BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 041393-EI

In the Matter of

PETITION FOR APPROVAL OF TWO UNIT POWER SALES AGREEMENTS WITH SOUTHERN COMPANY SERVICES, INC. FOR PURPOSES OF COST RECOVERY THROUGH CAPACITY AND FUEL COST RECOVERY CLAUSES, BY PROGRESS ENERGY FLORIDA, INC.
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VOLUME 1

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PROCEEDINGS: HEARING

BEFORE: CHAIRMAN BRAULIO L. BAEZ
COMMISSIONER J. TERRY DEASON
COMMISSIONER RUDOLPH "RUDY" BRADLEY

DATE: Thursday, June 2, 2005

TIME: Commenced at 9:30 a.m.

PLACE: Betty Easley Conference Center
Hearing Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: JANE FAUROT, RPR
Chief, Office of Hearing Reporter Services
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APPEARANCES:

GARY G. PERKO, ESQUIRE, and CAROLYN S. RAEPPLE, ESQUIRE, Hopping Green & Sams, P.A., P.O. Box 6526, Tallahassee, Florida 32314, appearing on behalf of Progress Energy Florida, Inc.

R. ALEXANDER GLENN, Progress Energy Service Company, LLC, 100 Central Avenue, Suite 1D, St. Petersburg, Florida 33701, appearing on behalf of Progress Energy Florida, Inc.

RICHARD A. ZAMBO, ESQUIRE, Richard A. Zambo, P.A., 1334 S.E. McArthur Boulevard, Stuart, Florida 34996, appearing on behalf of White Springs Agricultural Chemicals, Inc.

JAMES BUSHEE, ESQUIRE, and DANIEL FRANK, ESQUIRE, Sutherland Asbill & Brennan LLP, 1275 Pennsylvania Ave., N.W., Washington, DC 20004-2415, appearing on behalf of White Springs Agricultural Chemicals, Inc.

ADRIENNE VINING, ESQUIRE, FPSC General Counsel's Office, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, appearing on behalf of the Florida Public Service Commission Staff.

I N D E X

WITNESSES

EXHIBITS

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P R O C E E D I N G S

CHAIRMAN BAEZ: Good morning. Sorry for the late start, ladies and gentlemen. Counsel, will you read the notice.

MS. VINING: Pursuant to notice issued May 12th, 2005, the Florida Public Service Commission set this time and place for a hearing in Docket Number 041393-EI.

CHAIRMAN BAEZ: And we will take appearances.

MR. ZAMBO: Richard Zambo, 1334 S.E. McArthur Boulevard, Stuart, Florida 34996, on behalf of White Springs.

MR. BUSHEE: James Bushee of the law firm of Sutherland Asbill and Brennan, 1275 Pennsylvania Avenue, Washington, D.C., on behalf of White Springs.

MR. PERKO: Gary Perko of the law firm of Hopping Green and Sams in Tallahassee on behalf of Progress Energy Florida, Inc. And with me is my partner, Carolyn Raepple, and Mr. Alex Glenn, Deputy General Counsel of Progress Energy Services.

CHAIRMAN BAEZ: Thank you.

MS. VINING: Adrienne Vining appearing on behalf of the Commission.

CHAIRMAN BAEZ: Thank you all. And, Ms. Vining, we've got some preliminary matters?

MS. VINING: Yes, there are two pending matters that need to be decided. There is a motion for reconsideration that was filed by White Springs as well as a request for official recognition that was filed by Progress.

CHAIRMAN BAEZ: All right. And if you can clarify for me, the motion for reconsideration is by the panel, but the other -- I'm sorry, you said the request is by the presiding officer only?

MS. VINING: Yes.

CHAIRMAN BAEZ: Okay. So, why don't we take the motion for reconsideration first. And, Mr. Bushee, it is your motion.

MR. PERKO: I believe it is my motion, Your Honor.

CHAIRMAN BAEZ: I'm sorry. Mr. Perko, I apologize.

MS. VINING: You said you wanted to take up the motion for reconsideration, right?

CHAIRMAN BAEZ: I want to take up the motion for reconsideration, Mr. Perko.

MR. PERKO: I'm sorry. Excuse me.

CHAIRMAN BAEZ: See, now you're throwing me off.

MR. PERKO: I apologize, Mr. Chairman.

CHAIRMAN BAEZ: That's all right. Go ahead, sir.

MR. BUSHEE: Thank you, Mr. Chairman. White Springs requested reconsideration in this proceeding because on May 10th, Progress filed a motion to file revised supplemental testimony, and in that testimony it acknowledged that it had made an error in its initial analysis. It overstated the claimed benefits of the proposed agreements by approximately $90 million, or roughly 66 percent.

The reason that that came about is that White Springs in the course of discovery identified the error, and upon learning about it, Progress filed its revised testimony. White Springs filed an emergency motion to suspend the procedural schedule, or alternatively to dismiss Progress' case with leave to refile at a later point. That was denied by the prehearing officer's May 16th order.

Now, the reason that we have asked for reconsideration is that we believe that there is a fundamental change in Progress' cost-effectiveness analysis. When you take $90 million out, or 66 percent based on an error, that calls into question not only that particular analysis, but the validity of the entire analysis. The problem that we have, of course, is that absent time for discovery, and absent time to analyze what has happened, it is difficult to meaningfully address or to understand if there are additional flaws in the Progress analysis. Basically, White Springs needs the opportunity to fully understand Progress' case.

Now, the May 16th order concluded that the modifications to the cost-effectiveness analysis are not so fundamental to the proceeding to warrant a change in the procedural schedule. And that is one issue that we are asking the Commission to reconsider. We believe that a $90 million change is a very fundamental change. We believe that the fact that there could be additional errors, but we have not had the opportunity to determine that, constitutes a fundamental change.

The May 16th order allowed a four-day period for White Springs to submit responsive testimony. That four-day period simply didn't allow sufficient time to conduct discovery and to perform the sort of analysis we would have to perform and then to submit any meaningful responsive testimony.

Basically, we think that it is an issue of due process. Progress has filed a case. We have tried to come to grips with their analysis through discovery. There has not been adequate time, and at a relatively late point in the proceeding we see a fundamental change in their case. For that reason we ask that the Commission reconsider and grant reconsideration.

We note also that there is no need for expedition. There is no need to rush to a decision on the proposed agreements. One of the reasons that Progress gives is that they will be forced to take transmission if nothing happens, if the Commission doesn't act on their proposed agreements. We think that it is clear that there is additional time before they have any obligation to take transmission. And to the extent that they created deadlines by which they must act, they were deadlines of their own making which would have the unfortunate impact of forcing the parties and the Commission to rush to judgment. For that reason we ask that the Commission grant reconsideration.

CHAIRMAN BAEZ: Mr. Perko.

MR. PERKO: Thank you, Commissioners. First of all, this Commission has set forth a very clear standard for review of motions for reconsideration and has repeated it many times. And that standard is whether the prehearing officer overlooked or failed to consider in rendering the order a point of fact or law. Now, White Springs has in its motion stated all the arguments, and I would point out that they are primarily legal arguments, summarizing what they view the testimony will show in this proceeding, which actually goes to the merits. They presented all of those arguments in their emergency motion. The prehearing officer considered them and rendered his order. They have not pointed out one point of fact or law that the prehearing officer failed to consider.

And as far as any notion of denial of due process, neither their emergency motion nor their motion for reconsideration cites a single piece of legal authority to support the notion that there has been some violation of due process.

So, I think on its face their motion does not meet the criteria for motions for reconsideration. They have not pointed out a piece of fact or law that the prehearing officer failed to consider in rendering the order, and their motion should be denied on its face. Thank you.

CHAIRMAN BAEZ: Commissioners, questions?

COMMISSIONER DEASON: Mr. Chairman, I have no question. I can make a motion.

CHAIRMAN BAEZ: Okay.

COMMISSIONER DEASON: I move that the motion for reconsideration be denied.

COMMISSIONER BRADLEY: Second.

CHAIRMAN BAEZ: Motion and a second. All those in favor say aye.

(Unanimous affirmative vote.)

CHAIRMAN BAEZ: Thank you, gentlemen.

And, Mr. Perko, I guess now we can entertain the request for -- I'm sorry.

MR. PERKO: Official recognition.

CHAIRMAN BAEZ: Official recognition. I'm sorry.

MR. PERKO: Thank you, Mr. Chairman. This was just a simple request that we thought was important to bring to the Commission's attention. As you may recall, there was an earlier case back in the fuel docket last year where this Commission reviewed some unit power sales agreements between Florida Power and Light Company and the Southern Company. In that case there were a number of issues that were raised that are very similar, if not identical, to some of the issues in this case.

In the order approving the FPL agreements, the Commission stated that it was making its decision based on the evidence of the case as well as its review of the prehearing order. Now, the order does not specifically identify all the issues it considered, so for that reason we sought official recognition of the briefs of one of the opponents to the FPL agreements, Mr. Churbuck, who raised many of the same arguments that White Springs is raising in this proceeding.

