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JAMES A. MCGEE
ASSOCIATE GENERAL COUNSEL
PROGRESS ENERGY SERVICE COMPANY, LLC

October 29, 2004

VIA HAND DELIVERY

Ms. Blanca S. Bayó, Director
Division of the Commission Clerk
and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Application of Progress Energy, Inc. for authority to issue and sell securities during the twelve months ending December 31, 2005.

Dear Ms. Bayó:

Enclosed for filing is the original and five (5) copies of Progress Energy Florida, Inc.'s Application for authority to issue and sell securities during the twelve months ending December 31, 2005.

Please acknowledge your receipt of the above filing on the enclosed copy of this letter and return to the undersigned. A 3 ½ inch disk containing the above-referenced document is also enclosed in Word format. Thank you for your assistance in this matter.

Very truly yours,

James A. McGee

JAM/lms
Enclosures

cc: Office of Public Counsel

DOCUMENT NUMBER-DATE

11722 OCT 29 04

DOCKET NO. _____

FLORIDA PUBLIC SERVICE COMMISSION

TALLAHASSEE, FLORIDA

APPLICATION OF

PROGRESS ENERGY FLORIDA, INC.

(FORMERLY, FLORIDA POWER CORPORATION)

FOR AUTHORITY TO ISSUE AND SELL

SECURITIES DURING THE TWELVE MONTHS ENDING DECEMBER 31, 2005

PURSUANT TO SECTION 366.04, FLORIDA STATUTES,

AND CHAPTER 25-8, FLORIDA ADMINISTRATIVE CODE

Address communications in connection with this Application to:

Thomas R. Sullivan
Treasurer
Progress Energy Florida, Inc.
c/o Progress Energy, Inc.
410 S. Wilmington Street
Raleigh, NC 27601

R. Alexander Glenn
Deputy General Counsel
Progress Energy Service Company, LLC,
Counsel to Progress Energy Florida, Inc.
100 Central Avenue, Suite CX1D
St. Petersburg, FL 33701

Dated: October 28, 2004

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

IN RE: APPLICATION OF PROGRESS ENERGY
FLORIDA, INC. FOR AUTHORITY TO ISSUE
AND SELL SECURITIES DURING THE TWELVE
MONTHS ENDING DECEMBER 31, 2005
PURSUANT TO SECTION 366.04, FLORIDA
STATUTES, AND CHAPTER 25-8, FLORIDA
ADMINISTRATIVE CODE.

The Applicant, Progress Energy Florida, Inc., formerly Florida Power Corporation (herein called the "Company"), respectfully requests authority from the Florida Public Service Commission (herein called the "Commission"), to issue, sell or otherwise incur during 2005 any combination of additional equity securities and debt securities and obligations, consisting of (i) up to \$1 billion outstanding at any time of short-term debt, including commercial paper, bank loans or loans from affiliates, which amount shall be in addition to and in excess of the amount the Company is authorized to issue pursuant to Section 366.04, Florida Statutes, which permits the Company to issue short-term securities aggregating to more than five percent of the par value of the Company's other outstanding securities, and (ii) \$1 billion of any combination of equity securities and long-term debt securities and other obligations. The Company is wholly-owned by Florida Progress Corporation ("Florida Progress"), which is wholly-owned by Progress Energy, Inc. ("Progress Energy"). The Company hereby applies for requisite authority for these proposed financings, pursuant to Section 366.04, Florida Statutes, by submitting the following information in the manner and form prescribed in Chapter 25-8, Florida Administrative Code, including the required Exhibits A-C.

CONTENTS OF APPLICATION

- (1) The exact name of the Company and address of its principal business office is as follows:

Progress Energy Florida, Inc.
100 Central Avenue, Suite CX1D
St. Petersburg, Florida 33701

(2) The Company was incorporated in Florida in 1899 and reincorporated in Florida in 1943. The Company is continuing its corporate existence pursuant to its Amended Articles of Incorporation, as amended, a copy of which was filed as Exhibit A to the Application Of Florida Power Corporation For Authority To Issue And Sell Securities During The Twelve Months Ending December 31, 1994 (Docket No. 931029-EI) and is incorporated herein by reference. The Company's financial statement schedules required under Sections 25-8.003 (1)(a)-(b), Florida Administrative Code, are filed herewith as Exhibits A (6) (i) and (ii) and B (1) and (2), respectively.

(3) The name and address of the persons authorized to receive notices and communications with respect to this Application are as follows:

Thomas R. Sullivan
Treasurer
Progress Energy Florida, Inc.
c/o Progress Energy, Inc.
410 S. Wilmington Street
Raleigh, NC 27601

R. Alexander Glenn
Deputy General Counsel
Progress Energy Service Company, LLC
Counsel to Progress Energy Florida, Inc.
100 Central Avenue, Suite CX1D
St. Petersburg, FL 33701

(4)(a)(b)(c) A statement detailing information concerning each class and series of the Company's capital stock and long-term debt is contained in Exhibit C attached hereto.

(d) The amount held as reacquired securities: The Company does not hold any reacquired securities. From time to time, the Company has redeemed certain outstanding first mortgage bonds and

shares of its cumulative preferred stock, but such bonds and shares are canceled upon redemption or reacquisition. Under the Company's articles of incorporation, all or any shares of Preferred Stock or Preference Stock redeemed or acquired by the Company may thereafter be reissued or otherwise disposed of at any time, subject to limitations imposed by law and in the articles.

(e) **The amount pledged by the applicant:** From time to time the Company issues First Mortgage Bonds that are secured by the lien of its Indenture, dated as of January 1, 1944 with First Chicago Trust Company of New York as successor trustee, as supplemented by supplemental indentures (the "Mortgage"). The Mortgage constitutes a first mortgage lien, subject only to permitted encumbrances and liens, on substantially all of the fixed properties owned by the Company except miscellaneous properties that are specifically excepted. After-acquired property is covered by the lien of the Mortgage, subject to existing liens at the time such property is acquired.

(f) **The amount owned by affiliated corporations:** All of the Company's outstanding common stock (100 shares) is owned by the Company's parent, Florida Progress. The Company has no other stock or debt owned by affiliated corporations. See paragraph (10) hereof.

(g) **The amount held in any fund:** None.

(5) The Company seeks authority to issue and sell and/or exchange equity securities and issue, sell, exchange and/or assume short-term or long-term debt securities and/or to assume liabilities or obligations as guarantor, endorser or surety during the period covered by the Application. The Company ultimately may issue any combination of the types of securities described below, subject to the aggregate dollar limitations requested in this Application.

(5)(a)(1) The kind and the nature of the securities that the Company seeks authority to issue and sell during 2005 are equity securities and short-term and long-term debt securities and other obligations, including, but not limited to, borrowings from banks which are participants in credit facilities the Company may establish from time to time, uncommitted bank facilities and affiliate loans which are available through

Progress Energy's utility moneypool facility. The Company also seeks authority to enter into interest rate derivative contracts to remove financial risk associated with its existing and future debt obligations.

The equity securities that the Company may issue include cumulative preferred stock, preference stock, or warrants, options or rights to acquire such securities, or other equity securities, with such par values, terms and conditions and relative rights and preferences as are deemed appropriate by the Company and permitted by its articles of incorporation, as they may be amended from time to time.

The Company also may enter into preferred securities financings that may have various structures, including a structure whereby the Company would establish and make an equity investment in a special purpose trust, limited partnership or other entity. The entity would offer preferred securities to the public and lend the proceeds to the Company. The Company would issue debt securities to the entity equal to the aggregate of its equity investment and the amount of preferred securities issued. The Company may also guarantee, among other things, the distributions to be paid by the entity to the holders of the preferred securities.

Short-term debt securities and obligations may include notes to be sold in the commercial paper market ("commercial paper"), loans from affiliates and bank loans, credit agreements or other forms of securities and debt obligations, with maturities of less than one year.

The long-term debt securities and obligations may take the form of first mortgage bonds, debentures, medium-term notes or other notes, loans from affiliates and bank loans, installment contracts, credit agreements, securitization of storm cost receivables or other forms of securities and debt obligations, whether secured or unsecured, with maturities greater than one year. In addition, the Company may enter into options, rights, interest rate swaps or other derivative instruments. The Company also may enter into installment purchase and security agreements, loan agreements, or other arrangements with political subdivisions of the State of Florida or pledge debt securities or issue guarantees in connection with such

political subdivisions' issuance, for the ultimate benefit of the Company, of pollution control revenue bonds, solid waste disposal revenue bonds, industrial development revenue bonds, variable rate demand notes, or other "private activity bonds" with maturities ranging from one to forty years, bond anticipation notes, or commercial paper. Such obligations may or may not bear interest exempt from federal tax.

The Company also may enter into nuclear fuel leases and various agreements that provide financial or performance assurances to third parties on behalf of the Company's subsidiaries. These agreements include guarantees, standby letters of credit and surety bonds. The agreements are entered into primarily to support or enhance the credit worthiness otherwise attributed to a subsidiary on a stand-alone basis. Specific purposes of the agreements include supporting payments of trade payables, securing performance under contracts and lease obligations, providing workers' compensation coverage, obtaining licenses, permits and rights-of-way and supporting other payments that are subject to contingencies.

The manner of issuance and sale of securities will be dependent upon the type of securities being offered, the type of transaction in which the securities are being issued and sold and market conditions at the time of the issuance and sale. Securities may be issued through negotiated underwritten public offerings, public offerings at competitive biddings, private sales or sales through agents, and may be issued in both domestic and foreign markets. Credit agreements may be with banks or other lenders. The Company's commercial paper will be for terms up to but not exceeding nine months from the date of issuance. The commercial paper will be sold at a discount, including the underwriting discount of the commercial paper dealer, at rates comparable to interest rates being paid in the commercial paper market by borrowers of similar creditworthiness. The Company plans to refund from time to time outstanding commercial paper, and short-term borrowings, which mature on a regular basis, with preferred stock, first mortgage bonds, medium-term notes, or other long-term securities and debt obligations.

(5)(a)(2) Contemplated to be included as long-term or short-term debt securities, as appropriate, are borrowings from banks and other lenders under the Company's credit facilities, as those may be entered into and amended from time to time. The Company's current facilities are a \$200 million 364-day revolving credit agreement and a \$200 million three-year long-term agreement with a group of banks. Borrowings under the facilities are available for general corporate purposes, including support of the Company's commercial paper program. The current 364-day facility will expire on March 29, 2005, unless it is extended pursuant to its provisions and the current three-year facility will expire on March 31, 2006. The Company may elect to terminate one, or both, of the existing facilities and replace it or them with a new facility, which could be multi-year or 365-day or a combination of the two.

(5)(b) The maximum principal amount of short-term securities and obligations proposed to be issued, sold, or otherwise incurred during 2005 is \$1 billion outstanding at any time, including commercial paper, bank loans or moneypool borrowings, which amount shall be in addition to and in excess of the amount the Company is authorized to issue pursuant to Section 366.04, Florida Statutes, which permits the Company to issue short-term securities aggregating not more than five percent of the par value of the Company's other outstanding securities. The maximum principal amount of equity securities, long-term debt securities and other long-term obligations (exclusive of bank loans issued under the Company's long-term credit facilities as mentioned above) proposed to be issued, sold, or otherwise incurred during 2005 is \$1 billion.

The Company will file a consummation report with the Commission in compliance with Rule 25-8.009, Florida Administrative Code, within 90 days after the close of the 2005 calendar year to report any securities issued during that year.

(5)(c) On September 30, 2004 the estimate of the interest rates for securities proposed to be issued by the Company were as follows (with reference to current rates for comparable securities):

2. The interest rate on 10-year BBB+ rated senior unsecured debt was about 5.0%.
3. The interest rate on 10-year A1 rated first mortgage bonds was about 4.88%.
4. The interest rate (on a bond equivalent basis) for second-tier 30-day commercial paper sold through dealers was about 2.0%.
5. Prime interest rate was 4.75%.

The actual interest rates to be paid by the Company during 2005 will be determined by the market conditions at the time of issuance.

(6) The net proceeds to be received from the sale of the additional securities will be added to the Company's general funds and may be used to provide additional electric facilities during 2005 pursuant to the Company's construction program, to repay maturing long-term debt or short-term unsecured debt, to refund existing obligations with lower cost debt, or for other corporate purposes.

A more detailed statement of the Projected Sources and Uses of Funds during 2005 is included as Exhibit B(1) attached hereto. The Company's construction program is developed from its long-range plan to determine needed construction facilities. While the final 2005 Construction Budget is not yet available, the Company's most recently approved construction expenditures forecast excluding Allowance for Funds Used During Construction ("AFUDC") for 2005 is approximately \$516 million. A detailed listing of this 2005 construction program excluding AFUDC is found in Exhibit B(2) attached hereto. These construction estimates are subject to periodic review and revision to adjust for such factors as changing economic conditions, environmental requirements, regulatory matters and changing customer usage patterns.

(7) Based on the reasons shown in sections (5) and (6) above, the Company submits that the proposed financings are consistent with the proper performance by the Company of service as a public utility, will enable and permit the Company to perform that service, are compatible with the public interest

and are reasonably necessary and appropriate for such purposes.

(8) R. Alexander Glenn, Deputy General Counsel for the Company, will pass upon the legality of the securities involved herein. His office address is:

Progress Energy Florida, Inc.
100 Central Avenue
Suite CX1D
St. Petersburg, Florida 33701

(9) Except for those issuances of securities that are exempt from the registration requirements of the Securities Act of 1933, the issue and sale of the various securities involved herein will require the filing of Registration Statements with the Securities and Exchange Commission ("SEC"), 450 Fifth Street N.W., Washington, DC 20549. A copy of each Registration Statement that has been or will be filed with the SEC will be included with the Company's annual Consummation Report relating to the sale of securities registered thereunder. No other state or federal regulatory body has jurisdiction over the transactions proposed herein, although certain state securities or "blue sky" laws may require the filing of registration statements, consents to service of process or other documents with applicable state securities commissions, including in particular the Florida Division of Securities and Investor Protection, 101 E. Gaines St., Tallahassee, FL 32399; the Nevada Department of State, Securities Division, 555 East Washington Avenue, 5th Floor, Las Vegas, NV 89101; the New York Department of Law, Bureau of Investor Protection and Securities, 120 Broadway, 23rd Floor, New York, NY 10271; and the Oregon Department of Consumer & Business Services, Division of Finance & Corporate Securities, Labor & Industries Building, Salem, OR 97310.

(10) The measure of control or ownership exercised by or over the Company by any other public utility is set forth below. The Company is a wholly owned subsidiary of Florida Progress, a public utility holding company. On November 30, 2000, all the outstanding shares of Florida Progress common stock were acquired by CP&L Energy, Inc., a North Carolina corporation, which subsequently changed its name to Progress Energy in a statutory share exchange pursuant to the terms of an Amended and Restated Agreement and Plan of Exchange dated as of August 22, 1999, Amended and Restated as of March 3, 2000 (the “Agreement”).

Following the closing of the share exchange, Progress Energy became a registered holding company under the Public Utility Holding Company Act of 1935 (the “Act”). Progress Energy retained Florida Progress as a wholly owned subsidiary and Florida Progress continues to own all of the issued and outstanding common stock of the Company. Thus, Progress Energy indirectly owns all of the common stock of the Company. Florida Progress remains generally exempt from registration under the Act and attendant regulation because its utility operations are primarily intrastate.

(11) The following Exhibits are filed herewith and made a part hereof:

- Exhibit A (6)(i) The financial statements and accompanying footnotes as they appear in the Company’s Annual Report on Form 10-K for the year ended December 31, 2003, and filed with the SEC in file no. 1-03274 on March 12, 2004.
- Exhibit A (6)(ii) The financial statements and accompanying footnotes as they appear in the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2004, and filed with the SEC in file no. 1-03274 on August 6, 2004.
- Exhibit B(1) Projected Sources and Uses of Funds Statement for 2005.
- Exhibit B(2) Preliminary Construction Expenditures for 2005.
- Exhibit C Capital Stock and Funded Debt of the Company as of September 30, 2004.

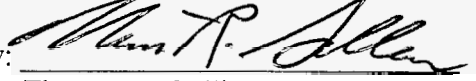
WHEREFORE, the Company hereby respectfully requests that the Commission enter its Order approving this Application for authority to issue and sell securities during the twelve months ending December 31, 2005, and more specifically, to order that:

- (a) The request of Progress Energy Florida, Inc. to issue and sell securities during the twelve months ending December 31, 2005, pursuant to Section 366.04, Florida Statutes, and Chapter 25-8, Florida Administrative Code (the “Application”) is granted;
- (b) Progress Energy Florida, Inc. is authorized to issue, sell, or otherwise incur any combination of additional equity securities, and short-term and long-term debt securities and obligations during 2005, consisting of (i) up to \$1 billion outstanding at any time of short-term debt, including commercial paper, bank loans or moneypool borrowings, which amount shall be in addition to and in excess of the amount the company is authorized to issue pursuant to Section 366.04, Florida Statutes, which permits the Company to issue short-term securities aggregating not more than five percent of the par value of the Company’s other outstanding securities; and up to (ii) \$1 billion of any combination of equity securities and long-term debt securities and obligations;
- (c) The kind and nature of the securities that Progress Energy Florida, Inc. is authorized to issue during 2005 are equity securities and short-term and long-term debt securities and obligations, as set forth in the Company’s Application.
- (d) Progress Energy Florida, Inc. shall file a Consummation Report in accordance with Rule 25-8.009, Florida Administrative Code, within 90 days after the close of the 2005 calendar year

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Respectfully submitted this
28th day of October, 2004

PROGRESS ENERGY FLORIDA, INC.

By: 

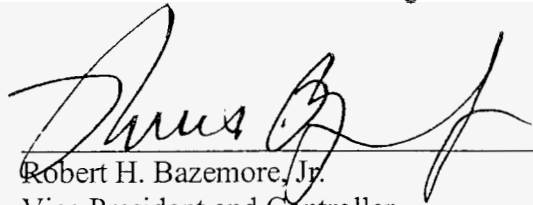
Thomas R. Sullivan
Treasurer

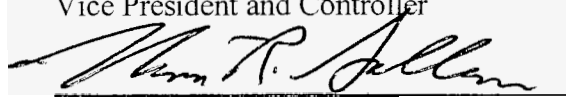
[Signature page for Progress Energy Florida's 2005 Application for Authority to Issue and Sell Securities]

STATE OF NORTH CAROLINA)
)
COUNTY OF WAKE)

CERTIFICATION OF APPLICATION AND EXHIBITS

Each of the undersigned, Robert H. Bazemore, Jr. and Thomas R. Sullivan, being first duly sworn, deposes and says that he is the Vice President and Controller, and the Treasurer, respectively, of PROGRESS ENERGY FLORIDA, INC., the Applicant herein; that he/she has read the foregoing application and exhibits of said Progress Energy Florida, Inc. and knows the contents thereof; and certifies that the same are true and correct to the best of his/her knowledge and belief.

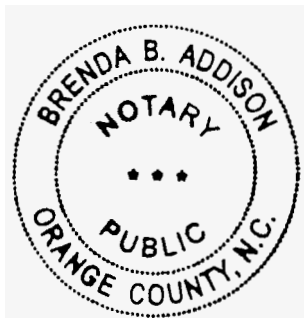

Robert H. Bazemore, Jr.
Vice President and Controller

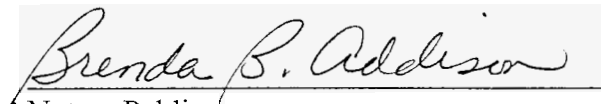

Thomas R. Sullivan
Treasurer

STATE OF NORTH CAROLINA)
)
COUNTY OF WAKE)

The foregoing instrument was acknowledged before me this 28th day of October, 2004, by Robert H. Bazemore, Jr. and Thomas R. Sullivan, who are personally known to me and who did take an oath.

(Seal)




Notary Public

Brenda B. Addison
Printed Name
My Commission Expires: 5/19/2009

INDEPENDENT AUDITORS' REPORT

TO THE BOARDS OF DIRECTORS OF FLORIDA PROGRESS CORPORATION AND FLORIDA POWER CORPORATION d/b/a
PROGRESS ENERGY FLORIDA, INC

We have audited the accompanying consolidated balance sheets of Florida Progress Corporation and its subsidiaries (Florida Progress) and the accompanying balance sheets of Florida Power Corporation d/b/a Progress Energy Florida, Inc. (PEF) at December 31, 2003 and 2002, and the related Florida Progress consolidated statements of income and comprehensive income, of common equity, and of cash flows and the related PEF statements of income and comprehensive income, of common equity, and of cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the respective company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Florida Progress and of PEF, respectively, at December 31, 2003 and 2002, and the results of their respective operations and cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 5F to the financial statements, in 2003, the Companies adopted Statement of Financial Accounting Standards No. 143.

/s/ DELOITTE & TOUCHE LLP
Raleigh, North Carolina
February 20, 2004

FLORIDA PROGRESS CORPORATION
CONSOLIDATED STATEMENTS of INCOME AND COMPREHENSIVE INCOME

(In millions)	Years ended December 31		
	2003	2002	2001
Operating Revenues			
Utility	\$ 3,152	\$ 3,062	\$ 3,213
Diversified business	1,856	1,438	1,367
Total Operating Revenues	5,008	4,500	4,580
Operating Expenses			
Utility			
Fuel used in electric generation	870	834	905
Purchased power	566	515	515
Operation and maintenance	640	591	495
Depreciation and amortization	307	295	453
Taxes other than on income	241	228	230
Diversified business			
Cost of sales	1,635	1,343	1,351
Depreciation and amortization	92	66	69
Impairment of long-lived assets	15	281	161
Other	137	94	92
Total Operating Expenses	4,503	4,247	4,271
Operating Income	505	253	309
Other Income (Expense)			
Interest income	3	7	9
Other, net	(12)	(20)	(32)
Total Other Income (Expense)	(9)	(13)	(23)
Interest Charges			
Interest charges	169	186	195
Allowance for borrowed funds used during construction	(6)	(3)	(1)
Total Interest Charges, Net	163	183	194
Income before Income Taxes	333	57	92
Income Tax Benefit	(110)	(173)	(173)
Income from Continuing Operations	443	230	265
Discontinued Operations, Net of Tax:			
Income from discontinued operations	-	-	3
Net gain (loss) on disposal of discontinued operations, (net of applicable income tax expenses and benefit of \$2, \$3 and \$8, respectively)	4	5	(24)
Net Income	\$ 447	\$ 235	\$ 244
Change in net unrealized losses on cash flow hedges (net of tax of \$7 and \$4, respectively)	(13)	(6)	
Reclassification adjustment for amounts included in net income (net of tax of \$(6) and \$-, respectively)	11	(1)	
Minimum pension liability adjustment (net of tax of \$(3) and \$3, respectively)	(3)	(5)	
Foreign currency and other	4	(1)	(1)
Comprehensive Income	\$ 446	\$ 222	\$ 243

See Notes to Financial Statements.

FLORIDA PROGRESS CORPORATION
CONSOLIDATED BALANCE SHEETS

<i>(In millions)</i>	<i>December 31</i>	
Assets	2003	2002
Utility Plant		
Utility plant in service	\$ 8,150	\$ 7,477
Accumulated depreciation	(2,845)	(2,672)
Utility plant in service, net	5,305	4,805
Held for future use	8	8
Construction work in progress	328	427
Nuclear fuel, net of amortization	69	40
Total Utility Plant, Net	5,710	5,280
Current Assets		
Cash and cash equivalents	27	34
Accounts receivable	554	385
Unbilled accounts receivable	59	60
Receivables from affiliated companies	27	42
Deferred income taxes	39	26
Inventory	422	492
Deferred fuel cost	204	38
Assets held for sale	75	24
Prepayments and other current assets	70	71
Total Current Assets	1,477	1,172
Deferred Debits and Other Assets		
Regulatory assets	126	130
Unamortized debt expense	33	23
Nuclear decommissioning trust funds	433	374
Diversified business property, net	841	699
Miscellaneous other property and investments	90	83
Prepaid pension cost	223	226
Deferred tax asset	204	67
Other assets and deferred debits	99	84
Total Deferred Debits and Other Assets	2,049	1,686
Total Assets	\$ 9,236	\$ 8,138
Capitalization and Liabilities		
Common Stock Equity		
Common stock without par value	\$ 1,699	\$ 1,629
Retained earnings	842	598
Accumulated other comprehensive loss	(17)	(16)
Total Common Stock Equity	2,524	2,211
Preferred Stock of Subsidiaries - Not Subject to Mandatory Redemption	34	34
Long-Term Debt, Affiliate	809	500
Long-Term Debt, Net	2,045	1,710
Total Capitalization	5,412	4,455
Current Liabilities		
Current portion of long-term debt	68	275
Accounts payable	456	331
Payables to affiliated companies	68	103
Notes payable to affiliated companies	636	380
Short-term obligations	-	257
Customer deposits	127	122
Other current liabilities	287	235
Total Current Liabilities	1,642	1,703
Deferred Credits and Other Liabilities		
Accumulated deferred income taxes and investment tax credits	99	108
Regulatory liabilities	1,348	61
Cost of removal	-	1,452
Asset retirement obligations	339	-
Other liabilities and deferred credits	396	359
Total Deferred Credits and Other Liabilities	2,182	1,980
Commitments and Contingencies (Note 19)		
Total Capitalization and Liabilities	\$ 9,236	\$ 8,138

See Notes to Financial Statements.

FLORIDA PROGRESS CORPORATION
CONSOLIDATED STATEMENTS of CASH FLOWS

<i>(In millions)</i>	<i>Years ended December 31</i>		
	2003	2002	2001
Operating Activities			
Net income	\$ 447	\$ 235	\$ 244
Adjustments to reconcile net income to net cash provided by operating activities:			
Income from discontinued operations	-	-	(3)
Net (gain) loss on disposal of discontinued operations	(4)	(5)	24
Impairment of long-lived assets	15	281	161
Depreciation and amortization	405	386	538
Deferred income taxes and investment tax credits, net	(134)	(239)	(202)
Deferred fuel cost (credit)	(167)	(22)	75
Cash provided/(used) by changes in operating assets and liabilities:			
Accounts receivable	(128)	(34)	40
Inventories	72	(40)	(132)
Prepayments and other current assets	1	(12)	(11)
Accounts payable	101	39	56
Other current liabilities	59	29	217
Other	(3)	63	(56)
Net Cash Provided by Operating Activities	664	681	951
Investing Activities			
Utility property additions	(548)	(550)	(353)
Diversified business property additions	(424)	(154)	(133)
Nuclear fuel additions	(51)		(43)
Net contributions to nuclear decommissioning trust	-	12	(20)
Acquisition, net of cash acquired	-	(17)	-
Proceeds from sale of discontinued operations	-	8	28
Proceeds from sale of subsidiaries and assets	100	35	25
Other	(15)	9	(7)
Net Cash Used in Investing Activities	(938)	(657)	(503)
Financing Activities			
Proceeds from issuance of long-term debt	935	236	299
Proceeds from issuance of long-term debt to parent	-		500
Net increase (decrease) in short-term obligations	(258)	103	(813)
Retirement of long-term debt	(534)	(350)	(191)
Net increase (decrease) in intercompany notes	258	233	(102)
Equity contributions from parent	168	87	90
Dividends paid to parent	(301)	(303)	(249)
Other	(1)	(1)	(1)
Net Cash Provided by (Used in) Financing Activities	267	5	(467)
Net Increase (Decrease) in Cash and Cash Equivalents	(7)	29	(19)
Cash and Cash Equivalents at Beginning of Year	34	5	24
Cash and Cash Equivalents at End of Year	\$ 27	\$ 34	\$ 5
Supplemental Disclosures of Cash Flow Information			
Cash paid during the year – interest (net of amount capitalized)	\$ 159	\$ 180	\$ 170
income taxes (net of refunds)	\$ 32	\$ 60	\$ (4)

Noncash Activities

- In April 2002 Progress Fuels Corporation received an equity contribution from Progress Energy, Inc., with which it acquired 100% of Westchester Gas Company. In conjunction with the purchase, Progress Energy, Inc. issued approximately \$129 million in common stock (See Note 4C).
- In December 2003, Progress Telecommunications Corporation (PTC) and Caronet, Inc. both indirectly wholly-owned subsidiaries of Progress Energy, and EPIK Communications, Inc., a wholly-owned subsidiary of Odyssey Telecorp, Inc., contributed substantially all of their assets and transferred certain liabilities to Progress Telecom, LLC, a subsidiary of PTC (See Note 4A).

See Notes to Financial Statements.

