ORIGINAL

Florida Power
A Progress Energy Company

JAMES A. McGEE
ASSOCIATE GENERAL COUNSEL

October 8, 2001

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

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Re: Docket No. 010001-EI

Dear Ms. Bayó:

Enclosed for filing in the subject docket are an original and ten copies of the Direct Testimonies of Thomas R. Connolly, Pamela R. Murphy, Robert D. Niekum and Javier Portuondo.

Please acknowledge your receipt of the above filing on the enclosed copy of this letter and return to the undersigned. Also enclosed is a 3.5 inch diskette containing the above-referenced document in Word format. Thank you for your assistance in this matter.

Very truly yours,

James A. McGee

JAM/scc
Enclosure

cc: Parties of record

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FLORIDA POWER CORPORATION

DOCKET NO. 010001-EI

DIRECT TESTIMONY OF THOMAS R. CONNOLLY

Q. Please state your name and business address.

A. My name is Thomas R. Connolly. My business address is Post Office Box 14042, St. Petersburg, Florida 33733.

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

A. I am employed by Florida Power Corporation (Florida Power or the Company) in the capacity of Manger, Engineering Programs.

Q. What are the duties and responsibilities of your position with Florida Power?

A. As Manager of Engineering Programs, I am responsible for engineering programs, testing and inspection, and document management support for Florida Power's fossil fuel generating units, as well as those owned by other subsidiaries of Progress Energy located in North Carolina, South Carolina and Georgia.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address Issue 19E identified in the Prehearing Officer's September 11, 2001 revised procedural order, regarding the reasonableness of the replacement fuel costs associated with the

unplanned outage at the Company's Crystal River Unit 2 (CR2) coal plant that began on June 1, 2000 and concluded on September 6, 2000.

Q. What caused the 14-week unplanned outage at CR2?

A. The outage began when a high voltage disconnect switch between CR2's generator and an auxiliary station service transformer failed, which resulted in a high energy fault that caused significant damage to the generator rotor. The 60 ton, 40-foot long rotor had to be removed from the generator and shipped to the service facility of the generator vendor, General Electric, in Jacksonville for repair and then to the vendor's major equipment facility in New York for final testing and balancing. Finally, the rotor was shipped back to the Crystal River plant site and reinstalled, and CR2 was then returned to service.

Q. What were the replacement power costs associated with this unplanned outage?

A. Florida Power's response to Interrogatory No. 6 in Staff's first set of interrogatories to the Company describes the production cost modeling study that calculated total replacement fuel and purchased power costs of $36.5 million associated with CR2's unplanned outage.

Q. Could this outage have been avoided or its duration shortened?

A. Based on what the Company has learned from the outage at CR2, I doubt that the cause of this outage would occur today. Because of the outage, Florida Power decided that, system wide, this type of switch will no longer be operated while the related generating unit is on line. At the time CR2's outage occurred,

however, I can think of no reason why anyone on the plant's maintenance staff could have foreseen that the operation of that particular switch, which had been operated under similar circumstances many times, would lead to the significant damage to the generator rotor that took place.

Regarding the duration of the outage, it was only through the persistence of the Florida Power employees assigned to this project that a substantially longer outage was avoided. The vendor's initial recommendation was that the damage to the generator rotor was too extensive to be satisfactorily repaired and would have to be replaced. An extensive search disclosed that no existing replacement rotors suitable for use at CR2 were available. As a result, a new rotor would have to have been manufactured, which would have required the plant to be out of service for at least a year, and possibly as long as 18 months. Instead, after the Florida Power representatives requested the vendor to conduct additional evaluations of repair possibilities, a plan was devised under which temporary repairs were made to the rotor that enabled CR2 to be placed back in service in only three months. This plan also allowed the time consuming process of obtaining a replacement rotor to take place while the unit is in operation. Florida Power will then be able to install the new rotor in conjunction with other required maintenance work during a scheduled outage of the unit, which is currently planned for early 2002.