The reason for that is to provide the Commission a basis to interpret its prior order, and we have cited case law from the Florida Supreme Court where the court has similarly taken judicial notice of briefs in other cases so that they can interpret what that case means. **So White Springs basically** argues that because they dispute the request for official recognition that that in and of itself means it should be denied. I don't think that that is a valid argument on its face. So, we would respectfully request that the Commission grant our motion for official recognition.

CHAIRMAN BAEZ: Mr. Bushee.

MR. BUSHEE: Thank you, Mr. Chairman. White Springs opposes Progress' request. We think that the brief should not be accorded official recognition. That, if anything, it would add nothing to the resolution of the issues in this proceeding and it would raise a number of issues as to whether other portions of the record from the Florida Power and Light proceeding should be brought into this proceeding.

The reason we say that it will add nothing to this proceeding is it is an entirely different proceeding. It has different parties. It has a different record. There are different agreements there. The fact that there may be similar issues that were addressed is not helpful to Progress' arguments. If that argument held sway, then in every rate case the Commission had, it would be asked to give official recognition to the briefs of the parties and whatever documents might be there simply because there were similar issues.

The brief that Progress asked for official recognition would not help the Commission in resolving the issues here because the problem is that the Churbuck brief is addressing issues that White Springs has not had an opportunity to conduct cross-examination on. We would have to look through the remainder of the FPL record to see if there are other documents that should be brought into this proceeding. I suggest that it would delay, if anything, the resolution of this proceeding.

And I would add that to the extent that the argument is that the document would be helpful in understanding the Commission's order, the Commission recently issued the order. The Commission understands what they meant in that order. The order didn't address the Churbuck brief, it just simply said that they considered the record evidence and they considered the briefs of the parties. There is nothing remarkable there. That is what the Commission should do in this proceeding is consider the record evidence in this proceeding and the briefs of the parties in this proceeding.

CHAIRMAN BAEZ: Mr. Perko, is there -- I will tell what troubles me. Official recognition, and we have had enough -- I cannot specifically recall, but certainly generally recall enough back and forth between the Commissioners and the staff as to what can be officially recognized. How we should treat certainly our orders and so on. That now all of a sudden I feel I'm treading on some shaky ground in terms of expanding what we take official recognition of.

But my question to you would be this: Are there not alternatives within the context of the hearing in order to get, I guess, the clarification that you find you offer us the benefit of. You know, isn't there a more traditional way to be doing it, and is that opportunity foreclosed to you through testimony and cross-examination.

MR. PERKO: We can certainly do that, Your Honor.

CHAIRMAN BAEZ: Okay. And, Mr. Bushee, I do appreciate the fact that you would not be offered an opportunity to cross-examine on arguments that were made, what are essentially arguments made on brief. For that reason, Mr. Perko, I'm not going to allow or I'm not going to grant a request for official recognition. However, understanding that to whatever extent that brief as a document can be properly used according to our rules, those opportunities are still available to both parties.

So let the record show that Progress' request for official recognition is denied with the conditions that I have expressed previously. Do we have any other preliminary matters?

MS. VINING: None that I'm aware of.

CHAIRMAN BAEZ: Okay. And then we have got some pre-fab exhibit lists that we can start dealing with at this point?

MS. VINING: Yes. Everyone should have the comprehensive exhibit list.

CHAIRMAN BAEZ: Does everyone have the exhibit list?

MR. PERKO: Yes, sir.

CHAIRMAN BAEZ: Are there any exceptions that need to be taken by the parties?

MR. PERKO: None from Progress, Your Honor.

CHAIRMAN BAEZ: Okay.

MR. BUSHEE: None for White Springs, Your Honor.

CHAIRMAN BAEZ: Very well. Then according to the document entitled Comprehensive Exhibit List, which will be marked for hearing as Exhibit 1, and that Exhibit 1 also contains a sequential list of all exhibits that have been previously marked as 2 through 16.

Ms. Vining, anything else before we can get started?

MS. VINING: Well, we would just ask now that you have marked the exhibits, that Exhibits 1 through 3 be moved into the record.

CHAIRMAN BAEZ: Without objection, show Exhibits 1 through 3, consisting of the Comprehensive Exhibit List and Composite Stipulated Exhibit 2 and Composite Confidential Stipulated Exhibit 3 moved into the record.

(Exhibit 1 through 16 marked for identification. Exhibit 1-3 admitted into the record.)

COMMISSIONER BRADLEY: What is the number you put on it?

CHAIRMAN BAEZ: 1, 2, and 3, Commissioner.

Is there anything else, Ms. Vining?

MS. VINING: I would also just note that in the Comprehensive Exhibit List, because the direct testimonies of Mr. Waters and Mr. Brubaker are confidential, we have gone ahead and marked those as an exhibit to be entered in once they appear.

CHAIRMAN BAEZ: Yes, this is sort of incipient treatment of confidential testimony.

Did everyone get that? Mr. Bushee, are you clear with what we are doing?

MR. BUSHEE: Your Honor, I would like to be very clear. Should we go off the record for a minute just to have a discussion?

(Off the record.)

CHAIRMAN BAEZ: We will go back on the record now. Commissioner Deason, you had a question?

COMMISSIONER DEASON: I just wanted to make sure we were getting back on the record at some point.

CHAIRMAN BAEZ: You are my conscience. Very well.

And with that, if there is nothing else, no other questions that we need to take up, we can swear in witnesses and start calling them up for testimony. Is everybody in the room? I see Mr. Waters. I don't know if Mr. Brubaker is here. Okay.

Gentlemen, can you stand and I will swear you in.

(Witnesses sworn.)

CHAIRMAN BAEZ: Mr. Perko, we can move on to opening statements.

MR. PERKO: Thank you.

Good morning, Chairman. Good morning, Commissioner Deason. Good morning, Commissioner Bradley. We are pleased to present Progress Energy's case in support of the Commission's proposed agency action to approve two unit power sales, or UPS agreements, between Progress Energy and Southern Company Services.

The agreements will replace existing UPS agreements that have provided Progress Energy and its ratepayers substantial benefits. They call for Progress Energy to purchase 74 megawatts of coal-fired capacity from Plant Franklin in Alabama and 350 megawatts of gas-fired combined cycle capacity from Plant Franklin in Alabama. I'm sorry, it was 74 megawatts of coal capacity from Plant Scherer in Georgia.

Both agreements have roughly five-year terms extending from June 1st, 2010, through December 31st, 2015. As you will hear, the new agreements provide a unique opportunity to meet the company's 20 percent reserve margin in an economical manner, while at the same time providing important strategic benefits to the company and its ratepayers.

We will present the results of two economic analyses. One to assess the impact of the agreements during their five-year term, another to assess the impacts over a broader 45-year horizon. The results of the short-term analysis will show projected savings of $44 million over the five-year term of the agreements. Over the extended 45-year time period, when Progress Energy's resource plan is much less certain, the evidence will show projected net costs between 5 and 11 million, which is relatively small considering the size of these purchases.

You also will learn of important strategic benefits that the agreements will provide to Progress Energy and its customers. Specifically, the evidence will show that the agreements will allow Progress Energy to exercise its rollover rights to maintain transmission access to the Southern Company system and beyond. This will provide access to economy energy purchases and sales outside of Florida.

The agreements also will enhance fuel diversity by providing more coal capacity than Progress Energy's self-build option. They will provide planning flexibility by deferring the need for two combined cycle units. This will give Progress Energy additional time to study the cost-effectiveness and feasibility of coal.

The new agreements will increase reliability by adding an independent natural gas supply and by providing access to the Southern system and beyond. The new agreements will provide cost certainty because use of existing resources provides greater assurance of cost and performance than might be obtained from units that need to be constructed. And a right of first refusal associated with the agreements will provide Progress Energy the ability to obtain additional coal capacity from Southern Company, should it become available.

Now, White Springs has raised a number of issues, many of which are simply red herrings. First, they contend that Progress Energy should have conducted an RFP in hope of receiving offers for coal-fired generation. However, the Commission's rules do not require utilities to conduct an RFP before entering into a purchased power agreement of this nature. And as our witness, Mr. Waters, will explain, there is good reason for that. If Progress Energy were required to conduct an RFP, there is no reason to believe that Southern would hold this offer open indefinitely. The evidence also will show that Progress Energy has not received any proposals for coal-fired generation in response to recent RFPs, and that it is not feasible to site, design, license, and construct a new pulverized coal plant to meet Progress Energy's 2010 need.

Furthermore, as Mr. Waters will explain, the costs of the combined cycle portion of the agreements compares favorably to the responses to Progress Energy's most recent RFP for Hines Unit 4. There is no evidence to suggest that additional analysis would produce a better choice to meet Progress Energy's 2010 need.

Second, White Springs questions Progress Energy's economic analysis and will attempt to make much of an inadvertent error in the five-year analysis that Progress Energy previously provided. As Mr. Waters explains in his supplemental testimony, however, the error has been corrected. And the evidence will show that the revised analysis still projects significant savings of 44 million over the life of the agreements. The evidence also will show that the five-year and 45-year economic analysis appropriately account for costs associated with the agreements, including capacity and energy costs, O&M, fuel transportation, and transmission costs.