FLORIDA PROGRESS CORPORATION
CONSOLIDATED STATEMENTS of COMMON EQUITY

<i>(In millions)</i>	<i>Years ended December 31</i>		
	2003	2002	2001
	\$ 2,211	\$ 2,072	\$ 1,988
<i>Beginning Balance</i>			
Net income	447	235	244
Other comprehensive income (loss)	(1)	(13)	(1)
Equity contribution from parent, net	168	220	90
Dividend to parent	(301)	(303)	(249)
	\$ 2,524	\$ 2,211	\$ 2,072
<i>Ending Balance</i>			

CONSOLIDATED QUARTERLY FINANCIAL DATA (UNAUDITED)

<i>(In millions)</i>	<i>First Quarter</i>	<i>Second Quarter</i>	<i>Third Quarter</i>	<i>Fourth Quarter</i>
Year ended December 31, 2003				
Operating revenues	\$ 1,214	\$ 1,207	\$ 1,392	\$ 1,195
Operating income	126	122	193	64
Net income	92	114	174	67
Year ended December 31, 2002				
Operating revenues	\$ 1,005	\$ 1,145	\$ 1,226	\$ 1,124
Operating income (loss)	105	130	(42)	60
Net income (loss)	76	90	(52)	121

- In the opinion of management, all adjustments necessary to fairly present amounts shown for interim periods have been made. Results of operations for an interim period may not give a true indication of results for the year. Certain reclassifications have been made to previously reported amounts to conform to the current year's presentation. Amounts for 2003 were restated for the removal of reporting results for certain Energy and Related Service segment operations one month in arrears (See Note 1B).
- Fourth quarter 2003 includes impairment related to Kentucky May of \$15 million (\$10 million after-tax) (See Note 9).
- Third quarter 2002 includes impairment and other charges related to Progress Telecommunications Corporation, of \$233 million (\$137 million after-tax) (See Note 9).
- Fourth quarter 2002 includes estimated impairment on assets held for sale of Railcar Ltd. of \$67 million (\$45 million after-tax) (See Note 3B).

See Notes to Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA
STATEMENTS of INCOME AND COMPREHENSIVE INCOME

<i>(In millions)</i>	<i>Years ended December 31</i>		
	2003	2002	2001
Operating Revenues – Utility	\$ 3,152	\$ 3,062	\$ 3,213
Operating Expenses			
Fuel used in electric generation	870	834	905
Purchased power	566	515	515
Operation and maintenance	640	591	495
Depreciation and amortization	307	295	453
Taxes other than on income	241	228	230
Total Operating Expenses	2,624	2,463	2,598
Operating Income	528	599	615
Other Income (Expense)			
Interest income	-	2	3
Other, net	7	(7)	(11)
Total Other Income (Expense)	7	(5)	(8)
Interest Charges			
Interest charges	97	109	114
Allowance for borrowed funds used during construction	(6)	(3)	(1)
Total Interest Charges, Net	91	106	113
Income before Income Taxes	444	488	494
Income Tax Expense	147		
Net Income	297		
Dividends on Preferred Stock	2	2	2
Earnings for Common Stock	\$ 295	\$ 323	\$ 309
Comprehensive Income, Net of Tax:			
Net Income	\$ 297	\$ 325	\$ 311
Minimum pension liability adjustment (net of tax of \$1 and \$1, respectively)	(1)	(3)	
Comprehensive Income	\$ 296	\$ 322	\$ 311

See Notes to Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA
BALANCE SHEETS

<i>(In millions)</i>	<i>December 31</i>	
Assets	2003	2002
Utility Plant		
Utility plant in service	\$ 8,150	\$ 7,477
Accumulated depreciation	(2,845)	(2,672)
Utility plant in service, net	5,305	4,805
Held for future use	8	8
Construction work in progress	328	427
Nuclear fuel, net of amortization	69	40
Total Utility Plant, Net	5,710	5,280
Current Assets		
Cash and cash equivalents	10	16
Accounts receivable	191	187
Unbilled accounts receivable	59	60
Receivables from affiliated companies	7	45
Deferred income taxes	39	26
Inventory	230	235
Deferred fuel cost	204	38
Prepayments and other current assets	6	5
Total Current Assets	746	612
Deferred Debits and Other Assets		
Regulatory assets	126	130
Unamortized debt expense	25	14
Nuclear decommissioning trust funds	433	374
Miscellaneous other property and investments	40	39
Prepaid pension cost	220	223
Other assets and deferred debits	6	6
Total Deferred Debits and Other Assets	850	786
Total Assets	\$ 7,306	\$ 6,678
Capitalization and Liabilities		
Common Stock Equity		
Common stock without par value	\$ 1,081	\$ 1,081
Retained earnings	1,062	970
Accumulated other comprehensive loss	(4)	(3)
Total Common Stock Equity	2,139	2,048
Preferred stock - not subject to mandatory redemption	34	34
Long-term debt, net	1,904	1,244
Total Capitalization	4,077	3,326
Current Liabilities		
Current portion of long-term debt	43	217
Accounts payable	161	148
Payables to affiliated companies	75	89
Notes payable to affiliated companies	363	237
Short-term obligations	-	257
Customer deposits	127	122
Other current liabilities	147	136
Total Current Liabilities	916	1,206
Deferred Credits and Other Liabilities		
Accumulated deferred income taxes	363	361
Accumulated deferred investment tax credits	41	47
Regulatory liabilities	1,348	61
Cost of removal	-	1,452
Asset retirement obligations	319	-
Other liabilities and deferred credits	242	225
Total Deferred Credits and Other Liabilities	2,313	2,146
Commitments and Contingencies (Note 19)		
Total Capitalization and Liabilities	\$ 7,306	\$ 6,678

See Notes to Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA
STATEMENTS of CASH FLOWS

<i>(In millions)</i>	<i>Years ended December 31</i>		
	2003	2002	2001
Operating Activities			
Net income	\$ 297	\$ 325	\$ 311
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	314	321	467
Deferred income taxes and investment tax credits, net	(25)	(38)	(41)
Deferred fuel (credit) cost	(167)	(22)	75
Cash provided/(used) by changes in operating assets and liabilities:			
Accounts receivable	34	(27)	32
Inventories	5	(46)	(50)
Prepayments and other current assets	-	(1)	5
Accounts payable	(10)	(104)	131
Other current liabilities	29	15	108
Other	(7)	11	(110)
Net Cash Provided by Operating Activities	470	434	928
Investing Activities			
Property additions	(548)	(550)	(353)
Nuclear fuel additions	(51)	-	(43)
Net contributions to nuclear decommissioning trust	-	12	(20)
Other	(1)	6	7
Net Cash Used in Investing Activities	(600)	(532)	(409)
Financing Activities			
Proceeds from issuance of long-term debt	935	236	298
Net increase (decrease) in short-term obligations	(258)	103	(238)
Retirement of long-term debt	(476)	(278)	(82)
Net increase (decrease) in intercompany notes	126	358	(109)
Advances to parent	-	-	(140)
Dividends paid to parent	(203)	(303)	(249)
Dividends paid on preferred stock	(2)	(2)	(2)
Other	2	-	-
Net Cash Provided by (Used in) Financing Activities	124	114	(522)
Net Increase (Decrease) in Cash and Cash Equivalents	(6)	16	(3)
Cash and Cash Equivalents at Beginning of Year	16	-	3
Cash and Cash Equivalents at End of Year	\$ 10	\$ 16	\$ -
Supplemental Disclosures of Cash Flow Information			
Cash paid during the year – interest (net of amount capitalized)	\$ 85	\$ 106	\$ 106
income taxes (net of refunds)	\$ 177	\$ 173	\$ 211

See Notes to Financial Statements

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA
STATEMENTS of COMMON EQUITY

<i>(In millions)</i>	<i>Years ended December 31</i>		
	2003	2002	2001
	\$ 2,048	\$ 2,031	\$ 1,965
<i>Beginning Balance</i>			
Net income	297	325	311
Preferred stock dividends at stated rates	(2)	(2)	(2)
Other comprehensive loss	(1)	(3)	-
Equity contribution from parent	-	-	6
Dividends paid to parent	(203)	(303)	(249)
	\$ 2,139	\$ 2,048	\$ 2,031
<i>Ending Balance</i>			

QUARTERLY FINANCIAL DATA (UNAUDITED)

<i>(In millions)</i>	<i>First Quarter</i>	<i>Second Quarter</i>	<i>Third Quarter</i>	<i>Fourth Quarter</i>
Year ended December 31, 2003				
Operating revenues	\$ 728	\$ 767	\$ 904	\$ 753
Operating income	135	116	184	93
Net income	71	62	115	49
Year ended December 31, 2002				
Operating revenues	\$ 686	\$ 766	\$ 864	\$ 746
Operating income	120	151	207	121
Net income	58	77	124	66

In the opinion of management, all adjustments necessary to fairly present amounts shown for interim periods have been made. Results of operations for an interim period may not give a true indication of results for the year. Certain reclassifications have been made to previously reported amounts to conform to the current year's presentation.

See Notes to Financial Statements.

FLORIDA PROGRESS CORPORATION AND PROGRESS ENERGY FLORIDA NOTES TO FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies

A. Organization

Florida Progress Corporation (the Company or Florida Progress) is a holding company under the Public Utility Holding Company Act of 1935 (PUHCA). The Company became subject to the regulations of PUHCA when it was acquired by CP&L Energy, Inc. in November 2000. CP&L Energy, Inc. subsequently changed its name to Progress Energy, Inc. (Progress Energy or the Parent). Florida Progress' two primary subsidiaries are Florida Power Corporation (Progress Energy Florida or PEF) and Progress Fuels Corporation (Progress Fuels). Effective January 1, 2003, Florida Power Corporation began doing business under the assumed name Progress Energy Florida, Inc. The legal name of the entity has not changed. The current corporate and business unit structure remains unchanged. Throughout the report, the terms utility and regulated will be used to discuss items pertaining to Progress Energy Florida. Diversified business and nonregulated will be used to discuss the subsidiaries of Florida Progress excluding Progress Energy Florida.

B. Basis of Presentation

The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The financial statements include the financial results of the Company and its majority-owned subsidiaries. Significant intercompany balances and transactions have been eliminated in consolidation except as permitted by Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation," which provides that profits on intercompany sales to regulated affiliates are not eliminated if the sales price is reasonable and the future recovery of the sales price through the ratemaking process is probable.

Unconsolidated investments in companies over which the Company does not have control, but has the ability to exercise significant influence over operating and financial policies (generally 20% - 50% ownership), are accounted for under the equity method of accounting. Other investments are stated principally at cost. These equity and cost investments, which total approximately \$22 and \$14 million at December 31, 2003 and 2002, respectively, are included in miscellaneous property and investments on the Company's Consolidated Balance Sheets. The primary components of this balance are the Company's investment in FPC Capital I of \$9 million in 2003 and the Company's investment in affordable housing of \$8 and \$9 million at December 31, 2003 and 2002, respectively.

The results of operations of the Rail Services segment are reported one month in arrears. During 2003, the Company ceased recording portions of the Energy and Related Services segment operations one month in arrears. The net impact of this action increased net income by \$2 million for the year.

Certain amounts for 2002 and 2001 have been reclassified to conform to the 2003 presentation.

C. Significant Accounting Policies

Use of Estimates and Assumptions

In preparing financial statements that conform with GAAP, management must make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses reflected during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

The Company recognizes electric utility revenues as service is rendered to customers. Operating revenues include unbilled electric utility revenues earned when service has been delivered but not billed by the end of the accounting period. Diversified business revenues are recognized at the time products are shipped or as services are rendered. Leasing activities are accounted for in accordance with SFAS No. 13, "Accounting for Leases." Revenues relating to design and construction of wireless infrastructure are recognized upon completion of services for each completed phase of design and construction. Revenues from the sale of oil and gas production are recognized when title passes, net of royalties.

Fuel Cost Deferrals

Fuel expense includes fuel costs or recoveries that are deferred through fuel clauses established by the regulators of PEF. Those clauses allow PEF to recover fuel costs and portions of purchased power costs through surcharges on customer rates.

Excise Taxes

The Company collects from customers certain excise taxes levied by the state or local government upon the customer. PEF accounts for excise taxes on a gross basis. For the years ended December 31, 2003, 2002 and 2001, gross receipts tax and franchise taxes of approximately \$136 million, \$132 million and \$133 million, respectively, are included in taxes other than on income on the accompanying Statements of Income and Comprehensive Income. These approximate amounts are also included in electric operating revenues.

Income Taxes

Progress Energy and its affiliates file a consolidated federal income tax return. The consolidated income tax of Progress Energy is allocated to Florida Progress and PEF in accordance with the Intercompany Income Tax Allocation Agreement (Tax Agreement). The Tax Agreement provides an allocation that recognizes positive and negative corporate taxable income. The Tax Agreement provides for an equitable method of apportioning the carry over of uncompensated tax benefits. Progress Energy tax benefits not related to acquisition interest expense are allocated to profitable subsidiaries, beginning in 2002, in accordance with a PUHCA order. Income taxes are provided as if Florida Progress and PEF filed separate returns.

Deferred income taxes have been provided for temporary differences. These occur when there are differences between the book and tax bases of assets and liabilities. Investment tax credits related to regulated operations have been deferred and are being amortized over the estimated service life of the related properties. Credits for the production and sale of synthetic fuel are deferred to the extent they cannot be or have not been utilized in the annual consolidated federal income tax returns (See Note 13).

Stock-Based Compensation

The Company measures compensation expense for stock options as the difference between the market price of its common stock and the exercise price of the option at the grant date. The exercise price at which options are granted by the Company equals the market price at the grant date, and accordingly, no compensation expense has been recognized for stock option grants. For purposes of the pro forma disclosures required by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure – an Amendment of FASB Statement No. 123," the estimated fair value of Progress Energy's stock options is amortized to expense over the options' vesting period. The following table illustrates the effect on net income for Florida Progress Corporation and PEF if the fair value method had been applied to all outstanding and unvested awards in each period:

(in millions)

	2003	2002	2001
Florida Progress			
Net income, as reported	<u>\$ 447</u>	<u>\$ 235</u>	<u>\$ 244</u>
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	<u>3</u>	<u>3</u>	<u>-</u>
Pro forma net income	<u><u>\$ 444</u></u>	<u><u>\$ 232</u></u>	<u><u>\$ 244</u></u>

(in millions)

Progress Energy Florida	2003	2002	2001
Net income, as reported	\$ 297	\$ 325	\$ 311
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	2	2	
Pro forma net income	\$ 295	\$ 323	\$ 311

Utility Plant

Utility plant in service is stated at historical cost less accumulated depreciation. The Company capitalizes all construction-related direct labor and material costs of units of property as well as indirect construction costs. The cost of renewals and betterments is also capitalized. Maintenance and repairs of property, and replacements and renewals of items determined to be less than units of property, are charged to maintenance expense as incurred. The cost of units of property replaced or retired, less salvage, is charged to accumulated depreciation. Removal, disposal and decommission costs were charged to regulatory liabilities in 2003 and cost of removal in 2002. The Company follows the guidance in SFAS No. 143, "Accounting for Asset Retirement Obligations," to account for legal obligations associated with the retirement of certain tangible long-lived assets.

Depreciation and Amortization – Utility Plant

For financial reporting purposes, substantially all depreciation of utility plant other than nuclear fuel is computed on the straight-line method based on the estimated remaining useful life of the property, adjusted for estimated salvage (See Note 5A). The Florida Public Service Commission (FPSC) can also grant approval to accelerate or reduce depreciation and amortization of utility assets (See Note 7).

Amortization of nuclear fuel costs, including disposal costs associated with obligations to the U.S. Department of Energy (DOE) and costs associated with obligations to the DOE for the decommissioning and decontamination of enrichment facilities is computed primarily on the units-of-production method and charged to fuel used in electric generation in the accompanying Statements of Income and Comprehensive Income. In the Company's retail jurisdictions, provisions for nuclear decommissioning costs are approved by the FPSC and are based on site-specific estimates that include the costs for removal of all radioactive and other structures at the site. In the wholesale jurisdictions, the provisions for nuclear decommissioning costs are approved by the Federal Energy Regulatory Commission (FERC).

Cash and Cash Equivalents

The Company considers cash and cash equivalents to include cash on hand, cash in banks and temporary investments purchased with a maturity of three months or less.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts receivable, which totaled approximately \$15 million and \$28 million at December 31, 2003 and 2002, respectively, and is included in the accounts receivable balance in the accompanying Consolidated Balance Sheets. PEF's allowance for doubtful accounts receivable totaled \$2 million at December 31, 2003 and 2002 and is included in the accounts receivable balance in the Balance Sheets.

Inventory

The Company accounts for inventory using the average-cost method.

Regulatory Assets and Liabilities

PEF's regulated operations are subject to SFAS No. 71, which allows a regulated company to record costs that have been or are expected to be allowed in the ratemaking process in a period different from the period in which the costs would be charged to expense by a nonregulated enterprise. Accordingly, PEF records assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for nonregulated entities. These regulatory assets and liabilities represent expenses deferred for future recovery from customers or obligations to be refunded to customers and are primarily classified in the Balance Sheets as regulatory assets and regulatory liabilities (See Note 7A).

Diversified Business Property

Diversified business property is stated at cost less accumulated depreciation. If an impairment loss is recognized on an asset, the fair value becomes its new cost basis. The costs of renewals and betterments are capitalized. The cost of repairs and maintenance is charged to expense as incurred. Depreciation is computed on a straight-line basis over the estimated useful lives as indicated in Note 5B. Depletion of mineral rights is provided on the units-of-production method based upon the estimates of recoverable amounts of clean mineral.

The Company uses the full cost method to account for its natural gas and oil properties. Under the full cost method, substantially all productive and nonproductive costs incurred in connection with the acquisition, exploration and development of natural gas and oil reserves are capitalized. These capitalized costs include the costs of all unproved properties and internal costs directly related to acquisition and exploration activities. The amortization base also includes the estimated future costs to develop proved reserves. Except for costs on unproved properties and major development projects in progress, all costs are amortized using the units-of-production method over the life of the Company's proved reserves.

Goodwill and Intangible Assets

Effective January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142), and no longer amortizes goodwill. Instead, goodwill is subject to at least an annual assessment for impairment by applying a two-step fair value-based test. This assessment could result in periodic impairment charges. Prior to the adoption of SFAS No. 142, the Company amortized goodwill on a straight-line basis over a period not exceeding 40 years. Intangible assets are being amortized based on the economic benefit of their respective lives.

Unamortized Debt Premiums, Discounts and Expenses

Long-term debt premiums, discounts and issuance expenses of PEF are amortized over the life of the related debt using the straight-line method. Any expenses or call premiums associated with the reacquisition of debt obligations by PEF are amortized over the applicable life using the straight-line method consistent with ratemaking treatment.

Derivatives

Effective January 1, 2001, the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138 and SFAS No. 149. SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. SFAS No. 133 requires that an entity recognize all derivatives as assets or liabilities in the balance sheet and measure those instruments at fair value (See Note 15).

Environmental

The Company accrues environmental remediation liabilities when the criteria for SFAS No. 5, "Accounting for Contingencies," have been met. Environmental expenditures are expensed as incurred or capitalized depending on their future economic benefit. Expenditures that relate to an existing condition caused by past operations and that have no future economic benefits are expensed. Accruals for estimated losses from environmental remediation obligations generally are recognized no later than completion of the remedial feasibility study. Such accruals are adjusted as additional information develops or circumstances change. Costs of future expenditures for environmental remediation obligations are not discounted to their present value. Recoveries of environmental remediation costs from other parties are recognized when their receipt is deemed probable.

Impairment of Long-lived Assets and Investments

The Company reviews the recoverability of long-lived tangible and intangible assets whenever indicators exist. Examples of these indicators include current period losses, combined with a history of losses or a projection of continuing losses, or a significant decrease in the market price of a long-lived asset group. If an indicator exists, then the asset group is tested for recoverability by comparing the carrying value to the sum of undiscounted expected future cash flows directly attributable to the asset group. If the asset group is not recoverable through undiscounted cash flows, then an impairment loss is recognized for the difference between the carrying value and the fair value of the asset group. The accounting for impairment of long-lived assets is based on SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which was adopted by the Company effective January 1, 2002. Prior to the adoption of this standard, impairments were accounted for under SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," which was superseded by SFAS No. 144.

The Company reviews its investments to evaluate whether or not a decline in fair value below the carrying value is an other-than-temporary decline. The Company considers various factors, such as the investee's cash position, earnings and revenue outlook, liquidity and management's ability to raise capital in determining whether the decline is other-than-temporary. If the Company determines that other-than-temporary decline exists in the value of its investments, it is the Company's policy to write-down these investments to fair value. See Note 9 for a discussion of impairment evaluations performed and charges taken.

Under the full cost method of accounting for natural gas and oil properties, total capitalized costs are limited to a ceiling based on the present value of discounted (at 10%) future net revenues using current prices, plus the lower of cost or fair market value of unproved properties. If the ceiling (discounted revenues) is not equal to or greater than total capitalized costs, the Company is required to write-down capitalized costs to this level. The Company performs this ceiling test calculation every quarter. No write-downs were required in 2003, 2002 or 2001.

Subsidiary Stock Transactions

Gains and losses realized as a result of common stock sales by the Company's subsidiaries are recorded in the Company's Consolidated Statements of Income and Comprehensive Income, except for any transactions that must be credited directly to equity in accordance with the provisions of SAB No. 51, "Accounting for Sales of Stock by a Subsidiary".

2. Impact of New Accounting Standards

SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity"

In May 2003, the Financial Accounting Standard Board (FASB) issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." The adoption of SFAS No. 150 did not have an impact on the Company's financial position or results of operations as of and for the periods ended December 31, 2003.

EITF Issue No. 03-04, "Accounting for 'Cash Balance' Pension Plans"

In May 2003, the FASB Emerging Issues Task Force (EITF) reached consensus in EITF Issue No. 03-04, "Accounting for 'Cash Balance' Pension Plans" (EITF 03-04), to specifically address the accounting for certain cash balance pension plans. The consensus reached in EITF 03-04 requires certain cash balance pension plans to be accounted for as defined benefit plans. For cash balance plans described in the consensus, the consensus also requires the use of the traditional unit credit method for purposes of measuring the benefit obligation and annual cost of benefits earned as opposed to the projected unit credit method. The Company has historically accounted for its cash balance plan as a defined benefit plan; however, the Company was required to adopt the measurement provisions of EITF 03-04 at its cash balance plan's measurement date of December 31, 2003. Any differences in the measurement of the obligations as a result of applying the consensus were reported as a component of actuarial gain or loss. The on-going effects of this standard are dependent on other factors that also affect the determination of actuarial gains and losses and the subsequent amortization of such gains and losses. However, the adoption of EITF 03-04 is not expected to have a material effect on the Company's results of operations or financial position.

SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities"

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." The statement amends and clarifies SFAS No. 133 on accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. The new guidance incorporates decisions made as part of the Derivatives Implementation Group (DIG) process, as well as decisions regarding implementation issues raised in relation to the application of the definition of a derivative. SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003. Interpretations and implementation issues with regard to SFAS No. 149 continue to evolve. The statement had no significant impact on the Company's accounting for contracts entered into subsequent to the statement's effective date (See Note 15). Future effects, if any, on the Company's results of operations and financial condition will be dependent on the specifics of future contracts entered into with regard to guidance provided by the statement.

FIN No. 46, "Consolidation of Variable Interest Entities"

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51" (FIN No. 46). This interpretation provides guidance related to identifying variable interest entities and determining whether such entities should be consolidated. FIN No. 46 requires an

enterprise to consolidate a variable interest entity when the enterprise (a) absorbs a majority of the variable interest entity's expected losses, (b) receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity. Prior to the effective date of FIN No. 46, entities were generally consolidated by an enterprise that had control through ownership of a majority voting interest in the entity. FIN No. 46 originally applied immediately to variable interest entities created or obtained after January 31, 2003. During 2003, the Company did not participate in the creation of, or obtain a new variable interest in, any variable interest entity. In December 2003, the FASB issued a revision to FIN No. 46 (FIN No. 46R), which modified certain requirements of FIN No. 46 and allowed for the optional deferral of the effective date of FIN No. 46R until March 31, 2004. However, entities subject to FIN No. 46R that are deemed to be special-purpose entities (as defined in FIN No. 46R) must implement either FIN No. 46 or FIN No. 46R at December 31, 2003. The Company has elected to apply FIN No. 46 to special-purpose entities as of December 31, 2003. Because the Company expects additional transitional guidance to be issued, it has elected to apply FIN No. 46R to non-special-purpose entities as of March 31, 2004.

Prior to the adoption of FIN No. 46, the Company consolidated the FPC Capital I trust (the Trust), which holds FPC-obligated mandatorily redeemable preferred securities (See Note 11F). The Trust is a special-purpose entity as defined in FIN No. 46R, and therefore the Company applied FIN No. 46 to the Trust at December 31, 2003. The Trust is a variable interest entity, but the Company does not absorb a majority of the Trust's expected losses and therefore is not its primary beneficiary. Therefore, the Company deconsolidated the Trust at December 31, 2003. This deconsolidation resulted in recording an additional equity investment in the Trust of approximately \$9 million and an increase in outstanding debt of \$9 million. See Note 11F for a discussion of the Company's guarantees with the Trust.

The Company also has interests in several other variable interest entities created before January 31, 2003, for which the Company is not the primary beneficiary. These arrangements include equity investments in approximately six limited partnerships, limited liability corporations and venture capital funds. The aggregate maximum loss exposure at December 31, 2003 under these arrangements totals approximately \$11 million. The creditors of these variable interest entities do not have recourse to the general credit of the Company in excess of the aggregate maximum loss exposure.

In February 2004, the Company became aware that certain long-term purchase power and tolling contracts may be considered variable interests under FIN No. 46R. The Company has various long-term purchase power and tolling contracts with other utilities and certain qualifying facility plants. The Company believes the counterparties to these contracts are not special-purpose entities and, therefore, FIN No. 46R would not apply to these contracts until March 31, 2004. The Company has not yet completed its evaluation of these contracts to determine if the Company needs to consolidate these counterparties under FIN No. 46R and will continue to monitor developing practice in this area.

3. Divestitures

Mesa Hydrocarbons, Inc. Divestiture

In October 2003, the Company sold certain gas-producing properties owned by Mesa Hydrocarbons, LLC, a wholly-owned subsidiary of Progress Fuels Corporation, which is included in the Fuels segment. Net proceeds of approximately \$97 million were used to reduce debt. Because the Company utilizes the full cost method of accounting for its oil and gas operations, the pre-tax gain of approximately \$18 million was applied to reduce the basis of the Company's other U.S. oil and gas investments and will prospectively result in a reduction of the amortization rate applied to those investments as production occurs.

Railcar Ltd. Divestiture

In December 2002, the Progress Energy Board of Directors adopted a resolution approving the sale of Railcar Ltd., a subsidiary included in the Rail Services segment. In accordance with SFAS No. 144, an estimated pre-tax impairment of \$67 million on assets held for sale was recognized in December 2002 to write-down the assets to fair value less costs to sell. This impairment has been included in impairment of long-lived assets in the Company's Consolidated Statements of Income and Comprehensive Income (See Note 9).

The assets of Railcar Ltd. have been grouped as assets held for sale and are included in other current assets on the Company's Consolidated Balance Sheets at December 31, 2003 and 2002. The assets are recorded at approximately \$75 million and \$24 million at December 31, 2003 and 2002, respectively, which reflects the

Company's estimates of the fair value expected to be realized from the sale of these assets less costs to sell. The primary component of assets held for sale at December 31, 2003 was property and equipment of \$74 million. The primary component of assets held for sale at December 31, 2002 was current assets of \$22 million. The net increase in assets held for sale from December 31, 2002 to December 31, 2003 was primarily attributable to the purchase of railcars in 2003 that were subject to off-balance sheet obligations at December 31, 2002. In addition to the assets held for sale, the Company is subject to certain commitments under operating leases (See Note 19).

In March 2003, the Company signed a letter of intent to sell the majority of Railcar Ltd. assets to The Andersons, Inc. In November 2003, the asset purchase agreement was signed, and the transaction closed in February 2004. Proceeds from the sale were approximately \$82 million. The Company was relieved of the majority of the operating lease commitments when the assets were sold.

