BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 030001-EI

In the Matter of

FUEL AND PURCHASED POWER COST RECOVERY CLAUSE WITH GENERATING PERFORMANCE INCENTIVE FACTOR.
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VOLUME 3

Pages 398 through 563

PROCEEDINGS:	HEARING
BEFORE:	CHAIRMAN LILA A. JABER COMMISSIONER J. TERRY DEASON COMMISSIONER BRAULIO L. BAEZ COMMISSIONER RUDOLPH BRADLEY COMMISSIONER CHARLES M. DAVIDSON
DATE:	Wednesday, November 12, 2003
TIME:	Commenced at 9:30 a.m. Adjourned at 5:34 p.m.
PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	JANE FAUROT, RPR Chief, Office of Hearing Reporter Services FPSC Division of Commission Clerk and Administrative Services (850) 413-6732
APPEARANCES:	(As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

NUMBER:		ID.	ADMTD.
21	E-mail, 9/27/02, Shelnut to Scott and Sheffield	423	444
22	TECO Total Energy Supply O&M Expense	445	445
23	JP-1 through JP-4 and Schedules	449	561

PROCEEDINGS

(Transcript continues in sequence from Volume 2.)

CHAIRMAN JABER: Let's get back on the record. We'll let you finish your cross-examination before we take up the motion that's pending.

MR. VANDIVER: Thank you, Madam Chairman.

WILLIAM T. WHALE

continues his testimony under oath from Volume 2:

CONTINUED CROSS EXAMINATION

BY MR. VANDIVER:

Q Back on the record, Mr. Whale. Mr. Whale, I just wanted to summarize the cyclone issue, if we could, before we leave it. And going back to Exhibit Number 15, in August 2002, you had the estimate prepared, the Gannon 1 through 4 could be prepared for a 18-month run for $4 million, is that correct?

A That's correct. That repair is a patch and go repair.

Q Yes, sir. And then in February 2003, you decided to close 1 through 4 in 2003, is that correct?

A One through 4 in 2003, yes.

Q And then on the 3rd of March, you prepared or had prepared the MJM-6 charts that had the 53 million estimate of 85 percent reliability, is that correct?

A Which one is that again?

Q It says energy supply Gannon Station at the top. It is MJM-6.

A That's correct.

Q Okay. And that 85 percent reliability comes at a cost of 53 million, and that evolved into the 57 million figure?

A Correct.

Q Okay. And the second chart showed that to be 36 million for a 60 percent reliability figure?

A Correct.

Q And that is our EAF number?

A Correct. EAF.

Q EAF; yes, sir. At this time I would like to have you take a look at MJM-3, sir. I believe this is a 34-page document, is that correct?

A Correct.

Q And this, in fact, is a presentation that you gave to the Tampa Electric officers on August 26th, 2002, is that correct?

A Correct.

Q And if we could go to Page 17 of MJM-34 (sic). That is entitled changes in consequences, correct?

A Correct.

Q What did you mean when you said changes in consequences here?

A This would be the changes that would occur with a Gannon Unit 1 and 2 shutdown with a Bayside startup, and a Gannon Unit 3 and 4 shutdown September 1.

Q What does accelerated shutdown mean?

A It was moving the shutdown date to an earlier time.

Q An earlier time from what would have been previously planned?

A There were several dates in '04 that were initially contemplated, and this is moving it up to an earlier time.

Q Let's go back to MJM-1, briefly, sir.

A I have located it.

Q Okay. Is that, in fact, what you had budgeted for the shutdown?

A This was in -- MJM-1 is from myself to Karen Sheffield, subject base plan. We were initially starting the budget process and we had to budget off some kind of plan. It is not uncharacteristic that we establish a plan and change that plan through the year. And we had to start the budget process, so this was like the strawman I dictated to run off, build a plan based on this.

Q Could you point me to any other budget documents?

A There is a lot of budget documents. Can you clarify the question.

Q Yes, sir. This is the only budget document I have been able to find that states your original plan.

A Again, it was just a strawman to start the process with. There is, I consider, a lot of documents, budget documents.

Q Okay. If we could go back to 17 of 34, then, sir.

MR. BEASLEY: I'm sorry, what are you referring to?

MR. VANDIVER: I'm back to 17 of 34 on MJM-3, Mr. Beasley.

BY MR. VANDIVER:

Q Are you back with me, Mr. Whale?

A Yes, I am.

Q Okay. And what consequences were you discussing here?

A Changes in consequences. As far as consequences, there would be a reduction in 11.2 million if we ran the station and 16 million for 2004; 11.2 million for 2003, 16 in 2004.

Q And what were the contemplated shutdown dates of Units 1 and 2, and 3 and 4 under this plan?

A This changes was probably the original base plan which I had indicated to Karen Sheffield.

Q So that would have been March 15th for 1 and 2, and September 1 for 3 and 4?

A Correct.

Q Okay. And so you discussed the savings that could be achieved as a result of the accelerated shutdown with the officers, is that correct?

A These weren't really savings. This was basically the difference between if we were running with all units as far as Gannon, Bayside, Polk, and all the stations versus if the station was shut down.

Q But the chart says savings, does it not?

A It says savings, but that was under the pretense that we had the money. This was a budget presentation, and that was just identifying the delta with the unit shut down.

Q Okay. If we could go to Page 21 of 34, please, sir. Now, this is the consequences side of the changes in consequences, is it not?

A It says changes in consequences, Gannon accelerated shutdown consequences.

Q Yes, sir. Did you tell the officers that the accelerated shutdown of Gannon would result in higher purchased power costs?

A This presentation was a large presentation, the bulk of it was educating the officers as to where we spend our money, how those resources are spent.

Q Mr. Whale, could you just answer me with a yes or no, please, sir?

A I was identifying areas that needed to be highlighted to my peers, because those are areas that are not in my particular area.

Q Was higher purchased power cost identified as something the consumers would have to pay as a result of the accelerated shutdown?

A I did not know that at that time, I just identified it as something that we ought to investigate.

Q So did you see it as a consequence of shutting down the Gannon units early?

A I viewed it as something that needed to be investigated as far as options. I don't know for a fact whether it would or wouldn't at the time, but I thought it was something to highlight to my peers that handled those particular areas.

Q And did you also tell them it would have an impact on wholesale sales?

A I identified it as a potential because those megawatts would not be available.

Q And is that because when you shutdown Gannon earlier than originally planned you would have to go into the wholesale market to replace generating capacity again?

A No, I viewed it as because of the Bayside units coming on and the Gannon units, that there might be additional power available to sell, and if it was shutdown it would not be available to sell.

Q Now, in our deposition held on November 4th, I asked you if you had any subsequent discussions with Tampa Electric officers regarding shutting down Gannon 1 through 4 in 2003.

A Correct.

Q And I'm not sure whether your answer was yes or no. Did you, in fact, discuss this again with the officers of Tampa Electric?

A As far as in the deposition I was talking about discussions, I highlighted this. There were scenarios to look at, but that wasn't my area to look at the purchased power requirements. My area was to look at operationally what was required, so I didn't have any major discussions on purchased power.

Q Okay. Do you recall in your first deposition you and I had an extended discussion about the September 9th meeting with the officers, and if we could go to -- I believe it is MJM-4, please, sir. And this is a confidential document, so I'm not going to ask you to reveal any details. And I'll try to be careful, too, because this isn't my best thing, sir.

A Sure.

Q Now, specifically I want to take a look at -- I want to ask you first, was there a meeting on December 9th of the Tampa Electric officers?

A December 9th? No.

Q September 9th, 2002.

A Yes.

Q Okay. And this was of the top management of Tampa

Electric Company, was it not?

A It was the officers of Tampa Electric, yes.

Q Yes, sir. And those initials over on the left hand side of the margin identify the officers responsible for those discussion items, do they not?

A Correct.

Q And that WTW is, in fact, your discussion item, is it not?

A Yes.

Q And if we could just briefly turn to one more confidential item, and that is WJM-5. MJM-5, that is the next one over. And in Mr. Barringer's (phonetic) deposition I think we established that the notes there, the handwritten notes on the right-hand side of the page, in fact, correspond to the five scenarios.

MR. BEASLEY: Are you referring to MJM-5?

MR. VANDIVER: Yes, I am.

BY MR. VANDIVER:

Q And Mr. Barringer, in fact -- we established in Mr. Barringer's deposition that the first couple of lines there -- and I'm trying to not reveal any confidential information.

A Sure.

Q The first couple of items there discuss the early closure of the units in question, do they not, sir?

A The first two lines.

Q Yes, sir. Under WTW.

A They discuss items to achieve an O&M, and then they also talk about evaluating moving 3 and 4 to some different dates.

Q Yes, sir. And, in fact, if we look on MJM-5 -- and, again, we established in Mr. Barringer's notes or Mr. Barringer's deposition that the notes were from MJM-5, that same sheet of paper. And, in fact, Scenario 5 is the closest scenario to what actually happened, isn't it? And I can direct you to another sheet, if necessary, to establish that.

A You will have to do that.

Q Okay, sir. If we could go to MJM-2.

COMMISSIONER DEASON: Mr. Vandiver?

MR. VANDIVER: Yes, sir.

COMMISSIONER DEASON: We are at a loss up here. We don't really know what you are talking about because we don't have these confidential exhibits. Do you have a red folder --

MR. VANDIVER: Oh, you don't have it?

COMMISSIONER DEASON: Do you have any in red folders that we could look at while you are conducting --

MR. VANDIVER: I apologize, Commissioner. I assumed that you all had copies of the confidential testimony.

COMMISSIONER DEASON: I don't. And maybe other Commissioners do.

CHAIRMAN JABER: No, we don't automatically get the confidential documents.

MR. VANDIVER: Well, you would be at a loss then, because I assumed that the Commissioners had the confidential testimony.

CHAIRMAN JABER: No. That is why in the order on procedure in the prehearing order we let the parties know that if you intended to use confidential information you need to let us know seven days before or pass it out. Do you have copies available?

MR. VANDIVER: No, we don't. I assumed -- and, again, this is my ignorance, because I thought it was like the old days where you all had copies of testimony.

CHAIRMAN JABER: There is only one person here in the old days, and that was you.

COMMISSIONER DEASON: Mr. Keating is not that old.

MR. KEATING: I'm getting there, though.

CHAIRMAN JABER: Mr. Vandiver, do you have copies? If we take a break, do you want to make copies? I get the impression that the point you are trying to make is critical, so --

MR. VANDIVER: It is just four pages.

CHAIRMAN JABER: Can you move on to another round of questions?

MR. VANDIVER: This is the end of our cross-examination of Mr. Whale.

CHAIRMAN JABER: Okay. Then do you have any objection to us moving forward and then coming back.

MR. VANDIVER: Not at all.

CHAIRMAN JABER: Mr. Beasley, do you have any objection that we go on to the next counsel, and we allow Public Counsel to make the appropriate copies and we will come back to Mr. Vandiver's cross.

MR. BEASLEY: That's fine.

CHAIRMAN JABER: Ms. Kaufman, do you have questions?

MS. KAUFMAN: Yes. Thank you, Madam Chair. Are you ready, Mr. Whale?

THE WITNESS: Yes, I am.

MS. KAUFMAN: Okay, great.

CROSS EXAMINATION

BY MS. KAUFMAN:

Q I'm Vicki Gordon Kaufman. I'm here on behalf of the Florida Industrial Power Users Group, and I think we met over the phone, at any rate, at your deposition last week. Mr. Whale, just to kind of look at the situation from a high level, the Gannon Units 1 through 4 that were shut down burned coal, correct?

A Correct.

Q And the EPA issued a notice of violation in regard to these units in 1999, and basically they said that in their view TECO had begun major modifications of the units without the appropriate permits, correct?

A We have never agreed to that.

Q No, I'm just saying that that is what the EPA alleged, correct? I'm not asking whether you agreed or not.

A I really didn't read the document. I wasn't in the job at that time.

Q But would you accept, subject to check -- the documents are attached to Ms. Brown's testimony -- that at least the agencies responsible for this environmental area suggested that Tampa Electric had started modifications without the appropriate permits?

MR. BEASLEY: I think he has indicated he has not -- if I heard him right, he hasn't read those documents. And if Ms. Brown wants to make a point about them, she is free to do so.

BY MS. KAUFMAN:

Q Do you have a copy of Ms. Brown's testimony, Mr. Whale?

A No, I do not.

Q Let me see if I can get you an extra, because I am going to need my copy.

MR. McWHIRTER: Would you all like him to have the confidential information?

CHAIRMAN JABER: Mr. McWhirter, I need you to speak into the microphone.

MR. McWHIRTER: I was inquiring of counsel if it was all right for Mr. Whale to have confidential information.

MR. BEASLEY: If it's ours, it is.

BY MS. KAUFMAN:

Q Mr. Whale, I have just handed you a copy of Ms. Brown's testimony. Take a look at SLB-5, Page 1 of 55. And if you would just read that first paragraph to yourself.

A Okay.

Q And my question was simply isn't it true that the EPA had alleged that in 1999 Tampa Electric began modifications of the Gannon units without the appropriate permits?

A Maybe I have the wrong page. I was reading SLB-5, 54, under termination.

Q It's SLB-5, Page 1 of 55, entitled consent decree.

A I'm sorry, I read the wrong page.

Q That's okay. Maybe that's why you looked confused. I can understand that.

A Okay, I've read it.

Q Do you need me to repeat the question again?

A Yes, I do.

CHAIRMAN JABER: I do, Ms. Kaufman.

MS. KAUFMAN: I'm sorry.

BY MS. KAUFMAN:

Q Isn't it true that the EPA alleged that in 1999 Tampa Electric commenced construction of major modifications of major emitting facilities in violation of certain environmental acts?

A According to this document, they filed a complaint on November 3rd, 1999, alleging that the defendant, Tampa Electric, commenced construction of major modifications of major emitting facilities in violation of the PSD requirements of Part C of the Clean Air Act.

Q Okay. And as a result of this complaint, and also one that I believe that the Florida Environmental Agency filed, Tampa Electric entered into a settlement with these two agencies, correct?

A Correct.

Q And the settlement required that the Gannon Units 1 through 4 cease operation no later than December 31st, 2004, correct?

A On or before December 31st.

Q Now, as I understand your testimony, and you have discussed this with Mr. Vandiver, though the settlement did not require the units to be shut down until December 31st, 2004, the units were aging, you had reliability concerns, you had safety concerns, you thought significant amounts of money would have to be expended to keep the units running and, therefore, you made -- you or Tampa Electric made the decision to shut the units down prior to December 31, 2004?

A Correct.

Q And I think you discussed with Mr. Vandiver that 1 and 2 were shut down April '03; and 3 and 4 were shut down October '03?

A Correct.

Q Now, when you filed your direct testimony on December 15th, if you would look at Page 16, Line 6, you testified, and you discussed with Mr. Vandiver that in your opinion it would cost about $57 million to keep the Units 1 through 4 operating through the end of 2004?

A Correct.

Q And as I understand your testimony, and also you have an exhibit attached to your rebuttal, don't you, in which you detail the activities that would have had to occur for the units to keep operating?

A Correct.

Q And that is how you calculate your $57 million number?

A Correct.

Q And you also say on Page 16, beginning at Line 22, it actually could have cost more than 57 million, because there might have been some additional costs related to outages, unplanned outages, correct?

A Correct.

Q Now, since the units were shut down in April and October, we would be correct in assuming that this $57 million was not spent on the activities that would have kept the units running through 2004.

A That's an incorrect assumption. The 57 million was never budgeted. That was never a budgeted item. The 53 and 57 were in response to questions of how we could -- you know, what would be involved in expenditures to try to get the units up to a higher availability. The 53 and 57 was never a budgeted amount that was there to be saved.

Q You didn't spend 57 million or 53 million on the Gannon units, did you?

A No.

Q Mr. Whale, would you agree with me that generally O&M expenses are recovered through a utility's base rates?

A I'm not an expert on rates. I know what the O&M is. I don't -- as far as how it flows, that is not my area of expertise.

Q Do you know how O&M expenses are recovered?

A No, I do not.

Q Would you agree with me that what we are doing in this proceeding is determining how fuel expenses will be recovered?

A This is a fuel and purchased power proceeding, so I do understand that. But as far as power plant O&M, how it affects the rate, that is not my area of knowledge.

Q Do you understand that in this proceeding that we are involved in today that the Commission will approve amounts related to fuel and purchased power that will be recovered through the fuel clause as opposed to through base rates?

A Yes, I understand that.

Q So the amounts that Tampa Electric is seeking related to the fuel clause in this case, whether they be related to the Gannon shutdown or other issues, will be recovered directly from the ratepayers through the fuel clause, correct?

A Correct.

Q Mr. Whale, would it be fair to say that TECO Energy has had a couple of rough years financially?

A I mean, I think it is public knowledge that TECO Energy has had some difficulties financially. I guess public record.

Q And you are aware, are you not, that TECO Energy has had several negative downgrades of their bonds?

A Yes, I'm aware of that.

Q Is it your understanding as a Tampa Electric employee that Tampa Electric tries to support TECO Energy in its efforts to improve its financial situation and viability?

A The Tampa Electric -- we really in our discussions on budget and everything, TECO Energy people are not there. So, you know, we have our budget that we work with. How that interplays into TECO Energy is not -- that is not my knowledge or area, too.

Q Right. I don't think that was the question, either.

So let me see if I can ask it again.

A Okay.

Q Really -- well, first of all, what is your position with Tampa Electric?

A Vice-president of Operations for Energy Supply of Tampa Electric.

Q Do you think in your position, and the employees for whom you work, do you think that they try to support TECO Energy in its efforts to improve its financial situation?

A Trying to support Tampa Electric goals which, in turn, I would think would support -- it's a business, and so all businesses are trying to support each other as far as the needs.

Q Is that a yes?

A Yes. I mean, if the question is does a business want to be profitable, yes.

Q And the Tampa Electric employees do all that they can to support TECO Energy in that effort, is that fair?

A I think all the employees of TECO Energy are trying to do what they can to improve the business. I think any business employees are trying to do what they can for their business.

Q I totally agree with you. Mr. Vandiver asked you some questions about MJM-3, so I think we are going to turn back to that. And my questions don't involve any confidential pages, so I think we will be all right.

A I'm sorry, MJM-3?

Q Right. And I think Mr. Vandiver already established with you, and correct me if I'm wrong, that these 34 pages consist of essentially a PowerPoint presentation that you made to the officers of Tampa Electric, correct?

A Yes, that is correct.

Q And these slides and the content of the slides were prepared by you or under your supervision and direction?

A Yes, that is correct.

Q And their content was approved by you?

A Yes.

Q And in preparing these slides, correct me if I'm wrong, but part of what you were trying to accomplish in this presentation was to present to the officers of Tampa Electric various options and consequences of various budgetary decisions?

A The bulk of this slide presentation was to educate the officers as to how the resources with energy supply are spent. That is why the bulk of this is talking about a past year, to explain to them how the resources are spent because our budget is so large. And then we did touch on the '03/'04, and touched on several other things. The bulk of it is an educational purpose.

Q I think you might have discussed this slide with Mr.

Vandiver, but it's one of our favorites, so if you would turn to -- this is MJM-3, it is Page 21 of 34.

A I've got it.

Q And this slide, correct me if I'm wrong, is intended to let the officers know, in your view, what some of the consequences would be of the accelerated shutdown of the Gannon units, right?

A Correct.

Q And you may have discussed this with Mr. Vandiver, but one of the consequences that you recognize in the slides you prepared were higher purchased power costs, correct?

A It is something I thought we ought to look at, yes.

Q I'm sorry, I didn't hear?

A It was something that I was highlighting, I didn't know for a fact, but I thought it was something that we needed to investigate.

Q It certainly rose to a level of concern that you felt it appropriate to include it on your slide, correct?

A Again, it was areas that I thought -- again, they are not my areas, but I was trying to guess to make sure the peers, we all understood or at least would look at it and highlight it to my peers.

Q That your peers understood that one of the consequences of the accelerated shutdown could be higher purchased power costs for the ratepayers?

A It was something to be looked at, yes.
Q And we discussed this a little earlier, but those are some of the costs we are talking about recovering today in this proceeding, correct?
A Correct.
Q Now, if you will turn back to Page 16 of MJM-3, we are still talking about changes in consequences of the Gannon accelerated shutdown, correct?
A Correct.
Q And one thing you were pointing out to your peers here was that the shutdown would help to achieve the 2003 and 2004 plug, correct?
A Correct.
Q Which I take that to mean would help reduce expenses, correct?
A No, it was the difference -- this was an initial part of the budget process, and so we had the first rack-up. The station racks up everything they would expect, and that creates a number. And then there was a numbers as far as what expectations were, and that created plug, a delta. There was no indication that the initial rack-up is what was going to be funded in the first place. I have never had a budget where the initial rack-up is what you got. And so that was what the plug, the delta was.
Q But this was to illustrate, if I'm understanding your

slide, that part of the consequences of the shutdown, early shutdown would to be help achieve this plug. That's what the slide says, doesn't it?

