

FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

DOCKET NO. 160186-EI

PETITION FOR RATE INCREASE BY
GULF POWER COMPANY.

DOCKET NO. 160170-EI

PETITION FOR APPROVAL OF 2016
DEPRECIATION AND DISMANTLEMENT
STUDIES, APPROVAL OF PROPOSED
DEPRECIATION RATES AND ANNUAL
DISMANTLEMENT ACCRUALS AND
PLANT SMITH UNITS 1 AND 2
REGULATORY ASSET AMORTIZATION,
BY GULF POWER COMPANY.

VOLUME 5

(Pages 1026 through 1273)

PROCEEDINGS: HEARING

COMMISSIONERS
PARTICIPATING: CHAIRMAN JULIE I. BROWN
COMMISSIONER ART GRAHAM
COMMISSIONER RONALD A. BRISÉ
COMMISSIONER DONALD J. POLMANN

DATE: Monday, March 20, 2017

TIME: Commenced at 1:00 p.m.
Concluded at 2:53 p.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: LINDA BOLES, CRR, RPR
Official FPSC Reporter
(850) 413-6734

APPEARANCES: (As heretofore noted.)

I N D E X

WITNESSES

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

NAME:	PAGE NO.
JEFFREY LOITER	
Errata Sheet Inserted	1029
Prefiled Direct Testimony Inserted	1030
PHILIP MOSENTHAL	
Errata Sheet Inserted	1052
Prefiled Direct Testimony Inserted	1054
STEVE W. CHRISS	
Prefiled Direct Testimony Inserted	1087
RHONDA L. HICKS	
Prefiled Direct Testimony Inserted	1104
DONNA D. BROWN	
Prefiled Direct Testimony Inserted	1108
JUDY G. HARLOW	
Prefiled Direct Testimony Inserted	1113
JEFFREY A. BURLESON	
Prefiled Rebuttal Testimony Inserted	1131
J. TERRY DEASON	
Prefiled Rebuttal Testimony Inserted	1154
XIA LIU	
Prefiled Rebuttal Testimony Inserted	1190
S. W. CONNALLY, JR.	
Prefiled Rebuttal Testimony Inserted	1207
DANE A. WATSON	
Prefiled Rebuttal Testimony Inserted	1212
STEVEN P. HARRIS	
Prefiled Rebuttal Testimony Inserted	1267

EXHIBITS

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

NUMBER :

ID.

ADMTD.

No exhibits in this volume

ERRATA SHEET**Witness: Jeffrey Loiter – Direct**

Page	Line	Change to be made
14	3	Replace “17.5%” with “15%”
14	7	Replace “17.5%” with “15%”
14	7	Replace “1.7%” with “1.5%”

1 **I. IDENTIFICATION AND QUALIFICATIONS**

2 **Q. Please state your name and address.**

3 **A.**Jeffrey M. Loiter, Optimal Energy, Inc., 10600 Route 116, Hinesburg, VT 05461.

4 **Q. On whose behalf are you testifying?**

5 **A.**I am testifying on behalf of the Sierra Club.

6 **Q. By whom are you employed and in what capacity?**

7 **A.**I am a Partner in Optimal Energy, Inc., a consultancy specializing in energy
8 efficiency and utility planning. In this capacity, I direct and perform analyses, author
9 reports and presentations, manage staff, and interact with clients to serve their
10 consulting needs.

11 **Q. Have you testified before the Florida Public Service Commission?**

12 **A.**No.

13 **Q. Please provide a summary of your qualifications and experience.**

14 **A.**I have 20 years of consulting experience in environmental policy, energy, and natural
15 resource issues. For the past 10 years, I have been engaged in a variety of work at
16 Optimal Energy related to energy efficiency, electric utility policy, integrated
17 resource planning, and related topics. For example, I advise clients on energy
18 efficiency program design and implementation. I have assisted with the design and
19 development of statewide and utility-specific efficiency programs in Maine,

1 Maryland, New York, Massachusetts, and Tennessee. I currently support program
2 implementation and on-going efficiency program design and development for Orange
3 and Rockland Utilities in New York and the Connecticut Municipal Electric Energy
4 Cooperative. In addition, I provide planning and analysis services in support of three
5 bodies that have the responsibility of overseeing energy efficiency planning, design,
6 implementation, and evaluation in their respective states: the Massachusetts Energy
7 Efficiency Advisory Council, the Rhode Island Energy Efficiency Resource
8 Management Council, and the Delaware Energy Efficiency Advisory Council. I have
9 submitted written testimony to or testified before public utility commissions in
10 Arkansas, Kansas, Kentucky, Maryland, Ohio, Virginia, and West Virginia on topics
11 such as demand-side management, integrated resource planning, and efficiency as a
12 resource in state energy plans.

13 Prior to joining Optimal Energy in 2006, I was a Senior Associate at Industrial
14 Economics, Inc. in Cambridge, Massachusetts, where I supported state, federal, and
15 international governmental clients with analysis on topics of environmental policy
16 and natural resources damages. I have a B.S. with distinction in Civil and
17 Environmental Engineering from Cornell University and an M.S. in Technology and
18 Policy from the Massachusetts Institute of Technology. My resume is attached as
19 Exhibit JML-1.

20

21

1 **II. INTRODUCTION AND SUMMARY OF TESTIMONY**

2 **Q. What is the purpose of your testimony in this proceeding?**

3 **A.** My testimony addresses Gulf Power Company’s (“Gulf” or the “Company”) Petition
4 for approval of 2016 depreciation and dismantlement studies, approval of proposed
5 depreciation rates and annual dismantlement accruals, and Plant Smith Units 1 and 2
6 regulatory asset amortization. Specifically, I address Gulf’s proposal to increase its
7 residential fixed charges.

8 **Q. What are your overall conclusions?**

9 **A.** My analysis shows that Gulf’s proposed rate restructure is unfair, unjust, and
10 unreasonable. Contrary to the Company’s assertion, the proposed residential rates do
11 not recover demand-related costs more appropriately than do current rates. In fact, the
12 proposed rates will harm low-usage, low-income, and fixed-income customers, and
13 deprive all residential customers of control over their monthly bill.

14 **Q. What sources have you relied on in your assessment of Gulf’s proposal to**
15 **increase residential fixed charges?**

16 **A.** I have focused on Gulf’s filings related to changes in residential rates and in
17 particular the proposal to increase fixed charges, including its petition, direct
18 testimony and exhibits. I have also drawn on several recent publications, government
19 publications, and state electric utility regulatory proceedings pertaining to residential
20 rates and related topics. I have referenced the sources relied upon in my testimony
21 and/or attached these sources as exhibits.

1 **III. FINDINGS AND RECOMMENDATIONS**

2 **Q. Please summarize your findings in this case.**

3 A. My findings are as follows:

- 4 1. A residential customer’s individual maximum demand is not an appropriate
- 5 measure of the costs they cause to the Company.
- 6 2. Demand charges for residential customers are accompanied by several
- 7 drawbacks, including a lack of understanding, information, and control on the
- 8 part of the customer.
- 9 3. Increased fixed charges for residential customers are also accompanied by
- 10 significant drawbacks, including encouraging greater energy consumption,
- 11 discouraging energy efficiency, and penalizing previous investments in
- 12 efficiency.
- 13 4. Increased fixed charges for residential customers reduce customer control
- 14 over their energy costs.
- 15 5. Increased fixed charges for residential customers disproportionately harm
- 16 low-usage customers, who are more likely to be low-income and fixed-income
- 17 consumers.
- 18 6. The Company’s proposed program to assist low-income customers is unlikely
- 19 to adequately reach customers who will be harmed by increased fixed charges.
- 20 7. The Company’s methodology for determining the proposed fixed charge is
- 21 untested, has never been applied in any previous rate-making proceeding, and
- 22 begins with an incorrect assumption regarding the alignment of rates and

1 costs, namely, that a customer's individual maximum demand is a reasonable
2 representation of their cost causation.

3 **Q. What are your recommendations to this Commission?**

4 A. Based on my findings, I recommend that the Commission reject the Company's
5 proposed changes to its residential rates.

6 **IV. GULF'S CURRENT RESIDENTIAL RATE STRUCTURE**

7 **Q: Before we discuss Gulf's proposed changes, please describe the Company's**
8 **current rate structure.**

9 A: Gulf currently offers its non-lighting residential customers four rate options. The
10 Company's standard default rate, the Residential Service ("RS") rate, is a two-part
11 fixed-variable rate made up of a fixed base charge (assessed on a per day basis) to
12 cover fixed costs associated with serving each customer and a variable energy charge
13 assessed on each unit of energy (kWh) consumed. Ninety-two percent of Gulf's non-
14 lighting residential customers are on this rate. Gulf also offers two optional time-of-
15 use rates with variable energy charges based on the time of day. Gulf's Residential
16 Service Variable Pricing ("RSVP") rate, which about 4% of its residential customers
17 have opted into, divides the energy charge into low, medium, high, and critical tiers.
18 Gulf's Residential Service Time-of-Use ("RSTOU") rate divides the energy charge
19 into on- and off-peak tiers with a critical peak credit. However the RSTOU rate is part
20 of a pilot program, which is limited to about 400 customers and is currently full.
21 Finally, Gulf customers can also opt into the Company's FlatBill program whereby

1 Gulf and the customer negotiate an annual contract that is then divided into twelve
2 equal monthly payments. McGee (Pages 3-4).

3 **V. OVERVIEW OF GULF'S PROPOSAL TO INCREASE FIXED CHARGES**

4 **Q: What changes does the Company propose to current residential rates?**

5 **A:** With the exception of Flatbill, Gulf is proposing a large increase to the fixed base
6 charge in the company's current residential rates (that is, the RS, RSPV, and RSTOU
7 rates) of nearly 150%, from \$0.62 per day to \$1.58 per day. At the same time, the rate
8 for the variable portion of the customer's bill would be decreased from roughly 4.6
9 cents/kWh to 3.3 cents/kWh.

10 **Q: What reasoning does the Company give for making this rate change?**

11 **A:** The Company claims this improves both equity and customers' experience with
12 Gulf's product by recovering demand-related costs more appropriately than current
13 rates. The Company generally categorizes its costs as one of three types: customer-
14 related, demand-related, and energy-related. Company Witness O'Sheasy defines
15 these costs as follows: "(1) customer-related, which are costs that vary with the
16 number of customers or the fact that customers must be able to receive service; (2)
17 energy-related, which pertain to costs that vary with energy consumption (kWh); and
18 (3) demand-related, which are costs that are incurred to serve peak needs for
19 electricity (kW)." O'Sheasy (Page 8, lines 19-23).

20
21 The current rate structure collects all residential demand-related costs through the
22 energy charge. Therefore, the proposed change does not mean that the Company's

1 fixed costs of serving each customer have increased nearly three-fold, but that the
2 Company is shifting recovery of demand-related charges into fixed charges. The
3 Company asserts that it is better to collect a larger portion of demand-related costs
4 from something other than the energy charge and has proposed to do so largely
5 through the fixed charge.

6 **Q: How did the Company develop these rates/convert demand-related costs to a**
7 **fixed charge, which is not dependent on a customer's demand?**

8 **A:** The Company uses a methodology develop by Drs. Larry Blank and Doug Gegax
9 (“Blank & Gegax,” or “B&G”) of the Center for Public Utilities, a branch of the
10 College of Business at New Mexico State University that is sponsored by over a
11 dozen utility companies and industry groups, including Southern Company.¹ Briefly,
12 this method seeks to emulate a rate consisting of all three cost components using only
13 the fixed charge and the energy charge. It does so by developing a linear regression
14 from a set of customer bills under a hypothetical three-part rate as a function of
15 energy consumption. This function will indicate a non-zero bill for zero energy
16 consumption, which is taken to be the appropriate fixed charge to serve as a proxy for
17 the average customer demand charge. Because the result of the analysis is based on a
18 linear regression, it is most accurate for customers whose demand relative to
19 consumption is near the average. For those with relatively greater or lesser demand
20 for a given level of consumption, it will over or under-estimate their costs as assessed
21 under a three-part rate.

¹ *CPU Sponsors*, New Mexico State University, goo.gl/4GcVvw (last visited Jan.12, 2017). Exhibit JML-2.

1 **Q: Is the Company proposing any new residential rates that recover demand-**
2 **related costs based on a customer's actual demand?**

3 **A:** Yes, the Company is proposing two new optional three-part residential rates. The
4 Demand ("RSD") rate would include a fixed base charge, a variable energy charge,
5 and a variable demand charge based the customer's maximum demand (measured in
6 kW) during the month. The Demand Time of-Use Conservation ("RSDT") rate
7 divides the demand portion of the bill into two parts, one for the customer's
8 maximum demand during the month and one for their maximum demand during
9 defined on-peak hours. These new rates will have lower fixed base charges than the
10 other residential rates. McGee (Pages 10-11).

11 **Q: Is the Company proposing any other changes to residential rates?**

12 **A:** Yes, the Company is also proposing a new rate rider for low-income customers called
13 the Customer Assistance Program (CAP). Qualifying customers will receive a bill
14 credit of \$0.69 per day. Company Witness McGee presents information that asserts
15 that this will offset all of the increase these customers would have otherwise incurred
16 under the new rate structure, even for very-low use customers. McGee (Schedule 7).
17 However, even if the customer's bill would be equal with the rider, the fixed portion
18 of the bill would still increase by \$6.60. Furthermore, as I explain below this rider
19 does not go far enough to protect vulnerable ratepayers.

20 **Q: Do you agree with the Company's reasoning behind the proposed rate structure**
21 **changes?**

22 **A:** No. Gulf's proposal is a premature and unsubstantiated rate design change.

1 The Company's proposal is predicated on two assertions. First, that a customer's
2 individual demand is a reasonable measure of the demand-related costs they cause to
3 the Company, and second, that demand-related costs can be appropriately and
4 accurately recovered through the fixed charge. Neither of these assertions are
5 supported by the evidence. Furthermore, the Company has not adequately recognized
6 the potential disadvantages and negative outcomes for customers of either true
7 demand rates or increased fixed charges.

8 **VI. RESIDENTIAL DEMAND CHARGES HAVE MANY DISADVANTAGES AND MAY**
9 **NOT REFLECT COST-CAUSATION**

10 **Q: Is the Company's proposed rate structure based on the assumption that a three-**
11 **part rate that includes a demand charge is a more accurate reflection of cost**
12 **causation and therefore a more equitable rate for its customers?**

13 **A:** Yes. Witness McGee states that a three-part demand rate "best aligns with costs."
14 McGee (Page 9, lines 6-9).

15 **Q: But the Company is not proposing a three-part rate for its residential customers,**
16 **except as an optional rate that customers can choose on their own. Do they give**
17 **any reasons for this?**

18 **A:** Yes. The primary reason they cite is that mandatory three-part rates are met with
19 "limited customer acceptance." McGee (Page 9, lines 15-16). According to Witness
20 McGee "Demand rates...introduce a new concept called demand...,another

1 measurement..., another rate component..., and another line item on the customer's
2 bill." McGee (Page 10, lines 6-9).

3 **Q: Do you agree these rates will likely be met with limited customer acceptance?**

4 **A:** Yes, and given the steep learning curve and several other important problems with
5 demand rates for residential customers, I would say that limited customer acceptance
6 is an understatement. Even if they were implemented in a way that accurately reflects
7 customers' cost causation (which is far from a given, as I will explain later), a
8 reasonable and successful demand charge also requires that customers must be able to
9 know their total demand at all times, know what equipment and behavior contributes
10 to that demand, and have the ability to modify behavior and equipment to control
11 their demand. Currently, the vast majority of residential customers are incapable of
12 any of these.

13 **Q: Do residential customers typically know what their total or maximum demand**
14 **is?**

15 **A:** No, and Gulf has not indicated that residential customers have *any* information on
16 their maximum demand, let alone access to the real-time demand information
17 necessary to allow them to respond to demand charges.

18 **Q: Has the company indicated how they will measure maximum demand for their**
19 **optional demand rates?**

20 **A:** Yes. Maximum demand will be measured on an hourly basis (i.e. the customer's
21 demand charge will be based on her highest average hour of demand, as well as her

1 highest average hour of demand during peak hours under the RSDT rate). Evans
2 (Page 8, lines 2-15).

3 **Q: Assuming customers have a means of knowing their maximum demand and how**
4 **it is measured and determined, how can they understand what contributes to**
5 **their demand?**

6 **A:** Because a customer's demand is composed of the individual demand of dozens or
7 even hundreds of individual pieces of equipment and plug loads, understanding one's
8 demand potentially means understanding the demand for every one of these items.
9 Realistically, maximum demand is driven by a handful of relatively obvious
10 appliances (e.g., electric hot water heaters, electric ranges, heat pumps and air
11 conditioners, etc.) and some that may not be so obvious to the consumer (e.g., hair
12 dryer, coffee pot, refrigerator). Understanding these sources and how they interact
13 requires the customer to know both the potential maximum demand of each item and
14 the likely timing of that demand. While there are some sophisticated home energy
15 management systems available, they are expensive and installed in a de minimis
16 number of homes. Practically, residential consumers have no way of gathering this
17 information at this time.

18 **Q: If customers could develop an understanding of what contributes to their**
19 **maximum demand, what options are available for them to control this demand**
20 **and therefore control demand charges?**

21 **A:** As I just noted, home energy management systems are rare. Therefore, monitoring
22 and controlling demand by controlling equipment operation cycles is difficult at best.

1 Customers could put high-use equipment on a timer, but that is only useful in the case
2 of pre-determined peak hours, which is not the case with the proposed RSD rate or
3 the maximum demand portion of the proposed RSDT rate. Even customers who wish
4 to control their bills by controlling demand would have a very difficult time doing so.
5 More importantly, assessing demand charges based on a customer's own individual
6 maximum demand does not accurately reflect their cost-causation.

7 **Q: Can you please expand on that?**

8 A: Absolutely. Investments in demand-related infrastructure are based on the largest
9 aggregate demand served by that equipment, that is, the peak load on the system or
10 that portion of the system. But residential consumers have much more diversity in
11 their usage, with individual customer maximum demands seldom coinciding with the
12 system peak.² Because a customer's maximum demand is typically triggered by a
13 short period of time in which that customer is using numerous household appliances,
14 it is unlikely that this specific time period coincides exactly with when other
15 customers sharing the same infrastructure are experiencing their maximum demands.³
16 As a result, demand charges are unable to account for the diverse usage patterns of
17 residential and small commercial customers, often do not coincide with peak system
18 demand, and can result in significant and inequitable cost-shifting.⁴

² See Lazar, J., *Use Great Caution in Design of Residential Demand Charges*, *Natural Gas & Electricity*, Vol. 32, Issue 7, p. 13-19 (Feb. 2016), Exhibit JML-3.

³ See Whited, M. et al, *Caught in a Fix: The Problem with Fixed Charges for Electricity*, Prepared for Consumers Union by Synapse Energy Economics, p. 39 (February 9, 2016), Exhibit JML-4.

⁴ Southern Environmental Law Center, *A Troubling Trend in Rate Design: Proposed Rate Design Alternatives to Harmful Fixed Charges* (Dec. 2015), Exhibit JML-5.

1 **VII. INCREASED FIXED CHARGES ARE ALSO PROBLEMATIC AND ARE NOT A**
2 **REASONABLE MEANS OF RECOVERING DEMAND-RELATED COSTS**

3 **Q: What are the potential disadvantages associated with increasing the fixed charge**
4 **of the bill?**

5 **A:** There are several. Increased fixed charges encourage greater energy consumption as a
6 result of decreased marginal cost of energy; discourage energy efficiency and
7 penalize previous investments in efficiency; reduce customer control over their
8 energy costs; and disproportionately harm low-usage, low-income, and fixed-income
9 customers.

10 **Q: Please explain how increased fixed charges encourage greater energy**
11 **consumption.**

12 **A:** As the Company has explained, the increase in the fixed charge is offset by a decrease
13 in the variable energy charge. Basic economics tells us that as the price of a good or
14 service decreases, the demand for that good or service increases. The extent to which
15 this occurs for any item is called price elasticity, the change in consumption of a good
16 or service resulting from a change in pricing. As with most goods, the elasticity of
17 consumption for electricity is negative, meaning that as prices increase, consumption
18 decreases, and vice versa. Therefore, the lower unit cost of energy proposed by the
19 Company will result in an increase in consumption.

20

21 **Q: How large might this effect be for the Company's residential customers?**

1 **A:** I cannot say with any certainty, but I can provide some information that will indicate
2 the potential range of effect. First, I calculate that the variable portion of the basic
3 residential rate decreases by 17.5%, according to the data presented in McGee
4 Schedule 1. Next, we need an estimate for the price elasticity of electricity
5 consumption, which is relatively inelastic, meaning that for a 1% decrease in price,
6 we would expect a lower than 1% increase in consumption. Using a conservative
7 estimate of -0.1,⁵ a 17.5% decrease in price would be expected to result in a 1.7%
8 increase in consumption. This is a significant increase, equal to about one and a half
9 years of the Company's projected load growth.

10 **Q: You also mentioned that increased fixed charges would discourage energy**
11 **efficiency. Can you please explain the reasoning behind that statement?**

12 **A:** Increased fixed charges provide a disincentive for customers to invest in energy
13 efficiency measures or on-site generation such as solar PV systems. Because less of
14 their bill is tied to their usage, the connection between reducing consumption and
15 reducing bills is weakened. This lower return on investment would surely reduce the
16 number of customers investing in efficiency and renewables and the size of those
17 investments. Increased fixed charges particularly hurt those who have already
18 invested in these resources, as the return on their investment comes from the
19 reduction in their energy costs each year. Shifting costs away from the variable
20 charge and into the fixed charge will reduce this stream of benefits. For example, for

⁵ See Ros, A. J., *An Econometric Assessment of Electricity Demand in the United States using Panel Data and the Impact of Retail Competition on Prices*, NERA Economic Consulting (June 9, 2015), available at goo.gl/xPRcyl, Exhibit JML-6; Paul, A. et al, *A Partial Adjustment Model of U.S. Electricity Demand by Region, Season, and Sector, Resources for the Future Discussion Paper*, RFF DP 08-50 (April 2009), available at goo.gl/uYwEH9, Exhibit JML-7.

1 an efficiency investment with a simple payback of 10 years, the proposed reduction in
2 the variable energy charge will extend this to 12 years. Gulf's customers will have no
3 recourse for this change. Given that the Company invested over \$6 million in
4 residential DSM programs between 2010 and 2015, there are likely to be millions of
5 dollars of existing efficiency investments made by Gulf's residential customers,
6 which would become a greater financial burden.⁶

7 **Q: Have other commissions addressed the problem of increased fixed charges**
8 **discouraging energy efficiency?**

9 **A:** Absolutely. The Washington Utilities and Transportation Commission cited this
10 concern when it denied a 2015 request to increase fixed charges, stating, "Including
11 distribution costs in the basic charge and increasing it 81%, as the Company proposes
12 in this case, does not promote, and may be antithetical to, the realization of
13 conservation goals."⁷

14 **Q: You also stated that increased fixed charges reduce customer control. How so?**

15 **A:** Although technology increasingly empowers customers to understand and manage
16 their energy use, customers must pay fixed charges regardless of usage. Increased
17 fixed charges leave a smaller portion of the bill that customers can control by
18 reducing their energy use. This problem was cited by the Missouri Public Service
19 Commission to reject Ameren's request to increase its residential customer charge.

⁶ Data for residential DSM program spending sourced from McGee, R., *Gulf Power Company's 2015 Annual FEECA Program Progress Report* (March 1, 2016), Exhibit JML-8.

⁷ Washington Utilities and Transportation Commission, *Order 08 Final Order Rejecting Tariff Sheets, Resolving Contested Issues, Authorizing And Requiring Compliance Filings*, issued March 25, 2015 in Dockets UE-140762, UE-140617, UE-131384 and UE-140094, p. 91, Exhibit JML-9.

1 The Commission stated, “There are strong public policy considerations in favor of not
2 increasing the [fixed] customer charges. Residential customers should have as much
3 control over the amount of their bills as possible so that they can reduce their monthly
4 expenses by using less power, either for economic reasons or because of a general
5 desire to conserve energy. Leaving the monthly charge where it is gives the customer
6 more control.”⁸

7 **Q: Does the Company offer any solution to this?**

8 **A:** Not to my satisfaction, no. With respect to providing customers with more control
9 over their bill, Gulf states that customers can do so by opting-in to the proposed three-
10 part rates with demand charges. This is inappropriate; customers should have control
11 of their bills by default, not solely because they choose to participate in an optional
12 rate. Few customers are likely to do so, for several reasons. First, only 4% of Gulf’s
13 residential customers take service under the RSVP time-of-use rate with critical peak
14 pricing. Presumably, more than 4% of their customers are interested in controlling
15 their electric bill, yet do not select a more complicated rate as a means of doing so.
16 Second, as I explain above, demand charges represent an entirely new concept for
17 nearly every residential customer that will require great additional effort to
18 understand. I would expect even fewer customers to select an optional demand rate
19 than have selected the existing time-of-use rate. Finally, as previously discussed, even
20 assuming customers choose Gulf’s proposed optional demand rates and understand
21 them perfectly, because those customers have no way of accessing critical demand

⁸ Missouri Public Service Commission, *Report and Order*, issued April 29, 2015 in Case No. ER-2014-0258, In the Matter of Union Electric Company, d/b/a Ameren Missouri’s Tariff to Increase Revenues for Electric Service, p. 76-77, Exhibit JML-10.

1 data, they have very little ability to actually respond to any sort of demand price
2 signal. In short, despite Gulf's claim that it is providing customers with more options
3 to control their bill, the rate restructure proposal set forth here only serves to
4 undermine customer control.

5 **Q: How are low-income and low-usage customers affected by higher fixed charges?**

6 **A.** Low-usage customers will be the most negatively affected by higher fixed charges.
7 Their increased bills will compensate for the reduced bills of high usage customers.
8 Gulf asserts that income and energy usage (kWh) are not necessarily correlated
9 (McGee, p. 18) but presents no data or information to support that contention.
10 Instead, it offers unsupported anecdotal examples intended to demonstrate that they
11 may be INVERSELY correlated, noting that high energy users are those with "older
12 inefficient manufactured homes and poorly-insulated homes" (implying that these
13 customers would typically be low income) while low energy users are "condo owners,
14 vacation home owners, and boat dock owners," (implying that these customers would
15 typically be higher income). This type of anecdotal information fails to accurately
16 reflect the typical situation for most customers. In fact, low usage customers are
17 likely to be customers with lower incomes who can least afford to see increases on
18 their electric bills.

19

20 Research by the National Consumer Law Center found this to be true throughout the
21 U.S. generally, with Florida no exception. They found that households with annual
22 income less than \$25,000 use 13% less electricity on average than those with annual
23 incomes between \$25,000 and \$50,000, nearly 30% less than households earning

1 between \$50,000 and \$75,000 per year, 35% less than households earning between
2 \$75,000 and \$100,000, and 44% less – barely more than half – than households
3 earning over \$100,000. Older consumers, who are more likely to be on a fixed
4 income, are also typically lower users, with consumers over 65 using 24% less
5 electricity on average than those under 65.⁹ Lower-income and elder-headed
6 households clearly use less electricity than their counterparts, and as a result, utility
7 proposals to increase fixed charges while lowering the variable energy charge
8 penalize low-volume consumers and disproportionately harm these groups of
9 ratepayers.

10

11 The Minnesota Public Utilities recognized these problems in their recent ruling
12 against Xcel’s proposal to increase the fixed charge for residential customers by 15%
13 (as compared to nearly 150%, as proposed by Gulf). In its reasoning, the Commission
14 indicated that “this circumstance highlights the need for caution in making any
15 decision that would further burden low-income, low- usage customers, who are
16 unable to absorb or avoid the increased cost.”¹⁰

17 **Q: But doesn’t the Company also propose a program by which low-income**
18 **customers can receive a lower rate and therefore a lower total energy bill?**

⁹ National Consumer Law Center, *Utility Rate Design: How Mandatory Monthly Customer Fees Cause Disproportionate Harm* (2015) (prepared using data sourced from the U.S. Energy Information Administration’s Residential Energy Consumption Survey, 2009), Exhibit JML-11.

¹⁰ Minnesota Public Utilities Commission, *Findings of Fact, Conclusions, and Order*, issued May 8, 2015, in Docket No. E-002/GR 13-868, In re: Application of Northern States Power Company for Authority to Increase Rates for Electric Service in the State of Minnesota, p. 88, Exhibit JML-12.

1 A: Yes, but the proposed criterion for participating will not necessarily protect all low-
2 income or otherwise vulnerable customers for whom an increased electric bill would
3 be a burden. The proposed rider is only available to customers of record who are
4 participants in the Supplemental Nutrition Assistance Program (“SNAP”), excluding
5 many customers who are likely to be harmed by these rate changes. McGee (Page 17,
6 lines 2-5). Elderly customers, for instance, who often live on fixed incomes tend to
7 live in smaller households¹¹ and therefore are only eligible for SNAP at lower income
8 levels.¹² While they may not qualify for SNAP, these customers have little discretion
9 or ability to absorb a higher fixed energy cost burden that is beyond their control. The
10 company estimates that roughly 10% of its customers will be eligible for the low-
11 income credit, but the very nature of the proposed rate change suggests that roughly
12 half of customers will get a bill increase and half will get a bill decrease. There will
13 clearly be customers who will not be eligible for low-income assistance but for whom
14 the unavoidable bill increase will represent a hardship.

15 **Q: How does Gulf’s proposed fixed charge compare to those of other electric**
16 **utilities?**

17 **A.** The fixed charge proposed by Gulf is astronomical compared to the fixed charges of
18 most other utilities. Gulf proposes to nearly triple its fixed charges, resulting in a
19 fixed charge increase from about \$18.60 per month to about \$47.50 per month. A
20 recent report surveying similar requests for increases in fixed charges demonstrates

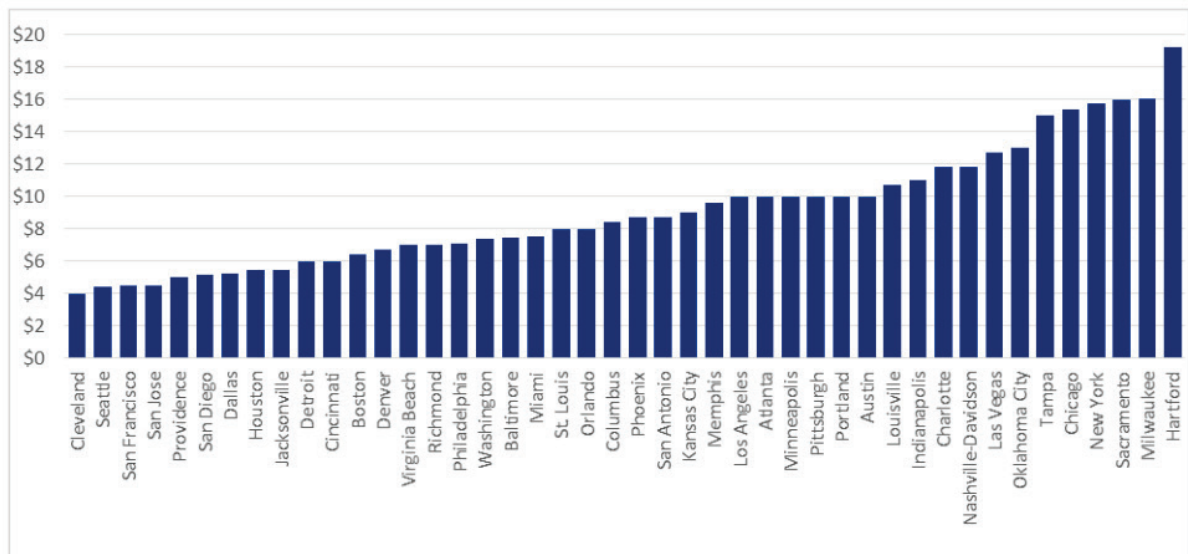
¹¹ United States Department of Agriculture, *Characteristics of Supplemental Nutrition Assistance Program Households: Fiscal Year 2014*, Report No. SNAP-15-CHAR (Dec. 2015), Exhibit JML-13.

¹² United States Department of Agriculture, *Supplemental Nutrition Assistance Program FY 2016 Income Eligibility Standards* (Updated Sept 24, 2015), Exhibit JML-14.

1 just how exceptional such a large increase is. If approved, this fixed charge would be
 2 among the highest in the country and far higher than those paid by the vast majority
 3 of electric consumers in the United States. The figure below, taken from the
 4 Consumers Union report, shows that the proposed fixed charge would be more than
 5 double the highest such charge in most major cities.¹³ Furthermore, at the existing
 6 fixed charge of \$18.60 per month, Gulf Power already charges residential customers a
 7 higher fixed charge than any other investor-owned electric utility in Florida.¹⁴

8

9 **FIGURE 1: MONTHLY FIXED CHARGES IN MAJOR CITIES**



10 *Source: Utility tariff sheets for residential service as of August 19, 2015.*

11 Not only is Gulf's proposed fixed charge out of scale with existing fixed charges at
 12 other utilities, the Consumers Union report shows that the requested increase is also
 13 greater than any similar proposals pending at the time of the report.¹⁵

¹³ Whited, *supra* note 3, at Figure 2.

¹⁴ Florida Public Service Commission, *2016 Facts & Figures of the Florida Utility Industry*, p. 5, Exhibit JML-15.

¹⁵ Whited, *supra* note 3, at Figure 4.

1 **Q: You have provided a lot of information on both demand charges and increased**
2 **fixed charges for residential ratepayers. Can you please summarize your**
3 **position on these topics as it related to Gulf’s proposal?**

4 **A.** Certainly. First, the Company asserts that demand charges for residential customers
5 more accurately and fairly recover demand-related costs, but fails to recognize that a
6 simple measurement of maximum individual demand does not in fact accurately
7 reflect demand-related costs and that demand charges present several disadvantages
8 for customers. Second, the Company asserts that using greater fixed charges is a
9 reasonable substitute for demand charges, but fails to recognize the disadvantages of
10 this strategy.

11 **VIII. THE COMPANY’S METHODOLOGY FOR DEVELOPING THE FIXED CHARGE IS**
12 **UNTESTED**

13 **Q: Leaving your objections aside for the moment, we have not discussed the**
14 **Company’s methodology for converting demand charges into a proxy fixed**
15 **charge. Do you have any comment on their approach?**

16 **A:** Yes, I do. The proposed Blank and Gegax methodology is a new concept that has
17 only recently been published.¹⁶ To my knowledge, it has never been applied in any
18 rate-making proceeding, nor have the Company’s witness provided any evidence that
19 it has been supported, critiqued, or otherwise commented on by any regulatory body
20 or peer-reviewed publication. Furthermore, it begins with the assumption that a three-
21 part rate that includes a demand charge is “best” because it appropriately aligns rates

¹⁶ Blank, L, and D. Gegax, *An enhanced two-part tariff methodology when demand charges are not used*, *Electricity Journal*. Vol. 29, Issue 3, p. 42-47 (April 2016).

1 with costs. McGee (Page 9, lines 6-9). Yet this suffers from the problems I have
2 already noted, primarily that to the extent the methodology uses data on customers'
3 individual maximum demand rather than their contribution to peak demand (and
4 therefore, demand-related costs), it is already an inaccurate representation of a cost-
5 based rate structure.

6 **Q: Does this conclude your testimony?**

7 **A:** Yes.

ERRATA SHEET

Witness: Philip Mosenthal – Direct

Section of Testimony	Change to be made
Table of Contents	Add new lines at the end reading: “IV. Hedging and Diversification.....13 V. Alternatives.....21”
Table of Figures	Replace: “Figure 6. Solar Purchase Prices..... 25” with: “Figure 6. Solar Purchase Prices.....24”
Table of Figures	Replace: “Figure 8. Wind Purchase Prices..... 27” with: “Figure 8. Wind Purchase Prices.....26”
Page 2, Line 2	Replace: “and the U.S. Nuclear Regulatory Commission.” with: “and before the U.S. Nuclear Regulatory Commission.”
Page 6, Line 18	Replace: “Pages 3-4” with: “Pages 3-4, 9-14”
Footnote 8	Replace: “Exhibit PHM-4” with: “Exhibit PHM-3”
Page 17, Line 10	Replace: “compared to Gulf.” with: “compared to Gulf.” Replace: “higher than any of state,” with: “higher than any other state,”
Page 19, Line 13	Remove: the extra period at the end of paragraph.
Page 22, Line 7	Replace: “least costs resource” with: “least cost resource”
Footnote 27	Replace: “Exhibit PHM-5” with: “Exhibit PHM-4”
Page 27, Line 7	Replace: “It also” with: “The Company also”

Footnote 34	Replace: " <i>Ibid.</i> " with: "Dockets 160186-EI and 160170-EI, Direct Testimony of Jeffrey Burleson, at 16."
Page 29, Line 14	Replace: "It also" with: "The Stipulation also"
Page 31, Lines 17-18	Replace: "customers. In neither case was there a customer need for the added capacity. Customers despite them not needing it." with: "customers, despite them not needing the added capacity."

1 **I. INTRODUCTION AND PURPOSE OF TESTIMONY**

2 **Q. Please state your name and business address.**

3 **A.** Philip H. Mosenthal, Optimal Energy, Inc., 10600 Route 116, Hinesburg, VT
4 05461.

5 **Q. On whose behalf are you testifying?**

6 **A.** I am testifying on behalf of the Sierra Club.

7 **Q. By whom are you employed and in what capacity?**

8 **A.** I am the founding partner in Optimal Energy, Inc., a consultancy specializing in
9 utility planning and energy efficiency. Optimal Energy advises numerous parties
10 including utilities, non-utility program administrators, governments, and
11 consumer and environmental groups.

12 **Q. Have you previously testified before the Florida Public Service
13 Commission?**

14 **A.** Yes. I testified in Commission proceedings to review numeric conservation goals,
15 Docket Nos. 080407–080413.

16 **Q. Have you testified elsewhere on long-term resource planning issues?**

17 **A.** Yes. I have testified before numerous states. This includes testimony related to
18 integrated resource planning and the prudence of building or procuring new

1 electric resources in Illinois, Indiana, Missouri, Vermont, and Virginia, the Texas
2 legislature, and the U.S. Nuclear Regulatory Commission.

3 **Q. Please describe your educational background and professional experience.**

4 **A.** I have 30 years of experience in utility resource planning, during which I have
5 focused on the costs and benefits of various resources and the opportunities for
6 demand-side resources to be considered on an equal footing with supply-side
7 resources. This has included leading or participating in numerous studies to assess
8 the quantity and economic value of efficiency and renewable resources as
9 potential alternatives to conventional supply-side options for short and long range
10 utility integrated resource planning. I have been involved in studies in numerous
11 jurisdictions throughout the U.S. and Canada, as well as work in Europe and Asia.

12 Additionally, I have addressed issues of utility cost recovery, lost revenue,
13 decoupling, and the creation of shareholder financial incentives to ensure that
14 utilities have appropriate incentives to consider all potential energy resources on
15 an equal footing and to pursue the prudent, least-cost solutions for customers. I
16 have also developed numerous utility efficiency plans, and designed and evaluated
17 utility and non-utility programs.

18 I have a *B.A.* in Architecture and an *M.S.* in Energy Management and Policy, both
19 from the University of Pennsylvania. My resume is attached as Exhibit PHM-1.

1 **Q. What is the purpose of your testimony in this proceeding?**

2 **A.** I address the proposal by Gulf Power Company (Gulf or the Company) to shift
3 its 25% ownership interest in Plant Scherer Unit 3 (Scherer 3) into rate base. The
4 proposal includes shifting the costs associated with Scherer 3 onto Gulf's native
5 load retail customers (customers), as well as allocating Scherer 3 capacity to
6 customers. My testimony assesses the prudence of that proposal and whether it
7 meets the Commission's least cost planning criteria.

8 **Q. What are your overall conclusions?**

9 **A.** Gulf's proposal is not prudent because it would impose a significant financial
10 burden on retail customers in exchange for speculative benefits. Evidently, other
11 market participants have rejected Scherer 3 in favor of other options. My analysis
12 confirms that there are abundant, low-cost, and low-risk options in the market
13 available to Gulf. Yet the Company presented no quantitative analysis of its
14 proposal relative to these alternatives; instead, Gulf asks the Commission to rely
15 on the Company's beliefs about alternatives that it acknowledges it never
16 evaluated with any quantitative rigor.

17 **Q. What sources have you relied on in your assessment of Scherer 3?**

18 **A.** I have focused on Gulf's filings related to Scherer 3 in this proceeding, including
19 its petition, direct testimony and exhibits, and discovery responses. I also
20 reviewed Gulf's recent ten-year site plan filings as well as Commission Order No.
21 PSC-16-0535-FOF-EI, which deferred environmental compliance cost recovery

1 related to Scherer pending the resolution of this proceeding. Finally, I have drawn
2 on several recent market studies and state electric utility regulatory proceedings
3 pertaining to resource planning and procurement. When relying on various
4 sources, I have referenced such sources in my testimony and/or attached these
5 sources as exhibits.

6 **II. FINDINGS AND RECOMMENDATIONS**

7 **Q. Please summarize your findings regarding Scherer 3 in this case.**

8 **A.** Including the costs associated with Scherer 3 in rate base, and allocating its
9 capacity to Gulf's retail customers is neither prudent nor consistent with least cost
10 planning, for the following reasons:

- 11 1. Gulf itself projects that there is no need for Scherer 3 capacity until 2023,
12 and even then the projected capacity need is not reliable.
- 13 2. Assuming a capacity need beginning in 2023, it is premature to burden
14 customers with the costs and risks of an aging coal plant now, when they
15 will see no concrete benefits from Scherer 3 for seven years or more, and
16 there is a significant risk that the costs will outweigh any long-term
17 benefits.
- 18 3. Approval of Gulf's proposal would result in an undiversified resource
19 portfolio that is dangerously dependent on coal, exposing customers to

1 unnecessary risk, and missing opportunities that would improve diversity
2 and offer a better hedge value.