Third, White Springs simply dismisses the important strategic benefits that the agreements will provide, such as fuel diversity, access to economic energy, and the other benefits that I previously mentioned.

White Springs' witness says that these nonprice factors or not sufficiently important or quantified to be given any significant weight by the Commission. As Mr. Waters will explain, however, nonprice factors are, by definition, nonquantifiable, at least in the same manner that the overall economics of the agreements. But nonquantifiable benefits are benefits nonetheless, and simply ignoring them is not consistent with prudent utility planning.

Fourth, White Springs questions whether Progress will be able to obtain sufficient transmission rights to implement these agreements. And they suggest that Progress may incur additional costs for transmission upgrades as a result of a pending transmission system impact study on Progress' request to redirect its rollover transmission rights.

Both of these issues are red herrings. If Progress is unable to obtain sufficient transmission rights, it has contractual remedies under the agreements. Likewise, the agreements include provisions that protect Progress Energy and its customers if the system impact study calls for additional costs for transmission upgrades.

Finally, White Springs raises other red herrings to suggest that the Commission delay its consideration of these two agreements. They say there is time to wait because the existing agreements don't expire for another five years. This ignores the potential loss of the opportunity if Southern places this power back in the market.

They also suggest that the Commission should wait until the transmission system impact study is complete, again, ignoring the mitigation provisions in the contracts. And they suggest that the Commission should wait until the completion of pending FERC investigations involving allegations that Southern Company has exercised market power within its control region. We respectfully submit that this issue is not appropriate for consideration in this proceeding because the Commission cannot speculate as to the disposition of a pending FERC matter.

In closing, Commissioners, there is no reason to wait. The evidence will demonstrate that the agreements are economical and will provide substantial nonprice benefits to Progress Energy and its customers. As the Commission stated when it approved FPL's new UPS agreements earlier this year, the Commission has the expertise to make a decision based on the economic impact of the new UPS agreements and the benefits they will bring to ratepayers. We will provide you the information you need to apply that expertise, and we respectfully request that you approve these agreements for cost-recovery purposes. Thank you.

CHAIRMAN BAEZ: Mr. Bushee.

MR. BUSHEE: Thank you, Mr. Chairman and Commissioners.

White Springs requested a hearing in this matter because it is one of Progress' largest customers and will be adversely impacted by any unreasonable rate increases such as would occur if these proposed agreements were approved. White Springs operates in a competitive industry and increased electric costs would substantially affect their competitive posture, that is why we are here.

In its answer to White Springs' petition for hearing, Progress asserted that it believed that this matter could be resolved informally once White Springs reviews the analyses supporting Progress' petition. White Springs took the opportunity to review those analyses. We took the opportunity to conduct discovery. And in relatively short order we determined that there was at least one major error in their near term analysis. That was $90 million, or 66 percent of the claimed near term benefits did not exist. We were further unable to satisfy ourselves that there weren't further flaws in the cost-effectiveness analysis.

In this proceeding, the evidence will show several things, all of which point to the fact that these agreements are unreasonable and imprudent. First of all, it's not disputed that over the long-term there would be a net cost to Progress and its ratepayers. That is the evidence that Progress has submitted. Second of all, the near-term analysis, as I have mentioned, has been reduced by -- the benefit has been reduced by $90 million or 66 percent. It is unclear whether there are additional flaws. We will point out various costs. The evidence will show that there are other costs that were not considered in that analysis and those costs are significant.

The evidence will show that Progress failed to meaningfully and methodically consider other alternatives to the proposed agreements. **When they say they weren't required** to conduct an RFP, that is a different question from whether they should have conducted an RFP. In other words, just because somebody doesn't tell you to do it doesn't mean that you shouldn't do it.

Progress claims a number of so-called strategic benefits. Merely invoking strategic benefits is not sufficient to offset the flaws in these proposed agreements. The evidence does not support that these agreements provide any -- that these strategic benefits are at all meaningful. **I will just** address two that Mr. Perko addressed. One is Progress claims that the agreements will allow Progress to use its rollover transmission rights. That is false. The agreements themselves do not give rise to rollover rights. **The transmission rights,** the rollover transmission rights arise independently of these proposed agreements.

Progress also cites the benefits of fuel diversity from these proposed agreements. In fact, what these proposed agreements would do would be to further a very troubling trend of increased reliance on gas-fired generation both on the Progress system as well as in the state of Florida as a whole. Those benefits plainly do not occur. The evidence will show that the other asserted strategic benefits are illusory.

What is clear is that under these proposed agreements Progress incurs no risk. Any costs that have to be paid get passed through to the ratepayers, such as White Springs, who are at risk.

There are also a number of unresolved issues and Progress urges the Commission to act swiftly. They say that transmission issues are a red herring. The fact is that sitting here today we do not know whether transmission will be available for these agreements. **Southern Company is conducting** a system impact study. The result of that study could be that transmission is not available. If that is the answer, this Commission has nothing to decide.

The system impact study may also conclude that substantial costs are needed to improve the system to accommodate these agreements. Depending on what those costs are, one of the remedies that Progress has would be to terminate the agreements. And, again, this Commission would have nothing to decide in that case. We will know those answers sometime this month. By mid to late June is the projected date of the system impact study. It strikes White Springs that it makes no sense to act on the agreements without knowing whether transmission is available, how much that would cost, how much the ratepayers will be required to bear.

The bottom line is that it is Progress' burden to prove that these agreements are reasonable and prudent. They must prove those points based on the record in this proceeding, not on the record in another proceeding, not based on idle speculation, but by providing evidence. They have utterly failed to do that. For that reason, White Springs urges the Commission to reject the proposed agreements.

CHAIRMAN BAEZ: Thank you, Mr. Bushee.

Mr. Perko, I think we are ready to call our first witness.

MR. PERKO: Mr. Chairman, we are ready to call Mr. Samuel S. Waters,'and we will be passing out red files with the confidential information in his testimony exhibits.

SAMUEL S. WATERS

was called as a witness on behalf of Progress Energy Florida, and having been previously duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. PERKO:

Q Could you please state your name and business address for the record?

A My name is Samuel S. Waters. My business address is 410 South Wilmington Street, Raleigh, North Carolina 27602.

Q Mr. Waters, are there any changes or revisions to your direct or supplemental testimony that you prefiled in this case?

A There are not.

Q At this time, Mr. Waters, could you read your summary of your direct and supplemental testimony?

A Yes. Good morning, Commissioners. My direct and supplemental testimonies describe the benefits associated with two new unit power sales agreements with Southern Company Services. These new agreements replace an existing UPS agreement executed in 1988 which has provided significant benefits to Progress Energy customers and expires on May 31st, 2010.

The term of the new agreements is June 1st, 2010 through December 31st, 2015. The capacity purchased under these contracts is needed to maintain a 20 percent reserve margin for the Progress Energy system and to provide important economic and strategic benefits to customers, as well. The new agreements displace new capacity on the Progress Energy system and show a net economic cost of between 5 and $11 million net present value. However, during the five-year term of the agreements, the purchases provide an economic benefit of $44 million net present value as described in my supplemental testimony.

In addition to the economic benefits, these agreements provide a number of other benefits including contribution to fuel diversity by providing a portion of the energy from coal-fired resources, a contribution to economy energy availability by making the southeastern market available, a contribution to increased reliability by providing a separate gas supply, a contribution to cost certainty by providing power from existing resources, a contribution to planning flexibility by providing the ability to extend a portion of the capacity purchased beyond the five-year term, and they provide the potential for increased access to coal resources through a right of first refusal associated with the agreements.

In accordance with the agreements, Progress Energy has requested transmission service under the rollover rights provided by current transmission service associated with the existing agreement. The process for obtaining this transmission service and the timing associated with confirmation of the service by Southern Company transmission makes expedited consideration of these agreements by this Commission imperative. There is no reason to believe the transmission service will be unavailable, and we are now within the period where transmission service may be affirmed by Southern.

Progress Energy has a unique opportunity to take advantage of a longstanding relationship with Southern Company and continue to provide benefits to its customers as it has for many years under the current agreement. Because this opportunity is unique, and because the transmission rollover rights provided under the current agreement are also unique, it is important that Progress Energy proceeds as expeditiously as possible to put these agreements in place.

For these reasons, I believe the Commission should find that entering into these two agreements at this time is a reasonable and prudent action by the company and that recovery of energy and capacity costs pursuant to these agreements would be permitted subject to a finding of reasonableness and prudence at the time the actual expenses are presented for cost-recovery.

That concludes my summary.

MR. PERKO: Your Honor, at this time we would ask that Mr. Waters' testimony be admitted as read and offer him for cross-examination.

