Progress Energy

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PROGRESS ENERGY SERVICE COMPANY, LLC

November 24, 2004

VIA HAND DELIVERY

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

Re: **Docket No. 041272-EI**; Progress Energy Florida Inc.'s Petition for Approval of Storm Cost Recovery Clause for Extraordinary Expenditures related to Hurricanes Charley, Frances, Jeanne, and Ivan.

Dear Ms. Bayó:

Enclosed for filing are an original and fifteen (15) copies of Progress Energy Florida Inc.'s Response in Opposition to Joint Motion to Dismiss.

Please acknowledge your receipt of the above filing on the enclosed copy of this letter and return to the undersigned. A 3½ inch diskette containing the above-referenced document in Word format is also enclosed. Thank you for your assistance in this matter.

Very truly yours,

James A. McGee

JAM/scc
Enclosures

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Progress Energy Florida's Petition for Approval of Storm Cost Recovery Clause for Extraordinary Expenditures related to Hurricanes Charley, Frances, Jeanne, and Ivan	Docket No. 041272-EI Submitted for filing: November 24, 2004

RESPONSE OF PROGRESS ENERGY FLORIDA
IN OPPOSITION TO INTERVENORS' JOINT MOTION TO DISMISS

Progress Energy Florida, Inc. ("Progress Energy" or the "Company"), pursuant to Rule 28-106.204, F.A.C., hereby submits its response in opposition to the joint motion to dismiss (the "Joint Motion") filed by intervenors Office of Public Counsel ("OPC") and the Florida Industrial Power Users Group ("FIPUG") (collectively, the "Intervenors"), and states as follows.

Response Summary

The Intervenors' argument that Progress Energy's petition to establish a Storm Cost Recovery Clause is prohibited by the Company's 2002 rate case Stipulation and Settlement (the "Settlement") is belied by specific language in the Settlement addressing the Company's use of cost recovery clauses. That language prohibits one particular use of the clauses -- the recovery of new capital items that are traditionally recovered through base rates. The Settlement imposes no restriction on Progress Energy's use of a clause to recover non-capital costs that have not been traditionally recovered through base rates, which are the only costs subject to the Company's proposed Storm Cost Recovery Clause.

The Joint Motion contends Progress Energy's proposed use of a cost recovery clause is "an attempt to do an end run around" the Settlement's restriction on the Company's ability to request a base rate increase through 2005, since "storm damage expenses are part of base rates." To the contrary, the catastrophic storm damage costs Progress Energy seeks to recover through the

Storm Cost Recovery Clause are not and never have been part of its base rates. In establishing the storm damage reserve for self-insured utilities in 1993, the Commission declined to provide for the recovery of costs associated with catastrophic storms, but made it clear the utilities could petition for recovery if they experience such costs. Moreover, the catastrophic storm-related costs Progress Energy has now petitioned to recover exhibit the classic characteristics of volatility, irregular occurrence, and unpredictability which make them ideally suited for recovery through a clause, rather than base rates.

The Intervenors' remaining grounds for dismissal are nothing of the sort. Instead of raising legal issues that require dismissal by the Commission as a matter of law, these purported "grounds" are simply a statement of the Intervenors' position on issues of regulatory policy and fact that are for the Commission to consider on their merits based on evidence presented at the hearing currently scheduled in this case. It would be improper and inappropriate for these matters of policy and fact -- principally, the recovery of costs through base rates or a clause -- to be considered and resolved on nothing more than an exchange of pleadings and legal arguments, as the Intervenors contend.

Among these specious grounds is the Intervenors' allegation that the cost recovery mechanism proposed in Progress Energy's petition, if approved, would "emasculate the existing settlement" and would "permanently chill any possibility of future settlement." This allegation begs the underlying question whether the Company's petition comports with the Settlement. In point of fact, as will be described below, Progress Energy has developed its cost recovery proposal to conform with the letter and spirit of the Settlement. The true chilling effect on future settlements would occur if the Intervenors' Joint Motion were allowed to prevent the Company from proposing a use of the cost recovery clauses that was preserved under its current Settlement.

