

Confidential Document (confidential information highlighted)

**Florida Power Corporation
Risk Management Plan
Fuel Procurement and Wholesale Power Purchases**

02.0001-ET

I. Objective

The objective of Florida Power Corporation's (FPC) Risk Management plan is to provide the mechanisms to manage Florida Power's overall fuel costs and wholesale power purchases to provide reliable service to FPC's customers at the same time providing the lowest cost.

As a result, this should ultimately reduce the number of mid-course corrections to the fuel factor portion of the customer's bill. The risk management plan allows for the use of various tools to manage the price volatility of natural gas and oil using approved products to hedge up to 60% of projected volumes by utilizing both financial and physical hedging strategies.

Progress Ventures acts as agent for FPC. FPC has adopted Progress Ventures' risk management policies and practices.

II. Fossil Fuel and Purchased Power Future Needs

A. Fossil Fuel

1. Coal

- FPC plans to burn approximately 6 million tons of coal per year in 2003 and in 2004

2. Residual Oil

- FPC plans to burn approximately 9 million bbls. of #6 fuel oil per year in 2003 and 7 million bbls. in 2004

3. Distillate Oil

- FPC plans to burn approximately 1.0 million bbls. of #2 fuel oil per year in 2003 and 2004

4. Natural Gas

- FPC plans to burn approximately 54,000,000 MMBTU in 2003 and approximately 65,000,000 MMBTU in 2004

B. Purchased Power - FPC plans to purchase approximately 0.7 million MWH/year and sell approximately 1.0 million MWH/year on the wholesale market in 2003 and 2004.

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III. Risk Management Profile

A. Risk Identification * The primary risks FPC has identified with procurement of fossil fuels and purchased power are:

1. Coal

- Plant availability due to unscheduled outages
- Supply or transport problems due to labor disputes, weather, or other unforeseen delays
- Coal quality errors
- Financial strength of suppliers
- Changes in laws regulating mining, transportation or burning of coal
- Price volatility

2. Oil (Residual and Distillate)

- Differences between forecasted/scheduled requirements and actual requirements due to economic changes, overall power demand, weather changes, change in price relationships between competing fuels, plant availability (maintenance/unexpected shutdowns or startups), out-of-economic plant dispatch (e.g., due to transmission system constraints), power market changes, etc.
- Differences between forecasted/scheduled deliveries and actual deliveries due to supply or transport problems, loading and unloading delays, etc.
- Fuel quality problems such as blending errors, off-spec deliveries, changes in SO₂ values, changes in plant fuel handling capability, etc.
- Changes in laws, regulations, plant permits, etc. that affect the amount, cost, testing requirements or quality of oil required
- Impact of regulatory, management, internal and external audit reviews
- General industry changes that impact overall availability/cost/quality of fuel oil
- Price volatility and fuel oil market related factors

3. Natural Gas

- Imbalance penalties with interstate pipelines as a result of over/under burns based on differences between forecasted /scheduled gas and actual requirements due to, but not limited to, changes in weather, plant availability, and alert day tolerances
- Deliveries by interstate pipelines and suppliers impacted by force majeure events, such as pipeline disruptions, production outages, hurricanes, etc.

- Natural gas storage level deviation from expected norms
- Crude oil prices
- Degree day deviations from expected monthly norms
- Defaults by suppliers (for example, bankruptcy)
- Price risk based on volatility in the natural gas industry caused by commodity funds (technical trading)
- Contractual disputes regarding payment and deliveries

4. Purchased Power

- Default risk – inability of the supplier to obtain adequate resources to deliver the power per contract or agreement
- Directional price risk – e.g., purchased power contracts in which the price of the purchased power is tied to an index
- Physical risk – inability of electrical grid to reliably support power transfer
- Credit risk – inability of contract counterparty to deliver per contract resulting in purchase of higher cost purchased power
- Basis risk – e.g., supplier(s) can experience adverse weather as compared with Florida Power's service territory

*Acts of terrorism are considered beyond FPC's control

B. Risk Quantification

- Quantification of various risks, including stop-loss limits and Value-at-Risk (VaR) calculations, are included in Progress Ventures Risk Management Guidelines Appendix 13.

C. Risk Management (Daily Management Activities)

1. Coal

- Review actual conditions and adjust delivery schedules as needed
- Maintain contacts with plants and suppliers
- Monitor market prices and spot market options
- Monitor suppliers financial strength
- Build flexibility on volume terms etc., into agreements
- Develop alternative supply sources whenever possible

2. Oil

- Monitor actual conditions and consumption levels vs. forecasted levels and update forecasts frequently as conditions change. Adjust delivery schedules as needed
- Monitor actual delivery status and maintain frequent contact with suppliers and receiving plants to anticipate problems and take corrective action
- Keep current on market prices and activity. Utilize contract price options, inventory, and spot market options as appropriate. Florida Power has used, and continues to use, negotiated fixed prices as a method of stabilizing prices. This is usually accomplished by fixing prices on all or part of individual ships or a series of shipments to be delivered over a period of time of one to three months.
- Continue to scrutinize a supplier's financial strength in order to assess ongoing creditworthiness.