CHAIRMAN BAEZ: Without objection, show the direct and supplemental -- direct and rebuttal testimony of Sam Waters be entered into the record as though read.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

PROGRESS ENERGY FLORIDA

DOCKET NO. 041393-EI

DIRECT TESTIMONY OF

SAMUEL S. WATERS

Q. Please state your name, employer, and business address.

A. My name is Samuel S. Waters and I am employed by Progress Energy Carolinas (PEC). My business address is 410 S. Wilmington Street, Raleigh, North Carolina, 27602.

Q. Please tell us your position with PEC and describe your duties and responsibilities in that position.

A. I am Manager of Resource Planning for Progress Energy Florida (PEF or the Company) and Progress Energy Carolinas. I am responsible for directing the resource planning process for both companies. Our resource planning process is an integrated approach to finding the most cost-effective alternatives to meet each company's obligation to serve, in terms of long-term price and reliability. We examine both supply-side and demand-side resources available and potentially available to the Company over its planning horizon, relative to the Company's load forecasts. In my capacity as Manager of Resource Planning, I oversaw the completion of the Company's most recent Ten Year Site Plan filed in April 2005.

Q. Please summarize your educational background and employment experience.

A. I graduated from Duke University with a Bachelor of Science degree in Engineering in 1974. From 1974 to 1985, I was employed by the Advanced Systems Technology Division of the Westinghouse Electric Corporation as a consultant in the areas of transmission planning and power system analysis. While employed by Westinghouse, I earned a Masters Degree in Electrical Engineering from Carnegie-Mellon University.

I joined the System Planning department of Florida Power & Light Company (FPL) in 1985, working in the generation planning area. I became Supervisor of Resource Planning in 1986, and subsequently Manager of Integrated Resource Planning in 1987, a position I held until 1993. In late, 1993, I assumed the position of Director, Market Planning, where I was responsible for oversight of the regulatory activities of FPL's Marketing Department, as well as tracking of marketing-related trends and developments.

In 1994, I became Director of Regulatory Affairs Coordination, where I was responsible for management of FPL's regulatory filings with the FPSC and the Federal Energy Regulatory Commission (FERC). In 2000, I returned to FPL's Resource Planning Department as Director.

I assumed my current position with Progress Energy in January of 2004. I am a registered Professional Engineer in the states of Pennsylvania and Florida, and a Senior Member of the Institute of Electrical and Electronics Engineers, Inc. (IEEE).

Q. Have you previously testified before this Commission?

A. Yes. I have testified in several dockets related to resource planning and the need for power.

Q. What is the purpose of your testimony in this proceeding?

A. My purpose in this testimony is to support the Company's request for approval of the long term purchase agreements reached with Southern Company Services, Inc. ("Southern Company"). While the agreements do not call for the delivery of energy and capacity until 2010, the purchases are components of the resource plan to meet our obligation to provide adequate and reliable electric service to our customers. Specifically these long term agreements are needed to maintain the 20 percent reserve margin. There would be a significant lead time associated with pursuing other alternatives to these agreements. For this reason we request a finding by the Commission that the agreements are a reasonable and prudent means to meet our long term resource plan.

Q. Are you sponsoring any exhibits to your testimony?

A. Yes. I am sponsoring the following exhibits:

- Exhibit No. ___ (SSW-1) - Contract for the purchase of Capacity and Energy Between Southern Company Services, Inc. and Florida Power Corporation D/B/A Progress Energy Florida, Inc. from Plant Scherer Unit No. 3, Dated as of November 24, 2004 (This document has already been filed as Exhibit "A" to the Petition filed by PEF on December 13, 2004 ("PEF's Petition");
- Exhibit No. ___ (SSW-2) - Contract for the purchase of Capacity and Energy Between Southern Company Services, Inc. and Florida Power Corporation D/B/A Progress Energy Florida, Inc. from Plant Franklin Unit No. 1, Dated as of November 24, 2004 (This document already has been filed as Exhibit "B" to PEF's Petition);
- Exhibit No. ___ (SSW-3) - Summary of Costs and Benefits of the Unit Power Sales Agreement with the Southern Companies (This document already has been filed as Exhibit "C" to PEF's Petition); and
- Exhibit No. ___ (SSW-4) – Savings of UPS Agreements with Economy Purchase Savings (This exhibit is attached to my testimony).

Q. Please briefly describe the new agreements.

PEF has entered into two Unit Power Sales ("UPS") agreements with Southern. The new agreements replace an existing UPS Agreement executed in 1988. The term of both agreements is June 1, 2010 through December 31, 2015. The capacity purchased under the new contracts is needed to maintain the 20 percent reserve margin for the PEF system and provides important strategic benefits to customers as well. Copies of the new agreements are provided in my Exhibit Nos. ___ (SSW-1) and ___ (SSW-2), which, as discussed above, were filed with PEF's Petition as Exhibits A and B, respectively.

Q. Please describe the agreements with the Southern Companies in more detail.

A. The agreements replace a long-standing agreement with the Southern Company which has provided substantial benefits to PEF customers. The agreements provide for the purchase of 424 MW of capacity for the period June 1, 2010 through December 31, 2015, to be provided from Georgia Power Company's Scherer 3 coal-fired unit (74 MW) and Franklin 1 combined cycle unit (350 MW), based on the current demonstrated capabilities of these units. The agreement specifies levelized capacity charges of [redacted] per kW per month for the Scherer capacity, and [redacted] per kW per month for the Franklin capacity. The capacity prices cover capital costs, costs of non-environmental capital additions, fixed O&M and allocated overhead expenses. PEF also will be charged the costs of fixed transportation required to deliver gas to the Franklin facility. Energy charges for these facilities will be based on delivered fuel prices, multiplied by a guaranteed heat rate at the Franklin unit, and the actual heat rate used at the Scherer unit. In addition, under a separate transmission service contract, PEF will be responsible for the costs of firm electrical transmission to the Florida-Georgia interface.

Q. Has PEF considered potential alternative sources of coal generation?

A. Yes. I do not believe that it is feasible to site, design, license and construct a new pulverized coal plant to meet the June, 2010 target date by which firm capacity is needed. Our estimate for the lead time required to complete all of these activities is approximately 8 years, with about 4 years of that time spent in construction. That leaves existing coal units as the only real source of firm power in the desired time frame. I am unaware of any merchant coal generation in Florida, other than one facility we are currently in negotiations with for purchases beginning in 2006. PEF has not received any proposals for coal generation in response to its recent Requests for Proposals (RFPs). Based on these facts, I do not believe that there are any reasonable alternatives to the coal-fired generation being offered as part of these UPS purchases.

Q. Was an extension of the existing UPS agreements available to PEF ?

A. No. Southern Company was not willing to extend the current contract, nor were they willing to provide the amount of coal capacity currently being purchased. Southern Company did offer the right of first refusal for specific coal capacity should it be available at a later time. However, continuation of the current levels of coal purchases was not an option.

Q. Please describe the methodology you used to analyze the cost-effectiveness of the new agreements.

A. For purposes of the analysis, we used the same industry standard models and assumptions typically used for developing PEF's ten year site plans and for conducting other system planning analyses. The analysis begins with the development of a base or self-build plan. This identifies the cost of resources that would be incurred if the purchase was not available. The identification of this plan takes place in two steps: first, the amount and timing of resources required to meet the minimum 20% reserve margin requirement is quantified, then the self-build alternatives are compared in an economic optimization to determine the most cost-effective self-build plan over the planning horizon, typically a 20-year period. The proposed purchase is then placed in the system and the two steps are repeated, producing an economically optimal plan that includes the proposed purchase. The costs of these two plans are then compared. When I refer to the plan costs, I am looking at not only the costs of construction, new unit fuel and O&M, and power purchase costs, but system fuel impacts as well. System infrastructure costs, such as fuel handling and transportation, and electrical transmission are also included. The totals are compared on a cumulative present value basis.

Q. How were economy purchase savings quantified for purposes of your analysis?

A. We quantified the economy purchase savings by looking at every hour through the term of the new agreements (June, 2010 through December, 2015) and comparing the cost of the Franklin unit to the marginal hourly cost in the

Southern Company region and the marginal hourly cost in the Florida Reliability Coordinating Council (FRCC) region. We looked at the FRCC because we assume that we would buy from Florida first if it was cheaper. We focused on the Franklin unit because the coal generation from the Scherer unit would never be expected to be more expensive than another marginal resource.

In any hour where the Southern Company hourly cost was less than both Franklin and FRCC, we assumed that we would buy up to the available MW during that hour, and added the dollars difference between Franklin and Southern Company costs as savings. The available MW were set by an estimate of market liquidity, but always less than the 350 MW available on the transmission system, to be conservative. To be even more conservative we only added savings when the difference between prices was greater than $3/MWh.

The hourly marginal costs for Southern and FRCC were taken from system simulations modeling the dispatch of those systems to meet native load within their regions. The next available MWH above native load (including firm sales) set the price.

