

AUSLEY & McMULLEN

ATTORNEYS AND COUNSELORS AT LAW

227 SOUTH CALHOUN STREET
P.O. BOX 391 (ZIP 32302)
TALLAHASSEE, FLORIDA 32301
(850) 224-9115 FAX (850) 222-7560

ORIGINAL

May 31, 2000

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Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Review of the appropriate application of incentives to wholesale power sales by investor-owned electric utilities; FPSC Docket No. 991779-EI

Dear Ms. Bayo:

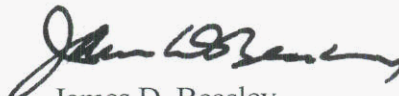
Enclosed for filing in the above docket are the original and fifteen (15) copies of Tampa Electric Company's Brief and Post-Hearing Statement of Issues and Positions.

Also enclosed is a diskette containing the above Brief and Post-Hearing Statement of Issues and Positions originally typed in Microsoft Word 97 format which has been saved in Rich Text format for use with WordPerfect.

Please acknowledge receipt and filing of the above by stamping the duplicate copy of this letter and returning same to this writer.

Thank you for your assistance in connection with this matter.

Sincerely,


James D. Beasley

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ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of Appropriate Application of)
Incentives to Wholesale Power Sales by)
Investor-Owned Utilities.)
_____)

DOCKET NO. 991779-EI
FILED: May 31, 2000

**TAMPA ELECTRIC COMPANY'S BRIEF AND
POST-HEARING STATEMENT OF ISSUES AND POSITIONS**

Tampa Electric Company ("Tampa Electric" or "the company"), pursuant to the Commission's order establishing procedure¹ issued January 26, 2000, submits this its Brief and Post-Hearing Statement of Issues and Positions:

BRIEF

Summary of Tampa Electric's Arguments

This case is about encouraging actions that provide ratepayer benefits. Since 1984, this Commission has recognized that ratepayer benefits are enhanced by a positive incentive mechanism that provides investor-owned electric utilities a modest twenty percent share of the gains they are able to achieve from making non-separated, non-firm wholesale sales. Retail customers of the investor-owned utilities have received significant benefits in the form of an eighty percent share of the gains from these wholesale transactions, and electric utility customers throughout Florida have benefited from lower electric bills. The Commission has recognized in its annual reporting that nearly a billion dollars in savings have resulted from broker sales transactions alone. It is also important to recognize that all retail customers in Florida, both of the selling and buying utilities, benefit from non-separated, non-firm wholesale sales without putting any particular customer class at risk.

¹ Order No. PSC-00-0195-PCO-EI.

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The wholesale market in recent years has shifted its focus from economy, or split-the-savings transactions, to more complex negotiated transactions. This shift has required greater creativity and resourcefulness on the part of utility management to maintain and hopefully increase gains from these types of sales. This has meant that utility management has made a concerted effort to allocate resources to transact sales and purchases. Although the transaction type has changed, the product has remained the same--surplus non-firm energy that must be generated and marketed by the utility after serving their retail customers.

The Commission should apply the shareholder incentive to all forms of non-separated, non-firm wholesale sales because they all perform the same function whether they are economy sales, split-the-savings type sales or negotiated sales. That function is to help optimize the available non-firm use of the utilities' generating resources while providing economic benefits to retail customers in Florida. A Commission decision to apply the shareholder incentive to all forms of non-separated, non-firm wholesale sales would maintain the Commission policy decision made in 1984 that is even more appropriate in today's wholesale energy market. Furthermore, the Commission should apply a greater incentive to those utilities making sales within the state. This greater incentive will encourage a more liquid and reliable Florida market.

The Office of Public Counsel ("OPC"), joined by the Florida Industrial Power Users Group ("FIPUG"), opposes incentives on an outright basis. This is nothing new. OPC has opposed the shareholder incentive since the very proceeding in which it was initially adopted by the Commission, claiming all along that the incentive is "unnecessary." OPC's opposition to the shareholder incentive is not based on any recent market developments or industry changes but is simply a repackaged version of the same opposition this Commission rejected as early as 1984.

