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July 13, 2005

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

RE: Petition for Rate Increase by Progress Energy Florida, Inc.
Docket No. 050078-EI

Dear Ms. Bayó:

Enclosed are an original and twenty-five (25) copies of the Direct Testimony of Helmuth W. Schultz, III (PUBLIC VERSION) on behalf of the Office of Public Counsel for filing in the above-referenced docket.

Also enclosed is a 3.5 inch diskette containing the Direct Testimony of Helmuth W. Schultz, III (PUBLIC VERSION) in Microsoft Word format. Please indicate receipt of filing by date-stamping the attached copy of this letter and returning it to this office. Thank you for your assistance in this matter.

Sincerely,

Joe McGlothlin

Joseph A. McGlothlin
Associate Public Counsel

JAM/dsb
Enclosures

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for Rate Increase by	)	
Progress Energy Florida, Inc.	)	DOCKET NO. 050078-EI
	)	Filed July 13, 2005

DIRECT TESTIMONY OF

HELMUTH W. SCHULTZ, III, CPA

ON BEHALF OF

THE CITIZENS OF THE STATE OF FLORIDA

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 050078-EI

DIRECT TESTIMONY OF HELMUTH W. SCHULTZ, III

ON BEHALF OF THE CITIZENS OF FLORIDA

I. INTRODUCTION

Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

A. My name is Helmuth W. Schultz, III, I am a Certified Public Accountant licensed in the State of Michigan and a senior regulatory analyst in the firm Larkin & Associates, PLLC, Certified Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan 48154.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES, PLLC.

A. Larkin & Associates, PLLC, is a Certified Public Accounting and Regulatory Consulting Firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.) Larkin & Associates, PLLC has extensive experience in the utility regulatory field as expert witnesses in over 600 regulatory proceedings, including numerous electric, water and wastewater, gas and telephone utility cases.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION?

A. Yes, I have testified before the Florida Public Service Commission. I have also testified a number of times before Public Service/Utility Commissions or Boards in other state jurisdictions.

Q. HAVE YOU PREPARED AN EXHIBIT DESCRIBING YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Ex. ___ (HS-1), which is a summary of my regulatory experience and qualifications.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. Larkin & Associates, PLLC, was retained by the Florida Office of Public Counsel (OPC) to review the rate request of Progress Energy Florida, Inc. (PEF or Company). Accordingly, I am appearing on behalf of the Citizens of the State of Florida (Citizens).

Q. ARE ANY ADDITIONAL WITNESSES APPEARING ON BEHALF OF THE FLORIDA OFFICE OF PUBLIC COUNSEL IN THIS CASE?

A. Yes. James Rothschild, Jacob Pous and Hugh Larkin, Jr. and Donna M. DeRonne, of my firm, are also presenting testimony.

Q. HOW WILL YOUR TESTIMONY BE ORGANIZED?

A. First, I will discuss the storm damage accrual, payroll components, incentive compensation, benefit expense and finally, the Company's new capitalization policy. Attached to my testimony is Ex. ___, (HS-2) which contains Schedules 1-6 that reflect the adjustments that I am recommending.

II. STORM DAMAGE ACCRUAL

Q. HAVE YOU REVIEWED PROGRESS ENERGY FLORIDA'S REQUESTED ACCRUAL FOR STORM DAMAGE?

A. Yes. Progress Energy Florida has requested that its annual storm damage accrual be increased $44 million from $6 million to $50 million. According to Company Exhibit No. __(JP-9) the Company wishes to collect $50 million a year over the next five years to build up its storm reserve to $180 million. That assumption would mean the Company would incur an average annual charge to the reserve of $14 million over each of the next five years. The Company's request is based on a February 2005 "Rapid Update to Progress Energy Florida Hurricane Risk Profile Memorandum of 2000." Company testimony provided as support for the $44 million increase in the accrual consists of two paragraphs in Mr. Portuondo's prefiled testimony and two paragraphs in Mr. Bazemore's testimony.

Q. IS THE COMPANY'S REQUEST TO INCREASE THE ANNUAL ACCRUAL BY $44 MILLION REASONABLE?

A. No. The Company's request is overstated by $37.5 million. The request is not appropriate because it ignores the historical charges to the reserve, relies on an updated study that is focused on the 2004 storms and assumes that storms similar to those that occurred in 2004 are not of an extraordinary nature. The Company's assumption is that $14 million, on average, will be charged annually, when historically the annual charge averaged $2 million.

Q. WHY SHOULD THE HISTORICAL CHARGES TO THE RESERVE BE CONSIDERED?

A. As shown on Exh.____, (HS-2), Schedule 1, the Company charged to the reserve, on average, $1,943,000 a year over the 10 year period 1994 to 2003. The highest amount charged to the reserve in any single year was $5,896,000 in 2001. That means the $6 million annual accrual currently allowed in rates was not exceeded once in that 10 year period. The accrual was sufficient enough to allow the reserve to increase to $40,916,000 as of December 31, 2003. The reserve represents funds advanced by current ratepayers for future storm costs. The facts that, prior to 2004, the annual cost for storms averaged less than $2 million a year and that the highest cost incurred in any one year was $5.9 million are significant in determining the level of annual accrual that is required to re-establish the reserve for a normal, recurring level of storm related costs.

Q. WHAT DO YOU MEAN BY YOUR STATEMENT THAT THE UPDATED STUDY FOCUSED ON THE 2004 STORMS?

A. According to the response to Citizens' Interrogatory No. 105, the updated study in question focused on an annual accrual from $40 million to $110 million because of the 2004 storm season. Despite factoring in the 2004 storm season, the study ignores the possibility of securitization and/or a surcharge for recovery of the unprecedented catastrophic storm costs incurred in 2004. To establish a reserve that attempts to recover the costs of hurricanes like those experienced in 2004 is neither appropriate nor consistent with current ratemaking theory.

Q. WHY IS RE-ESTABLISHING THE RESERVE BASED ON THE 2004 STORM SEASON NOT APPROPRIATE?

A. As shown on Schedule 1, the 10 year average cost for storms prior to 2004 was $1,943,000. If you determine a 10 year average with only the largest and the smallest cost storms included, the average increases to $13,353,000. Calculating the 10 year average based on Frances and Jeanne, the two mid-level cost storms, the average jumps to $21,743,000. Using all four of the Company's estimated 2004 costs, the 10 year average skyrockets to $33,153,000. The costs for 2004 were unprecedented, and the fact that the excess 2004 costs are being recovered through a surcharge is reasonable justification to exclude the extraordinary costs from the normal reserve determination. A base rate item is a normal operating cost, and the costs that are included in the reserve are included in base rates. While the reserve is to cover some level of storm costs, it is not established to cover the magnitude of costs incurred in 2004. In fact, in the Storm Cost Recovery proceeding (Docket No. 041272-EI) both the Company contended, and the Staff agreed, that the reserve is not intended to cover the level of cost incurred in 2004. Therefore, the cost incurred in 2004 should not be included in the determination of the annual accrual for storms.

Q. WHAT IS THE BASIS FOR YOUR STATEMENT THAT THE STAFF INDICATED THE RESERVE IS NOT INTENDED TO COVER THE LEVEL OF COST INCURRED IN 2004?