Q. How do the costs of these agreements compare to PEF's self-build alternatives?

A. Through the actual five-year contract term ending in December 2015, when PEF's resource plan is more certain, customers are expected to see significant cumulative savings of $133 million. Over the full term of the 45 year analysis, however, the contracts are projected to result in a net cost to customers of between $5 million and $11 million, CPVRR, as shown in my Exhibit No. ___ (SSW-3). These economics include the effects of potential economy energy purchases from the Southern Company system, but do not include any additional economic benefits from other neighboring systems. While I conclude that there may be a moderate net cost over the 45 year horizon resulting from this contract, it should be noted that the range of predicted benefits, depending on the assumptions made in calculating them, are relatively small compared to the overall value of the purchases, and that during the term of the purchases, additional benefits to customers should result. In my judgment this range of potential benefits is acceptable because of the strategic value of this contract, and the timing of the benefits/costs. Purchase of this capacity is expected to defer the need for a May, 2010 combined cycle unit, as was discussed in PEF's 2004 Ten Year Site Plan.

Q. You mentioned the timing of the benefits and costs on a PVRR basis. What is the significance of the timing of PVRR costs or benefits?

A. The results of the cost/benefit analysis which I have presented represent the cumulative effect of the purchases versus a self-build option over a more than 40 year period. I have presented the year-by-year cumulative PVRR in my Exhibit No. ___(SSW-4). Note that the bottom line number I have presented, a net cost of approximately $5 million, occurs at the end point of the curve, after the net cost or benefit of the agreements show significant variation as units shift in the plan. The importance of this curve is that the overall economics are highly dependent on resource plan assumptions after the deal ends. As noted above, in the earlier years, during the term of the contract extension, where the plan is more certain, customers are expected to see significant cumulative savings of $133 million. It is only in the years beyond the term of the extension, where the plan is less certain, that costs appear to outweigh these benefits.

Q. What level of economy purchase savings did you include in your economic analysis of the new UPS agreements?.

A. Using the methodology discussed above, we quantified approximately $6 million to $11 million, NPV, in economy purchase savings and included that level in our economic analysis.

Q. What other benefits will these agreements provide to PEF customers?

A. In addition to the economics of the purchase, these agreements:

- contribute to fuel diversity - A portion of the energy will come from coal-fired generating capacity, providing low-cost energy and serving to reduce the price volatility of PEF's fuel mix. Absent the new agreements, PEF would have no right to any of Southern Company's coal-fired generation after the existing agreement expires. With the new agreements, however, PEF will have rights to 74 MW of Southern coal generation. Moreover, the new agreements would defer the need for a new gas-fired unit during the 2010-2015 term. Thus, the new agreements will actually increase the projected amount of coal generation in PEF's resource plan

- contribute to economy energy availability – Access to the transmission facilities provided by the agreements will give PEF access to lower cost energy that may be available within the Southern region, in those hours when the units specific to the purchase are not scheduled.
- contribute to increased reliability - The agreements will allow PEF to maintain a transmission path to the Southern system, which provides access to a large resource pool, enhancing system supply reliability when the Scherer or Franklin units might be unavailable. In addition, the Franklin unit will be served from a separate gas supply system than other PEF units, enhancing fuel supply reliability.
- contribute to cost certainty - The purchases come from existing generating facilities. Utilization of existing resources provides greater assurance of cost and performance than might be obtained from units that would need to be constructed.
- contribute to increased access to coal resources - In connection with the agreements, PEF has secured a right-of-first refusal to the output of additional coal capacity in the Southern system, should that capacity be offered to the wholesale market.
- contribute to planning flexibility - the agreements provide for extension of the combined cycle capacity for an additional two years, which might

be used to meet additional load growth, defer investment in additional combined-cycle generation, or allow time for new technologies to develop. The agreement also spans a time frame that allows further consideration of the addition of coal-fired capacity on the PEF system.

In addition to these benefits, the agreements allow for preservation of PEF's transmission path to the north, which maintains an opportunity to access a wider range of economic resources from systems beyond the Southern Company system.

Q. Please explain how transmission requirements are addressed under the new agreements?

A. The agreements call for PEF to submit a request for sufficient transmission capacity to Southern Company Transmission within 30 days of the effective date of the agreement, November 24, 2004. The agreements further call for PEF to make commercially reasonable efforts to obtain an offer for transmission service by February 16, 2006, a date which may be extended by mutual consent. If any or all of the required transmission service cannot be provided, PEF will notify Southern Company, as seller, of the unavailability. The contracts also provide for PEF notification to Southern Company of the circumstance where transmission may be offered at a total cost greater than the embedded rate for Long Term Firm Transmission Service under Southern Company Transmission's Open Access Transmission Tariff (OATT). Upon notification, Southern Company has the option of offering to sell, including by reassignment, up to the required amount of transmission service, and/or offsetting any transmission costs above the OATT rate.

If the amount of available transmission is less than [redacted] for the Franklin agreement, or if the transmission available at the OATT rate is below [redacted], PEF may terminate the agreement. The similar threshold in the Scherer agreement is [redacted].

Q. What is the status of PEF's transmission requests?

A. PEF submitted its requests for transmission on November 30, 2004, within the 30 day period required by the agreements. These requests were submitted to Southern Company Transmission as "rollover" requests of the existing transmission paths from Southern Company's Scherer plant and Miller plant under PEF's current UPS agreement. On March 8, 2005, these requests for transmission were accepted and conditionally confirmed in a letter agreement signed by the parties. The letter agreement stated that Southern Transmission would accept the requests for transmission, and on March 15, the transmission requests were confirmed by PEF. The transmission agreements were contingent on PEF's ability to redirect the Miller transmission path to the Franklin plant, which PEF requested on March 15.

The next step in the process will be a System Impact Study ("SIS") and Southern Company Transmission has already sent notification of this study to PEF. PEF must respond with a deposit towards the study in the immediate future. Once PEF has submitted the deposit, Southern Company Transmission will begin the SIS to either confirm the transmission path for the Franklin purchase, or notify PEF of any system impacts that need to be addressed. If there are system impacts, an additional Facilities Study would follow. However, if no impacts are identified, the transmission request would be confirmed, in effect making PEF the owner of the Scherer and Franklin transmission paths at that time. This could occur any time after our submittal of the SIS deposit.

Q. Do you have any reason to believe that PEF will not be able to obtain sufficient transmission service to deliver the proposed purchases from Scherer and Franklin?

A. No. The magnitude of the purchases is basically the same as is currently being purchased. While the Franklin purchase delivers power from a different source than the current Miller purchases, I do not have any reason to believe that delivery from the new source will be a problem.

Q. Is there sufficient available capacity in the Florida-Georgia interface to accommodate the proposed purchases?

A. Yes. The interface allocation that currently accommodates the UPS purchases from Southern is sufficient to accommodate the proposed purchases. From the perspective of the Florida-Georgia interface, the new agreements are simply a continuation of the same magnitude of power flowing into the PEF system.

Q. Does the timing of the Commission's decision in the proceeding have any economic implications for PEF and its customers?

A, Yes. Based on the timing of the transmission studies and notices I discussed previously, there is a chance that PEF could be committed to transmission without approval of the corresponding purchases. This is a significant possibility because transmission service could be offered at any time after PEF submits the SIS deposit. The agreements also call for PEF to make diligent efforts to obtain Commission approval of these agreements within 180 days of the effective date, November 24, 2004. This date may be extended but is tied to the notices related to transmission service. Ultimately, a delayed decision by the Commission may put the agreements at risk, and I believe that loss of these contracts would be harmful to PEF's customers, denying them both the economic and strategic benefits associated with the purchases.

Q. What action should the Commission take at this time, regarding these two agreements?

A. The Commission should expeditiously find that entering these two agreements at this time is a reasonable and prudent action by the Company to maintain a 20% reserve margin over the long term. Recovery of energy and capacity costs pursuant to the agreements would be permitted subject to a finding of reasonableness and prudence at the time the expenses are presented for cost recovery.

Q. Does this conclude your testimony?

A. Yes.

PROGRESS ENERGY FLORIDA

DOCKET NO. 04393-EI

SUPPLEMENTAL DIRECT TESTIMONY OF

SAMUEL S. WATERS

Q. Please state your name, employer, and business address.

A. My name is Samuel S. Waters and I am employed by Progress Energy Carolinas (PEC). My business address is 410 S. Wilmington Street, Raleigh, North Carolina, 27602.

Q. Have your position, duties or responsibilities changed since you last filed testimony in this docket.

A. No.

Q. What is the purpose of your revised supplemental testimony?

A. My direct testimony provided an estimate of cost savings over the five year term of the proposed Unit Power Sales (UPS) Agreements. Since my direct testimony was filed on April 15, 2005, it has come to my attention that certain inputs to my original analysis were incorrect. The purpose of this supplemental testimony is to provide a revised estimate based on an updated analysis with corrected inputs.

Q. Have you prepared an exhibit for your revised supplemental testimony?

A. Yes. My Exhibit No. ___ (SSW-4R) replaces Exhibit No. (SSW-4) submitted with my prior testimony.

Q. What inputs to your analysis have you revised since your prior testimony?

A. My economic analysis for the five year term of the agreements includes a comparison of the cumulative NPV revenue requirements for alternative resource plans: (1) a base case without the UPS purchases; and (2) an alternative resource plan with the UPS purchases included. In my original analysis, the annual revenue requirements for units included in the both the base case and alternative UPS resource plans were too high. In addition, the original analysis assumed 12 months of revenue requirements even though, in some years, certain units were only projected to be online for a portion of the year. My updated analysis includes the correct annual revenue requirements and accounts for appropriately accounts for partial years.