3. Natural Gas

- Monitor plant gas burns vs. forecasted gas burns. If gas burn is projected to be out of tolerance on the pipeline, reschedule gas and re-allocate gas to different plants, or switching to alternative fuels, like oil
- Use fuel oil, where applicable, to maintain load
- Build additional optionality into seasonal/term contracts by specifying the use of a daily or a monthly market index (with the right to select either one), include take or release triggers on volumes to allow added flexibility, as well as the right to mutually agree to a fixed price
- Implement term contracts that allow swing volumes
- Evaluate fixing a percentage of the monthly natural gas requirements, in order to offset volatility for the ratepayers
- Evaluate zero cost collars for physical natural gas requirements in lieu of, or in conjunction with, fixed-price natural gas
- Evaluate the premium cost of purchasing a call option for a percentage of the utility's monthly natural gas requirements
- Use physical fuel oil inventory, where applicable, to dispatch at lowest fuel price. Logistics of physical fuel oil inventory levels must also be managed with this alternative
- Monitor natural gas trends to determine the direction of long-term market swings
- Re-market any excess gas supplies/capacity, separately or bundled, on a daily basis
- Continue to scrutinize a supplier's financial strength in order to assess ongoing creditworthiness

4. Purchased Power

- FPC assesses each supplier's ability to deliver power based on historical reliability as a supplier (default risk) and credit ratings
- FPC utilizes both fixed price contracts (next day purchases) and variable price contracts tied to a specific counterparty's incremental cost
- FPC utilizes firm transmission paths where available for reliable purchased power

5. Portfolio Management

- FPC will manage its risks associated with meeting its forecasted load requirements by maintaining a generation fleet with the capability of fuel switching, contracting for a diverse fuel supply and transportation portfolio, and the use of sales and purchases of energy to and from outside sources.

D. Acceptable Level of Risk

1. Oil and Coal - The amount of risk considered acceptable is based on past experiences with what has been successful and evaluating the risk profile of any problems or opportunities based on this experience.
2. Natural Gas - Decisions regarding acceptable risk are based on the circumstances at the time natural gas is purchased. The circumstances at the time may include scenarios involving all or a part of the following: force majeure events, fuel oil inventories, competitive fuel pricing, supply restraints, forward pricing trends etc. For example, if the utility views a strong directional market trend for natural gas based on industry reports, events in the marketplace, demand, national storage levels, etc., the utility would consider implementing the risk management tools identified for managing natural gas risk.
3. Purchased Power- Considerations for purchasing power on a long term and mid-term basis include, but are not limited to the following:
 - Price curves – directional price risk associated with fuel and power
 - Generator outages
 - Load forecast
 - Physical risk associated with transfer capability of transmission system
 - Credit worthiness of potential supplier(s)
 - Default risk of potential supplier(s)
 - Basis risk – e.g., supplier(s) can experience adverse weather as compared with FPC's service territory

E. Constraints to Implementing Financial Hedging Tools

1. Energy Trading and Risk Management Software System

- Progress Ventures (Ventures) has evaluated and is currently negotiating with specific vendors in purchasing an electronic energy trading and risk management software system to meet the reporting and control requirements of a financial hedging program. To the extent this negotiation is successful, the next phase of the program will be to transition and implement the new system.

2. Financial Trading Expertise

- FPC is evaluating the skill set and staffing requirements in the front, middle, and back office to, (i) transact in the financial markets, and (ii) to monitor, control, bill and report financial transactions.

IV. Fuel Procurement and Wholesale Purchased Power Plans for 2003

1. Coal

- All purchase are made on mid-term contracts.

2. Oil

- The majority of the fuel oil is covered by mid-term (1-3 years) supply contracts with flexible volume provisions and market based pricing. The spot market is utilized when contracts allow as a supplemental source of supply.

3. Natural Gas

- Approximately 50% of the natural gas requirements are covered by long term (greater than 3 years) contracts. About 40% of the natural gas contracts are covered by short term contracts with the remainder purchased on the spot market.

4. Purchased Power

- Long-term firm purchased power is usually solicited by a request-for-proposal from credible counterparties. Mid-term purchased power is usually solicited via a survey of credible counterparties by requesting bids for the nomination and terms for the product needed.
- Short-term firm purchased power is obtained through market assessment of bids and offers and negotiation with credible counterparties.

