



Florida Power

A Progress Energy Company

ASSOCIATE GENERAL COUNSEL

ORIGINAL

JAMES A. MCGEE

May 14, 2001

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

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RECORDS AND REPORTING

Re: Docket No. Docket No. 000824-EI; Petition of Florida Power Corporation for approval of proposal to resolve outstanding issues.

Dear Ms. Bayó:

Enclosed for filing in the subject docket are an original and fifteen copies of the subject petition.

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

Very truly yours,

James A. McGee

JAM/sc
Enclosure

cc: Parties of record

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of Florida Power Corporation's earnings, including effects of proposed acquisition of Florida Power Corporation by Carolina Power & Light.

Docket No. 000824-EI

Submitted for filing:
May 14, 2001

**PETITION FOR APPROVAL OF PROPOSAL
TO RESOLVE OUTSTANDING ISSUES**

Florida Power Corporation (Florida Power or the Company) hereby petitions the Commission for approval of the proposal set forth in Attachment A hereto to resolve all outstanding issues in this proceeding, and, in support hereof, states as follows:

Introduction

1. Petitioner, Florida Power, is a public utility subject to the jurisdiction of the Commission under Chapter 366, Florida Statutes. Florida Power's General Offices are located at One Progress Plaza, St. Petersburg, Florida, 33701.

2. All notices, pleadings and other communications required to be served on petitioner should be directed to:

James A. McGee, Esquire
Post Office Box 14042
St. Petersburg, FL 33733-4042
Facsimile: (727) 820-5519

For express deliveries by private courier, the address is:

One Progress Plaza
Suite 1500
St. Petersburg, FL 33701

DOCUMENT NUMBER-DATE

06003 MAY 14 2001

FPSC-RECORDS/REPORTING

Background

3. In July, 1997, the Commission approved a stipulation between Florida Power and certain other parties that provided, among other things, a freeze on the Company's base rates and the range of its authorized return on equity.¹ The stipulation was approved for a four-year period and will expire on June 30, 2001.

4. In August, 1999, an agreement was announced under which Carolina Power & Light Company would acquire Florida Power's parent company, Florida Progress Corporation, and merge their combined operations under a newly formed holding company, CP&L Energy, Inc. After obtaining all necessary regulatory and shareholder approvals, the acquisition and merger was consummated on November 30, 2000, at which time Florida Power's new parent company was renamed Progress Energy.

5. The acquisition agreement required CP&L Energy to pay a purchase price for the outstanding common stock of Florida Progress that included an acquisition premium of \$1.27 billion, which was financed by CP&L Energy through the issuance of debt securities. CP&L Energy determined after due diligence that the acquisition premium was warranted by the opportunity to achieve economic and strategic benefits, including synergy cost savings through consolidated utility operations. These synergies result from economies of scale and from greater efficiencies achieved by adopting the best practices and business strengths of each utility on a corporate-wide basis.

¹ Order No. PSC-97-0840-S-EI, issued July 14, 1997 in Docket No. 970261-EI.

6. Since the acquisition agreement was first announced and thereafter to the present, Florida Power has made known to all interested stakeholders its desire to develop and obtain Commission approval of a comprehensive plan that would (a) share the net synergy savings with its retail customers, (b) provide a regulatory mechanism for recognizing the acquisition premium paid to achieve these savings, and (c) address other significant regulatory issues that warrant attention before the expiration of the Company's current rate stipulation on June 30, 2001. Toward this end, Florida Power began informal negotiations with representatives of several key customer groups in April, 2000, with the objective of reaching a rate settlement for presentation to the Commission as soon as practicable after completion of the merger. Unfortunately, those negotiations did not proceed with the alacrity or success Florida Power had hoped, and by late 2000 the need to consider the possibility of a unilateral rate proposal as an alternative became apparent to the Company.

