Progress Energy

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R. ALEXANDER GLENN
Deputy General Counsel - Florida

VIA HAND DELIVER

October 28, 2005

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

050844-EI

Re: Application of Progress Energy Florida, Inc. for authority to issue and sell securities during the twelve months ending December 31, 2006.

Dear Ms. Bayó:

Enclosed for filing is the original certified and five (5) uncertified copies of Progress Energy Florida, Inc.'s Application for authority to issue and sell securities during the twelve months ending December 31, 2006.

Please acknowledge your receipt of the above filing on the enclosed copy of this letter and return to the undersigned. Thank you for your assistance in this matter.

Sincerely,

R. Alexander Glenn

Enclosures
RAG:at

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Progress Energy Service Company, LLC
P.O. Box 14042
St. Petersburg, FL 33733

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DOCKET NO. 050844 - EI

FLORIDA PUBLIC SERVICE COMMISSION

TALLAHASSEE, FLORIDA

APPLICATION OF

PROGRESS ENERGY FLORIDA, INC.

(FORMERLY, FLORIDA POWER CORPORATION)

FOR AUTHORITY TO ISSUE AND SELL

SECURITIES DURING THE TWELVE MONTHS ENDING DECEMBER 31, 2006

PURSUANT TO SECTION 366.04, FLORIDA STATUTES,

AND CHAPTER 25-8, FLORIDA ADMINISTRATIVE CODE

Address communications in connection with this Application to:

Thomas R. Sullivan
Treasurer
Progress Energy Florida, Inc.
c/o Progress Energy, Inc.
410 S. Wilmington Street
Raleigh, NC 27601

R. Alexander Glenn
Deputy General Counsel
Progress Energy Service Company, LLC,
Counsel to Progress Energy Florida, Inc.
100 Central Avenue, Suite CX1D
St. Petersburg, FL 33701

Dated: October 27, 2005

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

IN RE: APPLICATION OF PROGRESS ENERGY FLORIDA, INC. FOR AUTHORITY TO ISSUE AND SELL SECURITIES DURING THE TWELVE MONTHS ENDING DECEMBER 31, 2006 PURSUANT TO SECTION 366.04, FLORIDA STATUTES, AND CHAPTER 25-8, FLORIDA ADMINISTRATIVE CODE.

The Applicant, Progress Energy Florida, Inc., formerly Florida Power Corporation (herein called the "Company"), respectfully requests authority from the Florida Public Service Commission (herein called the "Commission"), to issue, sell or otherwise incur during 2006 any combination of additional equity securities and debt securities and obligations, consisting of up to $1.5 billion of any combination of equity securities and long-term debt securities and other obligations. Additionally, the Company requests authority to issue, sell or otherwise incur during 2006 and 2007 any combination of additional equity securities and debt securities and obligations consisting of up to $1 billion outstanding at any time of short-term debt, including commercial paper, bank loans or loans from affiliates, which amount shall be in addition to and in excess of the amount the Company is authorized to issue pursuant to Section 366.04, Florida Statutes, which permits the Company to issue short-term securities aggregating to more than five percent of the par value of the Company's other outstanding securities.

The Company is wholly-owned by Florida Progress Corporation ("Florida Progress"), which is wholly-owned by Progress Energy, Inc. ("Progress Energy"). The Company hereby applies for requisite authority for these proposed financings, pursuant to Section 366.04, Florida Statutes, by submitting the following information in the manner and form prescribed in Chapter 25-8, Florida Administrative Code, including the required Exhibits A-C.

CONTENTS OF APPLICATION

(1) The exact name of the Company and address of its principal business office is as follows:

Progress Energy Florida, Inc.
100 Central Avenue, Suite CX1D
St. Petersburg, Florida 33701

(2) The Company was incorporated in Florida in 1899 and reincorporated in Florida in 1943. The Company is continuing its corporate existence pursuant to its Amended Articles of Incorporation, as amended (the "Articles of Incorporation"), a copy of which was filed as Exhibit A to the Application of Florida Power Corporation For Authority To Issue And Sell Securities During The Twelve Months Ending December 31, 1994 (Docket No. 931029-EI) and is incorporated herein by reference. The Company's financial statement schedules required under Sections 25-8.003 (1)(a)-(b), Florida Administrative Code, are filed herewith as Exhibits A (6) (i) and (ii) and B (1) and (2), respectively.

(3) The name and address of the persons authorized to receive notices and communications with respect to this Application are as follows:

Thomas R. Sullivan
Treasurer
Progress Energy Florida, Inc.
c/o Progress Energy, Inc.
410 S. Wilmington Street
Raleigh, NC 27601

R. Alexander Glenn
Deputy General Counsel
Progress Energy Service Company, LLC
Counsel to Progress Energy Florida, Inc.
100 Central Avenue, Suite CX1D
St. Petersburg, FL 33701

(4)(a) A statement detailing information concerning each class and series of the Company's capital stock and long-term debt is contained in Exhibit C attached hereto.

(b) The amount held as reacquired securities: The Company does not hold any reacquired securities. From time to time, the Company has redeemed certain outstanding first mortgage bonds and shares of its cumulative preferred stock, but such bonds and shares are canceled upon redemption or reacquisition. Under the Company's Articles of Incorporation, all or any shares of Preferred Stock or Preference Stock redeemed or acquired by the Company may thereafter be reissued or otherwise disposed of at any time, subject to limitations imposed by law and in the Articles of Incorporation.

(c) The amount pledged by the applicant: From time to time the Company issues First Mortgage Bonds that are secured by the lien of its Indenture, dated as of January 1, 1944 with JPMorgan Chase Bank, N.A. as successor trustee, as supplemented by supplemental indentures (the "Mortgage"). The Mortgage constitutes a first mortgage lien, subject only to permitted encumbrances and liens, on substantially all of the fixed properties owned by the Company except miscellaneous properties that are specifically excepted. After-acquired property is covered by the lien of the Mortgage, subject to existing liens at the time such property is acquired.

(d) The amount owned by affiliated corporations: All of the Company's outstanding common stock (100 shares) is owned by the Company's parent, Florida Progress. The Company has no other stock or debt owned by affiliated corporations. See paragraph (10) hereof.

(e) The amount held in any fund: None.

(5) The Company seeks authority to issue and sell and/or exchange equity securities and issue, sell, exchange and/or assume short-term or long-term debt securities and/or to assume liabilities or obligations as guarantor, endorser or surety during the period covered by the Application. The Company ultimately may issue any combination of the types of securities described below, subject to the aggregate dollar limitations requested in this Application.

(5)(a)(1) The kind and the nature of the securities that the Company seeks authority to issue and sell during 2006 (and 2007 with respect to short-term debt securities and other obligations and securities), are equity securities and short-term and long-term debt securities and other obligations, including, but not limited to, borrowings from banks which are participants in credit facilities the Company may establish from time to time, uncommitted bank facilities and affiliate loans which are available through Progress Energy's utility moneypool facility. The Company also seeks authority to enter into interest rate derivative contracts to remove financial risk associated with its existing and future debt obligations.

The equity securities that the Company may issue include cumulative preferred stock, preference stock, or warrants, options or rights to acquire such securities, or other equity securities, with such par values, terms and conditions and relative rights and preferences as are deemed appropriate by the Company and permitted by its Articles of Incorporation, as they may be amended from time to time.

The Company also may enter into preferred securities financings that may have various structures, including a structure whereby the Company would establish and make an equity investment in a special purpose trust, limited partnership or other entity. The entity would offer preferred securities to the public and lend the proceeds to the Company. The Company would issue debt securities to the entity equal to the aggregate of its equity investment and the amount of preferred securities issued. The Company may also guarantee, among other things, the distributions to be paid by the entity to the holders of the preferred securities.

Short-term debt securities and obligations may include notes to be sold in the commercial paper market ("commercial paper"), loans from affiliates and bank loans, credit agreements or other forms of securities and debt obligations, with maturities of less than one year.

The long-term debt securities and obligations may take the form of first mortgage bonds, debentures, medium-term notes or other notes, loans from affiliates and bank loans, installment contracts, credit agreements, securitization of storm cost receivables or other forms of securities and debt obligations, whether secured or unsecured, with maturities greater than one year. In addition, the Company may enter into options, rights, interest rate swaps or other derivative instruments. The Company also may enter into installment purchase and security agreements, loan agreements, or other arrangements with political subdivisions of the State of Florida or pledge debt securities or issue guarantees in connection with such political subdivisions' issuance, for the ultimate benefit of the

Company, of pollution control revenue bonds, solid waste disposal revenue bonds, industrial development revenue bonds, variable rate demand notes, or other "private activity bonds" with maturities ranging from one to forty years, bond anticipation notes, or commercial paper. Such obligations may or may not bear interest exempt from federal tax.