V. Guidelines

1. The Board of Directors has established a Risk Management Policy which directs the Risk Management Committee (RMC) to oversee Progress Energy's management of financial risks. The Risk Management Policy states the RMC shall regularly report on activities related to and carried out under the Policy to the Chief Executive Officer (CEO), the Board of Directors and the Finance Committee. The CEO is ultimately responsible for the company's management of risk.
2. The Risk Management Committee Guidelines identify the roles, responsibilities and decision making process of the RMC and its agents.
3. Progress Ventures Risk Management Guidelines provide a methodology to assess, report, and mitigate risk associated with trading and marketing activities and procurement. In addition, there is a product approval process to provide a structure to validate that all significant product risks have been identified and integrated into the risk control structure.
4. Progress Ventures Credit Risk Management Guidelines provide a methodology to evaluate, measure, mitigate, and report credit risk associated with Ventures trading, marketing, and procurement activities.

VI. Processes (Front Office)

FPC's Oil Process Analysis, FPC's Natural Gas Process Analysis, and Progress Fuels' Coal Purchasing Procedures provide the procedures utilized to implement FPC's strategy. "Nucleus" is FPC's natural gas transaction software system utilized to track and verify natural gas transactions and "FMS" (Fuel Management System) is the system utilized to track and verify coal and oil transactions.

VII. Risk Reporting (Middle Office)

Risk control generates reports and distributes to both trading and senior management on a daily basis. This is the primary mechanism to communicate group performance to management, the RMC, and the Board of Directors. The reports include all current positions and updates according to the markets. Market changes include pricing, correlation, volatility, et cetera. In addition, as conditions differ from day-to-day, gas scheduling updates deals with best-available information to correctly reflect how much gas is received and delivered at their respective delivery and receipt points.

A. Risk control manages all of the following activities:

1. Forward Curves - Forward curves provide prices for delivery of products at future dates. Forward curves provide the critical data necessary to calculate mark-to-market, value-at-risk, and stress testing. These curves are generated daily.
2. Market Pricing – Daily prices received from index providers are updated on a daily basis to settle or to mark all positions to the correct market price as of close of business.
3. Mark-to-Market (MTM) - MTM is a methodology utilized to value all physical and financial instruments, including those associated with assets. MTM measures unrealized gains and losses (forward positions) prior to contract settlement by calculating the difference between the transaction price and the forward curve.
4. Stress Testing - Stress testing is used to simulate extreme market conditions (e.g., hurricane), and the results are delivered in the daily reports.

VIII. Controls and Oversight

1. The Risk Management Committee (RMC) – The RMC oversees Progress Energy’s management of financial risks.

Committee Members

- Chief Executive Officer - Progress Energy, Inc. (Optional)
- Chief Financial Officer - Progress Energy, Inc. (Chair)
- President – Progress Energy Service Company, LLC
- President – Energy Supply business unit
- President – Progress Ventures
- Executive Vice President – General Counsel – Progress Energy, Inc.
- Senior Vice President – Finance and Information Technology (*non-voting*) – Progress Energy, Inc.

Committee Members Responsibilities

- Identifies, assesses, and monitors corporate financial risks
- Approves:
 - (i) Risk guidelines for various company activities
 - (ii) New and existing trading, marketing, procurements and hedging products
 - (iii) Analytical methodologies, models and assumptions
 - (iv) Organization structure to ensure adequate segregation of duties
- Reviews:

- (i) Aggregate market and credit capital for approval by the BOD
 - (ii) Summary positions and financial reports
 - (iii) Broad trading, marketing, hedging, and procurement strategies
 - (iv) General business conditions, market and credit risk exposures
 - Presents to the CEO, BOD and Finance Committee:
 - (i) Recommended aggregate market and credit limits and modifications for approval
 - (ii) Summary positions and financial reports
 - (iii) Summary of valuation methods, key controls, limit exceptions and violations
 - (iv) Special studies as requested
 - Creates sub-committees to provide greater attention to risk issues in various company activities
2. Trading, Marketing and Fuels Sub-Committee - The Trading, Marketing and Fuels Subcommittee's objective is to review market and credit risk exposure and business development and proposal opportunities associated with trading, marketing and procurement activities.

Sub-Committee Members

- President – Ventures
- VP – Regulated Commercial Operations
- VP – Ventures Finance
- Manager – Middle Office
- Manager - Risk Management
- Manager – Credit
- Trading and Marketing Managers

Sub-Committee Responsibilities - Reviews, at a minimum:

- Commodity market trends
- Trading, hedging, procurement and marketing strategies
- Aggregate commodity risk exposures
- Market and credit exposure versus defined limits
- New products and services for RMC approval
- Model and model assumptions
- Key operational controls
- Credit exposure versus defined limits
- Pricing methodologies
- Summary exception reports
- Conducts special studies requested by the RMC
- Approves liquidity limits

3. Auditing Department – Audit Services provides independent assurance and consulting services that ensure regulatory compliance, effective corporate governance, operational excellence, and appropriate risk management for all major activities including fuel procurement. Activities are audited based on relative priority rather than a fixed cycle. Within that framework, Audit Services' oversight of fuel procurement risk management activities is addressed from the following perspectives:

- Compliance
- Trading and procurement
- Operational