Gulf Power

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VIA ELECTRONIC FILING

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

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

Dear Ms. Stauffer:

Attached is the Rebuttal Testimony and Exhibit of Gulf Power Company Witness Janet J. Hodnett.

(Document 7 of 16)

Sincerely,

Robert L. McGee, Jr.

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Regulatory & Pricing Manager

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 160186-EI

REBUTTAL TESTIMONY AND EXHIBIT

OF

JANET J. HODNETT

GULF POWER COMPANY

Before the Florida Public Service Commission
Rebuttal Testimony of
Janet J. Hodnett
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 Jan Hodnett. My business address is One Energy Place, Pensacola, Florida, 32520. I am the Comptroller 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. My rebuttal testimony responds to certain assertions and positions contained in the testimonies of Office of Public Counsel (OPC) Witnesses Ramas and McCullar. My rebuttal testimony addresses, in the order listed, the following areas discussed by these witnesses:

- Property Damage Reserve Accrual
- SCS Allocations
- Accounting for the Sale of the Pace Boulevard Office

Q. Are you sponsoring any rebuttal exhibits?

A. Yes. I am sponsoring rebuttal Exhibit JJH-2. Exhibit JJH-2 was prepared under my direction and control, and the information contained therein is true and correct to the best of my knowledge and belief.

I. PROPERTY DAMAGE RESERVE ACCRUAL

Q. Please summarize what Witness Ramas suggests in regard to the annual accrual to Gulf's property damage reserve.

A. Witness Ramas suggests that the annual accrual remain at the amount set over 20 years ago in 1996, $3.5 million. Her rationale is that even though the amount of funds in the reserve is still below the target amount set by the Commission in Gulf's 2012 test year rate case, the reserve level has nevertheless increased over the last few years because Gulf has not recently sustained large storm losses. Instead, Witness Ramas suggests that when a major storm event occurs, Gulf's customers be required to pay a surcharge to cover such losses.

Q. Do you agree with Witness Ramas's position?

A. No. Witness Ramas completely ignores the 2016 Storm Study filed with the Commission on April 8, 2016, pursuant to the requirement in Commission Rule 25-6.0143 (1)(l) to file a Storm Damage Self-Insurance Reserve Study (Storm Study) at least once every five years. The 2016 Storm Study concluded that the total annual reserve obligation required by Gulf, based on the expected annual, uninsured damage to Gulf's transmission and distribution system from hurricanes, is $7.9 million. Because the Storm

Study does not include expected losses from non-hurricane events, the annual accrual should also include an amount to account for these other types of losses, as I discuss in my direct testimony.

It is not in our customers' interests to be overly dependent on surcharges. An appropriate annual property damage reserve accrual will lessen the likelihood of any surcharge being imposed. When one is absolutely necessary, an appropriate annual property damage reserve accrual will lessen the amount of any surcharge and, thus, the burden imposed on customers when they can least afford it. While an appropriate annual property damage reserve accrual may slightly increase rates, it can and will provide greater benefits to customers when they need it the most.

It is my understanding that the Commission established and authorized the property damage reserve after Hurricane Andrew in 1992, a catastrophic event which effectively eliminated the availability of cost-effective insurance for these types of losses. The annual accrual in some sense replaces the insurance premiums that previously would have been paid to help address such losses. Our customers benefit far more from an annual accrual to the reserve, where the amount of the accrual is grounded in the results from an approved Storm Study, than from a larger surcharge in the wake of the inevitable hurricane strike. Such surcharges would be implemented at a time when our customers are dealing with their personal losses from a storm.

Q. Because Witness Ramas does not base her recommendation on the Storm Study, what, if anything, does she cite to support her argument that the annual accrual should not increase even though Gulf still has not reached the bottom range of the targeted property reserve level?