The Company also may enter into nuclear fuel leases and various agreements that provide financial or performance assurances to third parties on behalf of the Company's subsidiaries. These agreements include guarantees, standby letters of credit and surety bonds. The agreements are entered into primarily to support or enhance the credit worthiness otherwise attributed to a subsidiary on a stand-alone basis. Specific purposes of the agreements include supporting payments of trade payables, securing performance under contracts and lease obligations, providing workers' compensation coverage, obtaining licenses, permits and rights-of-way and supporting other payments that are subject to contingencies.

The manner of issuance and sale of securities will be dependent upon the type of securities being offered, the type of transaction in which the securities are being issued and sold and market conditions at the time of the issuance and sale. Securities may be issued through negotiated underwritten public offerings, public offerings at competitive biddings, private sales or sales through agents, and may be issued in both domestic and foreign markets. Credit agreements may be with banks or other lenders. The Company's commercial paper will be for terms up to but not exceeding nine months from the date of issuance. The commercial paper may be sold at a discount, including the underwriting discount of the commercial paper dealer, at rates comparable to interest rates being paid in the commercial paper market by borrowers of similar creditworthiness. The Company plans to refund, retire or redeem from time to time outstanding commercial paper, and short-term borrowings, which mature on a regular basis, with preferred stock, first mortgage bonds, medium-term notes, or other long-term securities and debt obligations.

(5)(a)(2) Contemplated to be included as long-term or short-term debt securities, as appropriate, are borrowings from banks and other lenders under the Company's credit facilities, as those may be entered into and amended from time to time. The Company's current facility is a $450 million five-year revolving credit agreement with a group of banks. Borrowings under the facility are available for general corporate purposes, including support of the Company's commercial paper program. The current five-year facility will expire on March 28, 2010.

(5)(b) The maximum principal amount of short-term securities and obligations proposed to be issued, sold, or otherwise incurred during 2006 and 2007 is $1 billion outstanding at any time, including commercial paper, bank loans or moneypool borrowings, which amount shall be in addition to and in excess of the amount the Company is authorized to issue pursuant to Section 366.04, Florida Statutes, which permits the Company to issue short-term securities aggregating not more than five percent of the par value of the Company's other outstanding securities. The maximum principal amount of equity securities, long-term debt securities and other long-term obligations (exclusive of bank loans issued under the Company's long-term credit facilities as mentioned above) proposed to be issued, sold, or otherwise incurred during 2006 is $1.5 billion.

The Company will file a consummation report with the Commission in compliance with Rule 25-8.009, Florida Administrative Code, within 90 days after the close of the 2006 calendar year to report any securities issued during that year.

(5)(c) On September 30, 2005, the estimate of the interest rates for securities proposed to be issued by the Company were as follows (with reference to current rates for comparable securities):

2. The interest rate on 10-year BBB+ rated senior unsecured debt was about 5.30%.

3. The interest rate on 10-year A3 rated first mortgage bonds was about 5.15%.

4. The interest rate (on a bond equivalent basis) for split-rated 30-day commercial paper sold through dealers was about 4.10%.

5. Prime interest rate was 6.75%.

The actual interest rates to be paid by the Company during 2006 will be determined by the market conditions at the time of issuance.

(6) The net proceeds to be received from the sale of the additional securities will be added to the Company's general funds and may be used to provide additional electric facilities during 2006 pursuant to the Company's construction program, to repay maturing long-term debt or short-term unsecured debt, to refund, retire or redeem existing obligations, or for other corporate purposes.

A more detailed statement of the Projected Sources and Uses of Funds during 2006 is included as Exhibit B(1) attached hereto. The Company's construction program is developed from its long-range plan to determine needed construction facilities. While the final 2006 Construction Budget is not yet available, the Company's most recently approved construction expenditures forecast excluding Allowance for Funds Used During Construction ("AFUDC") for 2006 is approximately $645 million. A detailed listing of this 2006 construction program excluding AFUDC is found in Exhibit B(2) attached hereto.

These construction estimates are subject to periodic review and revision to adjust for such factors as changing economic conditions, environmental requirements, regulatory matters and changing customer usage patterns.

(7) Based on the reasons shown in sections (5) and (6) above, the Company submits that the proposed financings are consistent with the proper performance by the Company of service as a public utility, will enable and permit the Company to perform that service, are compatible with the public interest and are reasonably necessary and appropriate for such purposes.

(8) R. Alexander Glenn, Deputy General Counsel for the Company, or his duly appointed successor, will pass upon the legality of the securities involved herein. His office address is:

Progress Energy Florida, Inc.
100 Central Avenue
Suite CX1D
St. Petersburg, Florida 33701

(9) Except for those issuances of securities that are exempt from the registration requirements of the Securities Act of 1933, the issue and sale of the various securities involved herein will require the filing of Registration Statements with the United States Securities and Exchange Commission ("SEC"), 100 F Street N.E., Washington, DC 20549. A copy of each Registration Statement that has been or will be filed with the SEC will be included with the Company's annual Consummation Report relating to the sale of securities registered thereunder. No other state or federal regulatory body has jurisdiction over the transactions proposed herein, although certain state securities or "blue sky" laws may require

the filing of registration statements, consents to service of process or other documents with applicable state securities commissions, including in particular the Florida Division of Securities and Investor Protection, 101 E. Gaines St., Tallahassee, FL 32399; the Nevada Department of State, Securities Division, 555 East Washington Avenue, 5th Floor, Las Vegas, NV 89101; the New York Department of Law, Bureau of Investor Protection and Securities, 120 Broadway, 23rd Floor, New York, NY 10271; and the Oregon Department of Consumer & Business Services, Division of Finance & Corporate Securities, Labor & Industries Building, Salem, OR 97310.

(10) The measure of control or ownership exercised by or over the Company by any other public utility is set forth below. The Company is a wholly owned subsidiary of Florida Progress, a public utility holding company. On November 30, 2000, all the outstanding shares of Florida Progress common stock were acquired by CP&L Energy, Inc., a North Carolina corporation, which subsequently changed its name to Progress Energy in a statutory share exchange pursuant to the terms of an Amended and Restated Agreement and Plan of Exchange dated as of August 22, 1999, Amended and Restated as of March 3, 2000 (the "Agreement").

Following the closing of the share exchange, Progress Energy became a registered holding company under the Public Utility Holding Company Act of 1935 (the "Act"). Progress Energy retained Florida Progress as a wholly owned subsidiary and Florida Progress continues to own all of the issued and outstanding common stock of the Company. Thus, Progress Energy indirectly owns all of the common stock of the Company. Florida Progress remains generally exempt from registration under the Act and attendant regulation because its utility operations are primarily intrastate.

(11) The following Exhibits are filed herewith and made a part hereof:

Exhibit A (6)(i)	The financial statements and accompanying footnotes as they appear in the Company's Annual Report on Form 10-K for the year ended December 31, 2004, and filed with the SEC in file no. 1-15929 on March 16, 2005.
Exhibit A (6)(ii)	The financial statements and accompanying footnotes as they appear in the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005, and filed with the SEC in file no. 1-15929 on August 5, 2005.
Exhibit B(1)	Projected Sources and Uses of Funds Statement for 2006.
Exhibit B(2)	Preliminary Construction Expenditures for 2006.
Exhibit C	Capital Stock and Funded Debt of the Company as of September 30, 2005.

WHEREFORE, the Company hereby respectfully requests that the Commission enter its Order approving this Application for authority to issue and sell securities during the twelve months ending December 31, 2006, and more specifically, to order that:

(a) The request of Progress Energy Florida, Inc. to issue and sell securities during the twelve months ending December 31, 2006, pursuant to Section 366.04, Florida Statutes, and Chapter 25-8, Florida Administrative Code (the "Application") is granted;

(b) Progress Energy Florida, Inc. is authorized to issue, sell, or otherwise incur any combination of additional equity securities, and short-term and long-term debt securities and obligations during 2006, consisting of up to \$1.5 billion of any combination of equity securities and long-term debt securities and other obligations. Additionally, the Company requests authority to issue, sell or otherwise incur during 2006 and 2007 any combination of additional equity securities and debt securities and obligations consisting of up to $1 billion outstanding at any time of short-term debt, including commercial paper, bank loans or loans from affiliates, which amount shall be in addition to and in excess of the amount the Company is authorized to issue pursuant to Section 366.04, Florida Statutes, which permits the Company to issue short-term securities aggregating to more than five percent of the par value of the Company's other outstanding securities.

(c) The kind and nature of the securities that Progress Energy Florida, Inc. is authorized to issue during 2006 (and 2007 with respect to short-term debt securities and other obligations and securities) are equity securities and short-term and long-term debt securities and obligations, as set forth in the Company's Application;

(d) Progress Energy Florida, Inc. shall file a Consummation Report in accordance with Rule 25-8.009, Florida Administrative Code, within 90 days after the close of the 2006 calendar year.