OPC's witness, the only witness advocating removal of the shareholder incentive, fails to present any plausible basis for such a drastic shift in Commission regulatory policy. With non-separated, non-firm wholesale sales becoming more difficult to achieve, this clearly is not the appropriate time to consider removing the existing policy of incenting utilities to make sales for the benefit of their customers.

Tampa Electric urges the Commission to reaffirm the important role of the existing incentive mechanism; confirm that the incentive should apply to all non-separated, non-firm wholesale sales, and approve Tampa Electric's proposal to weight the incentive mechanism to encourage sales to utilities within Florida in order to maximize the benefits of these incentives for all electric customers in this state.

Background

The current twenty percent shareholder incentive to make economy sales had its origin in a 1983 examination of whether such sales should be recognized and accounted for in base rates or moved to the fuel adjustment docket. Prior to the adoption of the current twenty percent shareholder incentive, utilities were incented to maximize economy sales by the fact that they were allowed to keep one hundred percent of the sales profits above the level included in the last rate case test year. (Tr. 180, lines 1-5). In testimony filed on November 7, 1983 in Docket No. 830001-EU, the Commission's Staff witness expressed a concern regarding the "potential for over recovery or under recovery of revenues associated with economy sales." The Staff further recommended that these sales be taken out of base rates and handled through the fuel adjustment mechanism. Staff also suggested that a specific incentive provision be adopted to encourage utilities to maximize economy sales (Tr. 179, lines 12-19).

As in the instant case, OPC's witness in the 1983 docket recommended no incentive. However, the Commission in its Order No. 12923, issued January 24, 1984 in Docket No. 830001-EU-B, adopted Staff's proposal and established the existing twenty percent positive shareholder incentive, recognizing the need to incent utility management to maximize sales of economy energy (Tr. 179, lines 19-24).

Thus, the former incentive of one hundred percent of the profits above the level included in base rates was replaced by a twenty percent shareholder incentive to maximize these types of sales. The Commission's 1984 change in Order No. 12923 did not initiate an incentive but rather improved upon the old incentive mechanism with one that also allowed the Commission to eliminate any concern that projections of economy sales might be manipulated to "game the system" (Tr. 180, lines 5-10).

The Supreme Court of Florida affirmed the Commission's position regarding incentives in Citizens v. Public Service Commission, 464 So.2d 1194 (Fla. 1985). It was clear then, as it is now, that positive incentives play an important role in maximizing economy sales to provide net benefits to Florida ratepayers (Tr. 237, lines 17-21).

All Customers Benefit from Non-Separated, Non-Firm Wholesale Sales

It is beyond question that all utility customers benefit from incenting the greatest possible level of non-separated, non-firm wholesale sales. Customers of the selling utility get immediate benefits in the form of their share of the gain. Customers of the purchasing utility benefit in two ways: first, from the fact that their serving utility has more resource options that provide competitively priced energy and second, through increased reliability for firm and non-firm customers. (Tr. 209, lines 18 – Tr. 210, line 12). All customers benefit from the existence of a more robust and competitive wholesale market.

Interruptible customers receive a proportionate share of the benefits from these sales, and are protected from any potential adverse effects. As Tampa Electric witness Lynn Brown testified, non-separated, non-firm sales are not made in circumstances when the company needs to interrupt or make buy-through purchases to serve its interruptible customers. (Tr. 222, lines 15-19; Tr. 232, lines 16-19; Tr. 233, lines 3-9).

Incentives play an important role in bringing about these significant benefits. The Commission should resist any invitation to jeopardize these benefits through any reduction or elimination of the utilities' motivation to pursue them.

The Important Role Of The Shareholder Incentive

The utility participants in this proceeding agreed that utilities have a general obligation to make prudent decisions and to take cost-effective actions to benefit ratepayers. However, the incentive fashioned by the Commission in 1984 has served as a means to encourage beneficial actions above and beyond the utilities' general obligation. In the instance of non-separated, non-firm wholesale sales, incentives motivate utilities to enter into prudent and cost-effective transactions and encourage increased efforts to maximize these transactions, for the benefit of both the utility and its customers (Tr. 246, lines 10-18).

Positive incentives provide a motivation to behave a certain way and to achieve a desirable result. Tampa Electric's ratepayers have benefited from the company's economy sales through significant rate offsets from gains on these sales (Tr. 206, lines 21-23).