A It helped allocate the money to the other stations, yes, and addressed the plug.

Q I have got a document, Mr. Whale, that I'm going to distribute.

MS. KAUFMAN: Madam Chairman, if I could have a number for this exhibit, please.

CHAIRMAN JABER: Let me just take a look at it first. Ms. Kaufman, counsel doesn't have a copy, so I'm not going to identify it until counsel has a copy.

MS. KAUFMAN: I'm sorry, we are going to ask if we could maybe have one back from the staff.

CHAIRMAN JABER: You know, let me tell you something, I do this with the industry, I've got to do it on this side, too. You need to read the orders on procedure, you need to read your prehearing order. It says bring enough copies, put confidential documents in red folders. You are hereby admonished.

MS. KAUFMAN: Yes, ma'am. I apologize.

CHAIRMAN JABER: It holds up the hearings, it is not very -- well, I will leave it at that, Ms. Kaufman. Thank you, I accept your apology.

MS. KAUFMAN: I apologize, Chairman.

CHAIRMAN JABER: We are going to take a ten-minute break. You are going to make enough copies for any exhibits that you have and intend to pass out, because I will not inconvenience staff. I'm not going to inconvenience this Commission, and you make sure this doesn't happen again.

MS. KAUFMAN: Yes, ma'am.

CHAIRMAN JABER: Ten minutes.

(Recess.)

CHAIRMAN JABER: Let's get back on the record. You had an exhibit that you wanted identified. It looks like it is an e-mail dated September 27th, '02, from Charles Shelnut to Darryl Scott and Karen Sheffield?

MS. KAUFMAN: Yes, ma'am.

CHAIRMAN JABER: You provided copies to all the parties, the Commissioners, and staff?

MS. KAUFMAN: I have.

CHAIRMAN JABER: And that document will be identified as Exhibit Number 21.

MS. KAUFMAN: Thank you, Madam Chair.

(Exhibit 21 marked for identification.)

BY MS. KAUFMAN:

Q Mr. Whale, you have a copy of the document?

A Yes, I do.

Q And as the Chairman indicated, this is a September 27th, 2002 memo from Mr. Shelnut to Mr. Scott and Ms.

Sheffield. Who is Mr. Shelnut?

A Charles Shelnut was part of the Bayside project team and was working on both the Bayside team, but also working on the O&M side for myself.

Q And you received a copy of this memo, correct?

A Yes, I did.

Q If you would turn to the second page, which is Bates stamped 408 on my copy. Essentially, as I understand this memo or this chart, it's detailing the various employee positions at Big Bend, Gannon, Bayside, and then it has a total column, correct?

A Correct.

Q And I want to look with you for a moment at the middle column, that is the employees at Gannon, correct?

A Correct.

Q For various time periods. If you would look with me at the column that is September '02, and am I correct that at that time there were 176 folks at Gannon?

A Yes. TECO folks.

Q Yes. This doesn't include contractors. This is TECO employees.

A Right.

Q And then in September '03, after the shutdowns or right before the shutdowns, there were 16 Tampa Electric employees left at Gannon, correct?

A According to the sheet, right.

Q Now, at Bayside in September '03, there were 42 employees, correct?

A These were projections, again. It is projecting 42.

Q Well, at the time this was prepared I guess we could assume, could we not, that this was Mr. Shelnut's best estimate of how many Tampa Electric employees would be at Bayside?

A Correct.

Q So my math isn't very good, but quite a few -- well, 176 minus 42 is the net loss, if you will, of employees that no longer worked at Gannon, correct?

A At Gannon, but those employees were still within the Tampa Electric system. Big Bend went up as far as the numbers of it went up, and then we had other folks go in other departments also.

Q We would other folks what, excuse me?

A Other folks we were looking at moving to other departments within Tampa Electric.

Q I'm sorry. But certainly the majority of the folks that no longer worked at Gannon did not go to Bayside, correct?

A They did not go to Bayside, correct.

Q And I just have one final line for you, Mr. Whale, if you will bear with me. You said earlier that you weren't familiar with how costs were recovered, how that related to base rates, and so I'm not going to pursue that with you any further. But I wanted to just give you a hypothetical and see if you could give us your opinion about it. And what I would like you to assume is that -- well, this part is part of your testimony. You have told us to keep the Gannon units running through 2004 would cost about $57 million, correct?

A Correct.

Q Now, if the units were shut down and fuel had to be procured from elsewhere and it cost about $110 million, what would be the prudent decision, would it be to spend 110 million, or would it be to spend the 57?

A I think a lot of factors go into that. That is a hypothetical that has got a lot of factors to it.

Q Can you envision a hypothetical where it would be prudent to spend 110 rather than 57 to accomplish the same thing?

A Again, you have taken two different numbers. The 57, that is not the total cost of running a unit. You are not talking about the cost for the replacement time to take the outages. The 57 is purely the cost to fix the units. There is a lot of other costs that are associated that are not quantifiable or identifiable. So I don't have those figures to say hypothetically whether it would or wouldn't be the right thing to do. In looking at it, you are saying, you know, what were the safety issues, those issues that came into play, the reliability issues, a lot of factors come into play to make the proper decision.

Q Would it ever be reasonable in your opinion to spend 110 million when you could spend 57, that's the question?

A Again --

Q You can't answer that?

A No, I'm not going to answer that.

MS. KAUFMAN: Thank you. That's all I have, Madam Chairman.

CHAIRMAN JABER: Thank you, Ms. Kaufman. Mr. Vandiver, are you ready to come back to your questions?

MR. VANDIVER: Yes, I am.

CONTINUED CROSS EXAMINATION

BY MR. VANDIVER:

Q Mr. Whale, we are back to MJM-4 and MJM-5, sir.

CHAIRMAN JABER: Mr. Vandiver, you have passed out two pages of what look like Confidential Exhibit MJM-4 and MJM-5. I would just caution you, the witness, and the Commissioners to remember these are confidential pages. And if you could make sure you pick up all the copies when you are done.

MR. VANDIVER: Yes, I will. Thank you, Commissioner. And I don't wish to verbalize anything in the specific numbers, and I will attempt to do that in my questions to Mr. Whale.

CHAIRMAN JABER: Thank you.

BY MR. VANDIVER:

Q Mr. Whale, this is a meeting that the officers held of Tampa Electric Company on September 9th, 2002, is that correct?

A Correct.

Q And the initials going down the left-hand side of the page are discussion items that each particular officer had responsibility for, is that correct?

A Correct.

Q And WTW are your initials, are they not, sir?

A Correct.

Q And under energy supply, the first two issues are concerned with this hearing, are they not? Do you see where it says --

A They are associated with the Gannon 1 through 4 shutdown.

Q Very well, sir. And is that amount shown on the first line we are discussing more or less the year 2002 budget?

A For energy supply, yes.

Q Was it more or less, sir?

A That was the budget for energy supply.

Q Oh, that was the budget for energy supply. Okay. And as I look at these items, and I look down here, it looks like, just eyeballing this thing, it looks like this was a meeting to cut the budget of Tampa Electric. Is that a fair assessment of these items?

A No, that is not correct. These were a list of items to look at, action items for a business plan as we are looking forward to the year. So there are a lot of lists of action items that are on there. Prepare for zero-based budgeting discussion is not cut the budget. Identify items to be leased or bought. There are several items on there -- it was business plan items.

Q Okay. Now, looking again at MJM-5. I believe we established in Mr. Barringer's deposition that the handwritten notes on the right-hand side of the page were, in fact, notes from this sheet MJM-5. And down there on the bottom of MJM-5 you see that column that says net savings, the bottom line on MJM-5?

A Yes, I see net savings.

Q Okay. And there at the top where it says total clause impact, is that the fuel clause, sir?

A I don't know that for a fact. I don't know.

Q What do you believe it to be?

A It says total clause impact, so I would have to take it that that is what the sheet says, so that is what I would have to assume the number is.

Q Do you believe that to be the fuel and purchased power clause that we are presently sitting in?

A It has fuel and purchased power on the top line, coal contracts, dead freight, so I assume that is the fuel and purchased power.

Q All right, sir. Is it correct that you made -- now, this is just about two weeks after your presentation to the officers that we were discussing earlier, is that correct?

A Correct.

Q It was August 26th. Did you have any further discussions, or do you recall any further discussions of the Tampa Electric management concerning the early shutdown of Gannon as a group?

A After the presentation there were several discussions, several scenarios ran on it. You know, one, what could we do to get the availability up? What were those concerns? And so there was multiple discussions that occurred on it.

Q With the Tampa Bay officers as a group, sir?

A I can't remember if it was all that exact number or whether there were specific ones, but there were other groups of other officers, peers talking about it.

Q Okay. And do you remember when those meetings were?

A No, we had several.

Q Okay. Do you recall what the average customer bill impact number meant there on MJM-5?

A No, I do not.

MR. VANDIVER: That's all the questions I have, Mr. Whale. Thank you.

CHAIRMAN JABER: Thank you, Mr. Vandiver.

MR. VANDIVER: I will collect those.

CHAIRMAN JABER: When we're done.

MR. VANDIVER: When you're done.

CHAIRMAN JABER: Staff.

MR. KEATING: Staff has no questions.

CHAIRMAN JABER: Commissioners?

Mr. Whale, I just have one. With regard to MJM-5, let me be clear. You prepared this chart?

THE WITNESS: No, I did not.

CHAIRMAN JABER: Tell me what you perceive the purpose of MJM-5 is.

THE WITNESS: MJM-5, I think, was looking at multiple scenarios as far as the shutdown. Multiple, looking at different ones. You know, different dates, what worked best.

CHAIRMAN JABER: Mr. Beasley, I have a question. I don't want to violate the confidentiality of this document. Are the numbers -- it's the numbers that are confidential, not the topics indicated on the left-hand side, is that correct?

MR. BEASLEY: You're referring to MJM-5?

CHAIRMAN JABER: Yes.

MR. BEASLEY: I don't think the headings would be confidential, so it would be the numbers.

CHAIRMAN JABER: Okay. Recognizing, Mr. Whale, that the -- what, Mr. Vandiver?

MR. VANDIVER: I was going to say that one of the numbers appears in Ms. Jordon's testimony, for whatever that's worth.

MR. BEASLEY: If it appears in a nonconfidential way, you are certainly free to refer to it.

MR. VANDIVER: Yes.

CHAIRMAN JABER: Mr. Whale, my question doesn't go to the numbers anyway. I'm just trying to glean what the purpose of this document was. And I'm taken back by your testimony that you don't know what the average customer bill impact means. Was the purpose of this document to understand what the impact of an early shutdown would be on a customer's bill, or was it to determine the net savings to the company, or both, or neither?

THE WITNESS: Again, I didn't prepare the document, Chairman, so I'm not sure. We were looking at several different options as far as how far we could get the units, you know, run, and I think they were looking at various different scenarios and asking me can you get to this point, can you get to this point, can you get to this point, and trying to look at those different scenarios as to where we would be.

CHAIRMAN JABER: And what point is that, a monetary point?

THE WITNESS: No, it was more of could we get 1 and 2 to the -- prior to the summer? Can we get 3 and 4 through the summer? Can you get 1 and 2 through the summer? And saying, no, we need to shut these down at this time. And as they looked at those different scenarios as to what we thought we could do, then people starting analyzing the different scenarios that we were looking at, and analyzing what those impacts were.

CHAIRMAN JABER: Okay. And, finally, who did prepare this document?

THE WITNESS: I'm sorry?

CHAIRMAN JABER: My final question is who did prepare this chart?

THE WITNESS: I don't know.

CHAIRMAN JABER: Mr. Beasley, let me ask you, did the person that prepared this chart, he or she, a witness for you?

MR. BEASLEY: I don't know that myself. I could find out for you if you would like to know that.

CHAIRMAN JABER: Please. And if you have redirect?

MR. BEASLEY: I'm sorry, redirect?

CHAIRMAN JABER: Yes, go ahead.

MR. BEASLEY: Yes, ma'am, I do.

REDIRECT EXAMINATION

BY MR. BEASLEY:

Q Mr. Whale, you were handed a document that has been marked Exhibit 15, which refers to budget needs and cost reductions. Do you have that document in front of you, Mr.

Chuck Hemrich's document?

A Yes, sir, I do.

Q That is the one that Mr. Vandiver handed out. Is it routine for you to discuss budget needs, and cost reductions, and plugs, and targets, and goals in the budgeting process, generally?

A Yes, we do discuss that with the plant manager as far as where we are as a department, and what we are, you know, what we are looking at, and what the different station needs are.

Q Is that common in the budgeting process generally, or was it anything unique to the 2002 period?

A No, it is a normal process.

Q Is the budgeting process an easy endeavor, or is it a difficult task?

A It is a very challenging task. It is a constant give and take as far as what the out of schedule looks like, what the different needs are for the station, if there are different equipment needs that come into play that wasn't expected. And so it was a constant triage to ensure that the highest priority needs are being addressed.

Q So the rack-ups, and the plugs, and the targets, and all of these terms that you refer to, that is something that is normal in the budgeting process over time?

A The normal process.

Q You were also handed what has been marked Exhibit 16 and 19, which are two charts showing the availability percentages of Gannon Station, and I think you indicated that there would be some difference in those percentages if that chart only related to Gannon Units 1 through 4, is that correct?

A That's correct.

Q What would be the impact by having that chart only address Gannon Units 1 through 4?

A Give me a minute here. OPA, I do not have the OPA information with me. Again, EAF and forced outages is what I look at. The EAF for the units when they were in 2000, was in the mid-70s, and in 2002 they were dropping down to the 60s. Again, in 1988 they were in the 80s, except for Gannon 4, which had a planned outage at that time, and that dropped that factor down.

The thing about availability, we also have to look on the EAFs, is that EAF has two components; it has forced outage and planned outage. And what was really getting us on the Gannon 1 through 4 is the forced outage factor. Which when you have a planned outage you know when you are going to shut down and you plan around it. When you have forced outages, that is like driving your car to work and it forces off. That is not a real pleasant time. And the forced outage factors, equivalent forced outage factors for Gannon 1 through 4 in 2000 was in the high teens. It was up into the high 20s.

Q Mr. Whale, you indicated that the safety and reliability of the Gannon Units 1 through 4 were impacted by boiler tube failures, I believe, is that correct?

A There were several drivers of safety at the station. There was boiler tube failures. We had structural steel problem, we had a few people go through the grating. We had gas leaks within the boiler. If it has a crack, the gas which stays inside the boiler escapes into the area. So we had several things that we were concerned about.

Q What happens when a boiler tube fails, if you could tell me?

A Let me show you an example, it would probably be easier. Again, I think it is hard for people to understand what a tube looks like.

MR. BEASLEY: If I could have Mr. May present for the Commissioners a close-up view of some of these boiler tubes so you can get a feel for what we are talking about. I wouldn't try it pick one up.

THE WITNESS: This particular tube that failed is not uncharacteristic of the pressures at Gannon. You're running anywhere from 15 to 2000-psi pressure. The temperature inside there is anywhere from 600 to 700 degrees Fahrenheit, if it has got water in it. If it has got steam, it is up to 1,000 degrees.

When that ruptures, it is a very violent event, because as that steam exits from that pressure into the atmosphere it expands considerably. It would fill this room up very, very quickly. It would displace the oxygen in this room, and those would be for the folks that survive the initial blast if it is an external. And that is why external tube failures are a concern to us.

An internal tube failure that blows into the firebox is contained within the firebox. An external tube failure that blows out expose workers to that, and that is of concern when you have an external tube failure. And Gannon has experienced some external tube failures, and that is a concern.

Q What incidents of boiler tube failures have you experience at Gannon Station in recent years?

A We have had several tube failures at Gannon. In fact, it is listed in the interrogatories as far as the number of tube failures that we listed. And, again, the rate was rapidly changing. In 2000 we had 264 tube failures at Gannon. In 2001 we had 330, and that is when we started going to reduced header operation to buy more safety margin. Again, that is where we start reducing the pressure inside the unit. We start losing some load, but it keeps the reliability up there. In 2002 it jumped to 1,319 tube failures, and in 2003 we had 2,623 tube failures.

When we were shutting down we had multiple areas of the units that had tube failures, and of those there were several that were external. Two that were rather violent. We had ten in the -- since the first of January we had ten external tube failures, two of them were rather large as they show there, but we had ten in total.

Q Well, why didn't you simply just put into your budget to replace all the old boiler tubes at Gannon Station and keep it running through the end of 2004? I think that is an issue here.

A The tubes that are inside the boiler, you have mechanisms to go in and test for them, and you can see where they are thinning. There is miles of tubing in these units. These units are 100 feet tall, 60 feet and 40 feet wide, and about 40 feet deep. And there is miles of tubing. The inside of the boilers, you can inspect them and look at it and get some feel for it. On the external, those tubes are covered by insulation, and it is extremely difficult to understand where the tube failure is occurring because of the fact that you don't know where it is corroding, what the driver is.

New units you don't have that problem, because they have got a lot of life and a lot of strength. But as units age, you introduce a new mechanism that is very, very difficult to detect. And the only way to really do it is to have wholesale changeouts which, again, gets into a large expense that wasn't accounted for there just to try to detect it.

Q Mr. Whale, you were asked about O&M savings, and I think you indicate you are in charge of all the energy supply for your company, is that correct?

A That's correct.

Q To put the alleged O&M savings into perspective, can you tell me what your overall O&M budget for power supply has been, say, from 2000 forward on a budgeted basis?

A In 2000 and forward, the total energy supply budget has been roughly about 100 million. It moves up and down a little bit because of outages. As shown on the presentation I gave the officers, in 2002 we had two major outages, but the following year we don't. So it moves around. But, you know, roughly a million, million and a half, or 100 million and 105 million.

Q Could you tell me what the budgeted O&M totals were, and this is total energy supply O&M expense for the year 2000?

A The year 2000 it was 112,000,385 million.

Q I'm talking budgeted.

A Budgeted, I'm sorry, is 104 million. We actually spent 112,000,385. We overspent that year by 8 million, again, to try to address the units. We have a budget, but if the unit comes down and it needs to be fixed and put back on line, we spend the money. And so we overspent by $8 million in 2000.

Q What did you do in 2001, if you would give me your budget, your actual, and your variance?

A The budget was 107 million and we spent 110 million.
Q How about 2002?
A 2002, we spent 117 million. I'm sorry, we budgeted 117 million, we spent 124 million. Again, that was really 125 million. It was 124.962, so rounded to 125. We spent approximately 8 million over in 2002. Half of it was for Big Bend Station and half of it was for Gannon. We spent approximately $40 million at Gannon Station in 2002, which was one of the highest O&M years since '97/'98 as far as what the chart says. Again, we were spending heavy amounts of O&M trying to address to keep the units running.
Q What have you done thus far in 2003 as far as -- well, first of all, tell me what your 2003 O&M budget is and where you are year-to-date?
A 2003 was 102.429 was our budgeted number. Right now we are forecast to send 110.274 million. Half of that, again, is Big Bend Station, and 3.3 million of it is at Gannon Station.

CHAIRMAN JABER: Mr. Whale, it seems like, historically, you are overspending since the year 2001, if I understood your testimony. At some point I question how you were allocating your expenses and your budget.

THE WITNESS: A lot of times it was driven by particular events that happened in the units. When we open these units up, you try to guess what is in there. You try to do the best guess as to what is in there and solve it, but a lot of times when we open them up, we find things that we need to fix, and when we do --

CHAIRMAN JABER: How long in advance do you prepare your budget?

THE WITNESS: The budget is prepared annually, but the units may run for 12 months, and we may not have had time to go in there and look at. So the engineers are trying to guess pretty far in advance what is going on inside that unit and what the needs are. And a lot of times we open it up, and it may be different than what the engineers thought they were addressing. The other thing is that you might have a forced outage that forced it off. Again, Gannon, we did the best that we could, thinking as far as how it would run. But as the unit was forced off and those things, we had to go in and fix it. We did the best that we could.

CHAIRMAN JABER: Did you have forced outages for every single Gannon unit?

THE WITNESS: Gannon had a lot of forced outages, yes, ma'am. In fact, I will say that the Gannon budget, we had budgeted a million dollars for forced outages. Up to June we had spent 2 million in forced outages, and that was just to get to June. We had overspent by a million dollars just addressing the forced outages at Gannon this year.

BY MR. BEASLEY:

Q What is your budgeted O&M expense for your total energy supply for the year 2004 as you currently see it?

A Right now we're thinking we are going to be somewhere around 96 million. And Bayside is coming on, it is a new unit, the O&M expenses should be lower. The equipment is new, and so we are looking at 96 million.

Q The numbers that you have given us hover around $100 million amount for total energy supply O&M expense with the exception of the year 2002, which I believe you indicated you had two major outages?

A Two large outages, yes.