7. On July 7, 2000, while completion of the merger was pending and settlement negotiations were still at a relatively early stage, this docket was opened to review the earnings of Florida Power (with the effects of the merger expressly included within the scope of the review). By late that year, Staff, which had been kept informed of the ongoing settlement negotiations, began expressing its concern to the Company about the lack of progress in the negotiations and the approaching expiration of the current rate stipulation. To complicate matters further, another impediment to the development of any rate proposal arose in early 2001 in the form of a potential major restructuring of electric utility regulation in the then upcoming legislative session. The uncertainty about the form or extent of regulation made the

commitment to binding rate terms that would apply during this uncertain future an unsettlingly high-risk proposition.

8. In early March, 2001, with the legislative session just underway, Florida Power learned that Staff was considering filing a recommendation for the March 13th Agenda Conference that the Commission initiate a formal rate proceeding and place revenues subject to refund. Acting on the belief that virtually all stakeholders would prefer to resolve the pending issues through negotiation and settlement instead of the arduous, time consuming process of a full revenue requirements rate case, Florida Power requested Staff to defer filing its recommendation in order not to impair the opportunity for settlement. Florida Power felt strongly that a deferral was necessary to avoid the polarizing effect of a formal proceeding on the positions of parties to informal negotiations; in addition, it would provide the time needed to eliminate the major obstacle to any rate proposal caused by the uncertain outcome of restructuring proposals pending in the then current legislative session. With Florida Power's agreement to the use of March 13, 2001 as the effective date if future interim rate action was deemed necessary, Staff agreed to the requested deferral.

9. Thereafter, on May 3, 2001, Staff filed a recommendation that the Commission initiate a formal rate proceeding by placing revenues subject to refund and requiring the Company to submit Minimum Filing Requirements. While Florida Power had hoped Staff would continue the deferral of its recommendation for the relatively short additional time needed by the Company to submit its rate proposal after the legislative session ended, Florida Power understands and shares Staff's impatience over the delays experienced since the initial negotiations began over a

year ago. Although not the reason for these delays, the additional time has provided one important benefit, particularly over the last several months. Now that Florida Power is emerging from the nearly two-year merger transition period, the Company has a much clearer insight into its post-transition operations under its new management. This increase in information and structure have provided an improved ability to project the costs and savings under consolidated operations, a better focus on particular areas of the Company's core utility business, and a better understanding of the specific programs, planning and budget priorities required to meet this focus. As a result, Florida Power is now better able to assess its operating costs and earnings capability over the three-year period covered by its rate proposal than it was during the understandably uncertain period of transition from old to new management.

10. Despite the filing of Staff's recommendation, Florida Power remains committed to providing a preferable informal alternative for resolving the pending rate issues. The Company has therefore expedited the filing of its rate proposal² in an effort to remove the doubt reflected in Staff's recommendation and to demonstrate that a viable alternative to a formal proceeding is available when the Commission considers this recommendation at its May 15th Agenda Conference. While it would be clearly premature to evaluate the merits of the Company's proposal at that time, Florida Power respectfully urges the Commission to provide the opportunity for Staff review and subsequent Commission consideration of the Company's rate proposal and the potential that it may lead to a preferable informal resolution of this matter,

² In addition to this effort to expedite its filing, Florida Power also held a meeting with Staff and all parties on May. 11. 2001 to discuss the components of the proposal as then contemplated and to solicit their comments, questions and suggestions, several of which are reflected in the proposal submitted with this petition.

and to defer consideration of Staff's recommendation until an informal resolution proves to be unsuccessful. In this regard, Florida Power offers to meet further with Staff and the parties to discuss its rate proposal and to cooperate fully with Staff in responding to its questions or information requests in order to facilitate Staff's review of proposal and the timely preparation of its recommendation to the Commission.