A. At page 41 of its memorandum, Staff states, "The record evidence suggests it would have been imprudent to require PEF's customers to fund in advance the <u>substantial additional reserves</u> that would be needed to cover the costs of catastrophic storms, which, statistically speaking, were unlikely to occur." (Emphasis added.)

Q. WHERE DID THE COMPANY ASSERT THAT THE RESERVE WAS NOT INTENDED TO COVER THE LEVEL OF COST INCURRED IN 2004?

A. At page 39, the memorandum cites the testimony of PEF witness Portuondo. Mr. Portuondo testified that it was neither practical nor cost-effective to provide coverage for all storm related costs the Company might experience and the annual accruals to the reserve were not designed to cover costs of potentially catastrophic hurricane seasons because studies that provide the basis for these accruals have shown a <u>low</u> probability that most severe storms or series of storms would impact the Company's service territory. In fact, the testimony cited continues with Mr. Portuondo's conclusion that the Commission does not want to collect from customers "significant additional reserves" to cover the costs of catastrophic storms that were unlikely to occur. Those significant costs are to be recovered if and when the need arises. The record is clear that the excessive level of costs in 2004 were unprecedented, catastrophic costs not intended to be included in the reserve that was established by base rates. And, because of the unprecedented series of events and costs incurred, the Company has been allowed to recover certain of those costs through a surcharge now that the need has arisen.

Q. WHAT DID YOU CONSIDER IN DETERMINING WHAT LEVEL OF ACCRUAL SHOULD BE INCLUDED IN BASE RATES?

A. The citation to Mr. Portuondo's testimony regarding the study in Docket No. 041272-EI indicates that the Company has a 23.3% chance of a storm occurrence and that 53% of the storms will impose costs of less than $5 million. The 10 year average storm cost from 1994-2003 is $1,943,000. Inflating the average using the Gross Domestic Price Inflator, in 2004 dollars, the annual accrual increases to $2,147,000. The Company's updated study, that factored in the 2004 storms, indicates that there is a 51.7% probability that at least $50 million of damage will occur over a five year period. As stated earlier, the Company's request of $50 million a year to establish a reserve of $180 million after five years would assume an average annual expense of $14 million. The estimated annual charges range from $1.9 million to $14 million. The reserve balance prior to 2004 was built up over a 10 year period. Historically, the charges have, on average, been relatively low and the current accrual was sufficient for storm costs that were likely to occur.

Q. WHAT CONCLUSIONS DID YOU REACH ABOUT THE RESERVE BALANCE AND THE ANNUAL ACCRUAL?

A. The Company's request is attempting to incorporate catastrophic level storm costs in the annual cost and ultimately in the desired reserve level of $180 million. As explained earlier, this is contrary to the Commission's intention, as described by Mr. Portuondo, to refrain from allocating catastrophic storm costs to ratepayers prior to a need for recovery of those costs. The request by the Company is not appropriate and should be disregarded. The historical average as inflated represents a normal level of recurring costs that can be expected going forward. However, I believe that instead of establishing a reserve of $50 million over 10 years that the $50 million should be established over five years. A $50 million reserve over five years will provide a cushion in the event that the average costs exceed the historical inflated average. It will also provide some coverage should another catastrophic season occur. Assuming $10 million a year for re-establishing the reserve balance and assuming an average expected annual charge against the reserve of $2.5 million, I am recommending an annual accrual of $12.5 million. As shown on Helmuth Schultz, Exh. ___, Schedule 1 this would reduce the Company's request by $37.5 million or $36,356,000 on a jurisdictional basis.

Q. DOES THE STORM ADJUSTMENT AFFECT RATE BASE?

A. Yes, it does. On Helmuth Schultz, Exh. ___, Schedule 1, page 2 of 2, I have reflected my adjustment of $18,976,000 to increase working capital as a result of the change I recommended in the annual accrual. I will note that the Company adjustment, although not in their favor, appears to be overstated because it assumes no charges will be reflected against the accrual in 2006. That would only be the case if the Company was assuming no storms in 2006.

Q. HOW DID YOU DETERMINE YOUR ADJUSTMENT?

A. Starting with the Company's 2006 beginning balance of $6,515,000, I added my recommended annual accrual of $12,500,000 and deducted my estimated annual expense of $2,147,000, resulting in a year end balance of $16,868,000. My projected year end balance is $39,147,000 less than the Company's estimated year end balance of $56,015,000. The Company's average in working capital for the year 2006 is $28,008,000. My projected average is $8,434,000. The average adjustment is $19,574,000 or $18,976,000 on a jurisdictional basis.

III. Incentive Compensation

Q. HAVE YOU REVIEWED THE COST ASSOCIATED WITH THE COMPANY'S INCENTIVE COMPENSATION?

A. The Company's response to Citizens' Interrogatory No. 27 shows that the cost of incentive compensation increased significantly since 2002. In 2003, the cost increased 83% over 2002 and was $7.7 million (54.7%) over budget. In 2004, incentive compensation increased $14.1 million (18.8%) over 2003 and was $9.8 million (60.8%) over budget. The 2004 incentive compensation of $26 million was over twice the 2002 incentive compensation of $12 million. During the same three year period the employee complement remained relatively stable. The average employee base pay increased 4.1% in 2003 and 7.3% in 2004. The total average payroll per employee increased 9.4% in 2003 and 13.5% in 2004 with incentive compensation factored in. It is a concern that during this period of time base pay increases were not curtailed, overtime was progressively increased (some of which is attributed to the hurricanes), and incentive compensation soared.

Q. WHY DOES THE INCREASE IN INCENTIVE COMPENSATION CONCERN YOU?

A. Incentive compensation is theoretically "at risk" compensation paid for increased performance, performance that in theory contributes to the success of the Company by achieving financial and operating performance goals. The significant increases in the amount of incentive compensation awards should be indicative of the Company's increased successful performance. However, despite the increases in incentive compensation, which if warranted would imply corporate financial success; the Company is requesting an increase in its rates.

Q. IS THERE ANY INDICATION AS TO WHY THE INCREASES IN INCENTIVE COMPENSATION OCCURRED?

A. Yes, to some degree there is an indication that the goals are not as challenging as they should be. The Company was requested in Citizens' Interrogatory No. 29 to provide the goals and the comparable actual results by year for 2002 to 2004. Each year instead of increasing the corporate earnings per share goal the Company decreased the earnings requirement. Reducing the primary goal is contradictory and defeats the purpose of the incentive plan. The environmental index goal, despite being achieved in 2002, remained the same each year thereafter. The Energy Supply customer care goal remained the same in each year. I question the efficiency of such static or diminishing goals.

Q WHAT IS THE PURPOSE OF THE COMPANY'S INCENTIVE COMPENSATION PLAN?

A. In response to Citizens' Production of Document No. 34, the Company provided copies of its Management Incentive Compensation Plan (MICP) and its Equity Incentive Plan (EIP). The stated purpose of the MICP "is to promote the financial interests of the Sponsor and its Affiliated Companies, including its growth…" The plan intends to accomplish this purpose by:

- Attracting and retaining executive officers and other management-level employees who can have a significant positive impact on the success of the Company;
- Motivating such personnel to help the Company achieve annual incentive, performance and safety goals;
- Motivating such personnel to improve their own as well as their business unit/work group's performance through the effective implementation of human resource strategic initiatives; and
- Providing annual cash incentive compensation opportunities that are competitive with those of other major corporations.