Q. Please provide the results of your updated analysis?

A. Using the correct inputs, I now estimate the cost savings during the five year terms of the agreements to be $44 million CPVRR, rather than the $133 million presented in my prior testimony. My revised Exhibit No. __ (SSW-4R) presents the year-by-year cumulative PVRR based on my revised analysis.

Q. Does this revised estimate affect the projected net cost to customers analysis presented in your direct testimony of April 15, 2005.

A. No. In my original testimony, I explained that based on a 45 year analysis, the contracts are projected to result in a net cost to customers of between $5 million and $11 million, CPVRR, as shown in my original exhibit Exhibit No. ___ (SSW-3). This estimate does not change because the economic result accounts for costs and benefits well beyond the 45 year study period, essentially to infinity, because economic carrying charges were used to obtain the bottom line result. This analysis using the economic carrying charge rate was a completely separate and independent analysis than the one used to generate the year-by-year savings. My revised Exhibit No. ___(SSW-4R) attempts to show the year-by-year economics, and if carried out to essentially an infinite time period, should produce the same bottom line. The year-by-year results do show that, at any given point of time, truncation of the analysis would produce a result that may differ from the end result produced by the economic carrying charge analysis.

Q. Do you have any other corrections or revisions to your direct testimony?

A. No.

Q. Does your revised estimate of cost savings during the five-year term of the UPS agreements affect your opinion regarding whether the agreements should be approved?

A. No. While the projected savings are not as high I had originally projected, I still project significant savings over the five terms of the agreements when the Company's resource plan is more certain. While there may be a moderate net cost over the 45 year horizon resulting from this contract, the range of predicted benefits, depending on the assumptions made in calculating them, are relatively small compared to the overall value of the purchases. In my judgment this range of potential economic benefits/costs is acceptable, particularly light of the strategic benefits of the contracts. As explained in my prior testimony, these strategic benefits include: fuel diversity; preservation of PEF's transmission path to the north; access to economy energy purchases and sales; increased reliability; cost certainty; increased access to coal resources; and planning flexibility.

Q. Does this conclude your supplemental testimony?

A. Yes.

CHAIRMAN BAEZ: Mr. Bushee, your cross.

MR. BUSHEE: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. BUSHEE:

Q Good morning, Mr. Waters.

A Good morning.

Q You are still the manager of resource planning for Progress Energy Florida and Progress Energy Carolina?

A Yes, I am.

Q And you are employed by Progress Energy Carolina?

A That is correct.

Q Who do you report to within the Progress organization?

A I report to the director of system resource planning.

Q And who are the individuals that report directly to you?

A I have five individuals that report to me. I have two lead engineers, I have two -- and three analysts, one of whom is retiring. I guess it was effective yesterday, so now I'm down to four as of today.

Q I may get the name wrong with pronunciation, but does a Mr. Dan Roeder work for you?

A Roeder is the pronunciation. He does not report to me. He reports also to the director of system resource planning.

Q You work with Mr. Roeder, however?
A Yes.
Q Do you believe him to be a competent employee?
A Yes, I do. I have great confidence in his capabilities.
Q Does a Mr. Roger Kramer work for you?
A No, he does not.
Q Do you work with Mr. Kramer?
A On some projects. He works in our treasury department.
Q And do you believe him to be a competent employee?
A Yes.
Q Do you perform the same resource planning functions for Progress Energy Carolinas as for Progress Energy Florida?
A Yes.
Q And you would obviously, then, be familiar with Progress Carolinas' resource planning practices?
A Yes.
Q How much time do you spend as a percentage on Progress Carolina matters?
A It varies, obviously, according to the issues at hand, but probably it's 50/50. I spend about equal amounts of time on both service areas.
Q Now, in this proceeding, Progress is asking the Commission to approve two unit powers sales agreements for

cost-recovery purposes, correct?

A Subject to my language before, what we are asking is for a ruling on the prudence of entering into the agreements at this time. The ultimate cost-recovery would be, of course, subject to review in a cost-recovery proceeding.

Q Now, one of the agreements is for 350 megawatts from Southern Power Company, the Franklin unit, is that correct?

A Correct.

Q And the Franklin unit is gas-fired?

A Yes. It is a combined cycle unit, natural gas-fired.

Q And the second agreement is for 74 megawatts from the Alabama Power Scherer unit?

A That would be the Georgia Power Scherer unit. With that correction, yes, that is correct.

Q Thank you. And I believe you mentioned earlier the term of each agreement is from June 1st, 2010, through December 31st of 2015?

A Correct. The new agreements, yes.

Q Is there also an option to extend those agreements?

A There is an option to extend on the Franklin portion, the combined cycle portion, for an additional two years. There is not an option within the current agreement to extend the Scherer portion.

Q Would Progress need further Commission approval if it decides to extend the agreements?

A I'm not sure whether that ventures into a legal opinion. I would assume that cost-recovery would still be subject to review by the Commission, so in that sense there would be an approval process. But I'm not certain that preapproval of the extension would be required. I think that is probably a legal question.

Q And I'm not asking for a legal conclusion, just simply your impression as to whether Progress would have to come back to the Commission for approval as it is here today if it were to exercise an option to extend the contracts, excuse me, the contract?

A Well, as a non-lawyer, I guess my opinion would be it is probably not required. It might be a prudent action on our part if we decided to take that extension, but I don't know that it is required.

Q Progress would not request recovery of the actual costs incurred under these agreements until it purchases power under the agreements, is that correct?

A That is correct. That would be subject to review, the actual expenses.

Q So in a proceeding during the years 2010 through 2015, Progress would come in and ask for recovery of the actual costs, correct?

A That is correct, under the current system. Assuming there are no changes to the current system of cost-recovery, I think that would be correct.

Q And if the Commission grants your request in this docket, then Progress' customers would be precluded from challenging the prudence of those costs when Progress seeks to recover the costs?

A No, I don't think that's correct. I think what would be challengeable is the expenses versus the contractual costs and expenses. In other words, whether or not we acted prudently within the terms of the contract, I think that is still challengeable. What I don't think would or should be challengeable, if this is approved at this time, is entering into the contracts themselves. I think that is the judgment we would like to get out of this proceeding.

Q I want to ask you a question about the total costs that are incurred, would be incurred under the contracts. And because that is obviously a confidential number, I can't ask you the question. I think the easiest way to do it may be to show you a number that is in Mr. Brubaker's testimony and see if you agree with that.

A Okay.

MR. BUSHEE: If I may, Mr. Chairman, we would like to --

Q May I ask do you have a copy of Mr. Brubaker's confidential testimony?

A I do not. Well, was it provided in the -- I don't think I have a copy of that.

MR. BUSHEE: Mr. Chairman, if I could, I will circulate copies to everybody in the hearing room.

(Pause.)

BY MR. BUSHEE:

Q Mr. Waters, just to give you a head start, while the copies are being distributed, I will be directing your attention in Mr. Brubaker's direct testimony to Page 15, and specifically Line 9, but I will hold the question.

A I'm there.

Q I believe everybody has a copy. Looking again at Page 15 of your direct testimony, Line 9, there is a number representing the fixed costs over the five-year term of the contract. Does that appear to be a correct number to you?

A Subject to check, I think that's close. It is an approximate number, and that is just the fixed costs, so I think that is close.

Q So in addition to that number, there would be fuel costs associated with these contracts?

A Yes.

Q The proposed agreements would take effect upon the expiration of the existing UPS agreement with Southern Company, is that correct?

A Essentially, that is correct. They are back to back, in effect.

Q The proposed agreements involve different parties and different units, however, than the existing agreement, is that not correct?

A Well, when you say different parties, they are coming from Southern Company and the member companies just as the current contracts are, and Franklin is coming from the independent part of the Southern Companies, but the Scherer portion is still coming from Georgia Power, so to that extent it is a similar arrangement from what we have.

Q So Franklin is owned by the Southern Power Company?

A I believe that is the correct name for the independent part, yes.

Q And that is an independent corporation. And Southern Power Company was not a party to the existing UPS agreement?

A I don't believe so, no. That was between Progress Energy and the member companies of Southern Company.

Q And the existing agreement does not take any power from the Franklin unit, so in that respect it is a different unit?

A That is correct, yes.

Q The pricing terms of the existing agreement and the proposed agreements are different, are they not?

A Yes. Obviously because we are buying from a combined cycle it would be a different pricing structure for that than for a coal unit.