Inland Marine Transportation Divestiture

In July 2001, Progress Energy announced the disposition of the Inland Marine Transportation segment of the Company, which was operated by MEMCO Barge Line, Inc. Inland Marine provided transportation of coal, agricultural and other dry-bulk commodities as well as fleet management services. Progress Energy entered into a contract to sell MEMCO Barge Line, Inc., to AEP Resources, Inc., a wholly-owned subsidiary of American Electric Power. In November 2001, the Company completed the sale of the Inland Marine Transportation segment. The results of operations for 2001 have been restated for the discontinued operations of the Inland Marine Transportation segment. The net income of these operations is reported in the Company's Consolidated Statements of Income and Comprehensive Income as discontinued operations.

Results of discontinued operations for year ended December 31, 2001, were as follows in millions:

Revenues	\$ 143
Earnings before income taxes	5
Income taxes	<u>2</u>
Net earnings	3
Loss on disposal of discontinued operations, including provision of \$5 for pre-tax operating income during phase-out period (net of applicable income tax benefit of \$8)	<u>(24)</u>
Loss from discontinued operations	<u>\$ (21)</u>

The net gain on disposal of discontinued operations in the Company's Consolidated Statements of Income and Comprehensive Income for year ended December 31, 2002, represents the after-tax gain from the resolution of approximately \$5 million of contingencies in the purchase agreement of the Inland Marine Transportation segment. In connection with the sale, the Company entered into environmental indemnification provisions covering both unknown and known sites. In 2003, the Company reduced the estimate for the environmental accrual by \$6 million, which is included as discontinued operations in the Company's Consolidated Statements of Income and Comprehensive Income (See Note 19E).

4. Acquisitions and Business Combinations

A. Progress Telecommunications Corporation

In December 2003, Progress Telecommunications Corporation (PTC) and Caronet, Inc. (Caronet), both wholly-owned subsidiaries of Progress Energy, and EPIK Communications, Inc. (EPIK), a wholly-owned subsidiary of Odyssey Telecorp, Inc. (Odyssey), contributed substantially all of their assets and transferred certain liabilities to Progress Telecom, LLC (PTC LLC), a subsidiary of PTC. Subsequently, the stock of Caronet was sold to an affiliate of Odyssey for \$2 million in cash and Caronet become a wholly-owned subsidiary of Odyssey. Following consummation of all the transactions described above, PTC holds a 55% ownership interest in, and is the parent of PTC LLC. ~~Odyssey holds a combined 45% ownership interest in PTC LLC through EPIK and Caronet.~~ The accounts of PTC LLC are included in the Company's Consolidated Financial Statements since the transaction date. The minority interest is included in other liabilities and deferred credits in the Company's Consolidated Balance Sheets.

The transaction was accounted for as a partial acquisition of EPIK through the issuance of the stock of a consolidated subsidiary. The contributions of PTC's and Caronet's net assets were recorded at their carrying

values of approximately \$31 million. EPIK's contribution was recorded at its estimated fair value of \$22 million using the purchase method, and was initially allocated as follows: property and equipment - \$27 million; other current assets - \$9 million; current liabilities - \$21 million; and goodwill - \$7 million. The goodwill was assigned to the Company's Other business segment and will not be deductible for tax purposes. The purchase price allocation is a preliminary estimate, based on available information, internal estimates and certain assumptions management believes are reasonable. Accordingly, the purchase price allocation is subject to finalization in 2004 pending the completion of internal and external appraisals of assets acquired. No gain or loss was recognized on the transaction. The pro forma results of operations reflecting the acquisition would not be materially different than the reported results of operations for the years ended December 31, 2003 or 2002.

B. Acquisition of Natural Gas Reserves

During 2003, Progress Fuels Corporation entered into several independent transactions to acquire approximately 200 natural gas-producing wells with proven reserves of approximately 190 billion cubic feet (Bcf) from Republic Energy, Inc. and three other privately-owned companies, all headquartered in Texas. The total cash purchase price for the transactions was \$168 million.

C. Westchester Acquisition

In April 2002, Progress Fuels acquired 100% of Westchester Gas Company (Westchester). The acquisition included approximately 215 natural gas-producing wells, 52 miles of intrastate gas pipeline and 170 miles of gas-gathering systems located within a 25-miles radius of Jonesville, Texas, on the Texas-Louisiana border.

The aggregate purchase price of approximately \$153 million consisted of cash consideration of approximately \$22 million and the issuance of 2.5 million shares of Progress Energy common stock valued at approximately \$129 million. The purchase price included approximately \$2 million of direct transaction costs. The final purchase price was allocated to oil and gas properties, intangible assets, diversified business property, net working capital and deferred tax liabilities for approximately \$152 million, \$9 million, \$32 million, \$5 million and \$45 million, respectively. The \$9 million intangible asset recorded relates to customer contracts acquired as part of the acquisition and are being amortized over their respective lives (See Note 8).

The acquisition was accounted for using the purchase method of accounting and, accordingly, the results of operations for Westchester have been included in the Company's Consolidated Financial Statements since the date of acquisition. The pro forma results of operations reflecting the acquisition would not be materially different than the reported results of operations for the years ended December 31, 2002 or 2001.

5. Property, Plant and Equipment

A. Utility Plant

The balances of utility plant in service at December 31 are listed below, with a range of depreciable lives for each:

(in millions)	2003	2002
Production plant (7-33 years)	<u>\$ 3,821</u>	<u>\$ 3,433</u>
Transmission plant (30-75 years)	1,012	976
Distribution plant (12-50 years)	2,894	2,728
General plant and other (8-75 years)	423	340
Utility plant in service	<u>\$ 8,150</u>	<u>\$ 7,477</u>

Substantially all of the electric utility plant is pledged as collateral for the first mortgage bonds of PEF (See Note

Allowance for funds used during construction (AFUDC) represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated assets. As prescribed in the regulatory uniform systems of accounts, AFUDC is charged to the cost of the plant. The equity funds portion of AFUDC is credited to other income and the borrowed funds portion is credited to interest charges. Regulatory authorities consider AFUDC an appropriate charge for inclusion in the rates charged to customers by the utilities over the service life of the property. The composite AFUDC rate for PEF's electric utility plant was 7.8% in 2003, 2002 and 2001.

Depreciation provisions on utility plant, as a percent of average depreciable property other than nuclear fuel, were 2.3% in 2003 and 2002 and 3.2% in 2001, respectively. The depreciation provisions related to utility plant were \$172 million, \$162 million and \$225 million in 2003, 2002 and 2001, respectively. In addition to utility plant depreciation provisions, depreciation and amortization expense also includes decommissioning cost provisions, ARO accretion, cost of removal provisions (See Note 5D) and regulatory approved expenses (See Note 7).

Amortization of nuclear fuel costs, for the years ended December 31, 2003, 2002 and 2001 were \$31 million, \$32 million and \$29 million, respectively.

B. Diversified Business Property

The following is a summary of diversified business property at December 31, with a range of depreciable lives for each:

(in millions)	2003	2002
Equipment (3 – 25 years)	\$ 283	\$ 329
Land and mineral rights	80	76
Buildings and plants (5 – 40 years)	99	91
Oil and gas properties (units-of-production)	412	265
Telecommunications equipment (5 – 20 years)	63	41
Rail equipment (3 – 20 years)	131	54
Marine equipment (3 – 35 years)	83	81
Computers, office equipment and software (3 – 10 years)	33	30
Construction work in progress	18	34
Accumulated depreciation	(361)	(302)
Diversified business property, net	\$ 841	\$ 699

Diversified business depreciation expense was \$92 million, \$66 million and \$69 million for the years ended December 31, 2003, 2002 and 2001, respectively. The synthetic fuel facilities are being depreciated through 2007 when the Section 29 tax credits will expire.

C. Joint Ownership of Generating Facilities

PEF is entitled to shares of the generating capability and output of Crystal River Unit No. 3 (CR3) equal to its ownership interest. PEF also pays its ownership share of additional construction costs, fuel inventory purchases and operating expenses. PEF's share of expenses for the jointly-owned facility is included in the appropriate expense category. The co-owner of Intercession City Unit P-11 (P11) has exclusive rights to the output of the unit during the months of June through September. PEF has that right for the remainder of the year. PEF's ownership interest in CR3 and P11 is listed below with related information at December 31, (\$ in millions):

Facility	Company Ownership Interest	Plant Investment	Accumulated Depreciation	Construction Work in Progress
2003				
Crystal River Unit No. 3	91.78%	\$ 875	\$ 441	\$ 49
Intercession City Unit P-11	66.67%	22	6	6
2002				
Crystal River Unit No. 3	91.78%	\$ 777	\$ 375	\$ 28
Intercession City Unit P-11	66.67%	22	5	4

D. Decommissioning, Dismantlement and Cost of Removal Provisions

PEF's nuclear plant depreciation expenses include a provision for future decommissioning costs, which are recoverable through rates charged to customers. In January 2002, PEF received regulatory approval from the FPSC to decrease its retail provision for nuclear decommissioning from approximately \$21 million annually to approximately \$8 million annually, effective January 2001. As a result of the settlement in the PEF rate case, PEF suspended accruals on its reserves for retail nuclear decommissioning through December 2005.

The provision for retail fossil plant dismantlement was previously suspended per a 1997 FPSC settlement agreement, but resumed mid-2001. The annual provision, approved by the FPSC in 2001, was \$9 million. The accrual for retail fossil dismantlement reserves was suspended again in 2002 by the Florida Rate Case settlement (See Note 7B).

PEF's cost of removal provisions, which are included in depreciation and amortization expense, were \$72 million, \$68 million and \$66 million in 2003, 2002 and 2001, respectively. These amounts represent the expense recognized for the disposal or removal of utility assets. The FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143), that changed the accounting for the decommissioning, dismantlement and cost of removal provisions (See Note 5F).

E. Insurance

PEF is a member of Nuclear Electric Insurance Limited (NEIL), which provides primary and excess insurance coverage against property damage to members' nuclear generating facilities. Under the primary program, PEF is insured for \$500 million at its nuclear plant, CR3. In addition to primary coverage, NEIL also provides decontamination, premature decommissioning and excess property insurance with a limit of \$1.1 billion.

Insurance coverage against incremental costs of replacement power resulting from prolonged accidental outages at nuclear generating units is also provided through membership in NEIL. PEF is insured thereunder, following a twelve-week deductible period, for 52 weeks in the amount of \$4.5 million per week at CR3. An additional 110 weeks of coverage is provided at 80% of the above weekly amount. For the current policy period, PEF is subject to retrospective premium assessments of up to approximately \$6 million with respect to the primary coverage, \$6 million with respect to the decontamination, decommissioning and excess property coverage, and \$5 million for the incremental replacement power costs coverage, in the event covered losses at insured facilities exceed premiums, reserves, reinsurance and other NEIL resources. Pursuant to regulations of the U.S. Nuclear Regulatory Commission, PEF's property damage insurance policies provide that all proceeds from such insurance be applied, first, to place the plant in a safe and stable condition after an accident and, second, to decontaminate, before any proceeds can be used for decommissioning, plant repair or restoration. PEF is responsible to the extent losses may exceed limits of the coverage described above.

PEF is insured against public liability for a nuclear incident up to \$10.9 billion per occurrence. Under the current provisions of the Price Anderson Act, which limits liability for accidents at nuclear power plants, PEF, as an owner of a nuclear unit, can be assessed for a portion of any third-party liability claims arising from an accident at any commercial nuclear power plant in the United States. In the event that public liability claims from an insured nuclear incident exceed \$300 million (currently available through commercial insurers), PEF would be subject to pro rata assessments of up to \$101 million for each reactor owned per occurrence. Payment of such assessments would be made over time as necessary to limit the payment in any one year to no more than \$10 million per reactor owned. Congress is expected to approve revisions to the Price Anderson Act during 2004, that could include increased limits and assessments per reactor owned. The final outcome of this matter cannot be predicted at this time.

Under the NEIL policies, if there were multiple terrorism losses occurring within one year, NEIL would make available one industry aggregate limit of \$3.2 billion, along with any amounts it recovers from reinsurance, government indemnity or other sources up to the limits for each claimant. If terrorism losses occurred beyond the one-year period, a new set of limits and resources would apply. For nuclear liability claims arising out of terrorist acts, the primary level available through commercial insurers is now subject to an industry aggregate ~~limit of \$300 million. The second level of coverage obtained through the assessments discussed above would~~ continue to apply to losses exceeding \$300 million and would provide coverage in excess of any diminished primary limits due to the terrorist acts aggregate.

PEF self-insures its transmission and distribution lines against loss due to storm damage and other natural disasters. Pursuant to a regulatory order, PEF is accruing \$6 million annually to a storm damage reserve and may defer any losses in excess of the reserve (See Note 7A).

F. Asset Retirement Obligations

SFAS No. 143, "Accounting for Asset Retirement Obligations," provides accounting and disclosure requirements for retirement obligations associated with long-lived assets and was adopted by the Company effective January 1, 2003. This statement requires that the present value of retirement costs for which the Company has a legal obligation be recorded as a liability with an equivalent amount added to the asset cost and depreciated over an appropriate period. The liability is then accreted over time by applying an interest method of allocation to the liability. Cumulative accretion and accumulated depreciation were recognized for the time period from the date the liability would have been recognized had the provisions of this statement been in effect, to the date of adoption of this statement.

Upon adoption of SFAS No. 143, PEF recorded asset retirement obligations (AROs) totaling \$303 million for nuclear decommissioning of irradiated plant. PEF used an expected cash flow approach to measure these obligations. This amount includes accruals recorded prior to adoption totaling \$284 million, which were previously recorded in cost of removal. The related asset retirement costs, net of accumulated depreciation, recorded upon adoption totaled \$39 million for regulated operations. The cumulative effect of adoption of this statement had no impact on the income of PEF, as the effects were offset by the establishment of a regulatory liability in the amount of \$20 million, pursuant to SFAS No. 71. The regulatory liability represents the amount by which previously recorded accruals exceeded the cumulative accretion and accumulated depreciation for the time period from the date the liability would have been recognized had the provisions of this statement been in effect to the date of adoption.

The asset retirement costs related to nuclear decommissioning of irradiated plant, net of accumulated depreciation, totaled \$37 million for regulated operations at December 31, 2003. The ongoing expense differences between SFAS No. 143 and regulatory cost recovery are being deferred to the regulatory liability.

Funds set aside in PEF's nuclear decommissioning trust fund for the nuclear decommissioning liability totaled \$433 million at December 31, 2003 and \$374 million at December 31, 2002. Net unrealized gains on the nuclear decommissioning trust fund were included in regulatory liabilities in 2003 and cost of removal in 2002.

The Company also recorded AROs totaling \$10 million for coal mine operations, synthetic fuel operations and gas production of Progress Fuels Corporation. The Company used an expected cash flow approach to measure these obligations. This amount includes accruals recorded prior to adoption totaling \$5 million, which were previously recorded in other liabilities and deferred credits. The related asset retirement costs, net of accumulated depreciation, recorded upon adoption totaled \$3 million for nonregulated operations. The cumulative effect of initial adoption of this statement related to nonregulated operations was \$2 million of pre-tax expense, which is included in other, net on the Company's Consolidated Statements of Income and Comprehensive Income for the year ended December 31, 2003.

The Company's AROs for coal mine operations, synthetic fuel operations and gas production of Progress Fuels Corporation totaled \$20 million at December 31, 2003. The related asset retirement costs, net of accumulated depreciation, totaled \$4 million for nonregulated operations at December 31, 2003. The following table shows the changes to the asset retirement obligations during the year ended December 31, 2003. Additions relate primarily to additional reclamation obligations at coal mine operations of Progress Fuels Corporation.

(in millions)	<u>Regulated</u>	<u>Nonregulated</u>
Asset retirement obligations as of January 1, 2003	\$ 303	\$ 10
Additions	-	11
Accretion Expense	16	1
Deductions		(2)
Asset retirement obligations as of December 31, 2003	<u>\$ 319</u>	<u>\$ 20</u>

Pro forma net income has not been presented for prior years because the pro forma application of SFAS No. 143 to prior years would result in pro forma net income not materially different from the actual amounts reported.

The Company has identified but not recognized ARO liabilities related to electric transmission and distribution and telecommunications assets as the result of easements over property not owned by the Company. These easements are generally perpetual and only require retirement action upon abandonment or cessation of use of the property for the specified purpose. The ARO liability is not estimable for such easements, as the Company

intends to utilize these properties indefinitely. In the event the Company decides to abandon or cease the use of a particular easement, an ARO liability would be recorded at that time.

PEF previously recognized removal, decommissioning and dismantlement costs as a component of accumulated depreciation in accordance with regulatory treatment. At December 31, 2003, such costs totaling \$1,175 million were included in regulatory liabilities on the Balance Sheets and consist of removal costs of \$970 million, decommissioning costs for non-irradiated areas at nuclear facilities of \$62 million and amounts previously collected for dismantlement of fossil generation plants of \$143 million. At December 31, 2002, such costs totaling \$1,452 million were included in cost of removal on the Balance Sheets and consist of removal costs of \$913 million, removal costs for both the irradiated and non-irradiated areas at nuclear facilities of \$397 million and amounts previously collected for dismantlement of fossil generation plants of \$142 million. With the adoption of SFAS No. 143 in 2003, removal costs related to the irradiated areas at nuclear facilities are reported as asset retirement obligations on the 2003 Balance Sheets.

In January 2003, the Staff of the FPSC issued a notice of proposed rule development to adopt provisions relating to accounting for AROs under SFAS No. 143. Accompanying the notice was a draft rule presented by the Staff which adopts the provisions of SFAS No. 143 along with the requirement to record the difference between amounts prescribed by the FPSC and those used in the application of SFAS No. 143 as regulatory assets or regulatory liabilities, which was accepted by all parties. The Commission approved this draft rule and a final order was issued in the third quarter of 2003. Therefore, the adoption of the statement had no impact on the income of PEF due to the establishment of a regulatory liability pursuant to SFAS No. 71.

6. Inventory

At December 31, inventory was comprised of the following:

(in millions)	Florida Progress		Progress Energy Florida	
	2003	2002	2003	2002
Fuel	\$ 126	\$ 183	\$ 90	\$ 111
Rail equipment and parts	132	155	-	-
Materials and supplies	154	134	140	124
Other	10	20	-	-
Total inventory	<u>\$ 422</u>	<u>\$ 492</u>	<u>\$ 230</u>	<u>\$ 235</u>

7. Regulatory Matters

A. Regulatory Assets and Liabilities

As a regulated entity, PEF is subject to the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation." Accordingly, PEF records certain assets and liabilities resulting from the effects of the ratemaking process, which would not be recorded under GAAP for nonregulated entities. The utility's ability to continue to meet the criteria for application of SFAS No. 71 may be affected in the future by competitive forces and restructuring in the electric utility industry. In the event that SFAS No. 71 no longer applied to PEF's operations, related regulatory assets and liabilities would be eliminated unless an appropriate regulatory recovery mechanism was provided. Additionally, these factors could result in an impairment of utility plant assets as determined pursuant to SFAS No. 144.

PEF has regulatory assets (liabilities) at December 31 as follows:

(in millions)	2003	2002
Deferred fuel cost	<u>\$ 204</u>	<u>\$ 38</u>
Income taxes recoverable through future rates (Note 13)	42	33
Deferred purchased power contract termination costs	-	47
Loss on reacquired debt (Note 1C)	33	20
Other	51	30
Total long-term regulatory assets	<u>126</u>	<u>130</u>
Non-ARO cost of removal (Note 5F)	(1,175)	-
Deferred impact of ARO (Note 5F)	(8)	-

Net nuclear decommissioning trust unrealized gains (Note 5F)	(105)	
Storm reserve (Note 5E)	(41)	(36)
Other	(19)	(25)
Total long-term regulatory liabilities	<u>(1,348)</u>	<u>(61)</u>
Net regulatory assets (liabilities)	<u>\$ (1,018)</u>	<u>\$ 107</u>

Except for portions of deferred fuel, all assets earn a return or the cash has not yet been expended, in which case the assets are offset by liabilities that do not incur a carrying cost. The utility expects to fully recover these assets and refund the liabilities through customer rates under current regulatory practice.

The Tiger Bay regulatory asset, for contract termination costs, is recovered pursuant to an agreement between PEF and several intervening parties, which was approved by the FPSC in June 1997. The amortization of the regulatory asset is calculated using revenues collected under the fuel adjustment clause as if the purchased power agreements related to the facility were still in effect, less the actual fuel costs and the related debt interest expense. Under the plan, PEF had the option to accelerate the amortization at its discretion. During 2001 PEF received approval from the FPSC to apply deferred revenues from the prior year towards the acceleration of the Tiger Bay regulatory asset amortization \$63 million plus interest. Including accelerated amounts, PEF recorded amortization expense of \$47 million, \$49 million and \$131 million in 2003, 2002 and 2001, respectively. By fourth quarter 2003 the regulatory asset was fully amortized.

In compliance with a regulatory order, PEF accrues a reserve for maintenance and refueling expenses anticipated to be incurred during scheduled nuclear plant outages.

B. Retail Rate Matters

PEF's retail rates are set by the FPSC, while its wholesale rates are governed by the FERC. PEF's last general retail rate case was approved in 1992 and allowed a 12% regulatory return on equity with an allowed range between 11% and 13%. PEF previously operated under an agreement committing several parties not to seek any reduction in its base rates or authorized return on equity. That agreement expired in June 2001. The FPSC initiated a rate proceeding in 2001 regarding PEF's future base rates. In March 2002, the parties in PEF's rate case entered into a Stipulation and Settlement Agreement (the Agreement) related to retail rate matters. The Agreement was approved by the FPSC in April 2002. The Agreement is generally effective from May 2002 through December 2005; provided, however, that if PEF's base rate earnings fall below a 10% return on equity, PEF may petition the FPSC to amend its base rates.

The Agreement provides that PEF will reduce its retail revenues from the sale of electricity by an annual amount of \$125 million. The Agreement also provides that PEF will operate under a Revenue Sharing Incentive Plan (the Plan) through 2005, and thereafter until terminated by the FPSC, that establishes annual revenue caps and sharing thresholds. The Plan provides that retail base rate revenues between the sharing thresholds and the retail base rate revenue caps will be divided into two shares – a 1/3 share to be received by PEF's shareholders, and a 2/3 share to be refunded to PEF's retail customers; provided, however, that for the year 2002 only, the refund to customers was limited to 67.1% of the 2/3 customer share. The retail base rate revenue sharing threshold amounts for 2003 and 2002 were \$1,333 million and \$1,296 million, respectively, and will increase \$37 million each year thereafter. The Plan also provides that all retail base rate revenues above the retail base rate revenue caps established for each year will be refunded to retail customers on an annual basis. For 2002, the refund to customers was limited to 67.1% of the retail base rate revenues that exceeded the 2002 cap. The retail base rate revenue cap for 2003 and 2002 was \$1,393 million and \$1,356 million, respectively, and will increase \$37 million each year thereafter. Any amounts above the retail base revenue caps will be refunded 100% to customers. At December 31, 2003, \$17 million has been accrued and will be refunded to customers by March 2004. Approximately \$5 million was originally returned in March 2003 related to 2002 revenue sharing. However, in February 2003, the parties to the Agreement filed a motion seeking an order from the FPSC to enforce the Agreement. In this motion, the parties disputed PEF's calculation of retail revenue subject to refund and contended that the refund should be approximately \$23 million. In July 2003, the FPSC ruled that PEF must provide an additional \$18 million to its retail customers related to the 2002 revenue sharing calculation. PEF recorded this refund in the second quarter of 2003 as a charge against electric operating revenue and refunded this amount by October 2003.

The Agreement also provides that beginning with the in-service date of PEF's Hines Unit 2 and continuing through December 2005, PEF will be allowed to recover through the fuel cost recovery clause a return on

average investment and depreciation expense for Hines Unit 2, to the extent such costs do not exceed the Unit's cumulative fuel savings over the recovery period. Hines Unit 2 is a 516 MW combined-cycle unit that was placed in service in December 2003.

PEF suspended retail accruals on its reserves for nuclear decommissioning and fossil dismantlement through December 2005. Additionally, for each calendar year during the term of the Agreement, PEF will record a \$63 million depreciation expense reduction, and may, at its option, record up to an equal annual amount as an offsetting accelerated depreciation expense. In addition, PEF is authorized, at its discretion, to accelerate the amortization of certain regulatory assets over the term of the Agreement. In 2003, PEF recorded \$16 million of accelerated amortization of a regulatory liability related to a settled tax matter. There was no accelerated depreciation or amortization expense recorded for the year ended December 31, 2002.

Under the terms of the Agreement, PEF agreed to continue the implementation of its four-year Commitment to Excellence Reliability Plan and expects to achieve a 20% improvement in its annual System Average Interruption Duration Index by no later than 2004. If this improvement level is not achieved for calendar years 2004 or 2005, PEF will provide a refund of \$3 million for each year the level is not achieved to 10% of its total retail customers served by its worst performing distribution feeder lines.

The Agreement also provided that PEF was required to refund to customers \$35 million of revenues PEF collected during the interim period since March 2001. This one-time retroactive revenue refund was recorded in the first quarter of 2002 and was returned to retail customers by December 2002. Any additional refunds under the Agreement are recorded when they become probable.

In February 2003, PEF petitioned the FPSC to increase its fuel factors due to continuing increases in oil and natural gas commodity prices. In March 2003, the FPSC approved PEF's petition and new rates became effective. In September 2003, PEF asked the FPSC to approve a cost adjustment in its annual fuel filing, primarily related to rising costs of fuel that will increase retail customer bills beginning January 2004. The total amount of the fuel adjustment requested above current levels was \$322 million. In November 2003 the FPSC approved PEF's request and new rates became effective January 2004.

C. Regional Transmission Organizations and Standard Market Design

In 2000, the FERC issued Order No. 2000 on Regional Transmission Organizations (RTOs), which set minimum characteristics and eight functions for transmission entities, including independent system operators and transmission companies that are required to become FERC-approved RTOs. As a result of Order 2000, PEF, along with Florida Power & Light Company and Tampa Electric Company, filed and received provisional approval from the FERC, for a GridFlorida RTO. However, in July 2001, the FERC issued orders recommending that companies in the Southeast engage in mediation to develop a plan for a single RTO for the Southeast. PEF participated in the mediation. The FERC has not issued an order specifically on this mediation.

In July 2002, FERC issued its Notice of Proposed Rulemaking in Docket No. RM01-12-000, Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design (SMD NOPR). If adopted as proposed, the rules set forth in the SMD NOPR would materially alter the manner in which transmission and generation services are provided and paid for. PEF filed comments in November 2002 and supplement comments in January 2003. In April 2003, the FERC released a White Paper on the Wholesale Market Platform. The White Paper provides an overview of what the FERC currently intends to include in a final rule in the SMD NOPR docket. The White Paper retains the fundamental and most protested aspects of SMD NOPR, including mandatory RTOs and the FERC's assertion of jurisdiction over certain aspects of retail service. FERC has not yet issued a final rule on SMD NOPR.

PEF has \$4 million invested GridFlorida at December 31, 2003. Given the regulatory uncertainty of the ultimate timing, structure and operations of GridFlorida or an alternate combined transmission structure, PEF cannot predict the effect on future results of operations, cash flows or financial condition. Furthermore, the SMD NOPR presents several uncertainties, including what percentage of the investment in GridFlorida will be recovered, how the elimination of transmission charges, as proposed in the SMD NOPR, will impact PEF, and what amount of capital expenditures will be necessary to create a new wholesale market

8. Goodwill and Other Intangible Assets

Effective January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets." This statement clarifies the criteria for recording of other intangible assets separately from goodwill. Effective January 1, 2002, goodwill was no longer subject to amortization over its estimated useful life. Instead, goodwill is subject to at least an annual assessment for impairment which could result in periodic impairment charges. As required by SFAS No. 142, the results for the prior years have not been restated. A reconciliation of net income as if SFAS No. 142 had been adopted is presented below for the year ended December 31, 2001.

(in millions)	
Reported net income	\$ 244
Goodwill amortization	<u>2</u>
Adjusted net income	<u>\$ 246</u>

The Company's carrying amount of goodwill at December 31, 2003 was \$10 million and at December 31, 2002 and 2001 was \$11 million, in the Fuels segment. In December 2003, \$7 million in goodwill was acquired as part of the PTC business combination and is in the Other segment (See Note 4A). The Company completed the annual goodwill impairment test for the Fuels segment in the second quarter of 2003, which indicated that the Company's goodwill was not impaired. The first annual test for the Other segment will be performed in 2004, since the goodwill was acquired in 2003. PEF has no goodwill at December 31, 2003 or 2002 or 2001.