Reducing the earnings per share makes it easier for a payout of incentive compensation and it does not promote the financial interest of the Company or ratepayers.

It is also interesting to note that the Progress Energy, Inc.'s Chief Executive Officer has sole and complete authority to select participants and to establish and <u>adjust</u> performance criteria. (Emphasis added.) The level of discretion available is a major concern because it allows for performance criteria to be adjusted during the test year that would allow for payment of incentive compensation when performance may not be at a level that would normally result in an award.

The purpose of the EIP is "to promote the interests of the Sponsor and its shareholders" by attracting key employees, motivating the key employees using "performance-related and stock-based incentives linked to the interests of the Sponsor's shareholders" and enabling key employees to "share in the long-term growth and success of the Sponsor and its Affiliates." (Emphasis added.) This stock plan is truly company oriented. I also do not believe that it is appropriate for ratepayers to pay for the cost of this extra benefit to select employees and then pay a return on that cost in future years.

Finally, the percentage of compensation that can be rewarded to individual members of management is significantly higher than the Employee Cash Incentive Plan (ECIP) percentage identified in the ECIP. The increased disparity in compensation combined with the fact that the plans purpose is to enhance shareholders value raises a concern as to where customer service falls on the priority list. When the purpose of the plan does not mention customers or customer service it is difficult to understand how the ratepayers interest is considered or how ratepayers will benefit from the plan.

Q. IS THE EMPLOYEE CASH INCENTIVE PLAN CUSTOMER ORIENTED?

A. No. In fact, the plan does not even have a stated purpose. The plan states that it "is designed to ensure a close link between pay and performance and to share the Company's financial success." That financial success is later described as "Progress Energy's performance in the marketplace." The plan states that it awards an employee only when individual performance meets certain expectations. The plan also states that achievement of the plan goals "will generally influence the amount of any base pay increases for the year." Reflecting on both statements one would have to question whether employees are rewarded twice for the same performance. First employees are rewarded in the form of a base pay increase and then employees are compensated a second time for the same performance with incentive compensation.

Q. SHOULD THE COMMISSION BE CONCERNED WITH THE COMPANY'S INCENTIVE COMPENSATION PROGRAM?

A. Yes. Clearly, the focus is shareholder oriented and the goals do not appear to provide a true incentive to provide superior performance that would justify an award. Instead, the plans appear to be designed with goals that almost guarantee a payout. The only question that remains is how much will be paid out. As discussed earlier, the actual payout exceeded the budget by more than 50% in both 2003 and 2004. It is not appropriate for ratepayers to fund the incentive compensation plans of Progress Energy when the purpose of the plan is to benefit shareholders and/or employees.

Q. ARE YOU RECOMMENDING AN ADJUSTMENT BE MADE TO THE INCENTIVE COMPENSATION COSTS?

A. Yes. Incentive compensation expense should be reduced by at least $7,967,000 or $7,143,000 on a jurisdictional basis.

Q. HOW DID YOU DETERMINE YOUR RECOMMENDED ADJUSTMENT?

A. As shown on Ex. ___ (HS-2), Schedule 2, I started with the total amount of projected 2006 incentive compensation by type and multiplied that by the Company's applicable expense allocator. The expensed amount is $9,617,000 for the Employee Cash Incentive

Plan (ECIP), $2,474,000 for the Management Incentive Compensation Plan (MICP), and $684,000 for the Long Term Incentive Plan (LTIP) or Equity Incentive. As discussed earlier the ECIP is questionable because goals are not set to create a true incentive and the benefit from the performance, if any, is flowing to shareholders. Without any specific evidence that there is a benefit to ratepayers, the entire amount should be disallowed. However, I am only recommending a disallowance of $4,808,000 or 50% on the presumption there is a benefit to ratepayers that is at least equal to the benefit shareholders receive. Based on the equal sharing of benefits I am recommending an equal sharing of the cost. The 50% disallowance recommended is the shareholders' cost for Progress Energy's performance in the marketplace.

Q. WHY DID YOU REMOVE ALL OF THE MICP AND LTIP?

A. Once again, the goals are a concern and the plans are specifically focused on the financial results of Progress Energy. In addition, the plans are designed to generously reward management for achieving that financial result. Without sufficient operating goals that are tied to customer satisfaction and reliable service the ratepayers' best interests could be sacrificed to attain the financial results that would trigger the payment of incentives to management. The checks and balances are not sufficient to allow the cost of the MICP and LTIP to be included in rates. There is no significant identifiable benefit to ratepayers that would justify the cost or even a portion of the cost of either plan in rates. As shown on Exh. ___ (HS-2), Schedule 2, I recommend adjustments of $2,174,000 and $601,000, on a jurisdictional basis, for MICP and LTIP, respectively.

<u>IV. Payroll</u>

Q. IS THE COMPANY'S REQUESTED PAYROLL REASONABLE?

A. The payroll dollars in total are not being questioned, at this time. However, the Company's projected expense of $156 million for base pay and overtime is considered excessive and, as shown on Ex. ___ (HS-2), Schedule 3, a reduction of $7,985,000 or $7,253,000 on a jurisdictional basis is recommended.

Q. WHY IS AN ADJUSTMENT NECESSARY?

A. In 2002 and 2003, the Company expensed approximately 54% of its payroll, capitalizing the remaining 46%. In 2006, the Company increased the expense factor to 57% without providing any justification. This increase is not supported by testimony or the filing and should not be allowed.

Q. HAVE YOU IDENTIFIED WHERE THE INCREASE WAS CHARGED?

A. Yes. The Company's response to Florida Retail Federations (FRF) Interrogatory No. 17 provided a comparison of the 2005 and 2006 projections to the actual levels for the years 2002-2004. In my review of the cost by activity, I identified a significant increase in the distribution operations and maintenance expenses in 2005 and 2006. A comparison of 2006 to 2002-2004 is shown on Schedule 3, lines 11-15. The distribution operating payroll exceeds the three year average by over $14 million. Coincidentally, the Company's adjustment (No. 19) for a change in accounting is also increasing distribution operations and maintenance expense significantly. In reviewing the response to Citizens' Interrogatory No. 4, it was noted that the accounts being charged are accounts that include labor and are in the same group of accounts that reflect the budget increase described above. The combination of the two increases would result in an extraordinary level of payroll dollars in these accounts when compared to historical levels. The filing does not provide justification for an increase of this magnitude. The expense factor should remain at the 2002 and 2003 level of 54%.

Q. ARE THERE ANY OTHER CONCERNS WITH PAYROLL?

A. Yes. The Company's filing reflects some downsizing. It is not clear from the information that I have reviewed whether the downsizing captures the full impact of the proposed reduction. For example, Citizens' Interrogatory No. 75 requested that the Company provide for 2005 and 2006 the budgeted employee levels, the adjustments proposed, and the resulting employees complement included in the filing in jurisdictional NOI. The response identified the budget levels on Company Schedule C-35 and referenced two types of adjustments being made, but the response did not identify the complement included in the jurisdictional NOI. When requested in Citizens' Interrogatory No. 22 to provide a listing of the employee positions projected to be added in 2005 and 2006, the Company responded by stating: "There will be no employee positions added in 2005 and 2006." The statement is not entirely accurate as evidenced by Company Schedule C-35, which shows the 2004 employee count to be 4,084, 2005 is 4,130, and 2006 is 4,131. The Company, prior to adjusting for the organization realignment and mobile meter reading, did in fact add 47 positions during 2005 and 2006.