Q. Please describe the specific events that led to this outcome.

A. As I mentioned earlier, a high voltage disconnect switch failed during opeation on June 1, 2000, while attempting to place an auxiliary station service transformer back in operation. The transformer had been taken out of service

several days earlier for maintenance and repair after sampling tests on the transformer's oil indicated a high percentage of combustibles.

The switch failure caused a high-energy electrical fault to occur, which tripped the generator off-line while the unit was operating at full load. Recognizing that a fault of this type had the potential to damage to the turbine generator and other components, a full visual inspection and test was performed immediately on critical major system components, *i.e.*, the generator stator, generator field rotor, step-up transformer, auxiliary transformers and the steam turbine.

The initial inspection of the generator rotor conducted with video probe instrumentation revealed significant surface damage that required further inspection, which required that the rotor be removed from the stator. All other major components showed relatively minor or no damage during the initial inspection. After the rotor was removed from the stator, the rotor forging was observed to have suffered serious electric arc strikes and metal spatter from end to end.

Consequently, the decision was made to ship the rotor to GE's service facility in Jacksonville for disassembly and further damage assessment. Based on the results of this assessment, GE advised Florida Power that no experiential repairs were available and that the rotor should be replaced. This would have been a serious setback, since the availability of an existing replacement rotor was uncertain and the need to manufacture a new rotor would require a lengthy extension of CR2's unplanned outage. A subsequent search disclosed that, in fact, no replacement rotors suitable for use at CR2 were available.

For this reason, Florida Power asked GE to conduct additional evaluations to confirm whether concerns over the reliability, scope, and limitations of repairs to the rotor precluded this alternative and required replacement of the rotor. These evaluations involved extensive multiple tests of hundreds of systematically selected locations on the surface of the rotor, which were then repeated two, and in some cases, three times. Analysis of the test results led to the conclusion that repairs could be made that would allow the rotor to be used for limited period, thus avoiding the need to extend CR2's unplanned outage until a replacement rotor could be obtained and installed.

The rotor repairs were performed in the Jacksonville service shop under the direction of specialists with GE Engineering from its headquarters in Schenectady, New York. Upon completion of the repairs, a boresonic evaluation of the rotor was performed, which confirmed that the rotor was ready for final testing. The rotor was then shipped to GE's major testing facility in Schenectady on August 7, 2000 for high-speed balancing and dynamic thermal testing to insure that the rotor could be reliably returned to service.

The work at the GE testing facility was completed on August 17th and the rotor was shipped back at the Crystal River plant site, where it was received on August 22nd. Florida Power maintenance crews were awaiting the rotor's arrival and were able to complete the reinstallation of the rotor the same day. After completion of start-up testing, CR2 was returned to service on September 6th.

All of the repairs, shipping and testing of the rotor were performed on a expedited basis. The overall generator rotor repair activity was the "critical path" component for the entire outage and the activity was worked in this manner to minimize its impact on the duration of the outage.

Q. Does this conclude your testimony?

A. Yes.

FLORIDA POWER CORPORATION

DOCKET NO. 010001-EI

DIRECT TESTIMONY OF PAMELA R. MURPHY

Q. Please state your name and business address.

A. My name is Pamela R. Murphy. My business address is Post Office Box 1551, Raleigh, North Carolina 26702.

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

A. I am employed by Carolina Power & Light Company (CP&L) in the capacity of Director, Gas & Oil Trading.

Q. What are the duties and responsibilities of your position with CP&L?

A. As Director of Gas & Oil Trading, my responsibilities include managing the purchase, delivery and trading of natural gas, and the purchase and delivery of fuel oil, for Florida Power Corporation (Florida Power or the Company), as well as CP&L, North Carolina Natural Gas Corporation, and Monroe Power Company. I am also responsible for oversight in all negotiations regarding natural gas and oil contracts to meet the requirements of each of these companies.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address Issues 11 and 19D identified in the September 11, 2001 revised procedural order, regarding the reasonableness

of steps taken by Florida Power to manage certain risks associated with its fuel transactions. Because my responsibilities for Florida Power's fuel transactions did not begin until the completion of its merger with Progress Energy in December 2000, I will jointly sponsor this testimony with Mr. Robert Niekum, who was responsible for these fuel transactions prior to the merger. In this regard, I will sponsor those aspects of the testimony related to Florida Power's post-merger risk management activities, and Mr. Niekum will sponsor those aspects related to pre-merger activities.