The Company has \$9 million of net intangible assets at December 31, 2003 and no significant intangible assets at December 31, 2002. The \$9 million arose from the final purchase price allocation for a contract acquired as part of the Westchester acquisition net of amortization to date (See Note 4C). PEF has no significant intangible assets at December 31, 2003 or 2002.

9. Impairment of Long-Lived Assets and Investments

Effective January 1, 2002, the Company adopted SFAS No. 144, which provides guidance for the accounting and reporting of impairment or disposal of long-lived assets. The statement supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." In 2003, 2002 and 2001, the Company recorded impairments and other charges of approximately \$15 million, \$300 million and \$170 million, respectively.

Due to the reduction in coal production at the Kentucky May Coal Mine, the Company evaluated its long-lived assets in 2003. Fair value was determined based on discounted cash flows. As a result of this review, the Company recorded asset impairments of \$15 million on a pre-tax basis during the fourth quarter of 2003.

The 2002 amount includes an estimated impairment of assets held for sale of \$67 million related to Railcar, Ltd. (See Note 3B). In 2002, the Company also initiated an independent valuation study to assess the recoverability of the long-lived assets of PTC. Based on this assessment, the Company recorded asset impairments of \$215 million on a pre-tax basis and other charges of \$18 million on a pre-tax basis in the third quarter of 2002. This write-down constitutes a significant reduction in the book value of these long-lived assets. The long-lived asset impairments include an impairment of property, plant and equipment, construction work in process and intangible assets. The impairment charge represents the difference between the fair value and carrying amount of these long-lived assets. The fair value of these assets was determined using a valuation study heavily weighted on the discounted cash flow methodology, using market approaches as supporting information.

Due to results of divestiture efforts and the decision to retain the Rail Services business segment in the near term, coupled with prior and current year losses and a continued decline in the rail services industry, the Company evaluated the recoverability of rail long-lived assets and associated goodwill. Fair value was generally determined based on discounted cash flows. As a result of this review, the Company recorded asset impairments, primarily goodwill, of \$161 million pre-tax (\$108 million after-tax) during the fourth quarter of 2001.

The Company continually reviews its investments to determine whether a decline in fair value below the cost basis is other-than-temporary. During the fourth quarter of 2001, the Company determined that the decline in fair value of its affordable housing investments, held by Progress International Holdings, a subsidiary of Progress Capital Holdings, Inc. (Progress Capital) was other-than-temporary. As a result, the Company has recorded investment impairments for other-than-temporary declines in the fair value of its affordable housing investments. Investment write-downs of \$9 million pre-tax are included in other, net on the Company's Consolidated Statements of Income and Comprehensive Income.

10. Equity

A. Common and Preferred Stock

Common stock at December 31, 2003 and 2002 consisted of the following

(in millions except share data)	2003	2002
Florida Progress		
Common stock without par value, 250,000,000 shares authorized; 98,616,658 shares outstanding in 2003 and 2002	\$ 1,699	\$ 1,629
Progress Energy Florida		
Common stock without par value, 60,000,000 shares authorized; 100 shares outstanding in 2003 and 2002	\$ 1,081	\$ 1,081

From time-to-time the Company and its subsidiaries may receive equity contributions from and pay dividends to Progress Energy. The Company received equity contributions from Progress Energy of \$168 million, \$220 million and \$90 million during 2003, 2002 and 2001, respectively. The Company paid dividends to Progress Energy of \$301 million, \$303 million and \$249 million during 2003, 2002 and 2001, respectively.

The authorized capital stock of the Company includes 10 million shares of preferred stock, without par value, including 2 million shares designated as Series A Junior Participating Preferred Stock. No shares of the Company's preferred stock are issued or outstanding.

The authorized capital stock of PEF includes three classes of preferred stock: 4 million shares of Cumulative Preferred Stock, \$100 par value; 5 million shares of Cumulative Preferred Stock, without par value; and 1 million shares of Preference Stock, \$100 par value. No shares of PEF's Cumulative Preferred Stock, without par value, or Preference Stock are issued or outstanding. All Cumulative Preferred Stock series are without sinking funds and are not subject to mandatory redemption. Preferred stock outstanding at December 31, 2003 and 2002 consisted of the following (in millions):

4.00% - 39,980 shares outstanding (redemption price \$104.25)	\$ 4
4.40% - 75,000 shares outstanding (redemption price \$102.00)	8
4.58% - 99,990 shares outstanding (redemption price \$101.00)	10
4.60% - 39,997 shares outstanding (redemption price \$103.25)	4
4.75% - 80,000 shares outstanding (redemption price \$102.00)	8
Total Preferred Stock of Florida Power Corporation	\$ 34

B. Stock-Based Compensation

Employee Stock Ownership Plan

Progress Energy sponsors the Progress Energy 401(k) Savings and Stock Ownership Plan (401(k)) for which substantially all full-time non-bargaining unit employees and certain part-time non-bargaining employees within participating subsidiaries are eligible. Effective January 1, 2002, Florida Progress is a participating subsidiary of the 401(k), which has matching and incentive goal features, encourages systematic savings by employees and provides a method of acquiring Progress Energy common stock and other diverse investments. The 401(k), as amended in 1989, is an Employee Stock Ownership Plan (ESOP) that can enter into acquisition loans to acquire Progress Energy common stock to satisfy 401(k) common stock needs. Qualification as an ESOP did not change the level of benefits received by employees under the 401(k). Common stock acquired with the proceeds of an ESOP loan is held by the 401(k) Trustee in a suspense account. The common stock is released from the suspense account and made available for allocation to participants as the ESOP loan is repaid. Such allocations are used to partially meet common stock needs related to Progress Energy matching and incentive contributions and/or reinvested dividends.

Florida Progress' matching and incentive goal compensation cost under the 401(k) is determined based on matching percentages and incentive goal attainment as defined in the plan. Such compensation cost is allocated

to participants' accounts in the form of Progress Energy common stock, with the number of shares determined by dividing compensation cost by the common stock market value at the time of allocation. The 401(k) common stock share needs are met with open market purchases, with shares released from the ESOP suspense account and with newly issued shares. Costs for incentive goal compensation are accrued during the fiscal year and typically paid in shares in the following year; while costs for the matching component are typically met with shares in the same year incurred. Florida Progress' matching and incentive cost which was and will be met with shares released from the suspense account totaled approximately \$4 million and \$2 million for the year ended December 31, 2003 and 2002, respectively. Matching and incentive costs totaled approximately \$11 million, \$10 million and \$9 million for the years ended December 31, 2003, 2002 and 2001, respectively, including 2001 amounts incurred under the previous Florida Progress Plan.

Stock Option Agreements

Pursuant to the Progress Energy's 1997 Equity Incentive Plan and 2002 Equity Incentive Plans as amended and restated as of July 10, 2002, Progress Energy may grant options to purchase shares of common stock to directors, officers and eligible employees. For the years ended December 31, 2003, 2002 and 2001 approximately 3.0 million, 2.9 million and 2.4 million common stock options were granted, respectively. Of these amounts, approximately 1.0 million and 0.8 million options, respectively, were granted to officers and eligible employees of Florida Progress and PEF in 2003, approximately 0.5 million and 0.4 million options, respectively, were granted in 2002 and approximately 0.4 million were granted to both companies in 2001.

Other Stock-Based Compensation Plans

Progress Energy has additional compensation plans for officers and key employees that are stock-based in whole or in part. **The Company participates in these plans.** The two primary active stock-based compensation programs are the Performance Share Sub-Plan (PSSP) and the Restricted Stock Awards program (RSA), both of which were established pursuant to Progress Energy's 1997 Equity Incentive Plan and were continued under the 2002 Equity Incentive Plan, as amended and restated as of July 10, 2002.

Under the terms of the PSSP, officers and key employees are granted performance shares on an annual basis that vest over a three-year consecutive period. Each performance share has a value that is equal to, and changes with, the value of a share of Progress Energy's common stock, and dividend equivalents are accrued on, and reinvested in, the performance shares. The PSSP has two equally weighted performance measures, both of which are based on Progress Energy's results as compared to a peer group of utilities. Compensation expense is recognized over the vesting period based on the expected ultimate cash payout and is reduced by any forfeitures.

The RSA program allows Progress Energy to grant shares of restricted common stock to officers and key employees of Progress Energy. The restricted shares generally vest on a graded vesting schedule over a minimum of three years. Compensation expense, which is based on the fair value of common stock at the grant date, is recognized over the applicable vesting period and is reduced by any forfeitures.

The total amount expensed by the Company for other stock-based compensation under these plans was \$9 million, \$5 million and \$3 million in 2003, 2002 and 2001, respectively.

C. Accumulated Other Comprehensive Loss

Components of accumulated other comprehensive loss for Florida Progress and PEF at December 31, 2003 and 2002 are as follows:

(in millions)	Florida Progress		Progress Energy Florida	
	2003	2002	2003	2002
Loss on cash flow hedges	\$ (8)	\$ (6)	\$ -	\$ -
Minimum pension liability adjustments	(8)	(5)	(4)	(3)
Foreign currency translation and other	(1)	(5)	-	-
Total accumulated other comprehensive loss	<u>\$ (17)</u>	<u>\$ (16)</u>	<u>\$ (4)</u>	<u>\$ (3)</u>

11. Debt and Credit Facilities

A. Debt and Credit

At December 31, the Company's (including PEF) long-term debt consisted of the following (maturities and weighted-average interest rates at December 31, 2003):

(in millions)		<u>2003</u>	<u>2002</u>
Progress Energy Florida, Inc.			
First mortgage bonds, maturing 2004-2033	5.60%	\$ 1,330	\$ 810
Pollution control revenue bonds, maturing 2018-2027	1.04%	241	241
Medium-term notes, maturing 2004-2028	6.75%	379	417
Unamortized premium and discount, net		<u>(3)</u>	<u>(7)</u>
		<u>1,947</u>	<u>1,461</u>
Florida Progress Funding Corporation			
Debt to affiliated trust, maturing 2039	7.10%	309	
Mandatorily redeemable preferred securities, maturing 2039		-	300
		<u>309</u>	<u>300</u>
Progress Capital Holdings, Inc.			
Medium-term notes, maturing 2004-2008	6.78%	165	223
Unsecured note with parent, maturing 2011	6.43%	500	500
Miscellaneous notes		<u>1</u>	<u>1</u>
		<u>666</u>	<u>724</u>
Less: Current portion of long-term debt		<u>(68)</u>	<u>(275)</u>
Total Long-Term Debt, Net		<u>\$ 2,854</u>	<u>\$ 2,210</u>

At December 31, 2003, PEF had committed lines of credit which are used to support its commercial paper borrowings and had no outstanding loans. PEF is required to pay minimal annual commitment fees to maintain its credit facilities. The following table summarizes PEF's credit facilities (in millions):

<u>Description</u>	<u>Total</u>
364-Day (expiring 3/31/04)	\$ 200
3-Year (expiring 4/1/06)	<u>200</u>
	<u>\$ 400</u>

At December 31, 2003, PEF had no outstanding commercial paper and other short-term debt classified as short-term obligations. At December 31, 2002, PEF had \$257 million of outstanding commercial paper and other short-term debt classified as short-term obligations. The weighted-average interest rate of such short-term obligations at December 31, 2002 was 1.55%.

The combined aggregate maturities of Florida Progress long-term debt for 2004 through 2008 are approximately, in millions, \$68, \$49, \$109, \$124 and \$127, respectively. PEF's aggregate maturities of long-term debt for 2004 through 2008 are approximately, in millions, \$43, \$48, \$48, \$89 and \$82, respectively.

B. Covenants and Default Provisions

Financial Covenants

PEF's credit line contains various terms and conditions that could affect PEF's ability to borrow under these facilities. These include a maximum debt to total capital ratio, an interest test, a material adverse change clause and a cross-default provision.

PEF's credit line requires a maximum total debt to total capital ratio of 65.0%. Indebtedness as defined by the bank agreement includes certain letters of credit and guarantees which are not recorded on the Balance Sheets. At December 31, 2003, PEF's total debt to total capital ratio was 51.5%.

PEF's 364-day and 3-year credit facility have a financial covenant for interest coverage. The covenant requires PEF's EBITDA to interest expense to be at least 3 to 1. For the year ended December 31, 2003, this ratio was 9.22 to 1.

Material Adverse Change Clause

The credit facility of PEF includes a provision under which lenders could refuse to advance funds in the event of a material adverse change in the borrower's financial condition.

Default Provisions

PEF's credit lines include cross-default provisions for defaults of indebtedness in excess of \$10 million. PEF's cross-default provisions only apply to defaults of indebtedness by PEF and not to other affiliates of PEF. The credit lines of Progress Energy include a similar provision. Progress Energy's cross-default provisions only apply to defaults of indebtedness by Progress Energy and its significant subsidiaries, which includes PEF, Florida Progress, Progress Fuels and Progress Capital.

In the event that either of these cross-default provisions were triggered, the lenders could accelerate payment of any outstanding debt. Any such acceleration would cause a material adverse change in the respective company's financial condition. Certain agreements underlying the Company's indebtedness also limit the Company's ability to incur additional liens or engage in certain types of sale and leaseback transactions.

Other Restrictions

PEF's mortgage indenture provides that it will not pay any cash dividends upon its common stock, or make any other distribution to the stockholders, except a payment or distribution out of net income of PEF subsequent to December 31, 1943.

In addition, PEF's Articles of Incorporation provide that no cash dividends or distributions on common stock shall be paid, if the aggregate amount thereof since April 30, 1944, including the amount then proposed to be expended, plus all other charges to retained earnings since April 30, 1944, exceed (a) all credits to retained earnings since April 30, 1944, plus (b) all amounts credited to capital surplus after April 30, 1944, arising from the donation to PEF of cash or securities or transfers amounts from retained earnings to capital surplus. At December 31, 2003, none of PEF's retained earnings was restricted.

PEF's Articles of Incorporation also provide that cash dividends on common stock shall be limited to 75% of net income available for dividends if common stock equity falls below 25% of total capitalization, and to 50% if common stock equity falls below 20%. On December 31, 2003, PEF's common stock equity was approximately 52.5% of total capitalization.

C. Secured Obligations

PEF's first mortgage bonds are secured by their respective mortgage indentures. PEF's mortgage constitutes a first lien on substantially all of its fixed properties, subject to certain permitted encumbrances and exceptions. The PEF mortgage also constitutes a lien on subsequently acquired property. At December 31, 2003, PEF had approximately \$1,571 million in aggregate principal amount of first mortgage bonds outstanding including those related to pollution control obligations. The PEF mortgage allows the issuance of additional mortgage bonds upon the satisfaction of certain conditions.

D. Guarantees of Subsidiary Debt

Florida Progress has fully guaranteed the outstanding debt obligations for Progress Capital, a wholly-owned subsidiary of Florida Progress. At December 31, 2003 and 2002, Progress Capital had \$165 million and \$223 million, respectively; in medium term notes outstanding which are recorded on the Company's Consolidated Balance Sheets.

E. Hedging Activities

~~PEF uses interest rate derivatives to adjust the fixed and variable rate components of its debt portfolio and to hedge cash flow risk of fixed rate debt to be issued in the future. See discussion of risk management and derivative transactions at Note 15.~~

F. Company-Obligated Mandatorily Redeemable Cumulative Quarterly Income Preferred Securities of an Unconsolidated Subsidiary Trust Holding Solely Florida Progress Guaranteed Subordinated Deferrable Interest Notes

In April 1999, FPC Capital I (the Trust), an indirect wholly-owned subsidiary of FPC, issued 12 million shares of \$25 par cumulative FPC-obligated mandatorily redeemable preferred securities (Preferred Securities) due 2039, with an aggregate liquidation value of \$300 million and an annual distribution rate of 7.10%. Prior to the adoption of FIN No. 46, the Company consolidated the Trust, which holds the Preferred Securities. The Trust is a special-purpose entity, and therefore the Company applied FIN No. 46 to the Trust at December 31, 2003 (See Note 2). The adoption of FIN No. 46 required the Company to deconsolidate the Trust at December 31, 2003.

The existence of the Trust is for the sole purpose of issuing the Preferred Securities and the common securities and using the proceeds thereof to purchase from Florida Progress Funding Corporation (Funding Corp.) its 7.10% Junior Subordinated Deferrable Interest Notes (subordinated notes) due 2039, for a principal amount of \$309 million. The subordinated notes and the Notes Guarantee (as discussed below) are the sole assets of the Trust. Funding Corp.'s proceeds from the sale of the subordinated notes were advanced to Progress Capital and used for general corporate purposes including the repayment of a portion of certain outstanding short-term bank loans and commercial paper.

FPC has fully and unconditionally guaranteed the obligations of Funding Corp. under the subordinated notes (the Notes Guarantee). In addition, FPC has guaranteed the payment of all distributions related to the \$300 million Preferred Securities required to be made by the Trust, but only to the extent that the Trust has funds available for such distributions (Preferred Securities Guarantee). The Preferred Securities Guarantee, considered together with the Notes Guarantee, constitutes a full and unconditional guarantee by FPC of the Trust's obligations under the Preferred Securities.

The subordinated notes may be redeemed at the option of Funding Corp. beginning in 2004 at par value plus accrued interest through the redemption date. The proceeds of any redemption of the subordinated notes will be used by the Trust to redeem proportional amounts of the Preferred Securities and common securities in accordance with their terms. Upon liquidation or dissolution of Funding Corp., holders of the Preferred Securities would be entitled to the liquidation preference of \$25 per share plus all accrued and unpaid dividends thereon to the date of payment.

Prior to December 2003, these Preferred Securities were classified as long-term debt on the Company's Consolidated Balance Sheets. After deconsolidation of the Trust at December 31, 2003, FPC's subordinated notes payable to the Trust are classified as affiliate long-term debt on the Company's December 31, 2003 Consolidated Balance Sheet.

12. Fair Value of Financial Instruments

At December 31, 2003 and 2002, there were miscellaneous investments, consisting primarily of investments in company-owned life insurance and other benefit plan assets, with carrying amounts of approximately \$66 million and \$64 million, respectively, included in miscellaneous other property and investments. At PEF, these investments had carrying amounts of \$33 million at December 31, 2003 and 2002. The carrying amount of these investments approximates fair value due to the short maturity. The carrying amount of the Company's long-term debt, including current maturities, was \$2,922 million and \$2,485 million at December 31, 2003 and 2002, respectively. The estimated fair value of this debt, as obtained from quoted market prices for the same or similar issues, was \$3,105 million and \$2,654 million at December 31, 2003 and 2002, respectively. The carrying amount of PEF's long-term debt, including current maturities, was \$1,947 million and \$1,461 million at December 31, 2003 and 2002, respectively. The estimated fair value of this debt, as obtained from quoted market prices for the same or similar issues, was \$2,061 million and \$1,592 million at December 31, 2003 and 2002, respectively.

External trust funds have been established to fund certain costs of nuclear decommissioning. These nuclear decommissioning trust funds are invested in stocks, bonds and cash equivalents. Nuclear decommissioning trust funds are presented on the Balance Sheets at amounts that approximate fair value. Fair value is obtained from ~~quoted market prices for the same or similar investments.~~

13. Income Taxes

Deferred income taxes are provided for temporary differences between book and tax bases of assets and liabilities. Investment tax credits related to regulated operations are amortized over the service life of the related property. To the extent that the establishment of deferred income taxes under SFAS No. 109 is different from the recovery of taxes by PEF through the ratemaking process, the differences are deferred pursuant to SFAS No.

71. A regulatory asset or liability has been recognized for the impact of tax expenses or benefits that are recovered or refunded in different periods by the utilities pursuant to rate orders.

Net Accumulated deferred income tax assets (liabilities) at December 31 are (in millions):

Florida Progress	<u>2003</u>	<u>2002</u>
Accumulated depreciation and property cost differences	\$ (349)	\$ (385)
Deferred costs, net	2	5
Federal income tax credit carry forward	436	314
Miscellaneous other temporary differences, net	125	125
Valuation allowance	(29)	(26)
Net accumulated deferred income tax asset	<u>\$ 185</u>	<u>\$ 33</u>
Progress Energy Florida	<u>2003</u>	<u>2002</u>
Accumulated depreciation and property cost differences	\$ (354)	\$ (377)
Deferred costs, net	(22)	(6)
Miscellaneous other temporary differences, net	52	48
Net accumulated deferred income tax liability	<u>\$ (324)</u>	<u>\$ (335)</u>

Florida Progress's total deferred income tax liabilities were \$467 million and \$484 million at December 31, 2003 and 2002, respectively. Total deferred income tax assets were \$652 million and \$517 million at December 31, 2003 and 2002, respectively. PEF's total deferred income tax liabilities were \$396 million and \$361 million at December 31, 2003 and 2002, respectively. Total deferred income tax assets were \$72 million and \$26 million at December 31, 2003 and 2002, respectively.

Florida Progress's federal income tax credit carry forward at December 31, 2003 consists of \$429 million of alternative minimum tax credit with an indefinite carry forward period and \$7 million of general business credit with a carry forward period that will begin to expire in 2022.

Florida Progress established additional valuation allowances of \$3 million, \$5 million and \$10 million during 2003, 2002 and 2001, respectively, due to the uncertainty of realizing certain future state tax benefits. The Company believes it is more likely than not that the results of future operations will generate sufficient taxable income to allow for the utilization of the remaining deferred tax assets.

Reconciliations of the Company's effective income tax rate to the statutory federal income tax rate are:

Florida Progress	<u>2003</u>	<u>2002</u>	<u>2001</u>
Effective income tax rate	(32.7)%	(304.8)%	(186.4)%
State income taxes, net of federal benefit	(2.5)	(10.3)	(12.8)
AFUDC amortization	(0.7)	(4.1)	-
Federal tax credits	63.8	311.3	236.8
Goodwill amortization and write-offs	(0.5)	-	(9.7)
Investment tax credit amortization	1.8	11.3	8.4
Progress Energy tax allocation benefit	3.8	35.2	-
Other differences, net	2.0	(3.6)	(1.3)
Statutory federal income tax rate	<u>35.0%</u>	<u>35.0%</u>	<u>35.0%</u>
Progress Energy Florida	<u>2003</u>	<u>2002</u>	<u>2001</u>
Effective income tax rate	33.1%	33.6%	37.0%
State income taxes, net of federal benefit	(3.5)	(3.4)	(3.6)
Investment tax credit amortization	1.4	1.3	1.6
Progress Energy tax allocation benefit	2.7	3.8	-
Other differences, net	1.3	(0.3)	-

Statutory federal income tax rate	<u>35.0%</u>	<u>35.0%</u>	<u>35.0%</u>
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Income tax expense (benefit) applicable to continuing operations is comprised of (in millions):

Florida Progress	<u>2003</u>	<u>2002</u>	<u>2001</u>
Current - federal	\$ 6	\$ 43	\$ 3
state	18	23	26
Deferred - federal	(123)	(220)	(187)
state	(5)	(13)	(7)
Investment tax credit	(6)	(6)	(8)
Total income tax expense (benefit)	<u>\$ (110)</u>	<u>\$ (173)</u>	<u>\$ (173)</u>
Progress Energy Florida	<u>2003</u>	<u>2002</u>	<u>2001</u>
Current - federal	\$ 145	\$ 172	\$ 193
state	27	29	31
Deferred - federal	(16)	(29)	(30)
state	(3)	(3)	(3)
Investment tax credit	(6)	(6)	(8)
Total income tax expense (benefit)	<u>\$ 147</u>	<u>\$ 163</u>	<u>\$ 183</u>

The Company and each of its wholly-owned subsidiaries have entered into a Tax Agreement with Progress Energy (See Note 1C). The Company's intercompany tax payable was approximately \$22 million and \$33 million at December 31, 2003 and 2002, respectively. Progress Energy Florida's intercompany tax payable was approximately \$20 million and \$25 million at December 31, 2003 and 2002, respectively.

Florida Progress through its subsidiaries is a majority owner in three entities and a minority owner in three entities that own facilities that produce synthetic fuel as defined under the Internal Revenue Service Code (Code). The production and sale of the synthetic fuel from these facilities qualifies for tax credits under Section 29 of the Code (Section 29) if certain requirements are satisfied, including a requirement that the synthetic fuel differs significantly in chemical composition from the coal used to produce such synthetic fuel and that the fuel was produced from a facility that was placed in service before July 1, 1998. Total Section 29 credits generated to date are approximately \$787 million. All three majority-owned entities and all three minority-owned entities have received private letter rulings (PLRs) from the Internal Revenue Service (IRS) with respect to their synthetic fuel operations. The PLRs do not limit the production on which synthetic fuel credits may be claimed. Should the tax credits be denied on future audits, and the Company fails to prevail through the IRS or legal process, there could be a significant tax liability owed for previously taken Section 29 credits, with a significant impact on earnings and cash flows.

One of the Company's synthetic fuel entities, Colona Synfuel Limited Partnership, L.L.P. (Colona), is being audited by the IRS. The audit of Colona was expected. The Company is audited regularly in the normal course of business as are most similarly situated companies. The Company has been allocated approximately \$279 million in tax credits to date for this synthetic fuel entity.

In September 2002, all three of Florida Progress' majority-owned synthetic fuel entities, including Colona, and two of the Company's minority owned synthetic fuel entities were accepted into the IRS's Pre-Filing Agreement (PFA) program. The PFA program allows taxpayers to voluntarily accelerate the IRS exam process in order to seek resolution of specific issues. Either the Company or the IRS can withdraw from the program at any time, and issues not resolved through the program may proceed to the next level of the IRS exam process. While the ultimate outcome is uncertain, the Company believes that participation in the PFA program will likely shorten the tax exam process.

In June 2003, the Company was informed that IRS field auditors had raised questions regarding the chemical change associated with coal-based synthetic fuel manufactured at its Colona facility and the testing process by which the chemical change is verified. (The questions arose in connection with the Company's participation in the PFA program.) The chemical change and the associated testing process were described as part of the PLR request for Colona. Based on that application, the IRS ruled in Colona's PLR that the synthetic fuel produced at Colona undergoes a significant chemical change and thus qualifies for tax credits under Section 29.

In October 2003, the National Office of the IRS informed the Company that it had rejected the IRS field auditors' challenges regarding whether the synthetic fuel produced at the Company's Colona facility was the result of a significant chemical change. The National Office had concluded that the experts, engaged by Colona who test the synthetic fuel for chemical change, used reasonable scientific methods to reach their conclusions. Accordingly, the National Office will not take any adverse action on the PLR that has been issued for the Colona facility.

Although this ruling applies only to the Colona facility, the Company believes that the National Office's reasoning would be equally applicable to the other Progress Energy facilities. The Company applies essentially the same chemical process and uses the same independent laboratories to confirm chemical change in the synthetic fuel manufactured at each of its other facilities.

In February 2004, subsidiaries of the Company finalized execution of the Colona Closing Agreement with the Internal Revenue Service concerning their Colona synthetic fuel facilities. The Closing Agreement provided that the Colona facilities were placed in service before July 1, 1998, which is one of the qualification requirements for tax credits under Section 29 of the Internal Revenue Code. The Closing Agreement further provides that the fuel produced by the Colona facilities in 2001 is a "qualified fuel" for purposes of the Section 29 tax credits. This action concludes the IRS PFA program with respect to Colona.

Although the execution of the Colona Closing Agreement is a significant event, the audits of the Company's facilities are not yet completed and the PFA process continues with respect to the four synthetic fuel facilities owned by other affiliates of Progress Energy and FPC. Currently, the focus of that process is to determine that the facilities were placed in service before July 1, 1998. In management's opinion, Progress Energy is complying with all the necessary requirements to be allowed such credits under Section 29, although it cannot provide certainty, that it will prevail if challenged by the IRS on credits taken. Accordingly, the Company has no current plans to alter its synthetic fuel production schedule as a result of these matters.

In October 2003, the United States Senate Permanent Subcommittee on Investigations began a general investigation concerning synthetic fuel tax credits claimed under Section 29 of the Internal Revenue Code. The investigation is examining the utilization of the credits, the nature of the technologies and fuels created, the use of the synthetic fuel, and other aspects of Section 29 and is not specific to the Company's synthetic fuel operations. Progress Energy is providing information in connection with this investigation. The Company cannot predict the outcome of this matter.

14 Benefit Plans

The Company and some of its subsidiaries (including PEF) have a non-contributory defined benefit retirement (pension) plan for substantially all full-time employees. The Company also has supplementary defined benefit pension plans that provide benefits to higher-level employees. In addition to pension benefits, the Company and some of its subsidiaries (including PEF) provide contributory other postretirement benefits (OPEB), including certain health care and life insurance benefits, for retired employees who meet specified criteria. The Company uses a measurement date of December 31 for its pension and OPEB plans.