Q. ARE YOU RECOMMENDING ANY ADJUSTMENT FOR EMPLOYEES?

A. Not at this time. What I am recommending is that the Company be required to quantify the payroll expense it is reflecting in the 2006 year and the number of employees. It is not appropriate to provide a budgeted level as a starting point and not provide specific quantification of the changes so the requested cost can be readily identified.

V. Payroll Tax Expense

Q. WHY ARE YOU RECOMMENDING A REDUCTION TO PAYROLL TAX EXPENSE?

A. An adjustment to payroll tax expense is required to account for the recommended adjustment to incentive compensation. It reflects the effective tax rate and it reflects a proper allocation to expense. The adjustment, as shown on Exh. ___ (HS-2) Schedule 4, reduces expense by $3,314,000 or $3,062,000 on a jurisdictional basis.

Q. WHY IS THE EFFECTIVE TAX RATE USED?

A. The effective tax rate represents the actual effective tax that is paid on the actual payroll. In 2004 the actual effective tax rate was 7.7%. The 7.7% was multiplied by the adjusted total payroll, resulting in my adjusted total payroll taxes of $21,611,000 for 2006. The Company's assumed effective tax rate of 8% was not used because we are not aware of any justification for an increase.

Q. WHAT DID YOU MEAN THAT YOU REFLECTED A PROPER ALLOCATION TO EXPENSE?

A. According to the response to FAF Interrogatory No. 17, the Company expensed $15,039,934 or 64.4% of the projected payroll taxes. The Company expensed 57.8% of its projected 2006 payroll. Payroll taxes are based on payroll. The direct causal effect should require the tax to follow the payroll. Whatever percentage of payroll is charged to expense the payroll taxes should follow by applying the same allocation. In my calculation of payroll I used a 54.26% payroll; therefore, applying the 54.26% is consistent with the payroll expense recommendation. The jurisdictional reduction to payroll tax expense of $3,062,000 is appropriate and should be made.

VI. Healthcare Benefits

Q. ARE YOU RECOMMENDING AN ADJUSTMENT TO THE PROJECTED MEDICAL EXPENSE?

A. Yes. Healthcare expense is overstated by $3,046,351 or $2,767,305 on a jurisdictional basis. According to the response to Citizens' POD No. 31, the Company calculated its healthcare benefit cost based on information available as of August 2004. The healthcare estimate included separate cost calculations for medical, dental and vision. The primary cost is medical and it was based on a projected 2004 participant cost of $5,054. Dental was estimated to be $463 per participant and vision was projected to be $65 per participant. As shown on Schedule 5, the actual 2004 cost per participant for medical, dental and vision combined was $4,607. Therefore, the Company's starting point is overstated and, because the 2004 estimate was inflated to determine the 2006 estimated cost per participant, the 2006 projected cost is also overstated.

Q. ARE THERE OTHER CONCERNS WITH HOW THE COMPANY CALCULATED THE 2006 PROJECTED COST?

A. Yes. In response to Citizens' Interrogatory No. 33, the Company explained how 2005 and 2006 were projected. It also explained why the 2005 cost exceeded the 2004 cost by 24%. The first concern is that the 2005 inflation trend was based on the 2004 trend at the time the estimate was made. As indicated earlier, the 2004 trend was high. The 2005 cost projection also did not assume any level of refund/rebate. Next, the average cost used is a total Company average. Based on the response to Citizens' POD No. 31, the Florida specific cost is approximately $500 less per participant than the total Company cost per participant. Finally, in reviewing the historical and projected allocations of cost to accounts it was noted that the actuals reflected a clearing account credit to Account 926 in each year 2002-2004. The credit ranged from $2.9 million to $7.6 million. The projected 2006 credit is only $356,609. This difference is presumed to be the primary reason why the healthcare expense factor jumped 9.1% from a historical average of 51.1% to 60.2%.

Q. HOW DID YOU DETERMINE YOUR ADJUSTMENT FOR ACTIVE EMPLOYEES' HEALTHCARE EXPENSE?

A. As shown on Exh.___ (HS-2), Schedule 5, I started with the actual 2004 cost and divided that by the average number of full-time employees. The source for this is Company Schedule C-35. This resulted in an average cost per employee of $4,607 in 2004. The next step is to inflate the cost per employee for the estimated 2005 increase. The Company claimed it based its 12% estimate on the Company's projected 2004 costs that we now know was too high. Based on the information supplied by the Company in response to Citizens' POD No. 32, I opted to use the 7.5% increase that occurred in 2004 for 2005. (Citizens' POD No. 32 requested any studies utilized by the Company that compares medical costs per employee for 2004 and/or projections for 2005 and beyond.)

Q. WHY DID YOU USE THE 2004 INCREASE FOR 2005?

A. The Company based its 2005 and 2006 inflation assumptions on what was projected to be the 2004 increase. To remain somewhat consistent with the Company's approach, I chose to use the 2004 national average increase of 7.5%, per the Mercer Human Resource survey information that was provided in response to Citizens' POD No. 32. The information also included an outlook for 2005 that indicated employers expect plan costs to increase 10%, but the overall cost increase is expected to be only 6.6%. I considered the 6.6% to be too conservative.

Q. PLEASE CONTINUE WITH YOUR EXPLANATION OF HOW YOU DETERMINED YOUR ADJUSTMENT.

A. The use of the 7.5% inflation for 2005 increased the per employee cost to $4,953. That 2005 estimate was inflated by 10%, resulting in a 2006 estimated cost per employee of $5,448. I utilized a 10% inflation rate because I do not believe the 7.5% rate could continue for another year. The Company's 12% rate was not used in 2006 because, as stated earlier, the projected increase for 2004, which served as the basis for using 12%, did not materialize. I would also like to point out that the 10% inflation rate applied is to the total healthcare cost. The Company, for 2006, applied 12% to medical, 8% to dental and no increase for vision, so effectively the Company's 2006 increase was 11.7%.

The 2006 cost per employee of $5,448 was then multiplied by the 4,131 employees projected for 2006, as shown on Company Schedule C-35, resulting in a total healthcare cost of $22,506,612. That total was then multiplied by a 54.25% expense factor, resulting in my projected 2006 expense of $12,209,837, which is $3,046,351 less than the Company's proposed $15,256,188. On a jurisdictional basis expense should be reduced $2,767,305.

Q. WHY DID YOU USE A 54.25% EXPENSE FACTOR?

A. As stated earlier, I believe the Company's 60% expense factor is overstated because of its failure to adjust the expense in Account 926 consistently with a similar credit from the clearing account. The 54.25% represents an average of the 2002 and 2003 expense factor. That is consistent with the expense factor I recommend for payroll. The resulting actual healthcare average to be expensed of 54.25% is comparable to the actual payroll average of 54.26%. That would be expected, since the payroll cost allocation and the healthcare cost allocation are for the same group of active employees.

