BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

PETITION FOR INCREASE IN RATES BY PROGRESS ENERGY FLORIDA, INC.	DOCKET NO. 090079-EI
PETITION FOR LIMITED PROCEEDING TO INCLUDE BARTOW REPOWERING PROJECT IN BASE RATES, BY PROGRESS ENERGY FLORIDA, INC.	DOCKET NO. 090144-EI
PETITION FOR EXPEDITED APPROVAL OF THE DEFERRAL OF PENSION EXPENSES, AUTHORIZATION TO CHARGE STORM HARDENING EXPENSES TO THE STORM DAMAGE RESERVE, AND VARIANCE FROM OR WAIVER OF RULE 25-6.0143(1)(C), (D), AND (F), F. A. C., BY PROGRESS ENERGY FLORIDA, INC.	DOCKET NO. 090145-EU

VOLUME 29
Pages 4116 through 4264

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A CONVENIENCE COPY ONLY AND ARE NOT
THE OFFICIAL TRANSCRIPT OF THE HEARING,
THE .PDF VERSION INCLUDES PREFILED TESTIMONY.

PROCEEDINGS:	HEARING
COMMISSIONERS PARTICIPATING:	CHAIRMAN MATTHEW M. CARTER, II COMMISSIONER LISA POLAK EDGAR COMMISSIONER KATRINA J. McMURRIAN COMMISSIONER NANCY ARGENZIANO COMMISSIONER NATHAN A. SKOP
DATE:	Tuesday, October 1, 2009
TIME:	Commenced at 11:06 a.m. Concluded at 3:12 p.m.

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

REPORTED BY: RAY D. CONVERY
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and

JANE FAUROT, RPR
Official FPSC Reporter
(850) 413-6732

PARTICIPATING: (As heretofore noted.)

I N D E X

WITNESS

EXHIBITS

NUMBER:	ID.	ADMTD.
233, 234, 235, 236, 237, 238, 239, 240, 241, 242, 243, 244 and 245		4258
250, 251, 253 and 254		4126
317		4126
318		4127
319 Dow 2/2/09-3/30/09	4240	4240

P R O C E E D I N G S

(Transcript follows in sequence from Volume 28.)

Whereupon,

WILLIAM C. SLUSSER

was called as a witness on behalf of Progress Energy Florida and, having been duly sworn, was examined and testified as follows:

CONTINUED CROSS EXAMINATION

BY MR. SAYLER:

Q Okay. So also -- would it also -- would the company also need something like identifying customers, knowing which customers might be eligible for that new commercial time of use rate, need to do the load research data to make billing determinants and figure out the impact on the customers? I may have used the wrong terminology, but the company would need information like that; is that correct?

A Yes. All that information would be required, yes.

Q Okay. And does Progress currently have that information necessary to develop a commercial -- a new commercial time of use rate?

A It's my opinion that more research needs to be done, more load research needs to be done.

Q But you don't have that right now, is that correct?

A That's correct.

Q If you'll turn to page 17 of your rebuttal testimony -- and these are my last three questions. On line 6 through line 8, you state that "The determination of credit amounts and payment structures is a matter that should be addressed in the conservation docket." Is that correct?

A Yes.

Q All right. And the term "conservation docket," were you referring to the DSM numeric conservation goals dockets?

A I'm not absolutely certain of the form. I know annually the company is involved in a conservation filing where it has to present its costs and establish a cost recovery, and in that proceeding it makes sense that, since credits are a cost, that they be reviewed and established in that proceeding. If that's the goals proceeding, if they're one and the same, I would say yes.

Q Okay. But your testimony is you're not sure exactly which docket this needs to go into, is that correct?

A No, I'm not that familiar with the other forums.

Q Okay. Why do you think that it is appropriate to address the credits in something other than a base rate case proceeding?

A Because the interruptible and curtailable rate schedules are a demand-side management program. Just like residential load management and other general-service load management programs that the company has, all those should be analyzed since the credits are recovered in the conservation cost recovery clause.

MR. SAYLER: Thank you very much. That is it for staff's questions.

CHAIRMAN CARTER: Thank you. Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chairman.

Good morning, Mr. Slusser.

THE WITNESS: Good morning, Commissioner Skop.

COMMISSIONER SKOP: Just two brief followup questions. If I could turn your attention back to what I believe has been marked as Exhibit 317, and I think it's the exhibit that Ms. Kaufman handed out.

THE WITNESS: Yes, I have it.

COMMISSIONER SKOP: And if I could ask you to turn to page 1 of 4, please.

THE WITNESS: I have it.

COMMISSIONER SKOP: And the -- just to make sure we're on the same page, the header for that spreadsheet, if you will, is entitled "Progress Energy Florida Proposed Class Revenue Allocation." Is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Does this page reflect the impact of implementing the 12 CP 50 AD method on each of the respective rate classes?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. So, just to be clear, that is the 12 CP 50 AD and not another method?

THE WITNESS: Yes.

COMMISSIONER SKOP: All right. Thank you.

And just one followup question with respect to what staff had just asked on time of use rates. If Progress were to make subsequent modifications to the time of use rates, in your opinion would it be appropriate to benchmark on best practices, say perhaps on Pacific Gas & Electric with respect to policies that might encourage customers to transition to that but also provide some protection in terms of rate shock?

THE WITNESS: I would think so; yes, sir.

COMMISSIONER SKOP: All right. Thank you.

CHAIRMAN CARTER: Anything further from the bench? Redirect?

REDIRECT EXAMINATION

BY MR. MELSON:

Q Just a couple, Mr. Chairman.

Mr. Slusser, could you turn back to your exhibit WCS-7 for just a moment.

A I have it.

Q Mr. Brew asked you a couple of questions about Florida energy policy. Let me ask you this: Does your exhibit WCS-7 suggest that the company in fact should build peaking units to meet all demand?

A Absolutely not.

Q And we walked -- after Mr. Brew's cross -- I understand the mathematics of this exhibit, but I think we saw the trees instead of the forest. Could you tell me what this exhibit is intended to show?

A Yes, sir. The exhibit is intended to show that the support for the 12 CP and 50 percent AD method is that, if the emphasis was strictly on the need for capacity, then the company's capacity would effectively be nothing more than the least-cost type of capacity, and that being a peaker, a combustion turbine, and, of course, if the company did have to serve the energy from a combustion turbine, it would be very expensive, and that's what's shown on line 9 of the exhibit.

Because the company does recognize energy in its facility plans and especially all the off-peak energy, the company has built something other than an all CT system. It's built a lot of baseload capacity, and as a result of what it's built, the fuel cost is considerably less. It averages only $53 a megawatt hour as opposed to incurring the cost of peaking capacity at $152 a megawatt hour.

So simply by the additional cost that the company is incurring for its baseload units and that additional cost is being allocated in the company's cost-to-service study on an energy basis and is being compared with a theoretical savings by the fuel that the baseload units that have constructed have realized on the -- on the Progress Energy electric system, there are substantial savings by the company actually building its fleet of more efficient generation. And this shows that the benefit-to-cost ratio ends up actually being a very high number, a 9.9 to 1 benefit-to-cost ratio. So the exhibit is intended to show that it's been a -- obviously a very good economic decision to build much more expensive capacity for the benefits of realizing fuel savings on the system. The customers benefit from the fuel savings on an energy basis. So to match up with the way it's benefitted, the costs should be allocated on an energy basis, and that's all I'm trying to do with this exhibit.

MR. SAYLER: That's all we have.

CHAIRMAN CARTER: Okay. Exhibits?

MR. MELSON: Move Exhibits 250 through 254.

CHAIRMAN CARTER: Are there any objections?

Without objection, show it done, Exhibits 250 through 254.

(Exhibit Nos. 250, 251, 253 and 254 entered into the record.)

CHAIRMAN CARTER: Let's go to the back pages. Ms. Kaufman your recognized for 317.

MS. KAUFMAN: I would move 317.

CHAIRMAN CARTER: Are there any objections?

Without objection, show it done.

(Exhibit No. 317 entered into the record.)

CHAIRMAN CARTER: Staff, you're recognized for Exhibit 318.

MR. SAYLER: We move 318.

CHAIRMAN CARTER: Are there any objections?

MR. BREW: No objection.

CHAIRMAN CARTER: And, Mr. Brew, I did check in there and they did have those parts crossed out that you mentioned.

MR. BREW: Yes, thank you, and I appreciate the cooperation from staff in revising the proposed exhibit.

CHAIRMAN CARTER: Thank you. So, show it entered.

(Exhibit No. 318 entered into the record.)

CHAIRMAN CARTER: Okay. Anything further for this witness?

MR. SAYLER: No, Mr. Chairman.

CHAIRMAN CARTER: Mr. Slusser, you may be excused.

Mr. Brew, you're recognized. I think this was your last witness; is that right? You're recognized, sir.

MR. BREW: I don't have anything to add. It's just -- it's been a fun three weeks.

CHAIRMAN CARTER: Okay. Well, we want to say thank you very much for coming, and also you have conducted yourself with impeccable professionalism and high honor and integrity. It's been an honor and privilege to have you with us at the Florida Public Service Commission.

MR. BREW: Thank you, sir. That's high praise. I appreciate it.

MR. MELSON: And, Mr. Chairman, let the record reflect, we've only been a week and a half.

CHAIRMAN CARTER: Commissioners, we need to give Chris an opportunity to get the electronics fixed, and we'll take a -- we're going to give Chris ten minutes, so we'll come back at :25 after. We're in recess.

(Recess.)

CHAIRMAN CARTER: We are back on the record, and when we last left, we had finished with Witness Slusser.

Mr. Walls, you're recognized.

MR. WALLS: Progress Energy calls Tom Sullivan on rebuttal. He was here on direct, so he's still under oath.

CHAIRMAN CARTER: Okay.

Whereupon,

THOMAS R. SULLIVAN

was called as a witness on behalf of Progress Energy Florida and, having been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. WALLS:

Q Mr. Sullivan, have you filed prefiled rebuttal testimony and exhibits in this proceeding?

A Yes, I have.

Q Do you have your prefiled rebuttal testimony and exhibits with you?
A Yes, I do.
Q Do you have any changes to make to your prefiled rebuttal testimony?
A I have one correction to the testimony. It is on an MFR schedule. It's located on page 24, line 21, the schedule referred to as D-2, and that should be D-3.
With that correction, that is all that I have.
Q With that correction, if I asked you the same questions in your prefiled rebuttal testimony today, would you give the same answers?
A Yes, I would.
MR. WALLS: We request that Mr. Sullivan's prefiled rebuttal testimony be entered into the record as if it was read here today.
CHAIRMAN CARTER: The prefiled testimony of the witness will be inserted into the record as though read.

REBUTTAL TESTIMONY OF

THOMAS R. SULLIVAN

I. Introduction and Purpose of Rebuttal Testimony.

Q. Mr. Sullivan, did you file direct testimony in this proceeding?

A. Yes, I did.

Q. What was the purpose of your direct testimony?

A. The purpose of my direct testimony was to address Progress Energy Florida, Inc.'s ("PEF's" or the "Company's") capital structure and its requirements to ensure that it maintains continuous access to capital markets to obtain capital at a reasonable cost when that capital is needed to meet our customers' energy needs.

Q. Have any of the intervenor witnesses addressed PEF's capital structure or other issues that would impact the Company's ability to maintain continuous access to the capital markets at reasonable costs?

A. Yes, they have. Dr. Woolridge, Mr. Lawton and Mr. Schultz, on behalf of the Office of Public Counsel ("OPC"), and Mr. Pollack, on behalf of the Florida Industrial Power Users Group ("FIPUG"), have all filed testimony related to either capital structure or other issues, such as return on equity or cost of debt, that impact the Company's financial position and its ability to maintain access to the capital markets at reasonable costs.

Q. Have you read their testimony?

A. Yes, I have.

Q. What is your understanding of the intervenors' recommendations regarding PEF's capital structure and cost of capital, as well as their assessment of the impact of those recommendations on the Company's credit rating and financial health?

A. Dr. Woolridge and Mr. Pollack disagree with the Company's capital structure, recommending a common equity ratio of 50%. Dr. Woolridge also recommends a cost of equity of 9.75%, a short-term debt cost rate of 3.06% and a long-term debt cost rate of 6.05%. All of the intervenors believe that their recommendations, including the pre-tax cash flow impact of the $149 million adjustment to the depreciation reserve and the total $35 million reduction in base rates, would not negatively impact the Company's credit rating or its ability to access the capital markets at reasonable costs.

Q. Did any intervenors question the positions in your direct testimony regarding the importance of the Company strengthening its financial profile or achieving a consistent target credit rating of mid-single A?

A. No, they did not.

Q. Do you agree with the intervenors' recommended adjustments to PEF's proposed return on equity, capital structure and cost of debt, and the associated impact of those adjustments on PEF's credit rating and financial health?

A. No, I do not. In the testimony that follows, I will describe why I disagree with the intervenors' recommended adjustments to PEF's cash flow, return on equity ("ROE"), capital structure and cost of debt. Most importantly, I will discuss how the adjustments would negatively impact the Company's ability to maintain and improve its financial strength. This, in turn, would limit the Company's ability to access capital in order to provide reliable energy for its customers at a reasonable cost. The intervenors' recommended changes would represent a material change from the historically constructive regulatory environment in Florida, and would be viewed negatively by the financial markets. It is critical for PEF to maintain a strong financial position while meeting the growing needs of its customer base and increased environmental compliance, including the reduction of carbon emissions with the planned construction of nuclear generation. I believe the successful implementation of PEF's plans to achieve these goals will require the return on equity and cost of debt capital we originally requested, along with a strong capital structure. Without these, both the Company and its customers will be adversely impacted.

Q. How is your testimony organized?

A, First, I will address the cost of equity recommendation of Dr. Woolridge and its potential impact on the Company if adopted. I will then address the overall implications of the intervenors' combined recommendations on cash flow, and how they would hurt the financial position of the Company and negatively impact customers. I will then address the intervenors' recommendations regarding capital structure, their assertions regarding PPAs, and their recommendations for the cost of short-term and long-term debt.

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

A. Yes. I have the following exhibits to my rebuttal testimony:

- Exhibit No. __(TRS-13), Moody's Report "Industry Outlook: U.S. Investor-Owned Electric Utilities," January 2009;
- Exhibit No. __(TRS-14), Fitch's Report "U.S. Utilities, Power and Gas 2009 Outlook," December 2008;
- Exhibit No. __(TRS-15), Moody's Report "Rating Methodology: Regulated Electric and Gas Utilities," August 2009;
- Exhibit No. __(TRS-16), Fitch's Report "EEI 2008 Wrap-Up: Cost of Capital Rising," November 2008;
- Exhibit No. ___(TRS-17), Standard & Poor's ("S&P") Report "Credit FAQ: Top 10 Investor Questions for the U.S. Electric Utility Sector in 2009," January 2009;
- Exhibit No. __ (TRS-18), Moody's Credit Opinion: Progress Energy Florida, Inc., June 2009;
- Exhibit No. __ (TRS-19), PEF 2010 Adjusted Credit Metrics Chart;
- Exhibit No. __(TRS-20), "The A Rating," by Steven M. Fetter, Electric Perspectives, May/June 2009;

- Exhibit No. __(TRS-21), Moody's Report "Special Comment: New Nuclear Generation: Ratings Pressure Increasing," June 2009;
- Exhibit No. __(TRS-22), Fitch's Report "U.S. Electric and Gas Financial Peer Study," June 2009;
- Exhibit No. __(TRS-23), S&P's Report "Request for Comments: Imputing Debt To Purchased Power Obligations," November 2006;
- Exhibit No. __ (TRS-24), S&P Ratings Direct – Florida Power Corp. d/b/a Progress Energy Florida, Inc. credit report, June 2009;
- Exhibit No. __ (TRS-25), S&P Ratings Direct – Florida Power Corp. d/b/a Progress Energy Florida, Inc. credit report, May 2008; and
- Exhibit No. __ (TRS-26), Composite Exhibit of Forward 3-month London Interbank Offered Rate ("LIBOR") and 10-year and 30-year Treasury Note and Bond Forecasts.

These exhibits were either prepared by me or at my direction or they are industry information that I regularly obtain and review as part of my responsibilities as the Treasurer for PEF. They are true and correct.

II. Cost of Equity.

Q. Do you believe Dr. Woolridge's recommended ROE of 9.75% is appropriate for PEF?

A. No, I do not. The Company hired a well regarded witness, Dr. James A. Vander Weide, to recommend the appropriate return on equity for PEF. I have read and support Dr. Vander Weide's recommendation of a 12.54% ROE and believe it should be adopted by the Commission. Dr. Vander Weide will address the more technical aspects of Dr. Woolridge's recommendation, but I will address the overall reasonableness of the recommendation and its potential impact on the Company.