[The remainder of this page was intentionally left blank.]

Respectfully submitted this
27th day of October, 2005

PROGRESS ENERGY FLORIDA, INC.

By: ______________________

Thomas R. Sullivan
Treasurer

[Signature page for Progress Energy Florida's 2006 Application for Authority to Issue and Sell Securities]

STATE OF NORTH CAROLINA)
)
COUNTY OF WAKE)

CERTIFICATION OF APPLICATION AND EXHIBITS

Each of the undersigned, Jeffrey M. Stone and Thomas R. Sullivan, being first duly sworn, deposes and says that he is the Controller, and the Treasurer, respectively, of PROGRESS ENERGY FLORIDA, INC., the Applicant herein; that he has read the foregoing application and exhibits of said Progress Energy Florida, Inc. and knows the contents thereof; and certifies that the same are true and correct to the best of his knowledge and belief.

Jeffrey M. Stone
Controller

Thomas R. Sullivan
Treasurer

STATE OF NORTH CAROLINA)
)
COUNTY OF WAKE)

The foregoing instrument was acknowledged before me this 27th day of October, 2005, by Jeffrey M. Stone and Thomas R. Sullivan, who are personally known to me and who did take an oath.

(Seal)

Susan W. Manly
Notary Public

Susan W. Manly
Printed Name
My Commission Expires 8-2-2010

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following consolidated financial statements, supplementary data and consolidated financial statement schedules are included herein:

All other schedules have been omitted as not applicable or not required or because the information required to be shown is included in the Financial Statements or the accompanying Notes to the Financial Statements.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARDS OF DIRECTORS OF FLORIDA PROGRESS CORPORATION AND FLORIDA POWER CORPORATION d/b/a PROGRESS ENERGY FLORIDA, INC.:

We have audited the accompanying consolidated balance sheets of Florida Progress Corporation and its subsidiaries (Florida Progress) and the accompanying balance sheets of Florida Power Corporation d/b/a Progress Energy Florida, Inc. (PEF) as of December 31, 2004 and 2003, and the related Florida Progress consolidated statements of income, common equity, comprehensive income and cash flows and the related PEF statements of income, common equity, comprehensive income, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the respective company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Florida Progress and PEF are not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Florida Progress' and PEF's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Florida Progress and of PEF, respectively, at December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 1 and 6D to the financial statements, in 2003, Florida Progress and PEF adopted Statement of Financial Accounting Standards No. 143.

/s/ Deloitte & Touche LLP

Raleigh, North Carolina
March 7, 2005

FLORIDA PROGRESS CORPORATION
CONSOLIDATED STATEMENTS of INCOME

(in millions) Years ended December 31	**2004**	2003	2002
Operating Revenues			
Utility	**$ 3,525**	$ 3,152	$ 3,062
Diversified business	**2,410**	1,856	1,438
Total Operating Revenues	**5,935**	5,008	4,500
Operating Expenses			
Utility			
Fuel used in electric generation	**1,175**	870	834
Purchased power	**567**	566	515
Operation and maintenance	**630**	640	591
Depreciation and amortization	**281**	307	295
Taxes other than on income	**254**	241	228
Diversified business			
Cost of sales	**2,127**	1,639	1,343
Depreciation and amortization	**112**	92	66
Impairment of goodwill and long-lived assets	**8**	15	281
(Gain)/loss on the sale of assets	**(54)**	1	–
Other	**134**	132	94
Total Operating Expenses	**5,234**	4,503	4,247
Operating Income	**701**	505	253
Other Income (Expense)			
Interest income	**5**	2	7
Other, net	**1**	(8)	(20)
Total Other Income (Expense)	**6**	(6)	(13)
Interest Charges			
Interest charges	**183**	169	186
Allowance for borrowed funds used during construction	**(3)**	(6)	(3)
Total Interest Charges, Net	**180**	163	183
Income from Continuing Operations before Income Tax and Minority Interest	**527**	336	57
Income Tax Expense (Benefit)	**70**	(110)	(173)
Income from Continuing Operations before Minority Interest	**457**	446	230
Minority Interest, net of tax	**(17)**	3	–
Income from Continuing Operations	**474**	443	230
Discontinued Operations, Net of Tax:			
Net gain on disposal of discontinued operations, (net of applicable income tax expenses of $0, $2 and $3, respectively)	**–**	4	5
Net Income	**$ 474**	$ 447	$ 235

See Notes to Financial Statements.

FLORIDA PROGRESS CORPORATION
CONSOLIDATED BALANCE SHEETS (Continued)

(in millions) December 31	2004	2003
Assets		
Utility Plant		
Utility plant in service	**$ 8,387**	$ 8,155
Accumulated depreciation	**(2,978)**	(2,877)
Utility plant in service, net	**5,409**	5,278
Held for future use	**8**	8
Construction work in progress	**420**	292
Nuclear fuel, net of amortization	**45**	69
Total Utility Plant, Net	**5,882**	5,647
Current Assets		
Cash and cash equivalents	**29**	27
Receivables	**649**	618
Receivables from affiliated companies	**40**	44
Deferred income taxes	**68**	60
Inventory	**518**	449
Deferred fuel cost	**89**	204
Assets held for sale	**–**	75
Prepayments and other current assets	**35**	48
Total Current Assets	**1,428**	1,525
Deferred Debits and Other Assets		
Regulatory assets	**524**	126
Debt issuance costs	**30**	33
Nuclear decommissioning trust funds	**463**	433
Diversified business property, net	**776**	841
Miscellaneous other property and investments	**95**	90
Other assets and deferred debits	**488**	498
Total Deferred Debits and Other Assets	**2,376**	2,021
Total Assets	**$ 9,686**	$ 9,193

FLORIDA PROGRESS CORPORATION
CONSOLIDATED BALANCE SHEETS (Concluded)

(in millions) December 31	2004	2003
Capitalization and Liabilities		
Common Stock Equity		
Common stock without par value	**$ 1,712**	$ 1,699
Retained earnings	**976**	842
Accumulated other comprehensive loss	**(7)**	(17)
Total Common Stock Equity	**2,681**	2,524
Preferred Stock of Subsidiaries - Not Subject to Mandatory Redemption	**34**	34
Minority Interest	**32**	30
Long-Term Debt, Affiliate, Net	**809**	809
Long-Term Debt, Net	**2,052**	2,045
Total Capitalization	**5,608**	5,442
Current Liabilities		
Current portion of long-term debt	**49**	68
Accounts payable	**445**	413
Payables to affiliated companies	**71**	68
Notes payable to affiliated companies	**431**	636
Taxes accrued	**81**	33
Short-term obligations	**293**	–
Customer deposits	**135**	127
Other current liabilities	**364**	294
Total Current Liabilities	**1,869**	1,639
Deferred Credits and Other Liabilities		
Noncurrent income tax liabilities	**63**	47
Accumulated deferred investment tax credits	**36**	42
Regulatory liabilities	**1,362**	1,315
Asset retirement obligations	**358**	339
Accrued pension and other benefits	**229**	218
Other liabilities and deferred credits	**161**	151
Total Deferred Credits and Other Liabilities	**2,209**	2,112
Commitments and Contingencies (Notes 20 and 21)		
Total Capitalization and Liabilities	**$ 9,686**	$ 9,193

See Notes to Financial Statements.

FLORIDA PROGRESS CORPORATION
CONSOLIDATED STATEMENTS of CASH FLOWS

(in millions) Years ended December 31	**2004**	2003	2002
Operating Activities			
Net income	**$ 474**	$ 447	$ 235
Adjustments to reconcile net income to net cash provided by operating activities:			
Net gain on disposal of discontinued operations	**–**	(4)	(5)
Net (gain) loss on sale of operating assets	**(54)**	1	–
Impairment of goodwill and long-lived assets	**8**	15	281
Depreciation and amortization	**421**	405	386
Deferred income taxes and investment tax credits, net	**(7)**	(134)	(239)
Deferred fuel cost (credit)	**37**	(167)	(22)
Cash provided/(used) by changes in operating assets and liabilities:			
Receivables	**59**	(75)	(34)
Receivables from affiliated companies	**9**	14	(15)
Inventory	**(87)**	46	(40)
Prepayments and other current assets	**(118)**	(47)	3
Accounts payable	**(39)**	101	53
Accounts payable to affiliated companies	**4**	(27)	(29)
Other current liabilities	**125**	71	29
Changes in regulatory assets and liabilities	**(262)**	(22)	9
Other	**41**	18	54
Net Cash Provided by Operating Activities	**611**	642	666
Investing Activities			
Utility property additions	**(482)**	(526)	(535)
Diversified business property additions	**(203)**	(424)	(154)
Nuclear fuel additions	**–**	(51)	–
Net contributions to nuclear decommissioning trust	**–**	–	12
Acquisition, net of cash acquired	**–**	–	(17)
Proceeds from sale of subsidiaries and investments	**336**	100	35
Other	**(23)**	(15)	17
Net Cash Used in Investing Activities	**(372)**	(916)	(642)
Financing Activities			
Proceeds from issuance of long-term debt	**56**	935	236
Net increase (decrease) in short-term obligations	**293**	(258)	103
Retirement of long-term debt	**(68)**	(534)	(350)
Net (decrease) increase in intercompany notes	**(214)**	258	233
Equity contributions from parent	**13**	168	87
Dividends paid to parent	**(340)**	(301)	(303)
Other	**23**	(1)	(1)
Net Cash (Used in) Provided by Financing Activities	**(237)**	267	5
Net Increase (Decrease) in Cash and Cash Equivalents	**2**	(7)	29
Cash and Cash Equivalents at Beginning of Year	**27**	34	5
Cash and Cash Equivalents at End of Year	**$ 29**	$ 27	$ 34
Supplemental Disclosures of Cash Flow Information			
Cash paid during the year – interest (net of amount capitalized)	**$ 187**	$ 174	$ 176
income taxes (net of refunds)	**$ 5**	$ 32	$ 60

See Notes to Financial Statements.