3 4. Gulf has not evaluated alternative options to meet its projected 2023
4 reliability need, nor shown that Scherer 3 is a least cost option, and there is
5 ample evidence that lower-cost and lower-risk options are available in
6 today's market and more than likely in the 2023 market as well.

7 **Q. What are your recommendations to this Commission?**

8 **A.** As I will explain further, the Commission should deny Gulf's proposal to add
9 Scherer 3 to rate base in order to protect retail customers. The Commission
10 should also reinforce that the Company is responsible for presenting sufficient
11 information to reassure the Commission that it is planning an adequate and
12 reliable supply of electricity at the lowest cost possible. To this end, the Company
13 must make timely efforts, with proper Commission oversight, to evaluate and
14 then pursue all reasonably available prudent alternatives to minimize the cost of
15 serving its customers' needs.

16 **III. SCHERER 3: A "MISMATCH" FOR RETAIL CUSTOMERS**

17 **Q. What is Scherer 3?**

18 **A.** Scherer 3 is one of four steam units at Plant Scherer, a coal-fired power plant
19 located about 20 miles northwest of Macon, Georgia. In 1981, Gulf purchased a

1 25% ownership share of Scherer 3. This is equivalent to 211 MW capacity.

2 Scherer 3 began commercial operation in 1987.

3 For nearly its entire, thirty-year operating history, Gulf dedicated its portion of
4 Scherer 3 to wholesale power contracts instead of its customers. At the time of
5 purchase, Gulf did not have a resource capacity need, but projected that demand
6 would grow sufficiently to require this additional capacity in the future. Gulf then
7 entered into wholesale contracts to sell Scherer 3's available output. Gulf's
8 forecast of load growth was overly optimistic, however, and the Company still
9 does not have a need for this capacity to meet its reserve margins, despite some
10 recent retirements of its other coal plants.

11 As the Scherer 3 wholesale contracts have begun to expire, Gulf has not been able
12 to renew them or find new buyers, at least not at prices the Company will accept.¹
13 Nor has Gulf identified any viable options yet for an economic asset sale.²

14 **Q. What does Gulf propose to do now with Scherer 3?**

15 **A.** As witness Liu explained, Gulf is seeking authorization from the Commission to
16 allocate all of Scherer 3's available capacity (161 MW immediately, growing to 211
17 MW in 2020) to retail customers, and put all outstanding, "non-clause" costs into
18 rate base (Pages 3-4). Nevertheless, Gulf acknowledges that there is no need for

¹ See Gulf's Response to OPC Interrogatory No. 130, Exhibit PHM-2.

² *Ibid.*

1 Scherer 3 until 2023 at the earliest, and, as I will explain, it is unclear whether the
2 need will in fact materialize in 2023.

3 **Q. When does Gulf project a potential need for the Scherer 3 capacity?**

4 **A.** Gulf anticipates a potential need for capacity in 2023, when one of its power
5 purchase agreements (PPA) expires.³

6 **Q. Please explain whether you agree with Witness Burleson that there is a
7 “mismatch” between Scherer 3 and the needs of retail customers.**

8 **A.** Yes, there is a stunning mismatch because Scherer 3 does not line up with
9 customer needs—not now, in fact, perhaps never. Here, as Witness Liu explains,
10 Gulf seeks \$19.4 million in Scherer 3 costs from customers in 2017 (Page 15, lines
11 10-11), but they do not need any additional capacity for at least another 7 years,
12 until 2023.⁴ Furthermore, Scherer 3 would not be the best option to meet such
13 need should it ever materialize.

14 **Q. You state that Gulf’s projected need for new capacity in 2023 is not reliable.
15 What do you base this on?**

16 **A.** Gulf has a history of substantially overestimating load forecasts. For example,
17 Witness Liu states, “Gulf’s weather-normalized annual GWh sales have never
18 reached the level that we originally projected to achieve in 2012, and sales are not

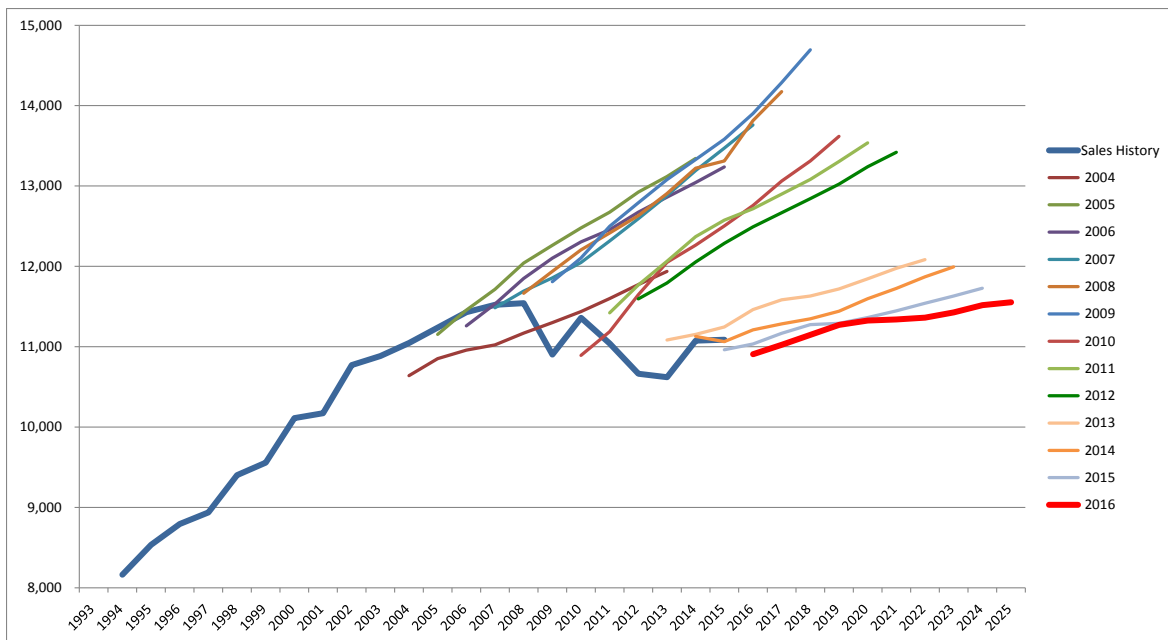
³ Gulf’s 2016 TYSP, at 52; Gulf’s Response to Staff Interrogatory No. 64, Exhibit PHM-3.

⁴ Exhibit PHM-3.

1 currently projected to reach that level in 2017” (Page 14, lines 12-15). Ms. Liu also
 2 states, “GWh sales for 2017 are forecast to be **6.3 percent below** the originally
 3 projected level for 2012” (Page 18, 12-14) [emphasis added].

4 Even with future load growth of approximately 1% per year – significantly more
 5 than recent history – the load in 2023 would still just barely reach the levels the
 6 Company originally projected for 2012. The figure below shows Gulf’s dramatic
 7 overestimation of load growth going back to 2004.⁵ Further, it depicts Gulf’s
 8 failure to recognize industry trends of low load growth and the sustained impacts
 9 of efficiency and distributed generation.

10 **Figure 1: Gulf Power Actual and Forecast Load Growth**



⁵ Source: Schedule 2.2 of past Gulf Ten-Year Site Plans, 2004-2016.

1 **Q. What evidence do you have for a trend of low energy load growth?**

2 **A.** There is substantial evidence of this phenomenon throughout the U.S. As an
3 example, EIA projects U.S. retail electricity sales will grow at an average annual
4 rate of just 0.39% from 2015-2030, substantially lower than the historic average of
5 1.6% from 1990-2010.⁶ Excluding transportation, which is expected to grow 14%
6 per year from adoption of electric vehicles, retail loads are projected to only grow
7 0.29% annually.

8 **Q. Isn't Gulf's justification for the 2023 need based on peak demand and the**
9 **expiration of an existing PPA, rather than energy load growth?**

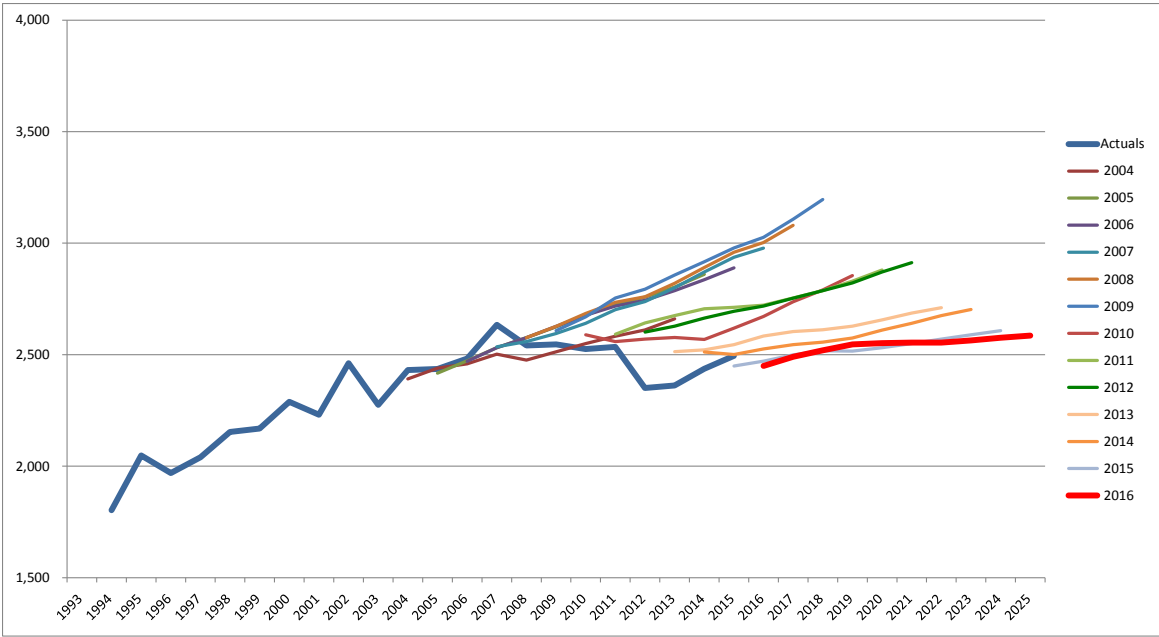
10 **A.** Yes, but the persistent bias in Gulf's above referenced projections calls into
11 question the accuracy of Gulf's forecasts in general, and especially the Company's
12 ability to accurately forecast the timing of a need so far in advance. In fact, as
13 Figure 2 below shows, Gulf appears to suffer from the same persistent bias when
14 it comes to summer peak demand, and has not experienced any actual load
15 growth since 2007.⁷

⁶ <https://goo.gl/2EEapV>.

⁷ Source: Schedule 3.1 from past Gulf Ten Year Site Plans.

1

Figure 2: Gulf Power Actual and Projected Summer Peak Demand



2

3

4

5

6

7

8

9

Furthermore, as shown in Gulf’s response to Staff interrogatories, its estimated 211 MW peak contribution in 2023 from Scherer represents **only 8%** of its projected 2023 summer peak.⁸ As I discuss, this is well within the range that can be captured solely through efficiency and demand response (DR) programs, and certainly could be made up with a mix of efficiency, DR, distributed generation (DG) and future PPAs. Gulf also has ample time to procure these potential resources by 2023, as I will explain.

10

Q. Assuming for the moment that the capacity driven reliability need does

11

exist in 2023, is Scherer a logical resource to fill that need?

⁸ Exhibit PHM-4.

1 A. Absolutely not. As Witness Burleson notes, Scherer 3 is a coal plant with a low
2 variable cost (Page 20, lines 25-25). Such plants generally serve as baseload plants,
3 and Gulf has indicated that Scherer is no exception.⁹

4 Gulf has also acknowledged that a peaking unit is more likely what its customers
5 would need next. Thus, Gulf plans to build a 654 MW gas combustion turbine to
6 go online in 2023. Such turbines are designed to serve as peaking units. This
7 makes them better able than Scherer 3 to serve customers' peak demand for
8 electricity.

9 In short, you can once again see the mismatch between Scherer 3 and customer
10 needs. It makes no sense to burden customers with a new, unneeded baseload
11 coal plant to meet a possible future peak capacity reliability need.

12 **Q. Could it nonetheless be prudent for customers to start funding Scherer 3**
13 **now to preserve the capacity for the future?**

14 A. No. To be prudent, the expense has to be "used and useful" to customers. This is
15 a core requirement in Florida, as in so many other states, to protect customers
16 from bearing the risk of utility expenses that may never confer concrete benefits
17 to the customers.

18

⁹ Exhibit PHM-2 (stating Gulf only responded to RFPs to sell Scherer on the wholesale market for "base load" needs).

1 As discussed, Scherer 3 does not meet the used and useful requirement because
2 customers do not need this coal plant now. Further, they may never need it.
3 Given Gulf's faulty forecasting, its substantial overestimation of loads, and
4 industry trends of low to no load growth, asking customers to begin paying now
5 for a speculative, possible need in the future is unreasonable. This would be true
6 even if Scherer 3 could somehow become a least-cost option in the future, a
7 position that Gulf has avoided taking and could not possibly justify under current
8 market conditions, as I will explain.

9

10 Second, even assuming a 2023 capacity need, there is no justification to impose
11 on ratepayers this financial burden now. There are many other options that Gulf
12 can rapidly deploy in the future, and which are likely to be less costly and require
13 far less lead-time. As an example, one option could be for Gulf to renew the
14 expiring Shell power purchase agreement (PPA), which as noted is mainly driving
15 the purported 2023 need. Gulf is yet to assess this as an alternative.¹⁰

16

17 Third, Gulf acknowledges that the ultimate, long-term costs of Scherer 3 are
18 uncertain and could be significantly higher in the future due to new and evolving
19 environmental compliance requirements and other risks yet-to-be quantified or
20 disclosed by the Company.¹¹ As a result, under Gulf's proposal, ratepayers would

¹⁰ Gulf's Response to OPC Interrogatory No. 174, Exhibit PHM-4.

¹¹ Gulf's 2016 TYSP, at 53-65.

1 be committed to paying for an aging coal plant that is unneeded, may never be
2 needed, and imposes new and unnecessary risks.

3 **Q. But didn't Witness Burroughs say that Scherer 3 is "fully controlled" in**
4 **terms of environmental compliance?**

5 A. He could have chosen his words more carefully. It is my understanding that
6 Scherer 3 does have some modern air pollution controls, but still faces additional
7 costs and risks, for example, based on a recent complaint filed in Georgia state
8 court concerning the water pollution control requirements for several coal plants,
9 including Scherer.¹²

10 Further, in its 2016 Ten-Year Site Plan, Gulf acknowledges that it does not know
11 the "ultimate financial and operational impact" of various regulations that are still
12 in flux.¹³ Keep in mind, whatever the Company has already sunk into Scherer
13 Unit 3 does not negate the risk and cost of such potential additional regulatory
14 compliance.

15 **IV. HEDGING AND DIVERSIFICATION**

16 **Q. Is there any evidence that pursuing PPAs could provide Gulf with greater**
17 **flexibility and potentially diminish risks?**

¹² *Sierra Club, Inc. et. al v. Richard E. Dunn*, CV #: 2017CV284719, Petition for Writ of Mandamus (Jan. 12, 2017), Exhibit PHM-5.

¹³ See generally Gulf's 2016 TYSP, Environmental Compliance Section, at 53-65.

1 A. Yes. Signing long or short term PPAs can lock in future prices now and provide a
2 significant hedge against future risks, including fuel price volatility and evolving
3 regulatory requirements for coal and carbon. Gulf evidently agrees, as “this
4 strategy of supplementing Gulf’s development of long-term capacity resources
5 with shorter-term power purchase has proven to be effective over the years.”¹⁴
6 Gulf also notes, “longer-term power purchases from the market” may “supply
7 flexibility and reduced commitment risk during periods in which environmental
8 regulations (with considerable economic impacts) and legislative initiatives
9 focusing on generation additions are in various stages of development.”¹⁵

10

11 **Q. Do you have other evidence that PPAs can be an effective hedge against**
12 **future risks such as price volatility or environmental risk?**

13 **A.** Yes. First, it is common practice for electric utilities to lock in contract prices as a
14 hedge against future financial risks.

15 Second, renewable energy PPAs are now often the cheapest and most prevalent
16 new generation resource, as I discuss below. These PPAs also have no fuel costs,
17 and thus completely hedge against volatile fuel prices. The U.S. Department of
18 Energy has found, “[s]olar and wind generation significantly reduces the exposure

¹⁴ Gulf’s 2016 TYSP, at 51.

¹⁵ *Id.* at 67.

1 of electricity costs to natural gas price uncertainty in fossil-based generation
2 portfolios on a multi-year to multi-decade time horizon.”¹⁶

3 Third, the Commission for Environmental Cooperation (CEC), which is the
4 collaborative between the U.S., Canada, and Mexico on advancing economic
5 development alongside environmental protection, has also found that long-term
6 renewable energy contracts are very attractive to utilities and their customers for
7 their long-term hedge value. The CEC concludes that the fixed, long-term price
8 of these contracts for terms that often exceed ten years, “offer[s] a **longer-term**
9 **hedge** than many of the conventional hedging strategies, which often focus on
10 short-term markets.”¹⁷

11 Further, the CEC has emphasized the value of renewables as a hedge against
12 regulatory compliance risks:

13 Future requirements are likely to be more severe than
14 they are today. Traditional air pollutants (SO_x, NO_x,
15 mercury, particulate matter) may be more tightly
16 regulated and new state or federal carbon regulations
17 may be implemented. Utility-owned fossil projects and
18 long-term power purchase agreements may be subject to
19 these downside regulatory risks. However, renewable
20 energy is likely to be unaffected.

¹⁶ <https://goo.gl/PAAwrR>.

¹⁷ <https://goo.gl/YeiOvm>.

1 Thus, the CEC concluded, “those utilities that consider seriously the risk of future
2 environmental regulations will prefer new renewable energy to new fossil
3 generation, all other things equal.”¹⁸

4 **Q. Doesn’t witness Burleson state that Scherer 3 will also offer value in the**
5 **long run by offsetting some coal plant retirements and tempering a trend in**
6 **Florida toward natural gas?**

7 **A.** While he does say that, his emphasis on the rest of Florida is misplaced. Gulf’s
8 own resource mix is the most relevant concern in this proceeding where the
9 Commission sets rates in order to minimize the costs and risks to Gulf’s captive
10 customers. As Staff demonstrated in their review of Gulf’s Ten Year Site Plan,
11 Gulf projects a dramatic shift away from its current mix with 40.6% coal
12 generation to a dangerously undiversified portfolio that relies on coal for 84.9%
13 of generation.¹⁹ See Figure 3 below.

¹⁸ *Id* at 34.

¹⁹ Florida PSC, *Review of the 2016 Ten Year Site Plans of Florida’s Electric Utilities*, November 2016, at 69.

1

Figure 3: Gulf Power Energy Consumption by Fuel Type

Fuel Type	Net Energy for Load			
	2015		2025	
	GWh	%	GWh	%
Natural Gas	7,787	64.9%	1,828	14.5%
Coal	4,876	40.6%	10,687	84.9%
Nuclear	0	0.0%	0	0.0%
Oil	1	0.0%	0	0.0%
Renewable ⁶	235	2.0%	1,091	8.7%
Interchange	-903	-7.5%	-1,023	-8.1%
NUG & Other	0	0.0%	0	0.0%
Total	11,996		12,583	

2

3 **Q. How does this compare with industry trends?**

4 **A.** Gulf is going in exactly the opposite direction as the industry. Utilities are
5 deliberately selecting strategies to avoid over-reliance on any single fuel source,
6 much less coal. It is a well-known fact that utilities across the country are rapidly
7 retiring and divesting their coal generation. The EIA expects this trend to
8 continue until 2050, as shown in Figure 4 below.

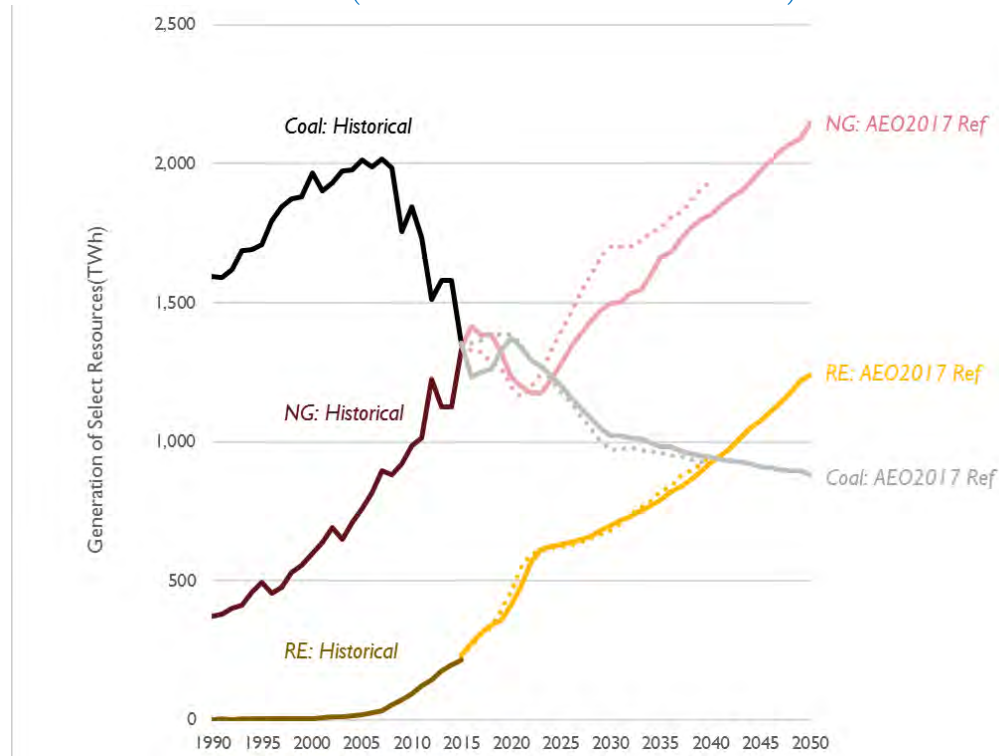
9 **Q. Is this national trend occurring in the Southeast as well?**

10 **A.** Yes. EIA notes, “[i]n the Southeast, coal consumption in Georgia, North
11 Carolina, and Alabama in 2015 was half the level it was in 2007.”²⁰ Quite simply,
12 Gulf’s heavy reliance on coal would result in a much less diverse resource mix and
13 represents a dangerous outlier in the region.

²⁰ <https://goo.gl/h6wQuF>.

1
2
3

Figure 4. Comparison of electricity generation from coal, natural gas, and renewables in the AEO 2017 Reference case (AEO2017 Ref) relative to the same cases in AEO 2016 (shown on this chart in dotted lines)²¹



4 **Q. Besides the coal divestment trend, what about new generation?**

5 **A.** The industry has turned sharply away from coal towards renewables, as the
6 dominant source of new generation. While the EIA is still finalizing the 2016 data,
7 it expects that, “[f]or the third consecutive year, more than half of [the country’s
8 new generation] additions are renewable technologies, especially wind and
9 solar.”²²

²¹ Note: In this figure, “renewables” includes all generation from wind and solar. Generation from hydro, geothermal, and biomass is excluded.

²² Marcy, Cara. “Renewable generation capacity expected to account for most 2016 capacity additions.” U.S. Energy Information Administration, 10 Jan. 2017, <https://goo.gl/Z5x1ao>, Exhibit PHM-6.

1 This trend is expected to continue, if not accelerate. The U.S. production tax
2 credit for wind and the solar investment tax credit were extended in 2015 and will
3 continue, although at declining levels, until 2020 (wind) and 2022 (solar).²³ With
4 the projected further cost reductions and performance improvements of
5 renewable technologies, today's renewable energy boom will very likely grow in
6 the future.

7

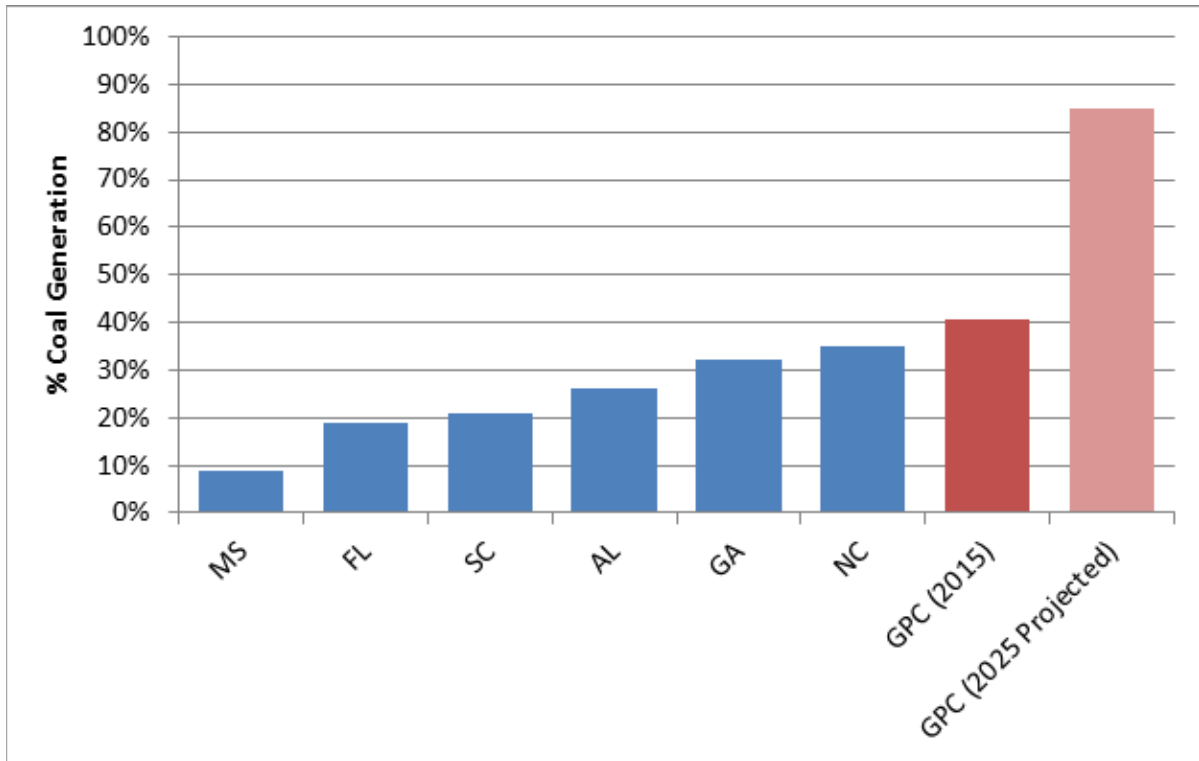
8 **Q. How does Gulf's coal dependence compare to its peers in the region?**

9 **A.** It is a clear outlier. The figure below shows installed coal capacity of states in the
10 Southeast U.S., compared to Gulf.. Gulf is already higher than any of state, and
11 significantly higher than Florida. What is even more concerning is that its
12 projected coal dependence by 2025 would be an extreme outlier and counter to
13 industry trends.²⁴ .

14 **Figure 5. Percent Coal Generation, by State and Actual and Forecast for Gulf**
15 **Power**

²³ *Id.*

²⁴ Source: <http://www.eia.gov/state/> Net Electricity Generation by Source, September 2016.



1

2

3 **Q. Why is Gulf's increased coal dependence risky?**

4 **A.** It is common practice with any asset portfolio to include a diverse mix of assets
5 to hedge against any particular asset becoming uneconomic, non-productive, or
6 otherwise a liability. Therefore, having 85% of any single asset type presents
7 significant risk if that asset becomes uneconomic or no longer viable. This is one
8 of the drivers of the significant coal retirements that have been occurring
9 throughout the country. Not only is new generation of coal generally no longer
10 competitive with gas plants or utility scale renewables, but concerns about climate
11 change clearly make dependence on the most carbon-heavy option especially
12 risky. As noted, uncertain environmental compliance requirements and fuel price

1 volatility pose additional financial risk, which can be hedged with renewables and
2 efficiency.

3 The Tennessee Valley Authority explicitly notes this in its 2015 findings on
4 financial risks: “Risks are minimized by maintaining a diverse portfolio and not
5 over-emphasizing any specific resource type.” Further, “[m]aintaining the diversity
6 of TVA’s energy resources is fundamental to our ability to provide low-cost,
7 reliable and clean electric power”²⁵ Consistent with these findings, TVA plans
8 further coal retirements and no new coal generation additions through at least
9 2033.²⁶

10 **V. ALTERNATIVES**

11 **Q. You have stated that Gulf failed to analyze alternatives to Scherer 3, or
12 show that it is the least-cost option. What is the basis for your statement?**

13 **A.** Gulf itself makes this perfectly clear in response to discovery. Public Counsel
14 asked what analysis of alternatives Gulf has done to assess whether Scherer 3 is a
15 least-cost resource, including any economic or risk assessments. Gulf responded,
16 it “has not performed, nor had performed on its behalf, an analysis to evaluate

²⁵ <https://goo.gl/ZljjYt>.

²⁶ *Id.*

1 utilizing Gulf's ownership share of Scherer Unit 3 to serve retail customers post-
2 2015 versus other alternatives.”²⁷

3 This is an unacceptable omission. It leaves the Commission with absolutely no
4 evidence that the Company made a timely effort to investigate and pursue every
5 reasonably available prudent action to minimize its cost of service. Furthermore,
6 since Gulf could not find any buyers for this power in competitive markets,
7 Scherer likely does not represent a least costs resource.

8 **Q. Is it common for utilities to assess alternative supply resources to
9 determine least cost solutions to future capacity needs?**

10 A. Yes. In my experience, best practice would include a robust scenario analysis of
11 the various electric resources that could be deployed, their projected capital and
12 variable costs, and the different risk factors. This analysis is even more important
13 due to rapid changes in electric markets. To be clear, this analysis is supposed to
14 help identify and manage uncertainty by calculating how sensitive the analysis is to
15 common risks such as fuel price volatility, potential variation between actual and
16 forecasted loads, and weather, economic and environmental risks.

17 The fact that Gulf has either failed to perform these analyses, or at least failed to
18 provide the Commission with convincing details and results of any integrated

²⁷ Exhibit PHM-5.

1 resource planning analysis, should be justification alone to reject its Scherer 3
2 proposal. Quite simply, Gulf failed to show that its proposal is in the best interest
3 of customers, and I will offer evidence that it is not.

4 **Q. What are the various alternatives that Gulf should have analyzed?**

5 **A.** Gulf should have done a comprehensive assessment of all reasonable potential
6 sources of new capacity, generation and demand management. This should
7 include: 1) ownership, construction and retirement options of traditional fossil
8 fuel plants in Gulf's existing fleet; 2) a full range of renewable energy options
9 (both utility-owned and built, PPAs and distributed generation); 3) pursuit of a
10 range of different PPA options, including the potential renewal of its expiring
11 Shell PPA; and 4) the full achievable potential of energy efficiency and demand
12 response resources.

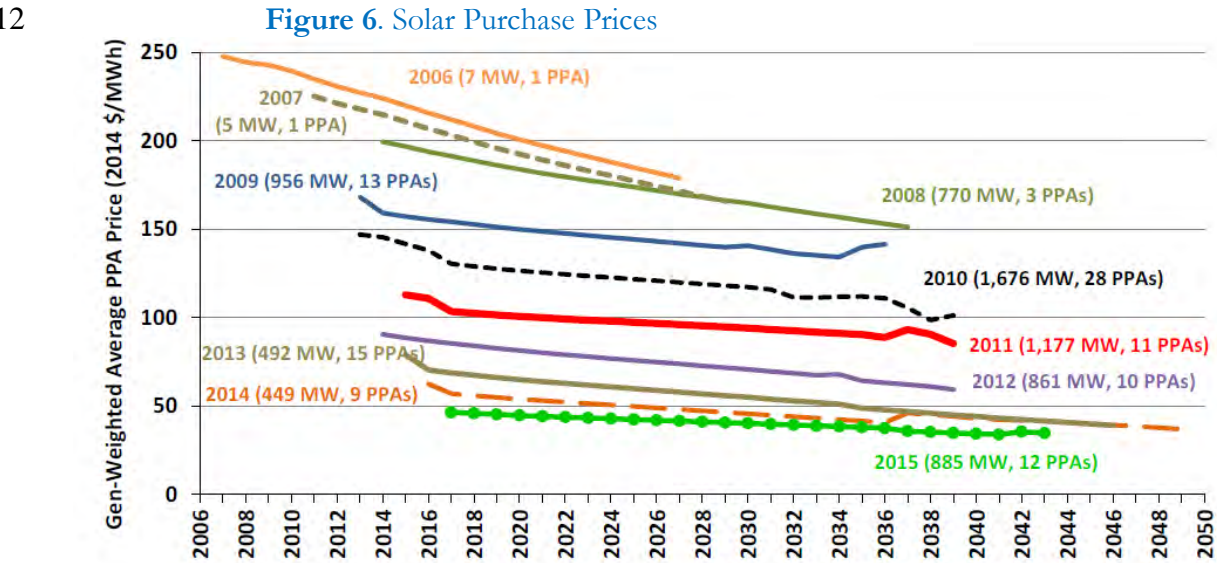
13 **Q. Is it likely that one or more of these alternatives are a lower-cost resource?**

14 **A.** Yes. There is much evidence that such alternatives are generally less costly and
15 less risky than a coal plant. For example, energy efficiency and demand response
16 are generally only a fraction of the cost of traditional supply-side options and
17 recent cost reduction in renewable energy have now made it the majority of new
18 generation investments in the U.S.

19 **Q. What evidence do you have that non-coal PPAs are available as a lower-**
20 **cost alternative?**

1 A. While I will describe some specific data on PPAs that are relevant, the most
 2 obvious evidence is the fact that Gulf has been unable to find buyers for Scherer
 3 generation through long-term wholesale contracts. Nor has the Company
 4 identified any viable asset sale opportunities.²⁸ If Scherer 3 does not represent a
 5 good value for power purchases or investors, the same is very likely true for
 6 Gulf's customers.

7 In terms of recent data on already executed PPAs, the U.S. Department of Energy
 8 has documented the dramatic decreases in solar PPA prices in the last 10 years.
 9 The figure below shows dramatic decreases in solar PPAs over recent years, with
 10 levelized average generation weighted prices below \$50/MWh now and projected
 11 to continue to decline.²⁹

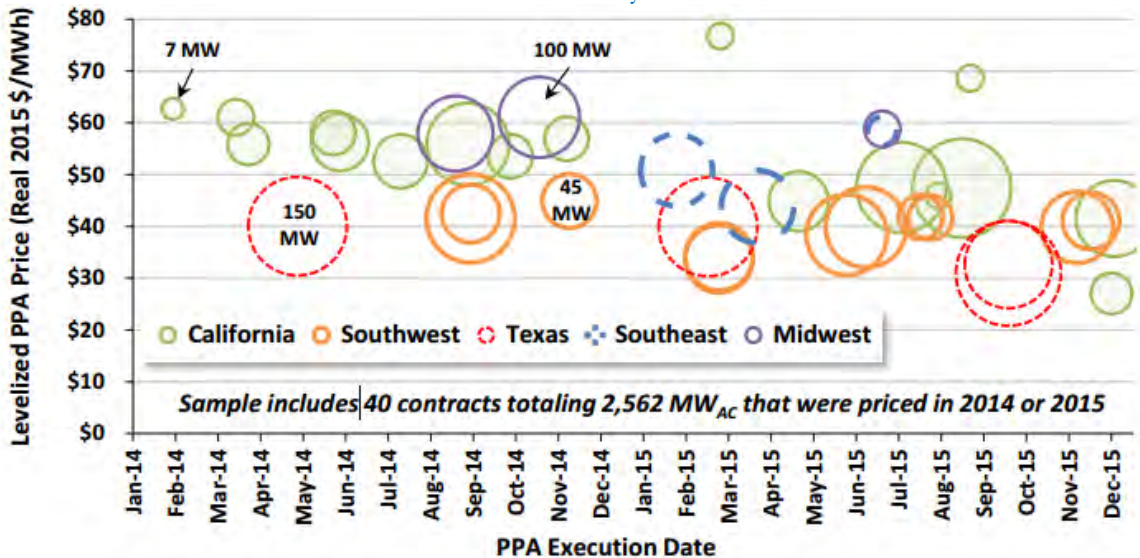


²⁸ Exhibit PHM-2.

²⁹ Figure 17, Utility-Scale Solar 2014: An Empirical Analysis of Project Cost, Performance, and Pricing Trends in the United State, Authors Mark Bolinger and Joachim Seel, Lawrence Berkeley National Laboratory, September 2015, Exhibit PHM-7.

1 While solar PPA costs have come down considerably nationally, the figure below
2 shows that two solar PPAs of between 50 and 100 MW each were signed in the
3 Southeast region in just the past two years at prices comparable to regions with
4 far more experience developing utility-scale solar resources.³⁰

5 **Figure 7. Levelized PPA Prices by Region, Contract Size, and PPA Execution**
6 **Date: 2014 and 2015 Contracts Only**



7 **Q. Besides solar PPAs, do you have any data on wind PPAs?**

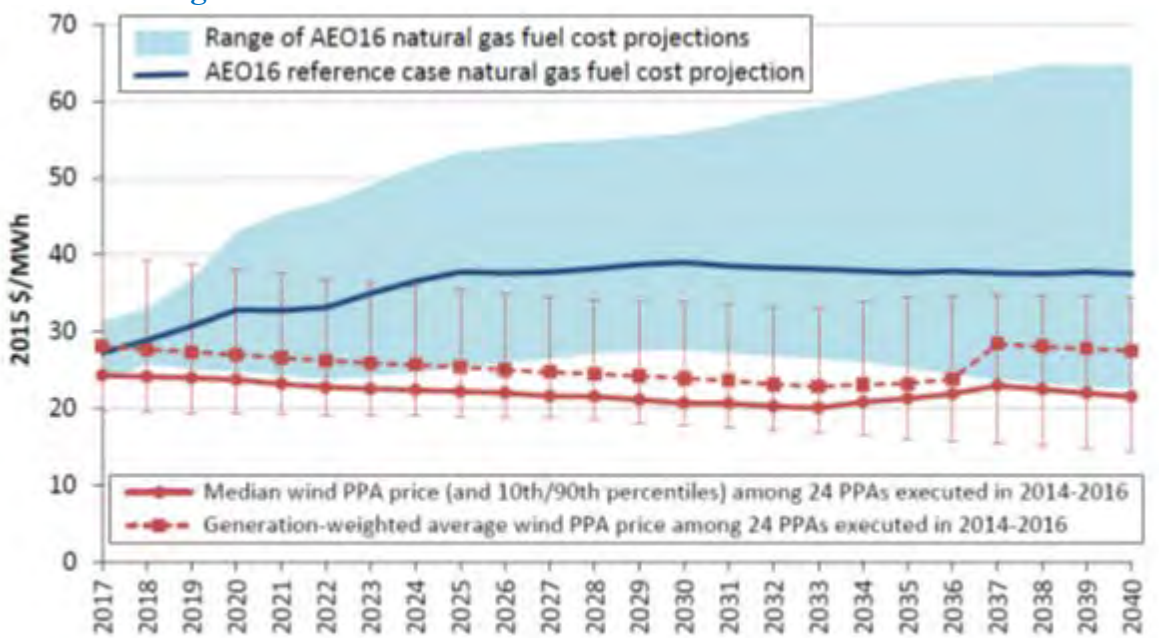
8 **A.** Yes. A similar report on wind from the U.S. Department of Energy shows, in
9 Figure 8 below, that median wind PPA price from contracts executed from 2014
10 to 2016 are roughly \$25 per MWh and are consistently at or below the low end of
11 the projected natural gas fuel cost range from now through 2040.³¹

³⁰ Figure 19, Utility-Scale Solar 2015: An Empirical Analysis of Project Cost, Performance, and Pricing Trends in the United State, Authors Mark Bolinger and Joachim Seel, Lawrence Berkeley National Laboratory, August 2016, Exhibit PHM-8.

³¹ Figure 50, 2015 Wind Technologies Market Report, Authors Ryan Wiser and Mark Bolinger, Lawrence Berkeley National Laboratory, August 2016, Exhibit PHM-9.

1

Figure 8. Wind Purchase Prices



2 **Q. You discuss options for PPAs, including renewables. Can they meet**
 3 **capacity reliability needs?**

4 A. Yes, so long as a diversified combination of resources is pursued. As noted,
 5 efficiency and DR alone could probably serve such needs in today’s market.
 6 However, even solar can potentially meet this need by 2023. NextEra Energy,
 7 owner of Florida Power & Light Company (FPL), recently confirmed that
 8 combinations of solar plus storage will be able to not only serve as peaker plants,
 9 but likely will be the preferred solution. In 2015, NextEra Energy Chairman Jim
 10 Robo stated: “Post-2020, there may never be another peaker built in the United
 11 States – very likely you’ll be just building energy storage instead.”³² In fact, FPL
 12 Witness Barrett recently testified before this Commission that in the next four
 13 years “large scale deployment” of energy storage and a “large program” of solar

³² <https://goo.gl/Z6WcyD>.

1 are not only possible, together, they can address peak demand, save customers
2 money, and produce other benefits.³³

3 **Q. Is there sufficient time for Gulf to forego dedicating Scherer 3 to its retail**
4 **customers now and pursuing a PPA?**

5 **A.** Yes. Gulf witness Burleson makes this clear. For example, he describes how Gulf
6 issued a request for proposal (RFP) for PPAs in February 2006 for capacity
7 starting in June 2009 (Page 16). It also began preparing in 2008 for a PPA RFP
8 for capacity in 2014.³⁴ The current 855 MW Shell PPA that will expire in 2023
9 creating a potential reliability need was actually signed in March 2009 for delivery
10 starting in November 2009.³⁵ Evidently, there is ample time for Gulf to solicit
11 new PPAs, or potentially renew the Shell PPA, to meet any potential capacity
12 shortfall seven years from now. In addition, given the continuing rapid declines in
13 renewable energy PPA costs, it is likely that going to market now or later for a
14 PPA could provide lower market prices than Scherer offers, while minimizing risk
15 and creating greater flexibility. It would also prevent ratepayers from accepting a
16 rate-based obligation today when their need is well in the future.