Q. Is Dr. Woolridge's recommended ROE consistent with other utilities in the southeast?

A. No, it is not. Tampa Electric was recently awarded a return on equity of 11.25% in 2009 by the Commission. When compared to Tampa Electric, PEF has additional risk factors including a much larger generating fleet that includes nuclear operating risk with our Crystal River Unit 3 ("CR3") nuclear power plant. In addition, PEF is moving forward with the construction of new nuclear power plants, and other large capital expenditure projects which significantly increase PEF's risk profile over Tampa Electric's and nearly every other electric utility's risk profile within the state. These additional risk factors translate into a higher cost of capital, which supports PEF's request for a higher return on equity than that awarded to Tampa Electric. In their June 2009 credit opinion for PEF, Moody's stated that the FPSC's decision in Tampa Electric's rate case "affirmed Moody's view that the regulatory environment for electric utilities in Florida has remained relatively supportive" (Exhibit No. __(TRS-18) to my rebuttal testimony). Providing PEF a lower return on equity than that awarded to Tampa Electric would be viewed as inconsistent and negative by the rating agencies and financial community and begin to raise doubts as to the regulatory climate in the state of Florida.

Dr. Woolridge's recommended ROE is also below other authorized ROEs for utilities in the southeastern United States, including Alabama Power (13.75%), Georgia Power (11.25%), Gulf Power (12.0%) and Progress Energy Carolinas, Inc. (12.75%). In addition, the Commission issued an order last year recognizing a 11% ROE for Florida Public Utility Company, which is a distribution only utility. These are all companies that compete with PEF for investor dollars needed to provide reliable electric service and fund capital expenditure plans at reasonable costs.

Q. What would be the implications to PEF if Dr. Woolridge's recommended ROE of 9.75% were adopted?

A. The ROE recommended by Dr. Woolridge would be a significant change from the historically supportive regulatory environment in Florida. The financial markets view this supportive regulatory environment as a critical element of the relationship between utilities, regulators and customers. In their January 2009 report titled "Industry Outlook: U.S. Investor-Owned Electric Utilities," Moody's states the following:

> "We continue to incorporate a view that individual state regulatory authorities will provide reasonably timely recovery of prudently incurred costs and investments. Moreover, we continue to believe that regulators prefer to otherwise regulate financially healthy companies. This relationship often creates a virtuous cycle, where financially healthy utilities have the balance sheet strength and liquidity to assure investment, maintain high levels of

reliability and attract economic development. In turn, this tends to facilitate contentment among consumers, legislators and regulators."

See Exhibit No. ___ (TRS-13) to my rebuttal testimony. Dr. Woolridge's proposed cost of equity would put PEF at a significant disadvantage in its competition for capital with other companies with similar risk profiles and would not be adequate to maintain access to capital markets at reasonable prices. When competing for capital with the southeastern utilities with higher allowed ROEs referenced above, PEF would be viewed as a less attractive investment. Investors would not invest in a company earning a lower ROE when they could invest in other companies of similar risk and earn a higher ROE.

PEF's operating cash flow would also be reduced, hurting investor confidence and likely resulting in a credit rating downgrade. The Company's ability to raise the capital necessary to meet customer needs would be hurt, and the cost of that capital would be higher. This position was summarized by Fitch in their December 2008 report titled "U.S. Utilities, Power and Gas 2009 Outlook" (Exhibit No. ___(TRS-14) to my rebuttal testimony):

> "All else equal, utilities operating in more balanced regulatory jurisdictions providing high-quality customer service are more likely to earn reasonable returns on investment and achieve higher creditworthiness. Conversely, utilities with suboptimal regulatory outcomes are more likely to experience lower relative returns, higher financing costs and relatively anemic credit profiles."

Lower credit ratings would also jeopardize the Company's ability to reduce fuel cost volatility through hedging, as the Company might not meet minimum credit standards required by counterparties. Access to capital required for immediate service restoration following storms could also be impacted by lower credit ratings. All of these negative ramifications from adopting the recommended ROE would severely impact the Company's ability to serve its customers effectively and would ultimately result in higher rates.

Q. Why do you believe the adoption of Dr. Woolridge's recommended ROE would likely result in lower credit ratings?

A. The regulatory framework and financial performance of a company are critical to the assessment of a utility's credit quality by the rating agencies. In their ratings assessment process, Moody's, for example, focuses on four key rating factors that are central to the assignment of ratings for companies in the regulated electric and gas utilities sector: (1) regulatory framework; (2) ability to recover costs and earn returns; (3) diversification; and (4) financial strength, liquidity and key financial metrics. The process is outlined in the Moody's report "Rating Methodology: Regulated Electric and Gas Utilities" issued in August 2009. See Exhibit No. ___(TRS-15) to my rebuttal testimony. The adoption of Dr. Woolridge's recommended ROE would hurt PEF's position in the first, second and fourth criteria listed above.

Fitch also places emphasis on the regulatory framework in determining credit quality. In their November 2008 report titled "EEI 2008 Wrap-Up: Cost of Capital

Rising" (Exhibit No. ___ (TRS-16) to my rebuttal testimony), Fitch states the following:

> "Jurisdictional regulatory practices promise to be a key element in determining the ultimate impact on issuer creditworthiness given the sharp increase in the cost of capital as a result of the ongoing financial crisis. Utilities in states that have authorized reasonable returns on equity and adopted balanced regulatory mechanisms, including forward test years and automatic fuel and other tariff adjustment mechanisms are more likely to come through this period of stress without undue deterioration to current creditworthiness."

Fitch further emphasized this position in their December 2008 report titled "U.S. Utilities, Power and Gas 2009 Outlook" (Exhibit No. ___ (TRS-14) to my rebuttal testimony), stating:

> "Average authorized returns on equity (ROE) for the regulated utility sector are currently in the 10.25% to 10.5% range, with some jurisdictions approaching 9%. Fitch is concerned that absent a meaningful up-tick in authorized ROE, the industry may have difficulty attracting adequate capital to fund new reliability, infrastructure and renewable energy projects in light of the significant change in capital market conditions and investor expectations…[The] ratings of utilities operating in states with relatively low authorized ROEs and significant regulatory lag are more likely to suffer credit deterioration."

While each rating agency uses a different methodology, they would all view the adoption of Dr. Woolridge's recommended ROE as very unsupportive to the overall financial health of PEF and would likely result in a rating downgrade.

III. <u>Importance of Cash Flow to PEF's Financial Health.</u>

Q. Mr. Lawton identifies the net impact from his adjustment to the depreciation reserve as a reduction of the Company's pre-tax cash flow of about $149 million per year for four years. He maintains that PEF will maintain its "financial integrity" after correcting for the excess depreciation reserve. Do you agree with his assertion?

A. No, I do not. Mr. Lawton clearly states that his adjustment will result in lower cash from operations for the Company, a key component of the credit rating evaluation process. Cash flow is emphasized by S&P in their January 2009 report titled "Top 10 Investor Questions For The U.S. Electric Utilities Sector In 2009" (Exhibit No. ___(TRS-17) to my rebuttal testimony), where they state that "[those] companies that fare poorly in the regulatory arena and experience significant deterioration in cash flow metrics and creeping debt leverage are most vulnerable to downward actions." Mr. Lawton then goes on to state that "the Company's cash flow ratios decline slightly, but remain well above industry averages," and that PEF "maintains financial integrity after correcting for the excess depreciation." (Lawton Test., p. 19).

I have several concerns with Mr. Lawton's conclusions. First, Mr. Lawton references the financial ratio medians by bond rating category in his Exhibit DJL-5, p. 2 of 2. Since no source is provided for this data, I cannot be sure if the financial ratios are provided on an unadjusted basis, or if they include adjustments made by the credit rating agencies. In any event, a comparison to industry medians is not the best comparison, as the rating agencies give specific guidance and target metric ranges that will more directly determine PEF's credit rating.

Mr. Lawton then references the ratios calculated in Exhibit DJL-5, p. 1 of 2, as evidence of PEF maintaining financial integrity after correcting for the excess depreciation. I have several issues with the ratios he calculates in this exhibit. First, the ratios are calculated based on the capital structure supplied by the Company on MFR Schedule D-1a, p. 1 of 3. This capital structure is the jurisdictional capital structure used for ratemaking purposes. The credit rating agencies calculate their metrics starting with the book capital structure for the entire company. Second, he includes only long-term debt in the metrics, while the rating agencies look at total debt (long-term and short-term). Third, the calculations are not made using the methodology or adjustments of the credit rating agencies for items such as capital leases, operating leases, PPAs, and pension liabilities. As such, the metrics are not comparable to the target ranges shown in his column C. Finally, Mr. Lawton states that financial ratios such as "debt ratio" are unaffected by the correction of the excess reserve. This is not possible, as his recommended correction to the excess reserve would result in lower cash from operations and thus higher financing needs. Finally, the interest expense of $189 million used in Mr. Lawton's calculation is grossly understated. S&P used adjusted interest expense of $295.7 million in its PEF credit metric calculations for 2008, and interest expense will be higher in 2010.

In addition to these calculation errors, Mr. Lawton states on page 20 that his "analysis focuses solely on the excess depreciation reserve impact and demonstrates that the cash flow reduction allows Progress to maintain solid financial metrics." This analysis is incorrect, as one must look at the *total of all the adjustments* proposed by the intervenors and those adjustments' impact on cash flow metrics, not individual adjustments in isolation. In short, neither the metric calculations nor comparisons referenced by Mr. Lawton allow any conclusions to be drawn regarding the financial integrity of PEF.

Q. The testimony of Mr. Schultz indicates that rates should be reduced by at least $35.038 million. This rate reduction, as calculated on Schedule A-1 of his testimony, uses the capital structure, return on equity and cost of debt recommended by Dr. Woolridge. Does Mr. Lawton capture all of the consequences the adoption of the proposed rate reduction would bring about?

A. No, he does not. His calculations incorrectly assume that there would be no negative consequences to the cost of capital for the Company if the rate decrease were adopted. As discussed above, Moody's specifically focuses on four key rating factors that are central to the assignment of ratings for utilities in their credit assessment process: (1) regulatory framework; (2) ability to recover costs and earn returns; (3) diversification; and (4) financial strength, liquidity and key financial metrics. The process is outlined in the Moody's report "Rating Methodology: Regulated Electric and Gas Utilities" issued in August 2009 (Exhibit No. __(TRS-15) to my rebuttal testimony). The primary financial metrics utilized by Moody's, along with guidelines for an "A" rating, are as follows:

Financial Metric	**Guidelines for "A" Rating**
(CFO[1] pre-WC[2] + Interest) / Interest	4.5x – 6.0x
CFO pre-WC / Debt	22% – 30%
(CFO pre-WC – Dividends) / Debt	17% – 25%
Debt / Capitalization	35% – 45%

[1] CFO = Cash from Operations

[2] WC = Working Capital

The credit metric guidelines for our target credit rating reflect all of the standard adjustments normally incorporated by Moody's when analyzing financial statements.

In their June 2009 credit opinion for PEF, Moody's said the following regarding what could cause a credit rating downgrade for PEF:

> "A downgrade could be considered if there is an adverse change in the regulatory environment in Florida which could limit full and timely recovery of costs, especially the cost of new nuclear generation; a continued increase in leverage; new, unanticipated capital expenditure requirements; if financial metrics do not recover from 2008 levels and CFO before working capital plus interest to interest remains below 4.0x; and CFO before working capital to debt remains below 20% for a sustained period."

See Exhibit No. __ (TRS-18) to my rebuttal testimony. Exhibit No. __ (TRS-19) to my rebuttal testimony shows the key 2010 cash flow credit metrics for PEF calculated using both S&P's and Moody's methodologies. The metrics are provided based on PEF's proposed rate increase and Mr. Schultz's proposed rate decrease. The calculations clearly show that PEF does not meet the standards specifically set forth by Moody's in their credit opinion for the Company if Mr. Schultz's recommendations were adopted. Thus, my conclusion is that PEF's credit rating would likely be downgraded. The metrics based on PEF's proposed rate increase are in line with the ranges for an A rating. As discussed above, no intervenor questioned the importance of PEF strengthening its financial profile or achieving a consistent target credit rating of mid-single A, and yet their recommendations would likely result in a credit rating downgrade. This would result in a higher cost of capital, which would ultimately increase rates for customers.

The importance of a strong credit rating was summarized by Steve Fetter, president of Regulation Un-Fettered, former chairman of the Michigan PSC, and former head of the global power group at Fitch Ratings in his May/June 2009 article titled "The A Rating" (Exhibit No. __ (TRS-20) to my rebuttal testimony):

> "Perhaps we have returned to a time when it would be in the interest of both companies and regulators to work in concert to support credit profiles for regulated electric utilities (optimally in the A category), for the good of both consumers and investors...The bottom line is that electric utilities must collect sufficient cash flow through rates to maintain strong credit ratings. This is especially true for companies needing to proceed with major generation construction, notwithstanding the negative economic environment. S&P has highlighted cash flow as the single most critical aspect of all credit rating

> decisions. And liquidity is the lifeblood of day-to-day utility management flexibility."

The intervenors' rate reduction proposal would accomplish just the opposite: reduced cash flows, weaker credit ratings, and a weaker balance sheet; all during one of the strictest capital markets and at a time when the Company is embarking upon one of the largest capital programs in its history and needs access to the lowest possible cost of capital.

Q. Do you believe the overall recommendation of the $35 million rate decrease, which includes the adoption of Dr. Woolridge's recommended ROE, could impact PEF's plans to construct new nuclear plants?

A. Yes, I do. In their June 2009 report titled "New Nuclear Generation: Ratings Pressure Increasing," Moody's states the following:

> "From a credit perspective, companies that pursue new nuclear generation will take on a higher business and operating risk profile, pressuring credit ratings over the intermediate- to long-term. Even so, we also believe companies will ultimately revise their corporate-finance policies to begin materially strengthening balance sheets and bolstering available liquidity capacity at the start of the construction cycle……In general, we believe a company should prepare for the higher risk associated with construction by maintaining, if not strengthening, its balance sheet, and by maintaining robust levels of liquidity capacity."

See Exhibit No. __ (TRS-21) to my rebuttal testimony. Clearly, the recommendation of a $35 million rate reduction does not help PEF strengthen its financial position. Given that the rating agencies and the financial community require sound financial management and a strong financial position before entering the construction cycle for new nuclear plants, our plans could certainly be in jeopardy if the recommendation is adopted.

IV. Capital Structure.

Q. Dr. Woolridge asserts that the Company's capital structure with a common equity ratio of 53.9% is high relative to (1) the Company's actual historic capital structure and (2) the capital structures of other electric utilities (page 5). Do you agree with these assertions?

A. No, I do not. Dr. Woolridge's comparisons are not correct, as he is comparing an adjusted equity ratio to book equity ratios. In addition, PEF's 2008 book equity ratio was low due to timing differences associated with fuel cost recovery and fuel hedging, leading to higher debt at PEF before those costs are recovered from customers. In the comparison to the capital structure of other utilities, Dr. Woolridge chose a peer group of other electric utilities that represents both operating companies and parent companies, leading to unfair comparisons. The June 2009 Fitch report entitled "U.S. Electric and Gas Financial Peer Study" stated that "the business risk profiles of utility parent companies remain widely disparate, which often accounts for the rating discrepancy among companies with similar ratios" (Exhibit No. ____

(TRS-22) to my rebuttal testimony). Neither comparison made by Dr. Woolridge supports his assertion that PEF's requested capital structure is high.

Q. On page 18 of his direct testimony, Dr. Woolridge references the capitalization ratios for Progress Energy over the past three years and states that "these ratios also show that Progress Energy finances its other businesses and operations with more debt than PEF." Do you agree with this conclusion?

A. No, I do not. Progress Energy has divested of all of its material non-regulated operations, leaving Progress Energy Carolinas (PEC) and Progress Energy, Inc. (the holding company) as the key remaining entities other than PEF. PEC ended 2008 with a book common equity ratio (GAAP) of over 54% and has thus been funded with less debt than PEF. As described above, the primary reason for Progress Energy's common equity ratio being lower than PEF's is the debt at the parent (Progress Energy, Inc.) that remains from the acquisition of Florida Progress Corporation.

Q. Do you agree with Dr. Woolridge's recommended capital structure, with a common equity ratio of 50%?

A. No, I do not. PEF's credit ratings are determined based a capital structure with imputed debt, which Dr. Woolridge ignores. A strong balance sheet is critical for PEF. S&P stated the importance of balance sheet strength in its January 2009 report "Credit FAQ: Top 10 Investor Questions For The U.S. Electric Utility Sector in 2009," saying:

"The electric utility industry is asset-intensive and relies heavily on debt. Balance-sheet strength is a distinguishing factor when Standard & Poor's assesses financial risk and determines credit quality. Our analysis attempts to portray the economic reality of the financial conditions and considers several items, including purchase power obligations, capital leases, hybrid equity instruments, pension liabilities, and regulatory assets."

See Exhibit No. __(TRS-17) to my rebuttal testimony. As this quote demonstrates, looking at PEF's capital structure on an adjusted basis is critical.

To correct one point, on page 21 of his testimony, Dr. Woolridge states that PEF's "real" recommended common equity ratio, on a jurisdictional basis, is 47.51% based on investor provided capital. His calculation of this "real" recommended common equity ratio does not properly account for the 75.95% jurisdictional factor of the equity adjustment for PPAs. The correct ratio should be 49.2% on a jurisdictional basis, not 47.51%.