The components of the net periodic benefit cost for the years ended December 31 are:

(in millions)	Pension Benefits			Other Postretirement Benefits		
	2003	2002	2001	2003	2002	2001
Service cost	\$ 21	\$ 19	\$ 11	\$ 5	\$ 5	\$ 4
Interest cost	46	44	42	16	15	13
Expected return on plan assets	(62)	(76)	(86)	(1)	(1)	(1)
Net amortization	3	(7)	(19)	5	4	4
Net cost/(benefit) recognized by Florida Progress	\$ 8	\$ (20)	\$ (52)	\$ 25	\$ 23	\$ 20
Net cost/(benefit) recognized by PEF	\$ 5	\$ (22)	\$ (50)	\$ 24	\$ 22	\$ 18

Prior service costs and benefits are amortized on a straight-line basis over the average remaining service period of active participants. Actuarial gains and losses in excess of 10% of the greater of the obligation or the market-related value of assets are amortized over the average remaining service period of active participants. The Company uses fair value for the market-related value of assets.

Reconciliations of the changes in the plans' benefit obligations and the plans' funded status are:

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2003	2002	2003	2002
Obligation at January 1	\$ 714	\$ 588	\$ 236	\$ 180
Service cost	21	19	5	5
Interest cost	46	44	15	15
Benefit payments	(41)	(39)	(15)	(14)
Actuarial loss	32	119	19	55
Transfers	-	(18)	-	(5)
Obligation at December 31	772	713	260	236
Fair value of plan assets at December 31	849	687	18	16
Funded status	77	(26)	(242)	(220)
Unrecognized transition obligation	-	(1)	31	35
Unrecognized prior service cost (benefit)	(18)	(20)	7	7
Unrecognized net actuarial (gain) loss	103	213	51	33
Minimum pension liability adjustment	(11)	(7)		
Prepaid (accrued) cost at December 31, net – Florida Progress	\$ 151	\$ 159	\$ (153)	\$ (145)
Prepaid (accrued) cost at December 31, net – PEF	\$ 183	\$ 188	\$ (148)	\$ (139)

The Florida Progress net prepaid pension cost of \$151 million and \$159 million at December 31, 2003 and 2002, respectively, is included in the Company's Consolidated Balance Sheets as prepaid pension cost of \$223 million and \$226 million, respectively, and accrued benefit cost of \$72 million and \$67 million, respectively, which is included in other liabilities and deferred credits. The PEF net prepaid pension cost of \$183 million and \$188 million at December 31, 2003 and 2002, respectively, is included in the Balance Sheets as prepaid pension cost of \$220 million and \$223 million, respectively, and accrued benefit cost of \$37 million and \$35 million, respectively, which is included in other liabilities and deferred credits. For Florida Progress, the defined benefit pension plans with accumulated benefit obligations in excess of plan assets had projected benefit obligations totaling \$74 million and \$68 million at December 31, 2003 and 2002, respectively. Those plans had accumulated benefit obligations totaling \$73 million and \$67 million, respectively, and no plan assets. For PEF, the defined benefit pension plans with accumulated benefit obligations in excess of plan assets had projected benefit obligations totaling \$38 million and \$35 million at December 31, 2003 and 2002, respectively. Those plans had accumulated benefit obligations totaling \$37 million and \$35 million, respectively, and no plan assets. For Florida Progress, the total accumulated benefit obligation for pension plans was \$729 million and \$662 million at December 31, 2003 and 2002, respectively. For PEF, the total accumulated benefit obligation for pension plans was \$653 million and \$592 million at December 31, 2003 and 2002, respectively. Accrued other postretirement benefit cost is included in other liabilities and deferred credits in the respective Balance Sheets of Florida Progress and PEF.

Florida Progress and PEF recorded a minimum pension liability adjustment of \$11 million and \$6 million, respectively, at December 31, 2003, with a corresponding pre-tax charge to accumulated other comprehensive loss, a component of common stock equity. Florida Progress and PEF recorded a minimum pension liability adjustment of \$7 million and \$4 million, respectively, at December 31, 2002, with a corresponding pre-tax charge to accumulated other comprehensive loss, a component of common stock equity.

Reconciliations of the fair value of plan assets are:

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2003	2002	2003	2002
Fair value of plan assets January 1	\$ 687	\$ 854	\$ 16	\$ 13
Actual return on plan assets	199	(114)	1	1
Benefit payments	(41)	(39)	(15)	(14)
Employer contributions	4	4	16	16
Transfers	-	(18)	-	-
Fair value of plan assets at December 31	\$ 849	\$ 687	\$ 18	\$ 16

In the table above, substantially all employer contributions represent benefit payments made directly from Company assets. The remaining benefits payments were made directly from plan assets. The OPEB benefit payments represent the net Company cost after participant contributions. Participant contributions represent approximately 10% of gross benefit payments.

The asset allocation for the Company's plans at the end of 2003 and 2002 and the target allocation for the plans, by asset category, are as follows:

Asset Category	Pension Benefits			Other Postretirement Benefits		
	Target Allocations	Percentage of Plan Assets at Year End		Target Allocations	Percentage of Plan Assets at Year End	
	2004	2003	2002	2004	2003	2002
Equity – domestic	50%	49%	47%			
Equity – international	15%	22%	20%			
Debt – domestic	15%	11%	15%	100%	100%	100%
Debt – international	10%	11%	10%		-	
Other	10%	7%	8%	-	-	-
Total	100%	100%	100%	100%	100%	100%

With regard to its pension assets, the Company sets strategic allocations among asset classes to provide broad diversification to protect against large investment losses and excessive volatility, while recognizing the importance of offsetting the impacts of benefit cost escalation. In addition, the Company employs external investment managers who have complementary investment philosophies and approaches. Tactical shifts (plus or minus five percent) in asset allocation from the strategic allocations are made based on the near-term view of the risk and return tradeoffs of the asset classes. The Company's OPEB assets are invested solely in fixed income securities.

In 2004, the Company expects to make required contributions of \$1 million directly to pension plan assets and \$1 million of discretionary contributions to OPEB plan assets. The expected benefit payments for the pension benefit plan for 2004 through 2008 and in total for 2009-2013, in millions, are approximately \$40, \$41, \$42, \$44, \$46 and \$269, respectively. The expected benefit payments for the OPEB plan for 2004 through 2008 and in total for 2009-2013, in millions, are approximately \$14, \$15, \$17, \$18, \$19 and \$116, respectively. The expected benefit payments include benefit payments directly from plan assets and benefit payments directly from Company assets. The benefit payment amounts reflect the net cost to the Company after any participant contributions.

The following weighted-average actuarial assumptions were used in the calculation of the year-end obligation:

	Pension Benefits		Other Postretirement Benefits	
	2003	2002	2003	2002
Discount rate	6.30%	6.60%	6.30%	6.60%
Rate of increase in future compensation				
Bargaining	3.50%	3.50%	-	-
Non-bargaining	-	4.00%		
Supplementary plans	5.00%	4.00%		
Initial medical cost trend rate for pre-Medicare benefits			7.25%	7.50%
Initial medical cost trend rate for post-Medicare benefits	-	-	7.25%	7.50%
Ultimate medical cost trend rate	-	-	5.25%	5.25%
Year ultimate medical cost trend rate is achieved	-	-	2009	2009

The Company's primary defined benefit retirement plan for non-bargaining employees is a "cash balance" pension plan as defined in EITF Issue No. 03-4. Therefore, effective December 31, 2003, the Company began to use the traditional unit credit method for purposes of measuring the benefit obligation of this plan and will use that method to measure future benefit costs. Under the traditional unit credit method, no assumptions are included about future changes in compensation and the accumulated benefit obligation and projected benefit obligation are the same.

The following weighted-average actuarial assumptions were used in the calculation of the net periodic cost:

	Pension Benefits			Other Postretirement Benefits		
	2003	2002	2001	2003	2002	2001
Discount rate	6.60%	7.50%	7.50%	6.60%	7.50%	7.50%
Rate of increase in future compensation						
Bargaining	3.50%	3.50%	3.50%			
Non-bargaining and supplementary	4.00%	4.00%	4.00%			
Expected long-term rate of return on plan assets	9.25%	9.25%	9.25%	5.00%	5.00%	5.00%
Initial medical cost trend rate for pre-Medicare benefits	-	-	-	7.50%	7.50%	7.20%
Initial medical cost trend rate for post-Medicare benefits	-	-	-	7.50%	7.50%	6.20%
Ultimate medical cost trend rate	-	-	-	5.25%	5.00%	5.30%
Year ultimate medical cost trend rate is achieved	-	-	-	2009	2008	2005

The expected long-term rates of return on plan assets were determined by considering long-term historical returns for the plans and long-term projected returns based on the plans' target asset allocation. For pension plan assets, those benchmarks support an expected long-term rate of return between 9.5% and 10.0%. The Company has chosen to use an expected long-term rate of 9.25% due to the uncertainties of future returns. The OPEB expected long-term rate of return of 5.0% reflects that the OPEB assets are invested solely in fixed income securities.

The medical cost trend rates were assumed to decrease gradually from the initial rates to the ultimate rates. Assuming a 1% increase in the medical cost trend rates, the aggregate of the service and interest cost components of the net periodic OPEB cost for 2003 would increase by \$1 million, and the OPEB obligation at December 31, 2003, would increase by \$18 million. Assuming a 1% decrease in the medical cost trend rates, the aggregate of the service and interest cost components of the net periodic OPEB cost for 2003 would decrease by \$1 million and the OPEB obligation at December 31, 2003, would decrease by \$15 million.

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. In accordance with guidance issued by the FASB in FASB Staff Position FAS 106-1, the Company has elected to defer accounting for the effects of the Act due to uncertainties regarding the effects of the implementation of the Act and the accounting for certain provisions of the Act. Therefore, OPEB information presented above and in the financial statements does not reflect the effects of the Act. When specific authoritative accounting guidance is issued, it could require plan sponsors to change previously reported information. The Company is in the early stages of reviewing the Act and determining its potential effects on the Company.

15. Risk Management Activities and Derivatives Transactions

Under its risk management policy, the Company may use a variety of instruments, including swaps, options and forward contracts, to manage exposure to fluctuations in commodity prices and interest rates. Such instruments contain credit risk if the counterparty fails to perform under the contract. The Company minimizes such risk by performing credit reviews using, among other things, publicly available credit ratings of such counterparties. Potential non-performance by counterparties is not expected to have a material effect on the consolidated financial position or consolidated results of operations of the Company.

A. Commodity Contracts – General

Most of the Company's commodity contracts either are not derivatives or qualify as normal purchases or sales pursuant to SFAS No. 133. Therefore, such contracts are not recorded at fair value.

B. Commodity Derivatives – Cash Flow Hedges

Progress Fuels held natural gas cash flow hedging instruments at December 31, 2003 and 2002. The objective for holding these instruments is to manage a portion of the market risk associated with fluctuations in the price of natural gas for Progress Fuel's forecasted sales. At December 31, 2003, Progress Fuels is hedging exposures to the price variability of natural gas through December 2005.

The total fair value of these instruments at December 31, 2003 and 2002 was a \$14 million and a \$10 million liability position, respectively. The ineffective portion of commodity cash flow hedges was not material in 2003 and 2002. At December 31, 2003, \$8 million of after-tax deferred losses in accumulated other comprehensive income (OCI) are expected to be reclassified to earnings during the next 12 months as the hedged transactions occur. Due to the volatility of the commodities markets, the value in OCI is subject to change prior to its reclassification into earnings.

C. Commodity Derivatives

Nonhedging derivatives, primarily electricity forward contracts, may be entered into for trading purposes and for economic hedging purposes. While management believes these derivatives mitigate exposures to fluctuations in commodity prices, these instruments are not designated as hedges for accounting purposes and are monitored consistent with trading positions. The Company manages open positions with strict policies that limit its exposure to market risk and require daily reporting to management of potential financial exposures. Gains and

losses from such contracts were not material during 2003, 2002 or 2001, and the Company did not have material outstanding positions in such contracts at December 31, 2003 or 2002.

D. Interest Rate Derivatives – Fair Value or Cash Flow Hedges

The Company manages its interest rate exposure in part by maintaining its variable-rate and fixed rate-exposures within defined limits. In addition, the Company also enters into financial derivative instruments, including, but not limited to, interest rate swaps and lock agreements to manage and mitigate interest rate risk exposure.

The Company uses cash flow hedging strategies to hedge variable interest rates on long-term debt and to hedge interest rates with regard to future fixed-rate debt issuances. PEF held no interest rate cash flow hedges at December 31, 2003. At December 31, 2002, PEF held an interest rate cash flow hedge, with a notional amount of \$35 million, related to an anticipated 2003 issuance of long-term debt. The hedge was settled at the time of issuing the related debt. At December 31, 2003, an immaterial amount of after-tax deferred losses in OCI is expected to be reclassified to earnings during the next 12 months as the hedged interest payments occur.

The Company uses fair value hedging strategies to manage its exposure to fixed interest rates on long-term debt. At December 31, 2003 and 2002, the Company had no open interest rate fair value hedges.

The notional amounts of interest rate derivatives are not exchanged and do not represent exposure to credit loss. In the event of default by a counterparty, the risk in these transactions is the cost of replacing the agreements at current market rates.

16. Related Party Transactions

The Company and its subsidiaries participate in money pools, operated by Progress Energy, to more effectively utilize cash resources and to reduce outside short-term borrowings. The money pools are also used to settle intercompany balances. The weighted-average interest rate for the money pools was 1.47%, 2.18% and 4.47% at December 31, 2003, 2002 and 2001, respectively. At December 31, 2003 and 2002, Florida Progress had \$602 million and \$380 million, respectively, and PEF had \$363 million and \$237 million, respectively, of amounts payable to the money pool that are included in notes payable to affiliated companies on the Balance Sheets. Net interest expense related to money pool borrowings was \$5 million, \$5 million, and \$6 million for Florida Progress in 2003, 2002 and 2001 respectively. PEF recorded net interest expense of \$2 million, \$1 million and interest income of \$2 million related to the money pool for 2003, 2002 and 2001, respectively.

Progress Energy formed Progress Energy Service Company, LLC (PESC) to provide specialized services, at cost, to the Company and its subsidiaries, as approved by the U.S. Securities and Exchange Commission (SEC). The Company and its subsidiaries have an agreement with PESC under which services, including purchasing, information technology, telecommunications, marketing, treasury, human resources, accounting, real estate, legal and tax are rendered at cost. Amounts billed by PESC for these services during 2003, 2002 and 2001 to Florida Progress amounted to \$190 million, \$173 million and \$116 million, respectively, and amounts billed to PEF were \$153 million, \$161 million and \$111 million, respectively. At December 31, 2003 and 2002, Florida Progress had a net payable to PESC of \$32 and \$43 million, respectively. PEF had a net payable to PESC of \$23 million and \$37 million, respectively, at December 31, 2003 and 2002. During 2002, the Office of Public Utility Regulation within the SEC completed an audit examination of Progress Energy's books and records. This examination is a standard process for all PUHCA registrants. Based on the review, the method for allocating PESC costs to the Parent and its affiliates changed for 2003 and retroactive reallocations of 2002 and 2001 charges were made during the first quarter. The net after-tax impact of the reallocation of costs for 2002 and 2001 was an increase in expenses of \$5 million at Florida Progress and a reduction of expenses at PEF by \$1 million.

Progress Fuels has an outstanding note due to the Parent. The principal outstanding on this note was \$500 million at December 31, 2003 and 2002. Progress Fuels recorded interest expense related to this note of \$32 million for 2003 and 2002.

The Company has an outstanding note due to a related trust. The principal outstanding on this note was \$309 million at December 31, 2003 (See Note 11F).

Progress Fuels sells coal to PEF which are eliminated from revenues in Florida Progress' Consolidated Financial Statements. In accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation,"

profits on intercompany sales between Progress Fuels and PEF are not eliminated if the sales price is reasonable and the future recovery of sales price through the ratemaking process is probable. The profits for all the years presented were not significant.

In April 2000, Progress Ventures, Inc. (PVI), a wholly-owned subsidiary of Progress Energy, purchased a 90% interest in an affiliate of Progress Fuels that owns a synthetic fuel facility located at the Company-owned mine site in Virginia. In May 2000, PVI purchased a 90% ownership interest in another synthetic fuel facility located in West Virginia. The purchase agreements contained a provision that would require PVI to sell, and the respective Progress Fuels affiliate to repurchase, the 90% interest had the share exchange among Florida Progress, Progress Energy and CP&L not occurred. Progress Fuels has accounted for the transactions as a sale for tax purposes and, because of the repurchase obligation, as a financing for financial reporting purposes in the pre-acquisition period and as a transfer of assets within a controlled group as of the acquisition date. At the date of acquisition, assets of \$8 million were transferred to Progress Energy. At December 31, 2003 and 2002, the Company has a note receivable of \$38 million and \$47 million from PVI that has been recorded as a reduction to equity for financial reporting purposes. Payments on the note during 2003 and 2002 totaled \$12 million and \$17 million, respectively, representing \$9 million and \$3 million in principal and interest, respectively, in 2003 and \$13 million and \$4 million in principal and interest, respectively, in 2002.

Progress Fuels sells coal feedstock to PVI to be used in its two synthetic fuel operations and is also the sales agent and operator of the facilities. The amount of revenue for sales and services during 2003, 2002 and 2001 was \$181 million, \$197 million and \$96 million, respectively. Amounts due from PVI at December 31, 2003 and 2002 were \$19 million and \$12 million, respectively. During 2003, in order to more effectively utilize cash resources, PFC and the two PVI synthetic fuel operations began to participate in a money pool with cash management functions provided by PFC. At December 31, 2003, Progress Fuels has a payable of \$34 million to PVI.

The Company and each of its wholly-owned subsidiaries have entered into a Tax Agreement with Progress Energy (See Note 13).

In August 2002, PEC transferred reservation payments for the manufacture of two combustion turbines to PEF at PEC's original cost of \$20 million. In December 2002, PVI transferred reservation payments for the manufacture of one combustion turbine and exhaust stack to PEF at PVI's original cost of \$16 million. At December 31, 2002, PEF had a \$14 million payable to PVI related to these transfers.

17. Financial Information by Business Segment

The Company's principal business segment is PEF, a utility engaged in the generation, purchase, transmission, distribution and sale of electricity primarily in Florida. The other reportable business segments are Progress Fuels' Energy & Related Services and Rail Services. The Inland Marine Transportation business, formerly a business segment, was sold in November 2001 (See Note 3C). The Energy & Related Services segment includes coal and synthetic fuel operations, natural gas production and sales, river terminal services and off-shore marine transportation. Rail Services' operations include railcar repair, rail parts reconditioning and sales, railcar leasing and sales, providing rail and track material, and scrap metal recycling. The Other category consists primarily of PTC, the Company's telecommunications subsidiary and the holding company, Florida Progress Corporation. PTC markets wholesale fiber-optic based capacity service in the Eastern United States and also markets wireless structure attachments to wireless communication companies and governmental entities. The Company allocates a portion of its operating expenses to business segments.

The Company's significant operations are geographically located in the United States with limited operations in Mexico and Canada. The Company's segments are based on differences in products and services, and therefore no additional disclosures are presented. Intersegment sales and transfers consist primarily of coal sales from the Energy and Related Services segment of Progress Fuels to PEF. The price Progress Fuels charges PEF is based on market rates for coal procurement and for water-borne transportation under a methodology approved by the FPSC. Rail transportation is also based on market rates plus a return allowed by the FPSC on equity in transportation equipment utilized in transporting coal to PEF. The allowed rate of return is currently 12%. No single customer accounted for 10% or more of unaffiliated revenues.

Segment net income (loss) for 2003 includes a long-lived asset impairment on certain assets at Kentucky May Mining Company of \$15 million (\$10 million after-tax) included in the Energy and Related Services segment. Segment net income (loss) for 2002 includes an estimated impairment on the assets held for sale of Railcar Ltd.

of \$67 million pre-tax (\$45 million after-tax) included in the Rail Services segment and an asset impairment and other charges related to PTC totaling \$233 million on a pre-tax basis (\$144 million after-tax) included in the Other segment. Segment net income (loss) for 2001 includes a long-lived asset impairment pre-tax loss of \$161 million (after-tax \$108 million) included in the Rail Services segment. The Company's business segment information for 2003, 2002 and 2001 is summarized below.

(in millions)	Utility	Energy and Related Services	Rail Services	Other	Consolidated
Year Ended					
December 31, 2003					
Unaffiliated revenues	\$ 3,152	\$ 982	\$ 846	\$ 28	\$ 5,008
Intersegment revenues	-	346	1	(347)	-
Total revenues	3,152	1,328	847	(319)	5,008
Depreciation and amortization	307	66	20	6	399
Total interest charges, net	91	22	29	21	163
Impairment of long-lived assets and investments	-	15	-	-	15
Income tax expense (benefit)	147	(246)	2	(13)	(110)
Income (loss) from continuing operations	295	166	(1)	(17)	443
Total segment assets	7,306	1,009	586	335	9,236
Capital and investment expenditures	548	310	103	11	972
<hr/>					
Year Ended					
December 31, 2002					
Unaffiliated revenues	\$ 3,062	\$ 690	\$ 714	\$ 34	\$ 4,500
Intersegment revenues	-	329	5	(334)	-
Total revenues	3,062	1,019	719	(300)	4,500
Depreciation and amortization	295	34	20	12	361
Total interest charges, net	106	22	33	22	183
Impairment of long-lived assets and investments	-	-	67	214	281
Income tax expense (benefit)	163	(207)	(19)	(110)	(173)
Income (loss) from continuing operations	323	122	(47)	(168)	230
Total segment assets	6,678	794	529	137	8,138
Capital and investment expenditures	550	121	8	42	721
<hr/>					
Year Ended					
December 31, 2001					
Unaffiliated revenues	\$ 3,213	\$ 512	\$ 820	\$ 35	\$ 4,580
Intersegment revenues	-	299	1	(300)	-
Total revenues	3,213	811	821	(265)	4,580
Depreciation and amortization	453	24	34	11	522
Total interest charges, net	113	18	36	27	194
Impairment of long-lived assets and investments	-	-	161	9	170
Income tax expense (benefit)	183	(254)	(75)	(27)	(173)
Income (loss) from continuing operations	309	129	(144)	(29)	265
Capital and investment expenditures	353	44	18	71	486

18. Other Income and Other Expense

Other income and expense includes interest income and other income and expense items as discussed below. The components of other, net as shown on the Statements of Income and Comprehensive Income for fiscal years 2003, 2002 and 2001 are as follows:

(in millions)	2003	2002	2001
<u>Other income</u>			
Net financial trading gain (loss)	\$ (1)	\$ -	\$ (4)
Nonregulated energy and delivery services income	14	17	18
AFUDC equity	12	2	-
Other	2	4	1
Total other income – Progress Energy Florida	\$ 27	\$ 23	\$ 15
Other income – Florida Progress	5	6	3
Total other income – Florida Progress	\$ 32	\$ 29	\$ 18
<u>Other expense</u>			
Nonregulated energy and delivery services expenses	\$ 11	\$ 15	\$ 13
Donations	9	10	7
Other	-	5	6
Total other expense – Progress Energy Florida	\$ 20	\$ 30	\$ 26
Loss from equity investments	15	5	12
Other expense – Florida Progress	9	14	12
Total other expense – Florida Progress	\$ 44	\$ 49	\$ 50
Other, net	\$ (12)	\$ (20)	\$ (32)

Net financial trading gain (loss) represents non-asset-backed trades of electricity. Nonregulated energy and delivery services include power protection services and mass market programs (surge protection, appliance services and area light sales) and delivery, transmission and substation work for other utilities.

19. Commitments and Contingencies

A. Purchase Obligations

The following table reflects FPC's contractual cash obligations and other commercial commitments in the respective periods in which they are due.

(in millions)	2004	2005	2006	2007	2008	Thereafter
Contractual Cash Obligations						
Fuel	\$ 796	\$ 368	\$ 248	\$ 159	\$ 102	\$ 790
Purchased power	317	329	340	349	357	4,237
Construction obligations	99	49				
Other purchase obligations	16	5	18	11	16	107
Total	\$ 1,228	\$ 751	\$ 606	\$ 519	\$ 475	\$ 5,134

Fuel and Purchased Power

FPC has entered into various long-term contracts for oil, gas and coal. Payments under these commitments were \$703 million, \$830 million and \$761 million in 2003, 2002 and 2001, respectively. Estimated annual payments for firm commitments of fuel purchases and transportation costs under these contracts are approximately \$796 million, \$368 million, \$248 million, \$159 million and \$102 million for 2004 through 2008, respectively, with approximately \$790 payable thereafter.

Progress Fuels has two coal supply contracts with PEF through 2004, which require PEF to buy and Progress Fuels to supply substantially all of the coal and transportation requirements of four of PEF's generating units. In connection with these contracts, Progress Fuels has entered into several contracts with outside parties for the purchase of coal. The annual obligations for coal purchases and transportation under these contracts are \$172 million, \$52 million and \$42 million for 2004, 2005 and 2006, respectively, with no obligations thereafter. The

total cost incurred for these commitments in 2003, 2002 and 2001 was \$284 million, \$289 million and \$173 million, respectively.

PEF has long-term contracts for approximately 474 MW of purchased power with other utilities, including a contract with The Southern Company for approximately 414 MW of purchased power annually through 2010. PEF can lower these purchases to approximately 200 MW annually with a three-year notice. Total purchases, for both energy and capacity, under these agreements amounted to \$141 million, \$159 million and \$112 million for 2003, 2002 and 2001, respectively. Total capacity payments were \$57 million, \$51 million and \$54 million for 2003, 2002 and 2001, respectively. Minimum purchases under these contracts, representing capital-related capacity costs, are approximately \$60 million annually through 2009 and \$30 million annually for 2010.

PEF has ongoing purchased power contracts with certain cogenerators (qualifying facilities) for 871 MW of capacity with expiration dates ranging from 2004 to 2025. These purchased power contracts provide for capacity and energy payments. Energy payments are based on the actual power taken under these contracts. Capacity payments are subject to the qualifying facilities meeting certain contract performance obligations. In most cases, these contracts account for 100% of the generating capacity of each of the facilities. Of the 871 MW under contract, 831 MW currently are available to PEF. All commitments have been approved by the FPSC. Total capacity purchases under these contracts amounted to \$241 million, \$232 million and \$226 million for 2003, 2002 and 2001, respectively. Minimum expected future capacity payments under these contracts at December 31, 2003 are \$257 million, \$269 million, \$280 million, \$289 million and \$297 million for 2004 through 2008, respectively.

The FPSC allows the capacity payments to be recovered through a capacity cost recovery clause, which is similar to, and works in conjunction with, energy payments recovered through the fuel cost recovery clause.

Construction Obligations

PEF has purchase obligations related to various plant capital projects at the Hines Complex. Total payments under these contracts were \$159 million, \$110 million, and \$18 million for 2003, 2002, and 2001 respectively. Future obligations under these contracts are \$99 million and \$49 million for 2004 and 2005, respectively.

Other

PEF has long-term service agreements for the Hines Complex. Total payments under these contracts were \$3 million, \$1 million and \$6 million for 2003, 2002 and 2001, respectively. Future obligations under these contracts are \$16 million, \$5 million, \$18 million, \$11 million and \$16 million for 2004 through 2008, respectively, with approximately \$107 million payable thereafter.

B. Other Commitments

Florida Progress has certain future commitments related to synthetic fuel facilities purchased that provide for contingent payments (royalties) of up to \$25 million on synthetic fuel sales from Florida Progress' interests in these plants annually through 2007. The related agreements were amended in December 2001 to require the payment of minimum annual royalties of which Florida Progress' share is approximately \$15 million through 2007. As a result of the amendment, Florida Progress recorded a liability (included in other liabilities and deferred credits on the Consolidated Balance Sheets) and a deferred asset (included in other assets and deferred debits in the Consolidated Balance Sheets) of approximately \$52 million and \$63 million at December 31, 2003 and 2002, representing the minimum amounts due through 2007, discounted at 6.05%. At December 31, 2003 and 2002, respectively, the portions of the asset and liability recorded that were classified as current were approximately \$13 million and \$13 million, respectively. The deferred asset will be amortized to expense each year as synthetic fuel sales are made. The maximum amounts payable under these agreements remain unchanged. Actual amounts paid under these agreements were approximately \$1 million in 2003, \$24 million in 2002 and \$25 million in 2001. Future expected royalty payments are approximately \$15 million for 2004

through 2007 and \$4 million for 2008. The large decline in amount paid from 2002 to 2003 is due to the Company's right in the related agreements and their amendments that allows the Company to escrow those payments if certain conditions in the agreements are met. The Company has exercised that right and retained 2003 royalty payments of approximately \$25 million pending the establishment of the necessary escrow accounts. Once established, these funds will be placed into escrow.