Q I would like to hand out just for convenience a chart that shows the numbers that Mr. Whale has indicated. Now, Mr. Whale, you have been asked about assumed O&M savings of some $57 million on account of Tampa Electric shutting down Gannon Units 1 through 4 in 2003, is that correct?

A Yes, that's correct.

Q Can you tell me where those savings are reflected and what you have got on this chart, your O&M expense for total energy supply?

A Those were never budgeted.

Q To keep Units 1 through 4 running through the end of 2004, what would you have had to do, what would you have had to spend, what kind of outages would you have had to incur?

A Again, we would have had to have gone into the acquisition phase of acquiring these cyclones and the rear wall tubes that were identified. That would have been a long process in itself identifying it. Then we would have had to slot in the outages, and 49 days is what we ballparked there, and we would have to fit that into the outage schedule as to when is the best time to do that.

Now, how that would move around the Big Bend units, because there is only certain times of the year that we take these units down. During the summer, from April to September, we try not to have any planned outages to address the summer peak that is coming in, and we have got to get all the work done between February and April, and September and November. Really December, we really like to have -- December 15th we like to have all the units back on. So how to fit those in during those time periods when we had the Big Bend units, the Polk units in there, we had to work on that.

Q Mr. Whale, in your budgeting process does your senior management challenge you and your peers to cut costs to the bone, to the extent you can, and still have safe and reliable electric power generation?

A We have been constantly challenged since we have brought on the Polk Power Station, that is Polk 1, Polk 2, Polk 3, it is roughly about 600 megawatts. We are bringing on the Bayside Power Station, and we are bringing those units on avoiding coming in for a rate case. And that is a challenge that we constantly look at your budgets and make sure we are prioritizing those dollars to the best that we can.

Q How many megawatts have you brought on line since your last full revenue requirements case?

A Polk 1 is 315, Polk 2 and 3 are about 150 megawatts apiece, and the Bayside megawatts I have listed previously.

Q Ms. Kaufman had asked you a question or a couple of questions about Bates stamped Page 555, which I think is in Mr. Majoros' -- I hope I am pronouncing his name correctly -- his exhibit. And that has to do with -- I think that was a slide presentation that mentioned higher purchased power costs. Do you know if Tampa Electric is actually seeking higher purchased power costs in this proceeding as a result of the shutdown scheduled for Gannon Units 1 through 4 that your company ultimately arrived at?

A I don't know that for a fact. I just highlighted. I don't know for a fact whether we are or aren't. It is not my area.

MR. BEASLEY: Thank you. That's all the redirect I have.

CHAIRMAN JABER: Without objection, Exhibits 14 through 21 are admitted into the record.

(Exhibits 14 through 21 admitted into the record.)

MR. BEASLEY: Madam Chairman, if I could ask that this document be marked as an exhibit that would be useful.

This is the one that I handed out, the O&M total energy supply expense.

CHAIRMAN JABER: Tampa Electric Company Total Energy Supply O&M expense will be identified as Exhibit 22. And without objection, Exhibit 22 will be admitted into the record.

(Exhibit 22 marked for identification and admitted into the record.)

MR. BEASLEY: And I don't know if you mentioned 14, as well. That was the Exhibit WTW-1 that accompanied Mr. Whale's direct case. Thank you.

CHAIRMAN JABER: I did, I moved -- if not, I intended to move Exhibits 14 through 22 into the record. And, Mr. Whale, you are excused for now. I understand you have rebuttal testimony that will come before us a little bit later. Thank you.

THE WITNESS: Thank you.

MR. BEASLEY: I would like to call Benjamin Smith.

CHAIRMAN JABER: Actually, Mr. Beasley, let me ask -- Mr. McGee, are you ready to come back to Mr. Portuondo?

MR. McGEE: Yes, ma'am, I believe we are.

CHAIRMAN JABER: And, staff, there was a pending motion that you all were -- you were going to inspect an exhibit for me, a document for me and be prepared to recommend on the ruling of the motion.

Mr. Keating, are you ready to do that now?

MR. KEATING: I have looked at it. I could make a presentation on it now. I know that our general counsel has just -- I think just sat down, or left the room to look at that document. You may want to wait for his review and input into the staff recommendation on that.

CHAIRMAN JABER: Okay. Well, let's proceed then with Progress' Witness Portuondo, and we will come back to that motion.

MR. McGEE: Madam Chairman, we would like to ask the Commission's indulgence to present a brief opening statement on the issue of 13E, the waterborne transportation question. We think that has some complexities to it that might benefit from setting the stage. Ms. Davis would like to make that opening statement.

CHAIRMAN JABER: Ms. Davis, tell me exactly what you want to do.

MS. DAVIS: Commissioners, Mr. Portuondo is testifying on several subjects in this docket. And on the issue of 13E having to do with the waterborne transportation costs, we would like to make an opening statement with respect to that particular issue.

CHAIRMAN JABER: For what purpose? Where we last left it, I thought you all were trying to negotiate with the parties on a resolution for that issue. Is this in the spirit of obtaining a resolution, or reporting to the Commission that you have a resolution?

MS. DAVIS: No, ma'am, I think it is just the opposite. I think we were not able to obtain a resolution of the issue, so we are prepared to try it. And to that point, we would like to make an opening statement.

CHAIRMAN JABER: Parties, do you have a response?

MS. KAUFMAN: Chairman Jaber, I think FIPUG would object to that. We had not discussed doing opening statements as to any of the issues.

CHAIRMAN JABER: Mr. Vandiver.

MR. VANDIVER: We haven't talked about it.

CHAIRMAN JABER: Sorry?

MR. VANDIVER: We haven't talked about it.

CHAIRMAN JABER: Ms. Davis, I am going to deny your request. There is a time and place for everything, and that issue, I would note, has been identified for quite some time. You could have taken it up with the prehearing officer. I'm not really sure I understand the nature of your request, but for now it is denied.

Do you want to call Mr. Portuondo up to the stand?

Thereupon,

JAVIER PORTUONDO

was called as a witness for Progress Energy Florida, Incorporated, and after being duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. McGEE:

Q Would you state your name and business address for the record, please.

A Javier Portuondo, 100 Central Avenue, St. Petersburg, Florida.

Q And what is your position?

A I am the Director of Regulatory Services for Florida.

Q Mr. Portuondo, have you caused to be prefiled in this docket true-up testimony on April 11th of this year, actual and estimated testimony on, I believe it was August 10th of this year, and projection testimony on September 12th of this year?

A Yes, I have.

Q Have you also filed supplemental testimony pursuant to the prehearing officer's direction at the prehearing conference?

A Yes, I have.

MR. McGEE: Madam Chairman, Mr. Portuondo has exhibits to the first three sets of those testimony, the true-up testimony, the estimated actual testimony, and the projection testimony. If we might have those marked for identification. If you wanted to do a composite for all of them, that would certainly be satisfactory.

CHAIRMAN JABER: Give me the exhibit numbers, Mr. McGee.

MR. McGEE: Those would be --

CHAIRMAN JABER: I've got JP-1 through JP-4, but I want to confirm that that is what you have, as well.

MR. McGEE: Yes. Actually in the true-up testimony, there are four sets of exhibits, JP-1 through 4. In the projection testimony we have Parts A through F, and Commission Schedules E1 through E10 and H1.

CHAIRMAN JABER: Say that again. You have Parts A through F, Schedules E1 through --

MR. McGEE: E1 through E10, and H1. And the one that I omitted was the middle of those three, the estimated actual testimony. The exhibits consist of Parts A through D and Schedules A1 through A9 for the month of July '03 period to date.

CHAIRMAN JABER: We will reflect that all of those exhibits will be identified as Composite Exhibit 23. There weren't any other exhibits, right?

(Composite Exhibit 23 marked for identification.)

MR. McGEE: That's correct, there were no other exhibits.

CHAIRMAN JABER: Now, walk me through the testimony. I have prefiled direct testimony filed April 1st, I have testimony filed August 11th, testimony filed September 12th, and testimony filed November 3rd.

MR. McGEE: That's correct. The first one was filed

April 11th. Actually if you have April 1st, I'm not sure my post-it note is correct, and I would be happy to take your date.

CHAIRMAN JABER: Okay. Let the record reflect that the testimony filed April 1st, August 11th, September 12th, and November 3rd shall be inserted into the record as though read.

MR. McGEE: Thank you.

PROGRESS ENERGY FLORIDA

DOCKET NO. 030001-EI

Fuel and Capacity Cost Recovery
Final True-Up for the Period
January through December, 2002

DIRECT TESTIMONY OF JAVIER PORTUONDO

Q. Please state your name and business address.

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

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

A. I am employed by Progress Energy Service Company, LLC, in the capacity of Manager, Regulatory Services – Florida.

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

A. Yes.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe Progress Energy Florida's (Progress Energy or the Company) Fuel Cost Recovery Clause final true-up amount for the period of January through December 2002, and the Company's Capacity Cost Recovery Clause final true-up amount for the same period.

Q. Have you prepared exhibits to your testimony?

A. Yes, I have prepared and attached to my testimony as Exhibit No. ___ (JP-1) a three-page true-up variance analysis which examines the difference between the estimated fuel true-up and the actual period-end fuel true-up. Attached to my testimony as Exhibit No. ___ (JP-2) are the Capacity Cost Recovery Clause true-up calculations for the January through December 2002 period. Exhibit No. ___ (JP-3) presents the revenues and expenses associated with the purchase of the Tiger Bay facility approved in Docket 970096-EQ and the corresponding amortization. In addition, I will sponsor the applicable Schedules A1 through A9 for the period-to-date through December 2002, which have been previously filed with the Commission and are also attached to my testimony for ease of reference as Exhibit No. ___ (JP-4).

Q. What is the source of the data that you will present by way of testimony or exhibits in this proceeding?

A. Unless otherwise indicated, the actual data is taken from the books and records of the Company. The books and records are kept in the regular course of business in accordance with generally accepted accounting principles and practices, and provisions of the Uniform System of Accounts as prescribed by this Commission.

FUEL COST RECOVERY

Q. What is the Company's jurisdictional ending balance as of December 31, 2002 for fuel cost recovery?

A. The actual ending balance as of December 31, 2002 for true-up purposes is an under-recovery of $31,685,712.

Q. How does this amount compare to the Company's estimated 2002 ending balance included in the Company's projections for the calendar year 2002?

A. An estimated over-recovery of $34,585,760 was included in the 2002 projections and is being refunded to customers through Progress Energy's currently effective fuel cost recovery factor. When this ending balance is compared to the actual year-end under-recovery balance of $31,685,712, the final true-up attributable to the twelve-month period ended December 31, 2002 is an under-recovery of $66,271,472.

Q. How was the final true-up ending balance determined?

A. The amount was determined in the manner set forth on Schedule A2 of the Commission's standard forms previously submitted by the Company on a monthly basis.

Q. What factors contributed to the period-ending jurisdictional under-recovery of $31,685,712 as shown on your Exhibit No. __ (JP-1)?

A. The factors contributing to the under-recovery are summarized on Sheet 1 of 3. A decrease in the fuel cost factor effective 4/29/02 due to a mid-course correction combined with lower jurisdictional KWH sales due to a weaker than projected economy resulted in jurisdictional fuel revenues falling below the forecast by $34.4 million. The $2.6 million favorable variance in jurisdictional fuel and purchased power expense was primarily attributable to lower system net generation cost offset by higher than projected net purchased power prices.

When the differences in jurisdictional revenues and jurisdictional fuel expenses are combined, the net result is an under-recovery of $31.8 million related to the January through December 2002 true-up period. Another factor not directly related to the period is an interest provision of $.1 million. This results in an actual ending under-recovery balance of $31.7 million as of December 31, 2002.

Q. Please explain the components shown on Exhibit No. __ (JP-1), Sheet 2 of 3 which produced the $2.9 million favorable system variance from the projected cost of fuel and net purchased power transactions.

A. Sheet 2 of 3 shows an analysis of the system variance for each energy source in terms of three interrelated components; (1) changes in the amount (MWH's) of energy required; (2) changes in the heat rate, or efficiency, of generated energy (BTU's per KWH); and (3) changes in the unit price of either fuel consumed for generation ($ per million BTU) or energy purchases and sales (cents per KWH).

Q. What effect did these components have on the system fuel and net power variance for the true-up period?

A. As can be seen from Sheet 2 of 3, variances in the amount of MWH requirements from each energy source (column B) combined to produce a cost increase of $16.7 million. I will discuss this component of the variance analysis in greater detail below.

The heat rate variance for each source of generated energy (column C) reflected a favorable variance of $16.1 million. This variance was primarily the result of improved efficiency from gas peaking unit operations.

A cost decrease of $3.4 million resulted from the price variance (column D), which was caused by a number of sources detailed on lines 1 through 19 of Sheet 2 of 3, of exhibit (JP-1). While for the year gas decreased $36.2 million and oil increased $10.4 million, the 4th quarter of 2002 showed significant cost increases in both these fuel types. These increases are the result of the colder than expected winter, the energy market's reaction to potential hostilities in the Middle East, and the Venezuelan oil worker's strike.

Q. What were the major contributors to the $16.7 million cost increase associated with the variance in MWH requirements?

A. The primary reason for the unfavorable variance in MWH requirements was the .5 million increase in supplemental KWH sales. The effect that generation mix has on total net system fuel and purchased power cost is another reason for the unfavorable variance in MWH requirements.

Q. Does this period ending true-up balance include any noteworthy adjustments to fuel expense?

A. Yes, Exhibit No. ___ (JP-4) shows other jurisdictional adjustments to fuel expense. Noteworthy adjustments shown in the footnote to line 6b on page

1 of 4, Schedule A2 of this exhibit include recovery of the Company's investment in 11 previously approved combustion turbine gas conversion projects at Intercession City Units P7-10, Debary Units P7-P9, Bartow Units P2 and P4, and Suwannee Units P1 an P3.

Q. Did Progress Energy's customers benefit during the true-up period from its investment in the Gas Conversion projects previously approved by the Commission?

A. Yes. The estimated system fuel savings for the period related to Progress Energy's approved gas conversion projects was $11,737,182. The total system depreciation and return was $1,603,401, resulting in a net system benefit to the Company's customers of $10,133,781. A schedule of depreciation and return by gas conversion unit is included in Exhibit No. ___ (JP-1), Sheet 3 of 3.

Q. Has Progress Energy included any sulfur dioxide emission allowance transactions in fuel expense for the true-up period?

A. Yes, during the true-up period the Company included $8,933,684 of emission allowances in fuel expense.

Q. Were any other adjustments of note included in the current true-up period?

A. Yes. On January 20, 1997, the Company entered an agreement with Tiger Bay Limited Partnership to purchase the Tiger Bay cogeneration facility and terminate the five related purchase power agreements (PPAs). The purchase agreement approved in Docket No. 970096-EQ was executed on July 15, 1997, at which time Tiger Bay became one of Progress Energy's generating facilities. Pursuant with the terms and conditions of the approved stipulation, the Company placed approximately $75 million of the purchase price into rate base, with the remaining amount set up as a regulatory asset for the retail jurisdiction, according to Progress Energy's jurisdictional separation at that time. The stipulation allows the Company to continue collecting revenues from its ratepayer's as if the five related purchase power agreements were still in effect. The revenues collected would then be used to offset all fuel expenses relating to the Tiger Bay facility and interest applicable to the unamortized balance of the retail portion of the Tiger Bay regulatory asset, with any remaining balance used to amortize the regulatory asset.

Following this methodology, a $40.9 million adjustment was made to remove the cost of fuel consumed by the Tiger Bay facility during the true-up period, since these costs were recovered from the PPA revenues. Exhibit No. __ (JP-3) shows a year-end retail balance for the Tiger Bay regulatory asset of $46,601,202, computed in accordance with the approved stipulation.

Q. Has the three-year rolling average gain on economy sales included in the Company's filing for the November, 2002 hearings been updated to incorporate actual data for all of year 2002?

A. Yes. Progress Energy has calculated its three-year rolling average gain on economy sales, based entirely on actual data for calendar years 2000 through 2002, as follows.

Year	Actual Gain
2000	$ 8,939,098
2001	10,283,714
2002	5,628,586
Three-Year Average	$ 8,283,799

Q. Order No. PSC-02-1484-FOF-EI, issued in Docket No. 011605-EI, requires each utility to include in the final true-up each year all base year and recovery year operating and maintenance expenses associated with financial and physical hedging activities. What were the base year and recovery year O&M expenses associated with hedging?

A. There were no base year or recovery year O&M expenses associated with financial and physical hedging. No financial hedging activities took place in the Company's base year (projected 2002) nor the recovery year (true-up 2002), and while Progress Energy was actively hedging physically, there were no transaction costs associated with any of the physical hedging activities that occurred in either period. Future incremental hedging costs will include net new personnel assigned to physical and financial hedging as well as new hedging computer systems and transaction costs.

CAPACITY COST RECOVERY

Q. What is the Company's jurisdictional ending balance as of December 31, 2002 for capacity cost recovery?

A. The actual ending balance as of December 31, 2002 for true-up purposes is an under-recovery of $4,408,138.

Q. How does this amount compare to the estimated 2002 ending balance included in the Company's projections for calendar year 2003?

A. When the estimated under-recovery of $8,906,021 to be collected during the calendar year 2003 is compared to the $4,408,138 actual under-recovery, the final net true-up attributable to the twelve-month period ended December 2002 is an over-recovery of $4,497,883.

Q. Is this true-up calculation consistent with the true-up methodology used for the other cost recovery clauses?

A. Yes. The calculation of the final net true-up amount follows the procedures established by the Commission, as set forth on Schedule A2, "Calculation of True-Up and Interest Provision" for fuel cost recovery.

Q. What factors contributed to the actual period-end under-recovery of $4.4 million?

A. Exhibit No. ___ (JP-2), sheet 1 of 3, entitled "Capacity Cost Recovery Clause Summary of Actual True-Up Amount," compares actual results to the original forecast for the period. As can be seen from sheet 1, the actual jurisdictional revenues were $8.9 million lower than forecasted revenues due to reduced customer usage. The $4.7 million reduction in net capacity expenses was the result of a combination of factors including a reduction in the base level jurisdictional allocation factor, the failure of a cogenerator to meet its contractual obligation, the elimination of the Sebring base rate credit and the inclusion of incremental security costs. An interest provision of $.2 million also contributed to the under-recovery.

Q. Were there any items of note included in the current true-up period?

A. Yes. In Order No. PSC-02-1761-FOF-EI, issued in Docket No. 020001-EI, the Commission addressed the recovery of incremental security costs through the capacity cost recovery clause. Exhibit No. __ (JP-2) includes incremental security costs of $4,831,124 (system).

Q. Does this conclude your direct testimony?

A. Yes.

PROGRESS ENERGY FLORIDA

DOCKET NO. 030001-EI

Fuel and Capacity Cost Recovery
Estimated/Actual True-Up Amounts
January through December 2003

DIRECT TESTIMONY OF
JAVIER PORTUONDO

Q. Please state your name and business address.

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

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

A. I am employed by Progress Energy Service Company, LLC, in the capacity of Director, Regulatory Services - Florida.

Q. Have your duties and responsibilities remained the same since your testimony was last filed in this docket?

A. Yes.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present for Commission approval Progress Energy Florida's (Progress Energy or the Company) estimated/actual fuel and capacity cost recovery true-up amounts for the period of January through December 2003.

Q. Do you have an exhibit to your testimony?

A. Yes. I have prepared an exhibit attached to my prepared testimony consisting of Parts A through D and Commission Schedules E1 through E9 for the month of July 2003 (period to date), which contain the calculation of the Company's true-up balances and the supporting data. Parts A through C contain the assumptions which support the Company's reprojection of fuel costs for the months of August through December 2003. Part D contains the Company's reprojected capacity cost recovery true-up balance and supporting data.

FUEL COST RECOVERY

Q. How was the estimated true-up under-recovery of $210,426,260 shown on Schedule E1-B, Sheet 1, line 20, developed?

A. The estimated true-up calculation begins with the actual balance of ($158,705,476), taken from Schedule A2, page 3 of 4, for the month of July 2003. This balance was projected to the end of December 2003, including interest estimated at the July ending rate of 0.085% per month. The development of the actual/estimated true-up amount for the period ending December 2003 is shown on Schedule E1-B.

Q. What are the primary reasons for the projected December-ending 2003 under-recovery of $210.4 million?

A. At the time Progress Energy prepared the projections used in its February 18, 2003 mid-course correction filing, oil and gas prices, which had risen sharply compared to the original projection, were projected to stabilize at above normal levels for the remainder of the year. While oil prices have remained in line with the mid-course projection, the price of natural gas has continued to rise and is forecasted to remain higher than that projection. This higher natural gas price is the primary reason for the projected $210.4 million under-recovery. Also contributing to the under-recovery is a $37.8 million carryover from 2002 that was included in the approved mid-course correction.