Q. Do you agree with Mr. Pollack's assertion that a 50% common equity ratio is sufficient to maintain PEF's current bond rating?

A. No, I do not. In order to determine the impact on PEF's bond rating, the adjustments made by the credit rating agencies (such as imputed debt for PPAs) are a financial reality for PEF and must be considered. In addition, a number of factors are used to determine PEF's credit rating, not just its capital structure. As described above, all of the intervenors' recommendations should be considered together to determine the impact on PEF's credit rating. In this case, the recommendations do not allow PEF to maintain sufficient credit metrics to support its current rating and would likely result in a credit rating downgrade.

V. **Financial Impact of PPAs.**

Q. How do the rating agencies treat long-term power supply contracts and what is the impact of their treatment of the PPAs on the Company?

A. As I explained in my direct testimony, while there are differences in methods, each rating agency views PPAs, with their long-term obligations, as essentially debt-like in nature. The main effect of the impact of this treatment of PPAs on PEF's financial structure is that the Company is considered to have more leverage than if you calculated its leverage ratio based only on the debt recorded on its balance sheet.

Q. Dr. Woolridge identified S&P's lack of guidance on the risk factor (page 60) as a flaw in the PPA equity adjustment. Similarly, Mr. Pollack states that S&P does not provide an objective standard for determining the appropriate risk factor for PPAs. Should there be any question regarding the risk factor S&P applies to PEF's PPAs?

A. No, there should be no question regarding the risk factor S&P applies to PEF's PPAs. In their November 2006 article entitled "Request For Comments: Imputing Debt To Purchased Power Obligations" (Exhibit No. ___ (TRS-23) to my rebuttal testimony), S&P states the following:

> "In those instances where recovery of PPA-related capacity costs is guaranteed by a legislative mechanism, the level of the risk factor will be

> determined by the timeliness provided by the legislative true-up mechanism. The strength of the mechanism can result in risk factors as low as 0% because legislatively prescribed recovery mechanisms are viewed as providing utilities with a greater level of protection than that provided by regulatory orders."

PEF's recovery of PPAs is not prescribed by legislation. Therefore, S&P does not use a 0% risk factor when imputing debt for PEF's PPAs. S&P's report goes on to say:

> "To date, where PPA capacity costs were recovered through a fuel adjustment clause (FAC), as compared with base rate recovery, a risk factor of 30% has generally been used...Based on the effectiveness of FAC mechanisms, we will adjust modestly the risk factor of 30% down to 25%."

Based on our discussions with S&P, a 25% risk factor is used for PEF's PPA adjustment.

Table 3 on Page 6 of the S&P credit opinion for PEF dated June 15, 2009 shows that PEF's book debt for 2008 was increased by $696.3 million for PPAs. See Exhibit No. __ (TRS-24) to my rebuttal testimony. Similarly, for 2007, S&P made a debt adjustment of $780.3 million for PPAs. See Exhibit No. __ (TRS-25) to my rebuttal testimony. The 2007 and 2008 adjustments are in line with the $711 million adjustment shown by the Company for 2010. Dr. Woolridge and Mr. Pollack reference general guidance published by S&P, but it cannot be disputed that S&P makes a significant debt adjustment at PEF for PPAs.

Q. Dr. Woolridge also points out that S&P's adjustments for PPAs are not GAAP accounting, and that PPA payments are unlike debt from a regulatory perspective (page 61). Do you agree with these points, and should they impact the imputed equity adjustment you have requested?

A. While I agree that S&P's adjustments for PPAs are not GAAP accounting, I do not agree that this impacts the Company's request for the imputed equity adjustment. The treatment of PPAs as debt by the rating agencies has a material impact on PEF's credit profile and potentially its cost of capital. For 2008, S&P increased PEF's book debt by $696.3 million and interest expense by $40.0 million for the effect of PPAs. The effect of off-balance sheet obligations like PPAs on a utility's capital structure has also been recognized by the Florida Public Service Commission, as outlined on pages 20 and 21 of my direct testimony. The points raised by Dr. Woolridge should have no impact on the imputed equity adjustment.

Q. Mr. Pollack states that "it seems unlikely that the debt [associated with PPAs] will be imputed [by Moody's] to PEF based on the cost recovery mechanisms applicable to purchased power capacity costs." Is this true?

A. No, this is not true. While Moody's does not make an explicit adjustment for PPAs like S&P, they do make adjustments for capital and operating leases. Many PPAs are classified as capital or operating leases under GAAP. Thus, Moody's does impute debt for PEF's PPAs that are classified as capital or operating leases. For example, in 2008 Moody's did not make a direct PPA adjustment, but did adjust 2008 book debt by $245 million for operating leases. Likewise, S&P made an operating lease adjustment of $28.7 million for PEF in 2008. This was in addition to the $696.3 million adjustment for PPAs. The higher operating lease adjustment by Moody's compared to S&P was driven by PPAs treated as operating leases by the Company. The operating lease adjustment by S&P specifically excludes PPAs treated as operating leases, as the debt is imputed through the PPA adjustment. Thus, both rating agencies adjusted PEF's book debt for PPAs, although their methodologies are different.

Q. Do you agree that the PPA adjustment should be removed?

A. No, I do not. All three rating agencies consider off-balance sheet obligations when assessing a company's credit quality. While each has different methodologies for the treatment of PPAs, each rating agency looks at PPAs when assessing PEF's credit quality. It is important for PEF to obtain a consistent target credit rating from all three rating agencies. As such, we focus on the most restrictive methodology for PPA treatment, which is S&P's.

VI. <u>Cost of Debt.</u>

Q. Has your view in interest rates changed since you prepared the forecast supporting PEF's rate request?

A. The financial markets and interest rates continue to be extremely volatile. While government intervention has led to recent historically low rates, the general consensus is that the cost of capital will increase in the future. S&P stated in its January 2009 report "Credit FAQ: Top 10 Investor Questions For The U.S. Electric Utility Sector

In 2009," that "regulators' willingness to recognize the higher cost of capital through overall returns is important for credit quality." See Exhibit No. __ (TRS-17) to my rebuttal testimony.

Our methodology for forecasting interest rates is based on observing market forward curves for LIBOR and U.S. Treasuries and expected credit spreads. While the mix of these elements has changed over the past year, we believe that the rates included in our rate request are still reasonable for 2010.

Q. Do you agree with Dr. Woolridge's recommended short-term debt cost rate of 3.06%?

A. No, I do not. Dr. Woolridge bases his short-term debt cost rate on spreads above the average three-month LIBOR rate for 2009 of 1.0%. Although this average is more than double the current three-month LIBOR rate, it does not properly capture future expectations for increases in three-month LIBOR. As shown in Exhibit No. __(TRS-26) to my rebuttal testimony, three-month LIBOR is expected to be approximately 1.25% by the middle of 2010 and over 2.0% in December of 2010.

In addition, Dr. Woolridge's recommended short-term debt cost rate of 3.06% includes 0.21% for fees associated with the Company's credit facility. These fees are fixed for 2010 as long as PEF's senior unsecured credit rating is not downgraded. The 0.21% fee used by Dr. Woolridge is incorrectly based on 2009 amounts, as reflected on page 2 of MFR Schedule D-2. For the 2010 test year, the correct fee adjustment is 0.75%, as reflected on page 1 of MFR Schedule D-2. Thus, Dr. Woolridge's recommended short-term debt cost rate is understated by 0.54% for the credit facility cost, as well as the understatement based on market expectations for increases in three-month LIBOR in 2010.

Q. **Do you agree with Dr. Woolridge's recommended long-term debt cost rate of 6.05%?**

A. No, I do not. The relevant long-term debt cost rate for this discussion is the long-term debt cost rate for 2010, the test year. Dr. Woolridge has chosen to use the overall embedded long-term debt cost rate for 2009 as the long-term debt cost rate for 2010, which does not properly reflect the long-term debt activity that will take place in 2010. PEF currently has a $300 million first mortgage bond outstanding with an interest rate of 4.50% that matures on June 1, 2010. In order for the 2010 long-term debt cost rate to remain at the 2009 embedded level of 6.05%, the $750 million new bond required in 2010 would have to be issued at a rate of 4.30%, assuming all other assumptions are held constant. This rate is well below the current yields Dr. Woolridge references for 10-year, A and BBB+ rated utility bonds of 5.19% and 5.60%, respectively (page 24).

In addition, Dr. Woolridge states that "a projected yield of 6.98% [PEF's assumed rate on the new $750 million bond on page 1 of MFR Schedule D-4a] is not reflective of current market interest rates" (page 24). PEF's projected yield is a reflection of expected *future* market interest rates, not current interest rates. His statement does not consider the fact that the yields on ten-year and thirty-year U.S. Treasury notes/bonds are expected to increase in the future, to well over 4.0% and

5.0%, respectively, in 2010. Please see Exhibit No. __(TRS-26) to my rebuttal testimony.

In addition, PEF has historically issued a mix of 10- and 30-year bonds. The assumed interest rate for the new 2010 issuance was intended to reflect the potential for a blend of 10-year notes and 30-year bonds. The 30-year bond would have a higher interest rate than the 10-year bond. Using only today's 10-year rates as a proxy for rates in the future leads to unrealistically low new debt issuance cost assumptions for 2010.

Q. Have you addressed the principle arguments raised by the intervenors that challenge the Company's proposed capital structure and the impact of their recommended return on equity and cost of debt on the Company's financial health?

A. Yes, I believe that I have. To the extent that I have not addressed some further argument to the contrary, however, the Company does not agree with it but rejects it for all the reasons that I have provided in my direct and rebuttal testimony.

Q. In conclusion, could you please summarize your conclusions regarding the impact of the intervenors' recommendations on the Company's financial health and credit rating?

A. As I stated in my original direct testimony, it is important for PEF to strengthen its credit profile and achieve a consistent target credit rating of mid-single A. No intervenor witness disputed these positions. Their recommendations regarding the cost of capital and capital structure, however, would not allow PEF to achieve these goals. If their recommendations were adopted, the change in the tone of the Florida regulatory environment and the resulting implications on the Company's cash flow and credit metrics would likely result in a credit rating downgrade, which in turn would jeopardize the Company's ability to serve its customers effectively and would ultimately result in higher rates.

Q. Does this conclude your testimony?

A. Yes, it does.

BY MR. WALLS:

Q And, Mr. Sullivan, do you have a summary of your prefiled rebuttal testimony?

A Yes, I do.

Q And will you please provide that summary to the Commission?

A Yes. Good day, Commissioners.

My rebuttal testimony addresses issues raised by the Intervenor witnesses Dr. Woolridge, Mr. Lawton, Mr. Schultz and Mr. Pollock. Each of these witnesses have filed testimony with recommendations that, if implemented, would adversely impact the company's financial position, jeopardize the company's current credit rating and its ability to meet customer needs.

These Intervenors recommend adjustment to PEF's cash flow, return on equity, capital structure and cost of debt. The adjustments would negatively impact the company's ability to maintain, much less improve it's credit and financial profile. This in turn would limit the company's ability to access the capital markets in order to provide reliable energy for its customers at a reasonable cost.

Furthermore, if implemented by the Commission, the Intervenors' recommended changes would represent a material departure from the historically constructive regulatory environment in Florida and would be viewed negatively by the financial markets.

Mr. Lawton's claim that the proposed adjustment to the depreciation reserve would not adversely affect the company is incorrect. Even he acknowledges his adjustment would result in an immediate reduction in cash flow, but the impact is worse than he states because of the calculation errors in his analysis, and he ignores the overall impact of the Intervenors' proposed $35-million rate reduction. The rate reduction proposal suggested by the Intervenors would result in, number one, reduced cash flow; number two, weaker credit metrics; and, three, an overall weaker balance sheet.

It is important for PEF to achieve and maintain it's target rating of mid-single A. No Intervenor witness disputes this position; however, their recommendations regarding the cost of capital and capital structure would not allow PEF to achieve this goal.

If their recommendations were adopted, the change in the tone of the Florida regulatory environment and the resulting implications on the company's cash flow and credit metrics would likely result in a credit rating downgrade. This in turn would jeopardize the company's ability to support the investment necessary to meet customer energy needs now and in the future.

Before I close, I would like to reiterate a statement introduced by Mr. Glenn earlier in this proceeding, and this is from a Fitch Rating Service note on September 8th of 2009. It states as follows: "PEF's stable rate outlook assumes that the outcome of the base rate and Levy filings will result in improvement in cash flow and credit metrics at PEF in 2010. On the other hand, if regulatory decisions are adverse, Fitch would expect to take negative rating action."

This concludes my summary and I'm happy to answer any questions.

MR. WALLS: We tender Mr. Sullivan for cross.

CHAIRMAN CARTER: Thank you. Mr. Rehwinkel, you're recognized.

CROSS EXAMINATION

BY MR. REHWINKEL:

Q Thank you, Mr. Chairman.

Good morning, Mr. Sullivan.

A Good morning.

Q The statement you just read from Fitch uses the word "adverse," is that correct?

A Let me go back and review it.

Yes, the word "adverse" was used by Fitch.

Q Okay. Does the document say what adverse means?

A No, it does not define adverse.

Q You've asked for a half-a-billion-dollar rate increase, correct?

A That is correct.

Q If the Commission grants -- and I see that the exact number is four-hundred-ninety-nine million nine ninety-seven, right?

A I'll take your word for it.

Q 997,000.

Okay. If the Commission knocks $997,000 off your request, would that be considered adverse by Fitch?

A My testimony is that we required the ask that we've made. I cannot answer what Fitch will do or not do.

Q Okay. Does the document that you read say what Fitch will do?

A Yes, it does.

Q Does it say what Fitch will do if the Commission gives you all but $997,000 of your request?

A No, it does not.

Q Would a $997,000 reduction to your request be considered adverse by Fitch?

A I can't judge what Fitch will assume is adverse or not.

Q Okay. So is it your testimony here today that you really can't tell this Commission what Fitch means by the use of the word adverse?

A My testimony is that we require the ask that we've -- or the request that we've asked for, and Fitch has said that any adverse change will cause a potential -- an increased potential for a ratings downgrade.

Q So the answer to my question is no, you cannot testify to the Commission what they mean by adverse?

A That's what I said.

Q Okay. Now, you said change, but doesn't it say adverse decision?

A I'm sorry. I don't get your question.

Q I thought the word after "adverse" and what you read was "decision."

A As -- let me read it back to you, if you don't have it in front of you. The last sentence, "On the other hand, if regulatory decisions are adverse, Fitch would expect to take negative rating action."

Q Okay. So the word decision was in front of adverse, right?

A I just read you the statement.

Q Okay. I want to talk to you or ask you some questions about the PPA adjustment that's at issue here. Would you object if I referred to the -- well, on page 22 of your rebuttal testimony, could you turn to line -- to that page on line 9?

A I am there.

Q Okay. There's $696.3 million number there, is that correct?

A Yes, it is.

Q Would it be correct to refer to that as phony debt?

A Excuse me.

Q Would it be correct to refer to that as phony debt?

A No. I believe the technical term is imputed debt, not phony debt.

Q Is it real debt?

A It is imputed debt.

Q Well, my question is is it real?

A It's real to the S&P rating agency.

Q Is it real to your books?

A It is real to our rating.

Q Is it real to your books?

A No, it is not.

Q Okay. And you have a number of interest expense of $40 million on that line, is that correct?

A That is correct.
Q Is that phony interest expense?
A That is again imputed, so it is not book.
Q Okay. So it's not real on your books?
A I said it is imputed, not book. I didn't say whether it was real or not.
Q Okay. Do you have MFR Schedule D, the D schedules with you?
A I'm sorry, my MFR?
Q Yeah, the D schedules, do you have your D schedules? I want to look at D-1-A. Do you have that one?
A I do not think I that I do here have all of my exhibits.
Q Well, if it's -- with your permission, Mr. Chairman, I will just hand him my copy of D-1-A.
CHAIRMAN CARTER: You may approach.
THE WITNESS: Thank you.
BY MR. REHWINKEL:
Q Is D-1-A, Mr. Toomey --
A Mr. Sullivan.
Q I'm sorry. It's been a while. This is day nine, I think; isn't it?
A Yes, sir; it's been a while.
Q I'm sorry, Mr. Sullivan.

Have you had a chance to look at D-1-A? Are you familiar with that document?

A Yes, I am.

Q Is that the capital structure that the company is submitting for purposes of the Commission setting rates in this docket?

A Yes, it is.

Q Are the S&P imputed debt dollars included in that capital structure?

A Yes. Under the specific adjustment column, if you follow that adjustment all the way over, it incorporates that into the capital structure.

Q Is that adjustment that you referred to, is that for equity or for debt?

A It is to compensate for the increase in debt that S&P imputes due to the PPA contracts.

Q Okay. So the $696 million that is referred to on line 9 on page 22 of your rebuttal testimony, are those dollars included in the long-term debt figures that are on D-1-A?

A No, they're not because, as we discussed earlier, they are imputed, not book.

Q Okay. Where does the interest expense that you refer to on line 9, page 22 -- where does that show up in the ratemaking calculation?