C. Leases

The Company leases transportation equipment, office buildings, computer equipment, and other property and equipment with various terms and expiration dates. The Company generally requires the subsidiaries to pay all executory costs such as maintenance and insurance. Some rental payments include minimum rentals plus contingent rentals based on mileage. These contingent rentals are not significant. Rent expense under operating leases totaled \$42 million, \$33 million and \$25 million during 2003, 2002 and 2001, respectively. In addition, PTC has entered into capital leases for equipment. Assets recorded under capital leases totaled \$4 million and \$3 million at December 31, 2003 and 2002, respectively. Accumulated amortization was not significant. These assets were written down in conjunction with the impairments of PTC recorded during the third quarter of 2002 (See Note 9).

Minimum annual rental payments, excluding executory costs such as property taxes, insurance and maintenance, under long-term noncancelable leases at December 31, 2003 are:

(in millions)	Capital Leases	Operating Leases
2004	\$ 1	\$ 20
2005	1	18
2006	1	16
2007	1	12
2008	1	9
Thereafter	9	54
	<u>\$ 14</u>	<u>\$ 129</u>
Less amount representing imputed interest	(4)	
Present value of net minimum lease payments under capital lease	<u>\$ 10</u>	

The Company is also a lessor of land, buildings, railcars and other types of properties it owns under operating leases with various terms and expiration dates. The leased buildings and railcars are depreciated under the same terms as other buildings and railcars included in diversified business property. Minimum rentals receivable under noncancelable leases for 2004 through 2008, in millions is \$4, \$4, \$3, \$1, and \$1, respectively and \$18 million thereafter. These rental receivable totals exclude all leases attributable to Railcar Ltd. which was sold during the first quarter of 2004 (See Note 3B).

PEF is the lessor of electric poles, streetlights and other facilities. Rents received are contingent upon usage and totaled \$56 million, \$53 million and \$48 million for 2003, 2002 and 2001, respectively.

D. Guarantees

As a part of normal business, Florida Progress and certain subsidiaries including PEF enter into various agreements providing financial or performance assurances to third parties. Such agreements include guarantees, standby letters of credit and surety bonds. These agreements are entered into primarily to support or enhance the creditworthiness otherwise attributed to a subsidiary on a stand-alone basis, thereby facilitating the extension of sufficient credit to accomplish the subsidiaries' intended commercial purposes. At December 31, 2003, management does not believe conditions are likely for performance under these agreements.

Guarantees at December 31, 2003, are summarized in the table below and discussed more fully in the subsequent paragraphs:

(in millions)
Guarantees issued on behalf of the Company and affiliates
 Standby letters of credit

\$ 33

Surety bonds	
Other guarantees	21
<u>Guarantees issued on behalf of third parties</u>	
Securities of affiliated trust	300
Other guarantees	13
Total	<u>\$367</u>

Standby Letters of Credit

The Company has issued standby letters of credit to financial institutions for the benefit of third parties that have extended credit to the Company and certain subsidiaries. Of the total standby letters of credit issued, PEF has issued commitments totaling \$2 million. These letters of credit have been issued primarily for the purpose of supporting payments of trade payables, securing performance under contracts and lease obligations and self insurance for workers compensation. If a subsidiary does not pay amounts when due under a covered contract, the counterparty may present its claim for payment to the financial institution, which will in turn request payment from the Company. Any amounts owed by the Company's subsidiaries are reflected in the Company's Consolidated Balance Sheets.

Surety Bonds

At December 31, 2003, the Company had \$0.2 million in surety bonds, of which PEF accounted for the entire amount, purchased primarily for purposes such as providing workers compensation coverage and obtaining licenses, permits and rights-of-way. To the extent liabilities are incurred as a result of the activities covered by the surety bonds, such liabilities are included in the Balance Sheets.

Other Guarantees

The Company has total other guarantees outstanding of approximately \$34 million. Included in the \$34 million are \$3 million of guarantees issued on behalf of third parties related to obligations on leasing arrangements and \$10 million in support of synthetic fuel operations at a third party plant. The Company estimates it will have to perform under the third party guarantees related to the leasing agreements and as such \$3 million has been accrued and is reflected in the Company's Consolidated Balance Sheets. The remaining \$21 million in other guarantees is related primarily to prompt performance payments and other payments subject to contingencies.

Securities of Affiliated Trust

The Company has guaranteed certain payments of an affiliated company, FPC Capital I (the Trust). Due to the nature of the relationship between the Trust and Florida Progress Funding Corporation, the Company has guaranteed the payment of all distributions related to the Trust's outstanding mandatorily redeemable preferred securities. At December 31, 2003, the Trust had outstanding 12 million shares of the securities with a liquidation value of \$300 million. See discussion at Note 11F for further discussion of the guarantee.

Guarantees Issued by Progress Energy

Progress Energy has issued approximately \$27 million of guarantees on behalf of Progress Fuels and its subsidiaries for obligations under coal trading operations.

E. Claims and Uncertainties

The Company is subject to federal, state and local regulations addressing hazardous and solid waste management, air and water quality and other environmental matters.

Hazardous and Solid Waste Management

Various organic materials associated with the production of manufactured gas, generally referred to as coal tar, are regulated under federal and state laws. The principal regulatory agency that is responsible for a specific former manufactured gas plant (MGP) site depends largely upon the state in which the site is located. There are several MGP sites to which the Company has some connection. In this regard, PEF and other potentially responsible parties, are participating in, investigating and, if necessary, remediating former MGP sites with several regulatory agencies, including, but not limited to, the U.S. Environmental Protection Agency (EPA) and the Florida Department of Environmental Protection (FDEP). In addition, PEF is periodically notified by regulators such as the EPA and various state agencies of its involvement or potential involvement in sites, other than MGP sites, that may require investigation and/or remediation.

PEF At December 31, 2003, PEF has accrued \$18 million for probable and estimable costs related to various environmental sites. Of this accrual, \$12 million is for costs associated with the remediation of distribution transformers which are more fully discussed below. The remaining \$6 million is related to two former MGP sites and other sites associated with PEF that have required or are anticipated to require investigation and/or remediation costs. PEF does not believe that it can provide an estimate of the reasonably possible total remediation costs beyond what is currently accrued.

In 2002, PEF accrued approximately \$3 million for investigation and remediation costs associated with distribution transformers and received approval from the FPSC for annual recovery of these environmental costs through the Environmental Cost Recovery Clause (ECRC). In September 2003, PEF accrued an additional \$15 million for similar environmental costs as a result of increased sites and estimated costs per site. PEF has received approval from the FPSC to recover these costs through the ECRC. As more activity occurs at these sites, PEF will assess the need to adjust the accruals.

These accruals have been recorded on an undiscounted basis. PEF measures its liability for these sites based on available evidence including its experience in investigating and remediating environmentally impaired sites. This process often includes assessing and developing cost-sharing arrangements with other potentially responsible parties. Presently, PEF cannot determine the total costs that may be incurred in connection with the remediation of all sites.

Florida Progress In 2001, Progress Fuels sold its Inland Marine Transportation business to AEP Resources, Inc. Progress Fuels established an accrual to address indemnities and retained environmental liability associated with the transaction. Progress Fuels estimates that its contractual liability to AEP Resources, Inc. associated with Inland Marine Transportation is \$4 million at December 31, 2003 and has accrued such amount. The previous accrual of \$10 million was reduced in 2003 based on a change in estimate. This accrual has been determined on an undiscounted basis. Progress Fuels measures its liability for this site based on estimable and probable remediation scenarios. The Company believes that it is not reasonably probable that additional costs will be incurred related to the environmental indemnification provision beyond the amount accrued. The Company cannot predict the outcome of this matter.

PEF has filed claims with the Company's general liability insurance carriers to recover costs arising out of actual or potential environmental liabilities. Some claims have been settled and others are still pending. The Company cannot predict the outcome of this matter.

Certain historical sites exist that are being addressed voluntarily by Progress Fuels and FPC. The Company cannot determine the total costs that may be incurred in connection with these sites. The Company cannot predict the outcome of this matter.

Rail Services is voluntarily addressing certain historical waste sites. The Company cannot determine the total costs that may be incurred in connection with these sites. The Company cannot predict the outcome of this matter.

The Company is also currently in the process of assessing potential costs and exposures at other environmentally impaired sites. As the assessments are developed and analyzed, the Company will accrue costs for the sites to the extent the costs are probable and can be reasonably estimated.

Air Quality

There has been and may be further proposed federal legislation requiring reductions in air emissions for nitrogen oxides, sulfur dioxide, carbon dioxide and mercury. Some of these proposals establish nationwide caps and emission rates over an extended period of time. This national multi-pollutant approach to air pollution control could involve significant capital costs which could be material to the Company's consolidated financial position or results of operations. Some companies may seek recovery of the related cost through rate adjustments or similar mechanisms. However, the Company cannot predict the outcome of this matter.

The EPA is conducting an enforcement initiative related to a number of coal-fired utility power plants in an effort to determine whether modifications at those facilities were subject to New Source Review requirements or New Source Performance Standards under the Clean Air Act. PEF was asked to provide information to the EPA as part of this initiative and cooperated in providing the requested information. During 2003, PEF received a supplemental information request from the EPA and responded to it. The EPA initiated civil enforcement actions against other unaffiliated utilities as part of this initiative. Some of these actions resulted in settlement agreements calling for expenditures ranging from \$1.0 billion to \$1.4 billion. A utility that was not subject to a civil enforcement action settled its New Source Review issues with the EPA for \$300 million. These settlement agreements have generally called for expenditures to be made over extended time periods, and some of the companies may seek recovery of the related cost through rate adjustments or similar mechanisms. The Company cannot predict the outcome of the EPA's initiative or its impact, if any, on the Company.

In 2003, the EPA published a final rule addressing routine equipment replacement under the New Source Review program. The rule defines routine equipment replacement and the types of activities that are not subject to New Source Review requirements or New Source Performance Standards under the Clean Air Act. The rule was challenged in the Federal Appeals Court and its implementation stayed. The Company cannot predict the outcome of this matter.

In 1997, the EPA's Mercury Study Report and Utility Report to Congress conveyed that mercury is not a risk to the average American and expressed uncertainty about whether reductions in mercury emissions from coal-fired power plants would reduce human exposure. Nevertheless, the EPA determined in 2000 that regulation of mercury emissions from coal-fired power plants was appropriate. In 2003, the EPA proposed, and solicited comment on, two alternative control plans that would limit mercury emissions from coal-fired power plants. The agency has indicated that it will choose one of the alternatives as the final rule, which is expected to be promulgated in December 2004. Achieving compliance with either proposal could involve significant capital costs which could be material to the Company's financial condition or results of operations. However, the Company cannot predict the outcome of this matter.

In conjunction with the proposed mercury rule, the EPA proposed a Maximum Available Control Technology (MACT) standard to regulate nickel emissions from residual oil-fired units. The agency estimates the proposal will reduce national nickel emissions to approximately 103 tons. The rule is expected to become final in December 2004. The Company cannot predict the outcome of this matter.

In December 2003, the EPA released its proposed Interstate Air Quality Rule (commonly known as the Fine Particulate Transport Rule and/or the Regional Transport Rule). The EPA's proposal requires 28 jurisdictions, including North Carolina, South Carolina, Georgia and Florida, to further reduce nitrogen oxide (NOx) and sulfur dioxide (SO2) emissions in order to attain pre-set NOx and SO2 emissions levels (which have not yet been determined). The rule is expected to become final in 2004. The installation of controls necessary to comply with the rule could involve significant capital costs.

In 2004, a bill was introduced in the Florida legislature that would require significant reductions in SO2, NOx and particulate emissions from certain coal, natural gas and oil-fired generating units owned or operated by investor-owned electric utilities, including PEF. The SO2 and NOx reductions would be effective beginning with calendar year 2010 and the particulate reductions would be effective beginning with calendar year 2012. Under the proposed legislation, the FPSC would be authorized to allow the utilities to recover the costs of compliance with the emission reductions over a period not greater than seven years beginning in 2005, but the utilities' rates would be frozen at 2004 levels for at least five years of the maximum recovery period. The Company cannot predict the outcome of this matter.

Water Quality

As a result of the operation of certain control equipment needed to address the air quality issues outlined above, new wastewater streams may be generated. Integration of these new wastewater streams into existing wastewater treatment processes may result in permitting, construction and water treatment challenges to the Company in the

immediate and extended future.

After many years of litigation and settlement negotiations, the EPA is scheduled to publish final regulations in February 2004 for the implementation of Section 316(b) of the Clean Water Act. The purpose of these regulations is to minimize adverse environmental impacts caused by cooling water intake structures and intake systems located at existing facilities. Over the next several years, these regulations may require the facilities to mitigate the effects to aquatic organisms by undertaking intake modifications or other restorative activities. Substantial costs could be incurred by the facilities in order to comply with the new regulations. The Company cannot predict the outcome and impacts to the facilities at this time.

The EPA has published for comment a draft Environmental Impact Statement (EIS) for surface coal mining (sometimes referred to as "mountaintop mining") and valley fills in the Appalachian coal region, where Progress Fuels currently operates a surface mine and may operate others in the future. The final EIS, when published, may affect regulations for the permitting of mines and the cost of compliance with environmental regulations. Regulatory changes for mining may also affect the cost of fuel for the PEC and PEF fueled electric generating plants. The Company cannot predict the outcome of this matter.

Other Environmental Matters

The Kyoto Protocol was adopted in 1997 by the United Nations to address global climate change by reducing emissions of carbon dioxide and other greenhouse gases. The United States has not adopted the Kyoto Protocol; however, a number of carbon dioxide emissions control proposals have been advanced in Congress and by the Bush Administration. **The Bush Administration favors voluntary programs.** Reductions in carbon dioxide emissions to the levels specified by the Kyoto Protocol and some legislative proposals could be materially adverse to the Company's financials and operations if associated costs cannot be recovered from customers. The Company favors the voluntary program approach recommended by the administration, and is evaluating options for the reduction, avoidance and sequestration of greenhouse gases. However, the Company cannot predict the outcome of this matter.

Other Contingencies

1) Franchise Litigation

Three cities, with a total of approximately 18,000 customers, have litigation pending against PEF in various circuit courts in Florida. As discussed below, three other cities, with a total of approximately 30,000 customers, have subsequently settled their lawsuits with PEF and signed new, 30-year franchise agreements. The lawsuits principally seek (1) a declaratory judgment that the cities have the right to purchase PEF's electric distribution system located within the municipal boundaries of the cities, (2) a declaratory judgment that the value of the distribution system must be determined through arbitration, and (3) injunctive relief requiring PEF to continue to collect from PEF's customers and remit to the cities, franchise fees during the pending litigation, and as long as PEF continues to occupy the cities' rights-of-way to provide electric service, notwithstanding the expiration of the franchise ordinances under which PEF had agreed to collect such fees. Five circuit courts have entered orders requiring arbitration to establish the purchase price of PEF's electric distribution system within five cities. Two appellate courts have upheld those circuit court decisions and authorized cities to determine the value of PEF's electric distribution system within the cities through arbitration. Arbitration in one of the cases (the City of Casselberry) was held in August 2002. Following arbitration, the parties entered settlement discussions, and in July 2003 the City approved a settlement agreement and a new, 30-year franchise agreement with PEF. The settlement resolves all pending litigation with that City. A second arbitration (with the 13,000-customer City of Winter Park) was completed in February 2003. That arbitration panel issued an award in May 2003 setting the value of PEF's distribution system within the City of Winter Park at approximately \$32 million, not including separation and reintegration and construction work in progress, which could add several million dollars to the award. The panel also awarded PEF approximately \$11 million in stranded costs. In September 2003, Winter Park voters passed a referendum that would authorize the City to issue bonds of up to approximately \$50 million to acquire PEF's electric distribution system. The City has not yet definitively decided whether it will acquire the system, but has indicated that it will seek wholesale power supply bids and bids to operate and maintain the distribution system. At this time, whether and when there will be further proceedings regarding the City of Winter Park cannot be determined. A third arbitration (with the 2,500-customer Town of Belleair) was completed in June 2003. In September 2003, the arbitration panel issued an award in that case setting the value of the electric distribution system within the Town at approximately \$6 million. The panel further required the

Town to pay to PEF its requested \$1 million in separation and reintegration costs and \$2 million in stranded costs. The Town has not yet decided whether it will attempt to acquire the system. At this time, whether and when there will be further proceedings regarding the Town of Belleair cannot be determined. A fourth arbitration (with the 13,000-customer City of Apopka) had been scheduled for January 2004. In December 2003, the Apopka City Commission voted on first reading to approve a settlement agreement and a 30-year franchise with PEF. The settlement and franchise became effective upon approval by the Commission at a second reading of the franchise in January 2004. The settlement resolves all outstanding litigation between the parties. Arbitration in the remaining city's litigation (the 1,500-customer City of Edgewood) has not yet been scheduled.

As part of the above litigation, two appellate courts have also reached opposite conclusions regarding whether PEF must continue to collect from its customers and remit to the cities "franchise fees" under the expired franchise ordinances. PEF has filed an appeal with the Florida Supreme Court to resolve the conflict between the two appellate courts. The Florida Supreme Court held oral argument in one of the appeals in August 2003. Subsequently, the Court requested briefing from the parties in the other appeal, which was completed in November 2003. The Court has not yet issued a decision in these cases. PEF cannot predict the outcome of these matters at this time.

2) DOE Litigation

As required under the Nuclear Waste Policy Act of 1982, PEF entered into a contract with the U.S. Department of Energy (DOE) under which the DOE agreed to begin taking spent nuclear fuel by no later than January 31, 1998. All similarly situated utilities were required to sign the same standard contract.

In April 1995, the DOE issued a final interpretation that it did not have an unconditional obligation to take spent nuclear fuel by January 31, 1998. In Indiana & Michigan Power v. DOE, the Court of Appeals vacated the DOE's final interpretation and ruled that the DOE had an unconditional obligation to begin taking spent nuclear fuel. The Court did not specify a remedy because the DOE was not yet in default.

After the DOE failed to comply with the decision in Indiana & Michigan Power v. DOE, a group of utilities petitioned the Court of Appeals in Northern States Power (NSP) v. DOE, seeking an order requiring the DOE to begin taking spent nuclear fuel by January 31, 1998. The DOE took the position that its delay was unavoidable, and the DOE was excused from performance under the terms and conditions of the contract. The Court of Appeals did not order the DOE to begin taking spent nuclear fuel, stating that the utilities had a potentially adequate remedy by filing a claim for damages under the contract.

After the DOE failed to begin taking spent nuclear fuel by January 31, 1998, a group of utilities filed a motion with the Court of Appeals to enforce the mandate in NSP v. DOE. Specifically, this group of utilities asked the Court to permit the utilities to escrow their waste fee payments, to order the DOE not to use the waste fund to pay damages to the utilities, and to order the DOE to establish a schedule for disposal of spent nuclear fuel. The Court denied this motion based primarily on the grounds that a review of the matter was premature, and that some of the requested remedies fell outside of the mandate in NSP v. DOE.

Subsequently, a number of utilities each filed an action for damages in the Federal Court of Claims. The U.S. Circuit Court of Appeals (Federal Circuit) has ruled that utilities may sue the DOE for damages in the Federal Court of Claims instead of having to file an administrative claim with DOE.

On January 14, 2004, PEF filed a complaint with the United States Court of Federal Claims against the United States of America (Department of Energy) claiming that the DOE breached the Standard Contract for Disposal of Spent Nuclear Fuel by failing to accept spent nuclear fuel from various Progress Energy facilities on or before January 31, 1998. Damages due to DOE's breach will likely exceed \$100 million. Similar suits have been initiated by over two dozen other utilities.

In July 2002, Congress passed an override resolution to Nevada's veto of DOE's proposal to locate a permanent ~~underground nuclear waste storage facility at Yucca Mountain, Nevada.~~ DOE plans to submit a license application for the Yucca Mountain facility by the end of 2004. On November 5, 2003, Congressional negotiators approved \$580 million for fiscal year 2004 for the Yucca Mountain project, \$123 million more than the previous year. PEF cannot predict the outcome of this matter.

PEF is currently storing spent nuclear fuel onsite in spent fuel pools. If PEF does not seek renewal of the Crystal River Nuclear Plant (CR3) operating license, CR3 will have sufficient storage capacity in place for fuel

consumed through the end of the expiration of the license in 2016. If PEF extends the CR3 operating license, dry storage may be necessary.

3) Easement Litigation

In December 1998, PEF was served with a class action lawsuit seeking damages, declaratory and injunctive relief for the alleged improper use of electric transmission easements. The plaintiffs contended that the licensing of fiber-optic telecommunications lines to third parties or telecommunications companies for other than PEF's internal use along the electric transmission line right-of-way exceeds the authority granted in the easements. In 1999, plaintiffs amended their complaint to add PTC. After several legal motions and appeals over the years the Company and the appellants reached a settlement resolving the appellants' dispute in 2003. In May 2003 the trial court entered an Amended Final Judgment approving the mandatory class settlement. No appeals have been taken from that judgment, and the time to appeal has expired. In July 2003, PEF, the class representatives and the appellants filed a joint withdrawal of all pending motions with the First District Court of Appeal. The First District Court of Appeal acknowledged the withdrawal of all pending motions and issued a mandate in July 2003. Under the terms of the mandatory class settlement, PEF made settlement payments to class members in August 2003. The settlement payments did not have a material adverse effect upon PEF's financial condition or results of operations.

4) Advanced Separation Technologies (AST)

In 1996, Florida Progress sold its 80% interest in AST to Calgon Carbon Corporation (Calgon) for net proceeds of \$56 million in cash. In January 1998, Calgon filed a lawsuit against Florida Progress and the other selling shareholder and amended it in April 1998, alleging misstatement of AST's 1996 revenues, assets and liabilities, seeking damages and granting Calgon the right to rescind the sale. The lawsuit also accused the sellers of failing to disclose flaws in AST's manufacturing process and a lack of quality control. Florida Progress believes that the aggregate total of all legitimate warranty claims by customers of AST for which it is probable that Florida Progress will be responsible for under the Stock Purchase Agreement with Calgon is approximately \$3 million, and accordingly, accrued \$3 million in the third quarter of 1999 as an estimate of probable loss. All parties filed motions for summary judgment in July 2001. The summary judgment motions of Calgon and the other selling shareholder were denied in April of 2002. The summary judgment motion of Florida Progress was withdrawn pending a legal challenge to portions of the report of Calgon's expert, Arthur Andersen, which had been used to oppose summary judgment. In September 2003, the United States District Court for the Western District of Pennsylvania issued final orders excluding from evidence in the case that portion of Arthur Andersen's damage analysis based on the discounted cash flow methodology of valuation. The Court did not exclude Arthur Andersen's use of the guideline publicly traded company methodology in its damage analysis. Florida Progress filed a renewed motion for summary judgment in October 2003, which is pending. The Company cannot predict the outcome of this matter, but will present a vigorous defense.

5) Other Legal Matters

Florida Progress and PEF are involved in various other claims and legal actions arising in the ordinary course of business, some of which involve claims for substantial amounts. Where appropriate, accruals have been made in accordance with SFAS No. 5, "Accounting for Contingencies," to provide for such matters. Florida Progress and PEF believe the ultimate disposition of these matters will not have a material adverse effect upon either Company's consolidated financial position, results of operation or liquidity.

INDEPENDENT AUDITORS' REPORT

TO THE BOARDS OF DIRECTORS OF FLORIDA PROGRESS CORPORATION AND
FLORIDA POWER CORPORATION d/b/a PROGRESS ENERGY FLORIDA, INC.:

We have audited the consolidated balance sheets of Florida Progress Corporation and its subsidiaries (Florida Progress) and the balance sheets of Florida Power Corporation d/b/a Progress Energy Florida, Inc. (PEF) at December 31, 2003 and 2002, and the related Florida Progress consolidated statements of income and comprehensive income, of common equity, and of cash flows and the related PEF statements of income and comprehensive income, of common equity, and of cash flows for each of the three years in the period ended December 31, 2003 and have issued our report thereon dated February 20, 2004 (which expresses an unqualified opinion and includes an explanatory paragraph concerning the adoption of new accounting principles in 2003); such financial statements and report are included herein. Our audits also included the financial statement schedules of Florida Progress and PEF for the years ended December 31, 2003 and 2002, listed in Item 8. These financial statement schedules are the responsibility of the respective company's management. Our responsibility is to express an opinion based on our audits. In our opinion, such financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly in all material respects the information set forth therein.

/s/ DELOITTE & TOUCHE LLP
Raleigh, North Carolina
February 20, 2004

Exhibit A (6)(ii)

FLORIDA PROGRESS CORPORATION
CONSOLIDATED INTERIM FINANCIAL STATEMENTS
June 30, 2004

UNAUDITED CONSOLIDATED STATEMENTS of INCOME

(in millions)	Three Months Ended June 30		Six Months Ended June 30	
	2004	2003	2004	2003
Operating Revenues				
Utility	\$ 860	\$ 767	\$ 1,644	\$ 1,495
Diversified business	644	440	1,171	927
Total Operating Revenues	1,504	1,207	2,815	2,422
Operating Expenses				
Utility				
Fuel used in electric generation	276	217	545	402
Purchased power	139	141	260	271
Operation and maintenance	152	154	312	295
Depreciation and amortization	72	80	141	159
Taxes other than on income	64	59	126	117
Diversified business				
Cost of sales	562	388	1,033	826
Depreciation and amortization	27	22	52	43
Other	32	25	65	62
Total Operating Expenses	1,324	1,086	2,534	2,175
Operating Income	180	121	281	247
Other Income (Expense)				
Interest income	1	1	2	2
Other, net	(2)	(1)	(7)	(7)
Total Other Expense	(1)	-	(5)	(5)
Interest Charges				
Interest charges	47	48	92	95
Allowance for borrowed funds used during construction	(1)	(2)	(2)	(4)
Total Interest Charges, Net	46	46	90	91
Income before Income Taxes	133	75	186	151
Income Tax Benefit	(2)	(39)	(4)	(55)
Net Income	\$ 135	\$ 114	\$ 190	\$ 206

See Notes to Interim Financial Statements.