Noncash Activities

- In April 2002 Progress Fuels Corporation received an equity contribution from Progress Energy, Inc., with which it acquired 100% of Westchester Gas Company. In conjunction with the purchase, Progress Energy, Inc. issued approximately $129 million in common stock (See Note 5C).
- In December 2003, Progress Telecommunications Corporation (PTC) and Caronet, Inc. both indirectly wholly owned subsidiaries of Progress Energy, and EPIK Communications, Inc., a wholly owned subsidiary of Odyssey Telecorp, Inc., contributed substantially all of their assets and transferred certain liabilities to Progress Telecom, LLC, a subsidiary of PTC (See Note 5A).

FLORIDA PROGRESS CORPORATION
CONSOLIDATED STATEMENTS of COMMON EQUITY

(in millions) Years ended December 31	2004	2003	2002
Beginning Balance	**$ 2,524**	$ 2,211	$ 2,072
Net income	**474**	447	235
Other comprehensive income (loss)	**10**	(1)	(13)
Equity contribution from parent, net	**13**	168	220
Dividend to parent	**(340)**	(301)	(303)
Ending Balance	**$2,681**	$ 2,524	$ 2,211

FLORIDA PROGRESS CORPORATION
CONSOLIDATED STATEMENTS of COMPREHENSIVE INCOME

(in millions) Years ended December 31	2004	2003	2002
Net Income	**$ 474**	$ 447	$ 235
Other Comprehensive Income			
Changes in net unrealized losses on cash flow hedges (net of tax benefit of $7, $7 and $4, respectively)	**(12)**	(13)	(6)
Reclassification adjustment for amounts included in net income (net of tax expense of ($9), ($6) and $0, respectively)	**15**	11	(1)
Reclassification of minimum pension liability to regulatory assets (net of tax expense of ($2))	**4**	–	–
Minimum pension liability adjustment (net of tax benefit (expense) of $1, ($3) and $3, respectively)	**(1)**	(3)	(5)
Foreign currency translation and other	4	4	(1)
Other Comprehensive Income (loss)	**$ 10**	$ (1)	$ (13)
Comprehensive Income	**$ 484**	$ 446	$ 222

See Notes to Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA
STATEMENTS of INCOME

(in millions) Years ended December 31	**2004**	2003	2002
Operating Revenues	**$ 3,525**	$ 3,152	$ 3,062
Operating Expenses			
Fuel used in electric generation	**1,175**	870	834
Purchased power	**567**	566	515
Operation and maintenance	**630**	640	591
Depreciation and amortization	**281**	307	295
Taxes other than on income	**254**	241	228
Total Operating Expenses	**2,907**	2,624	2,463
Operating Income	**618**	528	599
Other Income (Expense)			
Interest income	**–**	–	2
Other, net	**5**	7	(7)
Total Other Income (Expense)	**5**	7	(5)
Interest Charges			
Interest charges	**117**	97	109
Allowance for borrowed funds used during construction	**(3)**	(6)	(3)
Total Interest Charges, Net	**114**	91	106
Income before Income Taxes	**509**	444	488
Income Tax Expense	174	147	163
Net Income	**335**	297	325
Preferred Stock Dividend Requirement	**2**	2	2
Earnings for Common Stock	**$ 333**	$ 295	$ 323

See Notes to Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA
BALANCE SHEETS (continued)

(in millions) December 31	**2004**	2003
Assets		
Utility Plant		
Utility plant in service	**$ 8,387**	$ 8,155
Accumulated depreciation	**(2,978)**	(2,877)
Utility plant in service, net	**5,409**	5,278
Held for future use	**8**	8
Construction work in progress	**420**	292
Nuclear fuel, net of amortization	**45**	69
Total Utility Plant, Net	**5,882**	5,647
Current Assets		
Cash and cash equivalents	**12**	10
Receivables	**266**	250
Receivables from affiliated companies	**16**	7
Deferred income taxes	**42**	39
Inventory	**279**	268
Deferred fuel cost	**89**	204
Prepayments and other current assets	**12**	5
Total Current Assets	**716**	783
Deferred Debits and Other Assets		
Regulatory assets	**524**	126
Debt issuance costs	**21**	25
Nuclear decommissioning trust funds	**463**	433
Miscellaneous other property and investments	**46**	40
Prepaid pension cost	**234**	220
Other assets and deferred debits	**38**	6
Total Deferred Debits and Other Assets	**1,326**	850
Total Assets	**$ 7,924**	$ 7,280

See Notes to Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA
BALANCE SHEETS (concluded)

(in millions) December 31	**2004**	2003
Capitalization and Liabilities		
Common Stock Equity		
Common stock, without par value	**$ 1,081**	$ 1,081
Retained earnings	**1,240**	1,062
Accumulated other comprehensive loss	**–**	(4)
Total Common Stock Equity	**2,321**	2,139
Preferred stock – not subject to mandatory redemption	**34**	34
Long-term debt, net	**1,912**	1,904
Total Capitalization	**4,267**	4,077
Current Liabilities		
Current portion of long-term debt	**48**	43
Accounts payable	**262**	161
Payables to affiliated companies	**80**	75
Notes payable to affiliated companies	**178**	363
Short-term obligations	**293**	–
Customer deposits	**135**	127
Other current liabilities	**161**	154
Total Current Liabilities	**1,157**	923
Deferred Credits and Other Liabilities		
Noncurrent income tax liabilities	**489**	363
Accumulated deferred investment tax credits	**35**	41
Regulatory liabilities	**1,362**	1,315
Asset retirement obligations	**337**	319
Accrued pension and other benefits	**197**	188
Other liabilities and deferred credits	**80**	54
Total Deferred Credits and Other Liabilities	**2,500**	2,280
Commitments and Contingencies (Notes 20 and 21)		
Total Capitalization and Liabilities	**$ 7,924**	$ 7,280

See Notes to Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA
STATEMENTS of CASH FLOWS

(in millions) Years ended December 31	**2004**	2003	2002
Operating Activities			
Net income	**$ 335**	$ 297	$ 325
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**310**	314	321
Deferred income taxes and investment tax credits, net	**110**	(25)	(38)
Deferred fuel cost (credit)	**37**	(167)	(22)
Cash provided/(used) by changes in operating assets and liabilities:			
Receivables	**(20)**	(7)	2
Receivables from affiliated companies	**(8)**	36	(29)
Inventory	**(27)**	(33)	(46)
Prepayments and other current assets	**(8)**	–	(1)
Accounts payable	**13**	12	(3)
Payables to affiliated companies	**14**	(7)	(116)
Other current liabilities	**11**	35	18
Regulatory assets and liabilities	**(262)**	(22)	9
Other	**28**	15	(1)
Net Cash Provided by Operating Activities	**533**	448	419
Investing Activities			
Property additions	**(492)**	(526)	(535)
Nuclear fuel additions	**–**	(51)	–
Net contributions to nuclear decommissioning trust	**–**	–	12
Other	**(4)**	(1)	6
Net Cash Used in Investing Activities	**(496)**	(578)	(517)
Financing Activities			
Proceeds from issuance of long-term debt	**56**	935	236
Net increase (decrease) in short-term obligations	**293**	(258)	103
Retirement of long-term debt	**(43)**	(476)	(278)
Net increase (decrease) in intercompany notes	**(185)**	126	358
Dividends paid to parent	**(155)**	(203)	(303)
Dividends paid on preferred stock	**(2)**	(2)	(2)
Other	**1**	2	–
Net Cash (Used in) Provided by Financing Activities	**(35)**	124	114
Net Increase (Decrease) in Cash and Cash Equivalents	**2**	(6)	16
Cash and Cash Equivalents at Beginning of Year	**10**	16	–
Cash and Cash Equivalents at End of Year	**$ 12**	$ 10	$ 16
Supplemental Disclosures of Cash Flow Information			
Cash paid during the year – interest (net of amount capitalized)	**$ 118**	$ 104	$ 106
income taxes (net of refunds)	**$ 57**	$ 177	$ 173