<u>VII. Capitalization Policy</u>

Q. HAVE YOU REVIEWED THE COMPANY'S REQUEST FOR A CHANGE IN THE COMPANY'S CAPITALIZATION POLICY?

A. Yes. The Company's filing includes an adjustment that prospectively shifts certain types of costs to expense that previously would have been capitalized on its books. The Company explained the reason for the change in response to Citizens' Interrogatory No. 4 as follows: "Based on a detailed review of existing practices and the corresponding assets being installed, it was determined that a majority of the outage and emergency work, and a portion of the indirect charges to capital, was not supported by a corresponding level of addition of units of property that had been estimated in previous studies." It was determined that a majority of outage and emergency costs, and a portion of indirect support costs, should be expensed rather than charged to capital. ***** BEGIN CONFIDENTIAL***** [redacted] *****END CONFIDENTIAL***** The Company implemented a change in the accounting policy pertaining to the indirect support costs during 2004 and the change in accounting policy regarding the outage and emergency work in 2005. In my review of the information provided by the Company with regards to the changes in accounting, I found inconsistencies and noted areas of concerns with the request.

Q. WHAT INCONSISTENCIES WERE IDENTIFIED?

A. First, PEF witness Javier Portuondo states on page 9 of his prefiled testimony that the "best practices" recommendation was "prepared by an independent accounting firm hired by the Company." The Company was requested in Citizens Interrogatory No. 68 to identify the "independent accounting firm" and explain why it was hired to perform the best practice analysis. The response stated "The firm used to evaluate the methodology and make best practices recommendations was <u>not</u> an independent accounting firm." (Emphasis added.) The response did not, as requested, explain why a firm was hired to perform the "best practices" analysis even though it was not an independent accounting firm. It must be clarified that it was not the "best practices" review that initiated the changes in capitalization policy, as implied in Mr. Portuondo's testimony. According to the response to Citizens' Interrogatory No. 4, the Company performed an internal review that verified Company concerns. The outside consultant was hired to corroborate the Company's study and to make recommendations on how to properly account for the costs in question. The outside firm retained was not an accounting firm, as Mr. Portuondo had indicated in his testimony.

The Company was asked in Citizens Interrogatory No. 232 if the prior and recently implemented capitalization policies at PEF were in compliance with the FERC Uniform System of Accounts (USOA). The response was "The Company's books and records have been and are in compliance with the FERC Uniform System of Accounts." In response to Citizens' POD No. 5, the Company stated ***BEGIN CONFIDENTIAL*** [redacted]

[redacted]***END CONFIDENTIAL*** The information provided in testimony and in response to discovery is not sufficient or consistent enough for us to conclude whether the prior method of capitalizing costs would comply with the FERC USOA requirements.

Another inconsistency pertains to how the Company advised the various parties of the change and the impact the change will have on the Company's capital cost and expense. The Division of Economic Regulation was advised on December 16, 2004 of the change being implemented. The December 16, 2004 correspondence did not provide any detailed justification for the change. The Company's test year notification in this case, filed on January 28, 2005, made no specific mention of an accounting change as a significant contributing need for the filing. It was the initial filing on April 29, 2005 when the request for a change in accounting to be allowed in rates was officially made. According to the response to Citizens' Interrogatory No. 230, the Company has not requested permission for a change in the capitalization policy, but instead "The Company has informed the FPSC of the change in accounting procedures." In fact, the Company's 8-K to the SEC, dated December 16, 2004, states "The registrants do not believe that any regulatory action is necessary or warranted as a result of the accounting change." However, the 8-K disclosure then continues on to state that the Company could defer the adoption of the new methodology depending on the Commission's actions. It is not consistent to claim regulatory action is not necessary, but then state that the Company could defer adopting the new methodology depending on the Commission's actions.

Finally, the Company's filing makes no mention of whether this change could impact cost recorded in prior years, especially rate base. The Company's 8-K dated December 16, 2004 stated that if "regulators agree with our change in accounting methodology" there would be no impact on 2004. In Citizens' Interrogatory No. 234, the Company was asked if the regulators do not agree with the change to explain what impact that would have on 2004. The response did not answer the question. *****BEGIN CONFIDENTIAL***** [redacted] *****END CONFIDENTIAL***** The impact on prior years is not known at this time because the Company's responses were vague and/or evasive as to the quantification of costs.

Q. COULD THIS CHANGE IMPACT PRIOR YEARS?

A. Yes. The deciding factor is whether this is a correction of an error or a change in estimate. An error results from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time financial statements were prepared. An error will impact prior years. A change in estimate results from new information or subsequent developments and accordingly from better insight or improved judgment. An estimate change is made prospectively. Accounting principles dictate what should be capitalized and what should be expensed. The basic distinguishing factor is whether the cost incurred will benefit future periods or is it a cost that only benefits the current period. That distinguishing factor has not changed in recent years. A Company memo in June 2004 concluded that the change would be a change in estimate. The change in capitalization could be a correction of an error or a change in estimate. The decision is based on judgment. ***BEGIN CONFIDENTIAL*** [redacted] ***END CONFIDENTIAL*** Again, the information provided by the Company is insufficient to enable us to gauge the nature of the impact, if any, on prior years.

Q. WHAT CONCERNS DO YOU HAVE WITH THE REQUEST?

A. The first concern is whether plant is overstated because of an inappropriate allocation of costs. The period primarily of concern is the 2002-2004 timeframe. ***BEGIN CONFIDENTIAL*** [redacted] *** END CONFIDENTIAL*** The result was an overstatement of capital costs and an understatement of expense. It is my understanding no analysis was done for 2002 to quantify or estimate the impact of this change, but for 2003 the December 16, 2004 letter to the Director of Economic Regulation indicated approximately $33 million was capitalized that could have been expensed. As for 2004, I was unable to identify a conclusive estimate of the annual impact. That is a major concern. Based on the information reviewed, the Company adjustment is overstated and not fully justified.

Other concerns identified are: (1) the Company has not done an analysis to evaluate the impact of the change on 2006 had the proposed capitalization policy been implemented earlier; *** **BEGIN CONFIDENTIAL** *** [redacted] ***END CONFIDENTIAL***

Q. WHAT IS YOUR RECOMMENDATION REGARDING THE REQUESTED CAPITALIZATION POLICY?

A. The Company's proposed accounting change for outage and emergency and indirect costs appears to have merit. However, quantitatively the Company has not supported the claimed impact on the test year; nor has it addressed possible carry-over impacts from years past. The concern with the quantification is significant and should be addressed. I am recommending that the Company's estimated impact on operating income and rate base be reduced by 50%, and the Company should be required to provide a quantification of the overstatement of rate base for 2002-2004 due to the questionable capitalization practice utilized during that period of time. Additionally, in the future, the Company should be required to provide detailed justification of any significant changes in accounting along with a detailed quantification of the impact on net operating income and/or rate base. My recommended adjustment, as shown on Ex. ___ (HS-2), Schedule 6, reduces operating expense $10,356,000 on a jurisdictional basis and increases rate base $25,673,000 on a jurisdictional basis.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

QUALIFICATIONS OF HELMUTH W. SCHULTZ III, CPA

Mr. Schultz received a Bachelor of Science in Accounting from Ferris State College in 1975. He maintains extensive continuing professional education in accounting, auditing, and taxation. Mr. Schultz is a member of the Michigan Association of Certified Public Accountants

Mr. Schultz was employed with the firm of Larkin, Chapski & Co., C.P.A.s, as a Junior Accountant, in 1975. He was promoted to Senior Accountant in 1976. As such, he assisted in the supervision and performance of audits and accounting duties of various types of businesses. He has assisted in the implementation and revision of accounting systems for various businesses, including manufacturing, service and sales companies, credit unions and railroads.