The positive twenty percent incentive has encouraged Tampa Electric to be aggressive regarding the production and sale of economy energy. The company has optimized generating unit maintenance, operated generating units to make sales, optimized economy generation

dispatch and devoted time, effort and resources to consummating transactions (Tr. 207, lines 1-6). This has resulted in a win-win for the company and its retail customers.

By having an incentive in place, utilities are motivated to go above and beyond the norm in transacting non-separated, non-firm sales. The incentive provides additional justification and encouragement to maintain a professional staff that understands and can track the highly competitive wholesale market and knows how to optimize transactions thereby maximizing sales revenues (Tr. 210, line 22 through Tr. 211, line 2).

Incentives serve to promote management's willingness to allocate additional resources and funds to its energy marketing and trading functions (Tr. 33, lines 9-13). FPL's witness testified that it has made significant investments that have brought over a ten-fold increase in gains in off-system sales from 1996 to 1999 (Tr. 6-7), a period of time when the Commission's currently prescribed shareholder incentive was in place.

There are operating decisions utilities must make in assessing whether to pursue these types of sales, including operation and maintenance (O&M) costs. The shareholder incentive compensates the utility for disincentives such as increased O&M and wear and tear on the generating assets associated with making these sales (Tr. 39, lines 2-12; Tr. 100, lines 1-3).

Utilities engaged in economy sales transactions before the existence of the twenty-percent shareholder incentive and will continue to engage in these sales if the Commission improves the incentive. However, the more important question is, "To what degree would these sales occur?" (Tr. 180, lines 21-25). The incentive provision motivates a net selling utility to closely monitor the wholesale power market and proactively seek opportunities for increased economy energy sales in today's competitive wholesale power market (Tr. 181, lines 1-6).

Consequently, maintaining a direct regulatory incentive should maximize the degree to which utilities enter into these beneficial market-based economy sales.

Positive Incentives Should Apply To All Forms of Non-Separated, Non-Firm Sales

In this proceeding, the utility witnesses were uniform in their belief that the shareholder incentive should apply to all non-separated, non-firm wholesale sales (Tr. 33, lines 12-16; Tr. 100, lines 9-17; Tr. 125, lines 16-17; Tr. 182, lines 18-20; Tr. 206, lines 10-14; Tr. 239, lines 7-12). In Tampa Electric's case this would currently include Schedules J and G and all non-firm market based wholesale sales. The product that is sold under these schedules is the same surplus non-firm energy that was incented to be sold under Schedules C and X for over 15 years. *Id.* As witness Deirdre A. Brown testified, all of such sales provide the same types of benefits to retail customers as the Schedules C and X sales to which the incentive traditionally has been applied (Tr. 245, lines 5-12). It is irrelevant whether or not such sales are made on the Florida Energy Broker Network because the benefits to the customer on economy sales are independent of whether or not they occur on the broker system (Tr. 182, lines 18-25).

The record discloses no distinction between Schedules C and X sales and other forms of non-separated, non-firm wholesale sales. No witness made any distinction among the various categories of non-separated, non-firm sales or disclosed any reason for applying the incentive to one form of these sales as opposed to another. Clearly all of these sales are beneficial to a utility's general body of ratepayers and all forms of these sales should be incented on an equal basis.

Recent Market Changes Make The Incentive More Important Now Than When It Was Adopted

The market has changed significantly since 1984. Increased competition in the wholesale market makes it harder to make sales which means incentives play a more important role now than they did in 1984 (Tr. 99, lines 13-22). The uncertainty in today's market is much greater than the uncertainty regarding projections of economy sales which the Commission dealt with in the 1980s (Tr. 180, lines 10-13).

During the early 1980s, wholesale markets for economy sales were simple whereas today's markets are much more complex and take significantly more effort and expertise in resources to participate successfully (Tr. 123, lines 12-19). In light of the current level of competition in the wholesale power market, the case for positive incentives is stronger today than in 1984, when the Commission instituted the 80/20 sharing of gains on economy sales (Tr. 123, lines 3-6). The seller in today's market must manage additional risks associated with transactions that take place at future times when costs are not known with certainty (Tr. 123, line 24 through Tr. 124, line 1).