Florida Power's Rate Proposal

11. Florida Power's rate proposal would provide \$150 million in ratepayer benefits over a three-year period, coupled with a permanent reduction in the fuel adjustment charge of \$37 million per year beginning January 1, 2004. These benefits reflect all of the net synergy savings Florida Power expects to realize from its merger with Progress Energy over the three-year period, based on the Company's most optimistic estimate.

12. The ratepayer benefits contained in this proposal consist of an immediate annual reduction of \$30 million in the bills of retail customers for three years and a contribution of approximately \$60 million over this three-year period to accelerate and complete the amortization of the Tiger Bay regulatory asset.³ The significance of this contribution is that, unlike with other regulatory assets, fully amortizing the Tiger Bay regulatory asset will reduce fuel and capacity costs, rather than base rate costs, which results in an immediate and automatic reduction of the fuel adjustment

³ The Tiger Bay regulatory asset was established by Order No. PSC-97-0652-S-EQ in Docket No. 970096-EQ, in which the Commission approved the purchase of the Tiger Bay cogeneration facility and the termination of five high-cost QF contracts served by the facility.

charge on customer bills.⁴ Florida Power will attempt to complete this amortization by the end of 2003 so that the fuel adjustment charge placed into effect on January 1, 2004 can reflect the full annual reduction, which is expected to be \$37 million. Over the life of the QF contracts whose termination costs constitute the Tiger Bay regulatory asset, the total customer savings through reduced fuel adjustment charges were originally projected to exceed \$2 billion. With the completion of the amortization in 2003, five years ahead of schedule, the savings will increase by more than another \$200 million.

13. The rate proposal also contains a surveillance mechanism which allows Florida Power to offset a portion of its share of the cost to finance the market premium paid by Progress Energy to effectuate the merger with up to \$65 million of annual merger-related synergy savings, which is Florida Power's current estimate of the synergy savings it will achieve over the proposal's three-year period. An adjustment of the kind provided by this mechanism is appropriate⁵ and essential, as a matter of both sound regulatory practice and basic fairness, in order to properly recognize the true *net* synergy savings resulting from the merger for surveillance

⁴ This reduction occurs through the elimination of the high-cost capacity charges under the five Tiger Bay QF contracts currently included in the Capacity Cost Recovery component of the fuel adjustment charge. Because these high capacity charges would have automatically increased to even higher levels over the life of the QF contracts, the savings from termination of the contracts increase over time correspondingly.

⁵ This adjustment is consistent with Commission policy allowing an acquisition adjustment where extraordinary circumstances in the form of customer benefits are shown, which have been enumerated to include increased quality of service, lower operating costs, increased ability to attract capital and lower overall cost of capital, and more professional and experienced managerial, financial, technical and operational resources. Florida Power has provided Staff under confidentiality protection a detailed listing of over 200 merger initiatives and projected savings addressing these benefit categories. The net synergy savings provided to customers in the form of an immediate rate reduction, as discussed in this paragraph below, is a clear and tangible example of a customer benefit justifying such an acquisition adjustment.

purposes. The reason such a mechanism is necessary for sound surveillance reporting is that gross synergy savings, \$65 million in this instance, are automatically reflected as cost reductions in surveillance reporting, without the need for any adjustment. However, the cost to achieve these gross synergies, *i.e.*, the market premium paid by Progress Energy, is not automatically reflected in surveillance reporting, and therefore requires an adjustment in order to be recognized and thus capture the net merger synergies.

In terms of fairness, Florida Power has continually expressed a willingness to provide its customers the opportunity to share in the savings from the merger. To be fair, however, the synergies received by customers must recognize the cost incurred to achieve these synergies, just as Florida Power must do. The Company's proposal allows it use up to \$65 million of expected annual synergy savings, but only if the savings can actually be achieved, to offset only a portion of its share of the acquisition premium, and also includes \$5 million of annual synergy savings in the three-year rate reduction to customers. In effect, by guaranteeing the first \$5 million of annual synergy savings to customers, Florida Power has given customers more than all of the expected net synergies, and must therefore achieve a stretch goal of \$70 million in annual synergies to fully utilize the surveillance mechanism. Florida Power believes its rate proposal goes to great lengths to ensure customers are treated fairly with respect to merger related savings, and it feels strongly that a surveillance mechanism which recognizes the cost to achieve these savings is essential for the Company to be treated fairly as well.