17 **Q. What evidence do you have that energy efficiency or demand response**
18 **could provide a lower cost alternative to Scherer 3?**

³³ Docket 160021, October 27, 2017, Hearing Transcript at 104, 113, 116–17 (Barrett),
<https://goo.gl/JBlbuO>.

³⁴ *Ibid.*

³⁵ *Ibid.*

1 **A.** There is ample evidence that energy efficiency and demand response (collectively,
2 “demand-side management” or “DSM”) are the lowest cost resource to meet
3 marginal energy and capacity needs. The record in the 2014 hearings on the
4 numeric conservation goals of the utilities subject to the Florida Energy
5 Efficiency and Conservation Act provides such evidence. Witness Sim testified
6 that the total revenue requirement for the utility (i.e., the costs paid by ratepayers)
7 is lower under a plan with higher energy efficiency savings.³⁶ Other witnesses
8 demonstrated that energy efficiency generally costs less than half as much as
9 conventional power plants.³⁷

10 Turning to demand response, the experience of two large independent system
11 operators is instructive. Both the PJM regional transmission organization (PJM)
12 and the Independent System Operator of New England (ISO-NE) have
13 emphasized the deployment of demand response in those regions to ensure
14 sufficient capacity to meet expected loads. More specifically, they provide
15 payments for capacity that are determined three years in advance of when that
16 capacity is needed, thus giving capacity suppliers confidence that their
17 investments will earn some financial return. In both cases, demand response
18 participates in the market as a cost-effective means of supplying needed capacity.

³⁶ Docket No. 130199, Hearing Transcript, Aug. 8, 2014, at 1492 (FPL witness Sim).

³⁷ *See, e.g., id.* at 1116-17 (Sierra Club witness Woolf).

1 The most recent results have demand response providing nearly 8 percent³⁸ and 6
2 percent³⁹ of ISO-NE's and PJM's capacity requirement in 2019, respectively. This
3 demonstrates that demand response is cost-competitive with traditional supply
4 options, and that even without added efficiency programs it could potentially
5 replace the entire capacity shortfall covered by Scherer.

6 **Q. Can you cite any recent examples of utilities in the region that are, as part**
7 **of an IRP process, planning to pursue a greater mix of renewables,**
8 **distributed generation and efficiency?**

9 **A.** Yes. For example, Georgia Power—a Gulf sister company—recently entered into
10 a stipulation on its integrated resource plan that includes commitments to procure
11 1.2 GW of renewable energy, including 150 MW of distributed generation, and
12 1,050 MW of utility scale resources. These would be primarily procured through
13 RFPs that would include 525 MW of renewables with in service dates of 2018 and
14 2019—just 3 years after the stipulation signing and well before Gulf's need. It also
15 calls for the rapid procurement of customer sited distributed generation in 2017
16 and 2018. This 150 MW of DG alone is approximately $\frac{3}{4}$ of the Scherer 3
17 capacity needed in 2023. The stipulation also calls for investment in energy
18 efficiency and capital expenditure limits on existing coal plants.⁴⁰

³⁸ <https://goo.gl/0PzLd5>

³⁹ <https://goo.gl/5v7fRj>

⁴⁰ Georgia Power IRP Stipulation, Exhibit PHM-10.

1 **Q. Gulf argues that because its share of Scherer 3 was originally purchased in**
2 **1981 with the intent of being used in the future as a dedicated retail**
3 **customer resource, that alone is reason to adopt that 35 year old plan now.**
4 **Can you comment on that?**

5 **A.** It has been my experience, having worked in the regulated utility industry in many
6 jurisdictions throughout the U.S. over the past three decades, that regulated
7 electric utility commissions seek the best current evidence and judge the prudence
8 of utility cost recovery proposals based on that evidence. This is not just a matter
9 of custom and practice, but also common sense—to protect captive customers
10 from undue rate increases. I can see no justification for now burdening Gulf's
11 customers with an imprudent and non-least cost solution to future reliability
12 needs simply because of a decision that the company made 35 years ago. Gulf
13 took the risk and had a responsibility to mitigate it.

14 **Q. Are you aware of any Florida precedent that might be germane to this**
15 **issue?**

16 **A.** Yes. In fact, Gulf witness Deason testified about it (Pages 17-18). As part of its
17 rate case in 1989, Gulf proposed transferring 63 MW of the 212 MW of Scherer
18 capacity into rates.⁴¹ The bulk of this capacity (44 MW) had become available as a
19 result of a default by Gulf States Utilities on a wholesale power contract with
20 Gulf. Mr. Deason acknowledges that the commission denied this request to put a

⁴¹ Docket No. 891345-EI, and Deason Direct Testimony, at 17.

1 portion of Scherer into rate base because: 1) there was no current need for the
2 capacity on the retail system; 2) the proposal for the 44 MW was only being made
3 because of the contract default; and 3) that because only the shareholders derived
4 benefit from the off-system sales they should absorb any liability related to an
5 inability to sell wholesale power and retail customers should be insulated from
6 this liability. ⁴²

7 **Q. What do you conclude from the Commission's decision in that proceeding?**

8 **A.** The issue there was directly analogous to Gulf's proposal today in two ways. First,
9 the Commission found that a current lack of need for the available capacity was
10 important and a reason for not burdening customers with the unnecessary costs. I
11 have already described how this is also true for Scherer 3, and Gulf confirms this
12 with its own data.⁴³ Second, because the off-system sales had the potential to
13 benefit shareholders rather than customers, the Commission found that
14 shareholders now faced with a potential financial loss from the default should
15 absorb this liability. This is also clearly analogous to the present Scherer situation,
16 where Gulf has attempted but failed to find buyers for its excess capacity at its
17 required return and is therefore now proposing to shift this financial burden to its
18 customers. In neither case was there a customer need for the added capacity.
19 customers despite them not needing it.

⁴² *Ibid.*

⁴³ Exhibit PHM-3.

1 **Q. What evidence do you have that Gulf’s decision to allocate Scherer power**
2 **to customers was driven by the fact that it was no longer able to profitably**
3 **engage in off-system sales.**

4 **A.** In its response to discovery, Gulf explains its efforts in recent years to enter into
5 either long term wholesale contracts, or to pursue an asset sale.⁴⁴ Gulf pursued
6 numerous long-term wholesale contracts, both solicited and unsolicited, including
7 13 RFPs, without success. They also explored possible asset sales and determined
8 that “there do not currently appear to be any **economically viable** asset sale
9 opportunities.” [emphasis added]⁴⁵ This response indicates that Gulf made serious
10 efforts to either sell the Scherer asset or capacity but could not find buyers in the
11 market and therefore is now attempting to off-load it to its captive customers.

12 **Q. Please summarize your testimony regarding Gulf’s proposal to move**
13 **Scherer 3 into rate base.**

14 **A.** My testimony shows that Gulf’s proposal to burden ratepayers with financial
15 responsibility for Scherer 3 capacity is not justified or in the public interest,
16 because:

- 17 1. Customers have no need for new capacity resources through at least
18 2023, so absorbing Scherer 3 power now will not benefit them.

⁴⁴ Exhibit PHM-2.

⁴⁵ *Ibid.*

- 1 2. Any need for new capacity or energy resources in 2023 and beyond is
2 speculative, and there is ample time to refine forecasts and procure
3 alternative resources later if necessary.
- 4 3. It will exacerbate an already dangerously undiversified portfolio at a
5 time when heavy exposure to coal resources is considered financially
6 risky by many in the industry, it diverges from current trends to divest
7 of coal resources, and alternative renewable resources are both
8 affordable and could provide a hedge against such risk.
- 9 4. Gulf has failed to analyze any alternatives to meet the need in 2023 and
10 beyond, consistent with planning best practices and the desire to
11 identify the least cost solutions.
- 12 5. Not only has Gulf failed to analyze whether Scherer 3 is an optimal
13 and least cost solution for its ratepayers, but there is substantial
14 evidence that it is not, and that Gulf has plenty of time to perform this
15 analysis and procure alternative resources.

16 **Q: Does this conclude your testimony?**

17 A. Yes.

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 **Introduction**

2 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND OCCUPATION.**

3 A. My name is Steve W. Chriss. My business address is 2001 SE 10th St.,
4 Bentonville, AR 72716-0550. I am employed by Wal-Mart Stores, Inc.
5 ("Walmart") as Director, Energy and Strategy Analysis.

6 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS DOCKET?**

7 A. I am testifying on behalf of Wal-Mart Stores East, LP and Sam's East, Inc.
8 (collectively, "Walmart").

9 **Q. PLEASE DESCRIBE YOUR EDUCATION AND EXPERIENCE.**

10 A. In 2001, I completed a Master of Science in Agricultural Economics at Louisiana State
11 University. From 2001 to 2003, I was an Analyst and later a Senior Analyst at the
12 Houston office of Econ One Research, Inc., a Los Angeles-based consulting firm. My
13 duties included research and analysis on domestic and international energy and
14 regulatory issues. From 2003 to 2007, I was an Economist and later a Senior Utility
15 Analyst at the Public Utility Commission of Oregon in Salem, Oregon. My duties
16 included appearing as a witness for PUC Staff in electric, natural gas, and
17 telecommunications dockets. I joined the energy department at Walmart in July
18 2007 as Manager, State Rate Proceedings. I was promoted to Senior Manager,
19 Energy Regulatory Analysis, in June 2011. I was promoted to my current position in
20 October, 2016. My Witness Qualifications Statement is attached as Exhibit SWC-1.

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE THE FLORIDA PUBLIC**
2 **SERVICE COMMISSION ("COMMISSION")?**

3 A. Yes. I submitted testimony in Docket Nos. 160021-EI, 140002-EG, 130140-EI,
4 130040-EI, 120015-EI, and 110138-EI.

5 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE OTHER STATE**
6 **REGULATORY COMMISSIONS?**

7 A. Yes. I have submitted testimony in over 150 proceedings before 37 other utility
8 regulatory commissions. I have also submitted testimony before the Missouri House
9 Committee on Utilities, the Missouri House Energy and Environment Committee, the
10 Missouri Senate Veterans' Affairs, Emerging Issues, Pensions, and Urban Affairs
11 Committee, and the Kansas House Standing Committee on Utilities and
12 Telecommunications. My testimony has addressed topics including, but not limited
13 to, cost of service and rate design, return on equity ("ROE"), revenue requirements,
14 ratemaking policy, large customer renewable programs, qualifying facility rates,
15 telecommunications deregulation, resource certification, energy efficiency/demand
16 side management, fuel cost adjustment mechanisms, decoupling, and the collection
17 of cash earnings on construction work in progress ("CWIP").

18 **Q. ARE YOU SPONSORING EXHIBITS IN YOUR TESTIMONY?**

19 A. Yes. I am sponsoring the exhibits listed in the Table of Contents.

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 **Q. PLEASE BRIEFLY DESCRIBE WALMART'S OPERATIONS IN FLORIDA.**

2 A. Walmart operates 367 retail units and eight distribution centers and employs
3 109,849 associates in Florida. In fiscal year ending 2016, Walmart purchased \$5.7
4 billion worth of goods and services from Florida-based suppliers, supporting 89,773
5 supplier jobs.¹

6 **Q. PLEASE BRIEFLY DESCRIBE WALMART'S OPERATIONS WITHIN THE COMPANY'S**
7 **SERVICE TERRITORY.**

8 A. Walmart has 26 stores and related facilities that take electric service from Gulf
9 Power Company ("Gulf" or "Company") on several service schedules but primarily on
10 the Company's Real Time Pricing ("RTP") schedule.

11

12 **Purpose of Testimony and Summary of Recommendations**

13 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

14 A. The purpose of my testimony is to address aspects of Gulf's rate case filing and to
15 provide recommendations to assist the Commission in thoroughly and carefully
16 considering the customer impact of the Company's proposed rate increase.

17 **Q. PLEASE SUMMARIZE WALMART'S RECOMMENDATIONS TO THE COMMISSION.**

18 A. Walmart's recommendations to the Commission are as follows:

19 1) The Commission should thoroughly and carefully consider the impact on
20 customers in examining Gulf's requested revenue requirement and ROE, in

¹ <http://corporate.walmart.com/our-story/locations/united-states#/united-states/florida>

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 addition to all other facets of this case, to ensure that any increase in the
2 Company's rates is only the minimum amount necessary to provide safe,
3 adequate, and reliable service, while also providing Gulf the opportunity to
4 recover its reasonable and prudent costs and to earn a reasonable return on
5 its investment.

6 2) The Commission should closely examine the Company's proposed revenue
7 requirement increase and the associated ROE, especially when viewed in
8 light of:

9 a) The customer impact of the resulting rate increases;

10 b) The use of a future test year, which reduces regulatory lag by allowing
11 the utility to include the most current information in its rates at the time
12 they will be in effect;

13 c) The percentage of the Company's total jurisdictional revenues recovered
14 through base rates that are at risk due to regulatory lag versus the
15 amount of revenues collected through cost recovery clause charges; and

16 d) Recent rate case ROEs approved by other commissions nationwide.

17 3) Walmart does not expressly support the use of the 12 CP and 1/13th
18 methodology for the allocation of production costs due to the arbitrary
19 designation of a portion of production capacity cost as energy-related.
20 However, Walmart recognizes that this methodology has traditionally been
21 preferred by the Commission. As such, for the purposes of this docket

Wal-Mart Stores East, LP and Sam’s East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 Walmart does not oppose the Company’s proposed production cost
2 allocation methodology.

3 4) Walmart does not take a position at this time on the other facets of the
4 Company’s proposed cost of service study. However, to the extent that
5 alternative cost of service models or modifications to the Company’s model
6 are proposed by other parties, Walmart reserves the right to address any
7 such proposals in accord with the Commission’s procedures established for
8 this docket.

9 5) The Commission should require the Company to initiate a stakeholder
10 process within 60 days of the final order in this docket for the collaborative
11 development of additional energy supply options, with a particular focus on
12 renewables, to be proposed for Commission approval within six months of
13 the final order in this docket. This programming will broaden the scope of
14 Gulf’s tariffed products and services offered to existing and potential
15 business customers in its service territory and help Gulf promote economic
16 development as well as meet the needs of existing customers.

17 **Q. DOES THE FACT THAT YOU MAY NOT ADDRESS AN ISSUE OR POSITION**
18 **ADVOCATED BY THE COMPANY INDICATE WALMART’S SUPPORT?**

19 **A.** No. The fact that an issue is not addressed herein or in related filings should not be
20 construed as an endorsement of, agreement with, or consent to any filed position.

1 **Return on Equity**

2 **Q. WHAT IS YOUR UNDERSTANDING OF THE COMPANY'S PROPOSED ELECTRIC**
3 **REVENUE REQUIREMENT INCREASES?**

4 A. My understanding is that the Company proposes a revenue requirement increase of
5 approximately \$106.7 million for the projected test year ending December 31, 2017.
6 See MFR A-1, page 1. This represents a base rate increase of approximately 19.21
7 percent and a total company revenue increase of approximately 8.69 percent. See
8 MFR E-8, page 1.

9 **Q. IN SETTING THE REVENUE REQUIREMENT CHANGES AND ROE FOR THE COMPANY,**
10 **SHOULD THE COMMISSION CONSIDER THE IMPACT OF THE PROPOSED RATE**
11 **INCREASE ON CUSTOMERS?**

12 A. Yes. Electricity is a significant operating cost for retailers such as Walmart. When
13 electric rates increase, that increased cost to retailers can put pressure on consumer
14 prices and on the other expenses required by a business to operate. The
15 Commission should thoroughly and carefully consider the impact on customers in
16 examining the requested revenue requirement and ROE, in addition to all other
17 facets of this case, to ensure that any increase in the Company's rates is only the
18 minimum amount necessary to provide safe, adequate, and reliable service, while
19 also providing Gulf the opportunity to recover its reasonable and prudent costs and
20 to earn a reasonable return on its investment.

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 **Q. WHAT IS THE COMPANY'S PROPOSED ROE IN THIS DOCKET?**

2 A. The Company has calculated a "fair rate of return" of 10.4 percent based on a range
3 of cost of equity model results of 9.7 percent to 10.9 percent. However, the
4 Company proposes an adjustment of 60 basis points due to the relationship of its
5 proposed capital structure to the capital structures of the companies included in its
6 proposed proxy group. With the proposed adjustments to its model results, the
7 Company proposes an ROE of 11 percent. See Direct Testimony of James H. Vander
8 Weide, page 51, line 1 to page 53, line 13. The Company's overall proposed rate of
9 return is 6.04 percent. See MFR D1-a, page 1.

10 **Q. IS THE COMPANY'S PROPOSED ROE HIGHER THAN THE ROE CURRENTLY APPROVED**
11 **FOR ITS BUSINESS?**

12 A. Yes. The proposed ROE represents an increase of 75 basis points from the
13 Company's current approved ROE of 10.25 percent. See Docket No. 130140-EI,
14 Stipulation and Settlement Agreement, ¶18(b), and Order PSC-13-0670-S-EI.

15 **Q. ARE YOU CONCERNED ABOUT THE REASONABLENESS OF THE COMPANY'S**
16 **PROPOSED ROE?**

17 A. Yes. I am concerned about the reasonableness of the Company's proposed ROE,
18 especially when viewed in light of:

19 1) The customer impact of the resulting revenue requirement increases as I
20 discuss below;

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

- 1 2) The use of a future test year, which reduces regulatory lag by allowing the
2 utility to include the most current information in its rates at the time they
3 will be in effect;
- 4 3) The percentage of the Company's total jurisdictional revenues recovered
5 through base rates that are at risk due to regulatory lag versus the amount of
6 revenues collected through cost recovery clause charges; and
- 7 4) Recent rate case ROEs approved by other utility commissions nationwide.

8

9 ***Customer Impact***

10 **Q. WHAT IS THE IMPACT ON GULF'S CUSTOMERS OF THE PROPOSED 75 BASIS POINT**
11 **INCREASE IN ROE?**

12 A. The revenue requirement impact on the Company's customers of the proposed
13 increase in ROE is approximately \$12.8 million. The requested increase related to
14 ROE constitutes about 12 percent of the Company's increase request. See Exhibit
15 SWC-2.

16

17 ***Future Test Year and Regulatory Lag***

18 **Q. FOR THE COMPANY'S PROPOSED TEST YEAR, WHAT PERCENT OF JURISDICTIONAL**
19 **REVENUES ARE PROPOSED TO BE COLLECTED THROUGH BASE RATES?**

20 A. Approximately 39 percent of jurisdictional revenues for the proposed test year
21 would be collected through base rates and would be essentially at risk due to

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 regulatory lag. See Exhibit SWC-3. This is significant because it indicates that Gulf
2 recovers more than 60 percent of its total costs through cost recovery, or "pass-
3 through" charges, and the greater the percentage of a utility's revenues that are
4 collected through pass-through charges, the lower the utility's risk due to regulatory
5 lag.

6 **Q. HAS THE COMMISSION RECOGNIZED THAT THE USE OF A FUTURE OR PROJECTED**
7 **TEST YEAR REDUCES GULF'S EXPOSURE TO REGULATORY LAG?**

8 A. Yes. The use of a projected test year reduces the risk due to regulatory lag because,
9 as the Commission has previously stated, "the main advantage of a projected test
10 year is that it includes all information related to rate base, NOI, and capital structure
11 for the time new rates will be in effect." See Order No. PSC-02-0787-FOF-EI, page 9.
12 As such, the Commission should carefully consider the level of ROE in relation to the
13 Company's relatively low exposure to regulatory lag.

14
15 ***National Utility Industry ROE Trends***

16 **Q. HOW DOES THE COMPANY'S PROPOSED ROE COMPARE WITH ROES APPROVED BY**
17 **OTHER UTILITY REGULATORY COMMISSIONS?**

18 A. The ROE proposed by the Company is significantly higher than the average ROE
19 approved by other utility regulatory commissions in 2014, 2015, and 2016.²
20 Additionally, the gap between the national average ROEs and the Company's

² At the time of writing this testimony, no Commissions had authorized an ROE for an electric utility in 2017.

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 proposed ROE widens even more when 2015 and 2016 data are examined. See
2 Exhibit SWC-4.

3 **Q. WHAT IS YOUR UNDERSTANDING OF THE ROES APPROVED FOR ELECTRIC UTILITIES**
4 **BY COMMISSIONS NATIONWIDE DURING THIS TIME PERIOD?**

5 A. According to data from SNL Financial³, a financial news and reporting company,
6 there have been 88 reported electric utility rate case ROEs authorized by state
7 regulatory commissions for investor-owned electric utilities in 2014, 2015, and 2016.
8 The average of these reported ROEs is 9.65 percent. The range of reported
9 authorized ROEs for the period is 8.64 percent to 10.55 percent, and the median
10 authorized ROE is 9.70 percent. *Id.*

11 **Q. SEVERAL OF THE REPORTED AUTHORIZED ROES ARE FOR DISTRIBUTION-ONLY**
12 **UTILITIES, OR ARE ONLY FOR A UTILITY'S DISTRIBUTION SERVICE RATES. WHAT IS**
13 **THE AVERAGE AUTHORIZED ROE IN THE REPORTED GROUP FOR PARTIALLY OR**
14 **FULLY VERTICALLY INTEGRATED UTILITIES LIKE THE COMPANY?**

15 A. In the group reported by SNL Financial, the average authorized ROE for vertically
16 integrated utilities from 2014 to present is 9.81 percent. *Id.* When the average ROE
17 is broken down by year, the data show that recently awarded ROEs are lower than
18 those awarded in 2014.

³ Regulatory Research Associates is part of SNL Financial.

Wal-Mart Stores East, LP and Sam's East, Inc.
 Direct Testimony of Steve W. Chriss
 Florida Public Service Commission Docket No. 160186-EI

1 Q. PLEASE EXPLAIN.

2 A. The average authorized ROE for vertically integrated utilities in 2014 was 9.92
 3 percent, in 2015 it was 9.75 percent, and in 2016 it was 9.77 percent. As such, the
 4 Company's proposed 11 percent ROE is counter to broader electric industry trends
 5 and, if authorized, would be higher than any ROE authorized in the United States in
 6 at least the last three years. See Figure 1.

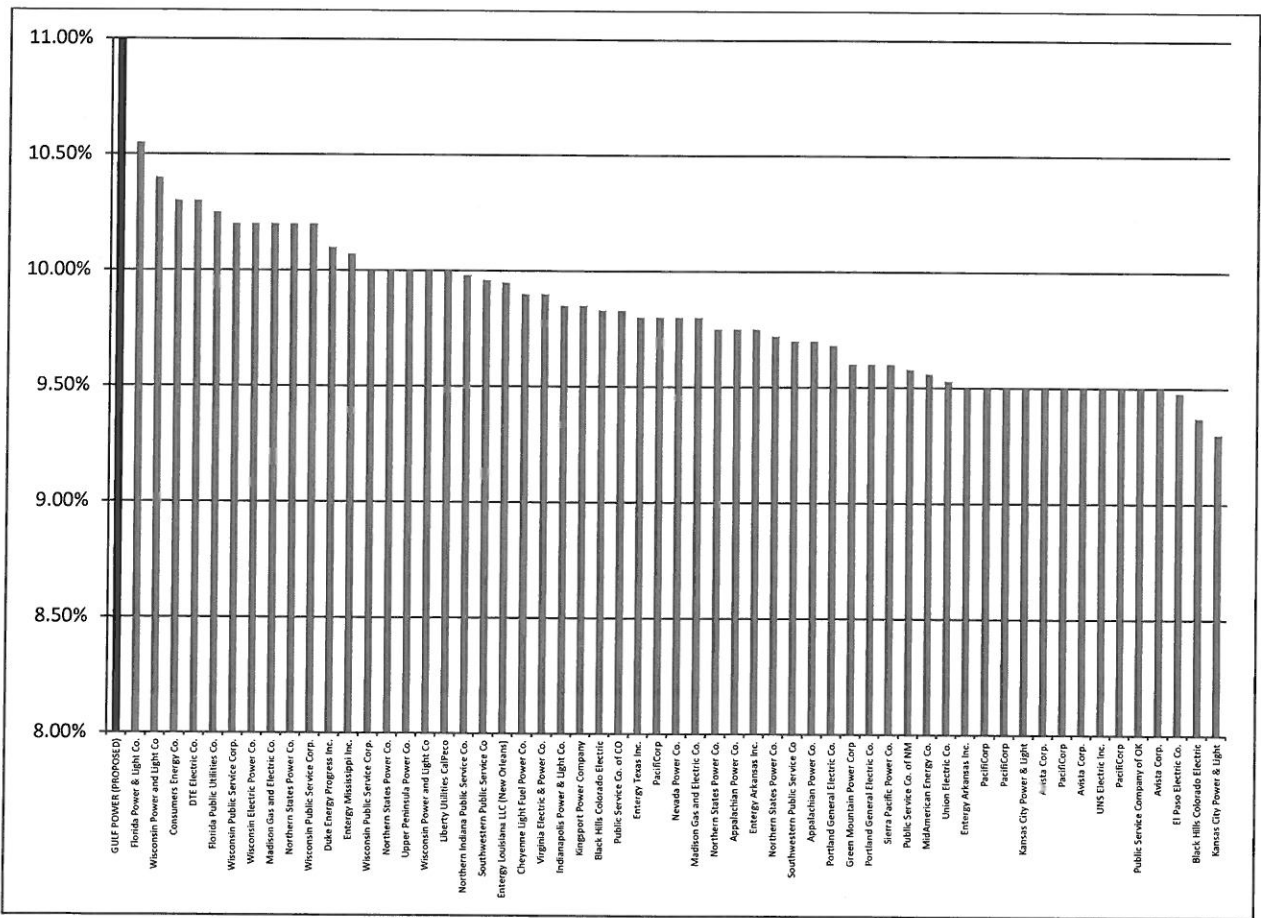


Figure 1. Gulf Proposed ROE Versus Authorized ROEs for Vertically Integrated Utilities, 2014 through 2016.

7
8
9

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 It should also be noted that even the Company's currently authorized ROE of 10.25
2 percent significantly exceeds the average of ROEs authorized for vertically integrated
3 utilities from 2014 to 2016.

4 **Q. WHAT IS THE REVENUE REQUIREMENT IMPACT OF THE DIFFERENCE BETWEEN THE**
5 **COMPANY'S PROPOSED 11 PERCENT ROE AND 9.81 PERCENT, THE AVERAGE**
6 **AUTHORIZED ROE FOR VERTICALLY INTEGRATED UTILITIES FROM 2014 TO 2016?**

7 A. The revenue requirement impact on the Company's rates of this difference in ROE is
8 approximately \$19.8 million. See Exhibit SWC-5.

9

10 **Conclusion**

11 **Q. GENERALLY, WHAT IS YOUR RECOMMENDATION TO THE COMMISSION ON THE**
12 **COMPANY'S PROPOSED INCREASE IN ROE?**

13 A. The Commission should closely examine the Company's proposed revenue
14 requirement increase and the associated ROE, especially when viewed in light of:

15 1) The customer impact of the resulting revenue requirement increases as I
16 discuss above;

17 2) The use of a future test year, which reduces regulatory lag by allowing
18 the utility to include the most current information in its rates at the time
19 they will be in effect;

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

- 1 3) The percentage of the Company's total jurisdictional revenues recovered
2 through base rates that are at risk due to regulatory lag versus the
3 amount of revenues collected through cost recovery clause charges; and
4 4) Recent rate case ROEs approved by other utility commissions nationwide.

5

6 **Cost of Service**

7 **Q. GENERALLY, WHAT IS WALMART'S POSITION ON SETTING RATES BASED ON THE**
8 **UTILITY'S COST OF SERVICE?**

9 A. Walmart advocates that rates be set based on the utility's cost of service for each
10 rate class. This produces equitable rates that reflect cost causation, send proper
11 price signals, and minimize price distortions.

12 **Q. WHAT IS YOUR UNDERSTANDING OF THE COMPANY'S PROPOSED PRODUCTION**
13 **CAPACITY COST ALLOCATION METHODOLOGY?**

14 A. My understanding is that the Company proposes to allocate production capacity
15 cost using a 12 coincident peak and 1/13th methodology, in which 12/13 of the
16 production capacity cost is allocated using the rate classes' contributions to the
17 Company's 12 monthly coincident peaks and the remaining 1/13 is allocated using
18 the Company's energy allocator. See Direct Testimony and Exhibits of Michael T.
19 O'Sheasy, page 16, line 10 to line 11.

Wal-Mart Stores East, LP and Sam’s East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 Q. DOES WALMART HAVE CONCERNS WITH THE COMPANY’S PROPOSAL?

2 A. Walmart does not expressly support the use of the 12 CP and 1/13th methodology
3 due to the arbitrary designation of a portion of production capacity cost as energy-
4 related.⁴ However, Walmart recognizes that this methodology has traditionally been
5 preferred by the Commission. As such, for the purposes of this docket Walmart
6 does not oppose the Company’s proposed production cost allocation methodology.

7 Q. DOES WALMART TAKE A POSITION ON THE OTHER FACETS OF THE COMPANY’S
8 PROPOSED COST OF SERVICE MODEL AT THIS TIME?

9 A. No. However, to the extent that alternative cost of service models or modifications
10 to the Company's model are proposed by other parties, Walmart reserves the right
11 to address any such changes in accord with the Commission’s procedures in this
12 docket.

13

14 **Economic Development and New Service Offerings**

15 Q. DOES GULF INDICATE ITS DESIRE TO BRING NEW BUSINESS TO NORTHWEST
16 FLORIDA AND TO PROMOTE THE EXPANSION OF EXISTING BUSINESSES?

17 A. Yes. See Direct Testimony and Exhibits of Bentina C. Terry, page 26, 6 to line 15.

⁴ The National Association of Regulatory Utility Commissioners “Electric Utility Cost Allocation Manual” (“NARUC Manual”) categorizes the 12 CP and 1/13th methodology in its “Judgmental Energy Weightings” section. See NARUC Manual, page 57 to page 59.

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 Q. WHAT IS YOUR UNDERSTANDING OF GULF'S PROPOSED ECONOMIC
2 DEVELOPMENT INITIATIVES IN THIS DOCKET?

3 A. My understanding is that Gulf proposes to modify its existing economic
4 development riders and introduce a new rider for businesses with a load of 5 MW or
5 greater. *Id.*, line 13 to line 15.

6 Q. DOES WALMART OPPOSE THE COMPANY'S PROPOSED MODIFICATIONS AND
7 ADDITIONAL RIDER?

8 A. No.

9 Q. DOES WALMART BELIEVE THAT OFFERING A BROADER RANGE OF SERVICES AND
10 RATE OPTIONS FOR BUSINESS CUSTOMERS IN THE COMPANY'S SERVICE
11 TERRITORY CAN FURTHER ENCOURAGE ECONOMIC DEVELOPMENT AND MEET THE
12 NEEDS OF EXISTING BUSINESS CUSTOMERS, WHILE AT THE SAME TIME
13 PROMOTING THE BEST INTERESTS OF THE COMPANY AND ALL OF ITS CUSTOMERS?

14 A. Yes. In particular, many business customers have renewable energy and
15 sustainability goals, which can require a supply mix different from that offered by
16 the utility. To meet the requirements of existing and potential customers, a
17 framework should be in place in which the customer can work with the utility to
18 ensure delivery of that supply mix on a cost-effective basis.

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 **Q. HAS WALMART ESTABLISHED CORPORATE RENEWABLE ENERGY GOALS?**

2 A. Yes. Walmart has established aggressive and significant renewable energy goals,
3 including: (1) to be supplied 100 percent by renewable energy⁵ and (2) by 2025, to
4 be supplied by 50 percent renewable energy. Additionally, Walmart has set a
5 science-based target to reduce emissions in our operations, through the deployment
6 of energy efficiency and consumption of renewable energy, by 18 percent by 2025.⁶
7 Walmart recognizes that Florida has significant renewable energy potential, and
8 strongly encourages the Commission to consider ways for customers like Walmart to
9 take advantage of that potential.

10 **Q. HAS WALMART WORKED CONSTRUCTIVELY WITH GULF'S SISTER COMPANIES ON**
11 **THE DEVELOPMENT AND IMPLEMENTATION OF LARGE SCALE RENEWABLE**
12 **PROGRAMS FOR BUSINESS CUSTOMERS?**

13 A. Yes. In Alabama, Walmart has contracted with Alabama Power for the offtake of 72
14 MW of solar power.⁷ This contract and its significant benefits are being realized
15 through the approval by the Alabama Public Service Commission of Alabama
16 Power's proposal to construct or otherwise acquire renewable generation resources
17 which are then paid for through agreements with specific customers, with no costs
18 shifted to non-participating ratepayers. See Order, Alabama Public Service
19 Commission Docket No. 32382, September 16, 2015.

⁵ <http://corporate.walmart.com/global-responsibility/environmental-sustainability>

⁶ <http://news.walmart.com/2016/11/04/walmart-offers-new-vision-for-the-companys-role-in-society>

⁷ <https://vimeo.com/170038083>

Wal-Mart Stores East, LP and Sam's East, Inc.
Direct Testimony of Steve W. Chriss
Florida Public Service Commission Docket No. 160186-EI

1 In Georgia, Walmart participated through the Commercial Group in
2 Georgia Power's 2016 integrated resource plan docket and advocated for a large
3 commercial and industrial renewable energy program. The Commercial Group was
4 party to a stipulation adopted by the Georgia Commission that creates a 200 MW
5 tranche of renewable resources to be allocated to programming for large
6 commercial and industrial customers and will be required to deliver value to all
7 Georgia Power customers. See Order Adopting Stipulation, Georgia Public Service
8 Commission Docket No. 40161 and Docket No. 40162, August 2, 2016.

9 **Q. WHAT IS WALMART'S RECOMMENDATION TO THE COMMISSION ON THIS ISSUE?**

10 A. Walmart proposes that the Commission should require the Company to initiate a
11 stakeholder process within 60 days of the final order in this docket for the
12 collaborative development of additional energy supply options, with a particular
13 focus on renewables, to be proposed for Commission approval within six months of
14 the final order in this docket. This programming will broaden the scope of Gulf's
15 tariffed products and services offered to existing and potential business customers
16 in its service territory and help Gulf promote economic development as well as meet
17 the needs of existing customers.

18 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

19 A. Yes.

20

1 DIRECT TESTIMONY OF RHONDA L. HICKS

2 Q. Please state your name and address.

3 A. My name is Rhonda L. Hicks. My address is 2540 Shumard Oak Boulevard;
4 Tallahassee, Florida; 32399-0850.

5 Q. By whom are you employed and in what capacity?

6 A. I am employed by the Florida Public Service Commission (FPSC or Commission) as
7 Chief of the Bureau of Consumer Assistance in the Office of Consumer Assistance &
8 Outreach.

9 Q. Please give a brief description of your educational background and professional
10 experience.

11 A. I graduated from Florida A&M University in 1986 with a Bachelor of Science degree
12 in Accounting. I have worked for the Florida Public Service Commission for 30 years,
13 and I have varied experience in the electric, gas, telephone, and water and wastewater
14 industries. My work experience includes rate cases, cost recovery clauses,
15 depreciation studies, tax, audit, consumer outreach, and consumer complaints. I
16 currently work in the Bureau of Consumer Assistance within the Office of Consumer
17 Assistance & Outreach where I manage consumer complaints and inquiries.

18 Q. What is the function of the Bureau of Consumer Assistance?

19 A. The Bureau's function is to resolve disputes between regulated companies and their
20 customers as quickly, effectively, and inexpensively as possible.

21 Q. Do all consumers, who have disputes with their regulated company, contact the Bureau
22 of Consumer Assistance?

23 A. No. Consumers may initially file their complaint with the regulated company and
24 reach resolution without the Bureau's intervention. In fact, consumers are encouraged
25 to allow the regulated company the opportunity to resolve the dispute prior to any

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Commission involvement.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to discuss/outline the number of consumer complaints logged with the Commission against Gulf Power Company under Rule 25-22.032, Florida Administrative Code, Consumer Complaints, from January 1, 2013, through December 31, 2016. My testimony will also provide information on the type of complaints logged and those complaints that appear to be rule violations.

Q. What do your records indicate concerning the number of complaints logged against Gulf Power Company?

A. From January 1, 2013, through December 31, 2016, the Florida Public Service Commission logged 1,866 complaints against Gulf Power Company. Of those, 1,781 complaints were transferred directly to the company for resolution via the Commission’s Transfer-Connect (Warm-Transfer) System. This system allows the Commission to directly transfer a customer to Gulf Power Company’s customer service personnel. Once the call is transferred to Gulf Power Company, it provides the customer with a proposed resolution.

Q. What have been the most common types of complaints logged against Gulf Power Company during the period January 1, 2013, through December 31, 2016?

A. During the specified time period, approximately eighty-five (85%) percent of the complaints logged with the Florida Public Service Commission concerned billing issues, while approximately fifteen (15%) of the complaints involved quality of service issues.

Q. Do you have any exhibits attached to your testimony?

A. Yes. I am sponsoring Exhibit RLH-1, which is a summary listing of customer complaints logged with the Commission against Gulf Power Company under Rule 25-

1 22.032, Florida Administrative Code. The complaints listed were received between
2 January 1, 2013, and December 31, 2016, and were captured in the Commission's
3 Consumer Activity Tracking System (CATS). The summary groups the complaints by
4 Close Type and within each Close Type, the complaints are segregated by Pre-Close
5 Type. The first grouping consists of Pre-Close types such as outages, repair, and
6 improper bills, that are still pending. The remaining groupings are categorized by
7 Close Type codes such as EB-24, ES-50, GI-02, etc.

8 Q. What is a Pre-Close Type?

9 A. A Pre-Close Type is an internal categorization that is applied to each complaint
10 upon receipt. A complaint is assigned a Pre-Close category based solely on the initial
11 information provided by the consumer.

12 Q. What is a Close Type?

13 A. A Close Type is also an internal categorization code. It is assigned to each complaint
14 once staff completes its investigation and a proposed resolution is provided to the
15 consumer. In some instances, the Pre-Close category will differ from the Close Type
16 because staff's investigation reveals facts that were not available upon receipt of the
17 complaint.

18 Q. A great majority of complaints were resolved as Close Type GI-02, Courtesy
19 Call/Warm Transfer. Can you explain this Close Type?

20 A. Yes. As previously stated, Gulf Power Company participates in the Commission's
21 Transfer-Connect (Warm-Transfer) System. This system allows the Commission to
22 directly transfer a customer to the company's customer service personnel. Once the
23 call is transferred to Gulf Power Company, it provides the customer with a proposed
24 resolution. Customers who are not satisfied with the company's proposed resolution
25 have the option of recontacting the Commission. While the Commission is able to

1 assign a Pre-Close Type to each of the complaints in this category, a specific Close
2 Type is not assigned because the proposed resolution is provided by Gulf Power
3 Company. Consequently, the GI-02 Close Type only allows staff to monitor the
4 number of complaints resolved via the Commission's Transfer-Connect System.

5 Q. How many of the complaints summarized on your exhibit has staff determined may be
6 a violation of Commission rules?

7 A. Of the 1,866 complaints logged against Gulf Power Company during the period
8 January 1, 2013, and December 31, 2016, staff determined that two complaints appear
9 to be violations of Commission rules.

10 Q. What was the nature of the apparent rule violations?

11 A. The apparent rule violations were related to billing the wrong customer and failure to
12 provide complaint resolution prior to the established deadline.

13 Q. Does this conclude your testimony?

14 A. Yes, it does.

15

16

17

18

19

20

21

22

23

24

25

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

COMMISSION STAFF

DIRECT TESTIMONY OF DONNA D. BROWN

DOCKET NO. 160186-EI

JANUARY 13, 2017

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Q. Please state your name and business address.

A. My name is Donna D. Brown. My business address is 2540 Shumard Oak Boulevard, Tallahassee, Florida, 32399.

Q. By whom are you presently employed and in what capacity?

A. I am employed by the Florida Public Service Commission (FPSC or Commission) as a Public Utility Analyst II in the Office of Auditing and Performance Analysis. I have been employed by the Commission since February 2008.

Q. Briefly review your educational and professional background.

A. I graduated from Florida A&M University’s School of Business & Industry in 2006 with a Bachelor of Arts degree in Accounting.

Q. Please describe your current responsibilities.

A. My responsibilities consist of planning and conducting utility audits of manual and automated accounting systems for historical and forecasted data.

Q. Have you presented testimony before this Commission or any other regulatory agency?

A. Yes. I filed testimony in the Fuel and Purchased Power Cost Recovery Clause, Docket Nos. 110001-EI and 120001-EI.

Q. What is the purpose of your testimony today?

A. The purpose of my testimony is to sponsor the staff audit report of Gulf Power Company Utility or GPC) which addresses the Utility’s application for a rate increase. This audit report is

1 filed with my testimony and is identified as Exhibit DDB-1.

2 **Q. Was this audit prepared by you or under your direction?**

3 A. Yes, it was prepared under my direction.

4 **Q. Please describe the work you performed in this audit.**

5 A. We performed the following procedures:

6 We verified, based on a judgmental sample of Utility Plant in Service (UPIS) additions,
7 retirements and adjustments for selected plant accounts, that the Utility’s UPIS is properly
8 recorded for the period January 1, 2013, through December 31, 2015. We traced the UPIS
9 adjustments to source documents and noted that they were consistent with Order No. PSC-13-
10 0670-S-EI. We recalculated a sample of 13-month average balances for UPIS included in the
11 filing.