Q. Does Progress Energy expect to exceed the three-year rolling average gain on Other Power Sales?

A. Yes, Progress Energy estimates the total gain on non-separated sales during 2003 will be $8,805,497, which exceeds the three-year rolling average for such sales of $8,283,799 by $521,698. The sharing mechanism approved by the Commission in Docket No. 991779-EI allocates 80% of this difference ($417,358) to customers, for a total customer benefit of $8,701,157, and 20% of the difference ($104,340) to shareholders.

Q. Were any other adjustments of note included in the current true-up period?

A. Yes. On January 20, 1997, the Company entered an agreement with Tiger Bay Limited Partnership to purchase the Tiger Bay cogeneration facility and terminate the five related purchase power agreements (PPAs). The purchase agreement approved in Docket No. 970096-EQ was executed on July 15, 1997, at which time Tiger Bay became one of Progress Energy's generating facilities. Pursuant with the terms and conditions of the approved stipulation, the Company placed approximately $75 million of the purchase price into rate base, with the remaining amount set up as a regulatory asset for the retail jurisdiction, according to Progress Energy's jurisdictional separation at that time. The stipulation allows the Company to continue collecting revenues from its ratepayer's as if the five related PPAs were still in effect. The revenues collected were then be used to offset all fuel expenses relating to the Tiger Bay facility and interest applicable to the unamortized balance of the retail portion of the Tiger Bay regulatory asset, with any remaining revenues used to amortize the regulatory asset. The retail balance of the regulatory asset is projected to be fully amortized by the end of October 2003. Beginning in November 2003, the Company is projecting to discontinue collecting revenues based on the PPAs and instead will recover only the fuel expense associated with the Tiger Bay generating facility.

Q. How does the current fuel price forecast compare with the forecast used in the Company's February 2003 mid-course correction filing?

A. Forecasted prices for coal on average increased $2.48 per ton, or 4.6% from the mid-course filing. Residual (heavy or No. 6) oil increased an average of $0.78 per barrel, or 3.0%, while distillate (light or No. 2) oil decreased an average of $0.84 per barrel, or 2.3%. The natural gas forecast rose $1.27 per MMBTU on average, or 23.8%. According to the Energy Information Administration, the low level of underground storage is the principal reason for the higher natural gas prices.

Q. What is the source of the Company's fuel price forecast?

A. The Company's fuel price forecast was based on forecast assumptions for residual oil, distillate oil, natural gas, and coal shown in Part B of my exhibit. The forecasted prices for each fuel type are shown in Part C.

CAPACITY COST RECOVERY

Q. How was the estimated true-up over-recovery of $3,309,148 shown on Part D, Line 29, developed?

A. The estimated true-up calculation begins with the actual balance of ($7,240,277) for the month of July 2003. This balance was projected to the end of December 2003, including interest estimated at the July-ending rate of 0.085% per month.

Q. What are the major changes between the February 2003 mid-course filing and the actual/estimated reprojection?

A. The variance between the mid-course filing and actual/estimated true-up balance at year-end 2003 is an over-recovery of $3.3 million. The variance is primarily attributable to a $2.4 million increase in revenue due to an increase in projected retail sales, combined with $0.9 million decrease in capacity expenses mainly due to lower projected incremental security costs.

Q. Does this conclude your estimated/actual true-up testimony?

A. Yes.

PROGRESS ENERGY FLORIDA

DOCKET NO. 030001-EI

Levelized Fuel and Capacity Cost Recovery Factors
January through December 2004

DIRECT TESTIMONY OF
JAVIER PORTUONDO

Q. Please state your name and business address.

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

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

A. I am employed by Progress Energy Service Company, LLC, in the capacity of Director, Regulatory Services - Florida.

Q. Have your duties and responsibilities remained the same since your testimony was last filed in this docket?

A. Yes.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present for Commission approval the levelized fuel and capacity cost factors of Progress Energy Florida (Progress Energy or the Company) for the period of January through December 2004. In addition, I will address Staff preliminary Issue 13D regarding the Company's market price proxy for waterborne coal transportation, including a detailed discussion of the circumstances that led to the Commission's adoption of the market proxy mechanism. I will then address Staff Issues 13A, 13B and 13C regarding ongoing Commission practices for the treatment of certain costs related to Progress Fuels Corporation, Issue 13E regarding Progress Energy's purchase of synthetic coal in 2002, and a new matter of which Staff has recently advised the Company regarding the treatment of Progress Fuel's FOB Barge coal purchases in 2002. Finally, I will address an issue raised by the Company in an attempt to resolve any uncertainty that may exists regarding the appropriate baseline O&M expenses to be used in determining recoverable incremental costs in this proceeding.

Q. Do you have an exhibit to your testimony?

A. Yes. I have prepared an exhibit attached to my prepared testimony consisting of Parts A through F and the Commission's minimum filing requirements for these proceedings, Schedules E1 through E10 and H1, which contain the Company's levelized fuel cost factors and the supporting data. Parts A through C contain the assumptions which support the Company's cost projections, Part D contains the Company's capacity cost recovery factors and supporting data, Part E contains the calculation of recoverable depreciation expense and return on capital associated with Progress Energy's new Hines Unit 2 in accordance with the rate case stipulation and settlement approved by the Commission in April 2002, and

Part F contains a graphic depiction of the Company's incremental cost evaluation process.

FUEL COST RECOVERY

Q. Please describe the levelized fuel cost factors calculated by the Company for the upcoming projection period.

A. Schedule E1, page 1 of the "E" Schedules in my exhibit, shows the calculation of the Company's basic fuel cost factor of 3.453 ¢/kWh (before metering voltage adjustments). The basic factor consists of a fuel cost for the projection period of 2.90246 ¢/kWh (adjusted for jurisdictional losses), a GPIF reward of 0.00714 ¢/kWh, and an estimated prior period true-up of 0.54052 ¢/kWh.

Utilizing this basic factor, Schedule E1-D shows the calculation and supporting data for the Company's final levelized fuel cost factors for service received at secondary, primary, and transmission metering voltage levels. To perform this calculation, effective jurisdictional sales at the secondary level are calculated by applying 1% and 2% metering reduction factors to primary and transmission sales, respectively (forecasted at meter level). This is consistent with the methodology used in the development of the capacity cost recovery factors. The final fuel cost factor for residential service is 3.458 ¢/kWh.

Schedule E1-E develops the Time Of Use (TOU) multipliers of 1.310 On-peak and 0.865 Off-peak. The multipliers are then applied to the levelized fuel cost factors for each metering voltage level, which results in the final TOU fuel factors for application to customer bills during the projection period.

Q. What is the change in the fuel factor for the projection period from the fuel factor currently in effect?

A. The projected average fuel factor for 2004 of 3.453 ¢/kWh is an increase of 0.717 ¢/kWh, or 26.2%, from the 2003 midcourse fuel factor of 2.736 ¢/kWh.

Q. Please explain the reasons for the increase.

A. The increase is primarily driven by the recovery of the projected 2003 true-up balance of $210.4 million. Also contributing to the higher fuel factor is an increase in the projected fuel cost of oil and natural gas, as well as a slight increase due to recovery of actual energy costs, since the regulatory asset associated with the 1997 buyout of the Tiger Bay purchase power agreements (PPAs) has been fully amortized. In 2004, Tiger Bay will be treated as a company owned generating facility rather than a contractual cogenerator. Partially offsetting this increase is a reduction in coal prices and higher nuclear generation due to no refueling outage scheduled for 2004.

Q. What is included in Schedule E1, line 4, "Adjustments to Fuel Cost"?

A. Line 4 shows the recovery of the costs associated with conversion of combustion turbine units to burn natural gas instead of distillate oil ($124,000), the annual payment to the Department of Energy for the decommissioning and decontamination of their enrichment facilities ($1,743,831), and the recovery of the depreciation and return associated with Hines Unit 2 ($42,589,716). These fuel cost adjustments total $44,457,547.

Q. Is the cost of purchasing emission allowances still included in Schedule E1, line 4, "Adjustments to Fuel Cost"?

A. No. Beginning in 2004, the cost of emission allowances will be recovered through the Environmental Cost Recovery Clause (ECRC). Order No. PSC-95-0450-FOF-EI in Docket No. 950001-EI allowed emission allowances to be recovered through the Fuel and Purchased Power Cost Recovery Clause if a utility was not participating in an ECRC. Progress Energy began utilizing the ECRC on January 1, 2003 and received Commission approval to move emission allowances to that clause in 2004.

Q. What is included in Schedule E1, line 6, "Energy Cost of Purchased Power"?

A. Line 6 includes energy costs for the purchase of 60 MWs from Tampa Electric Company and the purchase of 414 MWs under a Unit Power Sales (UPS) agreement with the Southern Company. The capacity payments associated with the UPS contract are based on the original contract of 400 MWs. The additional 14 MWs are the result of revised SERC ratings for the five units involved in the unit power purchase, providing a benefit to Progress Energy in the form of reduced costs per kW. Both of these contracts have been approved for cost recovery by the Commission. The capacity costs associated with these purchases are included in the capacity cost recovery factor.

Q. What is included in Schedule E1, line 8, "Energy Cost of Economy Purchases"?

A. Line 8 consists primarily of economy purchases from within or outside the state. Line 8 also includes energy costs for purchases from Seminole Electric Cooperative, Inc. (SECI) for load following, and off-peak hydroelectric purchases from the Southeast Electric Power Agency (SEPA). The SECI contract is an ongoing contract under which the Company purchases energy from SECI at 95% of its avoided fuel cost. Purchases from SEPA are on an as-available basis. There are no capacity payments associated with either of these purchases. Other purchases may have non-fuel charges, but since such purchases are made only if the total cost of the purchase is lower than the Company's cost to generate the energy, it is appropriate to recover the associated non-fuel costs through the fuel adjustment clause rather than the capacity cost recovery clause. Such non-fuel charges, if any, are reported on line 10.

Q. How was the Gain on Other Power Sales, shown on Schedule E-1, Line 15a, developed?

A. Progress Energy estimates the total gain on non-separated sales during 2004 to be $4,584,880, which is below the three-year rolling average for such sales of $8,239,266 by $3,654,386. Based on the sharing mechanism approved by the Commission in Docket No. 991779-EI, the total gain will be distributed to customers.

Q. How was Progress Energy's three-year rolling average gain on economy sales determined?

A. The three-year rolling average of $8,239,266 is based on calendar years 2001 through 2003, and was calculated in accordance with Order No. PSC-00-1744-PAA-EI, issued September 26, 2000 in Docket 991779-EI.

Q. Why has the depreciation expense and return on capital associated with Hines Unit 2 been included in the Adjustments to Fuel Cost entry you described earlier?

A. The stipulation approved by the Commission in April 2002 for Progress Energy's base rate review proceeding (Docket No. 000824-EI) provides that the Company will be allowed the opportunity to recover the depreciation expenses and return on capital for its new Hines Unit 2 through the fuel clause beginning with the unit's commercial operation through the end of 2005, subject to the limitation that the costs of Hines Unit 2 recovered over this period may not exceed the cumulative fuel savings provided by the unit over the same period. Because Hines Unit 2 is scheduled to begin commercial operation in December 2003, these two cost components of the unit for 2004 have been included in the projection period for recovery in accordance with the stipulation. Part E of my exhibit shows the calculation of the depreciation expense and return on capital associated with Hines Unit 2.

Q. Please explain the entry on Schedule E1, line 17, "Fuel Cost of Stratified Sales."

A. Progress Energy has several wholesale contracts with Seminole, some of which represent Seminole's own firm resources, and others that provide for the sale of supplemental energy to supply the portion of their load in excess of Seminole's own resources, 1528 MW in 2004. The fuel costs charged to Seminole for supplemental sales are calculated on a "stratified" basis, in a manner which recovers the higher cost of intermediate/peaking generation used to provide the energy. New contracts for fixed amounts of intermediate and peaking capacity began in January of 2000. While those sales are not necessarily priced at average cost, Progress Energy is crediting average fuel cost of the appropriate stratification (intermediate or peaking) in accordance with Order No. PSC-97-0262-FOF-EI. The fuel costs of wholesale sales are normally included in the total cost of fuel and net power transactions used to calculate the average system cost per kWh for fuel adjustment purposes. However, since the fuel costs of the stratified sales are not recovered on an average system cost basis, an adjustment has been made to remove these costs and the related kWh sales from the fuel adjustment calculation in the same manner that interchange sales are removed from the calculation. This adjustment is necessary to avoid an over-recovery by the Company which would result from the treatment of these fuel costs on an average system cost basis in this proceeding, while actually recovering the costs from these customers on a higher, stratified cost basis.

Line 17 also includes the fuel cost of sales made to the City of Tallahassee in accordance with Order No. PSC-99-1741-PAA-EI. The stratified sales shown on Schedule E6 include 100,140 MWh, of which 93% is priced at average nuclear fuel cost, the balance at an estimated incremental cost of $25 per MWh. Other transactions included on Line 17 are the 50 MW sale to Florida Power & Light and a 15 MW sale to the City of Homestead.

Q. Please explain the procedure for forecasting the unit cost of nuclear fuel.

A. The cost per million BTU of the nuclear fuel which will be in the reactor during the projection period (Cycle 14) was developed from the unamortized investment cost of the fuel in the reactor. Cycle 14 consists of several "batches" of fuel assemblies which are separately accounted for throughout their life in several fuel cycles. The cost for each batch is determined from the actual cost incurred by the Company, which is audited and reviewed by the Commission's field auditors. The expected available energy from each batch over its life is developed from an evaluation of various fuel management schemes and estimated fuel cycle lengths. From this information, a cost per unit of energy (cents per million BTU) is calculated for each batch. However, since the rate of energy consumption is not uniform among the individual fuel assemblies and batches within the reactor core, an estimate of consumption within each batch must be made to properly weigh the batch unit costs in calculating a composite unit cost for the overall fuel cycle.

Q. How was the rate of energy consumption for each batch within Cycle 14 estimated for the upcoming projection period?

A. The consumption rate of each batch has been estimated by utilizing a core physics computer program which simulates reactor operations over the projection period. When this consumption pattern is applied to the individual batch costs, the resultant composite cost of Cycle 14 is $.35 per million BTU.

Q. Please give a brief overview of the procedure used in developing the projected fuel cost data from which the Company's basic fuel cost recovery factor was calculated.

A. The process begins with the fuel price forecast and the system sales forecast. These forecasts are input into the Company's production cost model, PROSYM, along with purchased power information, generating unit operating characteristics, maintenance schedules, and other pertinent data. PROSYM then computes system fuel consumption, replacement fuel costs, and energy purchases and costs. This information is the basis for the calculation of the Company's levelized fuel cost factors and supporting schedules.

Q. What is the source of the system sales forecast?

A. The system sales forecast is made by the forecasting section of the Financial Planning & Regulatory Services Department using the most recent data available. The forecast used for this projection period was prepared in June 2003.

Q. Is the methodology used to produce the sales forecast for this projection period the same as previously used by the Company in these proceedings?

A. Yes. The methodology employed to produce the forecast for the projection period is the same as used in the Company's most recent filings, and was developed with an econometric forecasting model. The forecast assumptions are shown in Part A of my exhibit.

Q. What is the source of the Company's fuel price forecast?

A. The fuel price forecast was made by the Regulated Commercial Operations Department based on forecast assumptions for residual (#6) oil, distillate (#2) oil, natural gas, and coal. The assumptions for the projection period are shown in Part B of my exhibit. The forecasted prices for each fuel type are shown in Part C.

CAPACITY COST RECOVERY

Q. How was the Capacity Cost Recovery factor developed?

A. The calculation of the capacity cost recovery (CCR) factor is shown in Part D of my exhibit. The factor allocates capacity costs to rate classes in the same manner that they would be allocated if they were recovered in base rates. A brief explanation of the schedules in the exhibit follows.

<u>Sheet 1: Projected Capacity Payments.</u> This schedule contains system capacity payments for UPS, TECO and QF purchases. The retail portion of the capacity payments is calculated using separation factors from

the Company's most recent Jurisdictional Separation Study available at the time this filing was prepared.

Sheet 2: Estimated/Actual True-Up. This schedule presents the actual ending true-up balance as of July, 2003 and re-forecasts the over/(under) recovery balances for the next five months to obtain an ending balance for the current period. This estimated/actual balance of $3,309,148 is then carried forward to Sheet 1, to be refunded during the January through December, 2004 period.

Sheet 3: Development of Jurisdictional Loss Multipliers. The same delivery efficiencies and loss multipliers presented on Schedule E1-F.

Sheet 4: Calculation of 12 CP and Annual Average Demand. The calculation of average 12 CP and annual average demand is based on 2003 load research data and the delivery efficiencies on Sheet 3.

Sheet 5: Calculation of Capacity Cost Recovery Factors. The total demand allocators in column (7) are computed by adding 12/13 of the 12 CP demand allocators to 1/13 of the annual average demand allocators. The CCR factor for each secondary delivery rate class in cents per kWh is the product of total jurisdictional capacity costs (including revenue taxes) from Sheet 1, times the class demand allocation factor, divided by projected effective sales at the secondary level. The CCR factor for primary and transmission rate classes reflects the application of metering reduction factors of 1% and 2% from the secondary CCR factor.

Q. Please explain the decrease in the CCR factor for the projection period compared to the CCR factor currently in effect.

A. The projected average retail CCR factor of 0.77482 ¢/kWh is 13.6% lower than the 2003 mid-course factor of 0.89702 ¢/kWh. The decrease is primarily due to the elimination of the capacity payments associated with the buyout of the Tiger Bay PPAs, since the regulatory asset has been fully amortized. Partially offsetting this decrease is the annual contractual escalation in capacity payments.

Q. Has Progress Energy included incremental security charges in the 2004 projected capacity amount?

A. Yes. The Company has included $4,644,108 related to incremental security charges for 2004.

Q. What additional internal and/or external security initiatives have taken place or are anticipated to take place that will impact Progress Energy's request for recovery through the Capacity Cost Recovery Clause in 2004?

A. On April 29, 2003, the U.S. Nuclear Regulatory Commission (NRC) issued three orders intended to strengthen protection requirements for nuclear reactors (Design Basis Threat or DBT), limit working hours for security personnel, and improve training for guards. Licensees must submit revised DBT plans to the Commission for review and approval by April 29, 2004 and implement by October 29, 2004. Progress Energy is currently assessing this risk. The Company is also assessing the impact of limiting guard working hours and enhancing training. Licensees must start implementation immediately and must complete by October 29, 2004. The estimated cost of these NRC requirements is included in the total recoverable amount above. The NRC has also increased its annual license fee partly to cover the costs of making plants safe from terror attacks.

In addition to the NRC orders, the Coast Guard, Department of Homeland Security (DHS) issued on July 1, 2003 a series of interim rules to promulgate maritime security requirements mandated by the Maritime Transportation Security Act of 2002. The six interim rules consist of: Implementation of National Maritime Security Initiatives, Area Maritime Security, Vessel Security, Facility Security, Outer Continental Shelf Facility Security, and Automatic Identification System. The final rule is expected to be issued before November 25, 2003. The rule is expected to impact the following sites: Bartow Plant, Anclote Plant, Crystal River Complex, Higgins Plant, and Bayboro Station. These sites are expected to require such things as additional security officers, additional gates, and closed circuit television (CCTV) systems. The timing of this rule's issuance has not allowed Progress Energy enough time to thoroughly quantify the financial impact of its implementation. Therefore we have not included an estimate of the implementation cost but rather will include the actual cost incurred as part of the Company's Actual True-up filing. The costs will be accounted for in accordance with Order PSC-02-1761-FOF-EI, which states on page 10 that:

> "(B)ecause of the extraordinary nature of the costs in question and the unique circumstances under which they arose, we find that these costs do not clearly fall within the classification of 'items which traditionally and historically would be recovered through base rates'."

. . . Because these costs are extraordinary, these costs shall be treated as current year expenses. Further, we require that these expenses be separately accounted to enhance our staff's ability to audit them."

WATERBORNE COAL TRANSPORTATION

Q. Before addressing Staff Issue 13D regarding Progress Energy's market price proxy, please describe the background of waterborne coal transportation to the Company's Crystal River plant site and its regulation by the Commission?

A. The origin of the current arrangement for waterborne transportation of coal to the Crystal River plant site took place in 1976. At that time the Company, then Florida Power Corporation (FPC), had two units at the Crystal River site that had been previously converted from coal to oil and were then in the process of being converted back to coal. These units, Crystal River 1 and 2, had a combined capacity of approximately 750 MW and would require about 2 million tons of coal annually. At the same time, FPC was in the design and pre-construction stages of two new coal-fired units, Crystal River 4 and 5, with a combined capacity of approximately 1,450 MW and annual coal requirements of nearly 4 million tons per year.