See Notes to Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA
STATEMENTS of COMMON EQUITY

(in millions) Years ended December 31	**2004**	2003	2002
Beginning Balance	**$ 2,139**	$ 2,048	$ 2,031
Net income	**335**	297	325
Preferred stock dividends at stated rates	**(2)**	(2)	(2)
Other comprehensive income (loss)	**4**	(1)	(3)
Dividends paid to parent	**(155)**	(203)	(303)
Ending Balance	**$ 2,321**	$ 2,139	$ 2,048

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA
STATEMENTS of COMPREHENSIVE INCOME

(in millions) Years ended December 31	**2004**	2003	2002
Net Income	**$ 335**	$ 297	$ 325
Other Comprehensive Income			
Reclassification of minimum pension liability to regulatory assets (net of tax expense of ($2))	4	–	–
Minimum pension liability adjustment (net of tax benefit of $0, $1 and $1, respectively)	–	(1)	(3)
Other Comprehensive Income (loss)	**$ 4**	$ (1)	$ (3)
Comprehensive Income	**$ 339**	$ 296	$ 322

See Notes to Financial Statements.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization

Florida Progress Corporation (the Company or Florida Progress) is a holding company under the Public Utility Holding Company Act of 1935 (PUHCA). The Company became subject to the regulations of PUHCA when it was acquired by CP&L Energy, Inc. in November 2000. CP&L Energy, Inc. subsequently changed its name to Progress Energy, Inc. (Progress Energy or the Parent). Florida Progress' two primary subsidiaries are Florida Power Corporation (Progress Energy Florida or PEF) and Progress Fuels Corporation (Progress Fuels). Effective January 1, 2003, Florida Power Corporation began doing business under the assumed name Progress Energy Florida, Inc. The legal name of the entity has not changed. The current corporate and business unit structure remains unchanged. Throughout the report, the terms utility and regulated will be used to discuss items pertaining to Progress Energy Florida. Diversified business and nonregulated will be used to discuss the subsidiaries of Florida Progress excluding Progress Energy Florida.

B. Basis of Presentation

The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The financial statements include the financial results of the Company and its majority-owned subsidiaries. Significant intercompany balances and transactions have been eliminated in consolidation except as permitted by Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation," which provides that profits on intercompany sales to regulated affiliates are not eliminated if the sales price is reasonable and the future recovery of the sales price through the ratemaking process is probable.

The Financial Statements of the Company and its subsidiaries include the accounts of their majority-owned and controlled subsidiaries. Noncontrolling interests in the subsidiaries along with the income or loss attributed to these interests are included in minority interest in both the Consolidated Balance Sheets and in the Consolidated Statements of Income. The results of operations for minority interest are reported on net of tax basis if the underlying subsidiary is structured as a taxable entity.

Unconsolidated investments in companies over which the Company does not have control, but has the ability to exercise influence over operating and financial policies (generally 20% – 50% ownership), are accounted for under the equity method of accounting. These investments are primarily in limited liability corporations and limited liability partnerships, and the earnings from these investments are recorded on a pre-tax basis (See Note 19). These equity method investments are included in miscellaneous other property and investments in the Consolidated Balance Sheets. At December 31, 2004 and 2003, the Company has equity method investments of approximately $11 million and $12 million, respectively.

Certain investments in debt and equity securities that have readily determinable market values, and for which the Company does not have control, are accounted for as available-for-sale securities at fair value in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." These investments include investments held in trust funds, pursuant to NRC requirements, to fund certain costs of decommissioning nuclear plants. The fair value of these trust funds was $463 million and $433 million at December 31, 2004 and 2003, respectively.

Other investments are stated principally at cost. These cost method investments are included in miscellaneous other property and investments in the Consolidated Balance Sheets. At December 31, 2004 and 2003, the Company has approximately $12 million and $13 million, respectively, of cost method investments.

The results of operations of the Rail Services segment are reported one month in arrears. During 2003, the Company ceased recording portions of the Energy and Related Services segment operations one month in arrears. The net impact of this action increased net income by $2 million for the year.

Certain amounts for 2003 and 2002 have been reclassified to conform to the 2004 presentation.

C. Consolidation of Variable Interest Entities

Florida Progress and PEF consolidate all voting interest entities in which they own a majority voting interest and all variable interest entities for which they are the primary beneficiary in accordance with FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51" (FIN No. 46R). A subsidiary of Florida Progress is the primary beneficiary of and consolidates Colona Synfuel Limited Partnership LLLP (Colona), a synthetic fuel production facility that qualifies for federal tax credits under Section 29 of the Internal Revenue Code. As of December 31, 2004, Colona's total assets were $15 million. None of Florida Progress' consolidated assets are collateral for Colona's obligations.

Florida Progress and PEF have interests in several variable interest entities for which they are not the primary beneficiary. These arrangements include investments in approximately five limited partnerships, limited liability corporations and venture capital funds. The aggregate maximum loss exposure at December 31, 2004, that Florida Progress could be required to record in its consolidated income statement as a result of these arrangements totals approximately $13 million. The aggregate maximum loss exposure at December 31, 2004, that PEF could be required to record in its income statement as a result of these arrangements totals approximately $6 million. The creditors of these variable interest entities do not have recourse to the general credit of Florida Progress or PEF in excess of the aggregate maximum loss exposure.

D. Significant Accounting Policies

USE OF ESTIMATES AND ASSUMPTIONS

In preparing financial statements that conform with GAAP, management must make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses reflected during the reporting period. Actual results could differ from those estimates.

REVENUE RECOGNITION

PEF recognizes electric utility revenues as service is rendered to customers. Operating revenues include unbilled electric utility revenues earned when service has been delivered but not billed by the end of the accounting period. Diversified business revenues are generally recognized at the time products are shipped or as services are rendered. Revenues from sales of synthetic fuel and coal are recognized as products are shipped and title passes. Revenues from the sale of oil and gas production are recognized when title passes, net of royalties. Leasing activities are accounted for in accordance with SFAS No. 13, "Accounting for Leases." Lease revenue for dedicated transport and data services is generally billed in advance on a fixed rate basis and recognized over the period the services are provided. Revenues relating to design and construction of wireless infrastructure are recognized upon completion of services for each completed phase of design and construction. Revenues from the sale of oil and gas production are recognized when title passes, net of royalties.

FUEL COST DEFERRALS

Fuel expense includes fuel costs or recoveries that are deferred through fuel clauses established by the regulators of PEF. Those clauses allow PEF to recover fuel costs and portions of purchased power costs through surcharges on customer rates. These deferred fuel costs are recognized in revenue and fuel expenses as they are billable to customers.

EXCISE TAXES

PEF collects from customers certain excise taxes levied by the state or local government upon the customer. PEF accounts for excise taxes on a gross basis. For the years ended December 31, 2004, 2003 and 2002, gross receipts tax and franchise taxes of approximately $151 million, $136 million and $132 million, respectively, are included in electric operating revenues and taxes other than on income on the Statements of Income.

INCOME TAXES

Progress Energy and its affiliates file a consolidated federal income tax return. The consolidated income tax of Progress Energy is allocated to Florida Progress and PEF in accordance with the Intercompany Income Tax Allocation Agreement (Tax Agreement). The Tax Agreement provides an allocation that recognizes positive and negative corporate taxable income. The Tax Agreement provides for an equitable method of apportioning the carry over of uncompensated tax benefits. Progress Energy tax benefits not related to acquisition interest expense are allocated to profitable subsidiaries, beginning in 2002, in accordance with a PUHCA order. Except for the allocation of this Progress Energy tax benefit, income taxes are provided as if Florida Progress and PEF filed separate returns.

Deferred income taxes have been provided for temporary differences. These occur when there are differences between the book and tax bases of assets and liabilities. Investment tax credits related to regulated operations have been deferred and are being amortized over the estimated service life of the related properties. Credits for the production and sale of synthetic fuel are deferred as AMT credits to the extent they cannot be or have not been utilized in the annual consolidated federal income tax returns, and are included in income tax expense (benefit) in the Consolidated Statements of Income (See Note 14).