12 We verified, based on a judgmental sample of Plant Held for Future Use (PHFU)
13 properties presented in the filing, that the PHFU balance is properly stated as of December 31,
14 2015. We reviewed documents describing the planned use for properties in our sample and
15 inquired about changes in use for existing properties. We traced the PHFU adjustments to source
16 documents and noted that they were consistent with Order No. PSC-13-0670-S-EI. We
17 recalculated a sample of 13-month average balances for PHFU included in the filing.

18 We verified, based on a judgmental sample of Construction Work in Progress (CWIP)
19 projects included in the filing, that the CWIP balance is properly stated as of December 31, 2015.
20 We reviewed utility documents describing each project sampled to determine whether it was
21 eligible to accrue Allowance for Funds used During Construction (AFUDC). We verified that
22 projects accruing AFUDC were not included in rate base in the filing. We traced the CWIP
23 adjustments to source documents and noted that they were consistent with Order No. PSC-13-
24 0670-S-EI. We recalculated a sample of 13-month average balances for CWIP included in the
25 filing.

1 We verified, based on a judgmental sample of selected Accumulated Depreciation (AD)
2 accounts, that the AD is properly recorded for the period January 1, 2013, through December 31,
3 2015, and the Utility properly restated and used the depreciation rates approved in the order cited
4 above. We traced the AD adjustments to source documents and noted that they were consistent
5 with Order No. PSC-13-0670-S-EI. We recalculated a sample of 13-month average balances for
6 selected AD accounts included in the filing.

7 We verified, based on a judgmental sample of selected accounts, that the Working
8 Capital (WC) balance is properly stated, utility in nature, non-interest bearing, does not include
9 non-utility items, and is consistent with Order No. PSC-13-0670-S-EI. We verified, based on a
10 judgmental sample of selected accounts that the accumulated provision accounts year end
11 balances comply with Commission Rule 25-6.0143, Florida Administrative Code. We
12 recalculated a sample of 13-month average balances for selected WC accounts included in the
13 filing.

14 We reconciled 2015 revenues to the general ledger. We reviewed Commission audits of
15 the Utility's cost recovery clauses, which included recalculations of a sample of customer bills, to
16 ensure that the Utility was using the rates authorized in its approved tariffs. We verified that
17 unbilled revenues were calculated correctly. We traced the revenue adjustments to source
18 documents and noted that they were consistent with Order No. PSC-13-0670-S-EI.

19 We verified, based on a judgmental sample of utility transactions for select O&M
20 expense accounts, that 2015 O&M expense balances are adequately supported by source
21 documentation, utility in nature and do not include non-utility items. We reviewed samples of
22 utility advertising expenses, legal fees, outside service expenses, sales expenses, customer
23 service expenses, and administrative and general service expenses to ensure that amounts
24 supporting non-utility operations were removed. We traced the O&M expense adjustments to
25 source documents and noted that they were consistent with Order No. PSC-13-0670-S-EI. We

1 obtained a breakdown of the Affordable Health Care Act and its impact on revenues, expenses,
2 and tax liabilities.

3 We recalculated a judgmental sample of depreciation expense accruals to verify that the
4 Utility is using the correct depreciation rates established in Order No. PSC-13-0670-S-EI. We
5 traced the depreciation expense adjustments to source documents and noted that they were
6 consistent with the order cited above.

7 We verified, based on a judgmental sample of transactions for select TOTI accounts, that
8 TOTI expenses are adequately supported by source documentation. We traced the TOTI
9 adjustments to source documents and noted that they were consistent with Order No. PSC-13-
10 0670-S-EI.

11 Audit staff traced the Utility's net operating income reflected in the MFRs to the general
12 ledger. We reviewed the Utility provided schedule that reconciles the MFR amounts for the
13 taxable income per books, the temporary and permanent differences, and the deferred income tax
14 balances to the tax returns. We traced selected items to the 2015 tax return.

15 We obtained the rate base/capital structure reconciliation and determined that the non-
16 utility adjustments removed in rate base were removed in the capital structure. Audit staff
17 reconciled the cost of capital cost rates for the historical base year to the debt documentation.
18 We obtained a reconciliation of the rate base adjustments in the capital structure and traced it to
19 the MFRs and the general ledger.

20 We reviewed the Utility's MFR B-3 schedule and reconciled it to the general ledger. We
21 reviewed the Utility's 2014 and 2015 tax returns, and reconciled selected items to Utility support.
22 We also reviewed Utility provided support and reconciled the documentation to the general
23 ledger.

24 Audit staff developed a four year, 2012 to 2015, analytical review that compared the
25 annual percentage changes and the 2015 over 2012 total percentage change for the FERC account

1 balances. Accounts that demonstrated significant activity or percentage change, as determined
2 by the auditor, were randomly selected for additional review.

3 Audit staff reviewed the Utility’s policies and procedures relating to the recording of
4 affiliate transactions and the cost/allocation manual for employees. During the review of rate
5 base and net operating income, we examined items that were allocated as per the Utility’s
6 policies and procedures.

7 We requested a listing of audit reports of Gulf Power Company issued by FERC from
8 January 1, 2013, to December 31, 2015. There were none.

9 We reviewed the internal audits to determine if any adjustments materially affected the
10 historical base year. We noted that the Utility had performed any required corrective action in
11 the applicable follow-up audit. We reviewed the 2015 annual report. The annual report was
12 released on February 26, 2016, and included the unqualified opinion by Deloitte and Touche
13 LLP.

14 We reviewed Gulf Power Company’s Board of Directors meeting minutes from January
15 1, 2013 to December 31, 2015, for activities or issues that could affect the Utility in the current
16 rate case proceeding.

17 **Q. Were there any audit findings in the audit report, Exhibit DDB-1, which address the**
18 **historical 2015 amounts in the schedules prepared by the Utility in support of it’s filing in**
19 **the current docket?**

20 A. No.

21 **Q. Does that conclude your testimony?**

22 A. Yes, it does.

23
24
25

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

DIRECT TESTIMONY OF JUDY G. HARLOW

Q. Please state your name and business address.

A. My name is Judy G. Harlow. My business address is 2540 Shumard Oak Boulevard, Tallahassee, Florida, 32399-0850.

Q. By whom are you employed and in what capacity?

A. I am employed by the Florida Public Service Commission (FPSC or Commission) as the Chief of the Bureau of Conservation and Forecasting in the Division of Economics.

Q. Please describe your educational and professional background.

A. I attended Louisiana State University, where I received a B.S. in Business Administration with an Economics major in 1980 and a M.S. in Economics in 1982. Following graduate school, I was employed as a Business and Forecasting Analyst with VWR Scientific Corporation in Philadelphia, Pennsylvania. I was hired by the FPSC in 1991 as a Research and Planning Economist in the Division of Research and Regulatory Review. I then transferred to the Commission's Division of Electric and Gas as an Economic Analyst in the System Planning Section in 1996. Prior to joining the Division of Economics, I was a Senior Analyst in the Division of Regulatory Analysis. In 2012, I was promoted to Supervisor of the Conservation Section within the Commission's Division of Economics. I have held my current position as Chief of the Bureau of Conservation and Forecasting since 2015.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to highlight the potential impact on residential customer bills and energy usage resulting from Gulf Power Company's (Gulf) proposed change in rate structure, which would increase the residential customer, or base charge and

1 reduce the energy charge. I will focus on how Gulf intends to collect its revenue requirement
2 from its residential customers, rather than on the level of revenue requirement. My intent is to
3 provide a more complete record upon which the Commission may make an informed decision
4 regarding Gulf's proposed rate structure change.

5

6 Q. Are you sponsoring any exhibits with your testimony?

7 A. Yes. I sponsor Exhibits JGH-1 through JGH-6. These exhibits were prepared by me or
8 under my direct supervision. The information in the exhibits is correct to the best of my
9 knowledge.

10

11 Q. Please summarize Gulf's proposed change in rate structure for its residential customer
12 class.

13 A. Gulf's current standard Residential Service (RS) rate is composed of a base charge of
14 \$0.62 per day and an energy charge of 4.585 cents per kilowatt-hour (kWh) for costs
15 recovered through base rates. Approximately 365,000 of Gulf's 396,000 non-lighting
16 residential customers, or 92 percent, are on the RS rate. As of the October 12, 2016 testimony
17 filing date, Gulf's total energy charge, including clause recovery, was 11.4 cents per kWh.
18 Gulf has proposed an increase in the base charge to \$1.58 per day and a reduction in the
19 energy charge to 3.298 cents per kWh. For a 30-day typical billing period, Gulf's proposal
20 reflects a base charge increase from \$18.60 to \$47.40, a 155 percent increase in base charges.
21 At the same time, the energy charge would decrease 28 percent, from 4.585 to 3.298 cents per
22 kWh. Gulf's total energy charge, including cost recovery clauses, would decrease from 11.4
23 cents to 10.1 cents per kWh, or an 11 percent decrease, if both the proposed rate increase and
24 proposed rate structure are approved.

25

1 Q. How has Gulf's residential base charge changed over time?

2 A. Gulf's residential base charge was \$8.07 per month in 2001, increasing to \$10.00 in
3 2002. Gulf's base charge was increased to \$15.00 per month in 2012. In 2013, Gulf received
4 Commission approval for a rate settlement that included a daily base charge of \$0.60 in 2014,
5 increasing to \$0.62 in 2015, or \$18.60 for a 30-day typical billing period. Exhibit JGH-1
6 provides further detail on Gulf's historical base charges and the associated Commission
7 orders.

8

9 Q. How does Gulf's current residential base charge compare to those of other Florida
10 investor-owned utilities?

11 A. Gulf's current residential base charge of \$18.60 (assuming a 30-day period) is higher
12 than the residential base charges for the other four Florida investor-owned electric utilities.
13 Exhibit JGH-2 shows that as of December 31, 2015, the investor-owned utilities' base charges
14 ranged from \$7.57 per month for Florida Power & Light Company to \$18.60 for Gulf. Gulf's
15 proposed residential base charge of \$47.40 for a 30-day period would far exceed the next
16 highest investor-owned utility base charge of \$15.00, which was approved by the Commission
17 for Tampa Electric Company in 2013.

18

19 Q. How does Gulf's proposed residential base charge compare to those of the Florida
20 municipal and cooperative utilities?

21 A. As shown in Exhibit JGH-3, Gulf's current and proposed residential base charges
22 exceed the base charges for all Florida municipal utilities, which range from \$0.00 per month
23 for the City of Starke to \$15.03 per month for Key Energy Services.

24

25 As shown in Exhibit JGH-4, cooperative utilities in Florida currently have comparably higher

1 residential base charges than those of the investor-owned or municipal electric utilities.
2 Monthly residential cooperative utility base charges range from \$15.00 for Lee County
3 Electric Co-op to \$45.00 for Glades Electric Co-op. As can be seen in Exhibits JGH 2-4,
4 Gulf's proposed residential base charge of \$1.58 per day, or \$47.40 for a 30-day period, would
5 exceed that of any other electric utility within the state.

6

7 Q. How are the residential customers of investor-owned utilities in Florida typically
8 billed?

9 A. In general, Florida investor-owned utility residential customers are billed based on a
10 two-part rate composed of a fixed monthly base or customer charge and an energy charge that
11 varies with energy (kWh) usage.

12

13 Q. Please explain the types of costs that have traditionally been approved by the
14 Commission for recovery through a base or customer charge.

15 A. In general, the Commission has approved costs for recovery through the customer
16 charge that vary directly with the number of customers. These include costs such as customer
17 billing, metering, and service drop-related costs, including the meter.

18

19 Q. Did Gulf explain its methodology behind the proposed residential rate structure
20 change?

21 A. Yes. Gulf witness McGee explains that "Gulf's proposed two-part rates are designed to
22 collect revenue more like optimum three-part demand rates without using explicit demand
23 charges." Under a three-part demand rate, customer charges are designed to recover each of
24 the three broad categories of costs to provide electric service: (1) customer-related costs, (2)
25 energy-related costs, and (3) demand-related costs.

1 Gulf is proposing to employ a methodology developed by Dr. Larry Blank and Dr. Doug
2 Gegax as the basis for its rate structure change. The Blank and Gegax methodology begins
3 with the premise that a three-part demand rate is “the preferred rate design”; however, as
4 noted by Blank and Gegax, in some cases a three-part rate may not be practical due to
5 customer acceptance or the types of installed meters. Blank and Gegax use sample load
6 research data from a single electric utility to allocate the demand charges across the customer
7 and energy charges to “derive an enhanced two-part tariff, which serves as a substitute for the
8 benchmark three-part tariff.” In the 2016 article cited by Gulf, Blank and Gegax use sample
9 load data from Entergy Arkansas, Inc. to recommend that, for Entergy Arkansas, 50 percent of
10 demand-related costs should be recovered through the fixed charge and 50 percent through the
11 volumetric charge.

12
13 Gulf used its own residential load data and the Blank and Gegax methodology to determine
14 the same 50/50 recovery of its demand-related costs through its base charge and energy
15 charge. According to Gulf witness McGee, “When applied to Gulf’s residential customer data,
16 the B&G methodology suggests that approximately half of demand-related costs should be
17 allocated to the energy charge and the other half should be allocated to the base charge.”

18
19 Q. To your knowledge, has the FPSC ever employed this type of or a similar methodology
20 in setting rates?

21 A. No.

22
23 Q. Has this methodology been used by other state public utility commissions in setting
24 rates?

25 A. No, not to my knowledge.

1 Q. Do Blank and Gegax address the change in customer energy usage if their
2 methodology is used as a foundation for rate design?

3 A. No. Blank and Gegax do not estimate the impact on customer energy usage due to the
4 increased base charge and reduced energy charge that will result if their ratemaking
5 methodology is adopted. I believe the impact on customer bills and energy usage from the
6 proposed rate design merits consideration.

7

8 Q. In general, how do you believe Gulf's proposed increase in the residential base charge
9 and reduction in the energy charge will affect the utility's residential customers?

10 A. Gulf's high energy users will benefit through lower total bills; while lower usage
11 customers will experience higher bills than under the current rate structure. The proposed rate
12 structure change will also reduce customers' ability to control their bills through efficiency
13 actions or investing in distributed generation. The lower energy charge can be expected to
14 lessen the economic benefits for customers to use energy more efficiently or install distributed
15 generation, such as solar photovoltaic systems. The higher fixed base charge and lower
16 variable energy charge will also reduce volatility of customer bills from month to month.

17

18 Q. How will the proposed rate structure impact customers of varying consumption levels
19 within Gulf's residential rate class?

20 A. Gulf's proposal to recover 50 percent of its demand-related costs through the base
21 charge will increase the customer charge, resulting in a lower energy charge. Relatively low
22 usage customers, up to a breakeven point of approximately 1,200 kWh per month, will be
23 most impacted by the increased base charge, because the lower energy charge will not be
24 sufficient to overcome the higher base charge. For higher energy usage customers, the increase
25 in the base charge will be more than offset by the reduction in the energy charge. As a

1 reference point, Gulf estimates that its average monthly residential energy usage in the 2017
2 test year will be 1,112 kWh per month. Exhibit JGH-5 displays example bills based on data
3 provided by Gulf and calculates the percentage changes under the current and proposed rate
4 structures for two scenarios: (1) without Gulf's proposed rate increase, and (2) with the
5 proposed rate increase. As shown on Exhibit JGH-5, in both scenarios, the magnitude of the
6 loss from the proposed rate structure change, represented by a higher bill, will increase as
7 energy usage decreases. Conversely, the magnitude of the benefit, represented by a lower bill,
8 will increase as energy usage increases.

9
10 Q. Is there a way to determine the percentage of customers that will have higher bills due
11 to the proposed rate structure change?

12 A. Yes. The percentage of customers that will have higher or lower bills can be
13 determined based on: (1) the proposed rate structure change, (2) Gulf's distribution of
14 customers by average monthly kWh usage, and (3) any expected changes in customer energy
15 usage in response to the rate structure change. Exhibit JGH-6 displays data provided by Gulf
16 in response to staff discovery, with staff calculations of the current and proposed total
17 residential bills if the rate increase and proposed rate structure are adopted. Based on Gulf's
18 discovery response, staff calculated that approximately 57 percent of Gulf's residential
19 customers on the RS rate can be expected to have higher total bills due to the proposed rate
20 structure; while approximately 43 percent with higher energy usage will have lower bills.
21 Gulf's discovery response assumes that residential customers will react to the proposed rate
22 structure change by adjusting energy usage such that low energy users would reduce usage
23 while higher energy users would increase usage. As discussed further in my testimony, there is
24 uncertainty regarding the change in customer energy usage in response to Gulf's proposed rate
25 structure change. However, as shown in Exhibit JGH-6, given Gulf's assumptions, on a

1 percentage basis customers with the lowest usage will be the most impacted by the proposed
2 rate structure change. For example, the average bill for customers that use 0 to 2,000 kWh per
3 year will increase by 87 percent (4.7 percent of customers on the RS rate). Customers that use
4 2,000 to 4,000 kWh annually will experience an average 40 percent increase (4.2 percent of
5 RS customers). Customers that use 4,000 to 6,000 kWh annually will have a 22 percent total
6 bill increase (5.2 percent of RS customers).

7

8 Q. How will Gulf's proposal affect customers' ability to control their electric bills?

9 A. Customers cannot avoid the fixed base charge through energy efficiency measures,
10 customer behavior, or customer-owned generation. A higher fixed charge and lower energy
11 charge will reduce the bill impact of a change in customer energy usage. In addition, the
12 proposed rate structure alters the economics of investment in conservation measures by
13 creating a longer payback period. This impact affects all customers, but is a particular concern
14 for low usage customers that have already invested in energy saving measures. This leaves
15 less opportunity for these customers to implement additional conservation measures.

16

17 Q. Do you believe the proposed rate structure change can affect customer investment in
18 high efficiency equipment and customer-owned distributed generation?

19 A. Yes. A reduced energy charge will increase the payback period for consumers that are
20 considering investments in conservation measures or distributed generation. A longer payback
21 period may dissuade some customers from investing in energy efficiency measures or
22 distributed generation.

23

24 Q. How will the lower energy charge affect customer incentives to use energy efficiently?

25 A. A lower energy charge can be expected to impact customer incentives to use energy

1 efficiently. All else being equal, customers can be expected to increase energy usage due to a
2 lower energy charge. The Participants test required by Commission Rule 25-17.008, Florida
3 Administrative Code, recognizes the impact of the energy price on consumer efficiency
4 investments. This cost-effectiveness test uses the energy price as an input to determine
5 whether it is cost-effective for a customer to participate in a utility-sponsored demand-side
6 management (DSM) program. A lower energy charge will reduce the cost-effectiveness of a
7 conservation measure under the Participants test, indicating the customer would be less likely
8 to participate in a utility-sponsored program or make an investment on their own outside of a
9 program.

10

11 Q. Did Gulf provide an estimate of the price elasticity of demand for its residential
12 customers?

13 A. Yes. Price elasticity of demand is a measure of customer responsiveness to a change in
14 price. Gulf estimates a price elasticity of -0.25 percent for its residential customers. This
15 translates to an expectation that for every one percent increase in price, there is a 0.25 percent
16 decrease in the quantity demanded. Conversely, a one percent decrease in price is expected to
17 result in a 0.25 percent increase in the quantity demanded. In contrast, Gulf estimates small
18 commercial and large commercial price elasticities at -0.15 percent and -0.13 percent,
19 respectively. Thus, Gulf expects that residential customers are more likely to adjust
20 consumption in response to a change in electric prices than are commercial customers.

21

22 Q. Do you believe Gulf's forecast model appropriately accounts for the potential impact
23 on residential customer demand and energy usage due to the proposed change in rate
24 structure?

25 A. No. This question relates to the long standing argument about whether electric

1 customers react to bills or rates. Gulf's load forecast model appears to assume that residential
2 customers react to bills. To determine customer responsiveness to price, Gulf's load forecast
3 model assumes customers react to the average price on their bill, including the fixed and
4 variable components. Gulf did not provide an analysis that separates the fixed and variable
5 components of the electric price to test customer responsiveness to the rate structure change.
6 In response to staff discovery, Gulf estimated a 0.7 gigawatt-hours (GWh) increase in energy
7 sales due to the rate design change out of a total 5,371 GWh in annual residential energy sales.
8 Gulf's estimated sales increase is relatively small because Gulf projects that customers with
9 increased bills (low usage) under the new rate structure will reduce consumption, while
10 customers with decreased bills (higher usage) will increase consumption. Gulf projects that the
11 reduced consumption by the lower usage customers will partially offset the increased
12 consumption by higher usage customers. Gulf's relatively small projected increase in energy
13 sales is the result of its assumption that customers react to average price.

14

15 It is notable that Gulf's forecast model in its previous rate case also used an average price,
16 rather than separate fixed and variable components to determine residential customer
17 responsiveness to price. This rate case is significantly different for residential customers,
18 however, because in addition to a proposed rate increase, Gulf has proposed the rate structure
19 change. I do not believe Gulf has provided sufficient information to the Commission regarding
20 the potential impact on customer behavior and its sales due to the proposed rate structure
21 change. Given the proposed reduction in the energy charge under the new rate structure, Gulf
22 should have performed a separate analysis that modeled residential customer responsiveness to
23 rates, rather than bills. If customers respond to the reduction in energy charge, I believe it is
24 entirely possible that the proposed rate design may increase sales beyond that predicted by
25 Gulf's forecast model.

1 Q. Please explain the reasons you believe conservation and distributed generation
2 investments will be impacted by the rate structure change.

3 A. The lower energy charge will lengthen the payback period on energy efficiency
4 investments and customer-owned distributed generation, such as solar photovoltaic systems.
5 As noted previously, longer payback periods may impact some customers' decisions to invest
6 in certain types of energy efficiency equipment and participate in Gulf's DSM programs. All
7 else being equal, customer participation in Gulf's existing DSM programs can also be
8 expected to decline. In order to maintain or increase customer participation, Gulf may have to
9 consider higher rebates and hence higher DSM program costs. As discussed below, Gulf has
10 proposed higher rebates for some, but not all of its residential DSM program measures.

11

12 Q. Are you aware that Gulf has proposed several new and modified residential demand-
13 side management programs in this proceeding?

14 A. Yes. According to Gulf witness Floyd, Gulf is proposing to add a new residential
15 ceiling insulation program. Gulf is also proposing to modify its existing residential HVAC
16 Efficiency program to include heat pump efficiency measures. In addition, Gulf proposes
17 increased maximum rebates for specified measures in its Residential Building Efficiency
18 program (reflective roofing) and its HVAC Efficiency program (HVAC maintenance and
19 repair measures).

20

21 Q. Do these new and modified residential DSM programs alleviate your concerns
22 regarding conservation?

23 A. No. In implementing the Florida Energy Efficiency and Conservation Act (FEECA),
24 Sections 366.80 through 366.83 and 403.519, Florida Statutes, the Commission has long
25 encouraged cost-effective DSM programs. However, according to witness Floyd, these new

1 and modified DSM programs would only be cost-effective if the Commission approves Gulf's
2 proposed residential rate structure change. Therefore, I believe it is appropriate to look at the
3 effects of Gulf's proposed rate structure change on customer demand and energy usage in
4 total, rather than reviewing the results of the DSM program modifications in isolation. Gulf
5 has projected that its proposed residential DSM program modifications will save peak summer
6 and winter demand and energy usage. However, these program savings may be overwhelmed
7 by the potential impact on customer behavior and Gulf's sales due to the rate structure change.
8 A 28 percent reduction in base rate energy charges (11 percent reduction in total energy
9 charge) can be expected to increase both customer demand and energy usage. Gulf's own
10 model estimates a -0.25 price elasticity for residential customers, indicating a 1 percent
11 reduction in price will lead to 0.25 percent increase in residential sales, or an approximately
12 2.8 percent increase in sales based on the total energy charge reduction.

13

14 Q. Do you have any concerns regarding the new and modified residential DSM programs
15 Gulf has proposed in this proceeding?

16 A. Yes. The cost-effectiveness of the proposed new and modified residential DSM
17 programs cannot be determined until Gulf's rates are established in this docket. Customer
18 rates are a key input into both the Rate Impact Measure (RIM) and Participants cost-
19 effectiveness tests. These tests, along with the Total Resource Cost test, are reviewed by the
20 Commission to determine whether a proposed DSM program or program modification is cost-
21 effective.

22

23 Q. Will Gulf's proposed new and modified residential DSM programs affect customer
24 costs recovered outside of base rates?

25 A. Yes. DSM program costs are recovered through the Energy Conservation Cost

1 Recovery clause (ECCR). ECCR cost recovery can be expected to increase to recover costs
2 associated with the proposed new and modified DSM programs and higher customer rebates.
3 Gulf estimates that cost recovery for the new and modified residential DSM programs will
4 increase the ECCR charge from \$1.60 to \$1.664 per month for a typical residential customer
5 using 1,000 kWh.

6
7 Q. Are there any other potential cost impacts related to Gulf's proposed rate structure
8 change?

9 A. Yes. If customers respond to Gulf's reduced energy charge by increasing energy usage,
10 Gulf will experience higher fuel and variable O&M costs to increase dispatch at existing
11 generating facilities, and/or higher purchased power costs to meet this incremental energy
12 usage. These costs will be recovered from ratepayers through the Fuel and Purchased Power
13 cost recovery clause. In addition, increased residential demand may advance the need for new
14 capacity. There will also certainly be costs associated with Gulf's proposed Low Income Rate
15 Rider, including the customer credits, as well as administrative costs to determine customer
16 eligibility and adjust billing software and to educate customers on the program's availability.

17
18 Q. What is Gulf's rationale for the proposed residential rate structure?

19 A. Gulf witness McGee stresses cost causation as the rationale for Gulf's proposed rate
20 structure change. He contends that the current residential rate structure has an "unnecessarily
21 large energy charge," which "... causes a misalignment between cost-causers and those who
22 pay." He also states that "A three-part demand rate best aligns rates with costs because it
23 mirrors these cost categories with three discrete rate components: a customer charge, a
24 demand charge and an energy charge."

25

1 Q. Do you agree that cost causation sufficiently justifies Gulf's proposed change in
2 residential rate structure?

3 A. No. I agree that cost causation is the appropriate basis for allocating costs of service
4 across rate classes. Once costs are allocated to each customer class, rates must be designed
5 that allow a utility to recover its costs. In reviewing utility rate requests and designing rates,
6 however, the regulatory body must balance the interests of the utility with those of its
7 customers. There are often competing objectives between the utility and various classes of its
8 customers, and the regulatory body itself may have guiding ratemaking principles or goals.

9
10 In addition to cost causation, the regulatory body may take other goals into consideration in
11 setting rates, such as: (1) minimizing rate shock, (2) minimizing uneven impacts to various
12 groups of ratepayers, and (3) sending appropriate price signals to customers. Gulf has
13 identified an additional ratemaking consideration - the ease of customer understanding for a
14 proposed rate design methodology.

15
16 I believe the principle of gradualism is instructive in this case. In electric rate cases, the
17 Commission has followed the principle that no class of customers will receive a rate increase
18 of over 1.5 times the system average increase. The Commission has also followed the
19 principle that no class of customers should receive a decrease while other classes receive an
20 increase. Gulf witness Evans notes that Gulf has respected these "traditional limits", and states
21 "First, because an overall rate increase is requested, no rate class is assigned a rate decrease.
22 Second, the base rate percentage increase for each class is limited to no more than 1.5 times
23 the overall retail average percentage increase to base rates." Witness Evans further notes that
24 on MFR E-8, Gulf shows that "the increases allocated to each rate class represent base rate
25 increases of 15.9 percent to 28.8 percent." The high end of this rate increase range, 28.8

1 percent, is 1.5 times Gulf's overall base rate increase request of 19.2 percent.

2

3 Gulf has proposed a base rate increase of 14.92 percent for residential customers as a class, as
4 shown on MFR Schedule E-8. As displayed on Exhibit JGH-5, the actual bill impact on
5 individual customers will vary depending on usage. The bills for higher energy users will go
6 down. At the same time, many of Gulf's relatively low usage customers will receive an
7 increase higher than 28.8 percent, or 1.5 times Gulf's overall rate request. An argument can be
8 made that the proposed rate structure change only impacts the class of residential ratepayers
9 and therefore the concept of gradualism as applied historically by the Commission does not
10 strictly apply. However, the Commission has broad authority relating to ratesetting and a long
11 history of considering customer impacts, for example, by phasing in authorized rate changes
12 over time.

13

14 Q. Other than the DSM programs discussed above, what other proposals has Gulf made in
15 this proceeding to address concerns with the proposed change in residential rate structure?

16 A. Gulf is proposing an Advanced Pricing Package composed of: (1) the rate structure
17 change under the traditional two-part RS rate, and (2) two new optional residential demand
18 rates. The proposed optional residential demand rates are three-part rates, composed of a base
19 charge, a maximum demand charge, and an energy charge. The proposed Residential Service
20 – Demand Time-of-Use Conservation rate also has a monthly on-peak demand charge. Gulf is
21 also proposing a Low Income Rider under its RS rate.

22

23 Q. Do you have any comments on Gulf's proposed optional residential demand rates?

24 A. Yes. Gulf's two optional residential demand rates may give customers who choose to
25 participate more ability to control their bills. Three-part demand rates are also one ratemaking

1 option to better align cost causation with revenue recovery, and to send improved price signals
2 to customers on how their actions impact system costs. Due to the additional complexity of a
3 three-part rate, Gulf's efforts to educate its customers will play an important role in
4 influencing customer acceptance and participation in these optional rates.

5

6 Q. Please briefly describe Gulf's proposed low income rate rider.

7 A. As explained by witness McGee, Gulf's proposed low income rate rider will provide a
8 bill credit of \$0.69 cents per day, or \$20.70 for a 30-day billing period to eligible low income
9 customers. Witness McGee states that the credit "will be available to all Gulf Power
10 residential customers of record who are also participants in the Supplemental Nutritional
11 Assistance Program (SNAP), also known as Food Stamps, and who apply for the credit."
12 Witness McGee projects 35,000 customers will receive these credits.

13

14 Q. Do you have any comments on Gulf's proposed low income rate rider?

15 A. Yes. Gulf acknowledges that the proposed low income rider creates a subsidy from the
16 general body of residential ratepayers to low income ratepayers. It is the utility's low usage
17 customers, however, that will be most impacted by the higher base charge. According to Blank
18 and Gegax, low income customers are not necessarily low energy users. Low income
19 customers with higher energy usage will experience lower bills from the proposed lower
20 energy charge and will be eligible for the low income rider. Gulf proposes that customers must
21 request the low income bill credit; so education and customer awareness about the rider's
22 availability and eligibility requirements will be necessary.

23

24 In addition, Gulf may have underestimated the potential number of customers that will
25 participate in the low income rider, and consequently, program costs. In response to staff

1 discovery, Gulf provided data obtained from the Florida Department of Children and Families
2 (DCF) indicating that as of June 2015, approximately 70,000 households within its territory
3 participate in SNAP, or over 19 percent of Gulf's customers on the RS rate. Gulf assumed a
4 49.9 percent participation rate (based on Florida's average Lifeline participation rate) to
5 determine its expected participation of 35,000 residential customers. Thus, the number of
6 eligible customers is approximately twice Gulf's estimated number of participants. If actual
7 participation in the Low Income Rider exceeds Gulf's projections, the costs of the program
8 will be higher than Gulf's estimated \$8.8 million in annual costs. In response to staff
9 discovery, Gulf stated that these projected Low Income Rider costs would be recovered from
10 residential customers through an increase in the base charge of approximately six cents per
11 day, or \$1.80 for a 30-day period. Gulf does not appear to have included the costs to
12 administer the program in this cost estimate.

13

14 Specific SNAP eligibility requirements are established by each state within federal guidelines.
15 In Florida, the SNAP program is administered by DCF. Without a waiver from an individual
16 SNAP recipient, DCF cannot release individual SNAP account data under state privacy
17 protections. This indicates that Gulf's customers will have to prove eligibility for the program
18 with their utility. Customers may be reluctant to divulge this personal information to Gulf,
19 which may result in lower participation by those customers in need.

20

21 Administering this program will be challenging for the utility and add additional customer
22 administrative costs. For example, most SNAP recipients are on an annual renewal. However,
23 some SNAP recipients are time limited to three months of benefits within a three-year period.
24 To capture changes in SNAP status, Gulf may have to require quarterly or even monthly
25 confirmation of benefits from customers. It is not clear how frequently Gulf intends to confirm

1 SNAP eligibility, or how long Gulf intends to maintain the Low Income Rider. In response to
2 staff discovery, Gulf stated that it has not proposed a phase-out of the Low Income Rider.

3

4 Q. Does this conclude your testimony?

5 A. Yes.

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

GULF POWER COMPANY
Before the Florida Public Service Commission
Rebuttal Testimony of
Jeffrey A. Burleson
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 Jeff Burleson. My business address is 600 North 18th Street, Birmingham, AL 35203. I am the Commercial Services and Planning 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 rebuttal testimony is to address the testimony of Office of Public Counsel (OPC) Witness Dauphinais and Sierra Club Witness Mosenthal. First, I will address Mr. Dauphinais’s claims that Gulf Power Company (Gulf) has broken the regulatory compact with regard to Gulf’s ownership interest in Plant Scherer Unit 3 (Scherer 3). Next, I will show that Gulf has made decisions that were in the best interest of retail customers and that were consistent with the regulatory compact throughout Scherer 3’s history. Then, I will respond to Witnesses Dauphinais and Mosenthal’s economic comparisons of Scherer 3 and will show that, under an appropriate comparison, Scherer 3 provides value to Gulf’s retail customers. Finally, I will address other portions of the testimonies of Witnesses

1 Dauphinais and Mosenthal that are misleading or factually incorrect and will
2 provide clarification or correction for the Commission regarding these
3 assertions.

4
5 Q. Are you sponsoring any rebuttal exhibits?

6 A. Yes. Exhibit JAB-3 includes two schedules. Schedule 1 of Exhibit JAB-3
7 shows Gulf's capacity need and type by year, as embedded in the Budget
8 2003 Southern Electric System Integrated Resource Plan (IRP). Schedule
9 2 of Exhibit JAB-3 is a table from the response Gulf provided to Staff's
10 Eleventh Set of Interrogatories, Item No. 376, which shows the results of an
11 economic analysis of continuing to operate Scherer 3 on behalf of Gulf's
12 customers in Northwest Florida. Exhibit JAB-4 is a listing of misleading
13 and/or incorrect assertions made by Witnesses Dauphinais and Mosenthal,
14 along with my clarification regarding those assertions. These exhibits were
15 prepared under my direction and control, and the information contained
16 therein is true and correct to the best of my knowledge and belief.

17

18

19 **I. SCHERER 3 AND THE REGULATORY COMPACT**

20

21 Q. What is the regulatory compact?

22 A. As Gulf Witness Deason describes in his direct testimony, the regulatory
23 compact is an implied contract that exists among a regulated public utility,
24 its regulators, and its customers. It lays the foundation for regulation and
25 balances the interests (and risks) of all stakeholders. It has been employed

1 to characterize the set of mutual rights, obligations, and benefits that exist
2 between the utility and its customers.

3

4 Q. Does Mr. Dauphinais address the regulatory compact?

5 A. Yes. Mr. Dauphinais refers to the regulatory compact five times in his
6 testimony. It should be noted that Mr. Dauphinais does not testify that the
7 concept of a regulatory compact does not exist among a regulated public
8 utility, its regulators, and its customers. However, as Mr. Deason points out,
9 Mr. Dauphinais demonstrates a lack of understanding of the nature of the
10 regulatory compact.

11

12 Q. Does Mr. Dauphinais testify that the regulatory compact did not apply when
13 Gulf acquired an ownership share of Scherer 3?

14 A. No, Mr. Dauphinais does not dispute the existence of a regulatory compact.
15 Moreover, he does not dispute the facts that Gulf committed to cancel
16 Caryville Unit 1, acquire an interest in Scherer 3 for the benefit of retail
17 customers, and secure temporary off-system wholesale contracts for the
18 benefit of its retail customers. All of these actions were taken at the
19 encouragement of the Commission. As described by Mr. Deason, these
20 actions were taken pursuant to and consistent with the regulatory compact.

21

22 Q. What specifically does Mr. Dauphinais claim in his testimony?

23 A. Mr. Dauphinais wrongly claims that the regulatory compact was broken.
24 (Page 22, lines 7 to11).

25

1 Q. What evidence does Mr. Dauphinais give that the regulatory compact
2 regarding Scherer 3 has been broken by the course of action Gulf chose to
3 follow over the past 35 years?

4 A. None. Mr. Dauphinais does not offer evidence in support of his claim.
5 Instead, he merely suggests that the timing of returning Scherer 3 to retail
6 service, coupled with his misperception of the motivation for doing so, has
7 broken the regulatory compact.

8

9 Q. What does Mr. Dauphinais claim regarding how the timing of returning
10 Scherer 3 to retail service has broken the regulatory compact?

11 A. Mr. Dauphinais suggests that Scherer 3 should have been utilized to serve
12 Gulf's retail customers "within six years of entering service, not 29 years
13 after entering service." (Page 24, line 5)

14

15 Q. Was it 29 years after entering service before Scherer 3 began serving Gulf's
16 retail customers?

17 A. No, in fact Scherer 3 has been serving Gulf's retail customers in varying
18 amounts at various times, starting with the day it was declared to be in
19 commercial operation. Notably, portions of Scherer 3 served retail
20 customers from January 1, 1987 through December 31, 1994 and from
21 January 1, 2016 through today. Portions of Scherer 3 have been dedicated
22 to retail customers in more than 25 percent of the years since it went in
23 service. Additionally, since Scherer 3 went commercial, it has been
24 available to serve, and in fact has served, Gulf's retail customers through

25

1 economic dispatch whenever the off-system wholesale customers were not
2 calling on their contracted portion of the output.

3

4 Q. Should the timing and amount of Scherer 3 that served Gulf's retail
5 customers at any given point in time invalidate or break the regulatory
6 compact?

7 A. No, absolutely not. The Commission encouraged Gulf to acquire the asset
8 and secure temporary off-system wholesale contracts for the benefit of retail
9 customers. As I will describe below, the date at which Scherer 3 would be
10 fully dedicated to retail service was appropriately postponed three times in
11 Scherer 3's history. Each time, the decision was enabled by the availability
12 of off-system wholesale opportunities, was in the best interest of Gulf's retail
13 customers, and was consistent with the regulatory compact. Because of the
14 ability to secure off-system wholesale contracts at each of these times, to
15 have fully dedicated Scherer 3 to serve retail customers at any one of those
16 three decision points would not have been in the best interest of retail
17 customers.

18

19 Q. What is Mr. Dauphinais's claim regarding how Gulf's motivation for returning
20 Scherer 3 to retail service has broken the regulatory compact?

21 A. Mr. Dauphinais claims that Gulf has broken the regulatory compact by
22 seeking to serve its retail customers with its Scherer capacity only "when it
23 has been unable to find better market opportunities for itself..." (Page 24,
24 lines 9 to 10)

25

1 Q. Is it true that Gulf is only seeking to serve its retail customers with its
2 Scherer capacity because it has been unable to find better market
3 opportunities for itself?

4 A. No. Unlike previous decision points, and despite Gulf's consistent efforts,
5 Gulf has been unable to find off-system wholesale market opportunities that
6 would temporarily relieve retail customers from the revenue requirements of
7 Scherer 3. Thus, Gulf has the decision either to rededicate Scherer 3 to
8 serve retail customers and allow retail customers to get the full benefits of
9 Scherer 3, or to divest its share of the unit, as discussed by Gulf Witnesses
10 Connally and Liu. In the event Gulf divests its Scherer 3 asset, customers
11 will have a cost obligation under the regulatory compact without the many
12 benefits that Scherer 3 can provide. It is in the best interest of customers
13 and entirely consistent with the regulatory compact to now return Scherer 3
14 to retail service as it was originally intended.

15

16 Q. What is your conclusion regarding Mr. Dauphinais's testimony that Gulf has
17 broken the regulatory compact regarding Scherer 3?

18 A. Gulf has not broken the regulatory compact regarding Scherer 3. Rather, it
19 has consistently acted in accordance with the regulatory compact. At each
20 decision point in Scherer 3's history, Gulf made decisions that were in the
21 best interest of retail customers. Moreover, the 1989 rate order, in referring
22 to Scherer 3, states "This capacity will not be available to serve Gulf's
23 territorial customers until the year 2010." (Order 23573, p. 12) Clearly, the
24 Commission did not view the regulatory compact as broken at that time.

25

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

**II. HOW SCHERER 3 DECISIONS WERE IN THE
BEST INTEREST OF RETAIL CUSTOMERS**

Q. What were the major decision points in Scherer 3’s history?

A. There are five major decision points in Scherer 3’s history.

(1) The 1981 decision to purchase a 25 percent ownership share in Scherer 3 in lieu of building the more costly Plant Caryville Unit 1.

(2) The decision to enter into off-system Unit Power Sales contracts that were executed in 1982 for the period 1987 through 1995.

(3) The decision to enter into the off-system Unit Power Sales contracts in 1988 that extended wholesale coverage through 2010.

(4) The decision to enter into off-system wholesale Power Purchase Agreements in 2004 to extend full wholesale coverage from 2010 through 2015.

(5) The decision to rededicate the uncovered portion of Scherer 3 to retail customers beginning in 2016.

Q. Were Gulf’s decisions consistent with the regulatory compact and in the best interest of customers at each of these five major decision points?

A. Yes, at each of these major decision points, Gulf made decisions that were consistent with the regulatory compact’s foundation of Gulf economically meeting its obligation to serve based on the information known at the time of each decision.

1 Q. How was the decision to purchase a 25 percent ownership share of Scherer
2 3 in 1981 consistent with the regulatory compact and in the best interest of
3 customers?

4 A. The acquisition of a 25 percent ownership interest in Scherer 3 was a lower
5 cost and better alternative for retail customers than the planned Caryville
6 Unit 1 for three reasons.