In short, the Intervenors' Joint Motion is an attempt to prevent the Commission's consideration of these important and timely issues of regulatory policy -- consideration that the Commission itself, on several occasions, assured the utilities they would have the opportunity to request. Progress Energy now seeks to avail itself of this opportunity, and the Intervenors have failed to demonstrate that dismissal of the Company's petition raising these policy issues is required as a matter of law. Their Joint Motion should therefore be summarily denied.

Argument

1. At the heart of the Intervenors' Joint Motion is the allegation that Progress Energy's proposed Storm Cost Recovery Clause "is nothing more than an attempt to do an end run around its Stipulation and Settlement" since the Company "agreed not to seek an increase in its base rates and charges ... prior to December 31, 2005." Joint Motion, p. 3. The Intervenors ascribe this ulterior "end run" motive to the Company on the premise that "clearly ... storm damage expenses are part of base rates" covered by the Settlement. Joint Motion, p. 4. This underlying premise that Progress Energy's petition seeks to recover storm damage expenses that are part of base rates is simply wrong.

2. As is more fully explained in the testimony of Javier Portuondo filed this day, the Company's storm damage reserve established by the Commission in 1993 was specifically designed to provide a source of funds to cover the Company's self-insured costs associated with "normal" storms (storms with a 23 percent annual probability of occurrence and a 53 percent probability that total damages will be less than $5 million) that the Company might be expected to experience based on historical data. And, in fact, as explained in Mr. Portuondo's testimony, that has been consistent with the experience of the Company's storm damage reserve since its inception -- in no year have storm-related costs exceeded the $6 million annual accrual to the reserve. Conversely, and specifically to the mistaken premise of the Intervenors' allegation, the

reserve and its accruals included in the Company's base rates were not designed to cover the costs of a less likely, more expensive catastrophic hurricane, much less a back-to-back series of four major hurricanes in a period of less than six weeks. The magnitude of the costs to cover such a catastrophic event was too great, and the likelihood of occurrence was too small, to warrant the funding of a reserve to that level. Instead, as the Commission stated in the 1993 proceeding that established Florida Power and Light's initial storm damage reserve:

> "The Commission will expeditiously review any petition for deferral, amortization or recovery of prudently incurred costs in excess of the reserve. Our vote today does not foreclose or prevent further consideration at a future date of some type of a cost recovery mechanism, either identical or similar to what has been proposed in this petition. The Commission could implement a cost recovery mechanism, or defer the costs, or begin amortization, or such other treatment as is appropriate, depending on what the circumstances are at that time."

Order No. PSC-93-0918-FOF-EI, issued June 17, 1993 in Docket No. 930405-EI. Similarly, in the Company's proceeding shortly thereafter, the Commission made the following statement after declining to act on the Company's request to address storm-related costs that exceed the reserve balance: "If FPC experiences significant storm related damage, it can petition for appropriate regulatory action." Order No. PSC-93-1522-FOF-EI, issued October 15, 1993 in Docket No. 930867-EI. As everyone is keenly aware, that event has now been experienced four-fold.

3. This background regarding the limited purpose of the storm damage reserve was carefully taken into account in developing the cost recovery mechanism proposed in Progress Energy's petition. The Company's proposal is limited to only the incremental non-capital operating and maintenance ("O&M") costs associated with the catastrophic storms which exceed the reserve's balance. The proposal does not seek to recover or replenish the depleted reserve balance that had been accrued for non-catastrophic storms, nor does it seek a higher level of accruals to the reserve that recent experience suggests is needed. The Company considered those

to be prospective matters outside its petition's limited scope related to the immediate consequences of the recent hurricanes, and therefore would be more appropriately dealt with in other proceedings.

4. In developing its proposal, Progress Energy took careful note of the Settlement as well, in particular, the provision dealing with the Company's use of cost recovery clauses. That provision, which is the last sentence in Section 12 of the Settlement, states:

> FPC will not use the various cost recovery clauses to recover new capital items which traditionally and historically would be recoverable through base rates, except as provided in Section 9 [regarding Hines Unit 2].