Faced with the need to arrange for the procurement and delivery of up to 6 million tons of coal a year starting almost from scratch, the Company elected a strategy aimed at securing a greater degree of control over the costs and reliability of its long-term coal supply and transportation needs than it could obtain as simply a purchaser of these services subject to the vagaries of an uncertain market. Under this strategy, the Company would acquire business expertise and ownership leverage through capital investment in partnerships with organizations experienced in the various segments of the coal supply and transportation business, particularly those segments lacking a competitive market. However, it would have been problematic for FPC to engage in such a business venture itself due to serious legal and tax impediments associated with multi-state operations and asset ownership and other key aspects of the strategy's business plan.

As a result, Electric Fuels Corporation (EFC), the predecessor of Progress Fuels Corporation (PFC), was formed in March 1976 as a wholly-owned subsidiary of FPC to carry out this long-term strategy for supplying the coal requirements of the Crystal River plant site.

Q. How did EFC implement this strategy with respect to waterborne coal transportation?

A. The most critical implementation issues were the absence of competitive markets in two key segments of the waterborne transportation route; (1) the storage and transloading of coal from river barges to Gulf barges at the mouth of the Mississippi River, and (2) the trans-Gulf transportation of coal to the Crystal River plant site. Neither segment had facilities with sufficient capacity to handle the approximately 2 million tons of waterborne coal annually that EFC needed to deliver to the Crystal River site (the requirements of the site remaining after maximum rail deliveries). This meant that a long-term commitment would have to be made for the construction of additional facilities to increase tonnage capacity in both segments. EFC chose to make that commitment through an ownership interest in the facilities, rather than entering into long-term contracts with third-party owners of the new facilities.

With respect to the river-to-Gulf transloading segment, EFC acquired a one-third ownership interest with two other experienced partners in International Marine Terminals (IMT), which began the construction of a new transloading and storage terminal on the Mississippi River approximately 60 miles south of New Orleans. In a similar vein, EFC acquired a 65% ownership interest in a partnership with Dixie Carriers, an experienced operator of ocean-going carrier vessels, for the transportation of coal to the Crystal River plant site. Since no carrier vessels capable of navigating the site's shallow, narrow channel were available, specially designed ocean-going tug-barge units had to be constructed by the partnership, Dixie Fuels Limited (DFL).

In addition to its investment in these two major undertakings, EFC also acquired ownership interests in several smaller upriver terminals, where coal delivered from the mines is loaded onto river barges. Due to the limited availability of upriver terminal capacity, these investments allowed EFC to obtain priority at existing terminals and to develop additional capacity by constructing new terminals. Since sufficient capacity existed at the time in the upriver mine-to-river (or "short-haul") transportation segment and the river barge transportation segment, EFC contracted with third-party suppliers of those services.

Q. What was the regulatory response of the Commission to the coal procurement and transportation responsibilities the Company placed with EFC?

A. As I indicated earlier, but for the legal and tax consequences it faced in 1976 (and still faces), the Company could have implemented its coal procurement and transportation strategy itself, through an internal operating division or department. Functionally, however, EFC served in much the same capacity and was indirectly regulated by the Commission in a similar manner. I use the term "indirectly regulated" because even though the Commission had no regulatory authority over EFC itself, the Commission had more than ample authority over the coal procurement and transportation costs the Company was allowed to recover through its fuel clause. And since FPC chose to pursue its strategy through an affiliate solely for business considerations, it supported the Commission's treatment of EFC in a utility-like manner.

Under this regulatory treatment, FPC was allowed to recover EFC's prudently incurred costs to procure and deliver coal to the Company, including a utility rate of return on its capital investment IMT and DFL. In return, any profits EFC earned from these investments would be returned to the Company and credited to the cost of coal charged to its customers. For example, because of its ownership interest in DFL, EFC receives 65% of DFL's profits. However, under the Commission's regulatory treatment, EFC would also earn a rate of return on its capital investment in DFL. Therefore, EFC would credit its DFL profits dollar-for-dollar against the cost of coal charged to the Company and, ultimately, its customers.

Q. How did this regulatory treatment of EFC work over time?

A. Initially, quite well. By 1986, however, several concerns about the continued use of this regulatory treatment, then referred to as "cost-plus" pricing, led the Commission to initiate an investigation into the matter (Docket No. 860001-EI-G). The investigation continued for nearly three years and included several hearings covering various aspects of EFC's operation. The following quotation from the Commission's final order concluding the investigation, although somewhat lengthy, best summarizes its findings and policy determinations, and also sets the stage for the currently pending issue regarding PFC's waterborne transportation market proxy mechanism:

> "[W]e believe and find that a change from cost-plus pricing is warranted. While we believe that the current system has been generally successful in allowing only reasonable and prudent cost to be passed through the utilities' fuel adjustment clauses, we believe that it has been administratively costly, caused unnecessary regulatory tension, and left the lingering suspicion that it has resulted in higher costs to the utility's customers. Implicit in cost-plus pricing is the requirement that one is capable of conducting a cost-of-service analysis of a business to determine that its expenses are both necessary and reasonable. This is a methodology that is demanded for monopoly utility services, and which usually proves to be complex, expensive and time consuming. It is a methodology which requires a high degree of familiarity with the capital requirements and expenses necessitated by the operation of the business being reviewed. Cost-

of-service analysis of affiliated operations places additional demands upon the regulatory agency in terms of time, expense and acquiring additional expertise. All come at some additional cost that must eventually be borne by the ratepayer, either in his role as customer or as a taxpayer. Furthermore, there seems to be no end to the types of affiliate business that we are expected to become sufficiently familiar with so that we might judge that reasonableness of their cost on a cost-of-services basis.

"Considering the many advantages offered by a market pricing system, we, as a policy matter, shall require its adoption for all affiliate fuel transactions for which a comparable market price may be found or constructed.

"In concluding, we note the following: (1) from the record in this case, we are convinced that market prices can be established for the affiliate coal; (2) market prices for the transportation-related services should be established if possible, but if not, methodologies for reasonably allocating the cost should be suggested; [and] (3) cost-of-service methodologies should be avoided, if possible; ... ." (Order No. 20604, issued January 13, 1989 in Docket No. 860001-EI-G.)

Q. With respect to the Commission's finding that "market prices for the transportation-related services should be established if possible," was a market price for EFC's waterborne transportation service eventually established pursuant to this finding?

A. In a strict sense, no. Unlike the situation with coal purchased by EFC from an affiliated supplier for which a market pricing mechanism was approved, the Commission recognized that comparable prices could not be found for some of the waterborne transportation services purchased by EFC from affiliates. In fact, this is the very reason EFC purchased these services from affiliates. As I described earlier, a market for river-to-Gulf transloading services and trans-Gulf transportation services to the Crystal River plant site did not exist at the time EFC was formed. That remained the situation when Order No. 20604 was issued, as it does today. This is particularly problematic with respect to the trans-Gulf transportation services provided by DFL's tug-barge units, which had to be custom made because of the unique and hazardous channel to the Crystal River plant site. There simply are no other vessels with the capacity to meet the waterborne coal requirements of the site that are capable of safely traversing the site's shallow, narrow channel.

Nonetheless, it was clear to the Company that the Commission expected an alternative to cost-plus pricing for EFC's waterborne transportation, even if a true market pricing mechanism could not be established. To this end, the Company began a series of negotiations with Staff, Public Counsel and FIPUG which ultimately led to the development of a pricing mechanism that the parties considered to be a reasonable alternative, or proxy, for a true market pricing mechanism. This alternative, referred to as a "market price proxy", was presented to the Commission at the August 1993 fuel adjustment hearing as a stipulated issue and was approved by Order No. PSC-93-1331-FOF-EI, issued September 13, 1993 in Docket No. 930001-EI.

Q. **Please describe the market price proxy approved by the Commission?**

The market price proxy became effective as of January 1993, and consists of a base price and a composite index used to escalate or de-escalate the base price annually. The base price of $23.00 per ton was derived from EFC's actual 1992 costs incurred for waterborne transportation services in delivering coal to the Crystal River plant site. The base price would then be adjusted as of January 1st each subsequent year using a composite index that consists of five individually weighted indices commonly used to adjust contract prices in the transportation services business. The total weighting of these indices is set at 90%, with 10% of the base price remaining fixed. In addition, the market proxy price may be adjusted for increases or decreases in EFC's waterborne transportation costs which result from governmental impositions on its transportation suppliers not in effect as of December 31, 1992.

Established and adjusted in this manner, the market proxy price is then paid to EFC in lieu of any payment for the costs it incurs to obtain waterborne transportation services in any of the five waterborne transportation segments; *i.e.*, short haul transportation to the upriver terminal, upriver storage and loading onto river barges, river barge transportation, storage and transloading from river barges to Gulf barges, and trans-Gulf transportation to the Crystal River plant site. In addition, EFC will no longer receive a return on its investment in IMT or DFL. In other words, compared to the price it will be paid under the market proxy mechanism, EFC will receive the benefit of any cost reductions it can achieve in providing waterborne transportation services to the Company, and it will incur the risk of any cost increases beyond its control, including the risk of catastrophic loss such as the loss of a DFL vessel at sea.

Q. With that background, please address Staff Issue 13D: Should the Commission modify or eliminate the method for calculating Progress Energy Florida's market price proxy for waterborne coal transportation that was established in Order No. PSC-93-1331-FOF-EI, issued September 13, 1993, in Docket No. 930001-EI?

A. I am not aware of any reason put forward by Staff or a party regarding a flaw or deficiency in the market proxy mechanism or a change of circumstances since the mechanism was approved by the Commission that would suggest it should be modified or eliminated. Nor am I aware of any reason to believe the mechanism has not performed reasonably in approximating the market price of waterborne coal transportation to the Crystal River plant site. To the contrary, when the market price proxy is measured against the benefits and objectives of market pricing articulated by the Commission in Order No. 20604 and quoted earlier in my testimony, I believe this consensus proposal developed jointly by the Company, Staff and other parties has served its intended purpose well. Moreover, the basis for the market price proxy remains conceptually sound. According to the Bureau of Labor Statistics (BLS), indices of the kind used in the market proxy mechanism are typically the basis for contract escalation. The indices used to escalate the market proxy base price are focused on the economic conditions that would reasonably and logically result in increases to the base price over time; and therefore result in an escalated price that fairly tracks these economic conditions, which the BLS quantified in the development of these indices.

In short, absent compelling reasons for change that have not yet been provided, the market price proxy developed to comply with the policy requirements of Order No. 20604, and which met the satisfaction of the Commission, Staff, the parties, and the Company, should remain in effect.

OTHER ISSUES

Q. Has Progress Energy confirmed the validity of the methodology used to determine the equity component of Progress Fuels Corporation's capital structure for calendar year 2002? (Staff Issue 13A)

A. Yes. Progress Energy's Audit Services department has reviewed the analysis performed by PFC. The revenue requirements under a full utility-type regulatory treatment methodology using the actual average cost of debt and equity required to support the Company's regulated business was compared to revenues billed using an equity component based on 55% of net long-term assets (the "short cut method"). The analysis showed that for 2002, the short cut method resulted in revenue requirements which were $47,749, or 0.01%, higher than revenue requirements under the full utility-type regulatory treatment methodology. Progress Energy submits that this analysis confirms again the appropriateness and continued validity of the short cut method.

Q. Has Progress Energy properly calculated the market price true-up for coal purchases from Powell Mountain? (Staff Issue 13B)

A. Yes. The calculation has been made in accordance with the market pricing methodology approved by the Commission in Docket No. 860001-EI-G.

Q. Has Progress Energy properly calculated the 2002 price for waterborne transportation services provided by Progress Fuels Corporation? (Staff Issue 13C)

A. Yes. Progress Energy has performed its calculation of the 2002 waterborne transportation price under the same methodology as the previous calculations that have been approved by the Commission.

Q. Were Progress Energy Florida's purchases of synthetic coal during 2002 cost effective? (Staff Issue 13E)

A. Yes. Progress Energy's purchases of synthetic coal (synfuel) in 2002 were made under an arrangement that allowed these purchases to substitute for purchases that would have been required under a contract for regular compliance coal at a price $2.00 per ton higher than was paid for the synfuel purchases. This resulted in fuel savings of over $1.3 million.

Q. In consideration of Order No. PSC-93-1331-FOF-EI, in Docket No. 930001-EI, issued September 13, 1993, should the Commission make an adjustment to Progress Energy Florida's 2002 waterborne coal transportation costs to account for upriver costs from mine to barge

for coal commodity contracts which are quoted FOB Barge? (New Staff Issue)

A. No adjustment is needed, since the Company and PFC have scrupulously followed the letter and spirit of the waterborne market proxy with respect to FOB Barge coal purchases. The market proxy's base price was determined from the waterborne transportation costs of PFC (then Electric Fuels Corporation, or EFC) in 1992. In that year, 27.8% of EFC's upriver waterborne coal was purchased at an FOB Barge price. This means that for these purchases the upriver "short-haul" transportation costs were included in the commodity purchase price, and were not included in the market proxy's waterborne transportations costs.

To avoid any significant over or under-recovery of these short-haul costs under the market proxy, PFC has attempted to maintain approximately the same ratio of purchases at an FOB Barge price since the inception of the market proxy in 1993. Over the ten-year period through 2002, PFC's purchases at the FOB Barge price have averaged 24.5%, meaning PFC has under-recovered the short-haul costs reflected in the market proxy through 2002. In 2002 itself, PFC's upriver waterborne coal purchases were 1,774,617 tons, of which 504,288 tons were purchased at an FOB Barge price, or 28.4% of its total upriver purchases. This slight imprecision in the 2002 ratio compared to the 27.8% base year guideline is not only small compared to the 24.5% 10-year average or the 2001 ratio of 19.0%, but is particularly small considering the complexities of optimizing individual purchase quantities, scheduling constraints, and periodic adjustments to the Company's coal requirements that PFC must take into account throughout the course of any given year.

Q. At the outset of your testimony you indicated a desire on Progress Energy's part to resolve any uncertainty that currently exists regarding the appropriate baseline expenses to be used in determining recoverable incremental costs. Please explain what you mean by the term "baseline expenses" as it is used in the determination of incremental costs.

A. The need to determine incremental costs in this proceeding arises because from time to time the Commission, under long-established policy, authorizes the recovery of certain O&M expenses through the fuel adjustment clause rather than base rates. Typically, this occurs when O&M expenses for an activity related to the adjustment clause are in excess of those that existed when the utility's base rates were last set. A recent example of this is the Commission's decision to authorize recovery of post-9/11 power plant security costs. Before actual recovery can begin, however, the Commission must assure itself that any portion of these expenses which may be included in base rates is not recovered twice – once through base rates and again through the clause. Therefore, to determine the level of incremental O&M expenses recoverable through the clause, the necessary first step is to establish the amount, if any, of these expenses included in the utility's base rates. This amount is sometimes referred to as the utility's "baseline expenses."

Q. Why has Progress Energy raised an issue regarding the appropriate baseline expenses to be used in determining recoverable incremental costs?

A. In each instance where the recovery of incremental costs has been requested by the Company and approved by the Commission since the 2002 rate case settlement went into effect, the baseline O&M expenses used to determine the recoverable amount of the incremental costs have been derived from the MFRs in that proceeding. Progress Energy believes that using the 2002 MFRs for that purpose is entirely appropriate. However, the continued use of these MFRs to establish the Company's baseline expenses has surfaced as a potential issue in pending matters.

To the extent any uncertainty exists as to the appropriateness of using the 2002 MFRs as source of baseline expenses, Progress Energy desires to have it resolved, since the need to establish baseline expenses is an ongoing one. Dealing with this issue on a case-by-case basis each time the recovery of incremental costs is sought appears unwise and inefficient. This is particularly so when the underlying question is the same in each instance: What baseline expenses best reflect the level of O&M expenses included in base rates? If the Company's base rates are unchanged, the answer to this question should be the same each time it arises.

For this reason, I believe that all concerned would benefit from the establishment of a uniform approach for setting the baseline level of O&M expenses when determining recoverable incremental costs. Doing so will allow everyone to know in advance how incremental costs are to be treated, and thus avoid the need to continually deal with this question on a case-by-case basis.

Q. Does Progress Energy seek to recover any incremental costs in this proceeding today that have been calculated using baseline O&M expenses from the Company's 2002 MFRs?

A. Yes. Based on the Commissions decision authorizing recovery of post-9/11 power plant security costs, these costs have been included in Progress Energy's true-up balance and in its projections for 2004 submitted for Commission approval in this proceeding. The Company has calculated the amount of its recoverable incremental power plant security costs using baseline expenses derived from the 2002 MFRs, as I will explain in greater detail latter in my testimony.

Q. Why is the use of baseline expenses derived from the Company's 2002 rate case MFRs the appropriate way to determine recoverable incremental costs?

A. The 2002 MFRs have been and should continue to be used by Progress Energy to establish baseline O&M expenses when determining recoverable incremental costs because they most accurately reflect the level of expenses included in the Company's current base rates. Based on long standing practice, I think it is clear that the MFRs would have been used for this purposes had the 2002 rate case been resolved in the traditional manner, *i.e.*, by a Commission decision based on the evidentiary record from a lengthy adversarial hearing. However, the fact that the 2002 rate case was resolved through settlement – a resolution that all agree is far superior to contentious, inefficient and costly litigation – provides no basis for a different conclusion about the appropriateness of using fully developed, rate case quality expense data in subsequent incremental cost determinations.

The 2002 MFRs were extensively reviewed and evaluated through discovery and testimony by Staff and the parties to the settlement negotiations. As has been previously noted, the Commission conducted a full rate case in every sense, except for the final hearing that was superceded by a negotiated settlement. The MFRs were a product of that fully developed rate case process and, as such, they and the related discovery and testimony served as a foundation for negotiations that led to the settlement and for Staff and Commission review and approval of the settlement. The use of the MFRs for incremental cost purpose is not only appropriate for this reason, but also because there simply is no other credible alternative for establishing baseline O&M expenses that reflects the level of expenses in current rates.

To summarize, by establishing a uniform treatment for the way in which baseline O&M expenses are determined, the Commission will resolve any uncertainty that now exist, avoid the need to address the issue on an inefficient and potentially inconsistent case-by-case basis, and allow all concerned to know the rules of the game in advance. By establishing the use of the Company's 2002 MFRs as that uniform treatment, the Commission will have selected the best, if not only, source of baseline O&M expenses that reflects the level included in the Company's currently approved base rates, as it must to ensure against double recovery of these expenses.

Q. Please describe the evaluation process used by Progress Energy to determine the incremental costs it submits for recovery through the adjustment clauses.

A. The evaluation process used by Progress Energy incorporates the Commission's long standing practice for determining recoverable incremental costs by removing any O&M expenses associated with the project that were included in the MFRs from the rate proceeding that established the Company's current base rates. Therefore, from the time Progress Energy's current rates were approved at the conclusion of its 2002 rate proceeding, the Company has evaluated the incremental costs associated with all projects submitted for adjustment clause recovery, including the incremental costs currently before the Commission, by first examining the 2002 rate case MFRs to determine whether any of the project's costs have been included. If none are found, all project costs are eligible for further evaluation. Any costs that are found to have been included in the MFRs are excluded from the project's recoverable costs at that point.

After this initial review, the second step is to identify any specific project costs that, although not associated directly with the project in the MFRs, are reflected elsewhere in base rates,. This step is performed by determining whether the cost would be incurred regardless of the new project. The following list provides an example of how several project cost component are broken down for analysis in this step.

- Labor from positions that were part of the last set of MFRs:
  - Regular labor is not considered incremental since is would be incurred regardless of the new project or task.
  - Overtime labor is considered incremental as it results only from the need to complete this new project or task.
  - Regular and Overtime labor for net new positions are considered incremental if it results only from the need to complete this new project or task.
- Outside Contract Labor is considered incremental since the expenditure would not have been incurred were it not for the new project or task.
- Outside Professional Services are considered incremental since the expenditure would not have been incurred were it not for the new project or task.
- Materials and Supplies are considered incremental since the expenditure would not have been incurred were it not for the new project or task.
- Travel is considered incremental since the expenditure would not have been incurred were it not for the new project or task.

The third step is to determine whether the new project will create any offsetting O&M savings associated with related activities, in which case the savings are credited to the project or task to reduce its total cost. Part F of my exhibit is a decision tree that graphically depicts the Company's incremental cost evaluation process using its post-9/11 power plant security project as an example.

Q. Does this conclude your testimony?

A. Yes, it does.

Progress Energy Florida

Docket No. 030001-EI

SUPPLEMENTAL DIRECT TESTIMONY OF JAVIER PORTUONDO

Q. Please state your name and business address.

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

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

A. I am employed by Progress Energy Service Company, LLC, in the capacity of Director, Regulatory Services - Florida.

Q. Have your duties and responsibilities remained the same since your testimony was last filed in this docket?

A. Yes.

Q. What is the purpose of your supplemental testimony?

A. The purpose of my supplemental testimony is to address the last sentence of Staff's position on Issue 30 regarding the methodology for determining the incremental costs of post-9/11 security measures. Because this portion of Staff's position was (a) disclosed to the parties for the first time in the draft Prehearing Order presented at the Prehearing Conference, and (b) unlike the rest of Staff's position, constituted a departure from the well established methodology currently utilized by the Commission that was not supported by Staff testimony or addressed by testimony of the parties, the Prehearing Officer allowed Staff and the parties an opportunity to file testimony limited to this matter. My supplemental testimony is submitted pursuant to this ruling by the Prehearing Officer.