No Party Has Presented Any Legitimate Basis For Removing The Incentive

The investor-owned utilities' witnesses testified about concrete efforts that they have made to maximize non-separated, non-firm wholesale sales in efforts to bring economic benefits to their customers and their shareholders through the 80/20 sharing mechanism. Against this backdrop, OPC presented testimony of a single witness who, like his predecessor in the 1983 proceeding, concluded that incentives are simply "unnecessary." The witness reached this conclusion admittedly without making any independent evaluation of the wholesale market in Florida (Tr. 277, line 23 through Tr. 278, line 4).

Dr. Dismukes candidly agreed that incentives are important and that incentive-based regulation can be an effective tool for regulators (Tr. 258, lines 10-11). However, he went on to ignore the intuitive and inescapable conclusion that any person or entity, including investor-owned electric utilities, will strive much harder to achieve gains if they receive a share of those gains than if they get no portion of them.

Removal of the existing incentive to make economy sales will send a signal to the utilities that their resources devoted to this activity are not as important to the Commission today as they once were, and they should be shifted to other activities. Surely this is not the signal the Florida Commission wants to send to the investor-owned electric utilities under its jurisdiction (Tr. 303, lines 9-15).

Witness Dismukes also overlooked the fact that increased competition in the wholesale market has been a result of the direct incentive wholesale competitors have in the form of an opportunity to make a profit (Tr. 303, line 24 through Tr. 304, line 2). The primary driving force behind a more competitive market in Florida today is the opportunity to increase profits. If these profits are acceptable for non-regulated market participants, it hardly seems fair to deny a portion of the profit margin to regulated utilities (Tr. 304, lines 11-14). Removing the direct shareholder incentive would discourage utilities from spending the money in developing the resources to more aggressively pursue sales (Tr. 305, lines 22-25). Today's market requires knowledge of market prices and conditions that only come through experience along with money and effort to acquire this knowledge. Without a direct incentive, the utilities would be encouraged to reduce their efforts in this area.

Removal of the twenty-percent incentive would discourage utilities from taking reasonable risks in making sales, resulting in lower share profits for their customers from these

sales. Such discouraged participation would reduce the pool of economy energy being sold, thereby reducing options of purchasing utilities, which increases their retail customer risk (Tr. 308, line 17 through Tr. 309, line 1).

Dr. Dismukes' contention that economy sales are one area where a utility has little ability to influence decisions completely misses the mark. Utilities can and do modify their operations to maximize sales volume when product demand is high (Tr. 318, lines 21-22). Removal of the shareholder incentive would discourage the utilities from taking such action.

This Commission has reaffirmed its policy of applying the shareholder incentive to economy sales on a number of occasions since its adoption in 1984, most recently in Order No. PSC-98-0073-FOF-EI. The Commission should do likewise in this proceeding and reject Dr. Dismukes' casual and unsupported suggestion that the incentive be removed.

The Alternative Incentive Proposed By Public Counsel's Witness Is Inappropriate

The Commission should reject out of hand Dr. Dismukes' alternative incentive recommendation that includes a "dead band" benchmark accompanied by incentives and penalties for performance levels that are over or under the benchmark. Witness Dismukes' proposal is flawed in many respects.

First of all, the alternative incentive would require projecting gains on economy sales, an activity which this Commission has already rejected in Order No. 12923 as constituting a difficult and unworkable endeavor. In that order, the very order which adopted the current shareholder incentive, the Commission agreed with Staff's testimony that establishing a "bar" or minimum level of economy sales is a problematic task. Because of this, the Commission agreed to remove economy sales transactions from general rate proceedings and to include them in the fuel and purchased power proceedings. In discussing this shift, the Commission observed:

. . . Problems with the current treatment stem from the difficulty in projecting economy sales and the potential bias of a utility to under project their economy sales profits. The difficulty in projecting the economy sales profits is due to uncertainty associated with fuel prices, weather, and forced outages of generating units and transmission lines. These variables affect not only how much a utility can sell and at what price, but also how much other utilities will pull by at different prices. (Order No. 12923 at page 2.)

Indeed forecasting gains on non-separated, non-firm sales is more difficult now than back when the Commission abandoned efforts to forecast economy sales.