A. Witness Ramas averaged annual charges to the reserve since 2006, the year immediately following Hurricane Katrina and Hurricane Dennis, and two years following Hurricane Ivan which devastated Northwest Florida, to support her argument that Gulf's reserve losses are expected to be only a little over $1 million per year. She takes the position that because the reserve is growing, albeit not at a rate that has allowed the reserve to reach even the bottom range of the targeted reserve, the annual accrual should remain the same, because customers can simply bear any deficiencies via bill surcharges in the event of a "major storm."

Q. What is wrong with Witness Ramas's position?

A. Witness Ramas's position is fundamentally flawed for multiple reasons. First, in order to come up with her average of storm losses to the reserve, she selectively excluded the years in which there were significant hurricane events. Hurricane Ivan caused $141.5 million in total damage, Hurricane Dennis caused $59.4 million in total damage, and Hurricane Katrina caused $4.3 million in total damage. Putting aside temporarily that the purpose of the Storm Study is to objectively evaluate hurricane losses over a period of time to obtain a more realistic probability of hurricane damage, the fallacy of Witness Ramas's logic is that even though Gulf has been fortunate not to sustain a significant hurricane strike event over the last several years, the current annual accrual of $3.5 million has not been sufficient to reach the Commission-established target reserve level. As I describe in my initial testimony, Gulf has sustained an average of over $1 million in annual losses charged to the reserve over the last several years due to events not covered by the Storm Study, such as floods, fires, and storms other than hurricanes. The question of the next hurricane event is one of “when,” not “if.” Witness Ramas’s suggestion that the Commission ignore the required Storm Study should be soundly rejected by the Commission.

Q. In her testimony, on page 34, line 14, Witness Ramas was asked about the consequences of a “major storm” that would impact Gulf’s system. She also states on page 34, lines 7-11, that the Commission’s stated goal is that the reserve be sufficient to cover most, but not all, storms. Is the current reserve level adequate to cover all but “major storms”?

A. No. As Gulf Witness Harris describes in his direct testimony, the 2016 Storm Study concludes that the reserve is too small to pay for most hurricane damage. I will defer to Mr. Harris for the specifics, but he explains that the reserve would not even cover all Category 1 or Category 2 single storm event damages, much less those from a “major” hurricane of Category 3 or higher.

Q. What effect would increasing the annual accrual amount have on the potential for customer surcharges in the event of a loss?

A. As the amount of the annual accrual increases, the likelihood of having to impose customer surcharges decreases. Furthermore, relying on customer surcharges when hurricanes occur assures intergenerational inequity. The property damage reserve is an accounting technique that provides a uniform and systematic means of matching costs to revenue recovery so that such costs will not be concentrated in a particular year. When customers receive service, they are not only receiving the electrons flowing through their meter, but also the reasonable expectation that their service will be restored as quickly and safely as possible should an interruption occur from a storm or other event. Since storms will occur and only their timing is uncertain, the cost of providing electric service should include an allowance for a level of restoration activity that approximates the expected annual storm costs. To a great extent, as I referenced earlier in this testimony, it is analogous to purchasing insurance coverage through a monthly premium. Even though a claim may not be filed, the premium is still a current cost of providing the service.

Q. Have Gulf's customers faced surcharges for hurricane-related damages in the past?

A. Yes. In 2005 and 2006, Gulf incurred hurricane damage that exhausted the then-existing property damage reserve. So when many of Gulf's customers were paying for repair of their own storm damage, they were required to pay a storm surcharge for Gulf's storm damage. The impact of a storm surcharge can be significant. Gulf's customers faced a surcharge of $2.71 for residential customers using 1,000 kWh per month from April 2005 through March 2006, followed by a surcharge of $2.57 for residential customers using 1,000 kWh per month from April 2006 through June 2009.

The total collected through surcharges over this 51-month period was more than $100 million.

Q. How do those historic Gulf hurricane surcharges compare to the monthly bill impact of Gulf's proposed increase in the property damage accrual?