The converse of this limitation on the Company's use of cost recovery clauses is that the Settlement does not preclude the use of a clause to recover capital items that have not been traditionally and historically recovered through base rates. However, the design of Progress Energy's proposal limited this permissible use of cost recovery clauses to exclude the recovery of capital costs altogether,[1] irrespective of traditional base rate status, and beyond this, to recover expenses only to the extent they exceed the balance of the storm damage reserve. In taking these additional steps to limit recovery under its proposal, the Company has attempted to comply with both the letter and the spirit of the Settlement's restriction on the use of cost recovery clauses. The Intervenors' allegation that the Storm Cost Recovery Clause proposed by Progress Energy attempts to recover expenses that are part of base rates completely ignores this background of the storm damage reserve and the design of the Company's proposal.

5. The remaining points in the Intervenors' Joint Motion simply state their position on disputed issues of regulatory policy and fact, and are insufficient to support their motion to

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[1] The Company's proposal includes incremental storm-related costs of capital items above the costs that would have been incurred under normal conditions, which have been reclassified as O&M expense. For example, if the cost to install a distribution pole during hurricane restoration conditions is $125 and the installation would cost $100 under normal conditions, the additional $25 is reclassified as an O&M expense. This accounting treatment is intended to prevent the addition of above-normal capital costs to rate base and was described by the Company in the initial 1993 proceeding that established its storm damage reserve.

dismiss. Cintron v. Osmose Wood Preserving, Inc., 681 So.2d 859, 860 (Fla. 5th DCA 1996)("In reviewing a motion to dismiss a complaint, the trial court must make its decision solely upon questions of law."). The Commission's decision on the Joint Motion must be based on issues of law, assuming all facts alleged in the Company's petition to be true. Connolly v. Sebeco, Inc., 89 So.2d 482 (Fla. 1956)("For purpose of passing upon a motion to dismiss a complaint, the court must assume all facts alleged in the complaint to be true and must decide the motion on questions of law only."). Whether or not the Intervenors dispute the regulatory policy proposed by Progress Energy's petition or the facts supporting its proposal has no bearing on their Joint Motion. Chaires v. North Florida Nat. Bank, 432 So.2d 183 (Fla. 1st DCA 1983)(function of motion to dismiss complaint is to raise as a question of law the sufficiency of facts alleged to state cause of action, and court is not permitted to speculate as to whether plaintiff has any prospect of proving the allegations). Moreover, by raising disputed issues of policy and fact, the Intervenors actually support the need for evidence adduced at hearing, since dismissal is not favored unless compelled as a matter of law. McClain v. Florida Parole and Probation Com'n, 416 So.2d 1209 (Fla. 1st DCA 1982)("Motions to dismiss should be primarily used for procedural and jurisdictional issues. Whenever possible, courts should decide cases on their merits, rather than on procedural grounds."); Ragoonanan by Ragoonanan v. Associates in Obstetrics & Gynecology, 619 So.2d 482 (Fla. 2nd DCA 1993)("Motions to dismiss are not favored methods of terminating litigation."); Obenschain v. Williams, 750 So.2d 771 (Fla. 1st.DCA 2000)("A court should not dismiss a complaint with prejudice if it is actionable on any ground.")

6. Despite the irrelevance of the Intervenors' policy and factual allegations to a legal decision on their Joint Motion, the inaccurate or misleading nature of these allegations leaves the Company reluctant to let them stand completely unanswered. The first of these allegations is

that Progress Energy's proposal for establishing a cost recovery clause was simply the Company's only alternative to accomplish its "end run" around the Settlement's restriction on base rate increases. Joint Motion, pp. 3 and 4. In point of fact, there are well recognized characteristics of the extraordinary hurricane-related costs at issue that make the use of a cost recovery clause, rather than base rates, particularly well suited for the recovery of these costs. These are set forth in Progress Energy's petition and are more fully discussed and explained in the testimony of Mr. Portuondo filed today. Among the characteristics associated with these hurricane-related costs that have been recognized as favoring the use of clause recovery over base rates are the volatility of costs, the irregular incurrence of the costs, and the inability to predict the occurrence, and therefore to budget for the costs, of the event or events in question.