Q And the existing agreement bundles transmission as part of the agreement, does it not?
A Yes, it does.
Q And the proposed agreements are -- the transmission is unbundled?
A Yes. Bundled agreements are no longer allowed by the FERC, so we have separate agreements for transmission and for the capacity.
Q Now, Florida Power and Light is not a party to either of these agreements, are they?
A Not these agreements, no.
Q Would you agree that Florida Power and Light has a different generation mix than Progress?
A You're talking about their existing mix?
Q Yes.
A Well, every utility will be different. They have a slightly different mix, yes.
Q Would you agree that they have a different load profile?
A In the sense that their load is larger, I would agree. I think the main drivers of their load and the load shapes are probably fairly similar.
Q I want to talk about the cost/benefit analysis.
A Okay.
Q And during the course of the questions I may ask a

question that calls for confidential material. I will try to alert you if I think I'm doing that. But if at any time you think that I am asking a question, please pause, feel free to consult with your counsel and to work it out so that we don't inadvertently bring anything out.

A Okay.

Q In your direct testimony you asserted that the proposed agreements would provide a net benefit during the five-year contract term of $133 million, is that correct?

A In the direct testimony, that's correct.

Q Did you prepare that testimony?

A Yes, I did.

Q And did you perform the analysis that resulted in the $133 million figure?

A I did not. I did not do the numbers, but the analysis was done under my direction.

Q And who did the numbers?

A Mr. Roeder.

Q I'm sorry, I couldn't hear the response.

A Mr. Roeder.

Q Thank you. Now, I recognize -- well, let me ask another question. You filed supplemental direct testimony that acknowledged that the claimed benefits, in fact, weren't 130 million, but were $43 million, correct?

A I believe it was 44 million, but that is correct.

Q Now, just as a matter of mathematical computation, that would be roughly a 66 percent reduction in the claimed benefits?

A Yes, for that five-year period, that's true.

Q So in your testimony where you say that there is a cumulative short-term savings of 133 million, the direct testimony is no longer correct?

A That is correct. That was the purpose of the supplemental testimony was to correct that 133 and essentially substitute 44 million in benefits during that period.

Q And your position after the supplemental direct is that the proposed agreements would still have a net cost to customers of between 5 and $11 billion?

A Yes, that did not change. That was an independent analysis, and that is the reason we have the apparent disparity is that the original analysis of 5 to 11 million of cost was the analysis used for management approval and review within the company. I requested the subsequent analysis, the annual year-by-year analysis, to add some information which I assumed, at the time, would show savings during that period and, of course, did show savings during the five-year term.

Q Let's talk about the $90 million discrepancy for a minute. Do you consider a $90 million discrepancy to be significant?

A It depends on the context. Given that I was just trying to show that there were savings during the five-year term, I don't consider it that significant, because I don't -- I was never resting the case on that savings, that is the five-year savings. It was intended to show that during the term there are savings, and that remains true. The magnitude of the savings was not really the point I was trying to make at the time, and is still not the point I'm trying to make.

Q So your testimony is that a $90 million mistake in this proceeding is not particularly significant?

A I don't think it should have any bearing on whether or not this is a good deal or whether the contract should be approved.

Q If Progress has $90 million less in benefits than it anticipates, does that not also mean that Progress' customers would pay $90 million more?

A No, that is not what it means at all. What we are saying is that Progress' customers will pay $44 million less than they would if we did not have these contracts in place. You are comparing two different cases, both assuming that the UPS contracts are put in place. And calculating relative payments on that basis, I don't think that is appropriate.

Q Let me make the question more specific. When Progress filed its application, it claimed that there would be $133 million in benefits over the five years of the contract, is that correct?

A That was the original application, yes.

Q And now the revised analysis shows that there would be $33 million -- excuse me, $43 million in benefits during the five years of the contract, that's correct?

A 44 million, yes.

Q And the result is if Progress has benefits of 44 rather than 133, using those two numbers, Progress' customers would pay an additional $90 million?

A No. I'm sorry, I follow your questions, but I still can't get there. Progress' customers are not going to pay more in either scenario. They are paying less than if we self-build. And that is the comparison that that is based on. If we did not implement these contracts, if we build capacity, based on today's estimates, Progress' customers would pay $44 million more during the five years. There is no scenario where -- you are taking an error and trying to translate it into practical terms. There is no scenario where they would be paying, you know, the difference between those two cases that I can see.

Q Well, then it sounds like what you are saying is that the cost/benefit analysis is really meaningless to Progress' customers?

A No, not at all. I go back to the main point. They are paying $44 million less during the five-year terms, terms of these agreements, than they would if we did not enter into these agreements.

Q Then the comparison that I'm trying to get you to make is between the initial claimed benefits and the actual claimed benefits.

A I understand, but savings are savings. The customers will be saving money, and what we are, I think, discussing is the magnitude of the savings. Correcting the error reduced the magnitude of savings, but it does not mean that they would pay $90 million less. If there was an error in the analysis, then that scenario is not a real analysis where they would be paying those rates. And we have admitted the error and corrected it, and what I'm saying is current projection is $44 million less under these agreements.

Q We will revisit this question again a little bit later because we seem to be going in different directions, and I think it will be easier to address it a little bit later.

Would Mr. Roeder be the individual that made the $90 million mistake?

A Since we were unable to track down the original spreadsheets that were the basis for that figure, I hate to blame Mr. Roeder, he may have had a technician running cases for him. But ultimately I would say I'm responsible for the error. I asked for the analysis, it was done under my direction, and I should have caught the error before it went out.

Q Did Progress implement any policies or procedures to prevent these sorts of mistakes happening in the future?

A I would say that our current level of review is much more substantial than it was in this particular analysis. This is not -- this was an analysis, as I said, that I requested in addition to the normal analysis. The normal process which gave us the 5 to 11 million cost is normally employed for corporate review, and it is extensively reviewed. And I think we, going forward, will be implementing that on any of the other analyses, also.

Q Did Progress take any action with respect to any individual in connection with the $90 million mistake?

A No.

Q You first became aware that the benefits were overstated by $90 million in the course of responding to a White Springs discovery request, is that correct?

A Not in responding to the discovery request. Where it became apparent, we provided all of the information in response to the discovery request, and there is a substantial volume of material. We were asked, as you are well aware, for an informal discussion of some of the spreadsheets that we had already provided. In the course of walking myself through the spreadsheets to prepare for the phone call, and pulling some of the material out of the discovery request, I found that there were some numbers in the calculation that had no backup spreadsheets.

I wanted, first of all, to make sure that that wasn't an omission in our discovery response. We were unable to track down any of the spreadsheets that would have backed up those calculations, so it became apparent that something was missing. We had the phone call, and at that time I had not had a chance to try and duplicate the results, but it was apparent there was a problem just looking at the numbers. Subsequent to the phone call, we tried to duplicate the results, could not, realized there was an error and corrected the analysis.

Q And the phone call that you are referencing would be a May 10th, 2005, telephone call involving yourself and Mr.

correct?

A You are talking specifically about the 133 million now?

Q Yes.

A Yes. We were unable to find any backup. Other than the spreadsheet, itself, which showed that number, we were unable to find the spreadsheets that gave the origins of the revenue requirements in that calculation.

Q And, in fact, the fixed cost numbers had been hard-wired into a spreadsheet, is that not correct?

A I have to speculate, since we can't find the backup spreadsheets. But typically what is done in that analysis, since there are several different units at different in-service dates and even different technologies, is a cut and paste. If you want to call that hard-wired, what is typically done is to calculate the revenues requirements, cut them from the originating spreadsheet, and then paste them into that spreadsheet.

Q And I think we are saying the same thing. By hard-wired I mean that it was a number that was put into a cell as opposed to a formula or a link to another spreadsheet?

A That would be correct.

MR. BUSHEE: I would like to mark as an exhibit a July 28th e-mail from Mr. Roeder to Mr. Waters. I'm not sure of the numbering convention of what we should number this.

CHAIRMAN BAEZ: Are you asking for a number?

MR. BUSHEE: I believe it is Number 17.

CHAIRMAN BAEZ: The next number is 17. If you can give me a title.

MR. BUSHEE: I would mark as Exhibit 17 a July 28th, 2004, e-mail from Mr. Roeder to Mr. Waters. And if we can take a moment, we'll provide a copy of this to --

CHAIRMAN BAEZ: Please.

MR. BUSHEE: Mr. Chairman, should we go off the record for a moment while this is --

CHAIRMAN BAEZ: Let's go off the record for a moment.

(Off the record.)

CHAIRMAN BAEZ: Let's go back on the record.

BY MR. BUSHEE:

Q Mr. Waters, do you have what has been marked as Exhibit 1 (sic) in front of you?

A Yes, I do.

Q We are treating this as a confidential document, so when I ask questions --

MR. PERKO: Chairman Baez, I do not believe this document is confidential. Mr. Waters can correct me if I'm wrong.

CHAIRMAN BAEZ: Well, if we can receive confirmation then perhaps the questions will get easier.

THE WITNESS: Yes. I think at this level it is not confidential, but I may have to use confidential information to answer the question.

CHAIRMAN BAEZ: You know, I'm not sure how you would do that, Mr. Waters, frankly. But if you are confirming for us that this document in particular is not confidential, then perhaps that will make it a little easier for Mr. Bushee to get his questions out.