In 1978, Mr. Schultz became the audit manager for Larkin, Chapski & Co. His duties included supervision of all audit work done by the firm. Mr. Schultz also represents clients before various state and IRS auditors. He has advised clients on the sale of their businesses and has analyzed the profitability of product lines and made recommendations based upon his analysis. Mr. Schultz has supervised the audit procedures performed in connection with a wide variety of inventories, including railroads, a publications distributor and warehouser for Ford and GM, and various retail establishments.

Mr. Schultz has performed work in the field of utility regulation on behalf of public service commission staffs, state attorney generals and consumer groups concerning regulatory matters before regulatory agencies in Alaska, Arizona, California, Connecticut, Delaware, Florida, Georgia, Kentucky, Kansas, Michigan, Minnesota, Mississippi, Missouri, New Jersey, New York, Nevada, North Dakota, Ohio, Pennsylvania, Rhode Island, Texas, Utah, Vermont and Virginia. He has presented expert testimony in regulatory hearings on behalf of utility commission staffs and intervenors on numerous occasions.

Partial list of utility cases participated in:

U-5331	Consumers Power Co. (Michigan Public Service Commission)
Docket No. 770491-TP	Winter Park Telephone Co. (Florida Public Service Commission)
Case Nos. U-5125 and U-5125(R)	Michigan Bell Telephone Co. (Michigan Public Service Commission)

Case No. 77-554-EL-AIR	Ohio Edison Company (Public Utility Commission of Ohio)
Case No. 79-231-EL-FAC	Cleveland Electric Illuminating (Public Utility Commission of Ohio)
Case No. U-6794	Michigan Consolidated Gas Refunds (Michigan Public Service Commission)
Docket No. 820294-TP	Southern Bell Telephone and Telegraph Co. (Florida Public Service Commission)
Case No. 8738	Columbia Gas of Kentucky, Inc. (Kentucky Public Service Commission)
82-165-EL-EFC	Toledo Edison Company (Public Utility Commission of Ohio)
Case No. 82-168-EL-EFC	Cleveland Electric Illuminating Company, (Public Utility Commission of Ohio)
Case No. U-6794	Michigan Consolidated Gas Company Phase II, (Michigan Public Service Commission)
Docket No. 830012-EU	Tampa Electric Company, (Florida Public Service Commission)
Case No. ER-83-206	Arkansas Power & Light Company, (Missouri Public Service Commission)
Case No. U-4758	The Detroit Edison Company - (Refunds), (Michigan Public Service Commission)
Case No. 8836	Kentucky American Water Company, (Kentucky Public Service Commission)
Case No. 8839	Western Kentucky Gas Company, (Kentucky Public Service Commission)
Case No. U-7650	Consumers Power Company - Partial and Immediate (Michigan Public Service Commission)
Case No. U-7650	Consumers Power Company - Final (Michigan Public Service Commission)

U-4620	Mississippi Power & Light Company (Mississippi Public Service Commission)
Docket No. R-850021	Duquesne Light Company (Pennsylvania Public Utility Commission)
Docket No. R-860378	Duquesne Light Company (Pennsylvania Public Utility Commission)
Docket No. 87-01-03	Connecticut Natural Gas (Connecticut Department of Public Utility Control)
Docket No. 87-01-02	Southern New England Telephone (Connecticut Department of Public Utility Control)
Docket No. 3673-U	Georgia Power Company (Georgia Public Service Commission)
Docket No. U-8747	Anchorage Water and Wastewater Utility (Alaska Public Utilities Commission)
Docket No. 8363	El Paso Electric Company (The Public Utility Commission of Texas)
Docket No. 881167-EI	Gulf Power Company (Florida Public Service Commission)
Docket No. R-891364	Philadelphia Electric Company (Pennsylvania Office of the Consumer Advocate)
Docket No. 89-08-11	The United Illuminating Company (The Office of Consumer Counsel and the Attorney General of the State of Connecticut)
Docket No. 9165	El Paso Electric Company (The Public Utility Commission of Texas)
Case No. U-9372	Consumers Power Company (Before the Michigan Public Service Commission)

Docket No. 891345-EI ER89110912J	Gulf Power Company (Florida Public Service Commission) Jersey Central Power & Light Company Board of Public Utilities Commissioners
Docket No. 890509-WU	Florida Cities Water Company, Golden Gate Division Florida Public Service Commission
Case No. 90-041	Union Light, Heat and Power Company (Kentucky Public Service Commission)
Docket No. R-901595	Equitable Gas Company Pennsylvania Consumer Counsel
Docket No. 5428	Green Mountain Power Corporation Vermont Department of Public Service
Docket No. 90-10	Artesian Water Company Delaware Public Service Commission
Docket No. 900329-WS	Southern States Utilities, Inc. Florida Public Service Commission
Case No. PUE900034	Commonwealth Gas Services, Inc. Virginia Public Service Commission
Docket No. 90-1037* (DEAA Phase)	Nevada Power Company - Fuel (Public Service Commission of Nevada)
Docket No. 5491**	Central Vermont Public Service Corporation Vermont Department of Public Service
Docket No. U-1551-89-102	Southwest Gas Corporation - Fuel Before the Arizona Corporation Commission
	Southwest Gas Corporation – Audit of Gas Procurement Practices and Purchased Gas Costs
Docket No. U-1551-90-322	Southwest Gas Corporation Before the Arizona Corporation Commission
Docket No. 176-717-U	United Cities Gas Company Kansas Corporation Commission

Docket No. 5532	Green Mountain Power Corporation Vermont Department of Public Service
Docket No. 910890-EI	Florida Power Corporation Florida Public Service Commission
Docket No. 920324-EI	Tampa Electric Company Florida Public Service Commission
Docket No. 92-06-05	United Illuminating Company The Office of Consumer Counsel and the Attorney General of the State of Connecticut
Docket No. C-913540	Philadelphia Electric Co. Before the Pennsylvania Public Utility Commission
Docket No. 92-47	The Diamond State Telephone Company Before the Public Service Commission of the State of Delaware
Docket No. 92-11-11	Connecticut Light & Power Company State of Connecticut, Department of Public Utility Control
Docket No. 93-02-04	Connecticut Natural Gas Corporation State of Connecticut, Department of Public Utility Control
Docket No. 93-02-04	Connecticut Natural Gas Corporation (Supplemental) State of Connecticut, Department of Public Utility Control
Docket No. 93-08-06	SNET America, Inc. State of Connecticut, Department of Public Utility Control
Docket No. 93-057-01**	Mountain Fuel Supply Company Before the Public Service Commission of Utah
Docket No. 94-105-EL-EFC	Dayton Power & Light Company Before the Public Utilities Commission of Ohio
Case No. 399-94-297**	Montana-Dakota Utilities Before the North Dakota Public Service Commission
Docket No. G008/C-91-942	Minnegasco Minnesota Department of Public Service