Q. Has Florida Power taken reasonable steps to manage the risks associated with its fuel transactions through the use of physical and financial hedging practices?

A. Florida Power has not historically used financial hedging in its management of fuel transaction risks. However, the Company has used a combination of pricing options and physical inventory controls to manage these risks in a reasonable manner. The discussion below addresses Florida Power's risk management practices for residual and distillate oil transactions. The Company's risk management practices for natural gas transactions will be discussed in response to the question that follows.

Residual (Heavy or No. 6) Oil: Florida Power has used, and continues to use, negotiated fixed pricing as a method of stabilizing prices. Usually, this is accomplished by fixing prices on all or part of individual shipments or a series of shipments to be delivered over a period of one to three months. As a result, the Company has achieved an overall cost savings to its customers for the period March 1999 through March 2001 of approximately $3 million. Since

residual oil is not actively traded, there are fewer hedging options available for this fuel. One key element in reducing price volatility is to build physical inventory when distressed cargoes are available at reduced prices. Other options include purchasing and blending multiple cargoes with varying specifications. This allows individual, lower priced cargoes that may not meet environmental restrictions to be mixed with compliance cargoes to achieve an overall blended product that remains in compliance, yet has a lower average price. In addition, Florida Power is in the market daily evaluating supply and prices as it relates to short-term and long-term market indicators and trends. This information is used to make decisions on purchasing residual oil at a market index or fixed price as a means to obtain fuel at the lowest cost.

Distillate (Light or No. 2) Oil: Generally, the demand for distillate oil is driven by simple-cycle combustion turbines used for peaking service. While the volume of fuel consumed by these units can be very substantial, the pattern of usage is difficult to predict since they operate mainly during periods of critical demand, such as extreme weather conditions and unplanned outages of major generating units. Price risk is primarily mitigated by inventory control and the use of natural gas as an alternative fuel. Florida Power has not used fixed pricing for distillate oil due to the difficulty in predicting future inventory levels. Instead, to the extent that Florida Power can take advantage of lower cost fuel, inventory is built up during periods of lower prices and drawn down in higher price periods.

Florida Power has also taken measures to mitigate price volatility associated with the limited availability of truck transportation during critical demand periods. For example, the Company is in the process of converting

nine of its trucks currently used to transport transformer oil into "terminal friendly" trucks, which will then be able to assist in transporting distillate oil from the terminals to the plants during critical demand periods. While Florida Power's transportation requirements are usually met by the commercial trucking industry under normal conditions, they do not find it financially attractive in invest in the additional trucking capacity needed to meet the Company's occasional and unpredictable higher requirements during critical demand periods, unless they receive a substantial premium. As a result, critical demand periods are typically accompanied by limited availability of trucking transportation for distillate oil and higher transportation charges for the trucking capacity that is available. The availability of Florida Power's own "terminal friendly" trucks to assist in transporting distillate oil to various plant locations will provide additional flexibility and cost savings to the Company and its customers in meeting it peak load requirements.

Another innovative transportation measure to mitigate distillate oil price volatility that Florida Power is currently evaluating involves the use of the off-loading capabilities of fuel storage facilities at certain plants where natural gas can be used in lieu of distillate oil. Utilizing this off-loading capability will allow Florida Power to transport distillate oil from these dual fuel plants to other plants that only use distillate oil. During periods of critical demand or supply shortages of distillate oil, this will provide additional flexibility to Florida Power in meeting its generation load requirements and, in some cases, minimizing the need to pay higher fuel or transportation prices. Another benefit this will provide is the ability to maximize the use of the Company's oil tank storage

capacity if market indicators and trends show a continuing upward movement in distillate oil prices.

Q. Did Florida Power take reasonable steps to manage the risk associated with changes in natural gas prices for the period March 1999 to March 2001?