A I believe that would show up as just the imputed interest expense on the imputed debt.
Q Okay. Is there any income tax effect or benefit to the company for that interest?
A Not that I'm aware of.
Q So interest expense normally represents a cost in the capital structure but a tax benefit in the income statement, is that correct?
A If it is on the books, that's correct, and we have established that it is not on the books.
Q Okay. On pages 21 and 22 of your rebuttal testimony you -- this is where you -- well, actually on page 22, this is where -- let me strike that and start -- pages 20 through 22 is where you address Dr. Woolridge's testimony with respect to PPAs in rebuttal, is that correct?
A That's correct.
Q And on page 22, lines 10 through 13, you reference in rebuttal your direct testimony on pages 20 and 21; is that right?
A I have.
Q Do you have your direct with you?
A My direct?
Q Yes, sir.
A No, I just have my rebuttal.

MR. REHWINKEL: Mr. Chairman, with your permission, I'd like to --

CHAIRMAN CARTER: You may approach.

MR. REHWINKEL: -- approach the witness and hand him a copy of his direct testimony.

BY MR. REHWINKEL:

Q And could I ask you to look on page 21 of your direct testimony starting on lines 18 through the end of that page, through page 3 of the next page.

A Line 3 the next page, is that --

Q Yes, sir.

A At the bottom of page 21?

Q Yeah, the bottom of page 21 through the top of page 22. There in your direct testimony you state that both the Public Service Commission, the Florida Public Service Commission and Standard & Poors have given recognition to PPAs; is that correct?

A Yes, that's correct.

Q Now, specifically you cite the 2005 stipulation; correct?

A Yes, that's correct.

Q Do you have a copy of that stipulation with you?

A No, I do not.

Q I have a copy of it, and it is --

CHAIRMAN CARTER: Do you need a moment, Mr. Rehwinkel?

MR. REHWINKEL: Mr. Chairman, I think I've got what I need. It's Exhibit 129 in the hearing already. It is attached to Mr. Slusser's testimony, and I had it in front of me and I lost it. Oh, here it is.

With your permission, if I could approach the witness --

CHAIRMAN CARTER: You may proceed.

BY MR. REHWINKEL:

Q -- and hand him Exhibit 129. Do you recognize Exhibit 129, Mr. Sullivan?

A This is the first time I've seen it.

Q Well, you reference an order in your direct testimony on page --

A Right. Well, this is -- I'm familiar with the order, but this is the first time I've seen the document.

Q Yes, sir. That's a fair answer.

Could I ask you to turn, please -- that -- what I've asked you to look at is the order that you reference in your direct testimony, correct?

A Yes.

Q Could I ask you -- now specifically you cite that order, the 2005 stipulation order, and that order, just for the record, is PSC-05-0945-S-EI. Is that correct? Is that what it says?

A Yes.

Q Okay. And you cite that order and a non-ratemaking order for the Public Service Commission's -- what you claim is their recognition of the PPAs, correct?

A Yes, and that was based upon the approval of the stipulation.

Q Okay. Now in your testimony you don't mention that there's a Tampa Electric Company order that's even more recent, in fact, a 2009 order that rejected Tampa Electric Company's request for a PPA, do you?

A Yes. I'm not sure if the timing of that -- what the timing of that decision was with our respective testimony, but I am aware of that decision, yes.

Q Okay. That order was filed on -- well, there's an April 30th order PSC-09-0283-FOF-EI. Does that ring a bell?

A If it's something I referenced in the testimony, yes. Otherwise I can't identify it.

Q Okay. If I represented to you that the TECO order was issued on April 30th, would you -- are you suggesting that, since you filed your testimony on March 20th, that this came after your testimony and that's why --

A My point was I just was not sure what the timing of that decision was relative to our filing.

Q Okay. Fair.

Can I get you to turn to page 21 of Exhibit 129?

A Which --

Q Which is the stipulation, the 2005 stipulation.

A I'm sorry. What page, please?

Q Page 21, and that would be also page 13 of the attached stipulation. Do you see that?

A It's Attachment A I believe at the top.

Q Yes, sir.

A Yes, I have that.

Q And in paragraph 13, would you review that paragraph, and I wanted to ask you a couple of questions about it.

A I have read it.

Q Now, would you agree with me that this paragraph 13 on page 21 of Exhibit 129 is the source of your statement and your testimony on direct that you cite on rebuttal that the Commission has given recognition to PPA?

A Yes, that's correct, and that's based upon their approval of the stipulation.

Q Okay. Can you read to me -- I've circled or outlined, if you will, in highlighter a sentence that starts, "The parties agree." Do you see that?

A Yes.

Q Could you read that sentence?

A "The parties agree that the common equity adjustment set forth in this section is unique to the specific circumstances of PEF as it relates to this agreement, and the treatment of PEF's common equity in this section shall not constitute binding Commission precedent in any future proceeding. PEF's adjusted equity ratio will be capped at 57.83 percent."

Q Okay. Thank you.

Do you have Dr. Woolridge's testimony with you?

A Yes, I do.

Q I can relieve you of that clutter, those two large documents on your desk.

CHAIRMAN CARTER: You may do so now.

THE WITNESS: You have one more.

CHAIRMAN CARTER: Mr. Rehwinkel.

THE WITNESS: One more.

CHAIRMAN CARTER: You may proceed.

BY MR. REHWINKEL:

Q Thank you.

You do not disagree with Dr. Woolridge on page 59 of his testimony on lines 21 through 22?

A I'm sorry?

Q Oh, I'm sorry, page 59.

A I'm there.

Q On lines 21 through 22, you do not disagree, do you, with his testimony where he states, "However, S&P does not indicate how the risk factor that ranges from zero percent to 100 percent is determined," do you?

A I don't believe they in their public literature do, but based upon our direct conversations with them, we do understand the risk system that they use.

Q Okay. I'll come back to that, but I want to ask you if you could turn to page 61 of Dr. Woolridge's direct testimony.

A I'm there.

Q Now, in your rebuttal testimony, you have not provided any rebuttal to Dr. Woolridge where he states on page 61, lines 9 through 12, "In a regulatory setting, a utility is given the," quote, "'opportunity to earn,'" close quote, "its cost of debt as well as its overall cost of capital through the ratemaking process. Given the many uncertainties associated with revenues and expenses between rate cases, there is no guarantee that the overall cost of debt can be earned." You don't disagree with that, do you?

A No, I don't.

Q And you have not rebutted that, correct?

A I have not.

Q PEF has never had any PPA costs disallowed, have they?

A Not to my knowledge, and that would stem from the time of the merger to the current.

Q Okay.

A I think it is important, as I discussed last week and I think it was even in our discussion, that we have made efforts to go to S&P to educate them about the tightness, if you will, of the contracts and therefore how they should look at them at a lower risk rating, but as I mentioned, we've been unsuccessful with that.

Q In your -- on page 21 of your rebuttal, line 5, you state, "PEF's recovery of PPAs is not prescribed by legislation," is that right?

A Yes, in the state of Florida, that's my understanding.

Q Are you saying when you say that, that the Florida Legislature has not given its approval to the Commission's practice of allowing PPA recovery?

A No, I'm not saying that. This is an S&P requirement, and they cite states such as New Jersey and so forth that have specific legislation associated with these contracts as opposed to Commission rules.

Q You only testify, do you not, that S&P's determination criteria that is publicly available as applied to PEF's PPA situation yields a number that is not zero; correct?

A That's correct.

Q And essentially on lines 12 and 13 of your rebuttal testimony on page 21, you confirm Dr. Woolridge's testimony that PPA does not disclose its criteria when you state, "Based on our discussions with S&P, a 25-percent risk factor is used for PEF's PPA adjustment," correct?

A The 25 percent is the factor that's used by S&P.

Q And by stating this the way you did, you're saying that they do not publicly disclose how they came up with that number; correct?

A Yes. As I said, they've disclosed methodologies, they've disclosed ranges; however, this is one thing within the PPA adjustment that they have not published publicly.

Q Okay. And you did -- there is no witness from

Standard & Poors here that we can cross-examine on how they came up with the 25-percent number?

A No, there is not.

Q Yet, the Florida Public Service Commission is being asked to grant $24 million -- 24.7 I think it is -- million dollars of the rate increase request based solely on this secret methodology of Standard & Poors, correct?

A I wouldn't call it a secret methodology. I would say that it's not fully vetted, but it is certainly developed over the last few years to be much more transparent than it was in the past.

Q Okay. But your testimony here today is that, between zero and 25, we don't know how Standard & Poors came up with that number; correct?

A Well, between zero and 100 would be the full range. Our contracts get assigned 25 percent, which is the lowest risk rating.

Q Well, the reason I asked that question that way is you testified that, because of this non-prescribed-by-legislation criteria, that the number has to be greater than zero; correct?

A Per the S&P guidelines, yes.

Q Per their guidelines. And they stopped at 25 percent on the continuum to 100 percent?

A No. It's zero to 100 percent.

Q But they came up with 25 percent?

A They valued ours at a 25-percent risk, yes.

Q And we have no testimony in the record as to how that number was generated, correct?

A How the 25 percent was arrived at?

Q Yes.

A No. That's S&P's decision.

Q So we don't know -- we know -- it's kind of interesting, isn't it, that, 24.7, if you round it up a little bit, that's $25 million; right?

A Yes.

Q So every percentage point from zero to 25 is a million dollars of revenue requirements, correct?

A If that's what the math works out to be, I would agree.

Q So what the Commission doesn't know is why they didn't stop at one percent or two percent or three percent or five percent or seven percent; correct?

A Right, that's because their ranges are in 25-percent increments.

Q So it is true, is it not, that, since they don't know how that number was derived at, that it is a secret to them, them being the Public Service Commission; correct?

A Well, it isn't a secret now that I've told them what it is.

Q No. How they arrived at that number is a secret, isn't it?

A How S&P arrived at that number?

Q Yes.

A Obviously they have some basis for that, but you'd have to ask them.

Q Okay. But my yes-or-no question is, it is a secret, isn't it?

A It's not a secret to me.

Q I'm asking if you it is a secret to the Public Service Commission?

A I don't know.

Q Well, let's do this -- I'm not going to stop with this line of questioning --

A That's okay.

Q -- because you've got to answer the question yes or no.

A That's fine.

Q You're asking for $25 million associated with this adjustment, and there's nowhere in your testimony or in the filing of the company MFRs or the testimony that discloses how that number was derived; correct?

A Correct.

Q Okay. Now, from a ratemaking standpoint, if they have to have information to make a decision and it is not provided to them because it is -- there is a party out there that is unwilling to disclose it, it is a secret; isn't it?

A As you define it that way, I'll agree.

Q Okay. I was going to ask you, are you familiar with your annual report that the company files?

A Yes.

Q I don't know that I really need to go through the rigmarole of handing this out to you.

You don't disclose -- on your data that you file with the SEC, your financial statements, you don't have in your debt instruments there -- you don't list this PPA adjustment, correct?

A No. Those are listed in the footnotes.

Q But they're not included in your capital structure on your balance sheet, correct?

A Of course, because they're not on the books. We've established that.

MR. REHWINKEL: All right. That's all the questions I have. Thank you.

CHAIRMAN CARTER: Thank you, Mr. Rehwinkel.

Mr. Moyle, good morning. You're recognized, sir.

CROSS EXAMINATION

BY MR. MOYLE:

Q Good morning. Thank you, Mr. Chairman.

Mr. Sullivan, good morning, John Moyle on behalf of FIPUG.

A Good afternoon.

Q And I have some questions I would like to ask you. The first thing I want to ask you about is you reference in your testimony --

A Direct or rebuttal, please?

Q Rebuttal. Well, I don't know that it's essential that I tag it for you, but one of the points was is that, to the extent that this commission took action on ROE that was less than you requested, that it might affect your ability to finance storm repairs; isn't that right?

A That sounds correct, but I don't recall specifically where that is.

Q It's on page 9, line 3, and I'll just quote it for you: "Access to capital required for immediate service restoration following storms could also be impacted by lower credit ratings." Do you see that?

A That's correct, yes.

Q When a storm hits, does the company currently have access to capital?

A Well, we have two things. Number one, we have a storm reserve --

Q Yes, sir.

A -- that we can call on. And then our additional liquidity plans are to access the commercial paper market, and if those aren't available, draw on our bank facilities.

Q Okay. So how much is in the storm reserve?

A I believe the current balance, accrued balance is about $150 million, but I may be off by a little bit.

Q Okay. And then, with respect to the commercial paper, how much capacity do you have with respect to your commercial paper as we sit here today?

A We have three different programs in the company. We have a holding company program, and then one at each of our utilities. We have -- currently have a $450 million facility at PEF.

Q So that's -- when you answered my question, you had talked about commercial paper, and then you also talked about credit facilities. I understood your answer to kind of mix those. Am I --

A They are mixed because you can't issue commercial paper without a credit facility.

Q Okay. Because you back up the commercial paper with the credit facility?

A In the instance where you cannot finance commercial paper, then you would fall back to the bank line.

Q Okay. And so, as we sit here today, you have a PEF -- Progress Energy Florida has a $450-million credit facility available to it?

A They have that much capacity. What's available to them now is about half of that.

Q So 225 is available?

A Right, and that's used -- the credit facilities and commercial paper are used for the day-to-day operations of the company, not for storm type situations unless we were forced to do that.

Q But you do plan for storms, do you not?

A Absolutely.

Q And that credit facility is available for storms, correct?

A It can be, yes.

Q And do you actually -- I have heard that some utilities, when they enter storm season, they take steps to try to free up additional capacity on their credit facilities to have additional funds available for storms. Do you all do that?

A We certainly evaluate that and we determine if we need to have ready funds available or not.

Q Have you historically taken steps to free up more money on the line of credit?

A As I said, we evaluate that every year. I would have to go back and look at each year to determine whether we did that or not.

Q Okay. So as we sit here today, you don't have a recollection one way or the other?

A No, because, as I said, we haven't -- fortunately, we haven't had any storms in the last few years, but again, we go into every -- the beginning of every hurricane season with a plan in case storms do hit.

Q So as we sit here today, if I were to ask you how much total funds do you have available if, God forbid, a storm were to hit, I would take your 150 number and add it to your 225 number, the 150 give or take in the storm reserve, and the 225 in the credit facility?

A And then, if the situation was really bad, if we got into a '04-'05 situation, then we would consider accessing the term capital markets by raising capital that way.

Q Okay. Could you also knock on the door of the parent?

A That would be possible if there's any capacity there. There is a separate credit facility there and funds can be shared through the money pool process that we have in place, but again, that would depend on what else the holding company's involved with.

Q Yes, sir. And with respect -- do you have information about the holding company's finances?

A Well, the holding company is really a consolidation of everything underneath it, so it has its own debt, but it doesn't own any assets or anything like that.

Q Yes, sir. I was going to ask you if you knew what the line of credit or the credit facility for the parent was.

A Yes. The credit facility for the parent is about a billion dollars. Currently -- it has about 80 percent of that capacity currently available.

Q So again, worst case scenario, as we sit here today, you would have -- and the parent was going to help the subsidiary, which it would do, would it not? I mean, it has two main subsidiaries, PEF of Florida and then the Carolina entity; right?

A Even though it's not there primarily for the utilities, it can be used in a backup situation, yes.

Q So at we sit here today, there's another 800 million available under the parent's credit facility?

A Sitting here today, but tomorrow that will change, as I said, because of our operating expenses and specifically with the margin that we have posted with our natural gas hedging program.

Q And to the extent it changes, it changes on a daily basis, but not in significant quantities; correct?

A Well, no. It could change -- for instance, we've had swings of $100 million a day on posting collateral for the gas hedge portfolio, so I would call that material.

Q All right. So, if you had a gas hedge position where you came up short and they hit you for a hundred million, you'd be down to 700 million on the parent?

A That would be one activity on a given day that would move funds around the company, yes.

Q But notwithstanding the fact that you have 375 available to Progress Energy Florida and between 700 and 800 million available through the parent, you're asking this commission to allow you to recover additional monies from ratepayers for storm expenses?

A I would have to correct you. The seven to 800 million in the holding company is not available because it's not specifically for Florida. And again it would be available first and primarily for emergency situations such as storm, not day-to-day operating expenses.

Q Okay. And I don't think we're missing each other on that.

And a storm would be an emergency situation, correct?

A Yes, that's correct.

Q And to the extent that you used up the 375 number available to Progress Energy Florida, you could, as I termed it, go knock on the parent's door, and to the extent there was an emergency situation, it would be appropriate for them to consider providing capital to you to deal with the storm situation; correct?

A That's correct, yes.

Q I guess my question was, you're asking this commission to also -- in these tough economic times, to have the ratepayers fund additional hurricane monies; correct?

A This is a continuation of the strategy that we employ that incorporates the storm reserve into the overall liquidity of PEF, and yes, that's what we're asking for.

Q Did you read the entire Fitch document that you referenced in your opening?

A Yes, I did.
Q So -- and you have familiarity with rating agencies and how they do their business.
A Yes. I've been doing it for 25 years.
Q What can a rating agency do when it is talking about a company? I mean, I understand that they provide outlooks, correct?
A Well, they provide credit ratings that determine ultimately the cost of debt for companies, and those credit ratings are based upon probability of default.
Q And when they establish their credit ratings, they do a very close review of the company, its business risks and its operational risks; do they not.
A Yes. We actually visit them formally once a year and pretty much have a consistent dialogue with them throughout the year.
Q And you would agree that the ratings provided by the credit agencies are relied on by the investment community, correct?
A Absolutely.
Q And as we sit here today, you don't challenge the credit rating agencies' judgments with respect generally to how they rate companies. Would you agree with that?