Docket No. R-00932670	Pennsylvania American Water Company Before the Pennsylvania Public Utility Commission
Docket No. 12700	El Paso Electric Company Public Utility Commission of Texas
Case No. 94-E-0334	Consolidated Edison Company Before the New York Department of Public Service
Docket No. 2216	Narragansett Bay Commission On Behalf of the Division of Public Utilities and Carriers, Before the Rhode Island Public Utilities Commission
Docket No. 2216	Narragansett Bay Commission - Surrebuttal On Behalf of the Division of Public Utilities and Carriers, Before the Rhode Island Public Utilities Commission
Case No. PU-314-94-688	U.S. West Application for Transfer of Local Exchanges Before the North Dakota Public Service Commission
Docket No. 95-02-07	Connecticut Natural Gas Corporation State of Connecticut, Department of Public Utility Control
Docket No. 95-03-01	Southern New England Telephone Company State of Connecticut, Department of Public Utility Control
Docket No. U-1933-95-317	Tucson Electric Power Before the Arizona Corporation Commission
Docket No. 5863*	Central Vermont Public Service Corporation Before the Vermont Public Service Board
Docket No. 96-01-26**	Bridgeport Hydraulic Company State of Connecticut, Department of Public Utility Control
Docket Nos. 5841/ 5859	Citizens Utilities Company Before Vermont Public Service Board
Docket No. 5983	Green Mountain Power Corporation Before Vermont Public Service Board
Case No. PUE960296**	Virginia Electric and Power Company Before the Commonwealth of Virginia State Corporation Commission

Docket No. 97-12-21	Southern Connecticut Gas Company State of Connecticut, Department of Public Utility Control
Docket No. 97-035-01	PacifiCorp, dba Utah Power & Light Company Before the Public Service Commission of Utah
Docket No. G-03493A-98-0705*	Black Mountain Gas Division of Northern States Power Company, Page Operations Before the Arizona Corporation Commission
Docket No. 98-10-07	United Illuminating Company State of Connecticut, Department of Public Utility Control
Docket No. 99-01-05	Connecticut Light & Power Company State of Connecticut, Department of Public Utility Control
Docket No. 99-04-18	Southern Connecticut Gas Company State of Connecticut, Department of Public Utility Control
Docket No. 99-09-03	Connecticut Natural Gas Corporation State of Connecticut, Department of Public Utility Control
Docket No. 980007-0013-003	Intercoastal Utilities, Inc. St. John County - Florida
Docket No. 99-035-10	PacifiCorp dba Utah Power & Light Company Before the Public Service Commission of Utah
Docket No. 6332 **	Citizens Utilities Company - Vermont Electric Division Before the Vermont Public Service Board
Docket No. G-01551A-00-0309	Southwest Gas Corporation Before the Arizona Corporation Commission
Docket No. 6460**	Central Vermont Public Service Corporation Before the Vermont Public Service Board
Docket No. 01-035-01*	PacifiCorp dba Utah Power & Light Company Before the Public Service Commission of Utah
Docket No. 01-05-19 Phase I	Yankee Gas Services Company State of Connecticut Department of Public Utility Control

Docket No. 010949-EI	Gulf Power Company Before the Florida Office of the Public Counsel
Docket No. 2001-0007-0023	Intercoastal Utilities, Inc. St. Johns County - Florida
Docket No. 6596	Citizens Utilities Company - Vermont Electric Division Before the Vermont Public Service Board
Docket Nos. R. 01-09-001 I. 01-09-002	Verizon California Incorporated Before the California Public Utilities Commission
Docket No. 99-02-05	Connecticut Light & Power Company State of Connecticut Department of Public Utility Control
Docket No. 99-03-04	United Illuminating Company State of Connecticut Department of Public Utility Control
Docket No. 5841/5859	Citizens Utilities Company Before the Vermont Public Service Board
Docket No. 6120/6460	Central Vermont Public Service Corporation Before the Vermont Public Service Board
Docket No. 03-07-02	Connecticut Light & Power Company State of Connecticut Department of Public Utility Control
Docket No. 6914	Shoreham Telephone Company Before the Vermont Public Service Board
Docket No. 04-06-01**	Yankee Gas Company State of Connecticut Department of Public Utility Control

Docket Nos. 6946/6988	Central Vermont Public Service Corporation Before the Vermont Public Service Board
Docket No. 04-035-42**	PacifiCorp dba Utah Power & Light Company Before the Public Service Commission of Utah

* Certain issues stipulated, portion of testimony withdrawn.
** Case settled.

PROGRESS ENERGY FLORIDA
Projected Test Year Ended December 31, 2006

Docket No. 050078-EI
Schultz Exh.__ (HS-2)
Storm Damage Accrual

Storm Damage Accrual
(Thousands of Dollars)

Schedule 1
Page 1 of 2

Line No.	Description	Beginning Balance	Accrual	Charges	Ending Balance	
1	1994	346	6,000	1	6,345	a
2	1995	6,345	6,000	5,044	7,301	a
3	1996	7,301	6,000	7	13,294	a
4	1997	13,294	6,000	1,159	18,135	a
5	1998	18,135	6,000	0	24,135	a
6	1999	24,135	6,000	4,506	25,629	a
7	2000	25,629	6,000	2,102	29,527	a
8	2001	29,527	6,000	5,896	29,631	a
9	2002	29,631	6,000	0	35,631	a
10	2003	35,631	6,000	715	40,916	a
11	2004	40,916	6,000	0	46,916	a
12	10 Year Average 1994-2003			1,943		
13	Charley			108,500		a
14	Frances			119,200		a
15	Ivan			5,600		a
16	Jeanne			78,800		a
17	10 Year Average 1995-2004 (Includes Charley & Ivan)			13,353		Testimony
18	10 Year Average 1995-2004 (Includes Frances & Jeanne)			21,743		Testimony
19	10 Year Average 1995-2004 (Includes All 4 Storms)			33,153		Testimony
20	Recommended Annual Accrual			12,500		Testimony
21	Company Requested Accrual			50,000		b
22	Recommended Accrual Adjustment			(37,500)		L.20-L.21
23	Jurisdictional Factor			0.96949		b
24	Jurisdictional Adjustment			(36,356)		L.22xL.23

Source: (a) Company responses to Citizens Interrogatory No. 2.
(b) Company Schedule C-4.

PROGRESS ENERGY FLORIDA
Projected Test Year Ended December 31, 2006

Docket No. 050078-EI
Schultz Exh.__ (HS-2)
Storm Damage Accrual

Storm Damage Accrual
(Thousands of Dollars)

Schedule 1
Page 2 of 2

Line No.	Description	Beginning Balance	Charges	Accrual	Ending Balance	
1	Accumulated Reserve	6,515	2,147	12,500	16,868	Testimony
2	Per Company	6,515		6,000	12,015	c
3	Per Company				44,000	a
4	Adjustment To Reserve				39,147	L.3+L.2-L.1
5	Average Adjustment to Working Capital				19,574	L.4/2
6	Jurisdictional Factor				0.96945	
7	Jurisdictional Working Capital Adjustment				18,976	

Line No.	Description	Charges	Inflation Indicator	Inflated Charges	
8	1994	1	90.259	1	b
9	1995	5,044	92.106	5,927	b
10	1996	7	93.852	8	b
11	1997	1,159	95.414	1,315	b
12	1998	0	96.472	0	b
13	1999	4,506	97.868	4,983	b
14	2000	2,102	100.000	2,275	b
15	2001	5,896	102.399	6,232	b
16	2002	0	104.092	0	b
17	2003	715	105.998	730	b
18	2004	0	108.237	0	b
19	10 Year Average 1994-2003			2,147	

Source: Inflation indicator is the GDP Implicit Price Deflator from the Congressional Economic Indicators from May 2005.
(a) Company Schedule B-1.
(b) Company responses to Citizens Interrogatory No. 2.
(c) Company Schedule B-21.