7

8 First, the 1977 Clean Air Act amendments required all new coal generating
9 units that had not begun construction to be equipped with scrubbers.

10 Scherer 3 had already begun construction by 1977, whereas Caryville Unit
11 1 had not. As a result, the acquisition of an ownership interest in Scherer
12 provided cost savings to Gulf's retail customers by avoiding the requirement
13 for a scrubber at the time the unit went in service.

14

15 Second, in 1984, Gulf was able to modify the original February 19, 1981
16 agreement with Georgia Power Company for the purchase of a 25 percent
17 ownership interest in both Units 3 and 4 at Plant Scherer to be only a 25
18 percent ownership interest in Scherer 3. This flexibility allowed Gulf, based
19 on information available at that point in time, to more closely align the
20 amount of capacity purchased to the need of its retail customers in a period
21 where load forecasts were declining. The decision to purchase a 25
22 percent ownership interest only in Scherer 3 was in the best interest of retail
23 customers based on everything known at that point in time.

24

25

1 Third, the units at Plant Scherer were designed as larger units than the
2 planned units at Caryville because of the larger load growth at Georgia
3 Power. Their size allowed Gulf to secure the benefits of the economies of
4 scale associated with Plant Scherer, resulting in a more efficient unit with a
5 lower cost per kilowatt than would have been achieved with the planned
6 Caryville units.

7
8 This set of conditions and actions allowed Gulf to meet its obligation to
9 serve with a lower cost, more efficient resource than would have been
10 available with Caryville, all while maintaining consistency with the regulatory
11 compact by acting in the best interest of retail customers. Therefore, it is
12 not at all surprising that the Commission encouraged the acquisition of
13 Scherer 3.

14
15 Q. How was the decision to enter into the off-system Unit Power Sales
16 contracts that were executed in 1982 consistent with the regulatory compact
17 and in the best interest of customers?

18 A. Gulf entered into the 1982 off-system UPS agreements to temporarily
19 relieve retail customers of revenue requirement responsibility for the units in
20 the early life of Scherer 3 in response to declining load forecasts. The
21 decision to temporarily sell the capacity in the wholesale market provided
22 significant benefits to Gulf's retail customers by enabling efficient, low cost
23 capacity to be secured for the future use of retail customers while, at the
24 same time, temporarily relieving them of the early year revenue
25 requirements. Gulf entered into these agreements at the encouragement of

1 the Commission and deferred the retail use of Scherer 3 in order to
2 minimize costs for its retail customers, an action which was consistent with
3 the regulatory compact.

4

5 Q. How was the decision to enter into the off-system Unit Power Sales
6 contracts in 1988 that extended wholesale coverage through 2010
7 consistent with the regulatory compact and in the best interest of
8 customers?

9 A. The option to enter into the 1988 UPS agreements enabled Gulf to continue
10 to temporarily defer the retail rate basing of Scherer 3 until its availability
11 better aligned with a baseload need, at which time Gulf's retail customers
12 would realize cost savings when they began to be served by a low variable
13 cost, efficient and partially depreciated unit.

14

15 By the latter part of the 1980's, due to continued declines in load forecasts,
16 reserves were projected to be adequate beyond the mid-1990s. At the same
17 time, the optimal type of capacity addition began to change from baseload
18 to peaking based on the lower load forecasts and the then-current mix of
19 existing generation. The 1988 agreements allowed Gulf to further defer and
20 reduce the revenue requirements for the benefit of retail customers during a
21 period when peaking capacity was a more cost-effective addition than
22 baseload capacity. Thus, the ability to enter into the 1988 agreements,
23 along with Gulf's decision to execute the agreements, assured that Gulf
24 continued to meet its obligation to serve in a low cost manner while
25 remaining consistent with the regulatory compact.

1

2 Q. How was the decision to enter into wholesale Power Purchase Agreements
3 (PPAs) in 2004 to extend full off-system wholesale coverage from 2010
4 through 2015 consistent with the regulatory compact and in the best interest
5 of customers?

6 A. The opportunity to enter into the 2004 PPAs, and Gulf's decision to execute
7 the 2004 PPAs that committed capacity to be supplied off-system starting in
8 2010, again temporarily deferred the retail rate basing of Scherer 3 to a time
9 when a better match was projected between the Scherer 3 capacity and the
10 capacity needed for Gulf to economically meet its obligation to serve.

11

12 In the 2003 timeframe, Gulf's Ten Year Site Plan showed that Gulf's first
13 capacity need was for peaking resources in 2007, and Gulf's first planned
14 resource addition was 314 MW of peaking capacity. As shown in Exhibit
15 JAB-3, Schedule 1, the Budget 2003 Southern Electric System IRP, which
16 extended the planning horizon beyond the 10 years included in the Ten
17 Year Site Plan, indicated that Gulf had a base load need in the 2016
18 timeframe.

19

20 In 2003, Florida Power and Light Company (FPL) and Progress Energy
21 Florida (Progress) each issued Request for Proposals (RFPs) seeking
22 capacity and energy for the 2010-2015 timeframe. A response to the RFPs
23 resulted in execution of new PPAs in 2004 to sell the output of Gulf's
24 interest in Scherer Unit 3 at wholesale to FPL and Progress starting in 2010
25 and an additional agreement was separately secured with Flint Energies

1 starting in 2010. Importantly, the ability to secure the off-system wholesale
2 PPAs allowed Gulf to meet its projected near-term peaking need with
3 peaking capacity while continuing to temporarily defer the retail rate basing
4 of Scherer Unit 3 costs until a better match existed between the Scherer 3
5 capacity and Gulf's need for the baseload resource. Based on everything
6 known to Gulf at that time, securing the PPAs was the best decision on
7 behalf of retail customers and was consistent with the regulatory compact.
8

9 Q. Finally, how was the decision to rededicate the uncovered portion of
10 Scherer 3 to retail customers beginning in 2016 consistent with the
11 regulatory compact and in the best interest of retail customers?

12 A. The decision to rededicate Scherer 3 to serve retail customers provides the
13 best value to Gulf customers who will receive all the benefits of this efficient,
14 low variable cost, well-controlled, reliable coal unit. At each of the previous
15 decision points, based on the availability of the wholesale market and
16 everything known at those specific points in time, Gulf was able to better
17 match the Scherer 3 capacity with the projected amount, timing and type of
18 capacity needed by its retail customers by entering into off-system
19 wholesale contracts that temporarily deferred the rate basing of the full
20 amount of the Scherer 3 capacity. This benefited Gulf's retail customers by
21 having off-system wholesale customers bear the majority of the Scherer 3
22 capacity costs during the highest annual revenue requirement years of
23 Scherer 3.
24
25

1 Gulf has marketed the output of Scherer 3 in recent years but has been
2 unable to find a buyer for the output of the unit due to wholesale market
3 conditions following the Great Recession. The only alternative to
4 rededicating the unit to retail service would be to divest the asset, likely at a
5 loss, which would put an unnecessary cost burden on the retail customers
6 for whom Scherer 3 was originally acquired. It is in the best interest of Gulf's
7 customers to place Scherer 3 in rate base now and receive all of the future
8 benefits of the unit, as opposed to making a decision that would result in
9 costs to retail customers without corresponding benefits.

10

11 Q. Have retail customers benefited from Gulf's decision to purchase a 25
12 percent ownership interest in Scherer 3?

13 A. Yes, had the Commission not given Gulf encouragement to purchase an
14 ownership interest in Scherer 3, Gulf would have almost certainly had to
15 build Caryville Unit 1. Due to the long lead times for new generation and
16 associated transmission, commitments to Caryville-related equipment and
17 construction would have been needed far in advance of its commercial
18 operation date. These commitments would have almost certainly been
19 needed before the growth rates of load forecasts began to slow enough to
20 significantly defer the need.

21

22 A commitment to Caryville Unit 1 would have been a commitment to a unit
23 with a significantly higher capital cost per kilowatt, lower efficiency and a
24 larger amount of capacity than Gulf's ownership interest in Scherer 3.

25 These Caryville commitments would mean that Gulf's customers would

1 have been served by a higher cost and less efficient unit than Scherer 3. In
2 addition, Gulf's customers would have been obligated to a larger number of
3 MWs than Scherer 3, despite load forecast growth rates and the associated
4 need for new capacity that were both declining.
5
6

7 III. SCHERER 3 ECONOMIC ANALYSIS

8

9 Q. Both Witnesses Dauphinais and Mosenthal assert that Gulf should be
10 required to perform an economic need analysis for Scherer 3 as if it
11 were a new generating resource being developed to meet a current
12 capacity need. Is such an analysis appropriate?

13 A. No. A capacity need assessment is required before the addition of
14 new generating capacity. An economic analysis is appropriate at that
15 time to demonstrate the economics of the type of generation targeted
16 to fill the need. The fundamental decision on the need and cost-
17 effectiveness of Scherer 3 was made when the Commission
18 encouraged Gulf to enter into the purchase of an interest in Plant
19 Scherer as a lower cost alternative to construction of a unit at
20 Caryville. It would be fundamentally unfair and, moreover, would
21 violate the regulatory compact, to second-guess that decision – or
22 any other past decision to invest in generating resources for the
23 benefit of retail customers – 30 years after the fact with the benefit of
24 hindsight.
25

1 The inappropriate approach proposed by Witnesses Dauphinais and
2 Mosenthal implies that every existing generating resource serving
3 retail customers under the regulatory compact could be subjected to
4 an economic need re-assessment at any time. It further implies that
5 if some of those resources are found not to be needed or not
6 economic at a given point in time, then customers should be relieved
7 of the associated revenue requirements. This approach would
8 require the Commission to continually reassess past generating
9 decisions with the benefit of 20-20 hindsight and would be totally
10 inconsistent with the regulatory framework under which the
11 Commission and utilities operate.

12
13 Q. What type of analysis would be appropriate for evaluating Gulf's
14 ownership interest in Scherer 3 or any other generating resource
15 serving retail customers under the regulatory compact?

16 A. The appropriate analysis would compare the incremental costs and
17 incremental benefits of Scherer 3 relative to the incremental cost and
18 incremental benefits of a reasonable alternative. This type of
19 analysis ignores sunk costs that are already committed based on the
20 regulatory compact. This type of approach is standard practice in the
21 industry for assessing whether to continue operating a unit for retail
22 service or whether to retire a unit and replace it with another capacity
23 option. Mr. Deason discusses Commission precedent on the use of
24 incremental costs instead of total costs (including sunk costs) in
25 making forward-looking economic analyses regarding assets under

1 construction. The same principles apply to existing assets covered
2 under the regulatory compact.

3

4 Q. Did Witnesses Dauphinais and Mosenthal provide economic comparisons of
5 alternatives to Scherer 3 that did not consider the regulatory compact?

6 A. Yes, they inappropriately provided comparisons between Scherer 3 and
7 other resource options such as a new natural gas-fired generating unit,
8 solar and wind generation, and demand side management as though
9 Scherer 3 were a new, uncommitted resource.

10

11 Q. Has Gulf conducted an economic analysis that utilizes the appropriate
12 analytical approach you describe for a resource like Scherer 3 which has
13 already met the economic need test?

14 A. Yes, in response to Staff's Eleventh Set of Interrogatories, Item No. 376,
15 Gulf performed an analysis of the benefits and costs of Scherer 3 serving
16 Gulf's retail customers over the next 30 years versus a discontinuation of
17 the unit's service to retail customers coupled with replacement capacity to
18 maintain adequate reliability. A table from Gulf's response to this
19 interrogatory is included as Exhibit JAB-3, Schedule 2.

20

21 Q. What type of replacement unit for Scherer 3 was considered in the
22 analysis?

23 A. The replacement unit considered was the addition of approximately 210 MW
24 of new gas-fired combustion turbine (CT) capacity. Without Scherer 3 in its
25 generation portfolio, Gulf's next capacity need would be approximately 210

1 MW higher. The capacity type currently contemplated in Gulf's Ten Year
2 Site Plan to meet the Company's next capacity need is a new CT
3 generation facility. Accordingly, the analysis assumes the Scherer 3
4 replacement capacity is a hypothetical new CT resource scaled to exactly
5 match the amount of capacity provided by Gulf's ownership interest in
6 Scherer 3.

7

8 Q. What costs did you assume for your analysis?

9 A. For Scherer 3, the analysis considered all costs that could be avoided if
10 Gulf's interest in Scherer 3 were sold or retired. These costs include
11 projections over the next 30 years of all maintenance capital, ongoing
12 operations and maintenance costs, fuel, and transmission costs. Costs that
13 are unavoidable such as the net book value that is ultimately a retail
14 obligation under the regulatory compact were excluded. For the
15 replacement unit, the analysis considered the construction costs, as well as
16 all costs to support operations over the next 30 years.

17

18 Q. What benefits did you assume for your analysis?

19 A. The analysis considered the capacity and energy benefits for both Scherer
20 3 and the replacement unit. Capacity benefits were calculated based on the
21 Retail Capacity Price Forecast used by Gulf. Energy benefits for Scherer 3
22 and the replacement unit were estimated by comparing the cost of each
23 option to the projected hourly Southern Electric System marginal
24 replacement costs.

25

1 Q. What did you assume happens to the Scherer 3 net book value if it is
2 replaced by the combustion turbine?

3 A. We assumed it would be a stranded cost. We did not assume any proceeds
4 if the asset were to be divested. Any reasonable estimate of such proceeds
5 would not materially change the results of the analysis.

6

7 Q. Did you perform your analysis for more than one scenario?

8 A. Yes. The analysis was performed across nine scenarios in order to capture
9 variations in the operating environments that could affect the units. The nine
10 cases are developed around uncertainty in long-term natural gas prices and
11 potential CO2 prices.

12

13 Q. What were the results of the analysis?

14 A. The results in eight of the nine scenarios show that continuing to operate
15 Scherer 3 over the next 30 years provides more value for Gulf's customers
16 than replacing the unit. The average value across the eight positive
17 scenarios was \$198 million Net Present Value. Only one scenario showed
18 that replacing Scherer 3 provides more value to Gulf's customers than
19 continuing to operate it, with only a \$5 million Net Present Value. The
20 analysis conclusively shows that there is more value to Gulf's customers by
21 continuing to operate Scherer 3 than replacing it.

22

23

24

25

1 Q. Are there any other considerations for the value of Scherer 3 to Gulf's
2 customers that were not captured in your economic analysis?

3 A. Yes. Plant Scherer was selected by the PRB Coal Users' Group as the
4 2017 Plant of the Year. This prestigious award recognizes a power plant for
5 its innovation and the implementation of "best practices and continual
6 improvements in areas including safety, environmental performance, coal
7 handling, boiler and combustion and risk management." This award is
8 recognition of the value that Scherer 3 brings to the customers of its co-
9 owners. Furthermore, as described in my direct testimony, retaining Scherer
10 3 complements Gulf's resource plans by offsetting a portion of the lost fuel
11 diversity associated with recently retired coal-fired units and serves as a
12 hedge to the volatility of natural gas prices.

13

14 Q. Mr. Mosenthal asserts that Scherer 3 is not used and useful for the retail
15 customers of Gulf Power. Is Scherer 3 used and useful for Gulf's retail
16 customers?

17 A. Yes. Scherer 3 is both used and useful for Gulf's retail customers. Scherer 3
18 is operating and economically dispatching in the Southern Company system
19 for the benefit of Gulf's retail customers. Since the 160 MWs became
20 available to serve retail customers starting in June, Scherer 3 has operated
21 at an average capacity factor of 59 percent. During this period, Scherer 3
22 represented five percent of Gulf's total capacity dedicated to retail and
23 supplied six percent (more than 400,000 MWh) of Gulf's retail customers'
24 total energy. Additionally, Scherer 3 is "used and useful" in that

25

1 it is reducing reliability risk for Gulf's customers today and will partially fill
2 the large capacity need that Gulf has in the next several years.

3

4 Q. What is your conclusion concerning the value of Scherer 3 as it relates to
5 this case?

6 A. A traditional economic need analysis of the type suggested by the
7 intervenor witnesses is neither necessary nor appropriate to evaluate the
8 benefits provided by the rededication of Scherer 3 to serve retail customers,
9 because Scherer 3's economic need test occurred approximately 30 years
10 ago. The appropriate analysis reflected in Schedule 2 of Exhibit JAB-3
11 shows that the rededication provides decisively positive value for Gulf's
12 customers across a wide range of future scenarios. Scherer 3 also provides
13 other non-quantifiable benefits related to its excellent operations and as a
14 hedge against natural gas prices.

15

16

17

IV. OTHER CLARIFICATIONS

18

19 Q. Are there other statements in the testimony of Witnesses Dauphinais and
20 Mosenthal that are misleading and/or incorrect?

21 A. Yes, there are a number of statements in their testimonies that are
22 misleading, factually incorrect, and/or distract from the central point of the
23 regulatory compact.

24

25

1 Q. Which statements do you believe are misleading, incorrect, or distracting
2 from the main point?

3 A. In Exhibit JAB-4, I have summarized the primary statements that I want to
4 clarify for the Commission so that there will be no misunderstanding that the
5 decision to rededicate Scherer 3 to Gulf's retail customers is in their best
6 interest, is consistent with the regulatory compact, and is the right decision.
7

8 Q. Please summarize your testimony.

9 A. Contrary to the testimony of Mr. Dauphinais, the regulatory compact as it
10 relates to Gulf's 25 percent ownership interest in Scherer 3 is in full effect.
11 It is this regulatory compact and Gulf's associated focus on consistently
12 making decisions in the best interest of its retail customers that led the
13 Company to purchase an interest in Scherer 3 and to determine the best
14 use of Scherer 3 at each subsequent decision point. Each of the three times
15 Gulf entered a set of long-term off-system wholesale sales contracts for the
16 capacity and energy output of Scherer 3, retail customers benefited. As I
17 have detailed in my testimony, in each of the times Gulf executed wholesale
18 contracts (1982, 1988, and 2004), Gulf leveraged an available wholesale
19 market to defer the rate basing of Scherer 3 until a time when Scherer 3
20 better matched the needs of Gulf's retail customers. These decisions
21 assured Gulf's retail customers would receive the benefit of a partially
22 depreciated, low variable cost, reliable generating resource.
23

24 Today, there are no more long-term off-system sales opportunities for
25 Scherer 3. Additionally, Gulf does have a large future capacity need in the

1 next several years. This capacity need is reduced by rededicating Scherer
2 3 to retail service as it was originally intended. The appropriate time for
3 rededication is now, and it is in the retail customers' best interest to retain
4 Scherer 3, along with all the capacity and energy benefits it provides.

5
6 The regulatory compact is the appropriate lens with which to view the
7 decision to rededicate Scherer 3 to the benefit of retail customers now, as
8 opposed to an economic analysis against other alternatives that would
9 accompany a capacity need re-assessment as Mr. Mosenthal asserts. That
10 economic need test was met when the Commission encouraged and Gulf
11 made the decision to purchase a 25 percent interest in Scherer 3 instead of
12 building Caryville 1. The appropriate economic analysis of an existing unit
13 consists of a comparison of the future avoidable costs and incremental
14 benefits of the unit versus that of a replacement unit. Gulf did perform that
15 analysis for Scherer 3 at the request of Staff, and the results confirmed that
16 continuing to operate Scherer 3 on behalf of retail customers is in their best
17 interest.

18
19 In Exhibit JAB-4, I provide clarifications or corrections for a number of other
20 statements in Witnesses Dauphinais and Mosenthal's testimonies that are
21 incorrect or misleading. Many of these statements attempt to distract from
22 the central matter that Scherer 3 was acquired for Gulf's retail customers in
23 full view of the regulatory compact, and each decision that was made in
24 Scherer 3's history was consistent with the regulatory compact and
25 benefited retail customers. This decision to rededicate Scherer 3 to serve

1 the retail customers for whom it was acquired is the right decision and is in
2 the retail customers' best interests.

3

4 Q. Does this conclude your testimony?

5 A. Yes.

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

GULF POWER COMPANY
Before the Florida Public Service Commission
Rebuttal Testimony of:
J. Terry Deason
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 Terry Deason. My business address is 301 S. Bronough Street, Suite 200, Tallahassee, FL 32301. I am a Special Consultant for the Radey Law Firm specializing in the fields of energy, telecommunications, water and wastewater, and public utilities.
- 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 rebuttal testimony is to respond to certain assertions and recommendations made by intervenor Witnesses Dauphinais, Mosenthal, and Ramas. The issues I address in rebuttal to these witnesses are: Plant Scherer Unit 3 (Scherer 3), At-Risk Compensation, and the Deferred Return on Transmission Investment.
- Q. Are you sponsoring any rebuttal exhibits?
- A. No.

I. SCHERER 3

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Q. What is Office of Public Counsel (OPC) Witness Dauphinais’s recommendation concerning Gulf’s investment in Scherer 3?

A. He recommends that the Commission reject Gulf’s proposal to rededicate Scherer 3 to retail service and to recognize Scherer 3 costs in retail rates.

Q. What is the basis for Witness Dauphinais’s recommendation?

A. He believes that Gulf, by its actions over the past 10 to 15 years, has broken any regulatory compact with respect to Scherer 3. He further opines that Scherer 3 should be subjected to another need assessment before its costs can be recognized in retail rates. He also implies that Gulf has earned excessive “profits” and has not shared those “profits” with retail customers.

Q. Do you agree with these bases for his recommendation?

A. No, I do not. Witness Dauphinais shows either a lack of understanding of the regulatory compact or a disregard of its importance in providing cost-effective and reliable service to customers of regulated utilities. Witness Dauphinais’s positions and recommendation can be succinctly characterized as a “heads I win, tails you lose” proposition that introduces elements of 20-20 hindsight, which is inconsistent with the most basic tenets of the regulatory compact.

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
2 review of FPL's and PEF's wholesale purchases raise the issue of Gulf
3 breaking the regulatory compact by virtue of including its interest in Scherer
4 3 as part of these transactions?

5 A. No.

6

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

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

11

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

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

23

24

25

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.

15

16

17

18

19

20

21

22

23

24

25

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

GULF POWER COMPANY
Before the Florida Public Service Commission
Rebuttal Testimony of
Xia Liu
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 Xia Liu. My business address is One Energy Place, Pensacola, FL 32520, and I am the Vice President and Chief Financial Officer (CFO) of Gulf Power Company (Gulf or the Company).
- 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 discuss the effect on Gulf and its customers of the proposed adjustments to Gulf's revenue requirements set forth in the testimony submitted by the intervenors -- Office of Public Counsel (OPC), Federal Executive Agencies (FEA), and Sierra Club -- and the devastating impact on Gulf's financial integrity if their recommendations were adopted. In particular, I respond to portions of the testimony provided by Witnesses Woolridge (OPC), Dauphinais (OPC), Ramas (OPC), Gorman (FEA), and Mosenthal (Sierra Club).

1 Q. Are you sponsoring any rebuttal exhibits?

2 A. Yes. Exhibit XL-2 was prepared under my direction and control. The
3 information contained in that exhibit is true and correct to the best of my
4 knowledge and belief.

5

6

7

I. IMPACT OF INTERVENORS' RECOMMENDATIONS

8

9 Q. What is the magnitude of the intervenors' proposed adjustments to Gulf's
10 revenue requirement in the test year?

11 A. If accepted by the Commission, the aggregate effect of the intervenors'
12 recommendations would be to reduce Gulf's rate request by well over \$100
13 million, resulting in a rate decrease of almost \$3 million. My rebuttal
14 testimony will focus on the three categories of intervenor recommendations
15 that have significant negative impact on Gulf's ability to continue to provide
16 high quality service to our customers: the proposed exclusion of costs
17 related to Scherer 3; the intervenors' return on equity (ROE) and capital
18 structure proposals; and some of Ms. Ramas's major rate base and O&M
19 expense adjustments.

20

21 Q. What is the impact of the intervenors' recommendations?

22 A. As shown on Exhibit XL-2, without any rate increase, Gulf's projected retail
23 ROE falls well below the bottom of our current authorized range in 2017.
24 With a rate reduction as proposed by the intervenors, Gulf's ROE will
25 continue to fall further beyond the test year. The aggregate

1 recommendation of a rate decrease would have a devastating impact on
2 Gulf's financial integrity and significantly impair Gulf's ability to continue to
3 consistently provide quality service to our customers. The Commission
4 should consider the detrimental effect on Gulf and our customers and reject
5 these proposals.

8 II. TREATMENT OF SCHERER 3

9
10 Q. In your direct testimony, you asked the Commission to recognize that 76
11 percent of Gulf's ownership of Scherer 3 is now serving retail customers
12 and to allow the corresponding portion of Scherer 3 non-clause costs to be
13 recovered in the base rates. How did the intervenors address these issues?

14 A. OPC Witness Dauphinais and Sierra Club Witness Mosenthal propose to
15 disallow recovery of Scherer 3 costs from the retail jurisdiction. If adopted,
16 their recommendations would also disallow the recovery through the
17 Environmental Cost Recovery Clause (ECRC) of the related environmental
18 costs. Gulf Witnesses Burleson and Deason respond to a number of
19 assertions made by the intervenors in support of their recommendations. I
20 will focus on the financial aspects of their positions.

21
22 Q. Please respond to Witness Dauphinais's assertion that over the years Gulf
23 has retained all of its profits from its wholesale unit power sales from
24 Scherer Unit 3.

25

1 A. Witness Dauphinais's assertion ignores several key facts. First, over the
2 past 30 years, Gulf's wholesale customers have been supporting Scherer 3,
3 thereby relieving Gulf's retail customers from the obligation to pay the unit's
4 revenue requirement, even though the investment was prudently made in
5 order to ultimately serve them.

6
7 Second, with the contribution of revenues from the wholesale contracts,
8 Gulf's total corporate return has been in line with the authorized range
9 applicable to Gulf's retail return over the past fifteen years, and has been
10 generally acceptable to its investors. This allowed Gulf to withstand
11 achieved retail returns lower than its authorized range for 45 months during
12 this same period and helped Gulf to avoid filing a rate case between 2002
13 and 2011.

14
15 Third, Witness Dauphinais's assertion ignores the fact that there are periods
16 during which portions of Scherer 3 have served Gulf's retail customers,
17 even though they have not paid to support the investment. Between 1987
18 and 1994, amounts ranging from 11 MW to 63 MW were not committed to
19 wholesale contracts and instead served retail customers. In addition, even
20 though 110 MW of Scherer 3 has been serving Gulf's retail customers since
21 January 1, 2016, and an additional 50 MW has been serving them since
22 June 1, 2016, Gulf's customers have not paid anything related to the non-
23 clause portion of the revenue requirement for these portions of the unit.
24 Due to the settlement agreement in Gulf's last rate case, Gulf did not
25 request recovery of the non-clause costs of these portions of the investment

1 for the 18-month period from January 1, 2016 through June 30, 2017. If the
2 Commission were to disallow retail recovery of the asset, then Gulf would
3 not recover either the base rate or environmental costs on a going-forward
4 basis, and it would also be required to true up the environmental portion of
5 the revenue requirement that is currently being collected through the ECRC.
6

7 Q. What would be the impact if the intervenors' recommendations to disallow
8 Scherer 3 in retail were adopted?

9 A. The disallowance would immediately reduce Gulf's allowed annual retail
10 revenues by approximately \$35 million on an annual going-forward basis.
11 This amount represents 76 percent of the total base and environmental
12 costs associated with Gulf's ownership in the unit, and its disallowance
13 would be equivalent to a 220 basis point reduction to Gulf's retail return.
14 Gulf would have no way to overcome an adverse impact of this magnitude.
15 In addition, there would be a one-time negative true-up to the ECRC of over
16 \$11 million, representing an additional 70 basis point reduction. Our returns
17 would remain well below what our investors require; the investment
18 community's perception of a constructive regulatory environment in Florida
19 would be damaged; our financial integrity would be impaired; our credit
20 quality would worsen; our financing costs would likely increase; and it would
21 be difficult for Gulf to continue to confidently make the long-term investment
22 decisions necessary to serve our retail customers.
23

24 Furthermore, as Mr. Connally states, Gulf would be forced to diligently
25 pursue an immediate disposition of its ownership interest in Scherer 3 in

1 order to minimize the adverse impact on Gulf's financial integrity. As Mr.
2 Deason addressed in his direct testimony, if a utility asset is sold for less
3 than its net book value, the typical ratemaking treatment is to amortize the
4 loss and reflect the amortization in rates. Under the regulatory compact,
5 Gulf's retail customers would be responsible for any remaining investment
6 not covered by any proceeds of a sale. In addition, they would no longer
7 receive any of the benefits of the continued ownership and operation of
8 Scherer 3 that Mr. Burleson describes in his testimony.

9
10 None of these results would be good for Gulf's customers.

11 12 13 **III. COST OF CAPITAL**

14
15 Q. Please describe the intervenors' proposed adjustments related to cost of capital.

16 A. FEA Witness Gorman proposes that a 9.2 percent ROE coupled with a
17 49.88 percent equity ratio will be sufficient to satisfy equity investors and will
18 be supportive of credit quality. OPC Witness Woolridge suggests that an
19 8.875 percent ROE and an equity ratio of 50 percent would be satisfactory.

20
21 Q. Are the intervenors' recommendations for ROE reasonable?

22 A. No. Neither OPC's ROE recommendation of 8.875 percent nor FEA's
23 recommendation of 9.2 percent would be sufficient for investors. Gulf
24 Witness Vander Weide recommends an ROE of 11.0 percent and
25 addresses the intervenor recommendations in his rebuttal testimony.

1 Q. Do you agree with the analysis that Witness Gorman relies on to support
2 the conclusion that his recommended ROE will support an investment grade
3 bond rating for Gulf?

4 A. No. First, Gulf targets A category credit ratings, not just investment grade
5 ratings. Gulf believes that A category credit ratings provide the best
6 opportunity to access the capital markets on the most favorable terms for
7 our customers. Second, Witness Gorman's analysis is based on a
8 calculation of Gulf's financial ratios using his recommended capital structure
9 and cost of capital. However, the cash flows he uses are based on Gulf's
10 "cost of service for its retail jurisdictional operations." (Gorman, page 59)
11 Witness Gorman's cash flows do not reflect the recommendations by other
12 witnesses to disallow recovery of Scherer 3 and to make significant rate
13 base and NOI adjustments. In other words, his financial integrity analysis
14 assumes that but for his capital structure and ROE proposals, the
15 Commission approves the balance of Gulf's rate request. Furthermore, if
16 the Commission approves the balance of Gulf's request, the proposed ROE
17 alone would send a very negative signal to the investment community and
18 the rating agencies and could put Gulf's targeted credit ratings in jeopardy.
19 It would not be beneficial to our customers.

20
21 Q. How do the intervenors' ROE recommendations compare with recent
22 decisions by this Commission?

23 A. Their recommendations are substantially below the 10.25 percent
24 established for Gulf in our last rate case, the 10.25 percent approved for
25 Tampa Electric Company (TECO), the 10.5 percent reaffirmed for Duke

1 Energy Florida (Duke), and the 10.55 percent approved for Florida Power &
2 Light Company (FPL) just a few months ago. Approval of their
3 recommendations would cause Gulf's authorized return to be between 105
4 and 167.5 basis points lower than those currently authorized for TECO,
5 Duke and FPL.

6
7 Such a result is unreasonable under the best of circumstances, and it would
8 put significant stress on Gulf's financial integrity and our long-term ability to
9 continue to provide quality service to our customers.

10
11 Q. What effect would an authorized ROE in the range of 8.875 percent to 9.2
12 percent have on Gulf?

13 A. An authorized return at those levels would have serious adverse impacts on
14 the confidence of both equity and debt investors.

15
16 Q. Please explain the impact on equity investors.

17 A. With the lack of sales growth largely due to continued decline in use per
18 customer, combined with continued infrastructure investment requirements to
19 provide service to our customers, investors are faced with significant business
20 risks. Investors are expecting an allowed ROE that will provide them an
21 opportunity to earn a fair return on their investment. Establishing and setting
22 rates based on an ROE at the levels recommended by the intervenors would
23 significantly challenge the notion of providing a fair return for the investors.
24 Consequently, it would put pressure on Gulf's ability to access the capital
25

1 markets at the most favorable terms for our customers, as well as adversely
2 impact Gulf's long-term ability to provide quality service to them.

3
4 Investors also consider the ratings of state regulatory environments
5 published by Regulatory Research Associates (RRA). While the Florida
6 regulatory environment is currently rated above average, during 2015 and
7 2016, the states that have awarded utilities ROEs at or below the levels
8 recommended by Witnesses Gorman and Woolridge are all rated Average
9 to Below Average by RRA.

10
11 Q. Please address the impact of unreasonably low ROEs on debt investors.

12 A. Debt investors will be looking to the credit rating agencies for reaction to the
13 outcome of our case and its implications for Gulf's credit risk. Authorizing
14 an ROE at the levels recommended by the intervenors would not be
15 received well by the credit rating agencies. The utility regulatory
16 environment in Florida has historically been viewed as credit supportive;
17 however, accepting these recommendations would revive recent concerns
18 about that environment in Florida – concerns that played a primary role in a
19 rating downgrade of Gulf Power in 2010. In its credit opinion of Gulf Power
20 (dated August 13, 2010), Moody's saw "the overall regulatory framework in
21 Florida as substantially less supportive of credit quality" and cited this as a
22 primary factor in downgrading Gulf's credit rating.

1 The rating agencies' opinions of Florida's regulatory environment have
2 improved over the past several years. In its last credit opinion of Gulf dated
3 August 15, 2016, Moody's cited a "credit supportive regulatory environment
4 in Florida." As evidenced by the weights applied in their assessments and
5 past rating agency actions, the perception of state regulatory environments
6 is critical to the credit quality of utilities. Joining the ranks of the states
7 authorizing unreasonably low ROEs would once again call into question the
8 supportiveness of the Florida regulatory environment and could result in
9 negative rating actions not just for Gulf, but for all electric utilities under the
10 Commission's jurisdiction.

11
12 Q. Are the intervenors' recommendations for Gulf's equity ratio reasonable?

13 A. Absolutely not. As stated before, Witness Gorman proposes an equity ratio
14 of 49.88 percent. Witness Woolridge recommends an equity ratio of 50
15 percent.

16
17 Q. What are your concerns with Witness Gorman's proposal?

18 A. First of all, Witness Gorman states that his proposed common equity ratio is
19 based on Gulf's actual common equity ratio on September 30, 2016. He
20 apparently overlooked the commitment in my direct testimony to issue
21 additional common stock by January 2017 in order to raise our equity ratio.
22 That commitment was fulfilled by Gulf's recent common stock issuance of
23 \$175 million in January, which brings our projected common equity ratio to
24 approximately 53 percent for 2017.

25

1 Second, Witness Gorman's recommendation on Gulf's equity ratio is
2 inconsistent with testimony he presented earlier this year in FPL's rate case.
3 In this docket, he recommends a 49.88 percent equity ratio and 9.2 percent
4 ROE for Gulf. In contrast, in FPL's recent rate case, Witness Gorman first
5 stated that FPL's 60 percent equity ratio was "excessive." He then said, "I
6 will consider FPL's excessive common equity weighted capital structure in
7 recommending a fair risk-adjusted rate of return on equity for FPL in this
8 proceeding." (Docket 160021-EI, Transcript p. 3840) Taking this
9 "excessive" equity ratio into account, he nevertheless recommended an
10 ROE of 9.25 percent for FPL. (Tr. 3872-3873) In other words, while
11 Witness Gorman recommends a lower ROE for Gulf (9.20 percent) than for
12 FPL (9.25 percent), he simultaneously recommends an equity ratio for Gulf
13 that is more than 10 percentage points lower than the 60 percent equity
14 ratio he accepted for FPL. This fundamental inconsistency calls his entire
15 recommendation into question.

16
17 Q. Do you have other concerns about the equity ratio recommendations by
18 Witnesses Gorman and Woolridge?

19 A. Yes. Both witnesses completely ignore the fact that these ratios clearly
20 would put us at a disadvantage when compared to our peers in Florida.

21
22 As stated in my direct testimony, Gulf's last approved equity ratio is four to
23 13 percentage points lower than that of the other major Florida investor-
24 owned utilities (IOUs). The average of the last approved equity ratios as a
25 percentage of investor-supplied capital for Duke, FPL and TECO is 54.4

1 percent. As stated before, we have recently completed the process of
2 increasing Gulf's equity by selling \$175 million of common stock, resulting in
3 a projected 2017 equity ratio of approximately 53 percent. This brings us
4 more in line with our peers in the state, allowing us to compete for capital on
5 a more comparable level.

6
7 In his testimony, OPC Witness Woolridge stated, ". . . as the amount of debt
8 in the capital structure increases, its financial risk increases and the risk of
9 the utility, as perceived by equity investors also increases." This means that
10 everything else being equal, a utility with a lower allowed ROE implies that
11 its financial risk is lower; therefore, it should have a higher equity ratio.
12 However, although Witness Woolridge recommends an ROE for Gulf that is
13 more than 130 basis points lower than the average of the major Florida
14 IOUs, he also recommends an equity ratio (50 percent) which is more than
15 4 percentage points lower than the average of the other Florida IOUs.

16 17 18 **IV. RATE BASE AND NOI ADJUSTMENTS**

- 19
20 Q. OPC Witness Ramas proposes a number of rate base and NOI
21 adjustments. Would you like to respond to any of those recommendations?
22 A. Yes. Other Gulf rebuttal witnesses address her NOI and rate base
23 recommendations in detail. I would like to focus, as CFO, on a broader
24 view of a few of her major proposed adjustments.
25

1 Q. Please address her recommendation regarding the treatment of vacant
2 positions.

3 A. As Gulf Witness Ritenour discusses in more detail, Witness Ramas
4 proposes to disallow compensation and benefit amounts associated with
5 positions that were vacant in September 2016. This type of disallowance
6 poses a challenge for Gulf. We must manage our business with the
7 resources we are given. If the Commission does not provide revenues to
8 fund needed positions, Gulf must either fill the positions at shareholder
9 expense or continue to operate with a less than optimal complement of
10 employees. In a very real sense the disallowance of positions is a self-
11 fulfilling prophecy. If positions are vacant, dollars are disallowed, and funds
12 are not available to fill the vacancies. The Commission should reject the
13 temptation to focus on current vacancies. Instead, it should focus on the
14 fact that Gulf has proposed the level of employees it believes are necessary
15 to continue to operate the business in the way that best meets the needs of
16 our customers.

17

18 Q. Do you have any other observations on her proposed labor adjustments?

19 A. Yes. In addition to her proposed vacancy adjustment, Witness Ramas
20 recommends disallowing a large portion of Gulf's at-risk pay, an issue that is
21 addressed in rebuttal by Gulf Witnesses Garvie and Deason. As CFO, I am
22 deeply concerned that her adjustments to Gulf's compensation and benefits
23 budget (excluding adjustments to affiliate labor costs assigned or allocated
24 to Gulf) total approximately \$20 million. This amount represents 17.2
25 percent of Gulf's overall O&M labor and benefits budget of \$114.6 million.

1 Gulf would never expect to put its hard-working employees in a position to
2 be compensated significantly below the market. Nor should the
3 Commission expect Gulf's shareholders to bear \$20 million of labor costs
4 that are prudently incurred to serve our retail customers.
5

6 Q. Have you reviewed Witness Ramas's recommendation to disallow the year-
7 end contribution that Gulf made to its pension plan?

8 A. Yes. She recommended total disallowance of the projected pension
9 contribution included in Gulf's test year unless Gulf could demonstrate that
10 the contribution had been made and benefitted Gulf's customers. As Mr.
11 Garvie discusses in his rebuttal testimony, Gulf made a total pension
12 contribution of \$55.8 million in December 2016. The important thing I
13 believe the Commission needs to know is that this funding decision was
14 absolutely in the best interest of Gulf's customers. The contribution not only
15 reduces Gulf's 2017 revenue requirement by \$100,000, it also reduces
16 Gulf's revenue requirement by almost \$4 million on a net present value
17 basis over the next 10 years compared to what it would have been if no
18 contribution had been made.
19

20 Q. Witness Ramas also proposes some adjustments that involve the updating
21 of selected test year information. Do you have any observation about these
22 adjustments?

23 A. Yes. Witness Ramas recommends several adjustments based on updated
24 information that was not available at the time the test year budget was
25 prepared. For example, she suggests updates to the inflation rates used to

1 project some O&M expenses and, as addressed by Gulf Witness Hodnett,
2 proposes some updates to Southern Company Services (SCS) allocation
3 factors. In addition, she states that “since the Company has not provided
4 either its preliminary or its final 2017 Budget and Forecast, additional
5 adjustments beyond those presented in this testimony may be appropriate.”
6 (Ramas, p. 9) The specific adjustments she does propose all involve
7 reductions in Gulf’s revenue requirement.
8

9 Q. Does Witness Ramas consider or acknowledge any updated information
10 that would increase Gulf’s revenue requirement and offset any portion of her
11 adjustments?

12 A. No. She chose not to address the fact that, as Gulf Witness Park discussed
13 in his direct testimony, Gulf’s more recent sales forecast of 2017 base
14 revenues showed a \$5.7 million shortfall compared to the forecast on which
15 the test year calculations were based. This shortfall has an impact of over
16 30 basis points on Gulf’s retail return on equity. More recent information
17 shows that our use per customer continues to decline, and the revenue
18 shortfall is currently projected to be greater than the \$5.7 million identified at
19 the time Gulf’s direct testimony was filed. If the Commission considers
20 Witness Ramas’s recommended downward adjustments to revenue
21 requirements based on more current data than what is contained in the
22 MFRs, then fundamental fairness requires consideration of any offsetting
23 updates – such as reduced sales revenues -- that would result in upward
24 adjustments.
25

V. CONCLUSION

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Q. What should the Commission do with regard to Witness Dauphinais's and Mosenthal's recommendations related to disallowance of Scherer 3?

