contribution, the PBGC variable-rate premiums were projected to be $125 per plan participant in 2017 and $200 per plan participant in 2018, totaling over $6 million during the next 10 years. Gulf has approximately 2,500 qualified plan participants as of January 1, 2016. The contribution eliminated these projected PBGC variable-rate premiums.

- Eliminated future required minimum contributions that were projected in the next 10 years

Projections of future minimum required contributions and PBGC variable-rate premiums assume future experience matches assumptions as of December 2016 and market conditions as of December 2016 remain the same during the projection period.

Please let us know if you have questions or need additional information.

Sincerely,

Hewitt Associates LLC, an Aon Hewitt company

Joy L. Ferguson

Joy L. Ferguson, ASA, EA

JF:cm
Attachments
cc: Mr. Brent Young, Southern Company Services, Inc.
Mr. Colby C. Park, Aon Hewitt

Florida Public Service Commission
Docket No. 160186-EI
GULF POWER COMPANY
Witness: James M. Garvie
Exhibit No._____ (JMG-2)
Schedule 2
Page 1 of 1

Gulf Power Company
Tax-Qualified Pension Plan Scenarios
(Does not include other post retirement components)

($ in 1,000,000s)	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
December 2016 Projection with no contribution (includes SCS allocations)											
Accounting Cost	2.2	4.6	4.7	5.4	6.4	6.3	6.2	5.3	1.9	(0.2)	(0.9)
Carrying Cost	6.1	5.9	5.6	5.2	4.8	4.4	4.0	4.9	7.1	8.8	9.4
Total Cost	8.3	10.5	10.3	10.7	11.2	10.6	10.1	10.1	9.0	8.7	8.5
Gulf Net Regulatory Asset	*58.6*	*56.3*	*53.3*	*49.9*	*46.1*	*42.0*	*38.0*	*42.2*	*58.1*	*72.0*	*77.1*
Funds for SCS Payable	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*	*4.4*	*10.1*	*12.5*	*12.8*
December 2016 Projection with $48M contribution (includes SCS allocations)											
Accounting Cost	2.2	(0.2)	(0.8)	(0.5)	(0.1)	(0.9)	(1.5)	(2.1)	(2.8)	(3.4)	(3.9)
Carrying Cost	6.1	10.6	10.6	10.7	10.7	10.7	10.8	10.9	11.1	11.3	11.5
Total Cost	8.3	10.4	9.9	10.1	10.6	9.9	9.3	8.8	8.3	7.9	7.6
Gulf Net Regulatory Asset	*58.6*	*93.7*	*94.0*	*94.3*	*94.5*	*94.7*	*95.4*	*96.6*	*98.1*	*100.1*	*102.4*
Funds for SCS Payable	*7.8*	*7.8*	*7.8*	*7.8*	*7.8*	*7.8*	*7.8*	*7.8*	*7.8*	*7.8*	*7.8*

Present Value Comparison

	Total	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
No contribution	108.0	8.3	10.5	10.3	10.7	11.2	10.6	10.1	10.1	9.0	8.7	8.5
With Contribution	101.0	8.3	10.4	9.9	10.1	10.6	9.9	9.3	8.8	8.3	7.9	7.6
Variance	(7.1)	0.0	(0.1)	(0.4)	(0.5)	(0.7)	(0.8)	(0.9)	(1.4)	(0.7)	(0.8)	(0.9)
Present Value	NPV	0	1	2	3	4	5	6	7	8	9	10
No contribution	$69.5	$8.3	$9.5	$8.4	$7.9	$7.6	$6.5	$5.6	$5.1	$4.1	$3.5	$3.1
With Contribution	$65.7	$8.3	$9.4	$8.1	$7.5	$7.1	$6.0	$5.1	$4.4	$3.7	$3.2	$2.8
Variance	(3.8)	0.0	(0.1)	(0.3)	(0.4)	(0.5)	(0.5)	(0.5)	(0.7)	(0.3)	(0.3)	(0.3)