A. The impact of the proposed property damage accrual would increase a residential bill by $0.49 for customers using 1,000 kWh per month.

Q. Does the inclusion of a property damage accrual in rates add to a utility's earnings?

A. No, it does not. It is an expense that is used exclusively to provide for future storm costs. It does add to a company's cash flow. However, Gulf has a partially-funded reserve, and the after-tax cash is deposited into the funded portion of the reserve.

Q. Does the reserve provide any benefit to Gulf's customers in addition to covering storm restoration costs?

A. Yes. The unfunded portion of the property damage reserve is treated as a reduction to rate base and therefore reduces rates.

Q. Another of Witness Ramas's arguments regarding continuance of the current property damage accrual is her belief that storm hardening efforts will reduce the expected storm damage. Has the Company included the impact of storm hardening in the calculation of its accrual?

A. Yes. As discussed in the direct testimony of Gulf Witnesses Smith and Harris, the Storm Study already assumes an estimated impact or reduction of loss of 1 percent due to storm hardening.

Q. Is any further adjustment warranted related to storm hardening?

A. No. As there has been no experience upon which to base a realistic assessment of how much storm damage costs savings might result, there is no basis for any further adjustment related to storm hardening.

Q. Did Witness Ramas consider all changes in circumstances in recommending no increase in the storm accrual?

A. No. She fails to recognize factors that are likely to increase costs charged to the reserve. Since the time the current accrual was set in 1996, there have been significant investments in transmission and distribution (T&D) plant. The cost of T&D investment back in 1996 was $479 million. The data used in Mr. Harris' 2016 Storm Study show an estimated replacement value of Gulf's overhead T&D plant to be $2.3 billion as of 2014. Based on net additions and retirements in T&D through 2016, the estimated replacement value increased to more than $2.5 billion. Additionally, as I discussed earlier, there are other types of property losses that are charged to the reserve which are not a part of the Storm Study. These factors show that the proposed annual accrual of $8.9 million is, in fact, a conservative estimate of what is actually needed to cover property damage losses.

Q. What annual accrual amount should the Commission approve to the property damage reserve?

A. As I stated in my direct testimony, the Commission should approve Gulf's proposed annual accrual of $8.9 million. This amount is based on an expected average annual hurricane loss charged to the reserve of $7.9 million and an additional $1 million related to non-hurricane damage losses.

II. SCS ALLOCATIONS

Q. What is OPC Witness Ramas's recommendation concerning the SCS allocation factors used in forecasting the SCS costs for the 2017 test year?

A. Witness Ramas is recommending a reduction to SCS test year expenses of $6,362,000.

Q. What is the basis for her recommendation?

A. Witness Ramas states that the allocation factors used in forecasting the SCS expenses to be allocated to Gulf for the 2017 test year did not consider the impact of several acquisitions by Southern Company in 2016.

Q. What are the acquisitions to which Witness Ramas is referring?

A. Witness Ramas is referring to Southern's merger with Southern Company Gas (formerly known as AGL Resources, Inc.), Southern's acquisition of PowerSecure, and Southern's acquisition of a 50 percent equity interest in the Southern Natural Gas pipeline.

Q. Do you agree that an adjustment should be made to the SCS test year expenses?

A. Yes, but the adjustment should be to reduce SCS test year expenses by $719,000, not $6,362,000.

Q. Why was an adjustment not included in the 2017 test year amounts when Gulf filed its case in October 2016?

A. Because the budget Gulf used for the 2017 test year was completed before the merger and acquisitions were finalized, the impact on the SCS allocations was not known when the case was prepared.

Q. Why is Witness Ramas's calculation of a $6,362,000 adjustment incorrect?

A. Witness Ramas assumes all allocated SCS expenses included in the 2017 test year will be impacted by changes in SCS allocators due to the merger and acquisitions. This assumption is false. Southern Company Gas has its own holding company and service company structure; thus, they do not need extensive services from SCS in some areas and would not be allocated a portion of the expenses in those areas. Moreover, many services provided by SCS support electric infrastructure activities and are not associated with gas activities. Only those costs that should be properly allocated to Southern Company Gas or PowerSecure would be changed.