7. The Intervenors repeatedly allege that Progress Energy's proposal is "a 100% pass through mechanism" which would "shift 100% of the risk to customers." Joint Motion, pp. 3, 4, and 6. The Intervenors make these misstatements despite their acknowledgement that the Company has limited potential cost recovery through the proposed clause. Joint Motion, pp. 2 and 3. To be clear, Progress Energy has not proposed a 100% pass-through mechanism. It has limited the portion of its total hurricane-related costs that would be subject to recovery through the proposed Storm Cost Recovery Clause to only the Company's O&M expenses by excluding the significant amount of hurricane-related capital costs, by further limiting O&M expenses to only the portion that exceeds the reserve balance, and by limiting the scope of the proposed Clause to only this portion of O&M expenses that are a direct consequence of the hurricanes, and not other pressing concerns related to the effects of the hurricanes on the storm damage reserve, such as replenishment of the depleted reserve balance and adjustment of the annual accrual in light of recent events.

8. The Joint Motion's allegation that establishment of the Storm Cost Recovery Clause would shift 100% of the risk to customers suffers from another basic consideration the Intervenors have failed to take into account. Progress Energy fulfilled its statutory obligation to serve by restoring service to its customers as expeditiously as circumstances permitted. The Company has now requested the Commission to establish a process under which all of the Company's storm-related costs will be examined by the Commission on a retrospective basis to determine whether the costs were reasonable and prudent under the circumstances in which they were incurred. By incurring these storm-related costs at the time and under the circumstances that it did, the Company assumed all the risk of subsequently demonstrating to the Commission that the costs were, in fact, reasonable and prudently incurred. However, once such a finding is made by the Commission, there is no sound regulatory policy to support the conclusion that the Company should not recover all of its reasonable and prudent storm-related costs which exceed the balance of the storm damage reserve. As noted earlier, these are precisely the sort of policy considerations that should be fully aired at a hearing on the merits, and not be volleyed back and forth in a rigid procedural vehicle which assumes by its nature that these matters are controlled solely by issues of law and warrant no further deliberation.

9. Finally, the Intervenors' Joint Motion makes a passing reference to the Settlement provision quoted in paragraph 4 of this response regarding the restriction that the cost recovery clauses not be used for recovery of new capital items traditionally recovered through base rates. The Intervenors then go on to state:

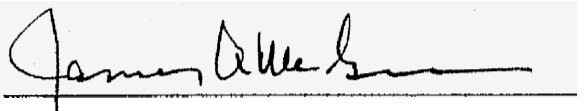
> "Given this previous agreement in the Stipulation and Settlement, it is virtually disingenuous for Progress now to seek to use a clause mechanism for storm-related costs which have been traditionally and historically treated as recoverable through base rates."

Joint Motion, p. 5. To reiterate the point made earlier, the storm damage reserve included in base rates was never designed and has never been funded for catastrophic storm-related costs

such as those experienced by Progress Energy this year. The Commission declined to do so because of the uncertainty as to if and when such a catastrophic event might occur and, if so, what the magnitude of the related costs might be. However, as described in paragraph 2 above, the Commission made clear that if a utility did, in fact, experience catastrophic storm-related costs, it would be receptive to considering the utility's petition for relief on a expedited basis. That is precisely the situation in which Progress Energy now finds itself.

WHEREFORE, based on the reasons set forth and discussed in this response, Progress Energy requests and urges the Commission to deny the Intervenors' Joint Motion.

Respectfully submitted,



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PROGRESS ENERGY FLORIDA

Docket No. 041272-EI

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the Progress Energy Florida's Response in Opposition to the Joint Motion to Dismiss has been furnished to the following individuals by electronic mail and regular U.S. Mail the 24th day of November, 2004.

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