STOCK-BASED COMPENSATION

The Company measures compensation expense for stock options as the difference between the market price of its common stock and the exercise price of the option at the grant date. The exercise price at which options are granted by the Company equals the market price at the grant date, and accordingly, no compensation expense has been recognized for stock option grants. For purposes of the pro forma disclosures required by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure – an Amendment of FASB Statement No. 123," the estimated fair value of Progress Energy's stock options is amortized to expense over the options' vesting period. The following table illustrates the effect on net income for Florida Progress Corporation and PEF if the fair value method had been applied to all outstanding and unvested awards in each period:

(in millions) Florida Progress	**2004**	2003	2002
Net income, as reported	**$ 474**	$ 447	$ 235
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	**3**	3	3
Pro forma net income	**$ 471**	$ 444	$ 232

(in millions) Progress Energy Florida	**2004**	2003	2002
Net income, as reported	**$ 335**	$ 297	$ 325
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	**2**	2	2
Pro forma net income	**$ 333**	$ 295	$ 323

UTILITY PLANT

Utility plant in service is stated at historical cost less accumulated depreciation. PEF capitalizes all construction-related direct labor and material costs of units of property as well as indirect construction costs. Certain costs that would otherwise not be capitalized under GAAP are capitalized in accordance with regulatory treatment. The cost of renewals and betterments is also capitalized. Maintenance and repairs of property (including planned major maintenance activities), and replacements and renewals of items determined to be less than units of property, are charged to maintenance expense as incurred with the exception of nuclear outages at PEF. Pursuant to a regulatory order, PEF accrues for nuclear outage costs in advance of scheduled outages, which occur every two years. The cost of units of property replaced or retired, less salvage, is charged to accumulated depreciation. Removal, disposal and decommissioning costs that do not represent ARO's under SFAS No. 143 "Accounting for Asset Retirement Obligations," (SFAS No. 143) are charged to regulatory liabilities.

Allowance for funds used during construction (AFUDC) represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated assets. As prescribed in the regulatory uniform system of accounts, AFUDC is charged to the cost of the plant. The equity funds portion of AFUDC is credited to other income and the borrowed funds portion is credited to interest charges.

ASSET RETIREMENT OBLIGATIONS

Effective January 1, 2003, the Company adopted the guidance in SFAS No. 143 to account for legal obligations associated with the retirement of certain tangible long-lived assets. The present value of retirement costs for which the Company has a legal obligation are recorded as liabilities with an equivalent amount added to the asset cost and depreciated over an appropriate period. The liability is then accreted over time by applying an interest method of allocation to the liability.

The adoption of this statement had no impact on the income of PEF, as the effects were offset by the establishment of a regulatory liability pursuant to SFAS No. 71 , "Accounting for the Effects of Certain Types of Regulation" (See Note 8A). The Florida Public Service Commission (FPSC) issued an order to authorize deferral of all prospective effects related to SFAS No. 143 as a regulatory asset or liability (See Note 8A).

DEPRECIATION AND AMORTIZATION – UTILITY PLANT

For financial reporting purposes, substantially all depreciation of utility plant other than nuclear fuel is computed on the straight-line method based on the estimated remaining useful life of the property, adjusted for estimated salvage (See Note 6A). Pursuant to its rate setting authority, the FPSC can also grant approval to accelerate or reduce depreciation and amortization of utility assets (See Note 8).

Amortization of nuclear fuel costs is computed primarily on the units-of-production method. In PEF's retail jurisdiction, provisions for nuclear decommissioning costs are approved by the FPSC and are based on site-specific estimates that include the costs for removal of all radioactive and other structures at the site. In the wholesale jurisdictions, the provisions for nuclear decommissioning costs are approved by the Federal Energy Regulatory Commission (FERC).

CASH AND CASH EQUIVALENTS

The Company considers cash and cash equivalents to include cash on hand, cash in banks and temporary investments purchased with a maturity of three months or less.

INVENTORY

The Company accounts for inventory using the average-cost method. Inventories are valued at the lower of cost or market.

REGULATORY ASSETS AND LIABILITIES

PEF's regulated operations are subject to SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," which allows a regulated company to record costs that have been or are expected to be allowed in the ratemaking process in a period different from the period in which the costs would be charged to expense by a nonregulated enterprise. Accordingly, PEF records assets and liabilities that result from the regulated ratemaking process that would not be recorded under GAAP for nonregulated entities. These regulatory assets and liabilities represent expenses deferred for future recovery from customers or obligations to be refunded to customers and are primarily classified in the Balance Sheets as regulatory assets and regulatory liabilities (See Note 8A).

DIVERSIFIED BUSINESS PROPERTY

Diversified business property is stated at cost less accumulated depreciation. If an impairment loss is recognized on an asset, the fair value becomes its new cost basis. The cost of renewals and betterments are capitalized. The cost of repairs and maintenance is charged to expense as incurred. For properties other than natural gas and oil properties, depreciation is computed on a straight-line basis over the estimated useful lives as indicated in Note 6B. Depletion of mineral rights is provided on the units-of-production method based upon the estimates of recoverable amounts of clean mineral.

The Company uses the full-cost method to account for its oil and gas properties. Under the full-cost method, substantially all productive and nonproductive costs incurred in connection with the acquisition, exploration and development of oil and gas reserves are capitalized. These capitalized costs include the costs of all unproved properties and internal costs directly related to acquisition and exploration activities. The amortization base also includes the estimated future costs to develop proved reserves. Except for costs on unproved properties and major development projects in progress, all costs are amortized using the units-of-production method on a country-by-country basis over the life of the Company's proved reserves. Accordingly, all property acquisition, exploration and development costs of proved oil and gas properties, including the costs of abandoned properties, dry holes, geophysical costs and annual lease rentals are capitalized as incurred including internal costs directly attributable to such activities. Related interest expense incurred during property development activities is capitalized as a cost of such activity. Net capitalized costs of unproved property are reclassified as proved property and well costs when related proved reserves are found. Costs to operate and maintain wells and field equipment are expensed as incurred. In accordance with Regulation 210.4-10 of Regulation S-X, sales or other dispositions of oil and gas properties are accounted for as adjustments to capitalized costs, with no gain or loss recorded unless certain significance tests are met.

GOODWILL AND INTANGIBLE ASSETS

Goodwill is subject to at least an annual assessment for impairment by applying a two-step fair value-based test. This assessment could result in periodic impairment charges. Intangible assets are being amortized based on the economic benefit of their respective lives.

UNAMORTIZED DEBT PREMIUMS, DISCOUNTS AND EXPENSES

Long-term debt premiums, discounts and issuance expenses are amortized over the terms of the debt issues. Any expenses or call premiums associated with the reacquisition of debt obligations by PEF are amortized over the applicable life using the straight-line method consistent with ratemaking treatment (See Note 8A).

DERIVATIVES

The Company accounts for derivative instruments in accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138 and SFAS No. 149. SFAS No. 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. SFAS No. 133 requires that an entity recognize all derivatives as assets or liabilities in the balance sheet and measure those instruments at fair value, unless the derivatives meet the SFAS No. 133 criteria for normal purchases or normal sales and are designated as such. The Company generally designates derivative instruments as normal purchases or normal sales whenever the SFAS No. 133 criteria are met. If normal purchase or normal sale criteria are not met, the Company will generally designate the derivative instruments as cash flow or fair value hedges if the related SFAS No. 133 hedge criteria are met (See Note 16).

ENVIRONMENTAL

As discussed in Note 20, the Company accrues environmental remediation liabilities when the criteria for SFAS No. 5, "Accounting for Contingencies," have been met. Environmental expenditures that relate to an existing condition caused by past operations and that have no future economic benefits are expensed. Accruals for estimated losses from environmental remediation obligations generally are recognized no later than completion of the remedial feasibility study. Such accruals are adjusted as additional information develops or circumstances change. Costs of future expenditures for environmental remediation obligations are not discounted to their present value. Recoveries of environmental remediation costs from other parties are recognized when their receipt is deemed probable. Environmental expenditures that have future economic benefits are capitalized in accordance with the Company's asset capitalization policy.

IMPAIRMENT OF LONG-LIVED ASSETS AND INVESTMENTS

The Company reviews the recoverability of long-lived tangible and intangible assets whenever indicators exist. Examples of these indicators include current period losses, combined with a history of losses or a projection of continuing losses, or a significant decrease in the market price of a long-lived asset group. If an indicator exists, then the asset group is tested for recoverability by comparing the carrying value to the sum of undiscounted expected future cash flows directly attributable to the asset group. If the asset group is not recoverable through undiscounted cash flows, then an impairment loss is recognized for the difference between the carrying value and the fair value of the asset group. The accounting for impairment of long-lived assets is based on SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

The Company reviews its investments to evaluate whether or not a decline in fair value below the carrying value is an other-than-temporary decline (See Note 10). The Company considers various factors, such as the investee's cash position, earnings and revenue outlook, liquidity and management's ability to raise capital in determining whether the decline is other-than-temporary. If the Company determines that other-than-temporary decline exists in the value of its investments, it is the Company's policy to write-down these investments to fair value.