A Well, I wouldn't challenge anything they rate other than our own company because I don't really get involved with other companies, but, no; we understand how they go about this and we do fight for the rating that we think we deserve.

Q What are you rated today?

A Which agency and what entity?

Q Why don't we just go through all three, Fitch Moody's and Standard & Poors.

A I don't have those off the top of my head, but basically you have -- as a matter of fact, I have a table in an exhibit that might help with that.

I'm sorry. I must have -- in my direct testimony, I must have had the ratings table at the bottom of the chart. At this point, if memory serves, S&P has us at triple B plus for senior, unsecured, and both of the other agencies have us as at an A rating, A minus and A for Moody's and Fitch respectively.

Q So triple B plus and --

A For S&P.

Q And then a couple of A's?

A Yes.

Q Do you think those are on target as we sit here today?

A We, as well as others in the industry, have had issue with the S&P consolidated rating methodology. Again, it's sometimes viewed as the least common denominator methodology, and -- however, we are -- since they are one of the two most powerful rating agencies, we're held accountable to those, and they're a financial reality for us.

Q And you had made a comment about fighting for your ratings. You're not suggesting that the rating agencies have overrated you as we sit here today, are you?

A No. In their minds they obviously have us rated appropriately, otherwise they would have an outlook change or have some other proceeding or review under way.

Q So from your judgment, you think the ratings are appropriate as we sit here today?

A I think they are in general. Again, we have our issues with the consolidated methodology of S&P, but in general, yes, they're reflective.

Q Okay. And you had made a comment about the outlook would have changed. If a rating agency had a concern about the future, what would they use as the description for the outlook?

A Most of them will -- prior to taking a rating action change, will change the outlook. So if it's good news, they'll change the outlook to positive and potentially look at an upgrade. If it's bad news, they'll change the outlook to negative and then potentially make a decision after that.

Q Okay. So just so we're clear, when they look at something, if it's looking pretty good, it's positive; if it's looking bad, it's negative; and I guess if it's okay, they say stable. Is that right?

A Yes. It's usually positive, negative or stable.

Q And the press release that you referenced, that -- Fitch has said that the outlook was stable for Progress Energy Florida, correct?

A That's correct, yes.

Q They -- even though they comment about what may happen, you know, notwithstanding that fact, their recommendation for the company is stable?

A In other words, going into, for instance, the two proceedings they reference, yes, the outlook is stable pending the outcome of those proceedings.

Q Right. But this press release was done on September 8th, correct?

A Yes, it was.

Q And the proceedings were ongoing then, were they not?

A I'm not sure when we started.

Q Okay. I'm not either at this point but -- the press release also indicates that the company's capital structure was enhanced by issuing 15.5 million common shares with net proceeds of $545 million including a public offering of 523 million in January, 2009; is that correct?

A Yes, that is correct. We did a marketed transaction at the beginning of this year.

Q Okay. And there's been some discussion about marketing stability back in the last quarter of 2008. You all were able to go in the market and raise over half a billion dollars in January, 2009.

A Well, we did that with a combination of things. This is not the only deal that we executed that week. We raised equity which is something we've been doing every year; however, the way that we do it is different. This was in a large single transaction as opposed to averaging in over the course of a year.

We executed at that time because we felt that the market had come back from the November lows and our outlook for the balance of this year was very uncertain. Our price/earnings ratio, which is an evaluation of stock, was at a high point, and we felt it was good time to go to the markets.

Q So how much equity did you raise in January?
A You quoted the numbers here.
Q Okay. So those numbers are all equity, no debt?
A That's correct.
Q And we had a lot of discussion about ROE, and you talked about it in your testimony; correct?
A Actually I'm -- cost -- not cost of equity. That was Dr. Vander Weide.
Q I'm sorry?
A That was Dr. Vander Weide that was our cost of equity witness.
Q Right. But you say you support a 12.54 ROE, correct?
A That's because I support his testimony, yes.
Q Well, do you know what the company's return on equity was for 2008 which presumably investors would have been looking at when deciding --
A Financial or regulatory ROE?
Q Both.
A No, I do not.
Q Do you know either one?
A Do I know either one of those? No, I do not.
Q If it was -- that information would be available to investors, would it not, when they were

making a decision as to whether to buy stock in the company?

A They should be able to look at our SEC filings and do the analysis necessary to make their decision.

Q Okay. And so, if the ROE -- just assume for the purposes of my question -- let's assume it was a flat 10 percent for 2008. An investor would have that in mind and that might be a piece of data that would be something they would consider when they were making a decision as to whether to invest in the stock of the parent company in January, 2009. You would agree with that, would you not?

A I would agree with the fact that they had the ability to look at the value of the stock. The return on equity calculation is done at the end of financial reporting periods. So they could go in and look at -- I think at that point they would have had September 30th numbers available to them.

Q Do you know what those September 30th numbers were?

A No, I do not.

Q And they probably could have looked at surveillance reports in front of the Public Service Commission as well, correct?

A Depending on how far they wanted to dig, yes.

Q The final point I wanted to just discuss with you briefly about this Fitch document that you referenced in your opening is is that you would agree that the rating agencies are aware that we are in a weak economy, correct?

A I would think that, given their responsibilities, they are aware of the economic conditions, yes.

Q Okay. And that is something that they consider when issuing press releases such as this, wouldn't you agree?

A Well, no. This is a press release on the company and its outlook. So, no, I don't agree with that.

Q The rating agencies consider the state of the economy when trying to predict or judge what a commission may do or the impacts upon the company. You would agree with that, would you not?

A Well, no. I think they'd look at the state of the economy. The reputation of the commission is established by their historic decisions.

Q So if I were to tell you that the weak economy may affect your -- Progress Energy Florida's chances for getting adequate, immediate relief to restore credit ratios to guidelines, you would say, well, that's probably not accurate?

A The economy -- the rating agencies look and are -- ask us for what we need to run the company to meet the credit ratings and deliver the proper level of service. So to me it doesn't have to do as much with the economy as what it takes to run the company and deliver the service we're required to.

Q Do you have that press release in front of you?

A The Fitch press release?

Q Yes, sir.

A Yes, I do.

Q Do you see the second to the last sentence in the fifth paragraph that starts with "however"?

A The fifth paragraph. I have it beginning with, "Fitch primarily rating concern include."

Q And you go down four or five sentence and you see the sentence that says, "However, the weak economy."

A Yes.

Q Don't you read that sentence to suggest that the weak economy is something that may affect your chances of getting the relief that you're seeking in this case?

A That's what they state here, yes.

Q And so, from a rating agency perspective --

and we've had a lot of discussion about it. I mean, it's -- you would agree, would you not, that commission decisions around the country are taking into account the weak economy and that that's a factor when they're setting rates. Would you agree with that?

A I would think that -- while I don't follow the other cases, I would think it's part of the responsibility of the Commission to consider all aspects in their decisions.

Q Let me direct your attention to page three of your testimony, of your rebuttal.

A I'm there.

Q Up at the first paragraph, you say that you're going to discuss how adjustments will negatively impact the company's ability to maintain and improve its financial strength, and you state, quote, "This in turn will limit the company's ability to access capital in order to provide reliable energy for its customers at a reasonable cost."

What is the basis for that statement? Are you saying that you don't think that, if this Commission goes with the Intervenors' position -- you know, let's say that, you know, they give a zero rate increase, not a negative 35 million. Are you saying that that will not allow you to access capital?

A I'm not saying it won't allow us to access capital. We're talking about timely and cost-effective access to capital.

Q So just -- I want to talk through this with you and make sure I'm understanding it. Let's say the decision is such that the rating agencies say, you know, we're going to have to downgrade this company and we're going to take them down one notch, okay. Typically when a rating agency takes action, they do it in one-notch increments unless there's something very dramatic; correct?

A I wouldn't say in these times. Normally it's one notch. They can do whatever they feel like doing.

Q Sure, they can, but in your 20 years of following it, it's typical, a one-notch downgrade or upgrade?

A I would say that probably something less than 50 percent of the time it's one notch.

Q So assume a one-notch downgrade for the purposes of this line of questioning. How would that affect the cost of access to debt, if you know?

A Right. The first thing it would do, it would lower our commercial paper rating which is an additional rating that the rating agencies provide that we're currently a Tier-2 issuer. This could push us to Tier

3. I would classify or characterize Tier 3 commercial paper issuers as the have-nots. Those are the people that were shut out of the market. They were not -- those are usually not investment grades or barely investment grade companies. So we would have difficulty accessing the commercial paper market, and also our costs would go up because the rate --

Q And is it your testimony that a Tier 3 cannot, as we sit here today, access debt, or are you --

A Possibly today, but they've been shut out of the market pretty much the last quarter of last year through the first half of this year.

Q Right. And that was the credit crunch that we've been talking about that was acute in the fourth quarter of 2008. Is that right?

A Well, I wouldn't say it was acute in the fourth quarter. I would stay it began in the third quarter of last year and extended through probably the middle of the second quarter of this year.

Q Okay. But it's abated and gotten better as we sit here today, correct?

A Yes. I think it's fair to say and I've heard it characterized that the market is not priced in a depression anymore but just a recession.

Q So what's the delta between a Tier 2

commercial paper and a Tier 3 commercial paper in terms of the spread, if you know?

A Well, the first thing would be access. Either your -- a 2 might have it and a 3 may not --

Q But as we sit here today -- and, I'm sorry, if I could just interject. As we sit here today, you don't know whether, you know, a 3 cannot access capital?

A It would be greater -- it would issuer specific.

Q Okay. So what would be the delta, if you know?

A I would say probably about 50 to 75 basis points today.

Q All right. Do you have information as to a delta between let's say -- you said that you were A rated. The difference between an A and the notch right below that --

A Triple B.

Q Triple B.

A Again, the market prices deals every day. I don't have a specific number for that.

Q Can you give me a general idea?

A Probably LIBOR plus 40, 40 basis points.

Q So a 40-basis-point spread?

A Right. And you would add what I gave you, the numbers before, on top of that to estimate a Tier 3 issuer.

Q And have you done any kind of an analysis to -- because I read your testimony to say, well, if we don't get, you know, the ROE we're asking for, then ultimately it will cost ratepayers more money. Isn't that the sense of the testimony?

A Yes, because it would affect the credit ratings and, as I said, a lower credit rating requires a higher cost to fund.

Q So if we were just to take, for example, 2010, how much debt are you looking -- or how much equity are you looking -- let's talk about debt. How much debt are you looking to raise in 2010?

A Just at PEF, I believe the number was 750,000 because we have a refinancing of a maturity and then we have some new cash to raise.

Q So 750,000, is that right?

A Or, excuse me, 750 million.

Q Let's just call it a billion for the purposes of this hypothetical because it's easier to work with.

A Okay.

Q Which will give you another 250 million that you don't need, but let's just --

A If the market gives it to us, yes.

Q So, if it's a billion dollars that you need next year and the difference between the A and the triple B is 40 basis points, is a 40-basis-point spread, how much would that cost on a billion dollars? 40 million, isn't that right?

A Forty, yes, .4 times a billion.

Q Right. And so each point of return on equity, each hundred basis points on return on equity is worth about $50 million, correct?

A I don't follow that calculation, but subject to verification, I would agree with you.

Q Okay. So from a pure economic standpoint, it would be better for ratepayers to say, look, I would rather save $10 million by this commission going with a 10 or 11.5 ROE and paying a little bit more for the cost of the debt next year as compared to paying 50 million for a 12.5 ROE --

A Well, I think that's a pretty narrow view of things given the fact that there are other things such as storms that we talked about that can come up that can impact the company over the course of the year. So, no, I wouldn't agree with that.

Q All right. And to the extent that this commission decided to hit the average for ROE that's been a ruling in 2009, do you know what that average is?

A That have been awarded in the United States in 2009?

Q Yes, sir.

A I'm aware of specific cases but not what those numbers would average to.

Q Have you seen an exhibit that's been used in this proceeding that has a list of all the 2009 decisions?

A I'm aware, but I don't think I've seen it.

Q Okay. If I represented to you that the average was 10.51, given our hypothetical discussion here, that would save ratepayers for 2010 $100 million and, given what you indicated were your debt needs -- and I raised it up to a billion dollars -- it would cost them 40 million. Wouldn't it be a better deal for ratepayers to get the lower ROE and pay a little bit more for the debt?

A I don't think it would be a better deal for ratepayers. It would be a better deal for their bill, but it may affect the service levels of the company.

Q And why do you say that?

A If we have trouble accessing capital or it costs more, we might end up doing less as far as capital investment and those things go.

Q But you're not telling this commission that you're not going to honor your statutory obligation --

A I didn't say that.

Q -- to serve?

A I didn't say that.

Q I thought I heard you in your answer suggest that, if you got a 10.51 ROE, that the quality of service might be adversely affected.

A I don't believe I said the quality of service. I said we may have to make prioritization decisions in investment in projects, things of that nature.

Q Okay. And you're aware that businesses make prioritization decisions every day. That's part of running a business, is it not?

A Absolutely.

Q And you're not suggesting that, if you got a 10.51, that you would not be able to provide safe, adequate and reliable energy; correct?

A No, because we would have to do that. I don't know to what degree we would be able to do that without lowering our ROE.

Q Right. And if you really got in a pinch -- you know, we've already talked about the credit facilities that are available to you.

A Well, you can't count on the parent being there because the parent isn't there for PEF. The parent is there for its own needs as well as a potential backstop, but only in emergency situations.

Q Does the parent have any operations?

A No, it does not.

Q The parent is a holding company, is it not?

A That is correct.

Q And it has two siblings, or not -- siblings isn't the right word, but I guess subsidiaries --

A They have several subsidiaries including the service company and two utilities, yes.

Q Okay. And the lion's share of the money comes from the two utilities, isn't that right.

A That's basically where all of the money comes from, yes.

Q Okay. So the -- I think we said 800 million available, that would largely be available to help in financial needs of the subsidiaries; would it not?

A I wouldn't say largely available. The holding company has interest expense on its debt and also common dividends to pay.

Q Let me direct your attention to page 8.

A I'm there.

Q And again we're talking about return on equity. On line 8 you state, I quote, "Investors would not invest in a company earning a lower ROE when they could invest in other companies of similar risk and earn a higher ROE." Do you see that?

A Yes.

Q And that's a true and accurate statement?

A I believe that's a fundamental investor philosophy, yes.

Q And wouldn't it also follow that investors -- you know, the converse of that would be true, that investors would invest in a company that has less risk if they could earn the same or a slightly higher return in investing in that company as compared to a similar company that has greater risk?

A Yes. I think investors would be looking for that market and efficiency in making investments.

Q Okay. And with respect to this capital that you have to attract, you would agree that's a national market, correct, a national market for capital?

A Yes, I would.

Q Okay. So a company like, you know, Progress Energy Florida's going to be competing with Idaho Power as it goes into the capital markets to get debt; correct?

A Right, or other utilities across the country, yes.

MR. MOYLE: Mr. Chair, if I could --

CHAIRMAN CARTER: Yes, sir, Mr. Moyle. Do you need a number?

MR. MOYLE: -- hand out a couple of exhibits. No, these are exhibit that are already in the record but I've marked on them a little bit.

CHAIRMAN CARTER: You're just going to use them for cross-examination?

MR. MOYLE: Yeah, and I guess they're probably demonstrative exhibits would be the right thing to call them, but --

CHAIRMAN CARTER: Okay. Let's take a moment here to get them passed out, and then we'll go from there. 264 again --

MR. MOYLE: Yes, sir.

CHAIRMAN CARTER: -- as opposed to 462 in the other case.

MR. MOYLE: I'm sorry. It's 264 in this case?

CHAIRMAN CARTER: Yes, sir. The one-pager.

MR. MOYLE: Yes, sir. Okay.

CHAIRMAN CARTER: You may proceed, Mr. Moyle.

BY MR. MOYLE:

Q Thank you. Mr. Sullivan, I've handed you what the Chairman has correctly indicated I think is already in the record. In this case it's 264, the 462 was also admitted in the FPL case, and then also a Fitch's rating document that I believe is in the record as 294 in this case, and I have some handwritten notes on it that I wanted to spend a minute and just talk with you about, particularly given our recent conversation where I think we agreed that investors would put their capital at work to earn a return -- if they could earn the same return with a company with less risk, that's where their money would go, okay?

A Uh-huh.

Q All right. So let's just take a couple of these. What I've done on the Exhibit 264 is I've circled all of the ones that I could find that came in at a return on equity of 10.5 that also were listed on Exhibit 294, the Fitch rating sheet. And if I were an investor -- let's just take the first one, Avista Power Corp there, do you see that?

A Yes, I do.

Q They have a return on equity of 10.5, correct?

A Yes.

Q And a common equity of about 50 percent.

A Yes.

Q All right. So if I had money to invest -- if you look over on the other sheet, Avista Capital is rated what?