In an effort to make his forecasted “bar” approach work, witness Dismukes arbitrarily selects the five-year moving average of sales made on the Florida Energy Broker Network. Apparently, witness Dismukes was not aware of the demise of the Energy Broker Network when he prepared his direct testimony and the use of such five-year moving average would now be meaningless.

Although witness Dismukes says his complex and difficult, if not impossible to administer, alternative incentive is intended to be symmetrical and offer proportional risks, he fails to acknowledge that those attributes already exist in the Commission’s existing shareholder incentive. Under the current incentive if a utility pursues opportunities and is able to effect incremental economy sales, the utility currently retains twenty percent of the gain. If the utility is complacent and foregoes sales that might otherwise have been attainable, the shareholders lose their twenty percent share of the foregone gain. This approach is symmetrical and avoids the pitfalls, previously recognized by the Commission, associated with any attempt to project an optimal or appropriate level of economy sales (Tr. 323, lines 4-16).

For these same reasons, it is not appropriate to establish a “bar” or minimum level for non-firm sales whereby the incentive applies only after the utility meets the minimum level. (Tr. 242, line 12 through Tr. 243, line 12.) While Tampa Electric agrees with Dr. Dismukes’

statement on page 2 of his testimony that “incentive-based regulation can be an effective tool for regulators,” the company strongly disagrees with Dr. Dismukes’ alternative recommendation and urges that it be rejected by the Commission as being inappropriate, unworkable and an incentive program for a type of wholesale sales that no longer exists.

The Commission Should Favorably Consider Tampa Electric’s Proposed Emphasis On Sales Within Florida

Tampa Electric has proposed a forty-percent shareholder incentive for non-separated, non-firm wholesale sales to customers within Florida and a twenty percent incentive for sales made to customers outside Florida. The higher incentive for in-state sales will encourage utilities to maximize transactions especially within the state (Tr. 209, lines 18-25).

Utilities that are willing to provide generation resources to serve the needs of its ratepayers and the Florida market due to changes in supply side resources and/or customer demand should receive a greater incentive. Larger volumes of non-firm energy on the wholesale market will result in a more robust and competitive Florida market. In addition, purchasers of energy will benefit by having more resource options that provide competitively priced energy and increased reliability for firm and non-firm retail customers. It follows that all Florida retail ratepayers (buyers and sellers) benefit by these types of transactions (Tr. 210, lines 1-12).

The Appropriate Design For Positive Incentives

As Tampa Electric witness Deirdre A. Brown testified, incentives should be designed and accounted for in a manner similar to how economy sales are treated today. Specifically, gains from these transactions should be determined by taking the overall transaction price less the incremental costs associated with making the sale. These costs include fuel, SO₂ and incremental O&M. The remaining amount is defined as a sale gain that can be comprised of capacity revenues and energy revenues. Capacity revenues may include reservation charges and

call premiums or other similar charges, plus associated transmission revenues. Energy revenues are all other revenues associated with making these non-separated, non-firm sales.

Tampa Electric proposes to credit eighty percent of the capacity revenues to the capacity clause and eighty percent of the energy revenues to the fuel clause for all sales made outside the state. The company proposes to credit sixty percent of the capacity revenues to the capacity clause and sixty percent of the energy revenues to the energy clause for all sales made within the state. The company will retain the remaining twenty percent or forty percent of the capacity and energy revenues depending on whether the sales were made to customers within Florida (Tr. 245, lines 13 through Tr. 246, line 9). This regulatory treatment is consistent with past Commission orders and is appropriate in this instance.

Conclusion

Abandoning the Commission's current policy of incenting investor-owned electric utilities to maximize non-separated, non-firm wholesale sales would serve as a direct disincentive to the affected utilities. Even OPC's own witness recognizes that incentives can be an important regulatory tool. Tampa Electric urges the Commission to continue its policy of applying positive incentives to maximize these sales; to confirm that the incentive should apply to all non-separated, non-firm wholesale sales, as they achieve the same benefits as economy sales; and to give favorable consideration to Tampa Electric's proposal to weight the incentive to favor in-state, non-separated, non-firm wholesale sales.

POST-HEARING STATEMENT OF ISSUES AND POSITIONS

ISSUE 1: Should the Commission eliminate the 20 percent shareholder incentive set forth in Order No. 12923, issued January 24, 1984, in Docket No. 830001-EU-B?