PROGRESS ENERGY FLORIDA
Projected Test Year Ended December 31, 2006

Docket No. 050078-EI
Schultz Exh.__ (HS-2)
Incentive Compensation

Incentive Compensation
(Thousands of Dollars)

Schedule 2

Line No.	Description	ECIP	MICP	Long Term	Total	
1	Incentive Compensation Per Company	14,922	3,840	684	19,446	a
2	Expense Percentage Per Company	64.44%	64.44%	100.00%		a
3	Incentive Compensation Expensed	9,617	2,474	684	12,775	L.1xL.2
4	Recommended Incentive Compensation	4,808	0	0	4,808	Testimony
5	Incentive Compensation Adjustment	(4,808)	(2,474)	(684)	(7,967)	L.4-L.3
6	Jurisdictional Factor	0.90840	0.87872	0.87872		b
7	Jurisdictional Expense Adjustment	(4,368)	(2,174)	(601)	(7,143)	L.5xL.6

Source: (a) Company responses to Florida Retail Federation Interrogatory No. 17.
(b) Company Schedule C-4.

PROGRESS ENERGY FLORIDA
Projected Test Year Ended December 31, 2006

Docket No. 050078-EI
Schultz Exh.__ (HS-2)
Payroll

Payroll
(Thousands of Dollars)

Schedule 3

Line No.	Description	Payroll Per Company	Payroll Per OPC	Adjustment	Source
1	Base Payroll	243,186	243,186		a
2	Overtime	29,741	29,741		a
3	Total	272,927	272,927		
4	Expense Factor	57.18%	54.26%		b
5	Payroll Expense	156,070	148,086	(7,985)	L.3xL.4
6	Jurisdictional Factor	0.90840	0.90840		c
7	Jurisdictional Expense	141,774	134,521	(7,253)	L.5xL.6
8	2002 Expense Factor		54.47%		b
9	2003 Expense Factor		54.04%		b
10	2 Year Average		54.26%		
		Operation	Maintenance		
11	2002	2,740	21,173		b
12	2003	3,322	22,431		b
13	2004	2,615	21,766		b
14	3 Year Average	2,892	21,790		
15	2006	17,042	26,343		b

Source: (a) Company responses to Citizens Interrogatory No. 25.
(b) Company responses to Florida Retail Federation Interrogatory No. 17.
(c) Company Schedule C-4.

PROGRESS ENERGY FLORIDA
Projected Test Year Ended December 31, 2006

Docket No. 050078-EI
Schultz Exh.__ (HS-2)
Payroll Tax Expense

Payroll Tax Expense
(Thousands of Dollars)

Schedule 4

Line No.	Description	Payroll Tax Per OPC	Source
1	Projected 2006 Payroll	292,372	a
	Incentive Compensation Adjustment		
2	-ECIP	(7,461)	Schedule 2
3	-MICP	(3,840)	Schedule 2
4	-LTIP	(684)	Schedule 2
5	Adjusted Projected 2006 Payroll	280,387	
6	Adjusted Payroll Tax	21,611	L.5xL.17
7	Expense Factor	54.26%	Testimony
8	Payroll Tax Expense	11,726	L.6xL.7
9	Payroll Tax Expense Per Company	15,040	b
10	Payroll Tax Expense Adjustment	(3,314)	L.8-L.9
11	Jurisdictional Factor	0.92421	c
12	Jurisdictional Expense Adjustment	(3,062)	L.10xL.11
	Effective Tax Rate Calculation		
13	Total 2004 Payroll	318,681	a
14	2004 FICA	22,683	a
15	2004 Federal & State Unemployment	1,880	a
16	Total 2004 Payroll Taxes	24,563	L.14+L.15
17	Effective Payroll Tax Rate	7.71%	L.16/L.13

Source: (a) Company Schedule C-35.
(b) Company responses to Florida Retail Federation Interrogatory No. 17.
(c) Company Schedule C-4.

PROGRESS ENERGY FLORIDA
Projected Test Year Ended December 31, 2006

Healthcare Expense

Docket No. 050078-EI
Schultz Exh.__ (HS-2)
Healthcare Expense

Schedule 5

Line No.	Description	Medical Per OPC	Source
1	Actual 2004 Cost	18,816,529	a
2	Average Regular Full Time Employees	4,084	a
3	2004 Cost Per Participant	4,607	L.1/L.2
4	Trended Inflation for 2005	1.075	Testimony
5	2005 Projected Cost Per Participant	4,953	L.3xL.4
6	Trended Inflation for 2006	1.100	Testimony
7	2006 Projected Cost Per Participant	5,448	L.5xL.6
8	Headcount	4,131	a
9	Projected 2006 Cost	22,506,612	L.7xL.8
10	Expense Factor	54.25%	Line 18
11	Projected 2006 Expense	12,209,837	L.9xL.10
12	Company Projected Expense	15,256,188	b
13	Healthcare Expense Adjustment	(3,046,351)	L.11-L.12
14	Jurisdictional Factor	0.90840	c
15	Jurisdictional Expense	(2,767,305)	L.13xL.14
16	2002 Expense Factor	52.30%	b
17	2003 Expense Factor	56.20%	b
18	2 Year Average	54.25%	

Source: (a) Company Schedule C-35.
(b) Company responses to Citizens Interrogatory No. 33.
(c) Company Schedule C-4.

PROGRESS ENERGY FLORIDA
Projected Test Year Ended December 31, 2006

Changing Practices
(Thousands of Dollars)

Docket No. 050078-EI
Schultz Exh.__ (HS-2)
Changing Practices

Schedule 6

Line No.	Description	Per Company	Per OPC	Adjustment	Source
	Jurisdictional Net Operating Income Adjustment				
1	Other O&M Expense	34,187	17,094	(17,094)	a
2	Depreciation & Amortization	(1,959)	(980)	980	a
3	Taxes Other Than Income Taxes	1,499	750	(750)	a
4	Current/Deferred Income Taxes	(13,015)	(6,508)	6,508	a
5	Total Operating Expense	20,712	10,356	(10,356)	a
	Jurisdictional Rate Base Adjustment				
6	Plant In Service	(50,601)	(25,301)	25,301	b
7	Accumulated Provision for Depreciation	(1,789)	(895)	895	b
8	Net Plant in Service	(48,812)	(24,406)	24,406	b
9	CWIP	(2,533)	(1,267)	1,267	b
10	Net Utilty Plant	(51,345)	(25,673)	25,673	b

Source: (a) Company Schedule C-2.
(b) Company Schedule B-1.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Direct Testimony of Helmuth W. Schultz, III, (Public Version) has been furnished by electronic mail and U.S. Mail on this 13th day of July, 2005, to the following:

Jennifer Brubaker, Esquire
Felicia Banks, Esquire
Jennifer Rodan, Esquire
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Florida Public Service Commission
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