Q. What is your overall reaction to Staff's position on the methodology for determining incremental costs?

A. With the exception of the last sentence, I am in agreement with the methodology described in Staff's position. While Issue 30 is stated broadly in terms of the incremental cost methodology in general, Staff's position correctly focuses on the aspect of this methodology that gave rise to the issue – identification of the base year expenses reflected in base rates that must be removed in determining incremental costs to avoid the possibility of double recovery. In this regard, I find all but the last sentence of Staff's position consistent with my projection testimony, which addresses the base year issue on pages 27 through 33. The only difference is one of scope. While the relevant portion of Staff's position purports to describe the methodology applicable to incremental security costs, it is equally applicable to the determination of incremental costs in adjustment clause proceedings in general. My projection testimony urges the Commission to recognize the general applicability of this methodology in order to avoid the need to address the same underlying issue on a case-by-case basis in the future.

Q. The last sentence of Staff's position on Issue 30 states: "Once the base year costs are determined, the costs would be grossed up (or down) for the growth (or decline) in KWH sold from the base year to the recovery year." What is your objection to this statement?

A. The preceding portion of Staff's position is a clarification of the current incremental cost methodology that provides a needed elaboration on the base year aspect of that methodology. In contrast, the quoted statement in the position's last sentence represents a significant departure from the current methodology through the addition of a new and, for several reasons, unsound "gross-up" feature

In the first place, the gross-up feature fails to recognize one of the basic tenants of ratemaking. When a utility's base rates are set using test year revenues and expenses, all involved understand that the utility's revenues will increase or decrease in subsequent years, primarily as a function of sales growth. However, this, in and of itself, does not indicate the need to adjust revenues, since it is also understood that expenses will likewise vary as a function of inflation and the need to serve the growth in sales. The fact that these variations in test year revenues and expenses have an offsetting effect is the reason base rates often produce earnings that remain within the range of reasonableness well beyond the test year on which the rates were set, absent a major rate base addition. Therefore, If the adjustment for increased revenues suggested in Staff's position were to be made, a corresponding and offsetting adjustment for expense increases would also be necessary. However, this is the slippery slope that can easily transform the fuel adjustment proceeding into a rate case exercise, which would completely defeat the purpose of having two fundamentally different rate-setting mechanisms.

Of particular concern to Progress Energy is the inconsistency of Staff's gross-up position with the revenue sharing mechanism contained in the Stipulation and Settlement approved by the Commission in the Company's 2002 rate proceeding (Docket No. 000824-EI). Under Staff's proposal, the revenues attributable to the component of security costs reflected in base rates would be grossed up for sales growth since 2002. The effect of this adjustment would be to reduce the incremental security costs recovered through the fuel clause by the amount of the gross-up. However, the revenue sharing mechanism would require that the Company refund to customers two-thirds of the base rate revenues from sales growth above the forecasted sharing threshold. As a result, Staff's proposal would reduce the incremental costs Progress Energy could otherwise recover through the fuel clause because of base rate revenues it did not fully receive. From the customers' perspective, they would receive the benefit of these revenues twice; once through a direct refund and again through a reduction in the incremental costs they would have paid through their fuel charge.

Q. Is this the first time Staff has proposed grossing up base year expenses when determining incremental costs for fuel clause recovery?

A. No. Staff witness Matthew Brinkley first proposed the gross-up adjustment through testimony submitted in last year's fuel clause proceeding, Docket 020001-EI. However, while Staff raised a generic issue and three company-specific issues regarding the recovery of incremental security costs, none of these issues made any reference to the methodology for calculating base year expenses in general or to the gross-up of these expenses specifically. Moreover, Staff's position on these issues did not endorse or even mention the gross-up adjustment described in witness Brinkley's testimony, which had been challenged by rebuttal testimony of three utility witnesses, including myself. The fact that Staff ignored the gross-up adjustment in formulating its positions for the November 2002 hearing, after it had the opportunity to consider the rebuttal testimony, suggests to me that Staff recognized the adjustment was not meritorious. The passage of time has not made it any more so today.

Finally, I would note that when the Commission considered the incremental security cost issue at the conclusion of the hearing, it voted unanimously to approve recovery of the individual utilities' incremental costs that were calculated using base year expenses determined in the traditional manner, without a gross-up adjustment. Progress Energy has calculated its incremental security costs now before the Commission in the same manner and urges the Commission to approved the continued use of this methodology.

Q. Does this conclude your supplemental testimony?

A. Yes it does.

BY MR. McGEE:

Q Mr. Portuondo, do you have a summary of your testimony?

A Yes, I do.

Commissioners, Progress Energy respectfully requests the Commission's approval of its filed purchased fuel, purchased power, and capacity costs for the periods 2002 through 2004. In addition, we request the Commission's approval for cost-recovery of incremental post 9/11 security costs necessary to comply with the NRC and Department of Homeland Security regulations and guidelines. This recovery would be net of projections included in the company's last base rate proceeding and net of any reductions which may result from the implementation of these incremental measures on related security activities.

Progress Energy would also appreciate the Commission's approval on this methodology for determining recovery of incremental costs through the pass-through clause as being appropriate. Progress Energy agrees with all but the last paragraph, and the position has been restated, but all but the staff's position requiring an annual adjustment to expenses, expense levels included in the company's last base rate proceeding, which is supported by the testimony of Mr. Brinkley.

I disagree with the concept proposed by Mr. Brinkley to gross up or gross down the costs included for post-9/11 security in the last base rate proceeding by the increase or decrease in kilowatt hour sales. This is inappropriate because it assumes that you can color code revenues collected for specific expenses incurred.

The Commission sets rates knowing that over time those rates will recover a variety of different levels of individual test year costs. This reflects the fact that internal and external forces will influence the increase or decrease in overall spending. An increase in revenues does not necessarily mean that a utility is collecting more for any one particular expense component, but rather that the utility will have a source of revenues with which to cover the constantly changing mix of expense levels. Staff's proposal also conflicts directly with the company's stipulation and settlement resulting from the last base rate proceeding. Finally, Mr. Brinkley's proposal attempts to create a base case outcome out of every fuel clause for this particular expense.

Lastly, I would address the current cost-recovery methodology for waterborne transportation services. Since the filing of my testimony, the company and the Staff have reached an agreement which covers all the issues related to waterborne transportation. We have agreed to support and adopt the recommendation of Mr. McNulty's testimony which outlines a plan for the orderly transition to a primarily RFP-based recovery method. The plan would call for the termination of the current market proxy methodology as of December 31st, 2004. It would require that Progress Energy Florida, through its agent, Progress Fuels Corporation, implement and conduct a RFP process in 2004 that would be the basis for future cost-recovery beginning in 1/1/2005. All this while not changing the methodology for 2003, which is already over, and keeping 2004 under the current methodology so that contracts can naturally expire and management has a chance to respond to these changes. The settlement proposal balances the interests of both the ratepayer and the utility by allowing this orderly transition to a new methodology beginning in 2005. Thank you.

MR. McGEE: We tender Mr. Portuondo for cross-examination.

CHAIRMAN JABER: Thank you, Mr. McGee.

Mr. Vandiver, again, have you all agreed on the order of cross-examination questions?

MR. VANDIVER: Yes, I think I will go first.

CHAIRMAN JABER: Okay. Mr. Twomey, I see you're at the table now. Do you intend to go after Ms. Kaufman?

MR. TWOMEY: I will be happy to go after the lady.

CROSS EXAMINATION

BY MR. VANDIVER:

Q Mr. Portuondo, good afternoon.

A Good afternoon.

Q Based on your testimony in deposition, is it correct that you have a longstanding contractual relationship with Progress Fuel to transport coal to your Crystal River plant?

A That's correct.

Q And can you explain what portion of your waterborne transportation is provided by Progress Fuels?

A About one-third of our total coal is provided by waterborne transportation.

Q And can you describe basically the various subparts of the waterborne transportation system that brings coal to the Progress plants, please, sir?

A The waterborne path begins at the mine. There is shorthaul transportation to the upriver terminal where the coal is transferred to river barges which bring it down the river to a Gulf terminal near the mouth of the Mississippi, and at that point it is transferred to a Gulf barge and transported to the Crystal River site.

Q And Progress Fuels is involved in which legs of that?

A Progress Fuels negotiates the entire coal transportation path.

Q Okay. And Progress Fuels bills Progress Energy for the service based on what?

A Progress Fuels bills Progress Energy based on the Commission's approved market proxy methodology approved in 1993.

Q Okay. And the proxy rate is different than the actual cost of Progress Fuels, is that correct?

A That's correct.

Q Okay. Now, Progress Fuels is the successor corporation to Electric Fuels, and both of those corporations are a wholly-owned subsidiary of Florida Progress, is that correct?

A Wholly-owned subsidiaries of Progress Energy.

Q Yes. Thank you for keeping my terminology straight. And this relationship has existed for many, many years, is that correct?

A Yes, it has.

Q Okay. Now, is this relationship basically the same as it was in the year 2000?

A Yes, it was.

Q Okay. And the audit that the Staff performed in this case was based on the year 2002, is that correct?

A That's correct.

Q Now, are the parties the same for 2003 and 2004?

A What parties are you referring to?

Q Okay. The audit that was performed for 2002?

A Yes.

Q Are the parties to the contract the same for 2003?

A Yes. The contracts for the most -- I think all but one continue on through 2004 and then one into 2005.

Q So basically the contracts just roll over from year to year, is that my understanding?

A Well, the term actually expires in '04 and '05. They were multiyear contracts that happened to cover the period in question.

Q Okay. And so it is your testimony that since 2000, though, the parties and the contracts are pretty much the same thing?

A Since 2002?

Q Yes.

A That is correct.

MR. VANDIVER: Okay, sir. That's all the questions I have at this time. Thank you, Mr. Portuondo.

THE WITNESS: Thank you.

CROSS EXAMINATION

BY MS. KAUFMAN:

Q Good afternoon, Mr. Portuondo. I have a couple of areas to cover with you, but I think I will stick on the coal proxy for the moment, which is Issue 13D. That market proxy mechanism has been in effect since 1993, is that correct?

A That is correct.

Q And as I understood your summary, Progress has agreed to phase that out beginning with contracts in 2005?

A Beginning in 2005 we will be under, if the Commission approves, under the proposal by Mr. McNulty which would call for RFPs to be initiated and conducted in 2004. The successor, or the successful contract will be introduced in the projection filing for '05. The areas or segments of the transportation path, it does not produce enough bids to deem it competitive, the Commission staff has asked that we, the company, propose an alternative market mechanism to reflect that particular segment. And that, too, would be done, hopefully, in time for the hearings in November of 2004 for setting 2005 rates.

Q Okay. And the bottom line of what you have just explained to us is that beginning, hopefully, with the factors that will be set in 2005, you are going to attempt to move to a competitive bid solicitation?

A Absolutely.

Q Now, I know you are aware that Mr. McNulty has filed testimony on behalf of the staff in this prehearing. Have you reviewed Mr. McNulty's testimony?

A Yes, I have.

Q Do you have a copy in front of you?

A I may. Yes, I do.

Q And I won't review again Mr. Vandiver's questions, but we have already established we have got the same parties and the same contracts in 2002, 2003, and 2004, correct?

A Yes, that's correct.

Q I want to direct you to Page 15 of Mr. McNulty's testimony beginning at Line 8. And are you there, sir?

A Yes, I am.

Q Mr. McNulty says there, and I will quote him, I conclude that both market price proxies exceeded the cost of providing service and allowed the affiliate, PFC, to achieve significantly more profit than is reasonable for this service, given the level of risk assumed. Also, I conclude that the market proxies escalators and their respective weightings do not reflect the cost structure of the industry.

Mr. McNulty is referring to the market proxy that you want to apply for this factor, correct?

A The market proxies approved by the Commission in 1993, yes, ma'am.

Q Okay. Turn, Mr. Portuondo, to Page 16, if you will, of Mr. McNulty's testimony, and look at Line 14. And I will quote Mr. McNulty. He says, "The market price proxies have worked to the detriment of PEFI's ratepayers by exceeding both the cost of service and the market price of WCTS." What does WCTS stand for?

A Waterborne coal transportation service.

Q And, again, he is discussing the proxy that you want to apply to the 2004 factors, correct?

A This is a -- yes, he is referring to those proxies, but if I could elaborate. This goes to one specific year, and it does not ignore the history and the performance of the proxy. There have been, as in 2001, when Progress Fuels sold certain ownership interests in those segments, it incurred a significant loss that the customers were insulated from because of the proxy.

Q But you would agree with me, based on the Staff audit, there is significant gain in 2002, correct, based on the Staff's audit?

A Based on the reading of the staff's report.

Q And I'm just going to refer you to one more passage in Mr. McNulty testimony, which is on Page 20, beginning at Line 14. Mr. McNulty says, "I have concluded that the current market price proxies for both domestic and foreign coal transportation are no longer relevant and sufficient for the purpose of assessing cost prudence. The margins PFC has achieved for providing domestic and foreign waterborne coal transport are excessive, given the relatively small additional risk PFC has incurred." Do you see that?

A I do see that, yes.

MR. McGEE: Madam Chairman, this is procedurally awkward, but I would like to object to the quoting of that last sentence that Ms. Kaufman read. Staff and the company have an understanding that the sentence that we are referring to now that begins on Line 16 and goes through Line 18 will be withdrawn. And the purpose of having that withdrawn would be somewhat frustrated if it gets quoted into the record now. So if I may make an objection, subject to the ultimate withdrawal of that sentence, then I would like to pose that at this time.

CHAIRMAN JABER: Let me make sure I understand, Mr. McGee. The proposed stipulation you and staff have reached was contingent somehow on the withdrawal of that sentence from Mr. McNulty's testimony?

MR. McGEE: That is essentially correct. Our understanding actually had to do with Progress Energy not filing rebuttal testimony. And the staff has --

CHAIRMAN JABER: I understand.

MR. McGEE: -- Mr. Keating to say, but the staff has agreed that that sentence would be withdrawn.

MR. KEATING: And, Chairman, what we intended to do was when Mr. McNulty was offered was to allow him to make that correction when his testimony is introduced.

CHAIRMAN JABER: Well, Mr. McGee and Mr. Keating, you're right, it is awkward. The dilemma is the Commission has not accepted your proposed stipulation, and I don't think that Ms. Kaufman's question goes to the merits of the statement that Mr. McNulty is testifying to. I mean, he hasn't testified yet.

MR. McGEE: Yes. And that is why if you would accept me making the objection, I would certainly make it subject to the actual withdrawal of that. But at the time that that sentence is withdrawn by staff, then it wouldn't be something that would be subject to quotation in the manner that Ms. Kaufman is doing. And I'm not being critical of her, because that, in fact, hasn't taken place yet. That's why I characterize it that way.

CHAIRMAN JABER: You want your objection on the record, but no ruling is required because there hasn't been acceptance of a proposed stipulation and Mr. McNulty hasn't testified. Staff, what would you recommend? Your proposed stipulation isn't binding on the parties if the parties haven't entered into that stipulation.

MR. KEATING: That's correct.

MR. McGEE: Madam Chairman.

CHAIRMAN JABER: Mr. McGee.

MR. McGEE: The one point that I would disagree on, you are correct, the stipulation is subject to Commission approval, and absent that it doesn't mean a thing.

Staff, though, has agreed that they would withdraw the sentence that we have been talking about on Page 20, and that was not contingent upon approval of the settlement. I believe it is within staff's prerogative to modify the witnesses -- or within Mr. McNulty's prerogative to modify his testimony as he sees fit.

MS. KAUFMAN: Chairman Jaber.

CHAIRMAN JABER: Ms. Kaufman.

MS. KAUFMAN: If I might be heard. I am unaware of any of this discussion as to what staff is or is not going to withdraw. And just so it is clear, certainly FIPUG has not entered into any stipulation on this issue. I just wanted the record to reflect that.

CHAIRMAN JABER: Mr. Twomey.

MR. TWOMEY: Yes, Madam Chairman, briefly. Commissioners, this is -- I think it is highly irregular. It strikes me as, following with this morning's discussion, almost snatching the exhibit in the deposition. This is the first, I think, any of the other parties have heard of this deal to take away part of his testimony. It is prefiled testimony, it has been out there for weeks. I propose to ask questions about it, as well. I understand Mr. McGee's point is that our questions would be rendered moot because it will become nonexistent if the Staff takes it away. But I just think it is irregular.

MR. KEATING: And let me be clear as to the extent of the clarification or the change that Mr. McNulty intends to make when his testimony is offered. It is not intended to change the substance of his testimony at all or his conclusions. It is, rather, a slightly reworded version of those two sentences. And I think what Mr. McGee is getting at is that Ms. Kaufman's question is going to refer to a sentence that we know we were going to come to later that is going to be clarified by Mr. McNulty when his testimony is offered. To me I think that is something that will be made clear through the record ultimately. If Ms. Kaufman has a question based on the testimony as filed, we are at the point in the proceeding now where that is what we have, and I think it is probably a fair question, but staff can then make its clarification.

CHAIRMAN JABER: Mr. Keating, let me ask you this. Did you give all the parties a heads up that that change would be made to Mr. McNulty's testimony?

MR. KEATING: I don't recall if we -- I don't believe we provided the exact language to the parties. I think what we indicated at the prehearing was that we would have a modification to a portion of his testimony, and then to be honest I don't recall the extent to which we clarified that.

CHAIRMAN JABER: This is the second time I'm going to remind staff. If you communicate with a party, you communicate with all parties. Your objection is overruled. Mr. McNulty hasn't testified. The testimony hasn't been inserted into the record yet. It has been prefiled. For whatever it is worth to Ms. Kaufman, Mr. Twomey, and the rest of the parties, it will be given the appropriate weight it deserves. The proposed stipulation will be ruled on in due course. Start communicating with all parties.

BY MS. KAUFMAN:

Q Mr. Portuondo, I am not going to belabor the point, given the discussion that we have had, but at least at the time Mr. McNulty filed his testimony the passage we were referring to at Page 20, it was his view that the benchmark was not relevant or sufficient for assessing the prudence of these costs that you are asking to recover, correct?

A Those are his statements, yes.

Q I'm going to move on to another area now, and I am going to be looking at your testimony that was filed on August 13th, which is your estimated actual true-up. And before we turn to that, Mr. Portuondo, I am correct, am I not, that Progress Energy received authority for a midcourse correction, and I think it became effective on April 1, is that right?

A Subject to check, I believe so.

Q And it was about $100 million, correct?

A I believe so, yes.

Q So when we're talking about the amount included for the true-up that is going to be in the 2004 factor, that is in addition to the $100 million that you got in the midcourse correction? It is over and above it?

A It is the projected and result of having received that midcourse correction this year, yes.

Q And it is about $210 million, correct?

A That is correct.

Q And as I understand your August testimony, and I'm referring to Page 3, beginning at about Line 4, the primary reason for the $210 million underrecovery is the natural gas prices?

A That is correct.

Q Were substantially higher than what you had projected?

A That is correct.

Q And you explain this error -- well, this forecasting difference, if you will, on Page 3 at Lines 1 through 8, correct? And basically what you say there is that gas prices continue to rise and were forecasted -- you didn't forecast them high enough is what I'm trying to say?

A That's correct. The conditions in the marketplace drove them higher than we had ever anticipated they would go.

Q Would you agree, Mr. Portuondo, that generally the Commission allows companies, including Progress Energy, to pass through to ratepayers these types of increases based on incorrect projections?

A I would say that the Commission allows recovery for the actual costs incurred irrespective of the ability to forecast market conditions.

Q And so even though you were substantially off in your forecast, generally it has been the Commission's policy to allow you to recover those dollars?

A If they were incurred prudently, yes.

Q Can you tell us what percentage of your fuel mix is natural gas, and what percentage is coal, and what percentage is nuclear?

A Sure. Gas is about 19 percent, nuclear is about 18 percent. Did you want all of them? I'm sorry.

Q Yes, go ahead.

A Coal is about 46 percent, oil about 16 percent.

Q So gas is about 19 percent of your fuel mix, really less than 25 percent, but that accounted for the majority of the underrecovery we are talking about?

A That is correct. Gas has tended to be the most volatile of the commodities in the past couple of years. It has been very difficult to anticipate the fluctuations in the marketplace.

Q Does Progress Energy have any plans in its future for some new base load generation that does not utilize natural gas?

A I have no knowledge.

Q You don't know one way or the other?

A I don't know.

Q Do you know when the last time was that Progress Energy built a plant that did not use natural gas?

A Wow.

Q Would you agree it has been some time?