A. Yes, the actions taken by Florida Power to manage the risk of natural gas price changes during this period were reasonable. These risk management actions concerned the price of both natural gas transportation and natural gas supply.

Natural gas transportation. Florida Power made arrangements for natural gas transportation on the Florida Gas Transmission (FGT) system through a variety of contracts, including long-term firm, short-term firm, and interruptible contracts. Florida Power also contracted for delivered bundled gas supply for its generation needs. Florida Power also was able to secure transportation through low cost FTS-1 transportation contracts obtained in the capacity release market. In addition, Florida Power actively negotiated with the Gulfstream Natural Gas system to obtain capacity on a new competitive interstate pipeline. This capacity augments our current portfolio of transportation assets to provide more diverse and reliable alternatives to serve it native load generation requirements.

Natural gas supply. Florida Power entered into contracts for the procurement of natural gas supply with over 20 vendors that contained terms ranging from 1 day to 15 years in duration. This portfolio approach avoided dependence upon sole or limited vendors and encouraged bidding on a more

competitive basis. In general, the pricing for the Company's supply contracts are based upon market indexes. However, Florida Power also negotiated terms in a number of supplier contracts that allowed the parties to fix prices for designated periods. This provided the ability to simulate a futures position by locking into a future price for a designated period. These options were exercised several times and resulted in substantial savings over the March 1999 - March 2001 period.

Since Florida Power is in the natural gas market on a daily basis either procuring or selling supply in order to stay within daily operational balance on FGT's system, it has been able to benefit from this market experience through a better ability to identify and act upon developing trends in the industry. One such market trend that the Company identified as it began in May, 2000 was the potential for a bullish market based on expectations of increased gas usage for power generation. This potential appeared even more promising when coupled with another piece of market intelligence in the form of reports that natural gas injections into underground storage facilities had decreased. Eventually this sparked uncertainty over the adequacy of existing natural gas reserves to meet the expected increase in power generation requirements which, in turn, led to higher natural gas prices. Having recognized this trend early, Florida Power was able to lock in a supply of approximately 35,000 MMBtu per day for the months of November 2000 through February 2001, well before the full price increase occurred. This resulted in a cost savings for the Company's customers of approximately $11 million. Overall, Florida Power achieved cost savings for its customers during the March 1999 - March 2001 period of over $19 million.

Q. Despite this positive experience, did Florida Power have any concerns about these kinds of hedging transactions that caused it to be less aggressive in taking similar action on other market trends anticipated by the Company?

A. Yes, Florida Power was reluctant to pursue these kinds of transactions more aggressively in large part because of its uncertainty over the regulatory treatment that they might receive, particularly since at least some of these transactions undoubtedly will prove to be unsuccessful under even to best of circumstances. To the extent that the Commission's consideration of hedging practices in this proceeding results in a clear and fairly balanced policy on the treatment of gains and losses associated with these kinds of transactions, this reluctance on Florida Power's part can be eliminated.

Q. Does this conclude your testimony?

A. Yes.

FLORIDA POWER CORPORATION

DOCKET NO. 010001-EI

DIRECT TESTIMONY OF ROBERT D. NIEKUM

Q. Please state your name and business address.

A. My name is Robert N. Niekum. My business address is Post Office Box 14042, St. Petersburg, Florida 33733.

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

A. I am employed by Florida Power Corporation (Florida Power or the Company). Since the merger of Florida Power with Progress Energy in December 2000, I have served in the capacity of Manager, Term Marketing - South. Prior to the merger, I served as Florida Power's Director of Fuels Supply.

Q. What were the duties and responsibilities of your former position with Florida Power as Director of Fuels Supply?

A. In my former position, I was responsible for managing the procurement of all fossil fuel, including coal, residual and distillate oil, and natural gas, used at Florida Power's generating facilities. My duties included responsibility for negotiations regarding contracts for the purchase of fossil fuel to meet the needs of these generating facilities.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to jointly sponsor the testimony submitted in this proceeding by Ms. Pamela Murphy, which addresses Issues 11 and 19D identified in the September 11, 2001 revised procedural order, regarding the reasonableness of steps taken by Florida Power to manage certain risks associated with its fuel transactions. In this regard, I will sponsor those aspects of that testimony related to Florida Power's pre-merger risk management activities, and Ms. Murphy will sponsor those aspects related to post-merger activities.