14. Florida Power's rate proposal also includes the following additional provisions:

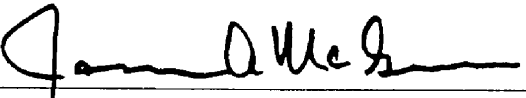
- A reduction in the mid-point of Florida Power's authorized return on equity to 11.75%, with a range of 100 basis points on either side.
- A three-year freeze on the rates and equity return range established by the rate proposal.
- An authorization for Florida Power to continue the surveillance adjustment to its equity capitalization ratio established in the current stipulation, subject to a limitation offered to address a concern expressed by Staff that the adjustment may not result in an equity ratio exceeding a cap previously approved by the Commission.
- An authorization for Florida Power to accelerate the amortization of certain regulatory assets listed in Attachment A to the rate proposal.
- A requirement suggested by a party that any earnings above the level allowed by the rate proposal be refunded to customers.
- A requirement suggested by a party that Florida Power hold customers harmless from any adverse rate impacts of a six-year divestiture of generating capacity required by the Federal Energy Regulatory Commission in its approval of the merger with Progress Energy.
- A requirement suggested by a party that Florida Power waive its right to assert that the Commission's regulation of affiliated transactions is preempted by federal law.

15. Florida Power believes and strongly urges that the immediacy, magnitude and fairness of the benefits and terms of its rate proposal, together with the avoidance of a protracted full revenue requirements rate case of uncertain results, warrant the Commission's approval of the proposal in the public interest.

WHEREFORE, Florida Power respectfully requests that the Commission grant this petition and approve the rate proposal set forth in the attached Exhibit A, effective upon the date determined in accordance with paragraph 1 of the proposal.

Respectfully submitted,

FLORIDA POWER CORPORATION

By 

James A. McGee
Post Office Box 14042
St. Petersburg, FL 33733-4042
Telephone: (727) 820-5184
Facsimile: (727) 820-5519

DOCKET No. 000824-EI**FLORIDA POWER CORPORATION'S
PROPOSAL TO RESOLVE OUTSTANDING ISSUES**

The following proposal is made by Florida Power Corporation (Florida Power) for the purpose of resolving all issues associated with (a) the expiration of the currently effective stipulation between Florida Power and certain other parties approved by the Commission in Order No. PSC-97-0840-S-EI, issued July 14, 1997 in Docket No. 970261-EI (the Current Stipulation), and (b) the pending review of Florida Power's earnings in Docket No. 000824-EI, including the effects of its merger with CP&L Energy, Inc., (now Progress Energy, Inc.) (the Merger).

1. Florida Power will reduce the rates of its retail customers through a credit on their bills in the total annual amount of \$30 million for a period of three years, effective beginning with the first billing month (Cycle 1 billings) following the date an order of the Commission approving this proposal in its entirety becomes final and no longer subject to appeal (the Effective Date). In addition, over the same three-year period Florida Power will make the required contributions, currently estimated to be \$60 million, to fully amortize the Tiger Bay regulatory asset established by Order No. PSC-97-0652-S-EQ, issued in Docket No. 970096-EQ, which will provide a further, long term reduction in the rates of retail customers of approximately \$37 million annually on or before the expiration of the billing credits provided above. The rate reductions from the foregoing billing credits and completion of the Tiger Bay amortization reflect Florida Power's share of the net synergy savings expected to be realized as a result of the Merger, a reduction in Florida Power's earned return on equity, and the regulatory practices provided by the terms of this proposal.
2. The mid-point of Florida Power's currently authorized return on equity will be reduced to 11.75%, with a range of 100 basis on either side of the mid-point, for a period of three years from the Effective Date.
3. In recognition of the premium paid by CP&L Energy to acquire Florida Power, thereby enabling Florida Power to achieve the net synergy savings from consolidated operations of the merged companies that are reflected in the rate reduction provided in paragraph 1 above, Florida Power will be allowed the opportunity to earn \$40 million above its authorized range of return on equity for surveillance reporting purposes. This surveillance adjustment will provide Florida Power the opportunity to apply the expected level of synergy savings, to the extent they are actually achieved, to offset a portion of Florida Power's annual revenue requirement to finance the acquisition premium over a 15-year period.