FLORIDA PROGRESS CORPORATION
UNAUDITED CONSOLIDATED BALANCE SHEETS

(in millions)	June 30	December 31
ASSETS	2004	2003
Utility Plant		
Utility plant in service	\$ 8,281	\$ 8,150
Accumulated depreciation	(2,856)	(2,828)
Utility plant in service, net	5,425	5,322
Held for future use	8	8
Construction work in progress	349	328
Nuclear fuel, net of amortization	57	69
Total Utility Plant, Net	5,839	5,727
Current Assets		
Cash and cash equivalents	30	27
Accounts receivable	540	487
Unbilled accounts receivable	77	59
Receivables from affiliated companies	45	43
Inventory	437	412
Deferred fuel cost	178	204
Assets held for sale	6	75
Prepayments and other current assets	166	137
Total Current Assets	1,479	1,444
Deferred Debits and Other Assets		
Regulatory assets	131	126
Nuclear decommissioning trust funds	436	433
Diversified business property, net	892	841
Miscellaneous other property and investments	95	90
Prepaid pension cost	226	223
Deferred tax asset	349	189
Other assets and deferred debits	130	132
Total Deferred Debits and Other Assets	2,259	2,034
Total Assets	\$ 9,577	\$ 9,205
CAPITALIZATION AND LIABILITIES		
Common Stock Equity		
Common stock without par value	\$ 1,701	\$ 1,699
Retained earnings	955	842
Accumulated other comprehensive loss	(30)	(17)
Total Common Stock Equity	2,626	2,524
Preferred Stock of Subsidiaries - Not Subject to Mandatory Redemption	34	34
Long-Term Debt, Affiliate	809	809
Long-Term Debt, Net	2,045	2,045
Total Capitalization	5,514	5,412
Current Liabilities		
Current portion of long-term debt	43	68
Accounts payable	458	415
Payables to affiliated companies	121	68
Notes payable to affiliated companies	327	636
Taxes accrued	177	16
Short-term obligations	231	-
Customer deposits	130	127
Other current liabilities	341	279
Total Current Liabilities	1,828	1,609
Deferred Credits and Other Liabilities		
Accumulated deferred income taxes and investment tax credits	81	85
Regulatory liabilities	1,388	1,365
Asset retirement obligations	347	339
Other liabilities and deferred credits	419	395
Total Deferred Credits and Other Liabilities	2,235	2,184
Commitments and Contingencies (Note 12)		
Total Capitalization and Liabilities	\$ 9,577	\$ 9,205

See Notes to Interim Financial Statements

FLORIDA PROGRESS CORPORATION
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

Six Months Ended June 30

(in millions)	2004	2003
Operating Activities		
Net income	\$ 190	\$ 206
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	207	215
Deferred income taxes and investment tax credits, net	(159)	(44)
Deferred fuel cost (credit)	26	(103)
Cash provided (used) by changes in operating assets and liabilities:		
Accounts receivable	(84)	(78)
Affiliate accounts receivable	(2)	(11)
Inventories	(23)	30
Prepayments and other current assets	(46)	(16)
Accounts payable	51	37
Affiliate accounts payable	51	(58)
Income taxes, net	162	38
Other current liabilities	45	56
Other	26	24
Net Cash Provided by Operating Activities	444	296
Investing Activities		
Utility property additions	(235)	(283)
Diversified business property additions	(103)	(214)
Nuclear fuel additions	-	(38)
Proceeds from sale of assets	84	1
Other	(13)	(8)
Net Cash Used in Investing Activities	(267)	(542)
Financing Activities		
Proceeds from issuance of long-term debt	1	639
Net increase (decrease) in short-term obligations	231	(35)
Retirement of long-term debt	(26)	(227)
Net change in intercompany notes	(309)	(78)
Equity contributions from parent	1	140
Dividends paid to parent	(78)	(203)
Other	6	(2)
Net Cash (Used in) Provided by Financing Activities	(174)	234
Net Increase (Decrease) in Cash and Cash Equivalents	3	(12)
Cash and Cash Equivalents at Beginning of Period	27	34
Cash and Cash Equivalents at End of Period	\$ 30	\$ 22
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year – interest (net of amount capitalized)	\$ 92	\$ 84
income taxes (net of refunds)	\$ (6)	\$ (1)

See Notes to Interim Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA, INC.
INTERIM FINANCIAL STATEMENTS
June 30, 2004

UNAUDITED STATEMENTS of INCOME

(in millions)	Three Months Ended June 30		Six Months Ended June 30	
	2004	2003	2004	2003
Operating Revenues	\$ 860	\$ 767	\$ 1,644	\$ 1,495
Operating Expenses				
Fuel used in electric generation	276	217	545	402
Purchased power	139	141	260	271
Operation and maintenance	152	154	312	295
Depreciation and amortization	72	80	141	159
Taxes other than on income	64	59	126	117
Total Operating Expenses	703	651	1,384	1,244
Operating Income	157	116	260	251
Other Income (Expense)				
Other, net	-	1	(1)	1
Total Other Income (Expense)	-	1	(1)	1
Interest Charges				
Interest charges	29	29	60	58
Allowance for borrowed funds used during construction	(1)	(2)	(2)	(4)
Total Interest Charges, Net	28	27	58	54
Income before Income Taxes	129	90	201	198
Income Tax Expense	45	28	67	65
Net Income	84	62	134	133
Preferred Stock Dividend Requirement	-	1	1	1
Earnings for Common Stock	\$ 84	\$ 61	\$ 133	\$ 132

See Notes to Interim Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA, INC.
UNAUDITED BALANCE SHEETS

(in millions)	June 30 2004	December 31 2003
ASSETS		
Utility Plant		
Utility plant in service	\$ 8,281	\$ 8,150
Accumulated depreciation	(2,856)	(2,828)
Utility plant in service, net	5,425	5,322
Held for future use	8	8
Construction work in progress	349	328
Nuclear fuel, net of amortization	57	69
Total Utility Plant, Net	5,839	5,727
Current Assets		
Cash and cash equivalents	11	10
Accounts receivable	217	191
Unbilled accounts receivable	77	59
Receivables from affiliated companies	6	7
Deferred income taxes	23	39
Inventory	241	230
Deferred fuel cost	178	204
Prepayments and other current assets	4	6
Total Current Assets	757	746
Deferred Debits and Other Assets		
Regulatory assets	131	126
Debt issuance costs	22	25
Nuclear decommissioning trust funds	436	433
Miscellaneous other property and investments	44	40
Prepaid pension cost	223	220
Other assets and deferred debits	5	6
Total Deferred Debits and Other Assets	861	850
Total Assets	\$ 7,457	\$ 7,323
CAPITALIZATION AND LIABILITIES		
Common Stock Equity		
Common stock without par value	\$ 1,081	\$ 1,081
Retained earnings	1,117	1,062
Accumulated other comprehensive loss	(4)	(4)
Total Common Stock Equity	2,194	2,139
Preferred Stock - Not Subject to Mandatory Redemption	34	34
Long-Term Debt, Net	1,902	1,904
Total Capitalization	4,130	4,077
Current Liabilities		
Current portion of long-term debt	43	43
Accounts payable	198	161
Payables to affiliated companies	132	75
Notes payable to affiliated companies		363
Taxes accrued	76	20
Interest accrued	39	42
Short-term obligations	231	
Customer deposits	130	127
Other current liabilities	114	85
Total Current Liabilities	963	916
Deferred Credits and Other Liabilities		
Accumulated deferred income taxes	353	363
Accumulated deferred investment tax credits	39	41
Regulatory liabilities	1,388	1,365
Asset retirement obligations	328	319
Other liabilities and deferred credits	256	242
Total Deferred Credits and Other Liabilities	2,364	2,330
Commitments and Contingencies (Note 12)		
Total Capitalization and Liabilities	\$ 7,457	\$ 7,323

See Notes to Interim Financial Statements

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA, INC.
UNAUDITED STATEMENTS of CASH FLOWS

(in millions)	Six Months Ended June 30	
	2004	2003
Operating Activities		
Net income	\$ 134	\$ 133
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	155	172
Deferred income taxes and investment tax credits, net	1	1
Deferred fuel cost (credit)	26	(103)
Cash provided (used) by changes in operating assets and liabilities:		
Accounts receivable	(43)	(18)
Inventories	(6)	(4)
Prepayments and other current assets	2	1
Accounts payable	87	(44)
Other current liabilities	82	124
Other	9	7
Net Cash Provided by Operating Activities	447	269
Investing Activities		
Property additions	(235)	(283)
Nuclear fuel additions	-	(38)
Other	-	1
Net Cash Used in Investing Activities	(235)	(320)
Financing Activities		
Proceeds from issuance of long-term debt	1	639
Net increase (decrease) in short-term obligations	231	(36)
Retirement of long-term debt	(1)	(227)
Net change in intercompany notes	(363)	(125)
Dividends paid to parent	(78)	(203)
Other	(1)	(1)
Net Cash (Used in) Provided by Financing Activities	(211)	47
Net Increase (Decrease) in Cash and Cash Equivalents	1	(4)
Cash and Cash Equivalents at Beginning of Period	10	16
Cash and Cash Equivalents at End of Period	\$ 11	\$ 12
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year – interest (net of amount capitalized)	\$ 62	\$ 48
income taxes (net of refunds)	\$ 11	\$ 15

See Notes to Interim Financial Statements.

**FLORIDA PROGRESS CORPORATION AND FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS**

1. ORGANIZATION AND BASIS OF PRESENTATION

A. Organization

Florida Progress Corporation (the Company or Florida Progress) is a holding company under the Public Utility Holding Company Act of 1935 (PUHCA). The Company became subject to the regulations of PUHCA when it was acquired by Progress Energy, Inc. (Progress Energy or the Parent). Florida Progress' two primary subsidiaries are Florida Power Corporation d/b/a Progress Energy Florida, Inc. (PEF) and Progress Fuels Corporation (Progress Fuels).

PEF is a regulated public utility engaged in the generation, purchase, transmission, distribution and sale of electricity primarily in portions of Florida. PEF is regulated by the Florida Public Service Commission (FPSC), the Federal Energy Regulatory Commission (FERC) and the Nuclear Regulatory Commission (NRC). Progress Fuels is a diversified non-utility energy company, whose principal business segments are Energy and Related Services and Rail Services. Throughout the report, the terms utility and regulated will be used to discuss items pertaining to PEF. Diversified business and nonregulated will be used to discuss the subsidiaries of Florida Progress excluding PEF.

B. Basis of Presentation

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Because the accompanying interim financial statements do not include all of the information and footnotes required by GAAP, they should be read in conjunction with the audited financial statements and notes thereto included in Florida Progress' and PEF's Form 10-K for the year ended December 31, 2003.

In accordance with the provisions of Accounting Principles Board Opinion (APB) No. 28, "Interim Financial Reporting," GAAP requires companies to apply a levelized effective tax rate to interim periods that is consistent with the estimated annual effective tax rate. The intra-period tax allocation, which will have no impact on total year net income, maintains an effective tax rate consistent with the estimated annual effective tax rate. For the three months ended June 30, 2004 and 2003, income tax expense was decreased by \$11 million and \$10 million, respectively. For the six months ended June 30, 2004 and 2003, income tax expense was increased by \$23 million and decreased by \$15 million, respectively. The income tax provisions for the Company differ from amounts computed by applying the federal statutory tax rate to income before income taxes, primarily due to the recognition of synthetic fuel tax credits.

PEF collects from customers certain excise taxes, which include gross receipts tax, franchise taxes, and other excise taxes, levied by the state or local government upon the customers. PEF accounts for excise taxes on a gross basis. For the three months ended June 30, 2004 and 2003, excise taxes of approximately \$37 million and \$34 million, respectively, are included in taxes other than on income in the accompanying Statements of Income. For the

six months ended June 30, 2004 and 2003, excise taxes of approximately \$69 million and \$64 million, respectively, are included in taxes other than on income in the accompanying Statements of Income. These approximate amounts are also included in utility revenues.

The amounts included in the interim financial statements are unaudited but, in the opinion of management, reflect all normal recurring adjustments necessary to fairly present Florida Progress' and PEF's financial position and results of operations for the interim periods. Due to seasonal weather variations and the timing of outages of electric generating units, especially the nuclear-fueled unit, the results of operations for interim periods are not necessarily indicative of amounts expected for the entire year or future periods.

In preparing financial statements that conform with GAAP, management must make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses reflected during the reporting period. Actual results could differ from those estimates. Certain reclassifications for 2003 have been made to conform to the 2004 presentation.

The results of operations of the Rail Services segment are reported one month in arrears.

C. Subsidiary Reporting Period Change

In the fourth quarter of 2003, the Company ceased recording portions of Fuels' segment operations, primarily synthetic fuel operations, one month in arrears. As a result, earnings for the year ended December 31, 2003 as reported in the Company's Form 10-K, included 13 months of results for these operations. The 2003 quarterly results for periods ended March 31, June 30 and September 30 have been restated for the above-mentioned reporting period change. This resulted in four months of earnings in the first quarter of 2003. The reclassification of earnings between quarters resulted in a \$4 million and a \$15 million increase in net income for the quarter and year to date periods, respectively, from \$110 million to \$114 million for the second quarter of 2003, and from \$191 million to \$206 million for the six months ended June 30, 2003.

D. Stock-Based Compensation

The Company measures compensation expense for stock options as the difference between the market price of its common stock and the exercise price of the option at the grant date. The exercise price at which options are granted by the Company equals the market price at the grant date, and accordingly, no compensation expense has been recognized for stock option grants. For purposes of the pro forma disclosures required by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure – an Amendment of FASB Statement No. 123" (SFAS No. 148), the estimated fair value of the Company's stock options is amortized to expense over the options' vesting period. The following table illustrates the effect on net income and earnings per share if the fair value method had been applied to all outstanding and unvested awards in each period:

(in millions)	Three Months Ended June 30		Six Months Ended June 30	
FLORIDA PROGRESS CORPORATION	<u>2004</u>	2003	<u>2004</u>	2003
Net Income, as reported	\$ 135	\$ 114	\$ 190	\$ 206
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	<u>1</u>	-	<u>2</u>	<u>1</u>
Pro forma net income	<u>\$ 134</u>	<u>\$ 114</u>	<u>\$ 188</u>	<u>\$ 205</u>

(in millions)	Three Months Ended		Six Months Ended	
	June 30		June 30	
PROGRESS ENERGY FLORIDA, INC.	2004	2003	2004	2003
Earnings for Common Stock, as reported	\$ 84	\$ 61	\$ 133	\$ 132
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	1	-	2	1
Pro forma earnings for common stock	\$ 83	\$ 61	\$ 131	\$ 131

E. Consolidation of Variable Interest Entities

Florida Progress and PEF consolidate all voting interest entities in which they own a majority voting interest and all variable interest entities for which they are the primary beneficiary in accordance with FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51" (FIN No. 46R). During the first six months of 2004 and 2003, Florida Progress or PEF did not participate in the creation of, or obtain a significant new variable interest in, any variable interest entity.

A subsidiary of Florida Progress is the primary beneficiary of Colona Synfuel Limited Partnership LLLP (Colona), a synthetic fuel production facility that qualifies for federal tax credits under Section 29 of the Internal Revenue Code and therefore has consolidated the entity under FIN No. 46R. As of June 30, 2004, Colona's total assets were \$16 million. None of Florida Progress' consolidated assets are collateral for Colona's obligations.

Florida Progress and PEF have interests in several variable interest entities for which they are not the primary beneficiary. These arrangements include investments in approximately six limited partnerships, limited liability corporations and venture capital funds. The aggregate maximum loss exposure at June 30, 2004, that Florida Progress could be required to record in its consolidated income statement as a result of these arrangements totals approximately \$15 million. The aggregate maximum loss exposure at June 30, 2004, that PEF could be required to record in its income statement as a result of these arrangements totals approximately \$5 million. The creditors of these variable interest entities do not have recourse to the general credit of Florida Progress or PEF in excess of the aggregate maximum loss exposure.

2. NEW ACCOUNTING STANDARDS

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. In accordance with guidance issued by the FASB in FASB Staff Position FAS 106-1, the Company elected to defer accounting for the effects of the Act due to uncertainties regarding the effects of the implementation of the Act and the accounting for certain provisions of the Act. Therefore, OPEB information presented in the financial statements does not reflect the effects of the Act. The FASB recently issued definitive accounting guidance for the Act in FASB Staff Position 106-2, which is effective for the Company in the third quarter of 2004. FASB Staff Position 106-2 will result in the recognition of lower OPEB costs to reflect prescription drug-related federal subsidies to be received under the Act. The Company is in the process of quantifying the impact of the Act on OPEB costs.

3. DIVESTITURES

A. Divestiture of Synfuel Partnership Interests

In June 2004, the Company through its subsidiary, Progress Fuels sold, in two transactions, a combined 49.8 percent partnership interest in Colona Synfuel Limited Partnership, LLLP, one of its synthetic fuel facilities. Substantially all proceeds from the sales will be received over time, which is typical of such sales in the industry. Gain from the sales will be recognized on a cost recovery basis. The Company's book value of the interests sold totaled approximately \$3 million. Based on projected production levels, the Company anticipates receiving total gross proceeds of approximately \$30 million per year, on an annualized basis. Under the agreements, the buyers have a right to unwind the transactions if an IRS reconfirmation private letter ruling (PLR) is not received by October 15, 2004. Therefore, no gain would be recognized prior to the expiration of that right.

B. Railcar Ltd. Divestiture

In December 2002, the Progress Energy Board of Directors adopted a resolution approving the sale of Railcar Ltd., a subsidiary included in the Rail Services segment. In March 2003, the Company signed a letter of intent to sell the majority of Railcar Ltd. assets to The Andersons, Inc., and the transaction closed in February 2004. Proceeds from the sale were approximately \$82 million before transaction costs and taxes of approximately \$13 million. The assets of Railcar Ltd. were grouped as assets held for sale and are included in other current assets on the Company's Consolidated Balance Sheets at June 30, 2004 and December 31, 2003. The assets were recorded at approximately \$6 million and \$75 million at June 30, 2004 and December 31, 2003, respectively, which reflects the Company's estimates of the fair value expected to be realized from the sale of these assets less costs to sell. In July 2004, the Company sold the remaining assets classified as held for sale to a third-party for net proceeds of \$6 million.

4. REGULATORY MATTERS

A. Retail Rate Matters

On June 29, 2004, the FPSC approved a Stipulation and Settlement Agreement, executed on April 29, 2004, by PEF, the Office of Public Counsel and the Florida Industrial Power Users Group. The stipulation and settlement resolved the issue currently pending before the FPSC regarding the costs PEF will be allowed to recover through its Fuel and Purchased Power Cost Recovery clause in 2004 and beyond for waterborne coal deliveries by the Company's affiliated coal supplier, Progress Fuels Corporation. The settlement sets fixed per ton prices based on point of origin for all waterborne coal deliveries in 2004, and establishes a market-based pricing methodology for determining recoverable waterborne coal transportation costs through a competitive solicitation process or market price proxies beginning in 2005 and thereafter. The settlement will reduce the amount that PEF will charge to the Fuel and Purchased Power Cost Recovery clause for waterborne transportation by approximately \$13 million beginning in 2004. This concludes the FPSC's investigation of PEF's recoverable waterborne coal transportation costs.

In March 2002, the parties in PEF's rate case entered into a Stipulation and Settlement Agreement (the Agreement) related to retail rate matters. The Agreement was approved by the FPSC and is generally effective from May 1, 2002 through December 31, 2005; provided, however, that if PEF's base rate earnings fall below a 10% return on equity, PEF may petition the FPSC to amend its base rates.

B. Regional Transmission Organizations

In 2000, the FERC issued Order No. 2000 on Regional Transmission Organizations (RTOs), which set minimum characteristics and functions that RTOs must meet, including independent transmission service. In July 2002, FERC issued its Notice of Proposed Rulemaking in Docket No. RM01-12-000, Remedying Undue Discrimination through Open Access Transmission Service and Standard Electricity Market Design (SMD NOPR). If adopted as proposed, the rules set forth in the SMD NOPR would materially alter the manner in which transmission and generation services are provided and paid for. PEF filed comments in November 2002 and supplement comments in January 2003. In April 2003, the FERC released a White Paper on the Wholesale Market Platform. The White Paper provides an overview of what the FERC currently intends to include in a final rule in the SMD NOPR docket. The White Paper retains the fundamental and most protested aspects of SMD NOPR, including mandatory RTOs and the FERC's assertion of jurisdiction over certain aspects of retail service. FERC has not yet issued a final rule on SMD NOPR. In December 2003, the FPSC issued an order requiring further state proceedings. The Company cannot predict the outcome of these matters or the effect that they may have on the GridFlorida proceedings currently ongoing before the FERC. It is unknown what impact the future proceedings will have on the Company's earnings, revenues or prices.

PEF has \$4 million invested in GridFlorida related to startup costs at June 30, 2004. PEF expects to recover these startup costs in conjunction with the GridFlorida original structure or in conjunction with any alternate combined transmission structure that emerges.

5. GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill, by reportable segment, are as follows:

(in millions)	<u>Energy and</u>		Total
	<u>Services</u>	<u>Other</u>	
Balance as of January 1, 2003	\$ 11	\$ -	\$ 11
Divestitures	(1)	-	(1)
Acquisition	-	7	7
Balance as of December 31, 2003	\$ 10	\$ 7	\$ 17
Purchase accounting adjustment	-	4	4
Balance as of June 30, 2004	\$ 10	\$ 11	\$ 21

In December 2003, \$7 million in goodwill was acquired as part of the Progress Telecommunications Corporation business combination and is in the Other segment. The \$4 million purchase accounting adjustment during the first half of 2004 resulted primarily from changes in the estimated restructuring costs related to the partial acquisition of EPIK in December 2003.

The Company has \$9 million of net intangible assets at June 30, 2004 and December 31, 2003. All of the Company's intangibles are subject to amortization. The Company's intangibles are primarily acquired customer contracts that are amortized over their respective lives. Amortization expense recorded on intangible assets for the three and six months ended June 30, 2004 and 2003, and estimated annual amortization expense for intangible assets for 2004 through 2008 are not material to the results of operations. PEF has no goodwill or significant intangible assets at June 30, 2004 or December 31, 2003.

6. COMPREHENSIVE INCOME

Comprehensive income for Florida Progress for the three months ended June 30, 2004 and 2003 was \$131 million and \$113 million, respectively, and \$177 million and \$204 million for the six months ended June 30, 2004 and June 2003, respectively. Comprehensive income for PEF for the three months ended June 30, 2004 and 2003 was \$84 million and \$62 million, respectively, and \$134 million and \$133 million for the six months ended June 30, 2004 and 2003, respectively. Items of other comprehensive income consisted primarily of changes in fair value of derivatives used to hedge cash flows related to interest on long-term debt and gas sales, and to foreign currency translation adjustments.

7. FINANCING ACTIVITIES

On February 9, 2004, Progress Capital Holdings, Inc. paid at maturity \$25 million 6.48% medium term notes with excess cash.

8. BENEFIT PLANS

The Company and some of its subsidiaries (including PEF) have a non-contributory defined benefit retirement (pension) plan for substantially all full-time employees. The Company also has supplementary defined benefit pension plans that provide benefits to higher-level employees. In addition to pension benefits, the Company and some of its subsidiaries (including PEF) provide contributory other postretirement benefits (OPEB), including certain health care and life insurance benefits, for retired employees who meet specified criteria. The components of the net periodic benefit cost for the three and six months ended June 30 are:

Three Months Ended June 30, (in millions)	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
Service cost	\$ 5	\$ 5	\$ 1	\$ 1
Interest cost	12	11	4	4
Expected return on plan assets	(18)	(15)	-	-
Net amortization	1	-	1	1
Net cost recognized by Florida Progress	\$ -	\$ 1	\$ 6	\$ 6
Net cost/(benefit) recognized by PEF	\$ (1)	\$ -	\$ 6	\$ 6

Six Months Ended June 30, (in millions)	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
Service cost	\$ 11	\$ 10	\$ 3	\$ 3
Interest cost	23	23	8	7

Expected return on plan assets	(36)	(31)	-	-
Net amortization	1	-	2	2
Net cost/(benefit) recognized by Florida Progress	\$ (1)	\$ 2	\$ 13	\$ 12
Net cost/(benefit) recognized by PEF	\$ (2)	\$ 1	\$ 12	\$ 12

9. RISK MANAGEMENT ACTIVITIES AND DERIVATIVE TRANSACTIONS

Progress Energy and its subsidiaries, including the Company and PEF, are exposed to various risks related to changes in market conditions. The Company has a risk management committee that includes senior executives from various business groups. The risk management committee is responsible for administering risk management policies and monitoring compliance with those policies by all subsidiaries.

The Company, under its risk management policy, may use a variety of instruments to manage exposure to fluctuations in commodity prices and interest rates.

The Company uses interest rate derivative instruments to adjust the fixed and variable rate debt components of its debt portfolio and to hedge interest rates with regard to future fixed rate debt issuances.

As of June 30, 2004, there were no outstanding interest rate derivatives at PEF.

PEF has entered into derivative instruments to hedge its exposure to price fluctuations on fuel oil purchases. These instruments did not have a material impact on the Company's consolidated and PEF's financial position or results of operations.

Progress Fuels Corporation, through an affiliate, periodically enters into derivative instruments to hedge its exposure to price fluctuations on natural gas sales. As of June 30, 2004, Progress Fuels Corporation has executed cash flow hedges of natural gas sales through December 2005. These instruments did not have a material impact on the Company's consolidated financial position or results of operations.

10. FINANCIAL INFORMATION BY BUSINESS SEGMENT

The Company's principal business segment is PEF, a utility engaged in the generation, purchase, transmission, distribution and sale of electricity primarily in Florida. The other reportable business segments are Progress Fuels' Energy & Related Services and Rail Services. The Energy & Related Services segment includes coal and synthetic fuel operations, natural gas production and sales, river terminal services and off-shore marine transportation. Rail Services' operations include railcar repair, rail parts reconditioning and sales, providing rail and track material, and scrap metal recycling. The Other category consists primarily of PTC LLC, the Company's telecommunications subsidiary, and the holding company, Florida Progress Corporation. PTC LLC markets wholesale fiber-optic based capacity service in the Eastern United States and also markets wireless structure attachments to wireless communication companies and governmental entities. The Company allocates a portion of its operating expenses to business segments.

The Company's significant operations are geographically located in the United States with limited operations in Mexico and Canada. The Company's segments are based on

differences in products and services, and therefore no additional disclosures are presented. Intersegment sales and transfers consist primarily of coal sales from the Energy and Related Services segment of Progress Fuels to PEF. The price Progress Fuels charges PEF is based on market rates for coal procurement. Prices for water-borne transportation in 2003 were based on a methodology approved by the FPSC. In April 2004, PEF executed a Stipulation and Settlement agreement with the Office of Public Counsel and the Florida Industrial Power Users Group which amends the transportation rate. On June 29, 2004, the FPSC approved the Stipulation and Settlement. This concludes the FPSC's investigation of PEF's recoverable waterborne coal transportation costs. See discussion at Note 4A. Rail transportation is also based on market rates plus a return allowed by the FPSC on equity in transportation equipment utilized in transporting coal to PEF. The allowed rate of return is currently 12%. No single customer accounted for 10% or more of unaffiliated revenues.

The following summarizes the revenues and segment profits or losses for the reportable business segments. The combined segment profits and losses represents Florida Progress' total income.

(in millions)	PEF	Energy and Related Services	Rail	Other	Consolidated
Three Months Ended June 30, 2004:					
Revenues	\$ 860	\$ 343	\$ 285	\$ 16	\$ 1,504
Intersegment revenues		69		(69)	
Total revenues	860	412	285	(53)	1,504
Segment profit	84	41	4	6	135
Total segment assets	\$ 7,457	\$ 1,002	\$ 532	\$ 586	\$ 9,577
Three Months Ended June 30, 2003:					
Revenues	\$ 767	\$ 219	\$ 214	\$ 7	\$ 1,207
Intersegment revenues		88		(88)	
Total revenues	767	307	214	(81)	1,207
Segment profit (loss)	61	42	2	9	114

	PEF	Energy and Related Services	Rail	Other	Consolidated
Six Months Ended June 30, 2004:					
Revenues	\$ 1,644	\$ 616	\$ 523	\$ 32	\$ 2,815
Intersegment revenues	-	151	-	(151)	-
Total revenues	1,644	767	523	(119)	2,815
Segment profit	133	79	9	(31)	190
Six Months Ended June 30, 2003:					
Revenues	\$ 1,495	\$ 522	\$ 392	\$ 13	\$ 2,422
Intersegment revenues	-	169	-	(169)	-
Total revenues	1,495	691	392	(156)	2,422
Segment profit (loss)	132	67	(1)	8	206

11. OTHER INCOME AND OTHER EXPENSE

Other income and expense includes interest income and other income and expense items as discussed below. The components of other, net as shown on the accompanying Statements of Income for the three and six months ended June 30, 2004 and 2003, are as follows:

(in millions)	Three Months Ended June 30		Six Months Ended June 30	
	2004	2003	2004	2003
<u>Other income</u>				
Nonregulated energy and delivery services income	3	3	7	7
AFUDC equity	1	3	2	4
Other	1	1	2	2
Total other income – PEF	\$ 5	\$ 7	\$ 11	\$ 13
Other income – Florida Progress	3	4	2	2
Total other income – PEF and Florida Progress	\$ 8	\$ 11	\$ 13	\$ 15
<u>Other expense</u>				
Nonregulated energy and delivery services expenses	\$ 3	\$ 3	\$ 5	\$ 6
Donations	1	2	5	4
Other	1	1	2	2
Total other expense – PEF	\$ 5	\$ 6	\$ 12	\$ 12
Loss from equity investments	4	4	7	7
Other expense – Florida Progress	1	2	1	3
Total other expense – PEF and Florida Progress	\$ 10	\$ 12	\$ 20	\$ 22
Other, net	\$ (2)	\$ (1)	\$ (7)	\$ (7)

Nonregulated energy and delivery services include power protection services and mass market programs such as surge protection, appliance services and area light sales, and delivery, transmission and substation work for other utilities.

12. COMMITMENTS AND CONTINGENCIES

Contingencies and significant changes to the commitments discussed in Note 19 of the Company's 2003 Annual Report on Form 10-K are described below.

A. Guarantees

As a part of normal business, Florida Progress and certain subsidiaries including PEF enter into various agreements providing financial or performance assurances to third parties. Such agreements include guarantees, standby letters of credit and surety bonds. These agreements are entered into primarily to support or enhance the creditworthiness otherwise attributed to a subsidiary on a stand-alone basis, thereby facilitating the extension of sufficient credit to

accomplish the subsidiaries' intended commercial purposes. At June 30, 2004, management does not believe conditions are likely for significant performance under these agreements.