A. It should reject them in their entirety. The portion of Scherer 3 for which Gulf is seeking recovery is currently providing service to the retail customers for whom it was originally planned, acquired and ultimately built. We ask the Commission to honor this regulatory compact and approve Gulf's request.

Q. Should the Commission accept the intervenors' recommendations related to ROE and capital structure, or OPC's overall recommendation to decrease Gulf's rates?

A. Absolutely not. The intervenors' objectives through both their proposals regarding ROE and their other adjustments seem to be simply to set rates as low as possible today, without concern for the impact on customers in the future. In their efforts to meet this objective, many of the proposed disallowances are evidence of a disregard for the expertise of Gulf's employees in determining what is required to provide safe and reliable service to our customers in both the near term and long term.

A Commission order establishing such low ROEs or decreasing rates would be detrimental and potentially devastating to Gulf's ability to access and raise capital on reasonable terms. Such a decision would damage Gulf's ability to provide quality service to its customers.

1 Gulf's credit quality is under pressure. Moody's, for example, states clearly
2 that Gulf's cash flow coverage metrics have been weak for its A2 rating.
3 Strong scores on the qualitative factors, specifically Florida's constructive
4 regulatory environment, have been essential to maintaining that rating.
5 Accepting the intervenors' recommendations would not only further weaken
6 Gulf's financial ratios, but as importantly, cause alarm and reignite concerns
7 about the regulatory environment in Florida. Those concerns would
8 certainly affect Gulf and would likely also affect other utilities in Florida.

9
10 The intervenors' recommended equity ratio is arbitrarily too low. Gulf's
11 current projected 2017 equity ratio helps improve its credit quality and
12 moves Gulf closer to the average of its Florida peers. The Commission
13 should recognize Gulf's capital structure change and approve its requested
14 equity ratio of 53.1 percent.

15
16 It is important to point out that even with 53.1 percent equity ratio and 11
17 percent ROE as proposed by Gulf Witness Vander Weide, Gulf's customers will
18 still enjoy a weighted average cost of capital that is among the lowest in Florida.

19
20 It is simply unreasonable for anyone to expect that a rate decrease or an
21 unrealistically low ROE or equity ratio could be supportive of Gulf's financial
22 integrity or would be in the best interest of our customers.

23
24 Q. Does that conclude your rebuttal testimony?

25 A. Yes.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

GULF POWER COMPANY
Before the Florida Public Service Commission
Rebuttal Testimony of
S. W. Connally, Jr.
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 Stan Connally. My business address is One Energy Place, Pensacola, Florida, 32520. I am Chairman, President and Chief Executive Officer (CEO) of Gulf Power Company (Gulf or the Company).

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 respond to the misguided notion contained in the testimony of Office of Public Counsel (OPC) Witness Dauphinais and Sierra Club Witness Mosenthal suggesting that the Commission should not consider including Gulf's ownership interest in Plant Scherer Unit 3 (Scherer 3) in Gulf's retail rate base until the year of Gulf's next needed capacity addition. Their misguided notion is based on the false assumption that Scherer 3 would still be available for retail customers at such future date if a decision to include Scherer 3 in retail rate base is postponed.

1 Q. Why is it important for the Commission to decide in this proceeding whether
2 Scherer 3 should be included in retail rate base?

3 A. Quite simply, if Gulf is not allowed retail recovery for Scherer 3 in this case,
4 Gulf will have no choice but to diligently pursue an immediate disposition of
5 its ownership interest in Scherer 3. Such action would be required in order
6 to minimize the adverse economic impacts on Gulf from holding an asset
7 intended to serve retail customers that is not fully supported by revenues
8 from those customers. As discussed in both the direct and rebuttal
9 testimonies of Gulf's other witnesses, Gulf's ownership interest in Scherer 3
10 was planned, acquired, and built to serve Gulf's customers in Northwest
11 Florida. Gulf's acquisition of a 25 percent interest in Scherer 3 in 1981 was
12 discussed with and approved by the Florida Public Service Commission as
13 the cost-effective replacement for the larger, more expensive generating
14 unit then under development at Caryville. The Caryville unit was being
15 developed pursuant to certification by the Governor and Cabinet under the
16 Power Plant Siting Act based on the Commission's finding of a need for the
17 unit.

18

19 When the Commission first approved Gulf's planned acquisition of Scherer
20 3 as the alternative for the certified Caryville unit, the Commission was
21 aware that Gulf would be relieving retail customers of immediate cost
22 responsibility by temporarily committing the Scherer 3 generating resource
23 to other utilities through off-system wholesale contracts. This temporary
24 commitment did not change the fundamental nature of Gulf's acquisition of
25 Scherer 3 from its intended purpose to ultimately serve retail customers.

1 Gulf did not plan, acquire and build Scherer 3 to serve off-system sales.
2 Such sales were made in order to temporarily mitigate the impact on retail
3 customers. Gulf did not choose and would not have chosen to participate in
4 the ownership of Scherer 3 as a merchant generating plant.

5

6 Q. Why is that history important today?

7 A. It unequivocally demonstrates that Gulf's role as a Florida public utility
8 providing retail electric service to customers in Florida is paramount.
9 Investing in merchant power plants would have been a fundamental
10 departure from that role and would have significantly altered the risk profile
11 of the Company.

12

13 Q. How do those circumstances affect the matter of Scherer 3 today?

14 A. Starting in January 2016, for the first time since Scherer 3 began
15 commercial operations in January 1987, a majority of Gulf's ownership
16 interest in Scherer 3 is no longer committed to or supported by long-term
17 off-system sales. Since January 2016, the portions of Scherer 3 previously
18 committed to long-term off-system sales have been serving and are
19 continuing to serve Gulf's retail customers. As a result, Gulf's retail
20 customers are directly benefiting from its operation as part of Gulf's retail
21 fleet in economic dispatch. In order to fulfill the original intent behind Gulf's
22 acquisition of Scherer 3, the time has come for the customers for whom the
23 unit was planned, acquired and built and is now operated to assume
24 responsibility for its revenue requirements.

25

1 Q. If the Commission were to decline to include Scherer 3 in rate base in this
2 case, would Scherer 3 be available to serve Gulf's retail customers in the
3 future?

4 A. No. As Gulf's CEO, I am here to advise the Commission that Gulf cannot
5 hold this asset without current recovery in retail rates. As discussed by Gulf
6 Witness Liu in her direct and rebuttal testimonies, holding an asset of this
7 magnitude without adequate revenues to support it would have a significant
8 and material adverse impact on Gulf's financial integrity and would thereby
9 jeopardize our ability to raise funds needed to maintain adequate and
10 reliable service to our customers.

11

12 A decision by the Commission in this case to exclude Scherer 3 from retail
13 rates must be made with the understanding that Gulf cannot and will not
14 hold the asset for the future benefit of Gulf's retail customers. Gulf's
15 divestiture of ownership under these circumstances will likely mean that
16 another entity would acquire the asset at a substantial discount below Gulf's
17 net book value. The new owner will therefore be able to achieve the
18 benefits of a highly-efficient, coal-fired generating unit that has a robust set
19 of air emission controls for the remaining 30-35 years of its economic life.
20 The difference between what Gulf has invested in the unit and what it is
21 able to achieve through such a forced sale would be stranded costs that are
22 properly borne by and should be recovered from Gulf's retail customers.

23

24

25

1 Q. Does the Commission have a better alternative?

2 A. Absolutely. The Commission can and should honor the regulatory compact
3 by allowing retail cost recovery of Scherer 3 in this case. In this manner,
4 Gulf's retail customers will continue to receive the benefits of Gulf's newest
5 and most cost-effective coal-fired resource as part of Gulf's increasingly
6 diversified mix of generating resources. Gulf's financial integrity will thereby
7 be preserved, allowing Gulf to continue to make reasonable and timely
8 investments, including additions of renewable and other generating
9 resources, in order to continue to provide reasonable and adequate service
10 to our retail customers in Northwest Florida in the manner they both expect
11 and deserve.

12
13 Q. Does this conclude your testimony?

14 A. Yes.
15
16
17
18
19
20
21
22
23
24
25

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

GULF POWER COMPANY
Before the Florida Public Service Commission
Rebuttal Testimony of
Dane A. Watson
Docket No. 160186-EI
In Support of Rate Relief
Date of Filing: February 8, 2017

**I. INTRODUCTION, QUALIFICATIONS, PURPOSE OF
TESTIMONY, AND RECOMMENDATIONS**

- Q. Please state your name, business address and occupation.
- A. My name is Dane Watson. My business address is 101 E. Park Blvd, Suite 220, Plano, TX 75074. I am the Managing Partner in Alliance Consulting Group (Alliance).
- 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 rebut the positions of Federal Executive Agencies (FEA) Witness Andrews and Office of Public Counsel (OPC) Witness McCullar on the topic of depreciation. Specifically, in the sections that follow, I will discuss:
 - Life parameters for various plant accounts proposed by Mr. Andrews that differ from those used to develop depreciation rates in the Depreciation Rate Study (Study) I sponsored as Exhibit DAW-1 filed on September 20, 2016 in Docket No. 160170-EI;

- 1 • The computation error in Account 390 that Mr. Andrews and Ms.
2 McCullar address in their respective testimony and that the Company
3 acknowledges and accepts in this rebuttal testimony;
- 4 • The different life recommendations proposed by Ms. McCullar for
5 distribution in Accounts 365 and 369.1;
- 6 • The proposed change to Net Salvage for Account 390 – Structures and
7 Improvements suggested by Ms. McCullar;
- 8 • The revision to Interim Retirement Ratio (IRR) for Production discussed
9 by Ms. McCullar; and
- 10 • The different fundamental definition of depreciation approach suggested
11 by Ms. McCullar.

12

13 Q. Are you sponsoring any rebuttal exhibits?

14 A. Yes. I am sponsoring six exhibits. These exhibits were prepared under my
15 supervision, and to the best of my knowledge, the information contained in
16 these exhibits is true and correct.

17

18 Q. What recommendations are you making in your rebuttal testimony?

19 A. I recommend that the Florida Public Service Commission (Commission)
20 approve the annual depreciation rates as presented in the revised
21 appendices included as Exhibit DAW-4 to my rebuttal testimony that
22 correspond to the appendices to the Depreciation Rate Study. Appendices
23 A-1, A-2, and A-3 list the annual depreciation rates for Steam Production;
24 Other Production; and Transmission, Distribution and General Plant,
25 respectively. Appendix B shows the comparison of the annual

1 depreciation accrual. The revised appendices incorporate the adjustments
 2 related to issues raised by intervenors to which the Company is agreeing as
 3 part of its rebuttal case.

6 II. RESPONSE TO FEA'S POSITIONS

8 Q. What topics will you address in this section of your rebuttal testimony?

9 A. In this section of my rebuttal testimony, I will address the revised individual
 10 account life and curve parameters being proposed by Mr. Andrews.

12 Q. What accounts are being challenged by Mr. Andrews?

13 A. Mr. Andrews has recommended changes in life for four accounts in
 14 transmission, two accounts in distribution and three accounts in general
 15 equipment for a total of nine accounts.¹ Table DAW-1 Rebuttal shown below
 16 is a summary of the plant accounts: Existing, Gulf Proposed, and FEA
 17 Revised life and survivor curve parameters.

18 **Table DAW-1 Rebuttal**
Summary of Proposed Life Parameters by Account

<u>Plant Account</u>	<u>Existing</u>		<u>Gulf's Proposed</u>		<u>FEA's Revised</u>	
	<u>Life</u>	<u>Curve</u>	<u>Life</u>	<u>Curve</u>	<u>Life</u>	<u>Curve</u>
<u>Transmission</u>						
<u>Transmission</u>						
353 - Station Equipment	45	S0	40	S0	40	L0.5
354 - Towers and Fixtures	50	R5	55	R4	56	R3
355 - Poles and Fixtures	38	S0	40	L0.5	41	S0
358 - Underground Conductor & Devices	45	R3	50	R4	55	R5
<u>Distribution</u>						
361 - Structures and Improvements	48	R3	50	R2.5	52	R2.5
364 - Poles, Towers and Fixtures	34	R1	33	R0.5	38	R1
<u>General</u>						
390 - Structures and Improvements	45	S1.5	46	R1.5	48	R1.5
396 - Power Operated Equipment	15	R5	16	R4	18	R4
397 - Communication Equipment	16	S1	16	L1.5	17	L1.5

¹ Direct Testimony of Brian C. Andrews, page 15, Table 2.

1 Q. Were there differences in Mr. Andrews' approach to this analysis and your
2 approach to this analysis?

3 A. Yes. Mr. Andrews' analysis relied primarily on a mathematically calculated
4 best statistical fit for a single placement and experience band. In contrast,
5 my recommendations relied on the graphical analysis of multiple placement
6 and experience bands. Mr. Andrews has performed his own life analysis
7 using his approach for all transmission, distribution, and general accounts
8 and has made alternative recommendations for nine accounts (eight that
9 used actuarial analysis and one account that used Simulated Plant Record
10 (SPR) analysis).

11

12 Q. You characterize Mr. Andrews' approach to life analysis as mathematical. Is
13 a mathematical approach the standard approach used in performing
14 actuarial life analysis?

15 A. Not to the extent Mr. Andrews has relied upon it. There are various
16 statistical or mathematical based analytics that we perform and provide, as
17 Alliance did in this case for the Depreciation Rate Study, to support the
18 overall life analysis for each account. However, the curve fitting process we
19 utilize is referred to as a "visual fit." A "visual fit" is the most commonly-used
20 approach by other depreciation consultants when actuarial data is available,
21 which it was for this Study.

22

23 Q. Are there weaknesses to solely using a mathematical approach?

24 A. Yes. There are times that the mathematical approach will produce results
25 that are not reasonable. For example, in Mr. Andrews' testimony, Account

1 358 results in a statistical best fit life of 14,184 years and curve O1.² In
2 contrast, the National Association of Regulatory Utility Commissioners
3 (NARUC) provides the following guidance: “Depreciation analysts should
4 avoid becoming ensnared in the mechanics of the historical life study and
5 relying solely on mathematical solutions.”³ Here, Mr. Andrews’ approach
6 relies solely upon mathematical solutions, which resulted in a facially
7 unreasonable result.
8

9 Q. Mr. Andrews states he performed his analysis using a full placement band
10 and the most recent experience band for all the accounts.⁴ What are the
11 implications of this approach?

12 A. The use of only one placement/experience band combination in the analysis
13 is an unusual practice in actuarial life analysis. A sound actuarial analysis
14 involves the use of multiple bands. The purpose of analyzing multiple
15 bands is to better understand trends in life and the effect of changes in
16 investment mix and Company practices in order to assist in the selection of
17 the appropriate life. Mr. Andrews’ analysis of a single band only allowed
18 him to focus on one “snapshot” in time. He did not extend his review to the
19 numerous actuarial visual fits that Alliance performs and, as a result, only
20 saw a single point of the account. In sharp contrast, the visual fits we
21 performed encompassed Mr. Andrews’ band, as well as a number of others
22 that spanned the various time frames of the Company’s assets. Our
23 numerous visual fitting placement and experience (observation) bands, by
24 design, capture retirement experience that is relevant in the life analysis
25

² Brian C Andrews Direct Testimony, Exhibit BCA-1, Page 26.

³ NARUC Public Utility Depreciation Practices, Page 126.

⁴ Brian C Andrews Direct Testimony, Page 13.

1 (contrary to what Mr. Andrews suggests in his testimony).⁵

2

3 Q. Please summarize your observations or concerns regarding Mr. Andrews’
4 life analysis and resulting proposals.

5 A. As discussed above, Mr. Andrews has not fully utilized a standard life
6 analysis through his reliance solely on mathematical fits. He also focuses
7 only on a singular band and analytic of only the most recent retirement
8 history. The recent retirement history may or may not be applicable to the
9 future. In contrast to Mr. Andrews’ approach, the more appropriate
10 approach, as recommended by depreciation literature and as I have done, is
11 to take the analysis further and perform visual fitting using a number of
12 bands (which is one of the most powerful tools in actuarial analysis) to help
13 understand what is happening through time in each account. Looking at
14 only one “snapshot” in time can create confusion and less-than-optimal
15 results, especially because actuarial analysis is designed to look at multiple
16 periods. In short, Mr. Andrews’ methodology is unreasonably limited and
17 fails to take into account other relevant data.

18

19 Q. What is the first asset account where Mr. Andrews proposes a different
20 curve/life combination than Gulf Power and what is his stated reason for the
21 proposed change?

22 A. Account 353 – Station Equipment. The existing approved life/curve is 45
23 S0. My recommendation is to change to 40 S0, decreasing the life by five
24 years. Mr. Andrews proposes using a life/curve of 40 L0.5 based on the
25 most recent experience band.

⁵ Brian C Andrews Direct Testimony, Page 13

1 Q. Do you agree with Mr. Andrews' basis for proposing a 40L0.5?

2 A. No. Mr. Andrews inappropriately focuses on a singular period contained in
3 the Depreciation Study and indicates the Sum of Squared Differences
4 (SSD) (the statistical match between the Company's actual experience and
5 recommended life/curve combination) for his recommendation is better and
6 therefore a better fit when compared to my 40 S0.⁶

7

8 Q. Is Mr. Andrews proposing the best mathematical fit based on his analysis?

9 A. No. In fact, the best fit indicated in Mr. Andrews' analysis is a 41 L0,⁷ but he
10 recommends a 40 L0.5.

11

12 Q. Is there any material difference between Mr. Andrews' recommendation of
13 40 L0.5 and your recommendation of 40 S0?

14 A. Yes. Although the life is the same, the dispersion pattern recommended by
15 Mr. Andrews results in a different pattern of retirement for the assets in the
16 account.

17

18 Q. Can you explain this further?

19 A. Yes. Despite both recommending a 40-year life, when one uses an L0.5
20 dispersion pattern, it results in assets reaching an age of 162.5 years. In
21 comparison, using the S0 dispersion pattern results in assets reaching an
22 age of 79.5 years. This long "tail" in the L0.5 retirement pattern may be
23 reasonable in an account with millions of small assets (such as a pole
24 account), but it is less appropriate for substation equipment. In this account,
25 the assets are generally much larger, and professional judgment would not

⁶ Brian C Andrews Direct Testimony, Exhibit BCA-1, page 13 of 73

⁷ Brian C Andrews Direct Testimony, Exhibit BCA-1, pages 13 of 73 and 14 of 73

1 suggest that any of those assets would last well over 150 years. The S0
2 curve is a better pattern for these types of assets. Also, in an account in
3 which the various components are being impacted by technological
4 changes, the L0.5 dispersion pattern is particularly not a good match, and
5 the difference is significant.

6
7 Q. Is the single placement and experience band used by Mr. Andrews more
8 indicative of the future than your analysis?

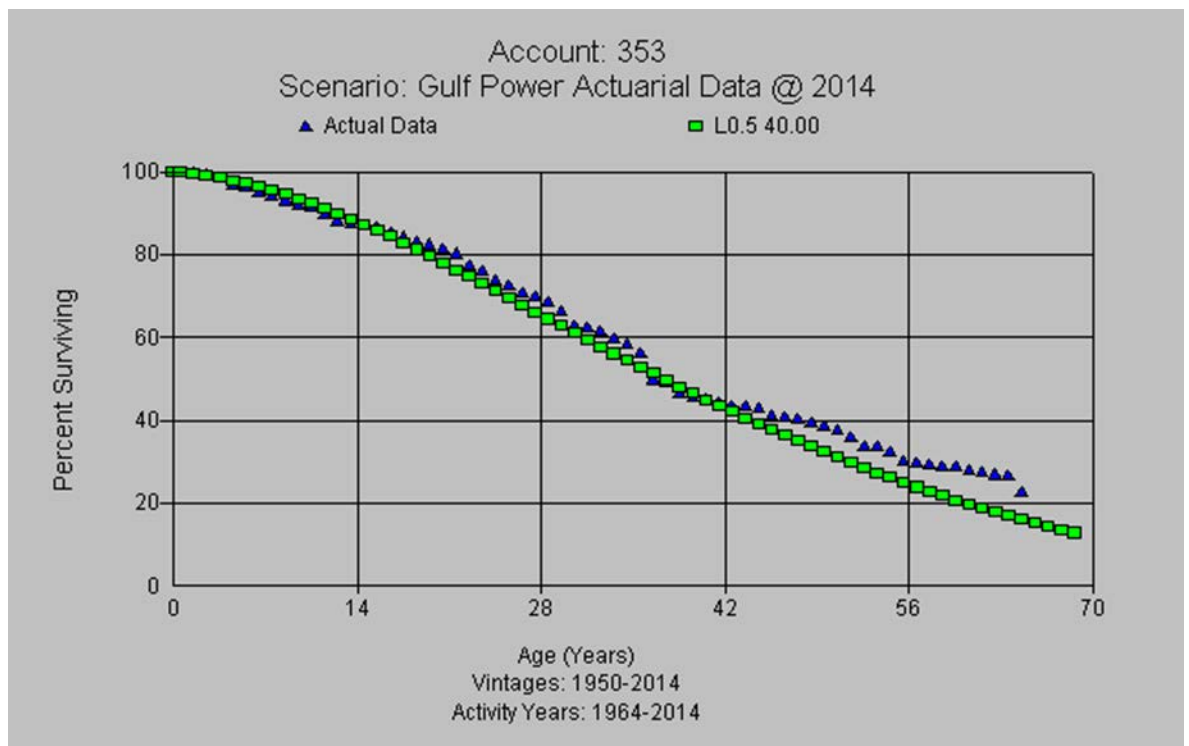
9 A. No. In his analysis, Mr. Andrews uses a placement band of 1900-2014,
10 whereas I used a number of placement bands (including a placement band
11 of 1950-2014). The surviving plant balances for vintages prior to 1950 show
12 less than \$300 thousand of investment with zero retirements for those
13 vintages. Given that the small number of assets from prior to 1950 is not
14 very representative of nearly all of the assets in the account (e.g. old analog
15 relays or oil circuit breakers), the influence they have on the curve selection
16 would not be representative of the future. In other words, the long "tail" of
17 the L0.5 curve is likely driven by those old, non-representative assets. By
18 excluding those vintages from my analysis, I focused on a more relevant mix
19 of assets that is a better representation of what we expect in the future. In
20 addition, by limiting the time period of retirement activity in Mr. Andrews'
21 analysis (i.e. experience band only from 1990 to current), Mr. Andrews
22 overemphasizes recent changes to the mix of assets in this account. For
23 example, throughout the 1990's the Company replaced all oil circuit breakers
24 with SF6 breakers, resulting in a different pattern of retirements during that
25 replacement time than experienced at other points in history or that would

1 necessarily be expected to occur in the future. Looking at a broader period
 2 of experience in this account ensures the replacement program does not
 3 overly influence the results of the analysis.

4
 5 Q. Can you illustrate Mr. Andrews' 40 L0.5 in a different placement and
 6 experience band compared to your 40 S0?

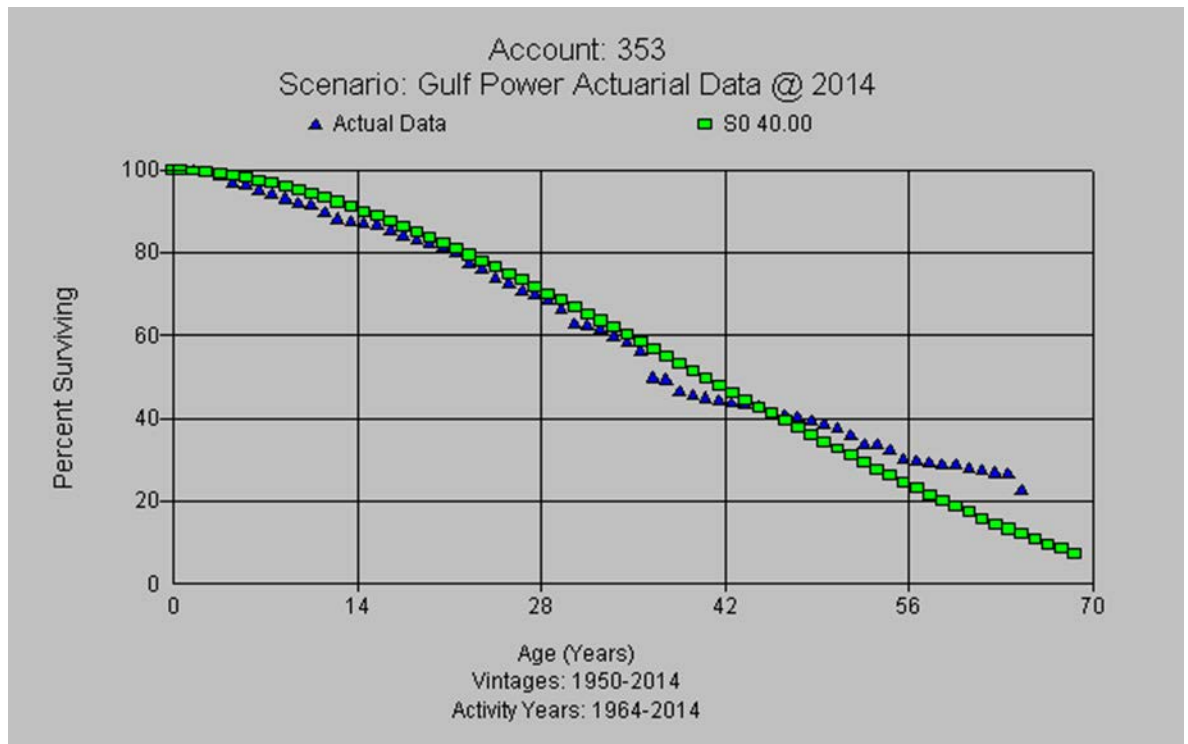
7 A. Yes. The first graph below illustrates Mr. Andrews' 40 L0.5 in a placement
 8 band of 1950-2014 and experience band of 1964-2014.

9
 10 Graph DAW-R-1



1 As shown above, the 40 L0.5 drops below Gulf Power's actual experience
 2 from just above the 80 percent surviving and 50 percent surviving. It
 3 departs again from around 40 percent to the end. The graph below is my 40
 4 S0 using the same band.

5
 6 Graph DAW-R-2



20 While the fits are both reasonable, during the most important period (80
 21 percent to 20 percent surviving), the 40 S0 is slightly better. The slightly
 22 better fit, coupled with the much more appropriate curve pattern for this type
 23 of account, make the 40 S0 a better selection for this account.

1 Q. What is Mr. Andrews' next asset account where he proposes a different
2 curve/life combination than Gulf Power and his stated reason for the
3 change?

4 A. Account 354 – Towers and Fixtures. The existing life curve is 50 R5. My
5 recommendation is 55 R4, adding 5 years to the life of the account. Mr.
6 Andrews proposes 56 R3 based on his single band and what he shows as a
7 better mathematical fit, which would add six years to the total life of the
8 account, or one year beyond my recommendation.

9

10 Q. Do you agree with Mr. Andrews' basis for proposing a 56 R3?

11 A. No.

12

13 Q. Does Mr. Andrews recommend the mathematical best fit from his analysis?

14 A. No. Mr. Andrews' overall approach is not only flawed, but even his life
15 selection does not match the results of his calculations. The mathematical
16 best fit as provided by Mr. Andrews is actually 57 R3, not the 56 R3 he
17 suggests.⁸

18

19 Q. Are there any other aspects in Mr. Andrews' mathematic analysis and
20 results that stand out?

21 A. Yes. Many of the mathematical fits shown in his analysis are well beyond
22 his proposal. Six of the 32 mathematical fits have a life over 100 years, and
23 two of those have a life of 249 years. I contrast that with 21 visual fits that
24 encompass several different placement and experience bands, none of
25 which exceed 55 years with the R4 or R5 dispersion pattern.

⁸ Brian C Andrews Direct Testimony, Exhibit BCA-1, pages 16 of 73 and 17 of 73

1 Q. How does limiting his analysis to a single placement and experience band
2 potentially impact his life/curve recommendation?

3 A. In a long-lived account with a limited number of technology changes (such
4 as this Tower account), analyzing a longer-term and different levels of
5 experience is important. As seen in the graphs below, the Company's
6 experience is not "smooth." The lack of "smoothness" makes both valid
7 matching (whether mathematically or visually) and the subsequent
8 interpretation of the matches more challenging.

9

10 Q. Is Mr. Andrews' proposed 56 R3 a better fit when you compare them?

11 A. No. Although the match between Mr. Andrews' recommendation and the
12 Company's recommendation are similar in his chosen band, looking at the
13 various bands shows that the Company's recommendation is superior.
14 Below are the graphs showing Mr. Andrews' recommendation and the
15 Company's recommendation based on Mr. Andrews' short experience band.
16 His recommendation matches slightly better towards the top of the curve
17 above 80 percent surviving. However, in the middle of the curve during the
18 period where more retirements were experienced, Alliance's selection
19 matches slightly better, although neither matches well to the stair-step
20 pattern.

21

22

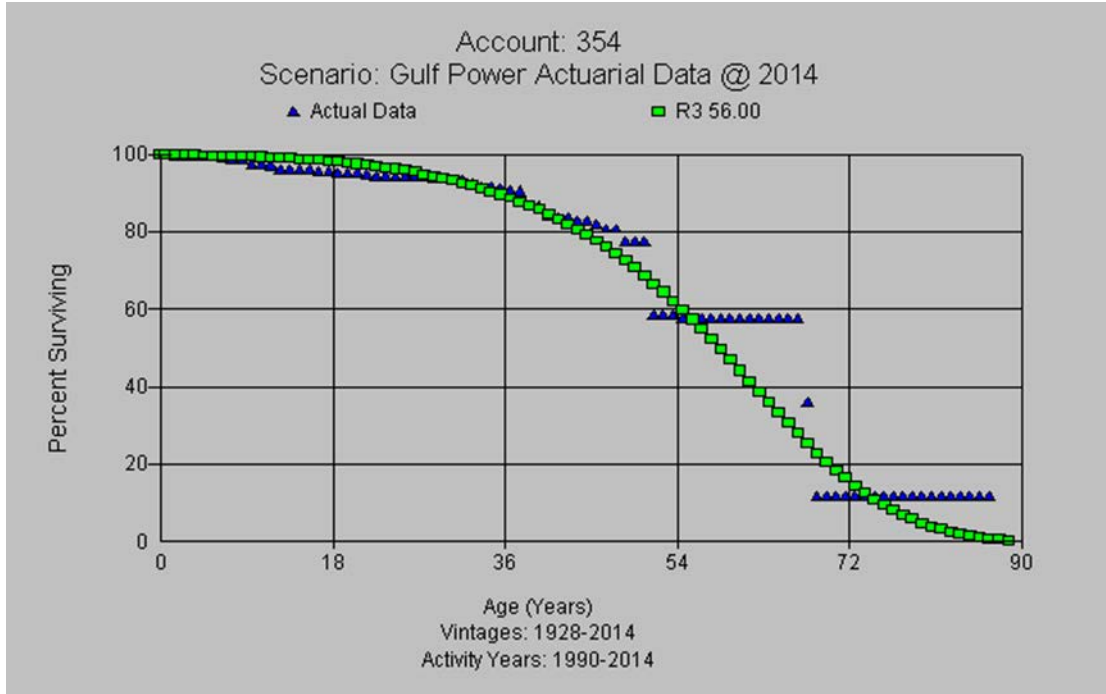
23

24

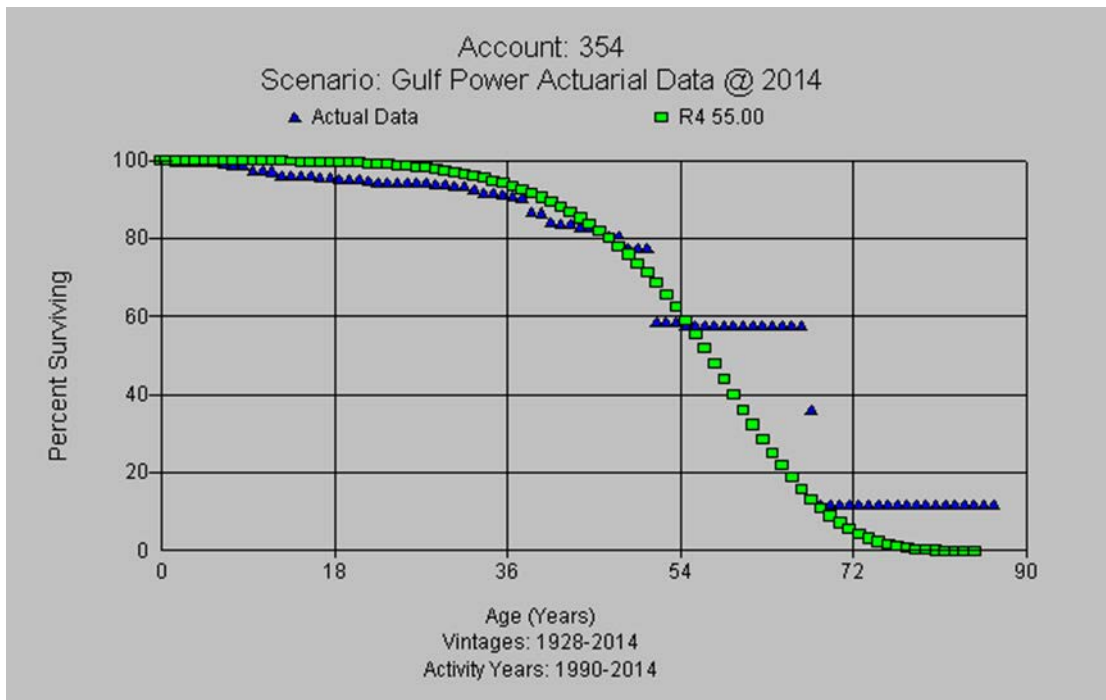
25

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Graph DAW-R-3

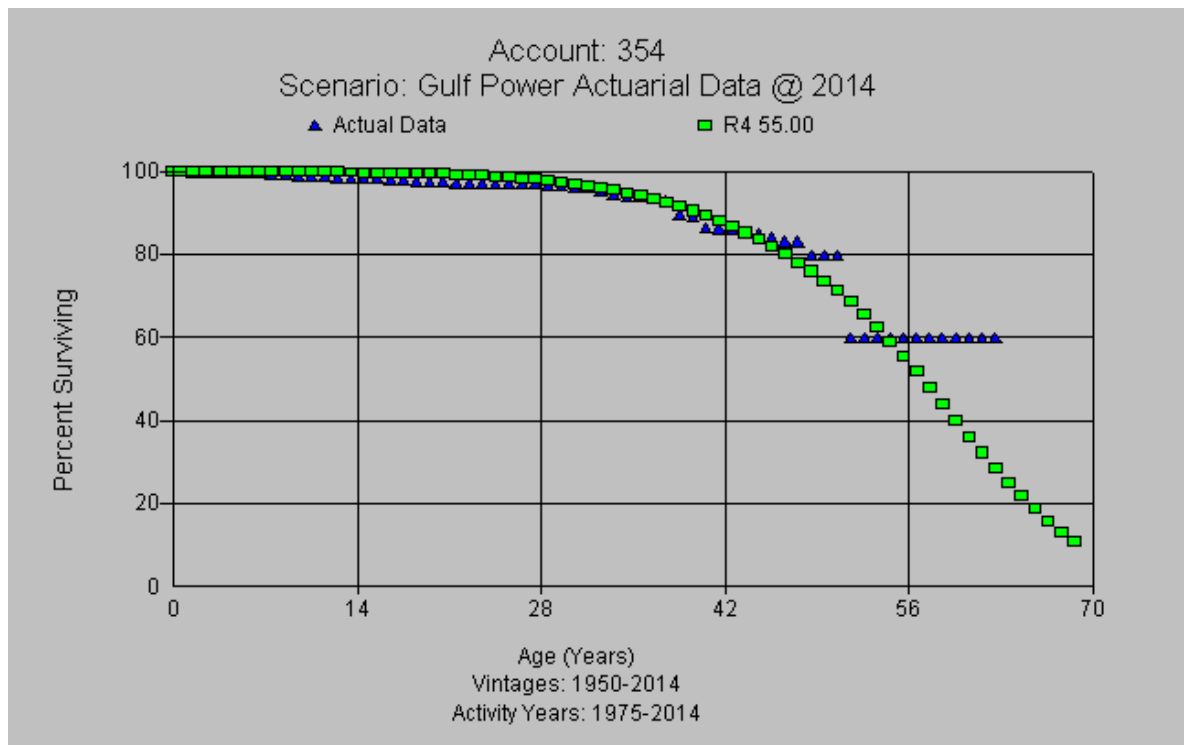


Graph DAW-R-4



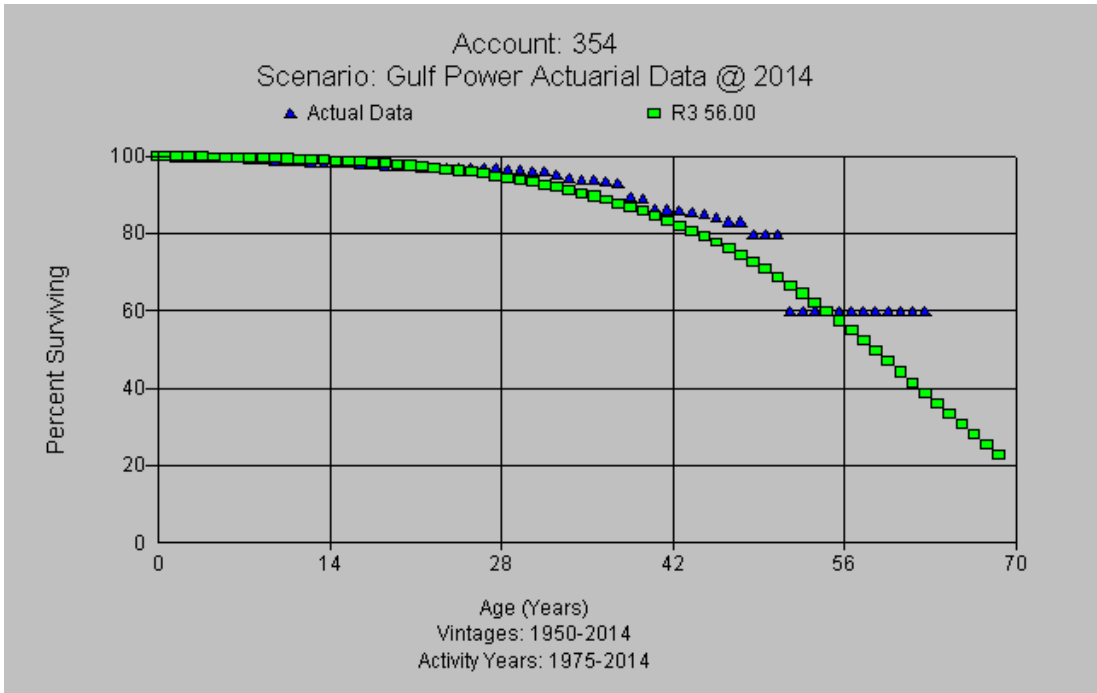
1 However, when more than the most recent band is analyzed, in each case,
 2 the Company's selection is a much better fit. Graphs of the different bands
 3 with the Company's and Mr. Andrews' selection are shown below. For long-
 4 lived, stable assets, one would expect the life indications to be fairly stable.
 5 Upon consideration of different bands and observing a consistently better
 6 (or, in the case of the most recent band, as good) fit, a reasonable analyst
 7 would recommend the Company's 55 R4 over Mr. Andrews' 56 R3.