A Double B plus.

Q Okay. And so, assuming that's the same rating today, but if I had money to invest, wouldn't the investor go to Progress Energy Florida because it is rated higher than Avista if the return on equity was the same as -- well, let's just say it's 10.51. Let's say this commission says 10.51 is the number. If you were an investor, you would go to a 10.51 number because it's slightly higher than 10.5, and Progress Energy of Florida is rated higher than Avista; correct?

A Well, again, we're mixing credit ratings and equity here. An equity investor is going to look at earnings, growth rates, EPS, as well as the things you've indicated here. A bond investor, in going over and looking at the Fitch rating sheet, is going to say, okay, if I buy a bond, this is my probability of default, and those are two separate investments, a debt investment versus an equity investment.

Q Assume a debt investor is making this decision. A debt investor would go to Progress Energy Florida given the information we just discussed, would they not?

A Yes, they would look at the two ratings of the companies and see where the respective bonds are priced and make a relative value assessment along the lines you outlined earlier.

Q And with respect to like the next one, Idaho Power, that decision was made on January 30th, 2009; correct?

A Yes.

Q And that was close to the period of time we were just talking about where you had said that credit was harder to come by, correct?

A And again, this is again a rate case. This would be the equity side of it. And again, the markets were certainly stressed at that period of time, yes.

Q Okay. And the Commission in Idaho, apparently they made a judgment that a 10.5 was a proper return on equity to allow that company to operate successfully; correct.

A I'm not aware of those circumstances, but obviously, if they approved that, they thought that was appropriate.

Q Okay. And the Idaho Power Company, they're rated lower than Progress; correct?

A Yes, and they also have a negative outlook.

Q All right. And I guess we could go through all of these questions, but I guess the point is is that, with respect to, you know, a 10.51 return on equity, you would agree, based on Exhibit 264, that that suggests that that's the average return on equity awarded in 2009; correct?

A The average for the country or for Idaho Power?

Q For the companies listed on this Exhibit 264.

A The exhibit, as I see it, has all the ten and a half's circled. I don't know what the arithmetic average is of those.

Q Do you see down at the bottom it says, "Average authorized ROE"?

A Okay. Is that the calculation of that?

Q You know, staff had originally introduced this exhibit. I presume it's right. I didn't do it myself, but I think, if you added them all up, that would be where you'd end up. And do you know, are any of thees companies currently not able to provide safe, reliable, adequate electricity to their customers?

A I have no idea.

Q If they weren't -- I assume you follow the trade press in the electric industry, do you not?

A We would probably hear about it, yes, if they ran into difficulties.

Q Back on page 3, you make this statement on line 9: "The Intervenors' recommended changes would represent a material change from the historically constructive regulatory environment in Florida and would be viewed negatively by the financial markets." Do you see that?

A Yes, that's correct.

Q And if you reference this exhibit, 264, you would agree with me, would you not, that, even if this commission only took 100 basis points off the request that your company is making, it would still be the highest return on equity award in 2009; correct?

A No, I'm not sure because I have some data that contradicts that. I have three companies --

Q Well, let me refer to you this chart, 2 of 4, okay.

A Based upon the data that's there, I would have to agree with that; yes.

Q Okay. And do you see the common equity totals that are also circled?

A Yes.

Q All right. You're seeking a common equity that is higher than any of the companies that are circled on Exhibit 264, correct?

A That would be correct, but I don't know the -- for instance, if they have nuclear exposure or anything like that. So I can't make a complete assessment.

Q If the average meant something -- and you would agree it probably does, does it not, the --

A I don't think averages mean a whole lot because I've got three other companies here that are above 12 and a half that filed this year.

Q Okay. Well, are those decisions that have been entered or requests being made, and what are you referring to?

I'm a little concerned I'm going to get something I haven't seen before, but let's go ahead.

A Again, I have three companies here that have filed rate filings this calendar year, and I was just looking to crosscheck to see if they're on this sheet.

Q And what are you looking at when you say you have three companies?

A I'm looking at information provided by Dr. Vander Weide.

Q Was that part in your testimony in any way?

A This so not part of my testimony.

Q Is this something that he just gave to you recently that you asked for or what?

A This is something that I did not ask for it myself but was provided to me.

MR. MOYLE: Mr. Chairman, could I take a look at that information?

CHAIRMAN CARTER: You may approach. Mr. Wright? Ms. Bradley? Mr. Walls?

MR. WALLS: I could probably explain this.

CHAIRMAN CARTER: Go ahead.

MR. WALLS: Dr. Vander Weide was here. I believe he was asked by one of the parties or staff -- I can't remember who asked him the question -- of whether he was aware of any other utilities that had asked for a higher ROE than the one he was asking for for the company, or recommending for the company this calendar year, and he said he wasn't aware, but when he left here, he checked, and that's what he sent Mr. Sullivan.

CHAIRMAN CARTER: Mr. Moyle, you're recognized.

BY MR. MOYLE:

Q Okay. And I think my question, sir, was focused on asking you whether you would agree that, as we sit here today, if this commission were to knock off 100 basis points from your requested ROE of 12.54, whether that would be the highest return on equity awarded in the country this year? Can you answer that?

A Based upon this sheet in front of me, I would have to agree with that.

Q And you would also agree with it based upon the sheet that I've just borrowed from you, would you not?

A No, because I don't know if those proceedings have been concluded yet.

Q There's nothing on this sheet that indicates that they have been concluded, correct?

A That's correct.

Q All there is is a column entitled "Date Filed." There's not a corresponding column like there is on this sheet to say increase authorized, correct?

A No, and that would lead me to believe that they're not completed. The proceedings are not completed at this time.

Q Okay. So the answer to my question would be, based on the best information you have today, even if 100 basis points were knocked off, this commission would still be the highest in the country on ROE; correct?

A Based upon this information I have in front of me, yes.

Q And this information?

A I don't know how they were decided yet. I don't know how you can decide on something until a decision is rendered or incorporated into the analysis.

CHAIRMAN CARTER: Mr. Moyle, I don't think we got your last comment for the record.

BY MR. MOYLE:

Q I'm sorry. Again, I'm just trying to make the point that the information that you referred me to, it doesn't have anything to indicate that a commission has awarded a return on equity higher than 11.54; correct?

A Based upon this information and the lack of a decision date here, yes, I would agree.

Q Okay. All right. And you're aware that the effect of this commission being number one in return on equity in the country if it were to award either a 12.54 or a 11.54 return on equity would be that ratepayers have to pay more in their bills, correct?

A That's a hypothetical.

MR. WALLS: Objection, lack of foundation.

CHAIRMAN CARTER: To the objection, Mr. Moyle.

MR. MOYLE: Well, I'm trying to test his understanding of return on equity. He testifies to it. He supports a 12.54 return on equity. I think it's a fair question.

THE WITNESS: But the --

CHAIRMAN CARTER: Mr. Walls.

MR. WALLS: I was objecting to the statement that Mr. Moyle made about this commission being number one in the country. I'm not sure anyone here has testified to that, and I don't know of any analysis that supports that, but --

CHAIRMAN CARTER: Rephrase, Mr. Moyle.

BY MR. MOYLE:

Q Okay. And when I say number one in the country, let me confine it by saying number one in the country for 2009, okay.

A As far as we know, because the year is not over yet, and obviously we have three proceedings that are not concluded yet.

Q Okay. And my question was, if they are -- if they make a decision that puts them number one in the country, doesn't that have the effect of having ratepayers pay more money in their rates?

A I don't know what ranking within the country has to do with anything. Our ask is for us to provide reliable service and we believe our ask is what's required to do that.

Q Let me ask it this way: If the Commission awards a 10.5 ROE as compared to an 11.5 ROE, a 10.5 ROE would mean ratepayers pay less money to your company; correct?

A I guess, depending upon the other aspects of the agreement, that could be the case, yes.

Q All other things being equal, again, just focusing on the ROE, you would agree with me; would you not?

A Could you state the question again, please?

Q Sure. If this Commission were to award a 10.5

ROE as compared to an 11.5 ROE, the result, all other things being equal, of the 10.5 ROE would be that consumers pay less money to the company in their rates; correct?

A Yes, they would pay less money.

Q And I had asked you previously about the markets for money being a national market, correct?

A Actually it's a global market, but yes.

Q Okay. And also the relevant points in time for that is try to ascertain current market conditions, correct?

A Yeah. Unfortunately this market has varied for the balance of this year from day to day and week to week.

Q Okay. So, to the extent that there was an ROE decision made ten years ago, that wouldn't have as much sway or import, you know, as one that was made at a closer point in time to where we are today; correct?

A In general I would agree with that, yes.

Q And that would be because the markets were different when the ROE decision that I referenced was made?

A It could be a lot of different reasons, but yes.

Q And in your testimony you reference some high

ROEs.

A Yes, I believe I do.

Q You reference them on --

A Page 7.

Q -- page 7. Do you see those? And you're talking about utilities in the southeastern United States. You're not suggesting that the market for money is limited in the southeastern United States, are you?

A No, but they -- as I said, we are compared with our neighbors both regionally and nationally.

Q Sure. Isn't it true that that Alabama Power ROE was authorized more than ten years ago?

A I'm not aware of the award date.

Q Do you know -- on any of these ROEs that you are referencing, do you have any information about when they were awarded?

A Yes, I do.

Q All right. So you don't know about Alabama Power as to the date of ROE?

A No, I don't. Georgia Power was last year.

Q I'm sorry. Let me just take them one at a time. Alabama Power, you do not know?

A No, I do not know.

Q Georgia Power was when?

A I believe it was last -- their most recent rate proceeding.

Q When was that?

A I believe it was last year.

Q What timeframe last year?

A I don't know.

Q Did you get this information off an order, off the orders in these cases?

A I can't recall where we sourced this information.

Q Did you source it?

A Yes.

Q But you're not sure --

A Personally I did not. I had staff help me with this.

And the Progress Energy Carolinas was also dated -- that was 1988.

Q 1988?

A That's correct.

Q And how about the Gulf Power?

A I believe it was their last rate case, which was three years ago maybe. I'm not quite sure of the timing of that, though.

Q Okay. Thank you for that.

CHAIRMAN CARTER: Are you ready for another line, Mr. Moyle?

MR. MOYLE: Yes, sir, and it might be a good chance for me to take a breath and --

CHAIRMAN CARTER: Okay. Why don't we do this: We're back on our regular lunch break. We'll go from 1:00 to 2:15. See everybody at 2:15.

(Recess.)

CHAIRMAN CARTER: We are back on the record, and when we last left, Mr. Moyle, you were on cross-examination. You are recognized, sir.

MR. MOYLE: Thank you. Thank you, Mr. Chairman.

BY MR. MOYLE:

Q Mr. Sullivan, I'm going to try to just finish the line of questioning about the return on equity and move on to a couple of other lines and then we'll be done.

I was asking you questions about the Exhibit 264, which is the rate case history for 2009.

A Yes, I have that in front of me.

Q With respect to any of the companies that I had circled that picked up a 10.5 ROE, you're not aware of any of them being downgraded following the issuance of the commission decisions, are you?

A I haven't done the analysis, but I'm not aware of it.

Q Okay. And with respect to some data points, the settlement agreement, Mr. Rehwinkel asked you some questions about that; right?

A Yes.

Q And do you know what the ROE was in that agreement that gave the company the ability to seek relief?

A And this is the 2005 stipulation?

Q Yes, sir.

A I believe it was not a specific ROE but a range, and there was a revenue-sharing component to that.

Q Right, but there was also a provision that said, if you go below a certain ROE, you can come in?

A Yes, I believe that was 10 percent.

Q So that was 10 percent. You weren't at that settlement. You didn't participate in that, did you?

A No, I did not.

Q Okay. Would it be fair to derive that, at least for the purposes of that settlement, that anything above 10 percent was satisfactory to the company?

A No, because I believe that 10 percent was there to allow for filing of interim rate relief as that was deemed to be too low a return.

Q Okay. We've already talked about Exhibit 264 and that average being 10.51. Let me refer you to page 10, line 14 of your testimony.

A I'm there.

Q In this section you're quoting a Fitch report, correct?

A That's correct, yes.

Q And Fitch is saying that it appears that return on equities are currently in the 10.25 to 10.5 range with some jurisdictions approaching nine. Is that right?

A Yes, and I believe that referenced recent commission decisions.

Q Okay. And if I showed you the annual report -- you're familiar with the company's annual report, are you not?

A Yes.

MR. MOYLE: Can I approach, Mr. Chairman?

CHAIRMAN CARTER: You may approach.

BY MR. MOYLE:

Q I place before you the company's annual report for what year?

A 2008.

Q Okay. And what was the ROE report in that annual report?

A Under the common stock data section, this is the financial ROE, return on average common equity of 9.59 percent.

Q And when was that report issued?

A It's usually in the spring of the following year. So this is for the year ended December 31, 2008, so sometime in the February-March timeframe I believe.

Q So the annual report reflects a 9.59. Now, Dr. Woolridge, he suggested that that -- that the appropriate number is 9.75, correct?

A Now, again, I want to make sure we're not mixing apples and oranges here. That is a financial return on equity, not a regulatory return on equity, and I believe we're discussing here the cost of equity relative to setting rates.

Q I understand. And then, with respect to the actual return on equity, that's something that investors look at to see how did the company do, how did it actually perform financially; correct?

A That's one measurement, yes.

Q Let me just spend a minute talking about the TECO decision. On page 6, line 8, you indicate that Tampa Electric was recently awarded a return of 11.25; correct?

A Yes.

Q And are you aware that staff had recommended a lower ROE in that case?

A No, I'm not. I just am aware of the outcome.

Q Okay. If we go back to the chart here and we were talking about -- on line 14, you talk about a higher cost of capital. Do you see that?

A Yes.

Q Capital can be either debt or equity, correct?

A That's correct.

Q So let's just focus on debt for a minute. Would it logically follow that, if Tampa Electric was awarded an 11.25 and they have more risk associated with them, that Progress Energy -- and assuming 11.25 was the right number, that Progress Energy should be awarded a lower return on equity. You would agree with that, would you not?

A No.

MR. WALLS: Objection, assumes facts not in evidence.

CHAIRMAN CARTER: To the objection, Mr. Moyle.

MR. MOYLE: What small fact is assumed that wasn't in evidence?

MR. WALLS: He said TECO had less risk than PEF. I'm not aware of any witness testifying to that fact.

CHAIRMAN CARTER: Mr. Moyle.

MR. MOYLE: There's a document that I can refer him to that we can talk about with respect to bond ratings.

CHAIRMAN CARTER: Rephrase.

BY MR. MOYLE:

Q We've already talked about the bond companies and that they evaluate risk when they put together their ratings, correct?

A Yes, and this is default risk, yes.

Q Okay. And with respect to Document No. 294, doesn't this reflect that Tampa Electric Company has more risk than Florida Power Corp, this document?

A These ratings reflect a higher risk of default on its debt, yes.

Q Okay. So then my question was, if you assume that's correct, that the rating agencies are correct and this commission made a correct judgment of 11.25 for Tampa Electric, given our discussion of economic theory and risk, wouldn't it make sense that, if this -- if Progress Energy had less risk, that it should be awarded a return on equity lower than 11.25?

A I'm not sure if the debt risk takes into account all the risks of the company because, again, that's default risk, not ability to earn.

Q And I'm just talking about debt risk right now.

A Yes, based upon the ratings -- not related to ROE, but just based upon the ratings of default, that would be correct.

Q And when you go to finance things, you typically do a combination of debt and equity; is that right?

A No, that's not the case. It depends on what the capital plan is and what our credit metrics situation is at the time will dictate how much of each we do.

Q So you kind of have the flexibility or discretion to finance it kind of depending on the facts and circumstances at the time?

A Well, I wouldn't call it total discretion but I would say that we do from time to time have flexibility and try to time that at the most appropriate moment.

Q Given our discussion, again, with respect to debt, your sentence on line 19, "Providing PEF a lower return on equity than that awarded to Tampa Electric would be viewed as inconsistent and negative by the rating agencies and the financial community," isn't really the converse of that true, again, if we're speaking to debt, that, to the extent that Progress

Energy has less risk than Tampa Electric, awarding Progress Energy a higher return on equity would raise questions?

A Based upon the rating agency disclosures that I've made as well as the Fitch exhibit, they have stated exactly what their expectations are, and again, if we don't meet those credit metrics, they will downgrade us.

Q But I don't think you answered my question which --

A Okay. Can you repeat it then, please?

Q Sure. You know, given our discussion on economic theory and the risk relative to debt, wouldn't it raise questions with respect to the logic if this commission were to award PEF a higher return on equity than Tampa Electric Company given the fact that Tampa Electric Company has greater risk than PEF?

A No, I would not agree with that because you're basing the greater risk only on the credit ratings and not on the whole operations of the company, which includes nuclear in our case.

Q Were the credit -- are the credit agencies aware that your company is pursuing nuclear?

A Yes, they are.

Q And isn't it true that the credit agencies take into account the fact that you're pursuing nuclear when they issue their ratings?

A The existing portfolio that we operate as well as any future plans, yes.