A It has been some time, yes, it has.

Q So would you agree that you are tending to move your generation toward natural gas even though it is a very volatile fuel in terms of price?

A I would say that at the time the plans were set in motion, the projected cost/benefit I would say has leaned towards gas. Not to say that if these trends continue that the company may not pursue other alternatives if they are deemed to be cost-effective.

Q But as you sit here today, you really -- you don't know what is going to happen, whether you will move away from natural gas because of its volatility or whether you will continue to rely on it?

A To be honest I don't. I am not in the generation planning area.

Q To your knowledge is Progress Energy taking any affirmative steps to encourage cogenerators in their territory?

A I do not know.

Q I guess that would have been the conservation witness in the other docket. Do you think it would make sense for Progress to encourage cogenerators to maybe stem somewhat some of the problems we are seeing from forecasting natural gas prices?

A All I could do is suggest that they would probably be seeing the same volatility that we are if they are using gas.

Q But, for example, if they are using waste heat or some other form to cogenerate, wouldn't it make sense to encourage that kind of activity?

A I think we have a standard offer contract out there that is intended to accomplish that.

Q Do you encourage it in any other ways that you are aware of?

A Again, that is outside my area of expertise.

Q Now, I'm going to move to your projection testimony.

A Okay.

Q And if would you look with me at Page 4, Line 7, and from actually beginning on Line 6 you are talking about the fuel factor that you are requesting for 2004, right?

A Yes.

Q And you have told us that that represents a 26.2 percent increase, correct?

A Yes, it does.

Q Would you agree that that is a pretty significant increase for customers to bear in the fuel factor that is going to appear on their bill?

A No, I think it sends a message that that is the cost for the commodity. It is no different than the struggles we go through when we go pump gas and we see the gas prices at the pumps go up. I think this is the cost, this is what we have incurred, plan to incur and project to incur. And we would be the first to try and mitigate that the best we can to get into the markets when they are low, renegotiate contracts. We do that, you know, all the time, but unfortunately sometimes the markets aren't conducive to that, and those are the prices we have to pay.

Q Right. And I guess my question is just whether or not you would agree or disagree that 26 percent is a very significant increase?

A Oh, I do agree.

Q That was the question. Would you accept, subject to check, that that 26 percent increase for some of your largest industrial customers results in an increase of about $4 million a year in their fuel cost bill?

A Subject to check, yes, I do not know.

Q Has Progress Energy done any analysis regarding this impact on their larger customers and whether those customers might, for example, cease operations in their service territory?

A The only knowledge I have about that would be that we attempted, once we knew the impact, to communicate with our commercial reps, who in turn went to the large commercial customers and advised them of the increase and tried to explain the reasons for the increase. I mean, we try to work with them to find options where options might exist and see if we could, you know, in some way help. But, that is really all I know of the subject is we are out there communicating with them and continuing to partner up with them to find ways to better -- for them to better deal with increasing fuel costs through some sort of conservation or something.

Q So if I can restate what you have said, and if I am incorrect, tell me, basically you have communicated with them that there is going to be what we have agreed is a significant increase?

A Yes, that is correct.

Q Do you know around when those communications occur?

A I think it is shortly after my testimony is filed.

Q So mid-September?

A Yes.

Q So they have from mid-September, two and a half months to try to incorporate a $4 million increase into their budgets for the coming year?

A That is correct.

Q Now, I think you said you try to partner with them to mitigate the impact?

A Well, I think we try and work with them to see if there is anything that we could do to help them better manage their energy needs.

Q Wouldn't one measure of mitigation be spreading this underrecovery over a longer period of time? Wouldn't that result in less of an increase?

A I think that has a tendency to mortgage the future. Given the volatility, it's hard to say what could happen. We could have more crises that impact the commodity prices, and you are risking an even larger increase in a future year. And, again, there has always been the Commission's desire to communicate the price signals to the customer, and I think that is what this does is to make them aware that in today's environment these are the types of prices we are being faced with, and hopefully things will improve in the future.

Q But all things being equal, you would agree, wouldn't you, that one way to mitigate this large price increase would be to spread that $210 million over a longer period of time and not try to collect it all in one year?

A That would be true in any situation.

Q I think I asked you if you had done any analysis of the impact of this on your large customers, and we got into the communication. So is it fair to say that you have not done any analysis, nor have you analyzed, for example, the impact on the tax base if these customers were to cease operations in your service territory?

A No, I have not.

Q Now, Progress Energy Florida is part of Progress Energy, is that what the parent company is called?

A That is correct.

Q And you have operations -- the Progress Energy parent has operations in North Carolina, correct?

A That is correct.

Q Now, in your North Carolina location has the company absorbed itself some of these large increases to mitigate the effect on its customers?

A I am not aware of that.

Q You have no knowledge one way or the other?

A No, I do not.

Q Would it surprise you to learn that that was the case?

A I mean, the one thing I do know is they have a very different fuel mix than we do. They are predominately coal and nuclear.

Q Has Progress Energy Florida given any thought to absorbing some of this increase themself?

A No, we have not.

Q So you have not considered that, and I guess you are telling us that is not something the company would consider?

A No, it is not.

Q There is one more area that I want to talk to you about, Mr. Portuondo, and that is beginning on Page 27 of the testimony we are looking at. I think this is -- I think this is Issue 30.

A Yes.

Q Which is how to figure out what the appropriate baseline is for incremental expenses. Is that your understanding?

A That is correct.

Q And you address that in our testimony beginning at Page 27. And on Page 30 at Line 6 you talk about the 2002 MFRs. If I understand your position, it's that those MFRs should be used as the baseline to determine future incremental costs?

A Yes.

Q Now, you agree, wouldn't you, that those MFRs were filed as a part of your rate case?

A Yes, they were.

Q And it's, I believe, 000824, correct?

A Yes, that is correct.

Q And the case there went to hearing, correct?

A That is correct.

Q The parties entered into a settlement?

A That is correct.

Q And the settlement was not based on any finding that those MFRs were or were not appropriate, was it? The parties did not agree that the MFRs were appropriate, did they?

A There is no mention of it in the stipulation, that is correct.

Q And, in fact, when you came in with your MFRs, you were seeking a substantial rate increase that by way of settlement did not occur, correct?

A As a result of the inclusion of the post-9/11 decline in sales, yes, it did result in an increase.

Q It didn't result in the increase that you were seeking when you filed your MFRs, did it?

A That is correct.

Q And on Page 30, still at Line 6, when you say the MFRs were extensively reviewed and evaluated through discovery and testimony by staff and the parties to the settlement, you are not intending to imply that there was ever any agreement on the proprietary of the MFRs, are you, among the parties?

A Well, to the extent that the MFRs were the basis from which the parties could negotiate and reach a settlement, it was the overwhelming, I think, direction of this Commission that we file MFRs for that purpose, so that all the parties could be on equal footing and understand the cost structures of the utility in order to reach a compromise and the settlement we ultimately signed.

Q My point is simply that those MFRs upon which you want to base your baseline were never accepted by the parties and, in fact, the settlement is not based on those MFRs?

A The implementation of the results of the settlement are applied to those MFRs. Those were our costs. The results of the settlement are applied to those MFRs to then derive the achieved return, the achieved revenues, based on the parties to the settlements.

Q We might be taking past each other, and I apologize if we are. My only point is that a settlement was reached and the parties did not agree that any portion of those MFRs was either appropriate or inappropriate because we settled the case, correct?

A Correct, the case was settled.

MS. KAUFMAN: If I could have just one minute.

BY MS. KAUFMAN:

Q I just want to go back for a moment to the fuel mix question that we were talking about earlier, if I could. I think we established that gas was about -- less than 25 percent of your fuel mix, and we established as well that you have about a 26 percent increase based on your true-up amount. Would you agree that as of the midcourse correction that was about an 18 percent increase, roughly?

A The midcourse?

Q Right.

A Subject to check.

Q So I'm going to do some math here. It is about a 50 percent increase, correct?

A Subject to check.

Q 48.7. So for gas alone to account for that much of an increase, since it is less than 25 percent of your fuel, it would have to have increased by about 250 percent, correct, and that would have had to happen in the past year?

A I don't have access to your analysis, so subject to doing my own analysis, I don't think I can respond. What I can say is that many of our projections for fuel prices during that period were in the maybe $4 MMBtu and it reached as high as 8 or $9 in certain months. So that is a 100 percent increase in certain months. And my testimony does say that it is primarily driven by gas. There are other commodities that also increased, but not at the magnitude of gas.

Q So essentially to kind of come full circle, the projections that you had made for natural gas were substantially off?

A Well, yes. I mean, in retrospect, yes, absolutely. But, again, we attempt to secure the intellectual, you know, knowledge of the markets through consultant studies, and those were the answers that they were providing. They too were wrong. I think for this coming year we attempted to use our own history in being in the markets and influenced the -- worked with the consultants and maybe arrived at hopefully what we hope to be a more accurate and closely tied to the market.

Q I appreciate that. And I don't want to belabor the point any further, but in 2003 they were off by a magnitude of about 50 percent, correct?

A That is your number.

Q You don't have any reason to question that, do you?

A Not until I go back and analyze it.

MS. KAUFMAN: Thank you.

COMMISSIONER DEASON: Mr. Twomey.

CROSS EXAMINATION

BY MR. TWOMEY:

Q Good afternoon, sir.

A Good afternoon.

Q I want to ask you what is your understanding of the Commission's standard by which -- let me ask you first, isn't it true that these fuel hearings attempt to, on one hand, look at the prudence of past expenditures, and on the other look at the reasonableness on a going-forward basis of company projections, is that generally the case?

A That is generally the case.

Q And what standard are you aware of that the Commission utilizes in ascertaining whether or not to sign off on past expenditures?

A I think the standard has been whether the utility has prudently entered into those costs. The audit is conducted by the Commission staff to review contracts, to review the costs incurred in those contracts, and make sure that they are accurately reflected.

Q Would you agree with me that the Commission should find that the costs you are requesting to have finalized for the year 2003, in this case, would have to be reasonable?

A I would say yes.

Q Now, is it my understanding that -- let me ask it this way. Are you suggesting that the Commission doesn't have the authority in these proceedings today to determine the reasonableness and prudence of your 2003 fuel transportation costs?

A No, I think that the Commission today is judging the reasonableness of our reprojection of what we believe the year end results will be, and that is what they are deciding today.

Q So not to belabor this point, but it is certainly within not only their jurisdiction, but would you agree it is their responsibility to determine before they sign off on the year 2003 expenditures that those costs are, in fact, reasonable and prudent?

A Well, yes, knowing that the Commission will have another opportunity to review the actual results next year and true-up their decision based on the Commission's audit of those costs.

Q I'm sorry, of 2003?

A Yes, sir.

Q So you are not asking for total approval of your 2003 costs in this proceeding?

A We never do. It is a true-up process in this proceeding.

Q But to the extent that you have demonstrated those costs through whatever time period your testimony covers, you want those approved, right?

A No, sir, those costs have not yet been audited by this Commission. That will take place in the first quarter of next year and we will file testimony in support of those actual results. And those actual results will go to hearing next year, and the Commission at that point will have the opportunity to decide their prudence and final recovery.

Q Excellent. I want to ask you some questions, if I may, about your testimony. At Page 18 of your prefiled testimony, in describing the prior treatment of the fuel transportation cost, you say at Line 16, "Under this regulatory treatment, FPC was allowed to recovery EFC's prudently incurred costs to procure and deliver coal to the company, including a utility rate of return on its capital investment," presumably in IMT and DFL, correct?

A That's correct.

Q And IMT is the transloading facility near New Orleans?

A Yes, sir.

Q And DFL is your cross-Gulf transportation?

A Yes, it is.

Q Now, am I correct in understanding that the ability to include a rate of return on its capital investment in those two companies is no longer operative under the proxy system approved by the Commission in 1993?

A The system approved by the Commission in '93 sets the amount that the affiliate would be paid for all services for waterborne transportation. It sets the components and it is up to the affiliate to manage its operations and achieve a return of, you know, whatever it can based on that proxy.

Q So if I understand correctly, the proxy sets the price that you can charge your customers through these hearings for coal transportation services, and that price is today completely independent of what your fuel affiliate actually pays for transportation, is that correct?

A That's correct.

Q So if they negotiate good contracts and save a substantial dollar margin per ton as compared to what the proxy provides, they get to keep that as their margin of profit, correct?

A That's correct. And the opposite also occurs, as I tried to indicate earlier in my testimony, that they have had opportunities where they have had to sell segments of their ownership and incur significant losses that the customer was insulated from because of the Commission's foresight to set up this market proxy.

Q Is it your testimony that during the term of this 1993 proxy that the overall cost in any given year allowed to be recovered from your customers through the proxy pricing methodology was less than your overall cost of transportation services in that year?

A Could you restate that, please?

Q Yes, sir. You are saying, I understand, that it is a double-edged sword. That your fuel affiliate can obtain certain savings and realize a profit by contracting in a reasonable manner and operating efficiently. On the other hand, it runs the risk of having to pay more than the proxy price and, therefore, losing which would insulate the customers. And what I want to know is has there ever been a year since the Commission's approval of this proxy in 1993 in which your actual fuel affiliates costs for total transportation of the coal exceeded the amount you recovered from your customers through the proxy?

A Well, I haven't gone back and calculated. I do have knowledge that in '01 through the sale of the downriver business and the sale of IMT there were significant losses incurred. I have not gone back to quantify what the per ton impact was, but it was close to $20 million that had to be absorbed by the affiliate.

Q So is your answer to my question, then, that you don't know?

A That I do not know.

Q Okay. On Page 22, sir, at Line 7 of Page 22 of your prefiled direct testimony, you say that the base price of $23 per ton was derived from EFC's actual 1992 costs incurred for waterborne transportation. In that regard, I want to ask you, didn't I hear you say earlier in response to Public Counsel's question, perhaps, that the composition of parties that are involved in carrying the coal from mine to Crystal River are different now than they were in 1992?

A Not totally.

Q Let me ask it this way. Is there a greater number of nonaffiliate parties in the contracts than there were in 1993 or '92?

A No, I think that today there is one less affiliate in the chain than there was in 1992.

Q Okay. The same page, Line 12, you say the total weighting of the indices is set at 90 percent with 10 percent of the base price remaining fixed. So, I take that to mean that 90 percent of the proxy was assumed to be associated with variable costs, is that correct?

A As my reading of the information surrounding this issue indicated that there was an attempt to identify the underlying drivers to those costs, and these were the percentages that the signatories to the settlement arrived at.

Q Yes, sir. I'm not questioning the fact that they arrived at these percentages in the settlement, I just want to understand, isn't it true that when you take into account the capital costs of the river barges and tugs, the capital costs of the transloading facilities at IMT, the large, presumably large capital costs of the tugs and seagoing barges for the trans-Gulf transportation, that the actual fixed costs as compared to the variable are substantially larger than 10 percent?

A I do not know. The fixed component would be the depreciation. But as we all know, O&M from be a utility perspective, can also be quite significant.

Q Okay. Thank you. Now, on the next page, 23, at Line 2, you talk about the fact that under the proxy that is currently approved, EFC will receive the benefit of any cost reductions that it can achieve in providing waterborne transportation services to the company. Then you go on and talk about it will also incur the risk.

Isn't it true that if there is a difference between the actual cost of transporting the coal and the price allowed by the proxy, due to the inappropriateness of the escalators being used, that EFC will benefit from that spread, as well?

A I don't think anyone has indicated there is an inappropriateness in the factors that the parties to the settlement were using at the time.

Q Did I hear you say earlier that you had read the testimony of Mr. McNulty?

A Yes, I did.

Q And didn't I hear you say that with few exceptions that you agreed with it?

A Yes, I do.

Q Okay. Let me change gears for a minute, then, if I may. Do you have a copy of Mr. McNulty's testimony?

A Yes.

Q I would like to ask you to look at Page 7 of Mr.

McNulty's testimony. In response to a question that was put to him starting at Line 16, he says -- and I would like to see if you agree with -- if this is one of the parts that you agree with or not -- he says according to Order Number PSC-93-1331-FOF-EI, PEFI's domestic WCTS market priced proxy was based on the EFC's 1992 cost of providing WCTS service to FPC. The market price proxy was a quote, unquote, best guess as to what direction market prices would be for WCTS for PEFI, but it was based on the application of cost escalators that imperfectly gave market price, especially over a long periods of time. The potential has always existed for a significant mismatch between the market price proxy resulting from the application of these cost escalators and the actual WCTS market price.

And with respect to that testimony of Mr. McNulty, I want to ask you, first, isn't that a criticism of the validity of the escalators used in the 1993 stipulation?

A Well, I think his testimony goes maybe more to the duration over which those indices were used rather than the specific indices chosen.

Q Let me ask you this question. His statement that it was based on application of cost escalators that imperfectly gauged market price especially over long periods of time, doesn't that mean that it is imperfect, period, and more so over longer periods of time?

A I'm not sure. Say that last part of the question.

Q Yes, sir. Don't you read his testimony as saying that the escalators were imperfect generally, but particularly over long periods of time?

A Yes, that is what I said.

Q In fact, elsewhere in his testimony, doesn't Mr. McNulty point out that based upon data the staff obtained that they had determined that the first five years of comparing the escalators to actual cost experience resulted in him believing that they were imperfect in the first time years, do you recall that?

A Subject to check, I will take your word for it. I think that the Commission, when it implemented the factors, was acknowledging to the company that it was up to the company to manage its procurement practices such that they could achieve a return. Because the original $23 was predicated on the actual costs incurred. So there must be a return component incorporated into the analysis, which Mr. McNulty does in the more recent years.

Q Yes, sir, but that is not my -- the point I want to get, and I'm not taking issue with the $23 base cost in 1993, but in that stipulation there was a methodology that was agreed to at that time by which you would have some basis for inflation or some escalation, correct?

A That's correct.

Q And there were five different escalators that were used, correct?

A That is correct.

Q And isn't a true now that Mr. McNulty is saying that some of those escalators doesn't work, that it doesn't bear any relation to what the actual cost experience was in the waterborne or multimodal transportation of coal?

A That is what Mr. McNulty is saying.

Q Yes. And to the extent that earlier in response to Mr. Vandiver's questions about whether you agreed with Mr. McNulty's testimony or not, is that one of the areas that you agree with or disagree with?

A We agreed to accept Mr. McNulty's testimony as a resolution to the issues in this case.

Q Well, let me ask you independent of that, sir. Irrespective of what he said, do you think that the -- and I think there is other evidence in the record, or will be that compares these, but based upon your awareness of the actual cost experience for your fuels provider versus the performance of the escalators since 1993, wouldn't you agree that it is off a bit?

A That is off a bit? Yes, I would agree.

Q In fact, I believe it was your testimony and the company's position in the stipulation that you are proposing with the Staff that you agree that it is sufficiently off that you are willing to abandon it in favor of some type of a competitive bid process beginning in January 1st of 2005, correct?

A Yes. We have agreed to use 2004 as a transition period to the alternative proposed by Mr. McNulty.

Q Now, would you agree with me that if 2003's results were ultimately to show that some of the cost recovery you are seeking approval of was not reasonable and not prudent because of the difference between the escalator and actual cost, if that were the case found eventually, would you agree that utilizing that same proxy on a going-forward basis in 2004 might cloud the prudence of the 2004 expenditures?

A I guess, no, I would not. The actions the company has taken in 2003, which were in November of the year already, were based on the Commission's standing order. We paid our affiliates based on the market proxy which the Commission established, which we calculated, which they review, and which we implemented. And we are abiding by that standing order. And we agree with Mr. McNulty's testimony that the company should be allowed a transition period to migrate from the methodology that has been in place for quite a number of years, and restructure its management to meet the RFP requirements.

Q Yes, sir. But doesn't Mr. McNulty say at the outset of his testimony that he doesn't believe that the Commission is bound by this proxy in terms of a given terms of years, that it

is capable of being reviewed at any point, essentially?
A Yes. And I think that is what we are doing now, review of the proxy and its use prospectively.
Q Right. And isn't it also true that he says in his testimony, and irrespective of whether he says it or not, that there was apparently some agreement in the 2002 fuel adjustment hearings among the parties that the fuel proxy for Progress Energy would be examined this year during these hearings?
A The issue that was raised in 2002, or the issue that was raised in the 2002 hearing was a matter of whether discovery could be undertaken in this docket or should another docket be opened in which to ask discovery type questions on this subject.
Q You are referring to the testimony of Mr. McNulty at Page 6, Line 9?
A I'm referring to my recollection from being there last year.
Q Let me just ask you to turn to Page 6, Line 9, if you would, please. Would you read that first sentence -- just read it to yourself, that first sentence starting at Line 9?
A Yes, that is what I have stated here, that the Commission agreed, or the parties agreed and submitted to the Commission that it was appropriate to conduct the discovery in this docket.
Q Well, actually it says that a review of the WCTS

market price proxy should take place as part of the fuel and purchased power cost-recovery clause proceeding, does it not? I'm just trying to make the distinction, sir, that it says a review, not just that discovery could take place.