Q. Please describe the process that was used by SCS to calculate the impact of the change in SCS allocation factors and SCS expense on Gulf's 2017 test year amount.

A. An analysis of the impact was prepared in January 2017 when the data became available. The costs of SCS are allocated to the companies served based on a set of specific allocators. With the acquisitions, the various statistics of the acquired companies (Southern Company Gas and PowerSecure) were added to develop the applicable allocators used to determine Gulf Power's share of costs. To determine the effect of the acquisitions, the SCS expenses allocated to Gulf Power were calculated with two different set of allocators: one set which was developed with the acquisitions in place and another set developed excluding the acquisitions. The difference between the two calculations is the effect of the acquisitions.

Q. How does the analysis account for the fact that the acquired companies are stand-alone firms with staff and systems already performing all the tasks normally performed by SCS and that some allocated costs are not applicable to Southern Company Gas or PowerSecure?

A. An integration team evaluated every allocated SCS Work Order and determined if it was appropriate for PowerSecure and Southern Company Gas to receive a portion of the costs.

Q. What are the overall results of the analysis of the incremental effect of the acquisitions on Gulf's SCS allocated costs for the 2017 test year?

A. The analysis estimated that the SCS expense allocated to Gulf for the 2017 test year would decrease by $719,000. Exhibit JJH-2 shows the breakdown of the amounts by SCS allocation factor for 2017.

Q. Are there any acquisitions not addressed by the revised allocation factor calculation?

A. Yes. Due to the timing of the acquisition of the 50 percent equity interest in the Southern Natural Gas pipeline, the calculation of the SCS allocation factors for this acquisition is not definitively known at this time. However, because this acquisition was of a 50 percent equity interest in a gas pipeline, the impact is expected to be insignificant to Gulf.

Q. What is Witness Ramas's recommendation concerning the SCS costs in the test year associated with Next Generation Nuclear Research & Development (R&D)?

A. Witness Ramas recommends that the SCS costs of $149,968 for next generation nuclear R&D be excluded from the test year.

Q. What is the basis for her recommendation?

A. Witness Ramas's rationale is based on Gulf Witness Burroughs' deposition where he indicated that there is no plan at this time for Gulf to build a nuclear facility.

Q. Do you agree with Witness Ramas's recommendation?

A. No. Research and development is a process intended to create new, improved, and diverse power generation options and requires long development cycles. R&D investments are required now to make these technologies available when needed by our customers. These R&D costs are shared appropriately among the operating companies and are leveraged heavily by co-funding from the U.S. Department of Energy. Denying recovery of costs to create new and improved technology within the Southern generation fleet simply because Gulf does not have plans to build nuclear generation at this time is extremely short-sighted by Witness Ramas. In the long run, research and development of better, less expensive, and more efficient generation resources for Southern's generation fleet, which serves Gulf's customers, will benefit Gulf customers, regardless of the technology under examination. Therefore, it is appropriate that Gulf pay for its portion of these research and development activities.

III. ACCOUNTING FOR THE SALE OF THE PACE BOULEVARD OFFICE

Q. What is OPC Witness McCullar's recommendation concerning the Company's proposed future net salvage percent for Account 390, Structures and Improvements, in the Company's Depreciation Study?

A. Witness McCullar is recommending a 0 percent future net salvage percent for Account 390, compared to the Company's proposed -5 percent future net salvage percent for this account.

Q. What is the basis for her recommendation?

A. Witness McCullar states that the historic net salvage analysis for Account 390 excludes gross salvage received from the retirement of one of the assets included in this account.

