BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by Progress Energy Florida, Inc.

Docket No. 050078-EI

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DIRECT TESTIMONY OF
MARK A. MYERS

On behalf of PROGRESS ENERGY FLORIDA

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DIRECT TESTIMONY OF
<u>MARK A. MYERS</u>

I. <u>Introduction and Purpose</u>.

Q. Please state your name and business address.

A. My name is Mark A. Myers. My business address is 410 S. Wilmington Street, Raleigh, North Carolina 27601.

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

A. I am employed by Progress Energy Service Company, LLC ("Service Company"), in the capacity of Vice President, Corporate Planning.

Q. What are the duties and responsibilities of your position?

A. As Vice President for Corporate Planning, I am responsible for strategic planning, financial planning and forecasting, business planning, budgeting and corporate development for Progress Energy.

Q. Please describe your educational background and professional experience.

A. I am a graduate of Florida State University, holding a degree of Bachelor of Business Administration, Accounting Major. In addition, I hold a Master of Business Administration from the University of Tampa. I joined Florida Power Corporation in 1983 as a financial auditor. Since then, I have held various management positions, including vice president of finance for Progress Energy Florida. Beginning in 2005, I became vice president of corporate planning. In addition to my work experience, I am a licensed certified public accountant in the state of Florida, a chartered financial analyst, and a certified internal auditor.

Q. What is the purpose of your direct testimony?

A. The purpose of my direct testimony is to present and explain the budgeting and financial forecasting process regularly employed by Progress Energy Florida ("PEF" or the "Company") for corporate planning purposes and used in this proceeding to develop the Company's detailed "per books" income statement and balance sheet information for 2005 and the 2006 test year, which provides the foundation for the Minimum Filing Requirements (MFRs) submitted by PEF in support of its rate relief request. I will also describe the procedures used by the Company to monitor and control, and to update when necessary, its Operation and Maintenance (O&M) and Construction budgets after they have been put into effect. Finally, I will present the key assumptions for, and the significant components of, the Company's 2005 and 2006 budgets.

The testimony of Mr. Javier Portuondo will address the use of the 2005 and 2006 budget information to produce the "per books" figures contained in PEF's MFRs, as well as the ratemaking and other regulatory adjustments to the per books figures necessary to derive the test year revenue requirements and resulting revenue shortfall upon which PEF's rate relief request is based.

Q. Do you have any exhibits to your testimony?

A. Yes, I have prepared or supervised the preparation of the following exhibits which are attached to my direct testimony:

- Exhibit No. _____ (MAM-1), a list of the schedules I sponsor in the Company's MFRs.
- Exhibit No. _____ (MAM-2), 2005 and 2006 Key Budget Assumptions.

These exhibits are true and correct.

Q. Do you sponsor any schedules of the Company's Minimum Filing Requirements (MFRs)?

A. Yes, I will sponsor the MFR schedules listed in Exhibit No. __ (MAM-1). These schedules are true and accurate, subject to their being updated in the course of this proceeding.

II. Corporate Planning and Budgeting Process.

Q. Would you please provide an overview of the Company's corporate planning and budgeting process?

A. Certainly. Normally, we plan and budget on a two year basis -- planning in 2004, for example, for the business years 2005 and 2006. We conduct this process throughout the course of the year in several stages. We begin by engaging in a review of strategic and corporate objectives for the coming year. Then we set financial targets for business units, taking into account the resource needs of each of the Company's business units and the corporate objectives we have established for the coming year. Next, the business units develop business plans and budgets calculated to achieve these targets. Once these are completed, we integrate them into an overall corporate plan and budget. Finally, this is reviewed, modified as may be appropriate, and approved by senior management and the Board.

The development of the budget and corporate plan is a dynamic process that involves the interplay of strategic planning, ongoing re-examination and adjustment of historical spending levels, continuous energy and sales forecast updating, rigorous review of resource needs and operational constraints, and target setting designed to drive performance and control costs and to ensure that any additional outlays for capital projects or O&M expenditures are necessary and cost-effective.

Q. Please describe the corporate operating budget and how it is developed.

A. The corporate operating budget includes all the components that comprise our annual profit plan, such as revenues, fuel and non-fuel expenses, O&M, taxes, etc. This is to be distinguished from the business unit O&M budget, which addresses the Company's period costs by functional areas, *i.e.*, power production, operations (transmission, distribution, and customer services), and Administrative and General expenses. The corporate operating budget includes the business unit O&M and Construction budgets. The corporate operating budgeting process begins in July with the conclusion of the financial target setting process. Business unit O&M and construction budgets are developed over a four month process running concurrently with the corporate operating budgeting process. Diligent coordination with various corporate departments is necessary to ensure an end-product that is cohesive and accurate.