A Well, I mean, that is what you do in discovery is review and ask questions.

Q Yes, sir. And that is what we are doing now, right?

A That is what we are doing now.

Q I want to ask you a few more questions about Mr. McNulty's testimony and which parts you concur in. If you would look at Page 10, sir. And I want to be sure I don't read any of the confidential material, but starting at Line 3, Mr. McNulty testifies, "My analysis shows that the growth rate of PEFI's domestic WCTS market price proxy exceeds the growth rate of the market price shown in the EIA data for these years," as depicted in his Exhibit WBM-1. "The data shows that the market rate for multimode coal transportation rates decreased in real terms from 1993 through 1997 by an average of 3.5 percent per year." So that would be -- four times that would give us a noncompounded rate, right?

A Yes, subject --

Q If we wanted a noncompounded rate of decrease, we would just take four times or three times 3.5?

A Subject to check, that's fine.

Q While PEFI's market price proxy, and then the next word is confidential, by confidential percent. And I wanted to ask you at this point, sir, is this any reason why that should be confidential, whether it went up or down, or the percentage, or is that something that the Staff did?

A The Staff made that confidential, and I think it does serve as a way to disclose the transportation costs.

Q Well, it also indicates at a core issue whether you are getting too much or too little by the way the calculations are computed versus the actual data, right?

A Like I mentioned earlier, we agreed to adopt staff's position as a prospective means of arriving at an alternative to today's situation, and I did not do any due diligence to analyze Mr. McNulty's growth rates here.

Q Yes, sir. Are you saying that you didn't check what he -- no one on your staff checked the figures that he used in this calculation?

A We agreed not to rebut his testimony.

Q Yes, sir. My question is different. My question to you is did you or anybody under your supervision and control check the calculations of the figures that Mr. McNulty made in the sentence that I just read to you?

A No, we did not.

Q Okay. But, for purposes of this hearing, you agree with that statement, right?

A Subject to check.

Q Okay. Same page, Line 13, just to see if you agree or disagree with this. This is Mr. McNulty again. The 1992 through 1997 price data comparison shows that PEFI's market price proxies were not reflective of the market trend during this period, and you have maintained that that next series of words is confidential, as well?

A Yes.

Q Okay. Do you agree with that statement and the conclusion reached?

A I would say that I agreed with adopting the testimony in its entirety.

Q Let me go on. I just have a few more. Still at the same page, Line 19. Mr. McNulty testifies -- and I think this is still going to be in -- based on the results of staff's discovery and staff's audit of the PFC's 2002 costs, PFC's 2002 cost of providing domestic WCTS for PEFI is blank than the 2002 domestic WCTS market price proxy as shown in Exhibit WBM-2. My estimate of PFC's 2002 margin for domestic WCTS provided on behalf of PEFI is blank percent or blank total dollars. Let me ask you, when he is referring to margin, I took that to mean profit. Do you take that to mean the same?

A No, it is revenues less cost of goods sold. You have to tax effect it to introduce the fact that you have got to pay Uncle Sam. Then you get to return.

Q Would I be correct in looking at it as gross profit?

A Yes.

Q You are aware of the numbers that are in that testimony, correct?

A I am aware of them.

Q Do you agree with the numbers and the conclusion he reached?

A Well, we did verify some of these numbers, and they are a bit off from my calculation. But, again, it was -- in terms of the approach that Mr. McNulty was putting forward seemed reasonable and equable for both the ratepayer and the company.

Q Yes, sir. Let me ask you with respect to the percentage shown on -- not shown on Line 23 --

A Yes, sir.

Q -- would you feel comfortable telling the Commission whether that number is greater or lesser than the authorized return for the electric utility?

A Oh, it is greater.

Q Okay.

A It is on a gross basis, also. And if I could tell you, if it is adjusted for the numbers presented in some of the discovery questions that came in after his testimony, it will actually show that the after-tax margin is actually below the utility's authorized.

Q Are you saying if it is adjusted by the adjustments that you have suggested to staff should be included?

A No, the costs that were presented in discovery question, I think, 77 and 76, or 76 and 77, if those were incorporated into Mr. McNulty's formula, and then tax-affected it actually shows that for that particular domestic commodity it would be below the utility's rate of return.

Q Thank you. The dollar figure that is not shown there --

A Yes, sir.

Q -- that is the result of staff's 2002 audit and it is the number for 2002, is that correct?

A That is the number that corresponds to the percentage that would also change.

Q And to my knowledge, nobody in this proceeding is suggesting that the Commission should reach back to 2002, correct?

A That's correct. Mr. McNulty's testimony, which we support, shows no adjustment to '02, '03, or '04.

Q Yes, sir. And what I want to ask you is if that number not shown is that big, what would the corresponding number be for 2003, if you know?

MR. McGEE: Madam Chairman, I think the witness has already said that the number that Mr. Twomey is referring to right now is not the correct number.

MR. TWOMEY: Yes, sir. But, Madam Chair, what I want to know is what the corresponding number is, whether it is correct or not, would be for the year 2003, which is, in fact, the year that we are suggesting that you should be -- well, not we are suggesting, that you are, in fact, looking at.

CHAIRMAN JABER: Mr. McGee, I understood the question to be whatever that correct number is, what is the corresponding number for 2003. And do you have an objection to that question?

MR. McGEE: No, that is not what I understood the question to be; but if that is it, I withdraw the objection.

MR. TWOMEY: Well, let me make -- I'm not sure.

CHAIRMAN JABER: Mr. Twomey, the way I understood your question, and perhaps you would want to rephrase it based on that, but I understood your question to be whatever the number is for 2002, what is the corresponding number for 2003.

MR. TWOMEY: Not quite.

CHAIRMAN JABER: Okay. Go ahead.

MR. TWOMEY: What I'm trying to get at, Madam Chair, and I apologize for the confusion, is that I will accept that he has got other adjustments that should be addressed that may even be correct. What I'm saying to the witness is that the number that is on this sheet, but you will see it later, I assume, when the McNulty confidential unredacted testimony is pointed out, what I want to know is, is that without the adjustments that he thinks should be made, does he know what the corresponding number would be for 2003 as shown in Mr. McNulty's Page 10, Line 23. And I don't want you to say it specifically, but is it in the same approximate range.

CHAIRMAN JABER: Well, Mr. Twomey, let's entertain the objection first. The question is, and thank you for clarifying it, because I didn't understand, apparently I didn't understand either. The second confidential spot on Line 23, Mr. McGee, the question posed to the witness is does he have the corresponding number for that confidential number for 2002.

MR. McGEE: And my only point is that the witness has said when discovery that was pending at the time Mr. McNulty testimony was prepared is taken into account, both the percentage and the dollar figure that is shown are incorrect. The effect of Mr. Twomey's question is asking him can you determine the incorrect number for the next year. And I would object to a request to calculate a number that he has already indicated is not the proper number in the prior year.

CHAIRMAN JABER: Mr. Twomey.

MR. TWOMEY: Madam Chair, I don't know whether staff has accepted the adjustments the witness speaks to or not. All I am suggesting is that whether it is inappropriate or not, someplace in somebody possession, and presumably in the company's, as well, is a number that corresponds to that number, the second number, irrespective of whether it is correct or not. I'm not asking -- he can say that it is not correct, but the corresponding number for 2003 is bigger, smaller, the same, way bigger, way smaller, that's all.

CHAIRMAN JABER: With regard to the question on the table, let me sustain the objection, because I think that is better asked of Mr. McNulty when he gets up on the stand. With regard to recognizing that this witness has twice said they disagree with the number, if you want to pose, well, what do you believe the number is for the year 2003, or do you know what the number is for 2003 recognizing your position is that this contains an error, I will allow that question.

MR. TWOMEY: Okay. And I appreciate that. And I will, of course, abide by that. Let me just suggest to you, I think when I asked that question of Mr. McNulty, based upon my understanding of the evidence and discovery presented to your Staff, is that I believe he is going to say that he doesn't know it because they don't have an audit of 2003.

CHAIRMAN JABER: Okay. Let's cross that bridge when we come to it.

MR. TWOMEY: Yes, ma'am.

BY MR. TWOMEY:

Q Let me ask the question, then. Given the adjustments that you would make, is that number larger, smaller, substantially larger, substantially smaller, or how would you characterize it?

A I mean, the adjusted number for '02 --

Q Pardon me?

A The adjusted number for the period Mr. McNulty addresses here is about a third of --

Q A third of that amount?

A No, pardon me. A third less, or two-thirds of that amount. And the '03 figure is probably slightly less because the market proxy goes down in '03.

Q Okay. Thank you.

A You're welcome.

Q If you would turn to Page 12 of his testimony, please. Again, I want to check on your concurrence of his testimony. Page 12, Line 20, my estimate of PFC's margin for domestic -- do you all have phrases for these things?

A Phrases for what, sir?

Q Instead of saying out W-C-T-S?

A Waterborne coal transportation service is what it stands for.

Q You don't have a name -- I'm sorry, you don't have a little name? WCTS is blank percent or blank dollars, and he goes on, and he says, "Also my comparison of the cost of domestic CWTS and foreign WCTS reveals that the ratio of transloading and Gulf shipping costs to total domestic cost has blank from 50.2 percent in 1992 to blank percent in 2002." Do you agree with his numbers and his conclusion?

A Again, this is another one where his numbers do not reflect the final responses to the interrogatory questions.

Q I see. And we would find those in the interrogatories?

A You would fine the new cost numbers and you would have to plug it into his formula.

Q And do they differ substantially?

A By about 500,000.

CHAIRMAN JABER: Did the interrogatory responses come in after Mr. McNulty filed testimony?

THE WITNESS: Yes, they did.

BY MR. TWOMEY:

Q You said 500,000?

A Yes, sir, I did.

Q Okay, thank you. Getting near the end on his stuff. Page 15, sir. Mr. McNulty says beginning at Line 8, "I conclude that both market price proxies exceeded the cost of providing service and allowed the affiliate, PFC, to achieve significantly more profits than is reasonable for this service given the level of risk assumed. Also, I conclude that the market proxies escalators and their respective weightings do not reflect the cost structure of the industry."

Is that one of the conclusions in Mr. McNulty's testimony that you concur with?

A Again, we adopted his testimony in totality.

Q So if Mr. McNulty is talking about the profit and the market price proxies not being reasonable for the service given in the year 2003, wouldn't it be reasonable for the Commission to conclude that they should not approve for recovery in your rates those portions of the costs that are unreasonable?

A I think the Commission has to weigh the fact that there is a standing order that provided the methodology under which the company was operating for these years. The contracts that were entered were based on the knowledge of that methodology, and I think these hearings are intended to flush out things of this nature so that the Commission can act prospectively to change existing orders that their staff and the parties may want to introduce going forward. I think that Mr. McNulty's proposal here does achieve a balance to allow the company to manage to the changes that he is proposing, quite significant changes, and also provide for the customer benefits that we hope are provided through the RFP process.

Q Yes, sir. But you have already agreed with me, I think as shown on Mr. McNulty's Page 6, that the Commission approved the stipulation by the parties, which I presume included your utility, that -- and this was in the latter part of 2002, that the proxies would be reviewed in these hearings. And if that is the case, didn't Progress Energy have notice that the costs they sought for recovery for fuel transportation through the fuel clause would be -- if not at risk, at least subject to examination for their reasonableness and prudence?

A No, sir. I think it was our understanding that since it has been such a long time, and since the composition of the staff had changed over those years, that there was a desire on the part of staff to understand the proxy. And I think as evidenced by the types of questions that the Commission staff asked through discovery, that they were trying to educate theirselves.

It was not until Mr. McNulty presented his testimony that we had real notice that there was a problem or the staff was taking exception to the market proxy. Prior to that no one had raised a concern with the methodology.

Q Okay. I just have a couple more, please. Look at Page 16 of his testimony. In his -- I guess close to his bottom line conclusions he says in the reasons he gives for recommending the elimination of the current market price proxy methodology that competitive markets already exist for most of the components. Do you agree with that?

A Again, we agreed to adopt his testimony.

Q Okay. His second reason, starting at Line 14, and I quote, "Two: The market price proxies have worked to the detriment of PEFI's ratepayers by exceeding both the cost of service and the market price of WCTS." Do you agree with that conclusion?

A Again, we accepted the testimony in totality as a resolution to the issues.

Q Okay. Would you agree with three the same, then?
A The same.
Q And number four says, and I quote at Line 20, "The foreign WCTS market proxy is completely obsolete as this time because it was based on a ratio of Gulf transport costs to total cost that existed ten years ago, but that has blank since that time." Do you agree with that?
A The same answer.
Q Okay. I think I'm almost to the end. I'm finished with his testimony. I want to ask you a few more on your testimony and I will be finished, if I may. Page 26 of your testimony, sir. You discuss on that page that the apparently 27.8 percent of EFC's upriver waterborne coal was purchased at an FOB barge price, correct?
A That is correct.
Q Now, is your discussion of that issue in part to alleve any concerns that there might be a double counting issue?
A Yes, sir.
Q And would you explain to the Commission how there could be a double counting issue?
A Well, if the utility were to include transportation costs that otherwise were intended to be recovered through the market proxy, there could be double recovery once through the commodity and then once through the market proxy.

Q And it is your testimony, as I understand it, that you haven't been doing that because -- is it your testimony that 27.8 percent of the coal that was purchased at FOB barge was not included in the calculation of the proxy?

A That's correct. That happened to be the basis for the development of that $23, and we have attempted to maintain that balance throughout the ten-year period.

Q Has the Staff, to your knowledge, audited that fact, or confirmed that fact in the construction of the 1993 base price?

A I don't know.

MR. TWOMEY: That's all I have. Thank you very much.

THE WITNESS: You're welcome.

CHAIRMAN JABER: Staff.

MR. KEATING: Just a few questions.

CROSS EXAMINATION

BY MR. KEATING:

Q Good afternoon, Mr. Portuondo. I believe earlier today your attorney indicated that Progress can agree that as stated in staff's position in the prehearing order on Issue 31A concerning post-9/11 incremental security costs that only 62 percent of a recent nuclear regulatory commission fee increase is attributable to homeland security costs, and thus that only 62 percent of the fee increase should be recovered through the capacity clause as incremental post-9/11 security cost, is that correct?

A That is correct.

Q I also want to ask just a few questions about the document that has been provided to the parties and to the Commissioners on Monday, the document identified as the proposed stipulation on pending Progress Energy issues concerning waterborne coal transportation services. Do you have that document?

A I do not.

Q And it may be that we don't need to refer to it for purposes of this set of two questions. I believe you discussed earlier with Mr. Vandiver some of Progress Fuel's existing contracts for various components of its coal transportation service it provides for Progress Energy.

A Yes, I did.

Q And you discussed one of the components, the trans-Gulf component. Is it correct that of the four components of waterborne coal transportation that you discussed with Mr. Vandiver that that is the only component that Progress Fuels is under contract for a period past the end of 2004?

A That's correct.

Q Now, this proposed stipulation or agreed position, however we characterize it, indicates that the way to handle that contract -- well, let me step back. That contract, is it correct, terminates at the end of March 2005?

A That's correct.

Q So under this proposed stipulation, it states that the trans-Gulf component for the period January 1, 2005, through March 31, 2005, will be equal to 26 percent of the 2005 market price per ton proxy. And as I understand, and you can correct me if I'm wrong, that was a means to deal with those three months of that contract even though the other contracts had expired and the market price proxy otherwise would be eliminated at the end of 2004?

A That's correct.

Q And if you could just explain the basis of the 26 percent?

A The 26 percent was the ratio of trans-Gulf actual costs to total actual costs for 2002.

Q On Paragraph 4, it is the last paragraph of that document, there is a provision that indicates that Progress would be allowed to recover some non-contractual miscellaneous charges imposed upon Progress Fuels in conjunction with providing waterborne coal transportation service, and it provides some examples of those types of costs. Do you see that?

A I do.

Q There is a cap, it appears, that is provided at the end of that paragraph, the 25 cents per ton for such miscellaneous charges?

A I see that.

Q Do you know what the basis of that 25 cents per ton cap is?

A If I recollect, I think that that was based on historical experience. Some of these costs are actually incurred directly at Progress Fuels rather than through one of the many contracts that are negotiated for the entire water path, so we wanted to make sure that we captured those, like port charges. Sometimes those are assessed directly to Progress Fuels rather than being incorporated within one of those contracts.

Q I don't have any other questions concerning that particular document, and I just have a couple of questions concerning your November 3rd supplemental filing. And this is the testimony that addresses growth adjustment or gross-up adjustment. It has been referred to differently by different people. In your testimony beginning at the bottom of Page 4 you discuss the fact that a staff witness filed testimony proposing this type of adjustment in last year's fuel docket, is that correct?

A That is correct.

Q You go on to suggest that because no adjustment was made, that staff may have recognized that the adjustment was not meritorious. Is that also correct?

A That was my opinion, yes. The Commission proceeded to approve the base level that we had in our MFRs as the appropriate adjustment to the incremental security calculation.

Q At last year's fuel hearing, what period of time would staff have made that type of adjustment for, and what was the period between a base year and a point in time in which incremental expenses would have been determined?

A I think it would have been the MFR versus the, I guess, projected results for 2002.

Q So it would have been --

A It would have been within the same year.

Q It would have been within the same year.

A Yes. Test period versus actual.

Q Is it possible that staff felt no need to make an adjustment in the 2002 fuel hearing because the MFRs had just been filed and base rates had just been set and there was that small period of time over which an adjustment could have been made?

A No. Well, I mean, that could have been what was thought on the part of staff. I think on my part I thought staff was proposing policy on how to calculate incremental costs, and that would be irrelevant of the time period. And the fact that it did not make its way into the recommendation and ultimately the Commission decision led us as a company to believe that the methodology that we had proposed, and that we continue to use, was acceptable to this Commission.

Q If an adjustment had been made in 2002, would you expect it to be significant to any degree, given the short time period over which growth would have been adjusted for?

A I have not gone back to calculate the differential between the projected sales and the actual 2002, or the reprojected at the time for 2002, so I don't know the magnitude.

MR. KEATING: Thank you. That's all the questions I have.

CHAIRMAN JABER: Commissioners, do you have any questions?

Redirect, Mr. McGee.

REDIRECT EXAMINATION

BY MR. McGEE:

Q Mr. Portuondo, you were asked a number of questions particularly by Mr. Twomey regarding whether you agreed or disagreed with numerous passages in the prefiled testimony of Mr. McNulty. Some of your answers were not completely direct and forthcoming, and I would like to make sure we have the opportunity to put that into a perspective so that that is understood.

Mr. McNulty's testimony concludes, for various reasons, that the market price proxy should be changed. Do you, on behalf of Progress Energy, concur that that is a correct conclusion?

A That is a correct conclusion.

Q Given that the company has agreed to his conclusion, is it your understanding that the company entered an agreement with the staff not to contest Mr. McNulty's testimony with respect to the various components that might have supported that conclusion?

A That is correct.

Q If you were to be critical of certain aspects of Mr. McNulty's testimony, even though you agreed with the conclusion that he reached based on various considerations, would you view this as being inconsistent with the assurance that you and your company has made to the Staff that we would not engage in contentious cross-examination or rebuttal?

A That is correct.

MR. McGEE: That is all we have, Madam Chairman.

CHAIRMAN JABER: Thank you, Mr. McGee. With that, seeing no objection to Exhibit 23, Exhibit 23 will be admitted into the record.

Mr. Portuondo, thank you for your testimony.

(Exhibit 23 admitted into the record.)

CHAIRMAN JABER: Commissioners, parties, I suggest we break for the evening and start tomorrow. I know that we have got a pending motion, but I have lost a Commissioner for the evening, so the motion will be taken up first thing in the morning, 9:00 o'clock.

Mr. Hart.

MR. HART: Will we be given -- the importance of the document is to be able to use it in these proceedings. And if we don't receive it, we won't be able to -- and if we don't receive it until right before the witness testifies, in the event we do receive part of it, it will be difficult to use it.

CHAIRMAN JABER: Mr. Hart, we're not going to rule on the motion tonight. And I understand your concern. It will be taken up first thing tomorrow morning at 9:00 o'clock. And I know you don't practice here very often, but for whatever it is worth to you, I assure you you will have time to review the document, if that's what the ruling is.

We will adjourn for the evening. We will start at 9:00 o'clock tomorrow morning.

(The hearing adjourned at 5:35 p.m.)

STATE OF FLORIDA)

: CERTIFICATE OF REPORTER

COUNTY OF LEON)

I, JANE FAUROT, RPR, Chief, Office of Hearing Reporter Services, FPSC Division of Commission Clerk and Administrative Services, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 24th day of November, 2003.

JANE FAUROT, RPR
Chief, Office of Hearing Reporter Services
FPSC Division of Commission Clerk and
Administrative Services
(850) 413-6732