Under the full-cost method of accounting for oil and gas properties, total capitalized costs are limited to a ceiling based on the present value of discounted (at 10%) future net revenues using current prices, plus the lower of cost or fair market value of unproved properties. The ceiling test takes into consideration the prices of qualifying cash flow hedges as of the balance sheet date. If the ceiling (discounted revenues) is not equal to or greater than total capitalized costs, the Company is required to write-down capitalized costs to this level. The Company performs this ceiling test calculation every quarter. No write-downs were required in 2004, 2003 or 2002.

SUBSIDIARY STOCK TRANSACTIONS

Gains and losses realized as a result of common stock sales by the Company's subsidiaries are recorded in the Company's Consolidated Statements of Income, except for any transactions that must be credited directly to equity in accordance with the provisions of Staff Accounting Bulletin No. 51, "Accounting for Sales of Stock by a Subsidiary."

2. IMPACT OF NEW ACCOUNTING STANDARDS

FASB STAFF POSITION 106-2, "ACCOUNTING AND DISCLOSURE REQUIREMENTS RELATED TO THE MEDICARE PRESCRIPTION DRUG IMPROVEMENT AND MODERNIZATION ACT OF 2003"

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) was signed into law. In accordance with guidance issued by the FASB in FASB Staff Position 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug Improvement and Modernization Act of 2003" (FASB Staff Position 106-1), the Company elected to defer accounting for the effects of the Medicare Act due to uncertainties regarding the effects of the implementation of the Medicare Act and the accounting for certain provisions of the Medicare Act. In May 2004, the FASB issued definitive accounting guidance for the Medicare Act in FASB Staff Position 106-2, which was effective for the Company in the third quarter of 2004. FASB Staff Position 106-2 results in the recognition of lower other postretirement benefits (OPEB) costs to reflect prescription drug-related federal subsidies to be received under the Medicare Act. The Company's and PEF's accumulated postretirement benefit obligations as of January 1, 2004 were reduced by approximately $36 million and $35 million, respectively, by the impact of the Medicare Act, and the Company's and PEF's 2004 net periodic cost was lower by approximately $5 million due to the Medicare Act.

STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 123 (REVISED 2004), "SHARE-BASED PAYMENT" (SFAS NO. 123R)

In December 2004, the FASB Issued SFAS No. 123R, which revises SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123) and supersedes Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." The key requirement of SFAS No. 123R is that the cost of share-based awards to employees will be measured based on an award's fair value at the grant date, with such cost to be amortized over the appropriate service period. Previously, entities could elect to continue accounting for such awards at their grant date intrinsic value under APB Opinion No. 25, and the Company made that election. The intrinsic value method resulted in the Company and PEF recording no compensation expense for stock options granted to employees (See Note 11B).

SFAS No. 123R will be effective for the Company on July 1, 2005. The Company intends to implement the standard using the required modified prospective method. Under that method, the Company will record compensation expense under SFAS No. 123R for all awards it grants after July 1, 2005, and it will record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at July 1, 2005. In 2004, Progress Energy made the decision to cease granting stock options and intends to replace that compensation program with other programs. Therefore, the amount of stock option expense expected to be recorded in 2005 is below the amount that would have been recorded if the stock option program had continued. The Company and PEF expect to record less than $1 million of pre-tax expense for stock options in 2005.

PROPOSED FASB INTERPRETATION OF SFAS 109, "ACCOUNTING FOR INCOME TAXES"

In July 2004, the FASB stated that it plans to issue an exposure draft of a proposed interpretation of SFAS No. 109, "Accounting for Income Taxes," that would address the accounting for uncertain tax positions. The FASB has indicated that the interpretation would require that uncertain tax benefits be probable of being sustained in order to record such benefits in the financial statements. The exposure draft is expected to be issued in the first quarter of 2005. The Company cannot predict what actions the FASB will take or how any such actions might ultimately affect the Company's financial position or results of operations, but such changes could have a material impact on the Company's evaluation and recognition of Section 29 tax credits.

3. HURRICANE-RELATED COSTS

Hurricanes Charley, Frances, Ivan and Jeanne struck significant portions of the PEF's service territory during the third quarter of 2004. As of December 31, 2004, restoration costs of PEF's systems from hurricane-related damage was estimated at $385 million, of which $47 million was charged to capital expenditures, and $338 million was charged to the storm damage reserve pursuant to a regulatory order.

In accordance with a regulatory order, PEF accrues $6 million annually to a storm damage reserve and is allowed to defer losses in excess of the accumulated reserve for major storms. Under the order, the storm reserve is charged with operation and maintenance expenses related to storm restoration and with capital expenditures related to storm restoration that are in excess of expenditures assuming normal operating conditions. As of December 31, 2004, $291 million of hurricane restoration costs in excess of the previously recorded storm reserve of $47 million had been classified as a regulatory asset recognizing the probable recoverability of these costs. On November 2, 2004, PEF filed a petition with the FPSC to recover $252 million of storm costs plus interest from retail ratepayers over a two-year period. Storm reserve costs of $13 million were attributable to wholesale customers. PEF has received approval from the FERC to amortize these costs consistent with recovery of such amounts in wholesale rates. PEF continues to review the restoration cost invoices received. Given that not all invoices have been received as of December 31, 2004, PEF will update its petition with the FPSC upon receipt and audit of all actual charges incurred. Hearings on PEF's petition for recovery of $252 million of storm costs filed with the FPSC are scheduled to begin on March 30, 2005.

On November 17, 2004, the Citizens of the State of Florida, by and through Harold McLean, Public Counsel, and the Florida Industrial Power Users Group (FIPUG), (collectively, Joint Movants), filed a Motion to Dismiss PEF's petition to recover the $252 million in storm costs. On November 24, 2004, PEF responded in opposition to the motion, which was also the FPSC staff's position in its recommendation to the Commission on December 21, 2004 that it should deny the Motion to Dismiss. On January 4, 2005, the Commission ruled in favor of PEF and denied joint Movant's Motion to Dismiss.

PEF's January 2005 notice to the FPSC of its intent to file for an increase in its base rates effective January 1, 2006, anticipates the need to replenish the depleted storm reserve balance and adjust the annual $6 million accrual in light of recent storm history to restore the reserve to an adequate level over a reasonable time period (See Note 8B).

4. DIVESTITURES

A. Sale of Natural Gas Assets

In December 2004, the Company sold certain gas-producing properties and related assets owned by Winchester Production Company, Ltd., an indirectly wholly owned subsidiary of Progress Fuels Corporation (Progress Fuels), which is included in the Fuels segment. Net proceeds of approximately $251 million were used to reduce debt. Because the sale significantly altered the ongoing relationship between capitalized costs and remaining proved reserves, under the full-cost method of accounting the pre-tax gain of $56 million was recognized in earnings rather than as a reduction of the basis of the Company's remaining oil and gas properties. The pre-tax gain has been included in (gain)/loss on the sale of assets in the Consolidated Statements of Income.

B. Divestiture of Synthetic Fuel Partnership Interests

In June 2004, the Company through its subsidiary, Progress Fuels, sold, in two transactions, a combined 49.8% partnership interest in Colona Synfuel Limited Partnership, LLLP, one of its synthetic fuel facilities. Substantially all proceeds from the sales will be received over time, which is typical of such sales in the industry. Gain from the sales will be recognized on a cost recovery basis. The Company's book value of the interests sold totaled approximately $3 million. The Company received total gross proceeds of $10 million in 2004. Based on projected production and tax credit levels, the Company anticipates receiving approximately $24 million in 2005, approximately $31 million in 2006, approximately $32 million in 2007 and approximately $8 million through the second quarter of 2008. In the event that the synthetic fuel tax credits from the Colona facility are reduced, including an increase in the price of oil that could limit or eliminate synthetic fuel tax credits, the amount of proceeds realized from the sale could be significantly impacted.

C. Railcar Ltd. Divestiture

In December 2002, the Progress Energy Board of Directors adopted a resolution approving the sale of Railcar Ltd., a subsidiary included in the Rail Services segment. An estimated pre-tax impairment of $67 million on assets held for sale was recognized in December 2002 to write-down the assets to fair value less costs to sell. This impairment has been included in impairment of long-lived assets in the Consolidated Statements of Income (See Note 10). In March 2003, the Company signed a letter of intent to sell the majority of Railcar Ltd. assets to The Andersons, Inc., and the transaction closed in February 2004. Proceeds from the sale were approximately $82 million before transaction costs and taxes of approximately $13 million. In July 2004, the Company sold the remaining assets classified as held for sale to a third-party for net proceeds of $6 million. The assets of Railcar Ltd. were grouped as assets held for sale and were included in other current assets on the Consolidated Balance Sheets at December 31, 2003, at approximately $75 million, which reflected the Company's estimates of the fair value expected to be realized from the sale of these assets less costs to sell.