Q. Would you explain the development of the significant components of your corporate operating budget for 2005 and 2006?

A. Yes. The budget of revenues is based on the most recent customer, load, and energy sales forecast and is integrated into the Company's corporate financial model (the "Model"). The Model is a computer simulation application used to forecast monthly and annual financial data through the use of a number of integrated calculation modules. The Model is updated on a timely basis to include the most current rate data as well as the approved corporate customer, sales, and demand forecast. The Model then calculates base revenues. Other revenue components, such as fuel, energy conservation, and franchise fees, are then computed to develop the total operating revenue projection. The fuel cost projection requires multiple inputs before a projection can be developed. First, a forecast of fuel prices by fuel type is prepared by the fuels department and is reviewed by senior management. The budgeted fuel cost forecast is incorporated as an input to the Company's production simulation model, known as PROSYM, along with numerous other factors associated with the load and operating characteristics of our generation system. PROSYM simulates the most economical dispatch from the Company's generating system to calculate fuel consumption and replacement fuel costs. This data is transferred as inputs to the Model. This is the same process used to generate the Company's annual fuel adjustment filing.

The O&M budget development is exclusive of fuel costs recoverable through the fuel adjustment clause. Managers develop a detailed operating plan for the budget year. From this operating plan, a preliminary budget is developed on a project/FERC/resource basis. This budget represents the base line for which the manager is held accountable during the upcoming year. The budget reflects the manager's goals and objectives to be justified to successive levels of management. The individual budgets are consolidated at various levels within each business unit to create a preliminary corporate budget. At the conclusion of the preliminary review and analysis, each department's detailed budget is input into the corporate budget system. Each department inputs its direct expenditures, and then a series of burdens and allocations are run. These include benefit and tax burdens on payroll, inventory burdening, and sales and use tax burdening on materials and allocation of Service Company costs to business units. Other adjustments are made to the budget for certain corporate level expenses and accruals, such as the nuclear outage, pension costs, and nuclear joint-owner credits.

Q. How are allocations from Progress Energy Service Company handled in the budget process?

A. The costs of the Service Company are classified into various products. We assign or charge directly to an affiliate those costs associated with a product that specifically benefits a particular affiliate or that a particular affiliate causes the Service Company to incur. Any costs that are not directly attributable to a particular affiliate are allocated to the various affiliates that use the service or product based on SEC-approved metrics.

Regardless of whether shared functions and services are managed directly by Progress Energy Service Company or are operated through other Progress Energy subsidiaries with cost allocation oversight by the Service Company, Progress Energy's entire cost-allocation program has been designed to guard against the subsidization of one entity at the expense of others. The testimony of Mr. Bazemore provides a more detailed discussion of Service Company allocations.

Q. Please provide a brief overview of the Company's construction program from a planning perspective.

A. The capital budget process begins with the development of initial targets that are based primarily on prior year budget estimates, most recent resource plans, and corporate financial objectives. The business units then conduct a thorough analysis of their capital requirements and prepare a preliminary capital budget. This information is reviewed and approved by the Company's Regulated Capital Committee, a cross-functional team of senior executives. The approved plans are incorporated into PEF's financial forecast. Senior management makes changes to the capital forecast as required to meet operational and financial objectives.

The foundation of the construction program and, in turn, the Construction Budget, is the need for the physical facilities required to provide electrical energy to our customers. Examples of the types of facilities are generating units, transmission lines and substations, and distribution substations and structures. The need for these facilities is generally based on customer growth projections, age and technological obsolescence of existing plant, availability of alternative energy sources such as purchased power and qualified facilities, demand-side management programs, and system reliability and qualitative considerations. A number of detailed studies are performed in which various alternatives are evaluated based on reliability, costs, and fuel type. The end result of these studies is a specific plan for construction of generating facilities of specific size, at specified points in time, including related transmission and distribution facilities. The essential construction requirements data included in this plan are then transmitted to the various construction management groups who develop the detailed Construction Budgets.

Q. What are the review and approval procedures for the O&M and Construction Budgets?

A. The O&M and Construction Budgets receive several levels of review and approval that begin at the individual manager level. The first review is conducted by the manager in each area. Each individual budget is then rolled up to the next level of management for review until ultimately they are reviewed by the senior management within each business unit. The senior management in each business unit evaluates the budgets in conjunction with the operational goals and objectives that have been established for that business unit and the spending limits that have been established. The business unit level budgets are submitted to Corporate Planning for consolidation into the corporate forecast. The business unit submissions are reviewed for consistency with targets and alignment with the corporate financial goals and objectives.