Q And if you said -- on line 12, you said that these capital expenditures significantly increase Progress Energy's risk profile over Tampa Electric. Are you suggesting that the rating agencies should rate you lower than Tampa Electric given that statement?

A No, I'm not.

Q You mentioned Levy. As we sit here today, you don't have any plans to construct Levy; correct?

A The current schedule is a 20-month delay on the proposed schedule.

Q Right. And there's still a number of steps that have to be taken with respect to Levy outside of this proceeding, such as obtaining approval by the Nuclear Regulatory Commission and renegotiating your EPC contract; correct?

A Yes, both of those items are correct.

Q I wanted to refer you to page 17, and you take issue with Dr. Woolridge's choice of a peer group because he selected a peer group that had both operating companies and parent companies. Do you see that?

A Yes.

Q Okay. Isn't it true that your expert also selected a peer group that contained both operating companies and parent companies?

A Yes, but I believe it's my understanding that he made some adjustments for that to isolate the electric utility operations of that entity.

Q What is that understanding based on?

A Going in and looking on the annual report which I believe he said he pulled and he was able to, where possible, delineate electric -- regulated electric operations from non-regulated electric operations.

Q Mr. Rehwinkel asked you a bunch of questions about purchase power agreements, and I don't want to re-plow that ground. I just want to have you confirm, if you know, that this Florida Public Service Commission has never denied one dollar of recovery related to a Progress Energy Florida purchase power agreement.

A They have not, but that wasn't the point I made. As I said, when we went up there and tried to convince them and educate them about the Florida situation and saying it's as good as legislation if you don't have legislation, and as I said, I think we accomplished getting the lowest possible risk rating that we could.

Q Don't you think that it's a little unfair to ask this Commission to make a judgment based on the thinking or the rationale of a third party who, you know, is not here --

A It's a financial reality that --

Q If I can finish my question please. Who is not here, who can't be asked questions about what goes into their thinking? Don't you think, given that, that that's unfair?

A I think in the exhibits, multiple exhibits that we've provided, they are very clear in delineating their analysis and their expectations.

Q And you provided your testimony, correct?

A Yes.

Q And the testimony provides words, but what we're doing now in having conversations of having me ask questions. Doesn't that draw out and help explain the thinking behind your testimony?

A I think it only depends on how specific or how in-depth their testimony was, just like the rating agency articles.

Q Lawyers have a hard time cross-examining documents, but let me move on.

The last sentence in your testimony, not the one about does this conclude it, but this one that is on page 27.

A I'm there.

Q You state, quote, "If their recommendations were adopted, the change in tone of the Florida regulatory environment and the resulting implications on the company's cash flow and credit matrix would likely result in a credit-rating downgrade which in turn would jeopardize the company's ability to serve its customers effectively and would ultimately result in higher rates."

Given the discussions that you've had with respect to questions by Mr. Rehwinkel where I think you agreed you don't know what the credit rating agencies will do, correct?

A Well, again, just based upon the indications they've given in their written documents, but again, you never know what they'll ultimately do.

Q Right. And given the fact that, with respect to the Fitch report, when compared to the exhibit that shows the return on equity decisions in 2009, you don't know whether any of those companies were downgraded; do you?

A As I said before when you asked, no.

Q All right. Isn't it overstated to suggest that a credit rating downgrade will result -- which will jeopardize the company's ability to serve the customers effectively and would result in higher rates, particularly given our discussion about the impacts of having, you know, higher debt costs, 40 basis points? Isn't that last statement really an overstatement?

A No.

MR. MOYLE: Okay. That's all I have. Thank you.

ACTING COMMISSIONER EDGAR: Mr. Wright, do you have questions on cross?

MR. WRIGHT: Yes, I do, Madam Chairman.

MS. BRADLEY: Madam Chairman.

ACTING COMMISSIONER EDGAR: Ms. Bradley.

MS. BRADLEY: Unfortunately I was out of the room, and when Mr. Wright finishes, if I could have just a moment, I would appreciate it.

ACTING COMMISSIONER EDGAR: You didn't have the opportunity?

MS. BRADLEY: No, I unfortunately had started sneezing and had to go outside.

ACTING COMMISSIONER EDGAR: I'm sorry. I apologize also because my days are blurring a tad. So deja vu all over again. Would you like -- Mr. Wright, would you let Ms. Bradley proceed first?

MR. WRIGHT: Certainly.

ACTING COMMISSIONER EDGAR: If you're ready, why don't you go ahead, Ms. Bradley.

CROSS EXAMINATION

BY MS. BRADLEY:

Q Thank you. Sir, I just have a few real quick questions. If you agree with me, we'll be right through them. No pressure.

Would you agree that a high ROE is not a guarantee of a better credit rating?

A There are no guarantees, but it certainly is supportive of a higher credit rating.

Q But standing alone?

A I said no, there is no guarantees.

Q Okay. Would you agree that the Commission, in considering the rate request by Progress, also has a duty to look at the needs of the customers and what is reasonable and fair for them as well?

A As I understand the Commission responsibilities, yes, that is a part of their role.

Q Okay. Did you hear Dr. -- and I'm hoping I'm pronouncing this correctly -- Vilbert's testimony last night?

A I was in and out during the course of the day.

Q Well, subject to check, he indicated that he believed that regulated utilities that are a monopoly are a safe investment, and would you agree with that?

A Well, based upon the stock performance, I would say no because it's acted not like a safe investment but like all other investments, equity investments over the last year.

Q But are not regulated utilities considered a safer risk than those that are not regulated?

A Generally, yes, that's true.

Q Okay. And also those that are monopolies are generally considered safer than those that are competitive in nature?

A Yes.

MS. BRADLEY: All right. Thank you.

No further questions.

ACTING COMMISSIONER EDGAR: Mr. Wright.

CROSS EXAMINATION

BY MR. WRIGHT:

Q Thank you, Madam Chairman.

Good afternoon, Mr. Sullivan. Welcome back.

A Thank you.

Q You're welcome.

I have a few questions following up on some questions that Mr. Moyle asked you, and then I have a few questions that I prepared on my own.

I'm not exaggerating on the downside. It's not many questions.

ACTING COMMISSIONER EDGAR: I guess we'll see, won't we?

BY MR. WRIGHT:

Q Yes, we will. Start the clock.

First, Mr. Moyle asked you about the current Georgia Power Company return on equity which you report in your testimony is 11.25 percent; correct?

A Yes.

Q Do you know whether that ROE was arrived at as the result of a stipulation?

A I do not.

Q Mr. Moyle gave you a document that's actually an exhibit I believe from the Florida Power & Light rate case. It's this Fitch ratings from its U.S. Utilities Power and Gas 2009 Outlook.

A Yes, I have that.

Q Thank you. I just want to clear up one thing. He asked you about Avista Corporation and he asked you what their rating was, and you responded double B plus or BB plus. Do you recall that?

A I'll just look and see. Yes. Yes, that's correct.

Q And in giving that answer, you are referring to what is known as the IDR or issuer default rating; correct?

A Yes, that was the rating I picked up.

Q Thanks. In your direct testimony you give the ratings for Progress' --

A Senior unsecured.

Q Yeah, senior unsecured, et cetera. And the senior unsecured rating for Progress is triple B, correct?

A From S&P, I believe. I don't have the chart in front of me, but --

Q Actually for Fitch it's A. For S&P it's triple B plus, and for Moody's it's A three.

All I wanted to clarify is that the corresponding rating on the table that you were discussing with Mr. Moyle for Avista would be a BBB minus per Fitch, correct?

A That is correct, yes. That is the senior unsecured rating.

Q Thank you. And I note that Avista's outlook is rated as positive by Fitch, correct?

A Yes, at the time of this publication, yes.

Q And am I correct that Progress' outlook is rated as stable at this time?

A That is correct, based upon the last annual review by each of the agencies.

Q Thank you. Another followup on a discussion you had with Mr. Moyle. You spent some time discussing short-term debt and commercial paper borrowing. Do you know offhand what the jurisdictional percentage of short-term debt in the company's capital structure is?

A At this point in time? I know we have commercial paper outstanding, but I don't know what percentage that would be as of today.

Q Well, I'm looking at Schedule D-1-A for the projected 2010 test year, and that shows a 13-month average short-term debt in the jurisdictional capital structure of about $38.6 million and a ratio of 06.2 percent. Does that sound about right to you?

A Subject to check, yes. As I said, those are jurisdictional, and while I do spend time with that, I spend more time with financial ratios outside of financial.

Q I apologize, but you trailed off there. You said --

A I spend more time dealing with investors on book and GAP numbers than I do on jurisdictional numbers.

Q Well, do you deal with them on the Progress Energy Florida Company totals?

A Yes, that would be something they'd be looking at more, I think, than jurisdictional breakdowns.

Q Well, the corresponding value for company total shown on your MFR schedule is about $72.9 million. Does that sound about right?

A And that was average you said for the period you --

Q The title -- the explanation of the schedule is: Provide the company's 13-month average cost of capital for the test year, the prior year and the historical base year. I interpret that as indicating that the dollar values shown are the projected 13-month average values for 2010. Does that sound right to you?

A Yes. Yes, that's correct.

Q Thank you. Does the $73 million sound about right on an average annual basis for 2010?

A Yeah. I think the mins and the maxes would arguably be higher or lower than that, but that sounds a reasonable average, yes.

Q Thank you. I have a few questions for you regarding page 6 of your testimony. At a couple of points on that page you talk about the company's capital requirements in relation to its nuclear program, correct?

A Yes.

Q I will bet that you and I will agree that investors are sophisticated. Would that be correct?

A I'm not sure after the last year or not, but we hope most of them are, yes.

Q Would you agree that most investors are aware of the capital recovery treatment given to Progress' proposed Levy nuclear project through the nuclear cost recovery clause?

A Absolutely. In fact, it's viewed as a very supportive piece of legislation.

Q And would you agree that they largely would be aware that the return on equity -- regulatory return on equity rate embedded in the capital cost factor for recovery of Levy -- of allowable Levy costs is 11.75 percent?

A I believe that is the currently-approved recovery rate for preconstruction dollars, yes.

Q Would you agree that it's also the approved recovery rate for what we might just call construction interest?

A It's my understanding that would be the case unless that was superseded by another stipulation or a litigated outcome.

Q Okay. Continuing on page 6, and you talk about the Tampa Electric decision in a few places, and I just want to ask you about that.

May I approach, Madam Chairman?

ACTING COMMISSIONER EDGAR: Yes.

MR. WRIGHT: Thank you. Madam Chairman, I have just handed the witness a copy of the Commission's staff recommendation in the Tampa Electric rate case, Docket 080317, issued on March 5th, 2009.

ACTING COMMISSIONER EDGAR: I remember it well.

MR. WRIGHT: As do we all. Thank you.

BY MR. WRIGHT:

Q First, Mr. Sullivan, I just want to ask you, if you would, turn to the first yellow tab there which is on page 88.

A I'm there.

Q Okay. And you see there the staff's initial recommendation in the case was that Tampa Electric's rates be set using a return on common equity of 10.75 percent, correct?

A Yes, with a range, plus or minus 100 basis points around that, yes.

Q And then if you'd look at page 172, which is where the second yellow Post-it is located, you would see that the staff -- staff's initial recommendation for revenue requirements as the outcome of the case was $76.7 million?

A Yes, I see that.

MR. WRIGHT: May I approach, again, Madam

Chairman?

ACTING COMMISSIONER EDGAR: Yes, sir.

BY MR. WRIGHT:

Q Thank you. Madam Chairman, I've just handed the witness a copy of Exhibit 297 which is already in evidence in this case. It's a printout from I think Yahoo Finance of Tampa Electric's stock prices during the course of this year.

If you would, Mr. Sullivan, just look at Tampa Electric's stock price on March 5, the date that the recommendation was issued, and on March 6th, the date following.

A I see those.

Q Thanks. And you'd agree that that information shows that the stock price increased by about 67 cents per share from March 5 to March 6?

A Yes, I would.

Q I'll aver to you that that's about 7.8 percent, but you're welcome to check the math, or you can accept that subject to check.

A Subject to check is fine.

Q And would you also agree that the volume of shares purchased on March 6th was more than twice the volume of shares purchased on March 5?

A Yes, there was.

MR. WRIGHT: Thanks.

Madam Chairman, I have asked my colleague, Mr. Moyle, to kindly distribute another exhibit which I would like numbered.

ACTING COMMISSIONER EDGAR: Okay. I am showing that this will be 319.

MR. WRIGHT: Thank you.

ACTING COMMISSIONER EDGAR: Title?

MR. WRIGHT: A short title, you can just call it Dow 2/2/09-3/30/09.

MR. WALLS: I'm sorry. I didn't catch that.

MR. WRIGHT: It's the Dow Jones Industrial Average for the period February 2nd, 2009 to March 30, 2009. I suggested a short title of Dow 2/2/09-3/30/09.

(Exhibit No. 319 marked for identification.)

BY MR. WRIGHT:

Q Mr. Sullivan, if you would, I'd like to ask you to look at what is the last page of the document there. That page happens to include the week of March 2nd through 6th.

A Yes, I'm there.

Q Okay. You'd agree that that week represented the lowest values of the Dow Jones Industrial Average at the bottom of the market this year, would you not?

A Again, I believe for the Dow Jones Average, that's correct. I believe S&P might have been around the 9th, but yeah, right around these two or three days was the bottom.

Q Thank you. I think actually the Dow itself bottomed on -- just flat out bottomed bottomed on Monday the 9th, and you can see those numbers there.

A Yes.

Q 6547 was the close and 6440 was the low for the date, correct?

A Yes, that's correct.

Q And if you'd look at -- again, looking at March 5 to March 6th, you can do the arithmetic, but would you agree that the close on the 6th was about half a percent higher than the close on the 5th?

A Yes.

Q Further down on -- really toward the bottom of page 6, you make the statement that, "Providing PEF a lower return on equity than that awarded to Tampa Electric would be viewed as inconsistent and negative by the rating agencies and financial community and begin to raise doubts as to the regulatory climate in the state of Florida." Now, that's your testimony, right?

A Yes, it is.

Q I just want to ask you this: Are you suggesting that, if the Florida Public Service

Commission believes that the appropriate return on equity for Progress for purposes of setting rates in this case is lower than that 10.5 percent, 10.75, ten whatever -- are you suggesting that, if the Commission believes it's lower than that, that they should still give you all 11 and a quarter?

A I'm sorry. Could you state the question again, please?

Q Sure. Are you suggesting by your testimony that we just confirmed that, even if the Commission thinks that the appropriate return on equity is less than 11 percent for Progress, that they should still give you 11 and a quarter because they gave that to Tampa Electric?

A Well, I think we should get 12.54, to start with, but again --

Q I understand that, but that wasn't the question.

A Right. No, I don't agree with that.

Q I'm sorry. Pardon?

A I said no, I don't agree that we should get a higher rating or a lower rating because of that.

Q Okay. You talked about other utilities in the southeast. Now, you live in Raleigh; correct?

A Yes.

Q And you're aware, I'll bet, that Duke Energy has a rate case pending in North Carolina; are you?

A Yes.

Q And do you recall what return on equity Duke is seeking in that proceeding?

A I do not know what they're asking for in this proceeding.

Q Okay. I will aver to you it's in evidence per Dr. Vander Weide they are seeking an 11 and a half percent return on equity. That's in evidence otherwise.

Do you know whether Duke's credit outlook is stable or positive, or do you know?

A I don't know what their current rating situation is.

MR. WRIGHT: Thank you, Madam Chairman and Mr. Chairman. Mr. Sullivan, that's all the questions I have.

CHAIRMAN CARTER: Thank you, Mr. Wright.

Staff, you're recognized.

CROSS EXAMINATION

BY MS. FLEMING:

Q Thank you. Good afternoon, Mr. Sullivan.

A Good afternoon.

Q I just have a few brief questions for you. Could I have you turn to your exhibit TRS-15, please.

A I'm there.

Q And looking at this, this is the August, 2009 Moody's report; is that correct?

A That's correct.

Q And this report provides guidance on Moody's approach to assigning credit ratings to electric utility companies, is that correct?

A Yes, that's correct.

Q Could I have you turn to page 31 of this exhibit, please.

A I'm there.

Q And I'm looking in the middle of the page under the heading "Factors Determining the Treatment of PPAs." Do you see that?

A Yes.

Q Could you please read aloud the first three sentences of that paragraph following that section?

A "Because PPAs have a wide variety of financial and regulatory characteristics, each particular circumstance may be treated differently by Moody's. The most conservative treatment would be to treat the PPA as a debt obligation of the utility as, by paying the capacity charge, the utility is effectively providing the funds to service the debt associated with the power station. At the other end of the continuum, the financial obligations of the utility could also be regarded as an ongoing operating cost with no long-term capital component recognized."

Q Thank you. During your direct testimony, we had a discussion regarding PEF's recovery of purchase power costs when you were on the stand. Do you remember that?

A Yes, I do.

Q And you testified that PEF recovered the capacity payments and fuel costs associated with the purchase power agreements through the cost recovery clauses, is that correct?

A Yes, that's my understanding.

Q Okay. Do you see the second bullet that's titled "Pass-through Capability"?

A Yes, I do.