4. In the event Florida Power's earnings for any 12-month period ending at an anniversary of the Effective Date exceed the increment above the range of its return on equity allowed pursuant to paragraph 3 above, such higher earnings will be refunded to retail customers through an additional one-time billing credit.
5. Florida Power's current base rates (less the three-year billing credit provided pursuant to paragraph 1 above) and its authorized range of return on equity established pursuant to paragraph 2 above will remain in effect for a period of three years from the Effective Date unless a reduction is sought by Florida Power.
6. Florida Power will be authorized to continue the adjustment established in paragraph 6 of the Current Stipulation regarding the calculation of its common equity capitalization ratios used for surveillance reporting purposes, provided that this adjustment does not result in common equity capitalization ratios greater than 55.83%, including off-balance sheet debt associated with purchased power obligations and the Tiger Bay regulatory asset in a manner consistent with the Standard & Poors methodology.
7. Florida Power will be authorized, at its discretion, to accelerate the amortization of the regulatory assets identified on Attachment A to this proposal.
8. Florida Power will hold its retail customers harmless from any adverse rate impacts associated with its six-year divestiture of generating capacity and energy required as a condition for approval of the Merger by the Federal Energy Regulatory Commission. The retail portion of any costs incurred by Florida Power to fulfill the foregoing hold harmless obligation will be considered legitimate utility costs for surveillance reporting purposes.
9. Florida Power agrees for retail ratemaking purposes that the Commission shall have authority over the treatment of the costs and revenues associated with non-power transactions between Florida Power and its affiliates, and further agrees to waive its right to assert the preemptive effect of the jurisdiction of the Securities and Exchange Commission under the holding of *Ohio Power Company v. FERC*, 954 F. 2d 779 (D.C. Cir. 1992).
10. Upon approval of this proposal by the Commission, Docket No. 000824-EI will be closed.

Regulatory Assets**Attachment 1**

Unamortized Balances
as of 3/31/01
(\$ Millions)

Tiger Bay Regulatory Asset* - Premium to terminate power contracts \$ 159

Prior Period Flowback of Deferred Taxes

- Flowthrough versus full normalization 34
- AFUDC Equity 48

The above prior period items are tax benefits on property-related temporary differences flowed through to customers.

Loss on Reacquired Debt - Cost to refinance higher interest rate debt. 21

Tax Rate Shortfall - Payment of tax on audit adjustments when the tax rate used exceeds the current tax rate. 3

Total of Assets Eligible for Accelerated Amortization \$ 265

* Authority for accelerated amortization provided in Order No. PSC-97-0652-S-EQ.

FLORIDA POWER CORPORATION

DOCKET NO. 000824-EI

CERTIFICATE OF SERVICE

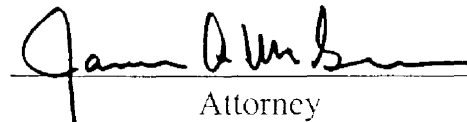
I HEREBY CERTIFY that a true copy of Florida Power Corporation's Petition for Approval of Proposal to Resolve Outstanding Issues has been furnished to the following individuals by regular U.S. Mail and by facsimile transmission this 14th day of May, 2001.

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Tallahassee, FL 32399-0850

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