If the consolidated corporate O&M and Construction Budgets reflect proposed spending levels above the approved corporate guidelines, senior management will meet to consider the merits of funding certain activities or programs based on overall corporate, rather than departmental, considerations. The conclusion may be a deferral or scope reduction in some activities or programs. Once the proposed consolidated O&M and Construction Budgets conform to the corporate guidelines, the individual budgets are revised, resubmitted, and re-examined by each departmental executive to assure consistency with the respective spending level contained in the consolidated O&M Budget. The final O&M Budget as compiled by the budgets department and endorsed by senior management is presented to the Board of Directors for approval.

Q. How does the Company monitor and control the O&M and Construction Budgets after they have been put into effect?

A. The primary means used to monitor and control the O&M and Construction Budgets is through the monthly Cost Management Reports (CMR). These reports reflect monthly and year-to-date variances by business unit and are distributed to senior management as part of the Company's monthly corporate financial report. Cost management reports also include current year projections of O&M and capital spending compared to annual budgets. These projections are the basis for updated corporate income and cash flow projections, which are presented to senior management monthly and to the Board of Directors quarterly.

Q. What are the key assumptions used by the Company in preparing its budgets for 2005 and 2006?

A. The key assumptions underlying the 2005 and 2006 budgets are listed in my Exhibit No. ___ (MAM-2), 2005 and 2006 Key Budget Assumptions and MFR Schedule F-8.

Q. What are the 2005 and 2006 operation and maintenance (O&M) and construction budgets for PEF's Distribution, Transmission, Production, Customer Services, and Administrative and General (A&G) functional areas that resulted from the budget process you have described?

A. The following is a breakdown of the Company's 2005 and 2006 O&M and construction budgets for the five functional areas. PEF's witnesses for these functional areas will address and support the specific components of the O&M and construction budgets for their respective areas.

Distribution		O&M	Construction
	2005	$ 77,636,000.	$216,506,000.
	2006	$ 80, 873,000.	$211,253,000.
Transmission		O&M	Construction
	2005	$ 27,609,000.	$ 64,324,000.
	2006	$ 27,647,000.	$ 77,829,000.
Production		O&M	Construction
	2005	$196,841,000.	$188,862,000.
	2006	$210,597,000.	$196,807,000.
Customer Services		O&M	Construction
	2005	$ 56,494,000.	$ N/A
	2006	$ 58,901,000.	$ N/A
A&G		O&M	Construction
	2005	$205,131,000.	$ 245,000.
	2006	$211,751,000.	$ 130,000.

Q. Have there been any adjustments to these 2005 and 2006 budget amounts?

A. Yes. There have been several adjustments to these budget based "per books" amounts that are discussed in the testimony of other witnesses. These adjustments include the Company's reorganization initiative, mobile meter reading initiative, distribution and transmission reliability initiatives, charging practices accounting change, and Storm Damage Reserve accrual. Preliminary estimates of the net cost savings or impacts of some of these changes or initiatives, like the reorganization initiative, were not available until early this year. Others, like the Storm Damage Reserve and the distribution and transmission reliability initiatives, reflect efforts to prepare the Company to meet the impacts of future storms and the growing priority our customers place on greater power reliability that have not yet been approved by the Commission. Mr. Portuondo and Mr. Lyash, Mr. DeSouza, and Mr. McDonald, respectively, provide full explanations for the latter two adjustments in their testimony.

Q. Does this conclude your direct testimony?

A. Yes.

MINIMUM FILING REQUIREMENT SCHEDULES
Sponsored, All or In Part, by Mark Myers

Schedule #	Schedule Title
C-33	Performance Indices
C-34	Statistical Information
F-5	Forecasting Models
F-6	Forecasting Models - Sensitivity of Output to Changes in Input Data
F-7	Forecasting Models - Historical Data
F-8	Assumptions

2006 Key Budget Assumptions

- Retail base revenue growth (weather adjusted) of approximately 3% per year
- Normal weather assumed over entire forecast horizon
- Hines #3 combined cycle placed in service in December 2005
- 2005 and 2006 construction expenditures include spending for Hines #4 combined cycle to be placed in service in December 2007
- 2004 hurricane O&M in excess of reserve recovered over a two year period beginning July 1, 2005
- Effects of the Company's reorganization initiative included as an adjustment to PEF's budget-based "per books" data
- Additional detailed assumptions for 2005 and 2006 are included in MFR F-8 ("Assumptions")