Tampa Electric's Position:

* No. The Commission should adhere to its existing policy of providing shareholder incentives to encourage non-separated, non-firm wholesale sales. Such incentives may provide greater benefits to ratepayers now than when they were first adopted by the Commission. No party has provided any basis for abandoning the Commission's present incentive policy. *

ISSUE 2: If the Commission decides to maintain the 20 percent shareholder incentive in Issue 1 or approves a new incentive, what types of non-separated, non-firm, wholesale sales should be eligible to receive the shareholder incentive?

Tampa Electric's Position:

* All non-separated, non-firm wholesale sales should qualify for the shareholder incentive as they all have the same beneficial effect of reducing the costs that the selling utility's retail customers would otherwise have to bear. They also provide savings to the retail customers of the purchasing utility. *

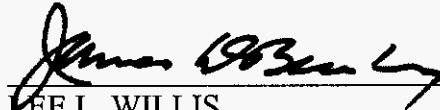
ISSUE 3: If the Commission decides to maintain the 20 percent shareholder incentive in Issue 1 or approves a new incentive, how should the incentive be structured?

Tampa Electric's Position:

* The incentive should apply to all non-separated, non-firm wholesale sales and to both demand and energy components of such gains, with sharing between customers on an 80/20 basis for out-of-state sales and a 60/40 basis for in-state sales, with calculation details as described by witness Deirdre Brown. * Those details include determining the gain from the transaction by taking the overall transaction price less incremental fuel costs, which should be

credited to the Fuel and Purchased Power Cost Recovery Clause ("Fuel Clause"), less incremental SO₂ costs, which should be credited to the Environmental Cost Recovery Clause, and less O&M costs which should be credited to operating revenues. The remaining amount is comprised of reservation charges, call premiums and associated transmission revenues ("capacity revenues") and energy revenues. According to Order No. PSC-99-2512-FOF-EI, dated September 22, 1999 in Docket No. 990001-EI, energy revenues for non-separated, non-firm transactions should be credited to the Fuel Clause. The same order acknowledged that if these sales include an identifiable capacity component the capacity revenues should be credited to retail ratepayers through the Capacity Cost Recovery Clause.

Dated this 31st day of May, 2000



LEE L. WILLIS
JAMES D. BEASLEY
Ausley & McMullen
Post Office Box 391
Tallahassee, FL 32302
(850) 224-9115

ATTORNEYS FOR TAMPA ELECTRIC COMPANY

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the foregoing Brief and Post-Hearing Statement of Issues and Positions, filed on behalf of Tampa Electric Company, has been furnished by hand delivery (*) or U. S. Mail on this 31st day of May 2000 to the following:

Mr. Wm. Cochran Keating*
Staff Counsel
Division of Legal Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Mr. John McWhirter, Jr.
Florida Industrial Power Users Group
McWhirter, Reeves, McGlothlin, Davidson,
Decker, Kaufman, Arnold & Steen, P.A.
Post Office Box 3350
Tampa, FL 33601

Mr. Bill Walker
Florida Power & Light Company
215 South Monroe Street, Suite 810
Tallahassee, FL 32301-1859

Mr. Matthew M. Childs
Steel Hector & Davis
215 S. Monroe Street – Suite 601
Tallahassee, FL 32301

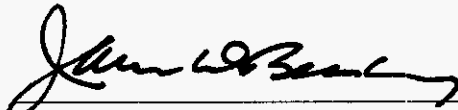
Mr. Jeffrey A. Stone
Beggs & Lane
Post Office Box 12950
Pensacola, FL 32576

Mr. James A. McGee
Senior Counsel
Florida Power Corporation
Post Office Box 14042
St. Petersburg, FL 33733-4042

Mr. Joseph A. McGlothlin
Ms. Vicki Gordon Kaufman
McWhirter, Reeves, McGlothlin, Davidson,
Decker, Kaufman, Arnold & Steen, P.A.
117 S. Gadsden Street
Tallahassee, FL 32301

Ms. Susan Ritenour
Gulf Power Company
One Energy Place
Pensacola, FL 32520

Mr. Stephen Burgess
Deputy Public Counsel
Office of Public Counsel
111 W. Madison Street, Suite 812
Tallahassee, FL 32399-1400



ATTORNEY