Guarantees at June 30, 2004, are summarized in the table below and discussed more fully in the subsequent paragraphs:

(in millions)	
<u>Guarantees issued on behalf of the Company and affiliates</u>	
Standby letters of credit	\$ 27
Surety bonds	
Other guarantees	20
<u>Guarantees issued on behalf of third parties</u>	
Securities of affiliated trust	300
Other guarantees	24
Total	<u>\$ 371</u>

Standby Letters of Credit

Financial institutions have issued standby letters of credit for the Company for the benefit of third parties that have extended credit to the Company and certain subsidiaries. These letters of credit have been issued primarily for the purpose of supporting payments of trade payables, securing performance under contracts and lease obligations and self insurance for workers compensation. If a subsidiary does not pay amounts when due under a covered contract, the counterparty may present its claim for payment to the financial institution, which will in turn request payment from the Company. Of the total standby letters of credit issued, PEF has outstanding letters of credit totaling \$2 million. Any amounts owed by the Company's subsidiaries are reflected in the Company's Consolidated Balance Sheets.

Other Guarantees

The Company has total other guarantees outstanding of approximately \$44 million. Included are \$10 million of guarantees in support of synthetic fuel operations at a third party plant. The remaining \$34 million in other guarantees is related primarily to prompt performance payments and other payments subject to contingencies.

In connection with the sale of partnership interests in Colona (see Note 3.A), Progress Fuels indemnified the buyers against any claims related to Colona resulting from violations of any environmental laws. Although the terms of the agreement provide for no limitation to the maximum potential future payments under the indemnification, the Company has estimated that the maximum total of such payments would be insignificant.

Securities of Affiliated Trust

The Company has guaranteed certain payments of an affiliated company, FPC Capital I (the Trust). Due to the nature of the relationship between the Trust and Florida Progress Funding Corporation, the Company has guaranteed the payment of all distributions related to the Trust's outstanding mandatorily redeemable preferred securities. At June 30, 2004, the Trust had outstanding 12 million shares of the securities with a liquidation value of \$300 million.

Guarantees Issued by Progress Energy

Progress Energy has issued approximately \$46 million of guarantees on behalf of Progress Fuels and its subsidiaries for obligations under coal brokering operations.

B. Insurance

PEF is insured against public liability for a nuclear incident up to \$10.76 billion per occurrence. Under the current provisions of the Price Anderson Act, which limits liability for accidents at nuclear power plants, PEF, as owner of a nuclear unit, can be assessed a portion of any third-party liability claims arising from an accident at any commercial nuclear power plant in the United States. In the event that public liability claims from an insured nuclear incident exceed \$300 million (currently available through commercial insurers), each company would be subject to assessments of up to \$101 million for each reactor owned per occurrence. Payment of such assessments would be made over time as necessary to limit the payment in any one year to no more than \$10 million per reactor owned. Congress is considering revisions to the Price Anderson Act during 2004, that could include increased limits and assessments per reactor owned. The final outcome of this matter cannot be predicted at this time.

PEF self-insures their transmission and distribution lines against loss due to storm damage and other natural disasters. PEF accrues \$6 million annually to a storm damage reserve pursuant to a regulatory order and may defer losses in excess of the reserve.

C. Claims and Uncertainties

The Company is subject to federal, state and local regulations addressing hazardous and solid waste management, air and water quality and other environmental matters.

Hazardous and Solid Waste Management

Various organic materials associated with the production of manufactured gas, generally referred to as coal tar, are regulated under federal and state laws. The principal regulatory agency that is responsible for a specific former manufactured gas plant (MGP) site depends largely upon the state in which the site is located. There are several MGP sites to which the Company has some connection. In this regard, PEF and other potentially responsible parties, are participating in, investigating and, if necessary, remediating former MGP sites with several regulatory agencies, including, but not limited to, the U.S. Environmental Protection Agency (EPA) and the Florida Department of Environmental Protection (FDEP). In addition, PEF is periodically notified by regulators such as the EPA and various state agencies of its involvement or potential involvement in sites, other than MGP sites, that may require investigation and/or remediation.

PEF has filed claims with the Company's general liability insurance carriers to recover costs arising out of actual or potential environmental liabilities. Some claims have been settled and others are still pending. The Company cannot predict the outcome of this matter.

PEF At June 30, 2004, PEF has accrued \$27 million for probable and estimable costs related to various environmental sites. Of this accrual, \$17 million is for costs associated with the remediation of distribution and substation transformers for which PEF has received approval by the FPSC for recovery through the Environmental Cost Recovery Clause (ECRC). For the six months ended June 30, 2004, PEF accrued an additional \$8 million related to the remediation of transformers and a regulatory asset for the probable recovery through the ECRC. The remaining \$10 million is related to two former MGP sites and other sites associated with PEF that have required or are anticipated to require investigation and/or

remediation costs. PEF is unable to provide an estimate of the reasonably possible total remediation costs beyond what is currently accrued.

These accruals have been recorded on an undiscounted basis. PEF measures its liability for these sites based on available evidence including its experience in investigating and remediating environmentally impaired sites. This process often includes assessing and developing cost-sharing arrangements with other potentially responsible parties. Presently, PEF cannot determine the total costs that may be incurred in connection with the remediation of all sites. As more activity occurs at these sites, PEF will assess the need to adjust the accruals.

Florida Progress In 2001, Progress Fuels sold its Inland Marine Transportation business to AEP Resources, Inc. Progress Fuels established an accrual to address indemnities and retained environmental liability associated with the transaction. Progress Fuels estimates that its contractual liability to AEP Resources, Inc. associated with Inland Marine Transportation is \$4 million at June 30, 2004 and has accrued such amount. The previous accrual of \$10 million was reduced in 2003 based on a change in estimate. This accrual has been determined on an undiscounted basis. Progress Fuels measures its liability for this site based on estimable and probable remediation scenarios. The Company cannot predict the outcome of this matter.

Certain historical sites exist that are being addressed voluntarily by Progress Fuels and FPC. An immaterial accrual has been established to address investigation expenses related to these sites. The Company cannot determine the total costs that may be incurred in connection with these sites. The Company cannot predict the outcome of this matter.

Rail Rail Services is voluntarily addressing certain historical waste sites. The Company cannot determine the total costs that may be incurred in connection with these sites.

The Company is also currently in the process of assessing potential costs and exposures at other environmentally impaired sites. As the assessments are developed and analyzed, the Company will accrue costs for the sites to the extent the costs are probable and can be reasonably estimated.

Air Quality

There has been and may be further proposed legislation requiring reductions in air emissions for nitrogen oxides, sulfur dioxide, carbon dioxide and mercury. Some of these proposals establish nationwide caps and emission rates over an extended period of time. This national multi-pollutant approach to air pollution control could involve significant capital costs which could be material to the Company's consolidated and PEF's financial position or results of operations. Some companies may seek recovery of the related cost through rate adjustments or similar mechanisms. However, the Company cannot predict the outcome of this matter.

The EPA is conducting an enforcement initiative related to a number of coal-fired utility power plants in an effort to determine whether modifications at those facilities were subject to New Source Review requirements or New Source Performance Standards under the Clean Air Act. PEF was asked to provide information to the EPA as part of this initiative and cooperated in providing the requested information. During 2003, PEF received a supplemental information request from the EPA and responded to it. The EPA initiated civil enforcement actions against other unaffiliated utilities as part of this initiative. Some of these actions resulted in settlement agreements calling for expenditures ranging from \$1.0 billion to \$1.4 billion. A utility that was not subject to a civil enforcement action settled its New Source Review issues with the EPA for \$300 million. These settlement agreements have generally called for expenditures to be made over extended time periods, and some of the companies may seek recovery of the related cost through rate adjustments or similar mechanisms. The Company cannot predict the outcome of the EPA's initiative or its impact, if any, on the Company.

In 2003, the EPA published a final rule addressing routine equipment replacement under the New Source Review program. The rule defines routine equipment replacement and the types of activities that are not subject to New Source Review requirements or New Source Performance Standards under the Clean Air Act. The rule was challenged in the Federal Appeals Court and its implementation stayed. In July 2004, the EPA announced it will reconsider certain issues arising from the final routine equipment replacement rule. Reconsideration does not impact the court-approved stay. The agency plans to issue a final decision on these reconsidered issues by year end. The Company cannot predict the outcome of this matter.

In 1997, the EPA's Mercury Study Report and Utility Report to Congress conveyed that mercury is not a risk to the average American and expressed uncertainty about whether reductions in mercury emissions from coal-fired power plants would reduce human exposure. Nevertheless, the EPA determined in 2000 that regulation of mercury emissions from coal-fired power plants was appropriate. In 2003, the EPA proposed, and solicited comment on, alternative control plans that would limit mercury emissions from coal-fired power plants. The first, a Maximum Achievable Control Technology (MACT) standard applicable to every coal-fired plant, would require compliance in 2008. The second, which the EPA has stated it prefers, is a mercury cap and trade program that would require limits to be met in two phases, 2010 and 2018. The EPA expects to finalize the mercury rule in March 2005. Achieving compliance with either proposal could involve significant capital costs which could be material and adverse to the Company's and PEF's financial condition or results of operations. However, the Company cannot predict the outcome of this matter.

In conjunction with the proposed mercury rule, the EPA proposed a Maximum Available Control Technology (MACT) standard to regulate nickel emissions from residual oil-fired units. The agency estimates the proposal will reduce national nickel emissions to approximately 103 tons. The EPA expects to finalize the nickel rule in March 2005. The Company cannot predict the outcome of this matter.

In December 2003, the EPA released its proposed Interstate Air Quality Rule, currently referred to as the Clean Air Interstate Rule (CAIR). The EPA's proposal requires 28 jurisdictions, including North Carolina, South Carolina, Georgia and Florida, to further reduce nitrogen oxide (NOx) and sulfur dioxide (SO2) emissions in order to attain pre-set NOx and SO2 emissions levels. **The rule is expected to become final in 2004.** In a supplemental notice of proposed rulemaking on the CAIR, the EPA indicated that compliance with the rule would meet the best available retrofit technology (BART) requirements of its regional haze rule, as the emissions controls to be installed for the CAIR are roughly equivalent to the regional haze BART provisions. The installation of controls necessary to comply with the rule could involve significant capital costs.

Water Quality

As a result of the operation of certain control equipment needed to address the air quality issues outlined above, new wastewater streams may be generated. Integration of these new wastewater streams into existing wastewater treatment processes may result in permitting, construction and water treatment requirements imposed on the Company in the immediate and extended future.

After many years of litigation and settlement negotiations, the EPA adopted final regulations in February 2004 for the implementation of Section 316(b) of the Clean Water Act. These regulations become effective September 7, 2004. The purpose of these regulations is to minimize adverse environmental impacts caused by cooling water intake structures and intake systems located at existing facilities. Over the next several years, these regulations may require the facilities to mitigate the effects to aquatic organisms by undertaking intake modifications or other restorative activities. Substantial costs could be incurred by the facilities in order to comply with the new regulations. The Company cannot predict the outcome and impacts to the facilities at this time.

The EPA has published for comment a draft Environmental Impact Statement (EIS) for surface coal mining (sometimes referred to as "mountaintop mining") and valley fills in the Appalachian coal region, where Progress Fuels currently operates a surface mine and may operate others in the future. The final EIS, when published, may affect regulations for the permitting of mining operations and the cost of compliance with environmental regulations. Regulatory changes for mining may also affect the cost of fuel for the coal-fueled electric generating plant. The Company cannot predict the outcome of this matter.

Other Environmental Matters

The Kyoto Protocol was adopted in 1997 by the United Nations to address global climate change by reducing emissions of carbon dioxide and other greenhouse gases. The United States has not adopted the Kyoto Protocol; however, a number of carbon dioxide emissions control proposals have been advanced in Congress and by the Bush Administration. The Bush Administration has stated it favors voluntary programs. Reductions in carbon dioxide

emissions to the levels specified by the Kyoto Protocol and some legislative proposals could be materially adverse to the Company's financials and operations if associated costs cannot be recovered from customers. The Company favors the voluntary program approach recommended by the administration, and is evaluating options for the reduction, avoidance and sequestration of greenhouse gases. However, the Company cannot predict the outcome of this matter.

Other Contingencies

1. Franchise Litigation

Three cities, with a total of approximately 18,000 customers, have litigation pending against PEF in various circuit courts in Florida. As discussed below, three other cities, with a total of approximately 30,000 customers, have subsequently settled their lawsuits with PEF and signed new, 30-year franchise agreements. The lawsuits principally seek (1) a declaratory judgment that the cities have the right to purchase PEF's electric distribution system located within the municipal boundaries of the cities, (2) a declaratory judgment that the value of the distribution system must be determined through arbitration, and (3) injunctive relief requiring PEF to continue to collect from PEF's customers and remit to the cities, franchise fees during the pending litigation, and as long as PEF continues to occupy the cities' rights-of-way to provide electric service, notwithstanding the expiration of the franchise ordinances under which PEF had agreed to collect such fees. Five circuit courts have entered orders requiring arbitration to establish the purchase price of PEF's electric distribution system within five cities. Two appellate courts have upheld those circuit court decisions and authorized cities to determine the value of PEF's electric distribution system within the cities through arbitration.

Arbitration in one of the cases (the City of Casselberry) was held in August 2002. Following arbitration, the parties entered settlement discussions, and in July 2003 the City approved a settlement agreement and a new, 30-year franchise agreement with PEF. The settlement resolves all pending litigation with that City. A second arbitration (with the 13,000-customer City of Winter Park) was completed in February 2003. That arbitration panel issued an award in May 2003 setting the value of PEF's distribution system within the City of Winter Park at approximately \$32 million, not including separation and reintegration and construction work in progress, which could add several million dollars to the award. The panel also awarded PEF approximately \$11 million in stranded costs, which according to the award decreases over time. In September 2003, Winter Park voters passed a referendum that would authorize the City to issue bonds of up to approximately \$50 million to acquire PEF's electric distribution system. While the City has not yet definitively decided whether it will acquire the system, on April 26, 2004, the City Commission voted to enter into a hedge agreement to lock into interest rates for the acquisition of the system and to proceed with the acquisition. The City sought and received wholesale power supply bids and on June 23, 2004, executed a wholesale power supply contract with PEF. On May 12, 2004, the City solicited bids to operate and maintain the distribution system. The City received bids on July 1, 2004, and expects to make its selection in August 2004. The City has indicated that its goal is to begin electric operations in June 2005. At this time, whether and when there will be further proceedings regarding the bids on City of Winter Park cannot be determined.

A third arbitration (with the 2,500-customer Town of Belleair) was completed in June 2003. In September 2003, the arbitration panel issued an award in that case setting the value of the electric distribution system within the Town at approximately \$6 million. The panel further

required the Town to pay to PEF its requested \$1 million in separation and reintegration costs and \$2 million in stranded costs. The Town has not yet decided whether it will attempt to acquire the system. At this time, whether and when there will be further proceedings regarding the Town of Belleair cannot be determined. A fourth arbitration (with the 13,000-customer City of Apopka) had been scheduled for January 2004. In December 2003, the Apopka City Commission voted on first reading to approve a settlement agreement and a 30-year franchise with PEF. The settlement and franchise became effective upon approval by the Commission at a second reading of the franchise in January 2004. The settlement resolves all outstanding litigation between the parties.

Arbitration in the remaining city's litigation (the 1,500-customer City of Edgewood) has not yet been scheduled.

As part of the above litigation, two appellate courts have also reached opposite conclusions regarding whether PEF must continue to collect from its customers and remit to the cities "franchise fees" under the expired franchise ordinances. PEF has filed an appeal with the Florida Supreme Court to resolve the conflict between the two appellate courts. The Florida Supreme Court held oral argument in one of the appeals in August 2003. Subsequently, the Court requested briefing from the parties in the other appeal, which was completed in November 2003. The Court has not yet issued a decision in these cases. PEF cannot predict the outcome of these matters at this time.

2. DOE Litigation

As required under the Nuclear Waste Policy Act of 1982, PEF entered into a contract with the U.S. Department of Energy (DOE) under which the DOE agreed to begin taking spent nuclear fuel by no later than January 31, 1998. All similarly situated utilities were required to sign the same standard contract.

In 1995, the DOE issued a final interpretation that it did not have an unconditional obligation to take spent nuclear fuel by January 31, 1998. In Indiana & Michigan Power v. DOE, the Court of Appeals vacated the DOE's final interpretation and ruled that the DOE had an unconditional obligation to begin taking spent nuclear fuel. The Court did not specify a remedy because the DOE was not yet in default.

After the DOE failed to comply with the decision in Indiana & Michigan Power v. DOE, a group of utilities petitioned the Court of Appeals in Northern States Power (NSP) v. DOE, seeking an order requiring the DOE to begin taking spent nuclear fuel by January 31, 1998. The DOE took the position that its delay was unavoidable, and the DOE was excused from performance under the terms and conditions of the contract. The Court of Appeals did not order the DOE to begin taking spent nuclear fuel, stating that the utilities had a potentially adequate remedy by filing a claim for damages under the contract.

After the DOE failed to begin taking spent nuclear fuel by January 31, 1998, a group of utilities filed a motion with the Court of Appeals to enforce the mandate in NSP v. DOE. Specifically, this group of utilities asked the Court to permit the utilities to escrow their waste fee payments, to order the DOE not to use the waste fund to pay damages to the utilities, and to order the DOE to establish a schedule for disposal of spent nuclear fuel. The Court denied this motion based primarily on the grounds that a review of the matter was premature, and that some of the requested remedies fell outside of the mandate in NSP v. DOE.

Subsequently, a number of utilities each filed an action for damages in the Federal Court of Claims. The U.S. Circuit Court of Appeals (Federal Circuit) has ruled that utilities may sue the DOE for damages in the Federal Court of Claims instead of having to file an administrative claim with the DOE.

In January 2004, PEF filed a complaint with the DOE claiming that the DOE breached the Standard Contract for Disposal of Spent Nuclear Fuel by failing to accept spent nuclear fuel from various Progress Energy facilities on or before January 31, 1998. Damages due to DOE's breach will likely exceed \$100 million. Similar suits have been initiated by over two dozen other utilities.

In July 2002, Congress passed an override resolution to Nevada's veto of DOE's proposal to locate a permanent underground nuclear waste storage facility at Yucca Mountain, Nevada. DOE plans to submit a license application for the Yucca Mountain facility by the end of 2004. On November 5, 2003, Congressional negotiators approved \$580 million for fiscal year 2004 for the Yucca Mountain project, \$123 million more than the previous year. In January 2003, the State of Nevada, Clark County, Nevada, and the City of Las Vegas petitioned the U.S. Court of Appeals for the District of Columbia Circuit for review of the Congressional override resolution. On July 9, 2004, the Court rejected the challenge to the constitutionality of the resolution approving Yucca Mountain, but ruled that the EPA was wrong to set a 10,000-year compliance period. The DOE continues to state it plans to begin operation of the repository at Yucca Mountain in 2010. PEF cannot predict the outcome of this matter.

PEF is currently storing spent nuclear fuel onsite in spent fuel pools. PEF's nuclear unit, Crystal River Unit No. 3, (CR3) has sufficient storage capacity in place for fuel consumed through the end of the expiration of the current license in 2016. PEF will seek renewal of the CR3 operating license and if approved, additional dry storage may be necessary.

3. Advanced Separation Technologies (AST)

In 1996, Florida Progress sold its 80% interest in AST to Calgon Carbon Corporation (Calgon) for net proceeds of \$56 million in cash. In 1998, Calgon filed a lawsuit against Florida Progress and the other selling shareholder and amended it in April 1998, alleging misstatement of AST's 1996 revenues, assets and liabilities, seeking damages and granting Calgon the right to rescind the sale. The lawsuit also accused the sellers of failing to disclose flaws in AST's manufacturing process and a lack of quality control. Florida Progress believes that the aggregate total of all legitimate warranty claims by customers of AST for which it is probable that Florida Progress will be responsible for under the Stock Purchase Agreement with Calgon is approximately \$3 million, and accordingly, accrued \$3 million in the third quarter of 1999 as an estimate of probable loss. All parties filed motions for summary judgment in July 2001. The summary judgment motions of Calgon and the other selling shareholder were denied in April 2002. The summary judgment motion of Florida Progress was withdrawn pending a legal challenge to portions of the report of Calgon's expert, Arthur Andersen, which had been used to oppose summary judgment. In September 2003, the United States District Court for the Western District of Pennsylvania issued final orders excluding from evidence in the case that portion of Arthur Andersen's damage analysis based on the discounted cash flow methodology of valuation. The Court did not exclude Arthur Andersen's use of the guideline publicly traded company methodology in its

damage analysis. Florida Progress filed a renewed motion for summary judgment in October 2003, which is pending. The Company cannot predict the outcome of this matter, but will present a vigorous defense.

4. Synthetic Fuel Tax Credits

At December 31, 2003, Florida Progress, through its subsidiaries, was a majority-owner in three entities and a minority owner in three entities that own facilities that produce synthetic fuel as defined under the Internal Revenue Code (Code). In June 2004, Progress Fuels sold, in two transactions, a combined 49.8 percent partnership interest in Colona Synfuel Limited Partnership, LLLP (Colona), one of its majority owned synthetic fuel operations. The Company is now a minority owner in Colona, but continues to consolidate Colona in accordance with FASB Interpretation No. 46R. Florida Progress, through its subsidiaries, is currently a majority owner in two synthetic fuel entities and a minority owner in four synthetic fuel entities, including Colona. The production and sale of the synthetic fuel from these facilities qualifies for tax credits under Section 29 of the Code (Section 29) if certain requirements are satisfied, including a requirement that the synthetic fuel differs significantly in chemical composition from the coal used to produce such synthetic fuel and that the fuel was produced from a facility that was placed in service before July 1, 1998. Synthetic fuel tax credit amounts not utilized are carried forward indefinitely as alternative minimum tax credits. All majority-owned and minority-owned entities received private letter rulings (PLRs) from the Internal Revenue Service (IRS) with respect to their synthetic fuel operations. The PLRs do not limit the production on which synthetic fuel credits may be claimed.

In September 2002, all of Florida Progress' majority-owned synthetic fuel entities at that time, including Colona, and two of the Company's minority owned synthetic fuel entities were accepted into the IRS's Pre-Filing Agreement (PFA) program. The PFA program allows taxpayers to voluntarily accelerate the IRS exam process in order to seek resolution of specific issues. Either the Company or the IRS can withdraw from the program at any time, and issues not resolved through the program may proceed to the next level of the IRS exam process.

In July 2004, Progress Energy was notified that the Internal Revenue Service (IRS) field auditors anticipate taking an adverse position regarding the placed-in-service date of the Company's four Earthco synthetic fuel facilities. Due to the auditors' position, the IRS has decided to exercise its right to withdraw from the Pre-Filing Agreement (PFA) program with Progress Energy. With the IRS's withdrawal from the PFA program, the review of Progress Energy's Earthco facilities is back on the normal procedural audit path of the Company's tax returns. The IRS has indicated that the field audit team will provide its written recommendation later this year. After the field audit team's written recommendation is received, the Company will begin the Appeals process within the IRS. Through June 30, 2004, based on its ownership percentage, the Company has claimed \$528 million of tax credits generated by Earthco facilities. If these credits were disallowed, the Company's one time exposure for cash tax payments would be \$64 million (excluding interest), and earnings and equity would be reduced by \$528 million, excluding interest. The Company believes that the appeals process could take up to two years to complete, however, it cannot control the actual timing of resolution and cannot predict the outcome of this matter.

In February 2004, subsidiaries of the Company finalized execution of the Colona Closing Agreement with the IRS concerning their Colona synthetic fuel facilities. The Closing Agreement provided that the Colona facilities were placed in service before July 1, 1998, which is one of the qualification requirements for tax credits under Section 29 of the Code. The Closing Agreement further provides that the fuel produced by the Colona facilities in 2001 is a “qualified fuel” for purposes of the Section 29 tax credits. This action concluded the IRS PFA program with respect to Colona.

In October 2003, the United States Senate Permanent Subcommittee on Investigations began a general investigation concerning synthetic fuel tax credits claimed under Section 29 of the Code. The investigation is examining the utilization of the credits, the nature of the technologies and fuels created, the use of the synthetic fuel, and other aspects of Section 29 and is not specific to the Company’s synthetic fuel operations. Progress Energy is providing information in connection with this investigation. The Company cannot predict the outcome of this matter.

In management’s opinion, the Company is complying with all the necessary requirements to be allowed such credits under Section 29, and, although it cannot provide certainty, it believes that it will prevail in these matters. Accordingly, the Company has no current plans to alter its synthetic fuel production schedule as a result of these matters. However, should the Company fail to prevail in these matters, there could be a material liability for previously taken Section 29 credits, with a material adverse impact on earnings and cash flows.

5. Other Legal Matters

Florida Progress and PEF are involved in various other claims and legal actions arising in the ordinary course of business, some of which involve claims for substantial amounts. Where appropriate, accruals have been made in accordance with SFAS No. 5, “Accounting for Contingencies,” to provide for such matters. Florida Progress and PEF believe the ultimate disposition of these matters will not have a material adverse effect upon either Company’s consolidated and PEF’s financial position or results of operations.

Exhibit B(1)

PROGRESS ENERGY FLORIDA, INC.
PRELIMINARY PROJECTION OF SOURCES AND USES OF FUNDS
(In Millions)

	12 Months Ending <u>December 31, 2005</u>
OPERATING ACTIVITIES	\$ <u>662</u>
INVESTING ACTIVITIES:	
Construction Expenditures	<u>(516)</u>
Other Investing Activities	<u>(8)</u>
Total	<u>(524)</u>
FINANCING ACTIVITIES:	
Long-Term Debt (Repayments)/Issuance	<u>(48)</u>
Dividends Paid on Common Stock	<u>(170)</u>
Increase (Decrease) in Short-Term Debt	<u>82</u>
Preferred Dividends	<u>(2)</u>
Total	<u>(138)</u>
TOTAL INCREASE (DECREASE) IN CASH	\$ <u><u>0</u></u>

PROGRESS ENERGY FLORIDA, INC.
PRELIMINARY CONSTRUCTION EXPENDITURES FOR 2005
(In Millions)

<u>BUDGET CLASSIFICATION</u>	<u>PRELIMINARY BUDGET</u>
PRODUCTION PLANT	
Nuclear Production	\$ 109
Fossil/Other Production	122
Steam Production	<u>15</u>
TOTAL PRODUCTION PLANT	246
TRANSMISSION PLANT	69
DISTRIBUTION PLANT	201
GENERAL PLANT	
TOTAL LESS AFUDC	\$ <u>516</u>

PROGRESS ENERGY FLORIDA, INC.
 CAPITAL STOCK AND LONG-TERM DEBT
 As Of September 30, 2003

<u>Title of Class</u> <u>Outstanding</u>	<u>Shares</u> <u>Authorized</u>	<u>Shares</u> <u>Outstanding</u>	Amount
Common Stock without par value N/A	60,000,000	100 ¹	
Cumulative Preferred Stock (Par Value \$100):			
4.00% Series	40,000	39,980	3,998,000
4.40% Series	75,000	75,000	7,500,000
4.58% Series	100,000	99,990	9,999,000
4.60% Series	40,000	39,997	3,999,000
4.75% Series	80,000	80,000	8,000,000
Total Cumulative Preferred Stock Outstanding			<u>\$ 33,496,700</u>
First Mortgage Bonds:			
6-7/8% Series, due 2008			80,000,000
6.65% Series, due 2011			300,000,000
4.80% Series, due 2013			425,000,000
5.10% Series, due 2015			300,000,000
5.90% Series, due 2033			225,000,000
Citrus County 2002, Series - A, Due 2027			108,550,000
Citrus County 2002, Series - B, Due 2027			100,115,000
Citrus County 2002, Series - C, Due 2027			32,200,000
Total First Mortgage Bonds Outstanding			<u>\$ 1,570,865,000</u>

¹All of the Company's outstanding shares of common stock are owned beneficially and of record by the Company's parent, Florida Progress Corporation.

Medium-Term Notes:

6.72%, due 2005	45,000,000
6.77%, due 2006	45,000,000
6.81%, due 2007	85,000,000
6.67%, due 2008	13,150,000
6.75%, due 2028	150,000,000

Total Medium-Term Notes Outstanding \$ 338,150,000

Total Long-Term Debt Outstanding: \$ 1,909,015,000

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