THE WITNESS: I would say that this is not confidential.

CHAIRMAN BAEZ: Very well. Then we don't have to treat it as confidential, Mr. Bushee. I guess we will deal with your responses somehow if they come up. Go ahead, sir.

MR. BUSHEE: Thank you. And I will make every effort to avoid eliciting a response that requires confidential.

BY MR. BUSHEE:

Q Would you direct your attention to the first paragraph of the e-mail, the one that begins everyone should keep in mind?

A Yes.

Q Mr. Roeder talks about the costs of the analysis using Strategist do not include start costs or run times. First, would you please explain what Strategist is?

A Strategist is a dynamic optimization model. It is the model we use to, first of all, determine our base resource plan by identifying the most cost-effective combination of alternatives, and it is also used in this case to evaluate alternative resource plans and the costs associated with alternative resource plans. It does both production costing and calculation of the capital associated with new unit additions.

Q And would you also explain what is meant by start costs?

A Start costs, as you look particularly at gas technologies, gas turbines are expected to start quite frequently. Combined cycle units, it varies quite a bit depending on how many starts you assume, but there is a cost associated with each start up that has to do with materials and wear and tear on the unit. And that is sometimes reflected as an operating or maintenance cost and sometimes as a separate start-up cost.

Q Do you have a copy of the unredacted version of the Franklin agreement with you?

A Yes.

MR. BUSHEE: May I ask if the Commissioners have a copy of this with them?

CHAIRMAN BAEZ: Commissioners, that should probably be contained in Mr. Waters' confidential exhibits, if I'm not mistaken.

MR. PERKO: That is correct. Are you referring to the Franklin agreement?

MR. BUSHEE: The Franklin agreement, correct. And we do have them available if it would be more convenient.

CHAIRMAN BAEZ: I know I have it. Commissioners?

MR. PERKO: It is Exhibit SSW-2.

CHAIRMAN BAEZ: I think we all have it, Mr. Bushee.

MR. BUSHEE: Thank you, Mr. Chairman.

BY MR. BUSHEE:

Q Mr. Waters, do you have that agreement before you now?

A Yes.

Q And would you please turn to Page 32, and specifically if you would direct your attention to Section 6.3.

A Yes.

Q And in Section 6.3, the agreement provides that Progress must make a monthly start payment, is that correct?

A Correct.

Q Am I also correct that the monthly start payment would be calculated according to the formula in Appendix C?

A That is correct.

Q And as I look at Appendix C, the entirety of that formula is confidential material, is it not?

A I believe that would be correct. Certainly the table in the formula would be confidential.

Q And why is it that that information is confidential?

A That is confidential to Southern Company. That is their pricing, and they consider that specific to the offer, and they consider that confidential information.

Q So it is confidential because you have agreed to keep it confidential, essentially? It is not a trick question, I'm just understanding that you have made an agreement that this is confidential?

A That is correct.

Q We will treat it that way.

MR. PERKO: Chairman Baez, just for the record, I believe there has been an order granting confidential classification for this document.

CHAIRMAN BAEZ: For the Franklin agreement in particular, or what are you referring to?

MR. PERKO: This document.

CHAIRMAN BAEZ: Okay.

MR. BUSHEE: I am not questioning the confidentiality of the material, I just wanted to understand the basis for it. I'm satisfied with that.

CHAIRMAN BAEZ: Very well.

BY MR. BUSHEE:

Q So to explore this formula and to try and see how it works would be essentially impossible in the context of this proceeding because we would have to reveal confidential information.

A It would be difficult to trace through the calculations without giving away confidential information. I guess maybe the easiest way to deal with this, the formula looks fairly complex, but there is one simple aspect to it that I can point to that may help. The non-inclusion of start-up costs was done at my request, that was my decision. If you look at Table C1, and without revealing numbers on the table, if you look at the first line of Table C1, and look at the costs associated with that first line, if I add to that information that the generic units we are comparing to the generic combined cycle units which we are measuring against have a comparable number of starts that would put them in that first line, in other words, the self-build options also would fall in that first line.

And assuming, which I think is fair, that this combined cycle is similar to the combined cycle that would be self-built, that the cost structure would be the same, my feeling was that the relative change in the economics would basically be a wash. We are comparing apples-to-apples, so there would be no real net effect on the economics.

Q But this contract does not apply to a generic unit, it applies to the Franklin unit, is that correct?

A That's true, and this is pricing versus cost, but there are costs associated with more frequent starts in a combined cycle, and we would have to evaluate that on the self-build side. And my feeling is that the costs would not be significantly different if we were to do that.

Q Well, let's turn, if we could, to Appendix H of the agreement.

COMMISSIONER DEASON: Let me interject a question at this point. The start-up cost, is this cycling of the unit on and off? Could you just define what start-up costs are.

THE WITNESS: The start-up, as defined in the contract, and I think it is fair to use that for self-build, too, is basically going from a state of zero, being off, to turning on whether it is at minimum load or any other level. As soon as we go to a non-zero level, that is a start-up. And there would be costs -- so it is basically turning the unit on and off, and there are costs associated with that.

COMMISSIONER DEASON: Just speaking generically and certainly avoiding any confidential information, the Franklin unit is of a certain class of units, it is a combined cycle gas-fired unit. I would assume it to be relatively efficient, is that a fair characterization?

THE WITNESS: That's correct. It's similar to the Hines units, for example, in its technology. Similar, what we would call generically an F class combustion turbine, that is the basis for it. It is a current design.

COMMISSIONER DEASON: So in a normal dispatch, these type units would be dispatched where on the load curve, generally?

THE WITNESS: They will be after coal and nuclear, obviously, and potentially after the coal portion of the UPS. They would probably be next in line. And they would compete, depending on fuel delivery and relative efficiency, but the combined cycles would be in the middle of the load curve.

COMMISSIONER DEASON: So it is in the middle of the load curve. What would you expect a plant of that particular class of technology to be cycled off and on? The reason is just to meet the demand on the curve, is that the reason, or is it for maintenance purposes?

THE WITNESS: It's to meet the demand. Generally speaking, we will dispatch everything in economic order. And as the load increases during the day, or from day to day, we will turn units on from least energy cost on up the line to highest energy cost. The combined cycles will fall between the base load units, which are coal and nuclear, and combustion turbines. So they would be in the middle of the cycle.

Now, depending on how much coal and nuclear a system has, you could end up running combined cycle quite a few hours if you don't have enough to cover all of that base load. The projections have varied over time, but we see combined cycles with the potential to run 70 or 80 percent of the time. And the basis for our generic unit in this analysis was an 85 percent capacity factor, so there are not a lot of starts on the unit when it runs in that mode.

Typically, I think people think about combined cycles running in more the 50 percent range where you would have more starts. So the costs would vary, of course, depending on how many starts you actually had on the unit.

COMMISSIONER DEASON: If you refer to Table C1, again -- and here again, not revealing anything that is confidential -- but the first line there, is that considered to be within a normal range for operation of this type unit?

THE WITNESS: Speaking industry-wide, I would say that is low.

COMMISSIONER DEASON: Low.

THE WITNESS: It would be more probably in the second line.

COMMISSIONER DEASON: And is this over what period of time?

THE WITNESS: This is an annual number.

COMMISSIONER DEASON: Annual?

THE WITNESS: Yes.

COMMISSIONER DEASON: Thank you.

BY MR. BUSHEE:

Q Would you please turn to Table H4, and that is located on Page H7.

A Okay.

Q Do you see just above the table there is a line that says assumptions for the example in Table H4 are?

A Yes.

Q And all of that information is confidential, so I can't refer to it. Do you know what the source of those assumptions is?

A This did not come from us. This is a Southern Company assumption, as most of the tables in these examples are. They are giving examples of various payments as you go through the appendices. So this, I think, is based on an assumption that they made about the performance of the unit.

And it may be consistent with the way they are operating it now, I don't know.

Q One would assume that Southern has some familiarity with how their unit will operate?

A Well, on their system I would assume that is correct. I don't think they would have any familiarity with how it would operate on our system.

Q Did Progress perform any analysis of the number of starts that would occur under this agreement?

A No, we didn't do it at that level of detail. And as I mentioned before, that was sort of my call because we have got two technologies here comparing to our self-build and comparing to this option. We would have additional costs for, I would think, relatively similar costs between the two units regardless of whether it was ours or theirs. I didn't expect it to significantly influence the results.

And one thing I would not do is add these start payments in or make some assumption on start-ups and simply add them as a cost to the Southern deal without analyzing in more detail the self-build option.

Q Would you please look at Line 11 of Table H4?

A Yes.

Q And if you go to the very far side of that table, and look at the number that you see there?

A Yes.

MR. BUSHEE: Mr. Chairman, could we go off the record a second? I would like to confer with counsel for Progress before I ask the next question. I am concerned that the question itself --

CHAIRMAN BAEZ: Why don't we pick this as a ten-minute break so you all can straighten it out.

(Recess.)

(Transcript continues in sequence with Volume 2.)

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 3rd day of June, 2005.

JANE FAUROT, RPR
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