Q. Does this conclude your testimony?

A. Yes.

FLORIDA POWER CORPORATION

DOCKET NO. 010001-EI

SUPPLEMENTAL DIRECT TESTIMONY OF JAVIER PORTUONDO

Q. Please state your name and business address.

A. My name is Javier Portuondo. My business address is Post Office Box 14042, St. Petersburg, Florida 33733.

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

A. I am employed by Florida Power Corporation (Florida Power or the Company) in the capacity of Manager, Regulatory Services.

Q. Have the duties and responsibilities of your position with the Company remained the same since you last testified in this proceeding?

A. Yes.

Q. What is the purpose of your supplemental testimony?

A. The purpose of my supplemental testimony is to address Issues 12, 13 and 14 identified in the Prehearing Officer's September 11, 2001 revised procedural order, regarding the appropriate regulatory treatment for the costs and benefits resulting from various hedging activities by utilities in connection with their fuel transactions.

Q. How has Florida Power approached the use of hedging activities in connection with its fuel transactions to date?

A. Florida Power has been engaged for many years in traditional hedging activities to mitigate volatility in the market price of the various types of fuel used in its generating facilities. These activities include such basic hedging practices as Florida Power's well established history of using long-term contracts for the procurement of varying portions of its coal requirements, as well as the hedging activities described in the testimony of Florida Power witnesses Murphy and Niekum regarding natural gas and oil procurement. However, Florida Power has taken a generally conservative approach to the use of non-traditional hedging practices, such as futures and options contracts, derivatives, and other financial instruments, which appear to be at the focus of the Staff's hedging issues in this proceeding.

Q. Why has Florida Power taken a conservative approach to the use of these non-traditional hedging practices?

A. Since the economic consequences of Florida Power's fuel procurement activities are borne by its customers, these activities are obviously, and for good reason, subject to considerable scrutiny by the Commission in the ongoing fuel adjustment proceeding. In the absence of a Commission policy on the appropriateness of these non-traditional hedging practices and recovery of their costs, Florida Power has been reluctant to presume these practices will be viewed with favor by the Commission. This reluctance is heightened by the realization that, even under the best scenario, these practices will occasionally result in higher costs.

Q. What would be the appropriate regulatory policy for the Commission to adopt regarding the treatment of the economic consequences associated with the various practices that an investor-owned utility may employ in hedging its fuel transactions?

A. If the Commission decides, as I believe it should, to adopt a policy on the treatment of the gains and losses, premiums paid and received, transaction costs, and other economic consequences of the various hedging practices, including those identified in Issues 12, 13 and 14, the policy should recognize the reality that a utility's hedging activities, even if successful overall, will necessarily involve some individual transactions in which the costs exceed the benefits. The policy must therefore provide for the recovery of a utility's costs associated with both successful and unsuccessful transactions, including transactions such as those identified in Issue 12 that may result in an outright loss. In this regard, the policy should be clear that the Commission's review of a utility's hedging activities will be based on the reasonableness of those activities at the time they were conducted, and not on the results of the activities determined after the fact.

In addition, if the Commission determines that it wants to affirmatively encourage utilities to proactively engage in hedging activities generally, or in certain particular types of hedging activities, it should consider including an explicit economic incentive in the policy. An incentive may be especially appropriate in view of the utility resources and infrastructure required to deal with the risks and complexity of many hedging activities. If the Commission decides to explore the possibility of adopting a utility hedging incentive, the workshop process may be an appropriate vehicle.

Q. Does this conclude your supplemental testimony?

A. Yes.

FLORIDA POWER CORPORATION

DOCKET NO. 010001-EI

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the Direct Testimonies of Thomas R. Connolly, Pamela R. Murphy, Robert D. Niekum and Javier Portuondo has been furnished to the following individuals by regular U.S. Mail this 8th day of October, 2001.

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