Q. To what specific transaction is she referring?
A. The transaction is the Company's sale of the Pace Boulevard office in 2008, which occurred approximately nine years ago. Gulf recorded in October 2008 a gain on the sale of the office. Therefore, this transaction has no bearing on Gulf's current base rate case.

Q. Has this transaction been subject to Commission review since 2008?
A. Yes. It was initially captured in a surveillance report filed with the Commission in October 2008. Since then, Gulf has filed two base rate cases and two depreciation studies. No adjustments related to this transaction were made by the Commission to any of the filings.

Q. Do you agree with Witness McCullar's recommendation regarding the impact on the future net salvage percent for Account 390 as a result of this sale?
A. No. As I stated earlier, the retirement of the asset she is referring to was the sale of Gulf's Pace Boulevard office in 2008. In accordance with Accounting Standard Codification (ASC) 360, Property, Plant, and Equipment and FERC Electric Plant Instruction, Part 101, Paragraph 5F, the Company correctly recorded a gain on the sale of the asset, instead of recording salvage. The gain was recorded on the Company's books to Account 421.1, Gain on Disposition of Property, in accordance with FERC requirements. The accounting for the sale of the asset was reviewed and agreed to by Gulf's independent auditors, Deloitte & Touche.

Q. Witness McCullar states that she has reviewed the Company's FERC Form 1 for the year 2008 and that Account 421.1 shows $0 in the filing. Please explain why the amount is $0.

A. Accounting and regulatory guidance is often provided on how to report certain accounting transactions in a company's financial statements. SEC Staff Accounting Bulletin (SAB) 13B, requires that gains or losses from the sale of assets be reported as "other general expenses" pursuant to SEC Regulation S-X, Article 5-03(6). In other words, the gain or loss on the sale of an asset would be included within an expense line item in the operating section of a company's income statement, unless the gain or loss is material. If material, the gain or loss would be reported as a separate line item in the operating section of a company's income statement.

Since the gain on the sale of the Pace Boulevard office was not considered material to the Company's financial statements, the gain was netted with depreciation expense on page 114, line 6 of Gulf's 2008 FERC Form 1 filing. The reporting of the gain on the sale was reviewed and agreed to by Gulf's independent auditors, Deloitte & Touche.

Q. Was the gain on the sale recognized for the benefit of Gulf's customers?

A. Yes. Gulf's retail customers received the benefit of the gain in the October 2008 surveillance report.

Q. Witness McCullar states Gulf should have amortized the gain over a five-year period based on previous rulings from the Commission. What impact would that have on Gulf's 2017 test year in light of the fact that this transaction occurred in 2008?

A. There would be no impact on Gulf's 2017 test year since the transaction occurred in 2008, approximately nine years ago. This transaction also has no impact on the net salvage percent for Account 390 in Gulf's Depreciation Study for this case since the Company properly recorded a gain on the sale instead of salvage.

Q. Does this conclude your testimony?

A. Yes.

AFFIDAVIT

STATE OF FLORIDA)
)
COUNTY OF ESCAMBIA)

Docket No. 160186-EI

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

s/ Janet J Hodnett
Janet J. Hodnett
Comptroller

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

Melissa Darnes
Notary Public, State of Florida at Large

Commission No. FF912698

My Commission Expires December 17, 2019

NOTARY PUBLIC STATE OF FLORIDA
MELISSA DARNES
MY COMMISSION # FF 912698
EXPIRES: December 17, 2019
Bonded Thru Budget Notary Services

Exhibit

Florida Public Service Commission
Docket No. 160186-EI
GULF POWER COMPANY
Witness: Janet J. Hodnett
Exhibit No. ___ (JJH-2)

Decrease in SCS Costs for 2017 Test Year Due to Southern Company's 2016 Mergers and Acquisitions:

	($000)	
SCS Cost Allocator	Total Amount	O&M Amount
Financial	492	487
Employee	89	81
Capitalization	53	53
Direct Accumulative	33	33
Corporate Services	80	65
Total Decrease	746	719