8
 9 Graph DAW-R-5



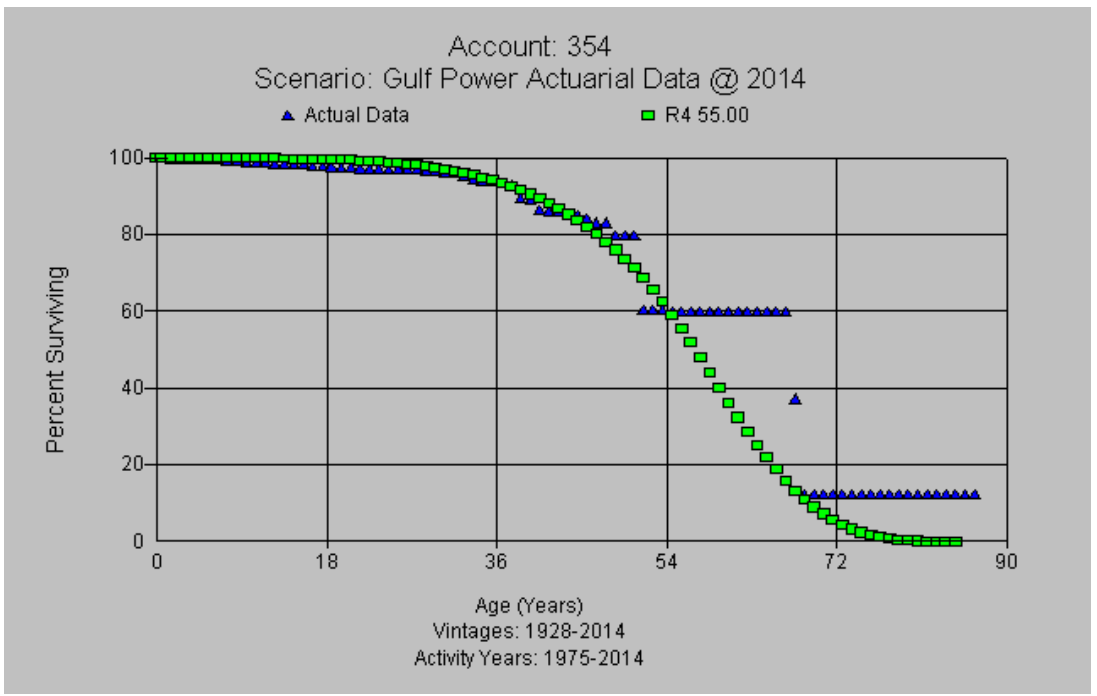
1 Graph DAW-R-6

2
3
4
5
6
7
8
9
10
11
12
13



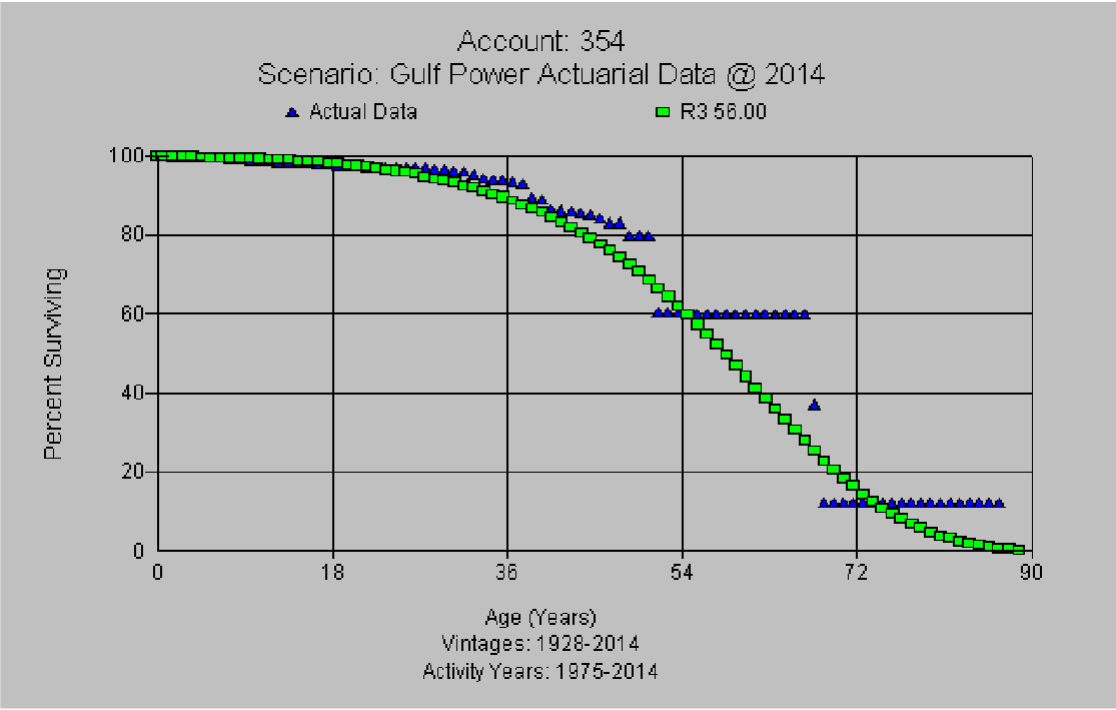
14 Graph DAW-R-7

15
16
17
18
19
20
21
22
23
24
25



1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Graph DAW-R-8



It is evident that, when using a wider experience band, the R4 55 is a better visual fit than the R3 56 until dropping below 60 percent surviving, which is a less weighted point on the curve. When comparing these two graphs, one sees slightly more retirements earlier in the more recent experience band. For example, at Age 54, the actual data shows approximately 58 percent surviving plant, while using the broader experience band (1975-2014), one sees 60 percent surviving plant at Age 54. The R4 curve shows a higher percent surviving, having already survived 98 percent (54/55) of the assets' average service life than the R3 curve.

1 Q. Are there other factors that should be considered?

2 A. Yes. Information provided by the Company should also be considered when
3 performing an actuarial analysis. Company experts indicated that the
4 assets in this account include steel poles and towers. The majority of the
5 towers in this account are steel. The Company further explained that steel
6 poles rust faster in its service area when compared to other areas of the
7 country, and galvanization sometimes disappears faster in this environment.
8 Many of the newer towers are aluminum and have a shorter life than steel.
9 With the mix of assets and varying life characteristics in this account, I
10 recommend the more conservative increase in the life of five years instead
11 of moving further to six years.

12

13 Q. Do you have summary comments on your life and curve recommendation
14 for Account 354?

15 A. Yes. A life recommendation should be reflective of all relevant factors, and
16 not just mathematical or visual fits. My recommendation reflects not only the
17 analytics, but also relies on visual fitting, discussions with Company
18 personnel, changes in the assets contained in the account over time, and
19 results in a gradual or conservative life increase. My 55 R4
20 recommendation is reasonable, is the best estimate for the assets at this
21 time, and should be adopted by the Commission.

22

23

24

25

1 Q. What is Mr. Andrews' next asset account where he proposes a different
2 curve/life combination than Gulf?

3 A. Account 355 – Poles and Fixtures. The existing, approved life curve is 38
4 S0. My recommendation is to change to 40 L0.5, increasing the life by two
5 years. Mr. Andrews proposes 41 S0 based on the most recent experience
6 band and a mathematical better fit, which would add one additional year to
7 the total life of the account, or one year beyond my recommendation.

8

9 Q. You call Mr. Andrews' proposed 41 S0 a better mathematical fit, not the best
10 mathematical fit. Why?

11 A. Mr. Andrews' analysis generates 32 different fits and statistically ranks them
12 by their SSD. The least SSD earns that curve and life the top ranking. As
13 shown in Mr. Andrews' Exhibit BCA-1, page 19 of 73, and on his graph on
14 page 20 of 73, the statistical best fit is 39 R1 (a decrease from both my
15 recommendation and that of Mr. Andrews).

16

17 Q. Where is the 41 S0 recommended by Mr. Andrews ranked?

18 A. It is ranked fourth.⁹ The distinction of better and best is confusing, but
19 essentially Mr. Andrews proposes a life/curve combination that has a lower
20 SSD than my proposed 40 L0.5, despite the clearly better visual fit that I will
21 show below in Graph DAW-R-9.

22

23 Q. Do you agree with Mr. Andrews' recommendation?

24 A. No. Mr. Andrews relies on only the most recent experience band and does
25 not factor in the changes to the asset mix or changes to other life

⁹ Brian Andrews Direct Testimony, Exhibit BCA-1, Page 19 of 73

1 characteristics of the assets in this account. My recommendation factors in
2 (a) the recent changes to the assets in this account, (b) a consideration as
3 to how those changes affect the current mix of assets, and (c) the best
4 indication of future retirement expectations. As is the case for any
5 depreciation analysis, an understanding of what has occurred, is occurring,
6 and is expected to occur operationally must be considered in any life
7 recommendation, as explained by NARUC.¹⁰
8

9 Q. What changes are occurring in this account that would indicate the assets in
10 this account will have a longer life?

11 A. The information provided in Company interviews indicates that there has
12 been a slight increase to the number of concrete poles being installed in this
13 account. Concrete poles would have a longer life than the wood poles.
14 Since 2008, the Company has also been replacing all wood cross arms and
15 replacing them with steel, which would also support extending the life of the
16 assets. On the other hand, due to a lot of wet conditions and woodpeckers,
17 the Company is experiencing a shorter life for wood poles, i.e., a total life of
18 approximately 30 years. The Company also switched from creosote to
19 Chromated Copper Arsenate (CCA) pole preservative in the 1980's.
20 This change in pole preservatives resulted in a shorter life for wood poles,
21 i.e., because wood poles purchased in recent years do not last as long as
22 those in the more distant past.

23 Considering all these pressures on the life of the account, it seems more
24 reasonable to increase the average service life slightly to 40, rather than the
25 41 years suggested by Mr. Andrews.

¹⁰ NARUC Public Utility Depreciation Practices, Page 111

1 Q. Are there other factors that should be considered?

2 A. Yes. As is the case with Account 354 and discussed earlier in my rebuttal
3 testimony, Mr. Andrews' recommendation heavily relies on the mathematical
4 best fits and looks only at a single analytic. For comparison, both
5 recommendations are shown in the graph below using a broader experience
6 band, which is just one of several different bands used in my analysis. In all,
7 we performed 55 visual fits across multiple placement and experience
8 bands to assist in making the 40 L0.5 recommendation.

9

10 Graph DAW-R-9

11

12

13

14

15

16

17

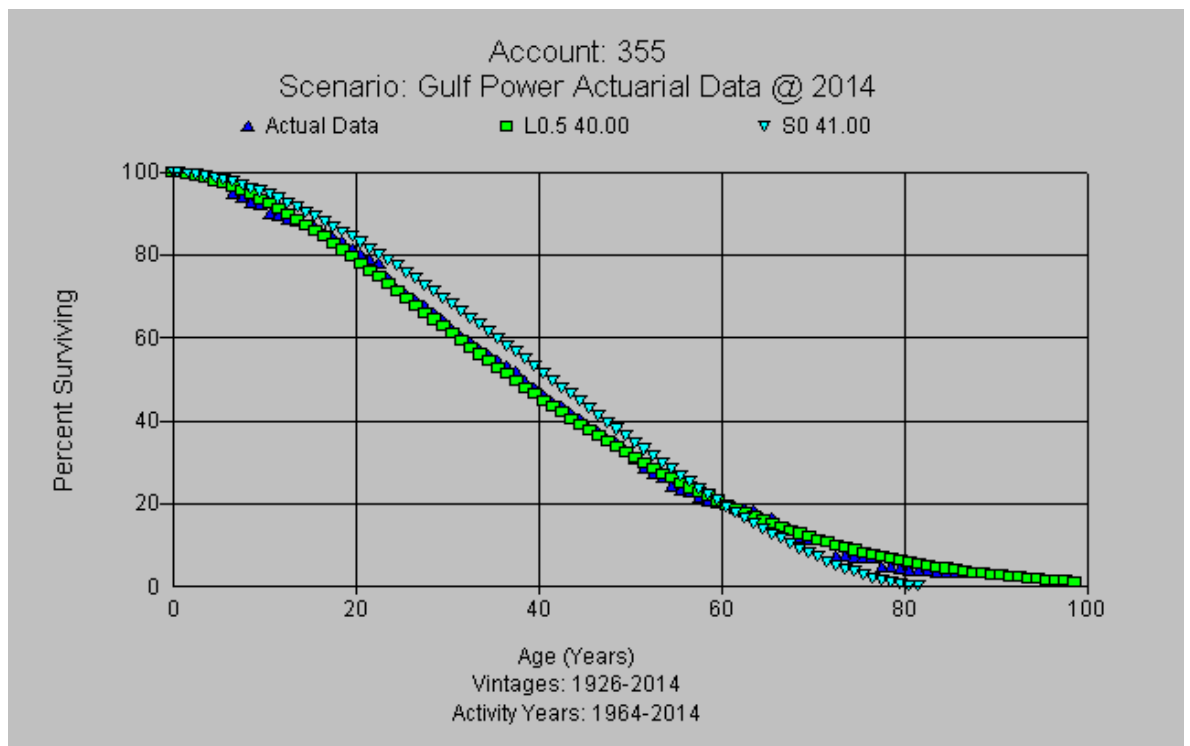
18

19

20

21

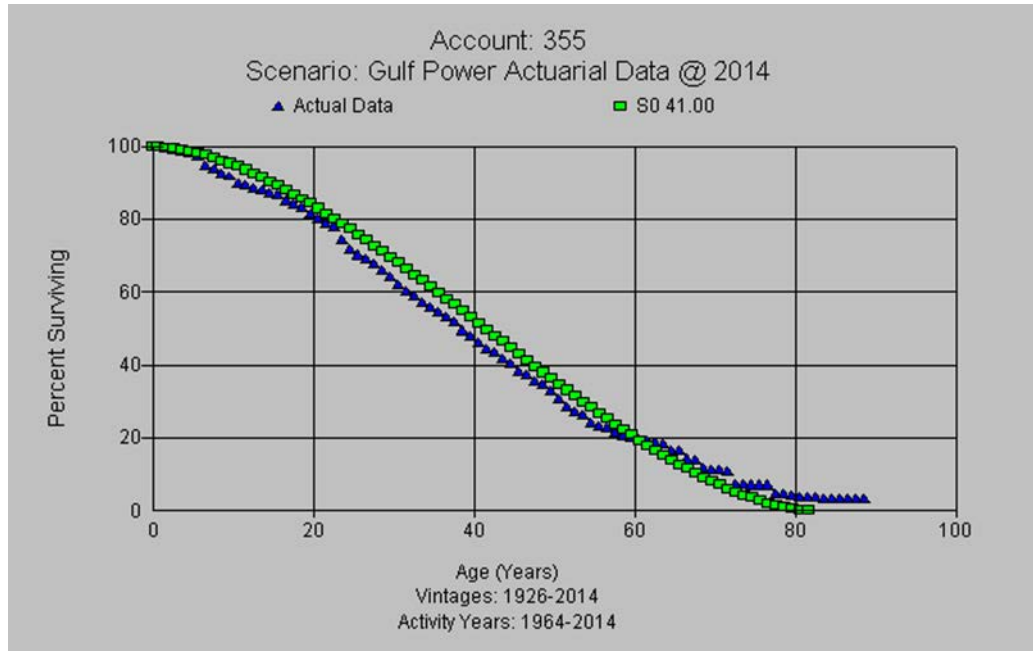
22



23 It is clear to see that Mr. Andrews' S0 41 departs from the actual data at the
24 top and continues until around 20 percent surviving where it comes back to
25 fit. The tail of the curve is the least important part of the curve to match.

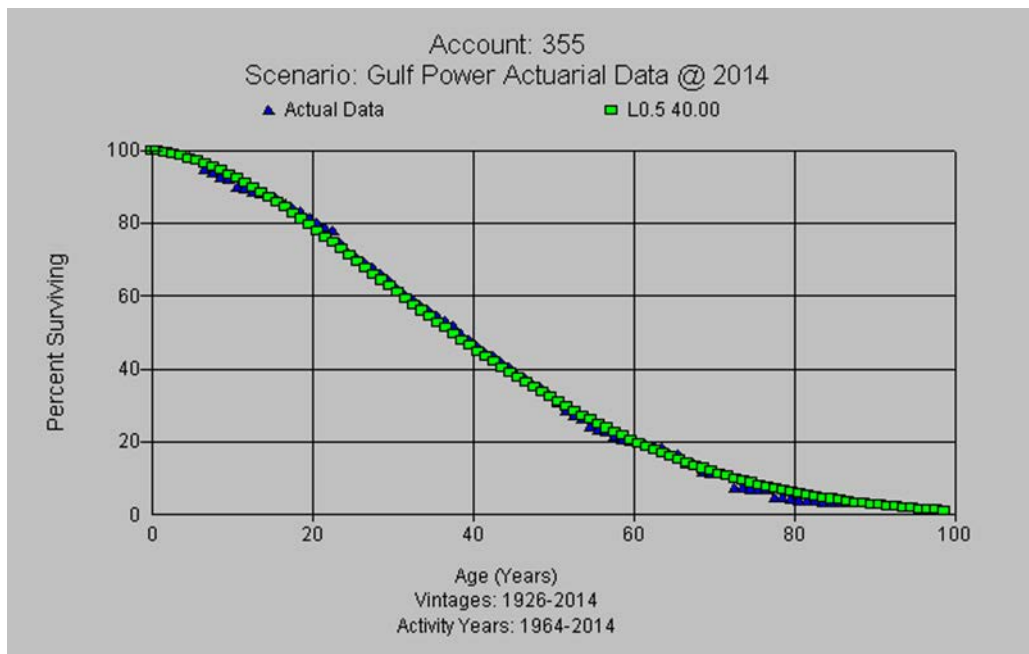
1 To allow for easier distinction, in the following graphs, the two proposals are
 2 shown separately. The first graph shows Mr. Andrews' 41 S0 for the 1926-
 3 2014 placement band with the 1964-2014 experience band.

4
 5 Graph DAW-R-10



17 Second, the graph shown below is my recommended 40 L0.5. From a
 18 visual fit, the 40 L0.5 fits Gulf Power's actual experience completely.

1 Graph DAW-R-11



13 It is evident that my recommendation is a better fit in this analysis and
 14 reflects the additional information provided by the Company that
 15 encompasses the changes in materials and life characteristics to the assets
 16 in this account.

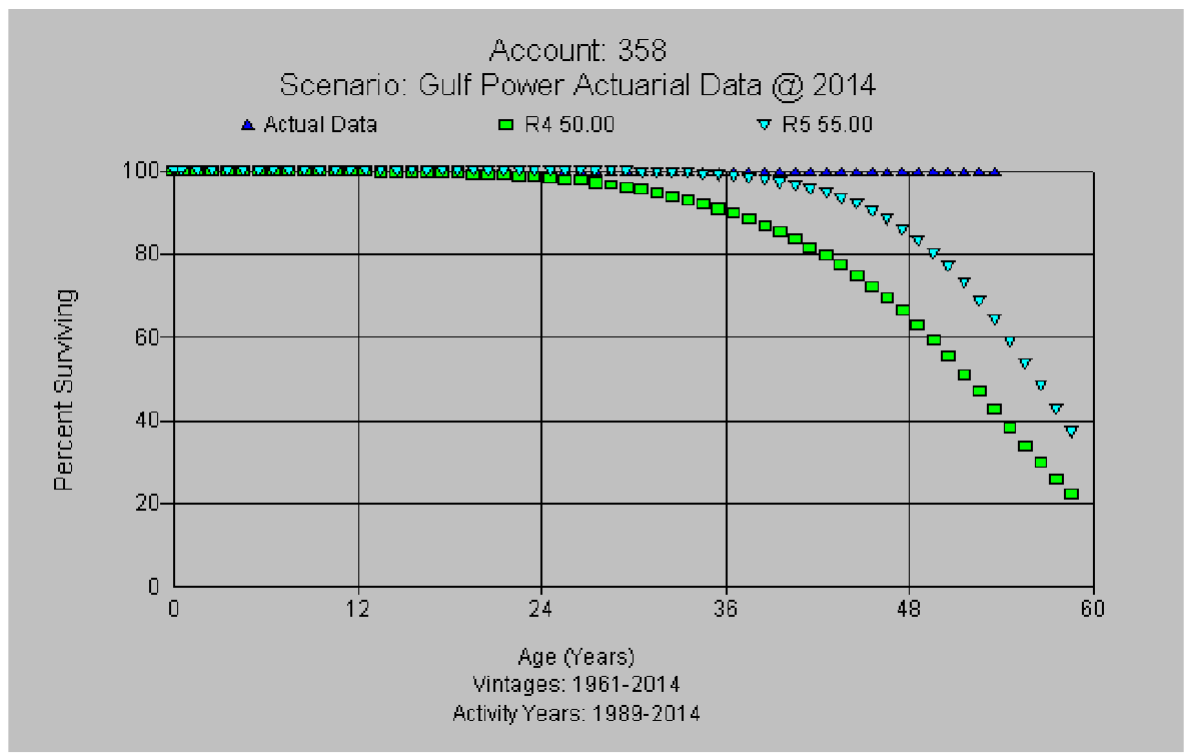
17
 18 Q. What is Mr. Andrews' next asset account where he proposes a different
 19 curve/life combination than Gulf Power and what is his rationale for the
 20 change?

21 A. Account 358 – Underground Conductor and Devices. The existing life is 45
 22 R3. My recommendation is 50 R4, adding five years to the life of the
 23 account. Mr. Andrews proposes 55 R5 based largely on his best
 24 mathematical fit, which would add 10 total years beyond what is currently
 25 approved for this account.

1 Q. Do you agree with Mr. Andrews' recommendation?

2 A. No. Mr. Andrews' recommendation is based on a better mathematical or
 3 statistical fit, but this does not result in a reasonable fit under the
 4 circumstances (as shown below in Graph DAW-R-12). In reality, this
 5 account has very little retirement experience, either historical or recent, to
 6 justify a 10-year life increase without additional support. Despite this lack of
 7 experience, Mr. Andrews suggests an approximately 20 percent increase in
 8 the asset life.

9
 10 Graph DAW-R-12



1 As the graph clearly illustrates, there has been minimal retirement
2 experience historically. The average age of surviving plant is 24.5 years.
3 Nearly all of the investment in this account is a single Hitachi submarine
4 cable running under water and providing power to the Destin area.
5 Typically, submarine cables are replaced due to capacity needs instead of
6 failure of the cable. Given the short period since the last study and the
7 continued growth in the energy needs in the Destin area, an incremental
8 movement in life is warranted. Mr. Andrews' proposed 20 percent increase
9 in the life is not warranted, as there is a lack of data to support any
10 significant movement in life.

11

12 Q. Do you have any general comments regarding the mathematical fits
13 provided in Mr. Andrews Exhibit BCA-1, page 25 of 73?

14 A. Yes. Due to the minimal retirement experience, the mathematical best fit
15 indicates a life of 14,184.3 years with the O1.¹¹ Clearly, this life is
16 unreasonable. Furthermore, depreciation experts typically do not fit the O
17 dispersion patterns due to this pattern not being representative of most
18 utility property. For example, the O1 curve exhibits the same level of
19 retirements each year over the life of the asset group, which is not a normal
20 retirement pattern for utility property. Mr. Andrews also appears to
21 recognize this "best fit" is an unrealistic selection.

22

23 Q. What is Mr. Andrews' next asset account where he proposes a different
24 curve/life combination than Gulf Power and his stated rationale for the
25 change?

¹¹ Brian C Andrews Direct Testimony, Exhibit BCA-1, Page 25 of 73 and 26 of 73

1 A. Account 361 – Structures and Improvements. The existing life is 48 R3. My
2 recommendation is 50 R2.5, which would add two years to the life of the
3 account. Mr. Andrews proposes a 52 R2.5 based on his use of a single
4 analytic and the better mathematical fit when compared to mine. Under Mr.
5 Andrews' proposal, four years are added to the total life of the account, or
6 two years beyond my recommendation. In this case, we are both proposing
7 the same survivor curve or retirement dispersion.

8

9 Q. Do you agree with Mr. Andrews' recommendation?

10 A. No. As in other accounts, Mr. Andrews relies on a single band, the full
11 placement band and the most recent experience band, and what I call a
12 better mathematical fit. As I stated previously, however, such an approach
13 is unreasonably limited. A valid approach would consider additional data,
14 including multiple bands and other information such as Company input,
15 knowledge of the characteristics of the assets in the account, and asset mix
16 in the account.

17

18 Q. What is the best mathematical fit based on Mr. Andrews' analysis?

19 A. The best mathematical fit is 54 R2.5.¹² We both agree on the dispersion
20 pattern but disagree on the best life.

21

22 Q. Do you have any general thoughts about the differences between you and
23 Mr. Andrews regarding the average service life?

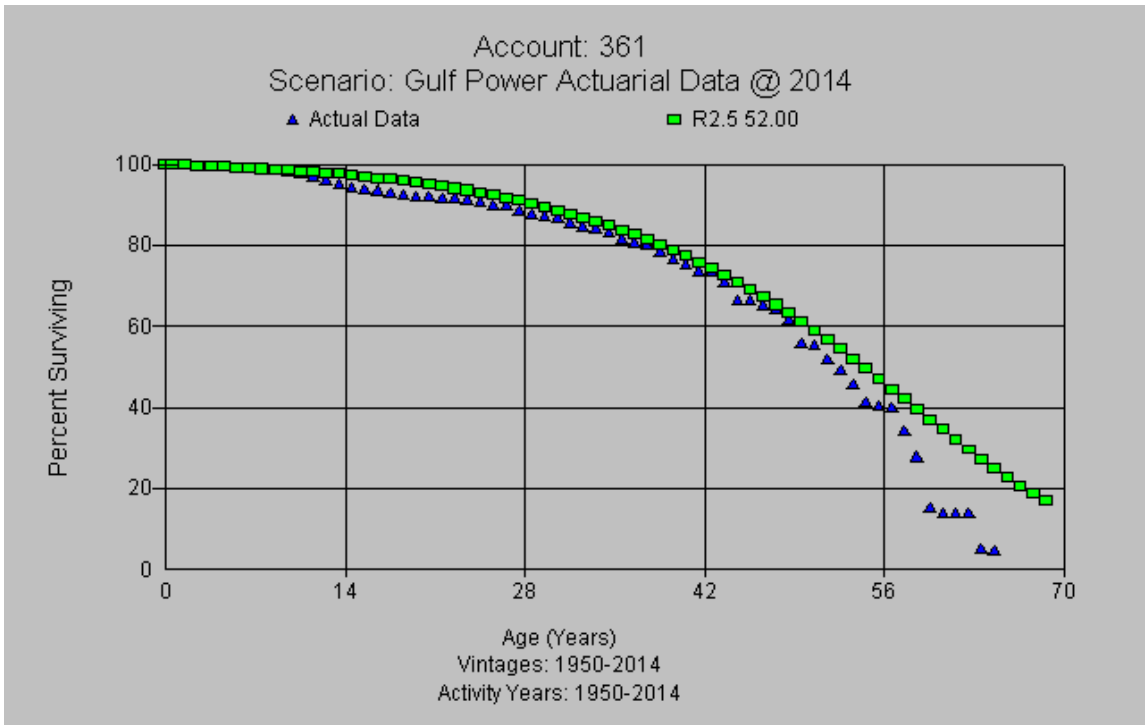
24 A. Yes. In reviewing the fits in Exhibit BCA-1, page 30 of 73, there are
25 extremes in life from the high of 200 years to the low end of life around 51

¹² Brian C Andrews Direct Testimony, Exhibit BCA-1, Page 30 of 73

1 years. To contrast this, our visual fits consisted of 53 fits across various
 2 placement and experience bands (not just one) with a low range of 42 years
 3 to the high of 53 years. Graph DAW-R-13 illustrates these differences.

4
 5 Specifically, the graph below compares the placement and experience band
 6 of 1950-2014 with Mr. Andrews' 52 R2.5.

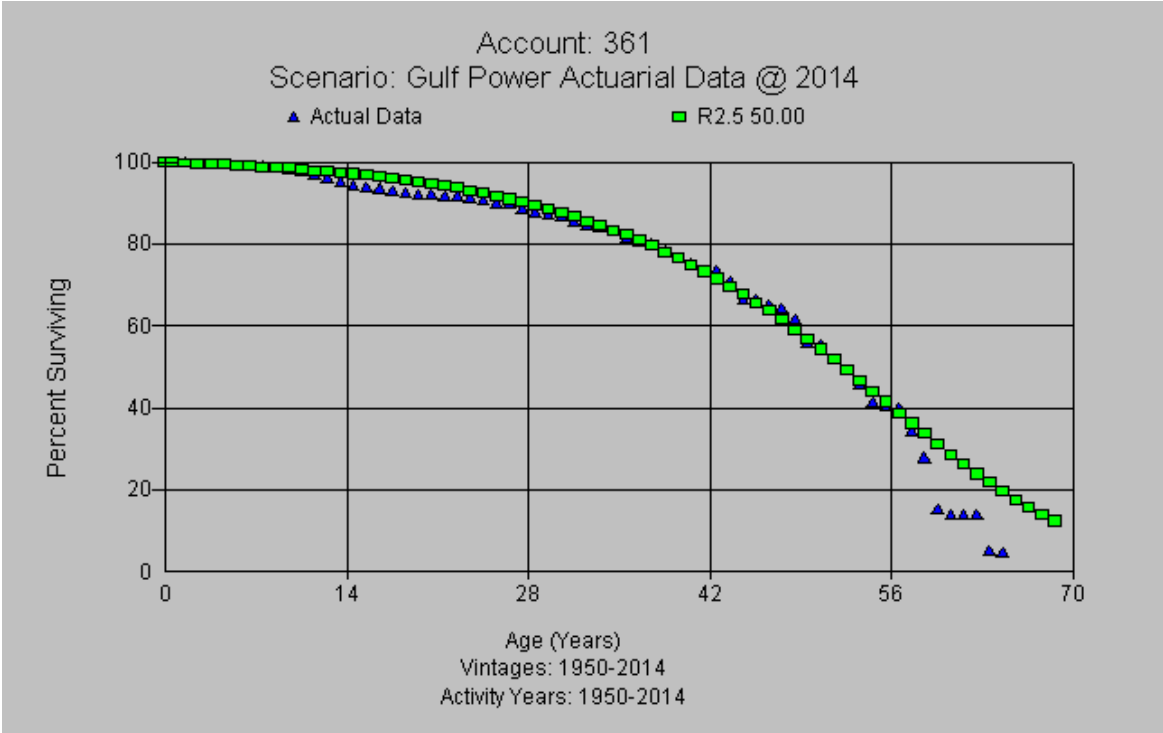
7
 8 Graph DAW-R-13



21 In contrast, the graph below illustrates the fit between the same placement
 22 1950-2014 and experience 1950-2014 bands, with my recommended 50
 23 R2.5. Clearly, my recommended 50 R2.5 is a better match to Gulf Power's
 24 actual experience than Mr. Andrews' recommendation.

25

1 Graph DAW-R-14

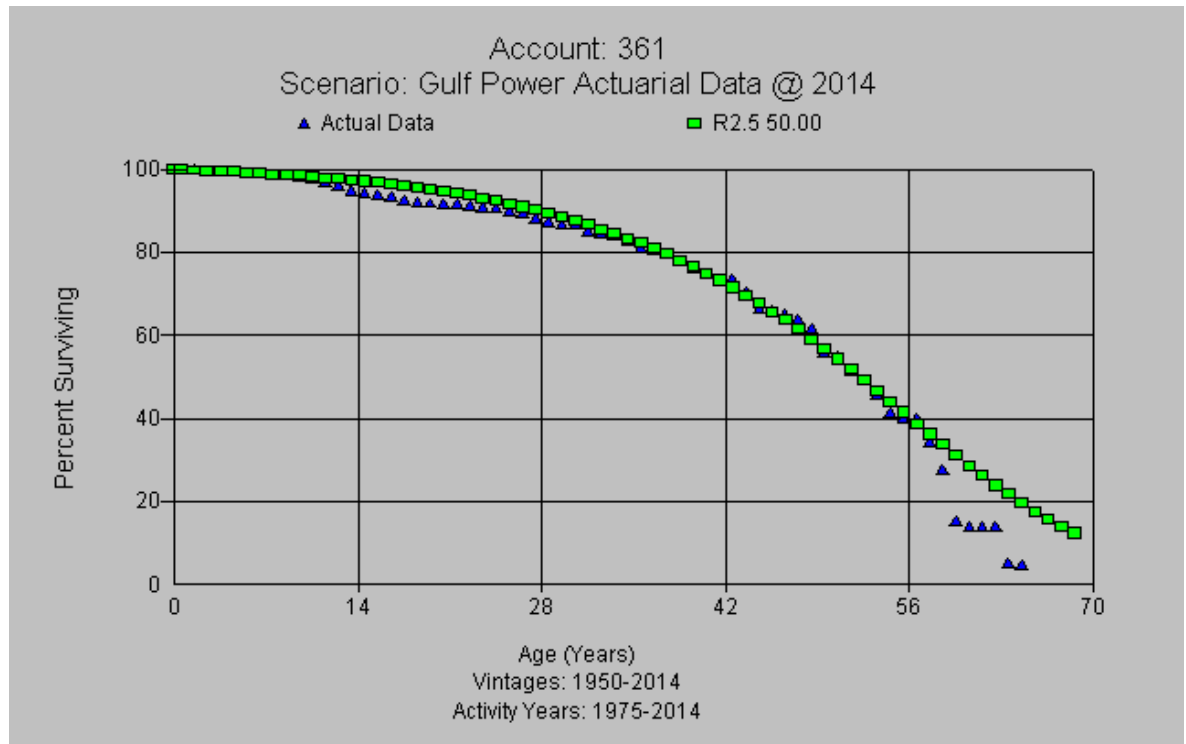


2
3
4
5
6
7
8
9
10
11
12
13
14

15 It is evident that my recommended curve (50 R2.5) is closer to the actual
16 data throughout the graph, in particular, the portion of the curve from around
17 90 percent to 40 percent surviving on the graph. At that area of the graph,
18 my recommended curve is congruent to the actual data experienced in this
19 account. That is the most concentrated point of retirements on the graph
20 and, therefore, should be the most heavily weighted points on the curve
21 where the assets reach the proposed average service life. As mentioned in
22 the authoritative text, Depreciation Systems (1994), “often the middle
23 section of the curve (that section ranging from approximately 80 percent to
24 20 percent surviving) is given more weight than the first and last sections.
25 The middle section is relatively straight and is the portion of the curve that

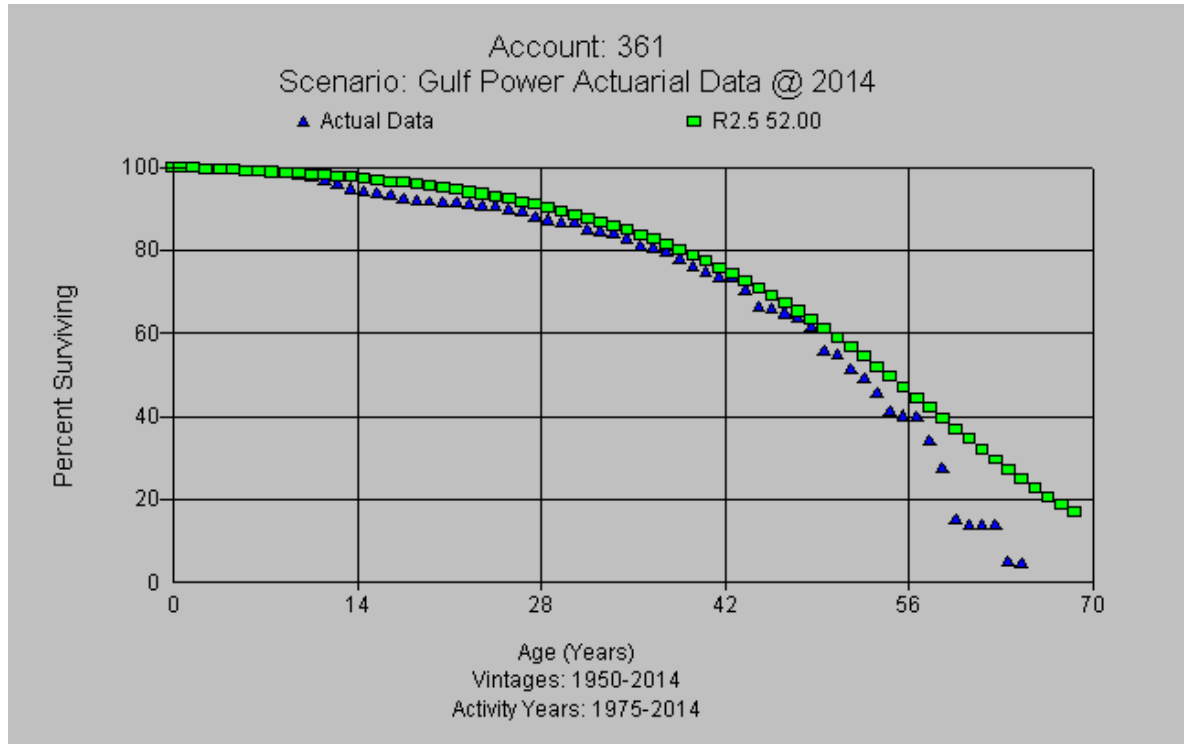
1 often best characterizes the survivor curve."¹³ A strictly statistical or
 2 mathematical approach assigns equal weight to all points along the curve in
 3 its calculation. When looking at even newer experience bands, the 50 R2.5
 4 is clearly a better fit than Mr. Andrews' recommendation as seen below.

6 Graph DAW-R-15



¹³ Depreciation Systems, Iowa State University Press, 1994, by Drs. F. K Wolf and W. C. Fitch, pages 46-47.

1 Graph DAW-R-16



15 Q. Are there other factors to consider?

16 A. Yes. Although Mr. Andrews' analysis uses the entire placement band (1926-
17 2014), his analysis does not take into account the proper mix of assets we
18 expect in the future. Surviving vintage balances prior to 1950 are less than
19 \$10,000 of the total investment in this account, which is \$26 million. There
20 is limited value to including the older vintages in this analysis, as they do not
21 accurately represent the future mix of assets in this account. My analysis
22 also incorporates information from the Company, which confirms there is no
23 change in life characteristics or operations that would support a significant
24 increase in the life of the assets in this account. The average age of
25 surviving plant is 13.7 years.

1 Q. Does Mr. Andrews' suggestion regarding Account 364 Poles, Towers and
2 Fixtures differ from your analysis?

3 A. Yes. Mr. Andrews recommends a 38 R1. My recommendation is a 33
4 R0.5. The existing life parameter is 34 R1.

5

6 Q. Do you agree with Mr. Andrews' position on Distribution Account 364 Poles,
7 Towers, and Fixtures?

8 A. No. This is the only account using the SPR life analysis which Mr. Andrews
9 challenges. He acknowledges his recommendation is based on his
10 judgment, not just the SPR analysis.¹⁴

11

12 Q. Does Mr. Andrews indicate your recommendation is in the top ranked
13 curves across multiple bands analyzed?

14 A. Yes. He acknowledges that my recommended 33 R0.5 is the second best
15 ranked curve in eight of the nine bands analyzed.¹⁵

16

17 Q. Mr. Andrews claims the SPR ranking is simply a "least worst" choice.¹⁶ Do
18 you agree?

19 A. No. I do not rely solely on the statistical ranking as Mr. Andrews suggests.
20 However, I do agree the Conformance Indices (CIs) are in the poor to fair
21 range while the Retirement Experience Indices (REIs) are in the excellent
22 range.

23

24

25

¹⁴ Direct Testimony Brian C. Andrews, p. 16

¹⁵ Direct Testimony Brian C. Andrews, p. 15

¹⁶ Direct Testimony Brian C. Andrews, p. 16

1 Q. If you do not rely solely on the statistical ranking, what other information did
2 you use to make your recommendation of 33 R0.5 for this account?

3 A. I also look at the other fits and average service life indications in each of the
4 bands analyzed. In fact, when viewing the overall band of 93 years, the
5 majority of fits (21 of the 28), indicate a life of 25-29 years. There are only
6 seven of the 28 that are in the 30-year range, and only two of those are
7 higher than my recommendation. In fact, there are no fits with a life as long
8 as Mr. Andrews' recommendation of 38 R1. For illustration of these points, I
9 am including the 93-year SPR analysis as Exhibit DAW-5.

10

11 Q. Are these indications the same across the various bands analyzed?

12 A. Yes. It is only at the 30-year band when the number of fits with a 30-36
13 year range increased from seven of 28 to nine of 28. This further supports
14 my recommendation of 33 R0.5 as not only reasonable but also
15 conservative when compared to the other fits and indications. For
16 illustration of these points, I am including the 30-year SPR analysis as
17 Exhibit DAW-6.

18

19 Q. Does Mr. Andrews provide other information to support his asserted
20 informed judgment?

21 A. Yes. He provides benchmarking from Florida Power and Light's (FP&L)
22 case, Docket No. 160021-EI to form his position.

23

24

25

1 Q. Do you believe the FP&L benchmarking is relevant to Gulf Power?

2 A. No. Gulf Power has many years of specific data available for analysis,
3 which reduces the need to rely solely on benchmarking. While the
4 companies are both in Florida, it does not mean they have the same
5 capitalization thresholds, retirement unit designations, operations and
6 maintenance processes, or the same operating environment. All of these
7 factors impact an account.

8

9 Q. Mr. Andrews claims there are more concrete poles than in the past, which
10 should increase, not decrease, the life. Do you agree?

11 A. From a conceptual perspective, it follows that concrete poles would have a
12 longer life than wood poles. However, what Mr. Andrews did not say is
13 there are only marginally more concrete poles than before, as stated in the
14 interview notes provided in the Depreciation Study work papers.¹⁷ He also
15 fails to address the other factors that would tend to reduce the life of the
16 account. There is no information to suggest there are significantly more
17 concrete poles than wood poles in the account. The interview notes also
18 provided that the environment is subtropical (i.e., wet and hot), which
19 decreases the life of wood poles.¹⁸

20

21 Q. Do you have any final comments regarding Mr. Andrews' proposal for
22 Account 364 Poles, Towers, and Fixtures?

23 A. Yes. Gulf Power routinely updates and files its depreciation studies as
24 required by the Commission, which will incorporate any future changes in a
25 timely manner. To move the life beyond the existing and beyond the

¹⁷ Watson Depreciation Study Work Papers, Interview Notes submitted in Citizens' First PODs, Item No. 3

¹⁸ Watson Depreciation Study Work Papers, Interview Notes submitted in Citizens' First PODs, Item No. 3

1 longest indicated life in the analysis is not reasonable, particularly when the
2 analysis shows such a poor match, and information from Company subject
3 matter experts would not support such a move. While it is important to
4 review and consider other information, such as that cited by Mr. Andrews, it
5 should not override the extensive and specific data and information provided
6 by Company operations employees contained in my Depreciation Study and
7 work papers. Finally, I believe Mr. Andrews inadvertently ran my
8 recommended 33 R0.5 in his Exhibit BCA-1, page 37 of 73 instead of his
9 recommendation of 38 R1. That calculation should be updated before
10 consideration by the Commission. That said, my recommended 33 R0.5 is
11 reflective of Gulf Power's specific historical experience and is also reflective
12 of its specific operating environment. Therefore, the Commission should
13 adopt my recommended 33 R0.5 as the most appropriate estimate of life for
14 this account at this time.

15
16 Q. What is the next account in which Mr. Andrews challenges the life
17 recommendation of Gulf Power?

18 A. General Plant Account 390 – Structures and Improvements. First, Mr.
19 Andrews noticed we had inadvertently run 45 R1.5 in our accrual rather than
20 our recommendation of 46 R1.5. Beyond the need to make that correction,
21 Mr. Andrews proposes increasing the life even further with a 48 R 1.5, even
22 while he indicates the best fit to be a 54 L1.¹⁹

23
24 Q. What is the basis for Mr. Andrews' proposal to increase the life from both the
25 existing and your recommendation?