Q Could you please read aloud the first three sentences of that section, please?

A "Some utilities have the ability to pass through the costs of purchasing power under PPAs to their customers. As a result, the utility takes no risk that the cost of power is greater than the retail price it will receive. Accordingly, Moody's regards these PPA obligations as operating costs with no long-term-debt like attributes. PPAs with no pass-through ability have a greater risk profile for utilities. In some markets the ability to pass through costs of a PPA is enshrined in the regulatory framework, and in others it can be dictated by market dynamics. As the market becomes more competitive, the ability to pass through costs may decrease, and as circumstances change, Moody's treatment of PPA obligations will alter accordingly."

Q Okay. Thank you. So, as a result of the Commission-approved cost recovery mechanisms for the costs associated with PPAs, isn't it true then that Moody's states it will treat PPAs or past PPA obligations as operating costs with no long-term-debt like attributes?

A I believe that's partially true because some of the PPAs are classified as operating leases and capital leases. So those would get picked up while they would most likely exclude PPAs that don't fit into those two categories.

Q And now could I have you turn to your exhibit TRS-21, please.

A I'm there.

Q And this is a Moody's Global Infrastructure Finance Report dated June, 2009. Is that correct?

A Yes.

Q And turning to page 10 of that report --

A I'm there.

Q In this section, it's titled, "New Nuclear Generation, Ratings Pressure Increasing." Do you see that?

A Yes.

Q And in this report Moody's states that, in order to defend existing ratings or to limit negative rating actions, they will look for investor-owned utilities to do four specific items. Do you see those?

A Yes, I do.

Q Could you please read aloud those four items that Moody's suggests that the IOUs do, take?

A No. 1 is, "Create strategic partnerships to share costs and risks; No. 2, increase reliance on equity as a component to financing plans; No. 3, moderate their dividend policies to retain cash flow; and 4, adopt a back-to-basics focus on core electric utility operations posing less distractions for management."

Q Now, during your testimony, we discussed these brief bullet points. Do you recall that during your deposition?

A Yes, I do.

Q And I believe that it was your testimony during that deposition that it is the discretion of

Progress Energy management as well as the Board of Directors as to how closely the company will comply with suggestions by Moody's regarding how a company can mitigate the perceived risk associated with new nuclear construction. Isn't that correct?

A Yes.

Q And even though Moody's in this article has written about the risks associated with new nuclear construction and it has made specific suggestions to IOUs of what they can do to maintain their existing bond rating through the construction cycle, it is ultimately up to the company, meaning PEF, PEF's management to determine whether those suggestions will be followed. Is that correct?

A Yes. This guidance is extremely helpful in setting those expectations, and then management and the Board acts accordingly.

MS. FLEMING: Thank you. We have no further questions.

CHAIRMAN CARTER: Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chairman, just briefly. Good afternoon, Mr. Sullivan.

THE WITNESS: Good afternoon.

COMMISSIONER SKOP: If I could turn your attention to page 17 of your rebuttal testimony, please, lines 14 through 17.

THE WITNESS: I'm there.

COMMISSIONER SKOP: Okay. And on those lines you discuss how the 2008 book equity ratio was lower due to timing differences associated with the fuel cost recovery and fuel hedging. Can you briefly explain that? Was that resultant from cash flow timing resultant of commission approval in 2007 and 2008?

THE WITNESS: I don't think it was as much commission approval because our fuel case was approved. It had to do with the timing and the magnitude of changes in the markets. We had two main drivers of debt, or that increased debt, which, in essence, lowered equity as a result of that, and they had to do primarily with margin postings associated with the gas hedging portfolio that I referred to earlier.

COMMISSIONER SKOP: So that was basically the change in the volatility of the fuel and the hedging losses that factored into that, is that correct?

THE WITNESS: Yes. And to give you an order of magnitude, we went from holding $500 million to posting $500 million in about six months.

COMMISSIONER SKOP: All right. Very well.

Turning to page 19 in your rebuttal testimony, please --

THE WITNESS: Yes.

COMMISSIONER SKOP: -- lines 9 through 14.

THE WITNESS: Uh-huh.

COMMISSIONER SKOP: And on that you I guess rebut Dr. Woolridge's presumption that the common equity ratio on a jurisdictional basis is approximately 47.51 percent. Can you briefly explain the adjustment and the correction there, please.

WITNESS: Yes, we believe that the -- or it's my testimony that his calculation of the real recommended common ratio does not properly incorporate the jurisdictional factor adjustment for PPAs, and that drives the difference.

COMMISSIONER SKOP: All right. So he did not do the imputed debt adjustment in his analysis that would have increased the equity, is that correct?

THE WITNESS: That is in the last sentence. It would increase it to 49.2 from 47.51.

COMMISSIONER SKOP: Okay. Very well. If I could briefly turn your attention to what has been previously marked as Exhibit 296, please, and I don't know if you have that available, but I'm sure your counsel might.

CHAIRMAN CARTER: Staff, do you have one you can share with the witness?

MS. FLEMING: We are looking for it.

CHAIRMAN CARTER: Okay. Let's take a moment.

Thank you, Mr. Walls. Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chairman.

I'll give Mr. Sullivan a moment to take a look at that page, please.

THE WITNESS: I have reviewed it.

COMMISSIONER SKOP: Subject to check, this is basically a summary of Florida Public Service Commission surveillance reports for earnings for Progress Energy of 1998 to 2008; correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Now, assuming that the numbers stated for ROE in the last column are purported to be accurate -- and again, I think Progress had reserved the right to check the accuracy of that, but do you see the years 1999 to 2004 and the ROEs identified for those years?

THE WITNESS: Yes, I do.

COMMISSIONER SKOP: Subject to check, for the years 1998 to 2004, would you agree that the average ROE would be approximately 13.09 percent for those years?

THE WITNESS: Subject to check for those years, I would agree.

COMMISSIONER SKOP: Okay. All right. Now, if

I could ask you to look briefly at years 2005 to 2008.

THE WITNESS: Yes.

COMMISSIONER SKOP: Subject to check, would you agree that the average ROE for those years, 2005 through 2008, is approximately 9.8 percent?

THE WITNESS: I would agree.

COMMISSIONER SKOP: Okay. I guess my question regarding the presentation of this information is, as treasurer, do you have an opinion as to what may have contributed to the sharp decline in the realized ROE during the settlement period as opposed to the presettlement period generally from 2002 to 2004?

THE WITNESS: I think, in reflecting back over those time periods, certainly you have a weakening and ultimately recessionary situation in the second group. The trend over that time period, as I said, is downward. If you look at the first group that you outlined, you have the tech bubble that burst, and then you had 9-11 in there. So again, I think overall that is a much more robust economic time in the first group of years you highlighted versus the second group of years.

Also I think our investment in plant increased significantly over that second group of time as we implemented post-acquisition a commitment to excellence and then addition of new plant and uprates.

COMMISSIONER SKOP: Okay. So the majority of that, if I heard you correctly, may have been improvements -- not improvements, but additions to capital in terms of new generation and such?

THE WITNESS: Yes, I think that going up and then revenues declining due to the economy caused the negative direction of ROE.

COMMISSIONER SKOP: All right. Just I believe three additional questions.

I think, in looking at your rebuttal testimony, in order to maintain the financial integrity of the company, including credit quality, debt ratings, I think you emphasized the importance of strong cash flow from operations; is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: And moving on to two additional points, and I'm sorry that -- I think it got punted to you, and it's in the gray area between ROE and executive compensation, so I'm going to ask the question and hopefully you're the right witness, but do you believe that there is a tradeoff between awarded ROE and the amount of executive compensation that shareholders should be required to absorb?

THE WITNESS: I think that that's one component because, again, we -- while we're mostly regulated, we do do some other things, but I think, yes, that's the -- some alignment with that would be applicable because that does roll up into, again, the overall company performance.

COMMISSIONER SKOP: Okay. And the reason I was asking is, you know, I was wondering if that could be viewed similarly to a leverage formula whereas, if you have higher equity, less risk, less ROE, whereas you have, you know, more debt, higher risk, a higher ROE, and I'm looking at that in the same rationalization and wondering if there is any correlation based on your previous response. Is that an appropriate way to look at it?

THE WITNESS: Again, I think there are other factors, but in general that is directionally correct, yes.

COMMISSIONER SKOP: Okay. And just the last question: Why is it not appropriate for executive compensation above a certain threshold level to be absorbed by shareholders utilizing the retained earnings of the company rather than having that be recovered through the ratepayers?

THE WITNESS: I don't really have a good answer for that. That's certainly a different way of looking at it than the historical ratemaking process that I'm aware of.

COMMISSIONER SKOP: All right. Thank you very much.

CHAIRMAN CARTER: Thank you, Commissioner.

Commissioners, anything further from the bench. Redirect?

MR. WALLS: Briefly.

CHAIRMAN CARTER: You're recognized.

REDIRECT EXAMINATION

BY MR. WALLS:

Q Mr. Sullivan, I wanted to direct your attention to page 7, lines 2 to 4 of your rebuttal testimony where you had referenced the other utilities in the southeast and their ROEs, and you may recall that Mr. Moyle was asking you questions regarding when these ROEs were issued or when the orders came out. Do you recall that?

A Yes, I do.

Q Does it matter, when you're competing in the market for capital, when these ROE awards were issued?

A No. If these are the existing returns that the companies are allowed to earn, the timing of that decision is not relevant.

Q And he also asked you a few questions about Idaho Power and that you compete with Idaho Power. Do you recall that?

A Yes, I do.

Q Do you also compete with the companies that are listed here on page 7 at lines 2 through 4 for capital?

A Yes, probably more so because they're more comparative in size and operations than Idaho Power would be.

Q You may also recall a series of questions that Mr. Moyle asked you about his customers' preference for the utility to be downgraded. Do you recall that?

MR. MOYLE: I'm not exactly sure it was stated that way, but --

MR. WALLS: That's the way I heard it.

MR. MOYLE: -- go ahead.

THE WITNESS: I'll answer the question.

BY MR. WALLS:

Q Do you recall that?

A It was certainly inferred in his statements. I don't know if he came right out and said that, but the accumulation of his comments would lead to that, yes.

Q Well, based on your experience over 25 years dealing with investors on both sides of the capital market, debt and equity, how do you think the investment community would react to a downgrade?

MR. MOYLE: I object to the extent it calls for speculation. We spent, you know --

CHAIRMAN CARTER: Overruled, overruled. You may answer.

THE WITNESS: I'm sorry. Could you repeat, please?

BY MR. WALLS:

Q Yes. Based on your 25 years of experience dealing with the capital markets, both the debt and equity side, how would you think the investment community would react to a downgrade of the utility?

A It would react negatively.

Q I'm sorry. I didn't catch the answer.

A It would react negatively.

Q All right. Thank you.

And one final question. You were asked about the June, 2009 Moody's report regarding nuclear and the four factors that Moody's had recommended that utilities follow. Do you recall that?

A Yes, I do.

Q And I believe one of them was adopt a back-to-basics focus on core electric utility operations.

A Yes.

Q Has the company done that?

A Yes, we have.

Q Okay. And, in fact, you've also increased equity in your company this year; right?

A Yes, we have.

MR. WALLS: No further questions.

CHAIRMAN CARTER: Exhibits?

MR. WALLS: Yes, we have -- if I can find the list.

CHAIRMAN CARTER: It's on page -- starting at page 44.

MR. WALLS: Exhibits 233, 233, 234, 235 --

CHAIRMAN CARTER: It goes to 245?

MR. WALLS: Yeah, to 245. We would move in evidence.

CHAIRMAN CARTER: Are there any objections?

Okay. Hang on a second before we go to the back pages.

Without objection, show it done.

(Exhibit Nos. 233, 234, 235, 236, 237, 238, 239, 240, 241, 242, 243, 244 and 245 entered into the record.)

CHAIRMAN CARTER: Now let's go to the back pages. Mr. Wright.

MR. WRIGHT: 319, Mr. Chairman, move it.

CHAIRMAN CARTER: Are there any objections?

MR. WALLS: No objection.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit No. 319 was received in evidence.)

CHAIRMAN CARTER: Anything further for this witness, staff or the parties? Commissioner Skop?

COMMISSIONER SKOP: Thank you, Mr. Chair.

Just one clarification to the last question you answered with respect to that you increased the equity in your company. Do you remember the last response that you gave?

THE WITNESS: Yes.

COMMISSIONER SKOP: Is that for Progress Energy at the corporate parent or would that be Progress Energy Florida?

THE WITNESS: Well, again, given that the entity or one view of the entity is a consolidated, yes, it affects the whole entity, depending upon, you know, ultimately where it gets invested, but it does raise the whole entity, yes.

COMMISSIONER SKOP: Thank you.

CHAIRMAN CARTER: Thank you, Commissioner.

Anything further from the bench? Anything further for this witness?

Thank you, sir. You may be excused. Have a great day and call your next witness.

MR. BURNETT: Mr. Chair.

CHAIRMAN CARTER: Yes, sir.

MR. BURNETT: With your indulgence, may I have five minutes or so with the parties and colleagues?

CHAIRMAN CARTER: Let's do this.

Commissioners, we are going to take a quick break. We will come back at -- is that 25 after -- 25 after.

(Recess.)

CHAIRMAN CARTER: We are back on the record.

Commissioners, I just wanted -- we have got a preliminary matter, and I think that everyone will be happy to hear this.

Mr. Burnett, you're recognized.

MR. BURNETT: Thank you, Mr. Chairman.

Mr. Chairman, in working with the intervenors to eliminate the portions of Mr. Toomey's testimony that dealt with Mr. Marz testimony, which we would need to strike, we also took the effort to look and see through Mr. Toomey's testimony of what, if anything, is left that other witnesses haven't covered. And Progress has been able to come to the determination that the record is sufficient from our perspective as we stand, and we will withdraw Mr. Toomey's rebuttal at this time. And I believe that would conclude our rebuttal case.

CHAIRMAN CARTER: Mr. Wright.

MR. WRIGHT: We certainly have no objection, and we're grateful for the great working relationship we have.

Thank you.

CHAIRMAN CARTER: Mr. Moyle.

MR. MOYLE: Thank you.

CHAIRMAN CARTER: Wow, Mr. Moyle, one word.

Ms. Bradley.

MS. BRADLEY: We concur.

CHAIRMAN CARTER: Mr. Rehwinkel.

MR. REHWINKEL: Yes. Mr. Burnett saved all the parties three hours of cross from me, literally. I really appreciate the collegial effort that everyone showed, despite our adversarial purposes here.

CHAIRMAN CARTER: Outstanding, Mr. Rehwinkel.

Staff, thank you for your hard work.

Commissioners, before we adjourn, let me just go and see if there are any closing comments.

Commissioner Skop, you're recognized for closing comments.

COMMISSIONER SKOP: Thank you, Mr. Chairman.

I just wanted to commend our staff, both the technical and legal staff, for the hard work, preparation, and dedication that they have shown during the course of these proceedings, and also recognize the parties for the professional manner in which they have litigated the case and conducted themselves.

CHAIRMAN CARTER: Thank you.

I'm coming from my left to my right.

Commissioner Edgar.

COMMISSIONER EDGAR: It's a beautiful day in the state of Florida, Mr. Chairman.

CHAIRMAN CARTER: Another great day.

And I want to say to the parties how you conducted yourself with the highest level of expertise. I'm privileged and pleased to be in the presence of so many outstanding legal minds. Things were tight, but they were right.

With that, Commissioners --

COMMISSIONER ARGENZIANO: Mr. Chair.

CHAIRMAN CARTER: Commissioner Argenziano, you're recognized.

COMMISSIONER ARGENZIANO: Just to reiterate just very quickly. I really do appreciate staff's hard work on this. They did a great job, and all involved. And nobody was killed while we did it. No doors, I mean, nothing really bad happened, so I appreciate everybody's hard work. And thank you.

CHAIRMAN CARTER: Thank you, Commissioner.

And to you, Commissioner Argenziano, I want to express our apologies for the technology concerns and problems that we have, but we think that you were able to get in most times and we appreciate your patience on that.

COMMISSIONER ARGENZIANO: Mr. Chair, I forgot to thank our technical staff. Really, they have done a great job in enabling me to be part of the meetings, the proceedings, and even the service hearings while I have been recuperating. I really can't appreciate it -- say how much more I appreciate it. They did a great job, and I think it was just about perfect.

CHAIRMAN CARTER: And to the greatest public service commission staff in the cosmos, you are the best.

With that, Commissioners, we are adjourned.

(The hearing concluded at 3:28 p.m.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)

COUNTY OF LEON)

WE, RAY D. CONVERY and JANE FOUROT, do hereby certify that we were authorized to and did stenographically report the foregoing proceedings at the time and place herein stated.

IT IS FURTHER CERTIFIED that the foregoing transcript is a true record of our stenographic notes.

I FURTHER CERTIFY that we are not a relative, employee, attorney, or counsel of any of the parties, nor are we a relative or employee of any of the parties' attorney or counsel connected with the action, nor are we financially interested in the action.

DATED this 5th day of October, 2009, at Tallahassee, Leon County, Florida.

Ray D. Convery

RAY D. CONVERY

JANE FOUROT