¹⁹ Brian C Andrews Direct Testimony, Exhibit BCA-1, page 53 of 73

1 A. As with all the prior actuarial accounts, Mr. Andrews has relied on the
2 statistical best fit as his guide. However, in this particular instance, the 54
3 L1 best fit is not his proposal. Mr. Andrews' graphic presents the placement
4 band 1950-2014 and experience band 1986-2014 with three different fits.
5

6 Q. Do you agree with Mr. Andrews' proposal for Account 390?

7 A. No. The graphical presentation certainly shows how close both our
8 recommendations fit Gulf Power's experience, but he does not provide any
9 other information or support for increasing the life further.
10

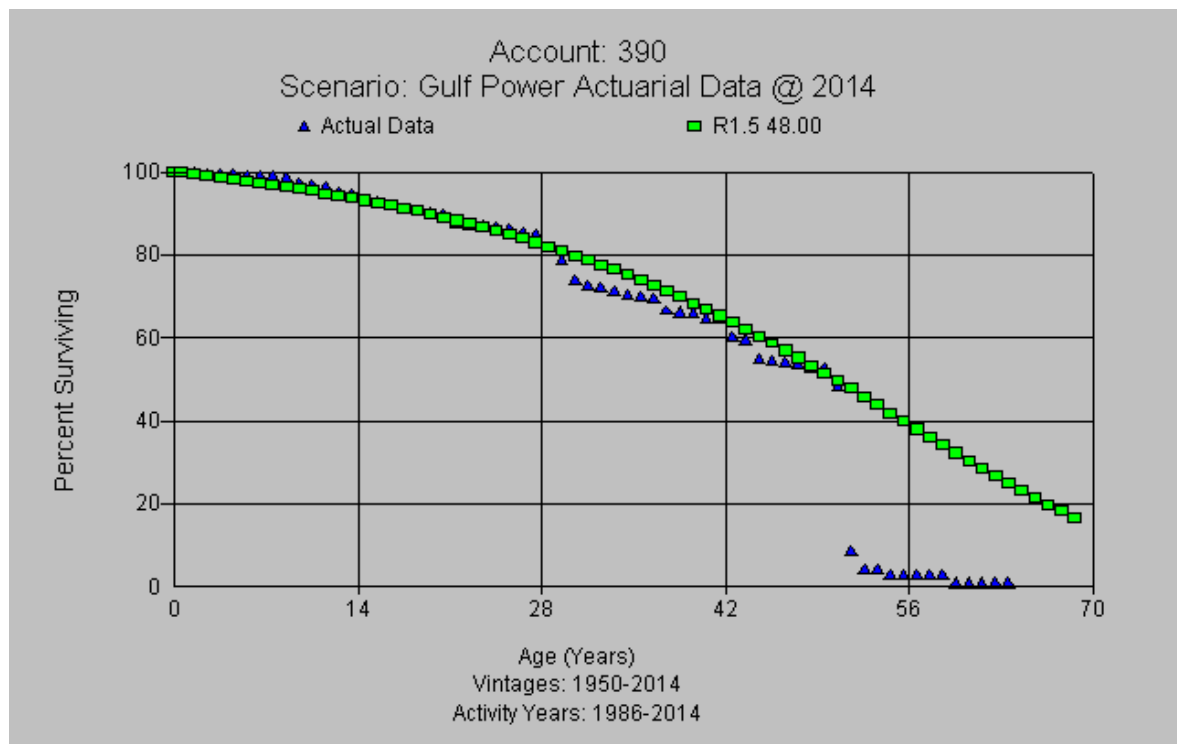
11 Q. What other information or support did you use and/or provide for your 46
12 R1.5 recommendation on this account?

13 A. For Account 390, there are 27 different graphical fits across varying
14 placement and experience bands that we performed and evaluated. The
15 majority of those fits had a life at or less than our recommended 46 years.
16 In addition to these fits, we conducted interviews with Company personnel
17 and assessed the average age of retirements and survivors. This additional
18 data helped to form what I consider to be a reasonable estimate based on
19 all the assets in the account.
20

21 Q. Was Mr. Andrews' 48 R1.5 one of the 27 fits you made?

22 A. Yes. In the placement band 1950-2014 experience band 1986-2014, I fit
23 both 48 R1.5 (Mr. Andrews) and my 46 R1.5. As shown below, the 48 R1.5
24 moves slightly above the actual data between 80 percent and 50 percent
25 surviving.

1 Graph DAW-R-17



14

15 Using the same placement 1950-2014 and experience 1986-2014 bands,

16 the 46 R1.5 below clearly fits Gulf Power's actual experience better all the

17 way down to around 40 percent surviving.

18

19

20

21

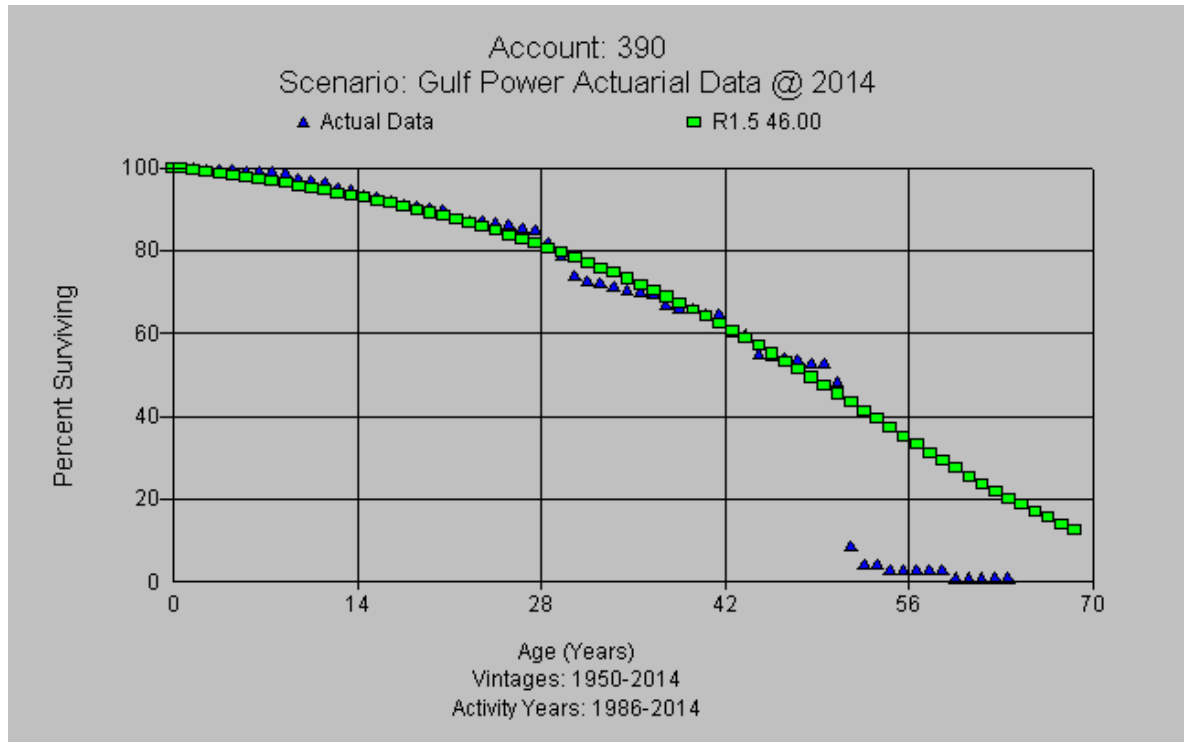
22

23

24

25

1 Graph DAW-R-18



15 Q. Is there any other information that you believe is important for the
16 Commission to consider when approving the life for this account?

17 A. Yes. The account consists of various building structures which have a 30-
18 60 year life expectancy, but there are also other assets such as roofs,
19 HVAC, parking lots, and various interior improvements that have a much
20 shorter life expectation.

21

22 Q. What is the next account Mr. Andrews challenges?

23 A. Account 396 – Power Operated Equipment. Mr. Andrews proposes 18 R4.
24 My recommendation is 16 R4. The existing is 15 R5.

25

1 Q. What is the basis for Mr. Andrews' proposed 18 R4?

2 A. Consistent with many of the other accounts, he relies on the statistics as the
3 measure of a better fit. However, he is not recommending what he
4 calculates as the statistical best fit of 25 L0.²⁰

5

6 Q. Does Mr. Andrews provide any additional information to support his
7 deviation from the statistical best fit of 25 L0 in favor of his 18 R4?

8 A. Not specifically. It appears that Mr. Andrews attempts to moderate the
9 statistical best fits when they are at the high end of a range or outside of a
10 range of reasonableness. In addition, it is evident from his graphic that the
11 best fit (25 L0) is not matching up to Gulf Power's actual data.

12

13 Q. Did Mr. Andrews fit other placement or experience bands?

14 A. No. Mr. Andrews provided only his fit to a placement band of 1955-2014
15 and experience band of 1994-2014 as shown on his graph.²¹

16

17 Q. Did you perform other fits to varying placement and experience bands?

18 A. Yes. As provided in my Depreciation Study work papers, there are 10
19 different curve/life fits across three different placement bands with one
20 experience band.

21

22 Q. What additional support do the 10 curve/life fits provide in your
23 recommended 16 R4?

24 A. The 10 curve/life fits we performed had a life range of 16 to 17 years with
25 either an R4 or R5 dispersion pattern. Mr. Andrews and I agree on the R4

²⁰ Direct Testimony of Brian C. Andrews, Exhibit BCA-1, page 65 of 73

²¹ Direct Testimony of Brian C. Andrews, Exhibit BCA-1, page 66 of 73

1 dispersion pattern, so an important fact is that the indicator for a longer life
2 was not seen in the 10 fits we made in the study.

3

4 Q. Is there a particular placement band that you relied on in making your
5 recommendation?

6 A. Yes. I relied on a more recent placement band 1975-2014 with the 1994-
7 2014 experience band. However, I reviewed and gave consideration to all
8 the bands.

9

10 Q. Can you provide a graphical comparison of your 16 R4 and Mr. Andrews' 18
11 R4?

12 A. Yes. Shown below is Mr. Andrews 18 R4 in the 1975-2014 placement band
13 with the 1994-2014 experience band.

14

15 Graph DAW-R-19

16

17

18

19

20

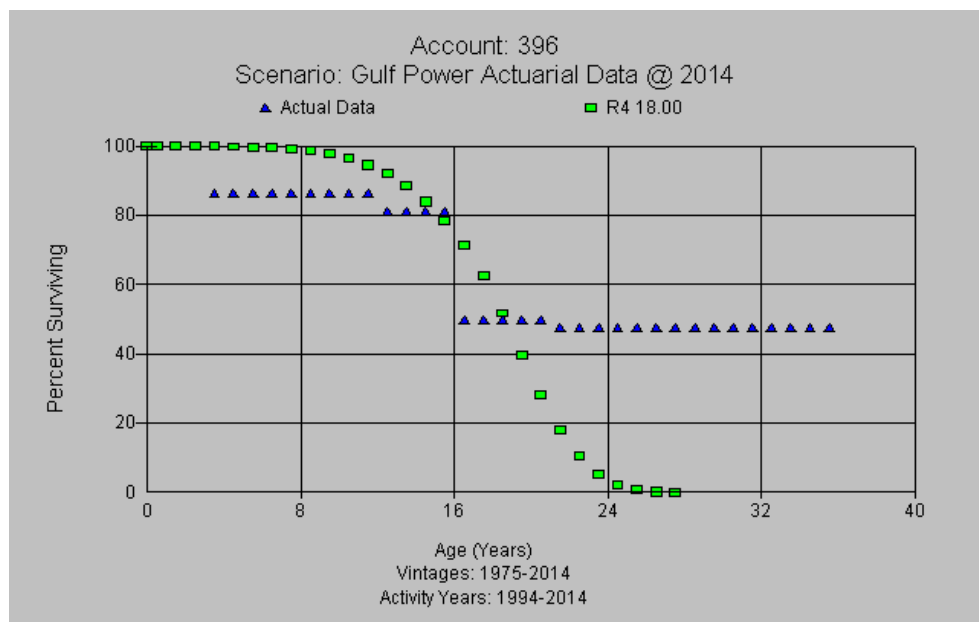
21

22

23

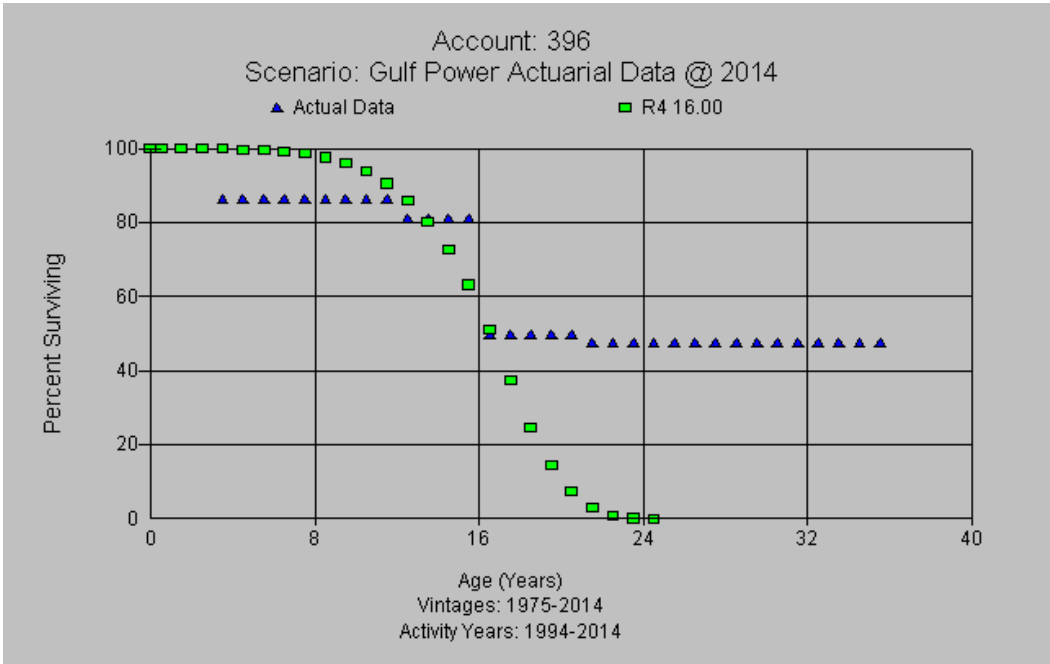
24

25



1 As can be seen in the graph above, the 18 R4 curve hits the data at the 80
 2 percent surviving and is somewhat close again when it drops to around 50
 3 percent surviving. However, as can be seen in my recommendation of 16
 4 R4 below, the 16 R4 curve hits the data at 80 percent surviving and again at
 5 50 percent surviving, which is at the 16-year age point. Our
 6 recommendations are similar, but my 16 R4 is a better overall fit and should
 7 be adopted by the Commission.

8
9 Graph DAW-R-20



- 10
11
12
13
14
15
16
17
18
19
20
21
- 22 Q. What is the final account challenged by Mr. Andrews?
 23 A. General Plant Account 397 – Communication Equipment. Mr. Andrews
 24 proposes 17 L1.5. My recommendation is 16 L1.5. The existing is 16 S1.
 25

1 Q. What is the basis for Mr. Andrews' recommendation of 17 L1.5?

2 A. His recommendation is based solely on the SSD index being less than
3 mine.

4

5 Q. Is Mr. Andrews' best fit a 17 L1.5?

6 A. No. Interestingly, the best fit curve and life shown by Mr. Andrews is the 16
7 S0.

8

9 Q. How is this interpreted?

10 A. When looking at Mr. Andrews' Exhibit BCA-1, page 68 of 73, it is evident
11 that only four of the 32 statistical fits have a life of 17 years or higher (not
12 rounded). The remaining 28 fits are in the 15-16 year range (not rounded).

13

14 Q. What is the significance of "not rounded"?

15 A. The statistical fits are shown rounded to one decimal. When rounded it may
16 change a modest amount, but realistically there is not a lot of difference in
17 Mr. Andrews' proposed 17 L1.5, my 16 L1.5, or the calculated best fit of 16
18 S0.

19

20 Q. Did you perform other curve/life fits for this account?

21 A. Yes. In my supporting work papers you will find a total of 22 different fits
22 over varying placement and experience bands. Mr. Andrews only fit to one
23 placement band of 1947-2014 and one experience band of 1989-2014.

24

25

1 Q. What are the life indications in those fits?

2 A. Generally, we fit either a 16 or 17-year life with either the L1.5, S0 or even
3 some R1 dispersion patterns.

4

5 Q. Do you have any final comments on this account?

6 A. Yes. The approved 16 S1 remains reasonable. My recommended 16 L1.5
7 reflects a curve/life selection that is a good visual fit over several different
8 bands and also produces a reasonable SSD. The Commission should
9 adopt the 16 L1.5 as a reasonable estimate of life for this account at this
10 time.

11

12

13 **III. POSITIONS OF OPC WITNESS MCCULLAR**

14

15 Q. Describe the differences between OPC Witness Ms. McCullar's analysis
16 and Gulf Power's previously-filed Depreciation Study recommendations.

17 A. In general, Ms. McCullar proposes different treatment of the following
18 issues.

- 19 1. The Interim Retirement Ratio (IRR) to be used for Steam Production
20 Accounts: 312 Boiler Equipment, 314 Turbogenerator Equipment,
21 and 315 Accessory Equipment;
- 22 2. The remaining life calculation of General Plant Account 390,
23 Structures & Improvements;
- 24 3. The life recommendations for Distribution Plant Account 365,
25 Overhead Conductor;

- 1 4. The life recommendations for Distribution Plant Account 369.1,
2 Overhead Services;
- 3 5. The net salvage recommendation for General Plant Account 390,
4 Structures & Improvements; and
- 5 6. The appropriate definition of depreciation to be used in this
6 proceeding.

7

8 Q. After reviewing Ms. McCullar's positions, are there any with which you
9 agree?

10 A. Yes. Ms. McCullar has identified two issues which require us to make
11 revisions to Gulf Power's filed Depreciation Study and resulting depreciation
12 rates.

13

14 Q. What are the two issues?

15 A. First, she proposes to remove terminal retirements related to Plant Crist
16 Units 1-3 from the IRR calculation for Steam Production Accounts 312, 314,
17 and 315. Second, she proposes a correction for the General Plant Account
18 390 accrual to be the stated 46 R1.5.

19

20 Q. Regarding the first issue, have you or Ms. McCullar calculated the revised
21 IRR for Steam Production Accounts 312, 314, and 315?

22 A. Yes. We have revised and calculated new IRRs for Accounts 312, 314, and
23 315 and confirm they are the same as Ms. McCullar's, which are Account
24 312, Boiler Plant Equipment IRR of 0.73 percent, Account 314,
25 Turbogenerator Equipment IRR of 0.93 percent, and Account 315,

1 Accessory Electric Equipment IRR of 0.50 percent.²² These should be
2 incorporated into the Steam Production depreciation rate calculations.
3

3

4 Q. Have you incorporated these revised IRRs into your Steam Production
5 recommended depreciation rates?

6 A. Yes. The subsequent inclusion of corrected IRRs in the applicable Steam
7 Production accrual calculations are shown in Exhibit DAW-4, Appendix A-1,
8 which lists the revised depreciation rates by unit and account and Appendix
9 D-2 shows the revised IRRs and Interim Net Salvage for Production Plant.
10 There were no other changes to any other Production Plant depreciation
11 rate calculations noted by Ms. McCullar or Mr. Andrews.
12

12

13 Q. Have you quantified the impact of these revisions?

14 A. Yes. The impact is so minimal when viewed at a composite level with
15 rounding, there is no difference. However, when viewed at a detailed level
16 by Plant, Unit, and Account there is a small decrease in the calculated
17 annual depreciation expense of \$545,665, which is provided in Exhibit
18 DAW-4, Appendix A-1.
19

19

20 Q. Regarding the second issue of agreement pertaining to the remaining life for
21 General Plant Account 390 Structures & Improvements, have you revised your
22 calculations?

23 A. Yes. Both Ms. McCullar and Mr. Andrews determined we had inadvertently
24 performed an accrual calculation with the 45 R1.5 and not our
25 recommended 46 R1.5.

²² Direct Testimony Roxie M. McCullar, p. 13

1 Q. Have you quantified the impact on annual depreciation expense based on
2 this revision?

3 A. Yes. The calculated remaining life for this account changes from 30.71
4 years to 31.67 years. The proposed rate changes from 2.2 percent to 2.1
5 percent. The annual depreciation expense for Account 390 changes from
6 \$1,850,197 to \$1,794,300, which is a decrease of approximately \$55,898.
7 This calculation is provided in Exhibit DAW-4, Appendix A-3.

8

9 Q. Please describe those matters in which you disagree with Ms. McCullar.

10 A. First, Ms. McCullar proposes a 50 R0.5 life and dispersion for Distribution
11 Account 365, Overhead Conductor and Devices. I proposed a 45 R1 life
12 and dispersion for Distribution Account 365.

13

14 Q. What is the basis for Ms. McCullar's 50 R0.5 for Distribution Account 365,
15 Overhead Conductor and Devices?

16 A. It appears to be based on the SPR life analysis statistical fitting and ranking.

17

18 Q. Is the statistical fitting and ranking of the SPR life analysis all that is needed
19 to reach a recommendation?

20 A. No. As described in my direct testimony Exhibit DAW-1 at pages 25-27, the
21 life analysis is merely one step, but certainly not the only step, in the
22 process that a depreciation analyst should use in making life
23 recommendations. The next step is the evaluation phase in which
24 additional information is sought to provide further insight and understanding
25 to the indications in the SPR analysis. Generally, a depreciation analyst

1 does not rely solely upon the life analysis, but takes into consideration other
2 information in order to gain a complete picture of what has, what is, and
3 what will occur during the life of the assets in an account.
4

5 Q. To what additional information are you referring?

6 A. In the evaluation phase, other information from interviews with Company
7 experts are obtained and considered. Examples include (a) past and
8 present operating and maintenance processes and programs, (b)
9 replacement programs, and (c) expected change in materials or impact of
10 technology on the assets in an account. Other information, such as the mix
11 of assets, the average age of the surviving assets, and the average age of
12 retirements, should also be reviewed and considered before making a life
13 and dispersion recommendation. This other information is contained in my
14 supporting Depreciation Study work papers provided in response to
15 Citizens' First Request for Production of Documents Item No. 3.
16

17 Q. Did Ms. McCullar follow this process in making her life recommendations for
18 Account 365, Overhead Conductor and Devices?

19 A. Her testimony does not suggest that she did. However, Ms. McCullar did
20 cite some of the information that resulted from my interviews and was
21 provided in my Exhibit DAW-1 of my direct testimony.²³
22
23
24
25

²³ Direct Testimony Ms. Roxie M. McCullar, p.7

1 Q. Is there other information from the Company interviews you considered in
2 making the recommendation of 45 R1 for this account?

3 A. Yes. The on-site interviews with Company operations personnel provided
4 this: "A longer life would not be unreasonable but should be stabilized
5 going forward. Moving from 40 years to 45 years would not be
6 unreasonable for a one time move."²⁴

7

8 Q. Is there additional information you considered in making the
9 recommendation of 45 R1 for this account?

10 A. Yes. A review of the SPR runs across the various years (bands) indicated
11 the life is generally between the low 30's and mid 40's. In perspective, out
12 of the 28 statistical fits shown in the 40-year band analysis, only three have
13 a life of 50 years or more. In fact, 19 of the 28 have a life between 30-40
14 years, which is even below my 45 R1 recommendation. While I
15 acknowledge that the recommendations that Ms. McCullar and I made are
16 in the top three best ranked curves, it is important to consider the overall
17 indications. More specifically, it is more reasonable to select a life that is
18 not at or near the longest possible life indicated, regardless the ranking.
19 Additionally, the CIs advocated by Ms. McCullar were generally low,
20 resulting in either a poor or fair category. In fact, it is not until the 40-year
21 band that Ms. McCullar's top ranked 50 R0.5 moved into the very bottom of
22 the good category with a CI of 54.28 according to the CI ranking table
23 provided.²⁵ The REIs across the bands were very high for all the fits. I am
24 including as Exhibit DAW-7 the referenced 40-year band SPR analysis to
25 illustrate these facts. Finally, the concept of gradualism is important in

²⁴ Watson Depreciation Study Workpapers, Interview Notes submitted in Citizens' First PODs, Item No. 3

²⁵ Direct Testimony Ms. McCullar, p. 8 as provided by footnote 15 citation of NARUC p. 96.

1 estimating the future life of an account. The current or approved life for this
2 account is a 38 R1. The recommendation I have made (45 R1) is already a
3 seven year, or approximately 18 percent, increase in life. Ms. McCullar's
4 proposal (50 R0.5) results in a 12 year, or approximately 32 percent,
5 increase in life at one time when compared to the existing. Given the
6 statistics that she relied upon were poor or fair, a move of this magnitude is
7 neither appropriate nor supportable.

8

9 Q. Do you have any final comments on the life proposal for Account 365?

10 A. Yes. Gulf Power is required to conduct and file a depreciation study with
11 the Commission for approval at least every four years. This ensures that
12 adjustments can be made in a timely manner and negates the need to
13 increase the life of an account so significantly at one point in time. The
14 Commission should adopt my recommended 45 R1 as the best and most
15 reasonable estimate of life for Account 365 at this time.

16

17 Q. Do you agree with Ms. McCullar's proposed life change to Distribution
18 Account 369.1, Overhead Services?

19 A. No. Ms. McCullar proposes 46 R0.5. My recommendation is 42 R1. The
20 existing is 35 R1.

21

22 Q. What is Ms. McCullar's basis for the 46 R0.5 for Distribution Account 369.1,
23 Overhead Services?

24 A. She based her recommendation primarily on the SPR life analysis statistical
25 fitting and ranking.

1 Q. Do you have any additional specific information that you believe is important
2 for the Commission to consider?

3 A. Yes. The top three best ranked curves and lives contain my
4 recommendation as well as Ms. McCullar's. Based on the full band (103
5 years) the CIs are 16.36 (McCullar) compared to 14.53 (Gulf), both of which
6 are in the "poor" category. The 40-year band is the first place where Ms.
7 McCullar's R0.5 has a CI that barely moves to a fair category (25 to 50) at
8 25.13 as provided in the NARUC CI tables in Ms. McCullar's testimony.²⁶
9

10 Q. What does this mean to someone who is not a depreciation expert?

11 A. It means there is very little statistical difference in the CIs, which is the
12 measure of closeness of fit. As a practical matter, neither recommendation
13 ever moves to a "good" category across the bands analyzed. The REIs for
14 both recommendations are 100 and considered excellent. This indicates
15 that additional information outside of the SPR statistical analysis and
16 ranking is important to distinguish between the top curve and life rankings.
17 Additionally, the poor or fair CI means that the results must be used with
18 caution and are not necessarily fully representative of the historical life.
19

20 Q. Did your on-site interviews with Company personnel provide any information
21 that was considered in your evaluation and recommendation for a 42 R1 for
22 this account?

23 A. Yes. The on-site interviews with Company operations personnel provided
24 the following information: "OH (overhead) longer and UG (underground)
25 lower life does not seem reasonable due to physical characteristics.

²⁶ Direct Testimony Ms. McCullar, p. 8 as provided by footnote 15 citation of NARUC p. 96.

1 Company does not believe anything should have changed enough to create
2 the change we are seeing.”

3

4 Q. Is there additional information to which you are referring?

5 A. In the evaluation phase of my work in this matter, other information from
6 interviews with Company experts was obtained and considered. Also, I
7 considered (a) past and present operating and maintenance processes and
8 programs, (b) replacement programs, (c) expected change in materials, and
9 (d) impact of technology on the assets in an account. Other information
10 such as the mix of assets, the average age of the surviving assets, and the
11 average age of retirements is reviewed and considered before making a life
12 and dispersion recommendation. All of these are contained in my
13 supporting Depreciation Study work papers provided in response to
14 Citizens' First Request for Production of Documents Item No. 3.

15

16 Q. Is there any other information you considered in making the
17 recommendation of 42 R1 for this account?

18 A. Yes. A review of the SPR runs across the various years (bands) indicated the
19 average service life is generally in the 30-39 year range. In perspective, out
20 of the 28 statistical fits shown in the 40-year band analysis, only three have a
21 life of 46 years or higher (including Ms. McCullar's). In fact, 23 of the 28 have
22 a shorter life than my recommended 42 R1. Although both Ms. McCullar's
23 and my recommendations are in the top three best ranked curves, it is
24 important to consider the overall indications. More specifically, it is more
25 reasonable to select a life that is not at or near the longest possible life

1 indicated despite the ranking. I am including as Exhibit DAW-8 the
2 referenced SPR 40-year band to illustrate these facts. Finally, the concept of
3 gradualism is important in estimating the future life of an account. The
4 current or approved life for this account is a 35 R1. The recommendation I
5 have made (42 R1) is already a seven year, or approximately a 20 percent,
6 increase in life. Ms. McCullar's proposal (46 R0.5) results in an 11-year, or
7 approximately 31 percent, increase in life at one time when compared to the
8 existing. Given that the statistics she relied upon were poor or fair, a move of
9 this magnitude is neither appropriate nor supportable.

10

11 Q. Do you have any final comments on the life proposal for Account 369.1?

12 A. Yes. Gulf Power is required to conduct and file a depreciation study with
13 the Commission for approval at least every four years. This ensures that
14 adjustments can be made in a timely manner and negates the need to
15 increase the life of an account so significantly at one point in time. The
16 Commission should adopt my recommended 42 R1 as the best and most
17 reasonable estimate of life for Account 369.1 at this time.

18

19 Q. Do you agree with Ms. McCullar's proposed net salvage change to General
20 Plant Account 390, Structures & Improvements?

21 A. No. Ms. McCullar raises a question as to Gulf Power's accounting for the
22 sale of its Pace Boulevard general office building in 2008 and the net
23 salvage analysis. The accounting entries for the sale will be addressed by
24 Gulf Power Witness Hodnett. I will address the net salvage analysis and
25 recommended negative 5 percent for this account.

1 Q. What is the basic premise of Ms. McCullar's analysis regarding the net
2 salvage for the 2008 sale of Gulf Power's Pace Boulevard building?

3 A. Ms. McCullar believes the receipts from the sale should have been included
4 as salvage.

5

6 Q. Does Ms. McCullar's premise adhere to common depreciation principles
7 related to sales of a large asset such as the Pace Boulevard office?

8 A. No. If the information of the sale is known, generally it would be excluded
9 from the net salvage analysis.

10

11 Q. Why are receipts from a sale of a building, such as the Pace Boulevard office,
12 generally excluded from salvage in the net salvage analysis?

13 A. Such exclusions are made so that the analysis will reflect the routine and
14 recurring transactions in an account rather than a one-time or unique
15 occurrence that isn't expected to reoccur with any frequency. To retain such a
16 transaction will inappropriately skew the results of an account, a particularly
17 important consideration given the prospective nature of utility depreciation.

18

19 Q. Have you evaluated the net salvage analysis including the proceeds from
20 the sale of the Pace Boulevard building as salvage?

21 A. Yes. Since there are a number of issues raised by Ms. McCullar regarding
22 the accounting and possible requirements of the Commission, I have
23 prepared Exhibit DAW-9, which is the net salvage analysis including the
24 Pace Boulevard sales proceeds. Although not appropriate, if one assumes
25 that the sale proceeds are treated as net salvage, the result is \$4,297,789 in

1 2008 as salvage. It does impact the most recent full (10-year) moving
2 average to move from a negative 7.74 percent to a positive 44.60 percent.
3 However, as shown in the most recent three and five-year moving
4 averages, the analysis still results in a negative 8.73 percent and negative
5 17.99 percent net salvage, respectively. These figures are consistent with
6 our original analysis.

7

8 Q. Based on both analyses, i.e., including and excluding the sale proceeds
9 from salvage, would you change your negative 5 percent net salvage
10 recommendation?

11 A. No. A depreciation analyst would consider both full and short band
12 indications along with the more routine activities contained within the
13 account. Despite inclusion of the sale proceeds as salvage, I would weigh
14 the other routine transactions more heavily and rely on the more recent
15 indications. My recommended negative 5 percent is still more conservative
16 than the negative 8 percent shown in the most recent three-year average;
17 my recommendation is certainly more conservative when compared to the
18 most recent five-year average of negative 17.99 percent.

19

20 Q. Do you have any final comments on the net salvage for Account 390?

21 A. Yes. The Commission should approve my recommended negative 5
22 percent net salvage as it is the best estimate and reflective of the future
23 expectations for the account at this time. Furthermore, it represents no
24 change from the approved net salvage for this account.

25

1 Q. What is the last issue in dispute between Gulf Power and Ms. McCullar in
2 this proceeding regarding depreciation?

3 A. Ms. McCullar takes exception to the definition of depreciation stated in my
4 direct testimony.

5

6 Q. What definition of depreciation do you propose for this proceeding?

7 A. I believe the appropriate definition is the one offered by AICPA as stated in
8 my direct testimony. The learned treatise, Depreciation Systems,²⁷ expand
9 the FERC definition of depreciation to include the following concepts: "To
10 evaluate depreciation, we must go back to accounting theory. In the
11 accounting framework, depreciation is defined as an allocation procedure,
12 not a valuation process."

13

14 Four accounting assumption concepts are necessary to apply depreciation
15 to the world of public utilities: entity, time period, going concern, and stable
16 monetary unit. By adding these concepts, Depreciation Systems describes
17 depreciation as "an allocation process that operates within the bounds of
18 the four basic assumptions to help accomplish income determination
19 through matching."²⁸

20

21 The following quote from Depreciation Systems,²⁹ melds the FERC definition
22 with the allocation concept. The dictionary defines depreciation as a loss in
23 value. Value can be measured in many ways. The valuation expert may
24 use market value, replacement cost, reproduction cost, and even
25 sentimental value as different approaches to establishing value. A study of

²⁷ Depreciation Systems, Iowa State University Press, 1994, by Drs. F. K Wolf and W. C. Fitch, p 4.

²⁸ Depreciation Systems, Iowa State University Press, 1994, by Drs. F. K Wolf and W. C. Fitch, p 5.

²⁹ Depreciation Systems, Iowa State University Press, 1994, by Drs. F. K Wolf and W. C. Fitch, p 13.

1 the history of depreciation as applied to regulated public utilities reveals a
2 narrowing of the meaning of depreciation to the allocation of cost concept.
3 Some might call depreciation, as defined earlier in this chapter, *depreciation*
4 *accounting* rather than depreciation. Nevertheless, an understanding of
5 basic accounting is necessary to provide an understanding of what
6 depreciation does and does not do.

7

8 Q. Do you believe there are other considerations regarding the definition of
9 depreciation?

10 A. Yes. The concepts of “loss of service value” and “allocation of costs” are
11 linked when giving consideration to the depreciation study process,
12 calculating depreciation rates, and incorporating depreciation expense into
13 the cost of service.

14

15 Q. Is the “definition of depreciation” relevant to the approval of depreciation
16 rates in this proceeding?

17 A. No. It is simply a theoretical and/or semantic discussion. Ms. McCullar’s
18 unique interpretation on this should not have any bearing on the evaluation
19 and approval of the Depreciation Study and results I submitted in this
20 proceeding. The parameters and calculations would be exactly the same
21 regardless of the outcome of the theoretical or semantic discussion.

22

23

24

25

IV. CONCLUSION

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Q. Do you have any concluding remarks?

A. Yes. The depreciation rates, as provided here in my rebuttal testimony as Exhibit DAW-4, Appendices A and B, should be applied to Gulf Power's plant in service. The attached Appendices incorporate the changes the Company made where we are in agreement with intervenors. My revised depreciation rates, when applied to Gulf Power's plant-in-service balances provide fair and reasonable recovery to both Gulf Power and its customers and should be adopted by this Commission.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

GULF POWER COMPANY
Before the Florida Public Service Commission
Rebuttal Testimony of
Steven P. Harris
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 Steven Harris. My business address is 555 12th Street Suite 1100, Oakland, California 94607. I am a Senior Manager with CoreLogic, Inc. Insurance & Spatial Services, Consulting Services Group.

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 rebuttal testimony is to rebut statements made by Office of Public Counsel (OPC) Witness Ramas regarding the adequacy of Gulf's annual accrual to its Property Damage Reserve.

Q. Are you sponsoring any rebuttal exhibits?

A. Yes, Exhibit SPH-3, "Comparison of protection afforded by \$3.5 million versus \$8.9 million annual accrual against potential average damage from SSI 2 Landfalls." This exhibit was prepared under my supervision and control and is true and correct to the best of my knowledge and belief.

1 Q. Do you agree with Witness Ramas that the current accrual provides
2 protection from most but not all storms?

3 A. No. Witness Ramas states that the Gulf reserve has increased by \$9.7
4 million over the past four years and ten months and has reached
5 \$40,173,002 as of October 2016. Witness Ramas implies that this level is
6 adequate to fund most but not all storms without an increase in the annual
7 accrual. A comparison of the current reserve accrual of \$3.5 million and the
8 requested \$8.9 million accrual is set forth in my exhibit. This comparison
9 demonstrates that the current \$3.5 million level of accrual provides
10 substantially less protection than the proposed \$8.9 million accrual.

11
12 Exhibit SPH-3 shows the results of a reserve solvency performance
13 analysis for an \$8.9 million annual accrual. This analysis shows the
14 protection afforded by expected reserve balances against mean damage
15 from Category 2 (also referred to as Saffir-Simpson Scale (SSI) Category 2)
16 storms making landfall at various mile markers along the Gulf Coast near
17 Gulf's service area.

18
19 The result from the \$8.9 million accrual is a positive expected reserve
20 balance at the end of five years of \$43.2 million, only slightly greater than
21 the current balance of \$40 million, and well below the Commission's
22 established target of \$48 to \$55 million. Exhibit SPH-3 illustrates that, at the
23 end of five years, the \$8.9 million accrual and its resulting \$43.2 million
24 reserve balance would be expected to provide adequate funds for simulated
25 average Category 2 storms.

1 On the other hand, the \$3.5 million accrual suggested by Witness Ramas
2 would only be expected to protect for average Category 2 hurricanes that
3 make landfall east of Panama City. The majority of Gulf's transmission and
4 distribution (T&D) assets are west of these landfall locations; thus Witness
5 Ramas's suggested reserve would be inadequate to fund average Category
6 2 damage for more direct landfalls in the Pensacola or Panama City area.

7
8 Category 2 storms that are greater than average would cause damage of
9 more than \$43.2 million for many of the landfall locations. Category 2
10 storms making landfall from Mobile Bay to Fort Walton Beach could cause
11 damage as large as \$110 million. Thus, assuming a greater-than-average
12 Category 2 storm which makes landfall in an area with a large concentration
13 of Gulf's T&D assets, the suggested \$3.5 million accrual would provide
14 dramatically less protection for storm damage.

15
16 Q. Do you agree with Witness Ramas that the current reserve accrual should
17 remain at \$3.5 million per year?

18 A. No. Witness Ramas states that the reserve balance has grown over the
19 period from 2010 to 2016 and concludes that the annual accrual level from
20 1996 is therefore adequate. The reason that Gulf's annual accrual appears
21 to have been sufficient between 2010 and 2016 was Gulf's very favorable
22 storm history over this period. There were no hurricanes with strong
23 Category 1 or greater winds that made direct landfalls in Gulf's service area
24 during this time. Some small losses and only one moderate storm loss of
25 about \$2 million was experienced over this period. The absence of large

1 hurricane losses between 2010 and 2016 is not a significant factor in an
2 actuarially sound analysis. Gulf has been very fortunate in the last decade
3 compared to the 115-year historical average. Over 115 years, there have
4 been many more hurricane landfalls and damaging events compared with
5 the last seven years used by Witness Ramas. The full historical hurricane
6 hazard in Florida is represented in my storm study.

7
8 Witness Ramas proposes maintaining the reserve accrual of \$3.5 million, an
9 amount well below the expected annual damage from my storm study of
10 \$9.6 million. This annual accrual was set and has been maintained at the
11 current level since 1996. Over this period, the cost of T&D infrastructure
12 has increased by a factor of more than two. A funding policy that
13 significantly under-accrues could be characterized as de-facto “pay-as-you-
14 go” funding and could result in a more volatile funding process for future
15 storm restoration.

16
17 Determining an annual reserve accrual amount based on data that
18 selectively excludes any possible damage events, whether large and
19 infrequent or small and frequent, is neither meaningful nor appropriate. Any
20 reliable estimate of the expected annual windstorm damage to which Gulf is
21 exposed (expected annual damage) must include the most complete and
22 full damage distribution that can be determined from both actual experience
23 and statistically rigorous simulations of future possible damage. Witness
24 Ramas’s approach disregards decades of Gulf’s storm experience as well
25 as the century of data that forms the basis of my storm simulation study.

1 Witness Ramas inappropriately assumes that the most recent seven years
2 of favorable storm history provide an adequate basis for Gulf and FPSC
3 funding decisions for the reserve.
4

5 Q. Does this conclude your rebuttal testimony?

6 A. Yes.
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

1 (Transcript continues in sequence with
2 Volume 6.)

3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25


1 STATE OF FLORIDA)
2 COUNTY OF LEON) : CERTIFICATE OF REPORTER

3
4 I, LINDA BOLES, CRR, RPR, Official Commission
5 Reporter, do hereby certify that the foregoing
6 proceeding was heard at the time and place herein
7 stated.

8 IT IS FURTHER CERTIFIED that I
9 stenographically reported the said proceedings; that the
10 same has been transcribed under my direct supervision;
11 and that this transcript constitutes a true
12 transcription of my notes of said proceedings.

13 I FURTHER CERTIFY that I am not a relative,
14 employee, attorney, or counsel of any of the parties,
15 nor am I a relative or employee of any of the parties'
16 attorney or counsel connected with the action, nor am I
17 financially interested in the action.

18 DATED THIS 22nd day of March, 2017.

19
20
21
22
23
24
25


LINDA BOLES, CRR, RPR
Official FPSC Hearings Reporter
Office of Commission Clerk
(850) 413-6734