D. Mesa Hydrocarbons, Inc., Divestiture

In October 2003, the Company sold certain gas-producing properties owned by Mesa Hydrocarbons, LLC, a wholly owned subsidiary of Progress Fuels Corporation (Progress Fuels), which is included in the Fuels segment. Net proceeds were approximately $97 million and were used to reduce debt. Because the Company utilizes the full-cost method of accounting for its oil and gas operations, the pre-tax gain of approximately $18 million was applied to reduce the basis of the Company's other U.S. oil and gas investments and will prospectively result in a reduction of the amortization rate applied to those investments as production occurs.

E. Inland Marine Transportation Divestiture

In July 2001, Progress Energy announced the disposition of the Inland Marine Transportation segment of the Company, which was operated by MEMCO Barge Line, Inc. Inland Marine provided transportation of coal, agricultural and other dry-bulk commodities as well as fleet management services. Progress Energy entered into a contract to sell MEMCO Barge Line, Inc., to AEP Resources, Inc., a wholly-owned subsidiary of American Electric Power. In November 2001, the Company completed the sale of the Inland Marine Transportation segment. The net income of these operations is reported in the Company's Consolidated Statements of Income as discontinued operations.

The net gain on disposal of discontinued operations in the Company's Consolidated Statements of Income for year ended December 31, 2002, represents the after-tax gain from the resolution of approximately $5 million of contingencies in the purchase agreement of the Inland Marine Transportation segment. In connection with the sale, the Company entered into environmental indemnification provisions covering both unknown and known sites. In 2003, the Company reduced the estimate for the environmental accrual by $6 million, which is included as discontinued operations in the Company's Consolidated Statements of Income (See Note 20).

5. ACQUISITIONS AND BUSINESS COMBINATIONS

A. Progress Telecommunications Corporation

In December 2003, Progress Telecommunications Corporation (PTC) and Caronet, Inc. (Caronet), both wholly owned subsidiaries of Progress Energy, and EPIK Communications, Inc. (EPIK), a wholly owned subsidiary of Odyssey Telecorp, Inc. (Odyssey), contributed substantially all of their assets and transferred certain liabilities to Progress Telecom, LLC (PT LLC), a subsidiary of PTC. Subsequently, the stock of Caronet was sold to an affiliate of Odyssey for $2 million in cash and Caronet became a wholly owned subsidiary of Odyssey. Following consummation of all the transactions described above, PTC holds a 55% ownership interest in, and is the parent of, PT LLC. Odyssey holds a combined 45% ownership interest in PT LLC through EPIK and Caronet. The accounts of PT LLC have been included in the Company's Financial Statements since the transaction date. The minority interest is included in other liabilities and deferred credits in the Consolidated Balance Sheets.

The transaction was accounted for as a partial acquisition of EPIK through the issuance of the stock of a consolidated subsidiary. The contributions of PTC's and Caronet's net assets were recorded at their carrying values of approximately $31 million. EPIK's contribution was recorded at its estimated fair value of $22 million using the purchase method. No gain or loss was recognized on the transaction. The EPIK purchase price was initially allocated as follows: property and equipment – $27 million; other current assets – $9 million; current liabilities – $21 million, and goodwill – $7 million. During 2004, PT LLC developed a restructuring plan to exit certain leasing arrangements of EPIK and finalized its valuation of acquired assets and liabilities. Management considered a number of factors, including valuations and appraisals, when making these determinations. Based on the results of these activities, the preliminary purchase price allocation for EPIK was revised as follows at December 31, 2004: property and equipment – $36 million; other current assets – $7 million; intangible assets – $1 million; current liabilities – $18 million; and exit costs – $4 million. The exit costs consist primarily of lease termination penalties and noncancellable lease payments made after certain leased properties are vacated. The pro forma results of operations reflecting the acquisition would not be materially different then the reported results of operation for 2003 or 2002.

B. Acquisition of Natural Gas Reserves

During 2003, Progress Fuels entered into several independent transactions to acquire approximately 200 natural gas-producing wells with proven reserves of approximately 190 billion cubic feet (Bcf) from Republic Energy, Inc., and three other privately owned companies, all headquartered in Texas. The total cash purchase price for the transactions was $168 million. The pro forma results of operations reflecting the acquisition would not be materially different from the reported results of operations for the years ended December 31, 2003 and 2002.

C. Westchester Acquisition

In April 2002, Progress Fuels, a subsidiary of Progress Energy, acquired 100% of Westchester Gas Company. During 2004 the name of the company was changed to Winchester Energy Company, Ltd. (Winchester Energy). The acquisition included approximately 215 natural gas-producing wells, 52 miles of intrastate gas pipeline and 170 miles of gas-gathering systems located within a 25-mile radius of Jonesville, Texas, on the Texas-Louisiana border.

The aggregate purchase price of approximately $153 million consisted of cash consideration of approximately $22 million and the issuance of 2.5 million shares of Progress Energy common stock then valued at approximately $129 million. The purchase price included approximately $2 million of direct transaction costs. The final purchase price was allocated to oil and gas properties, intangible assets, diversified business property, net working capital and deferred tax liabilities for approximately $152 million, $9 million, $32 million, $5 million and $45 million, respectively. The $9 million in intangible assets relates to customer contracts (See Note 9).

The acquisition has been accounted for using the purchase method of accounting and, accordingly, the results of operations for Winchester have been included in the Company's Financial Statements since the date of acquisition. The pro forma results of operations reflecting the acquisition would not be materially different than the reported results of operations for the year ended December 31, 2002.

6. PROPERTY, PLANT AND EQUIPMENT

A. Utility Plant

The balances of utility plant in service at December 31 are listed below, with a range of depreciable lives for each:

(in millions)	2004	2003
Production plant (7-33 years)	**$ 3,818**	$ 3,826
Transmission plant (30-75 years)	**1,070**	1,012
Distribution plant (12-50 years)	**3,047**	2,894
General plant and other (8-75 years)	**452**	423
Utility plant in service	**$ 8,387**	$ 8,155

Substantially all of the electric utility plant is pledged as collateral for the first mortgage bonds of PEF (See Note 12).

Allowance for funds used during construction (AFUDC) represents the estimated debt and equity costs of capital funds necessary to finance the construction of new regulated assets. As prescribed in the regulatory uniform system of accounts, AFUDC is charged to the cost of the plant. The equity funds portion of AFUDC is credited to other income and the borrowed funds portion is credited to interest charges. Regulatory authorities consider AFUDC an appropriate charge for inclusion in the rates charged to customers by the utilities over the service life of the property. The composite AFUDC rate for PEF's electric utility plant was 7.8% in 2004, 2003 and 2002.

Depreciation provisions on utility plant, as a percent of average depreciable property other than nuclear fuel, were 2.3% in 2004, 2003 and 2002. The depreciation provisions related to utility plant were $188 million, $172 million and $162 million in 2004, 2003 and 2002, respectively. In addition to utility plant depreciation provisions, depreciation and amortization expense also includes decommissioning cost provisions, ARO accretion, cost of removal provisions (See Note 6D) and regulatory approved expenses (See Note 8 and 20).

Amortization of nuclear fuel costs, including disposal costs associated with obligations to the U.S. Department of Energy (DOE) and costs associated with obligations to the DOE for the decommissioning and decontamination of enrichment facilities, for the years ended December 31, 2004, 2003 and 2002 were $34 million, $31 million and $32 million, respectively. These amounts are charged to fuel used in electric generation in the Statements of Income.

B. Diversified Business Property

The following is a summary of diversified business property at December 31, with a range of depreciable lives for each:

(in millions)	2004	2003
Equipment (3 – 25 years)	**$ 418**	$ 283
Land and mineral rights	**95**	80
Buildings and plants (5 – 40 years)	**106**	99
Oil and gas properties (units-of-production) (See Note 4A)	**336**	412
Telecommunications equipment (5 – 20 years)	**80**	63
Rail equipment (3 – 20 years) (See Note 4C)	**35**	131
Marine equipment (3 – 35 years)	**87**	83
Computers, office equipment and software (3 – 10 years)	**36**	33
Construction work in progress	**18**	18
Accumulated depreciation	**(435)**	(361)
Diversified business property, net	**$ 776**	$ 841

Diversified business depreciation expense was $112 million, $92 million and $66 million for the years ended December 31, 2004, 2003 and 2002, respectively. The synthetic fuel facilities are being depreciated through 2007 when the Section 29 tax credits will expire. Oil and gas depreciation, depletion, and amortization (DD&A) expense was $41 million, $33 million, and $11 million for the years ended December 31, 2004, 2003, and 2002, respectively. DD&A rates per Mcfe were $1.34, $1.31 and $0.92 for the respective years. Oil and gas properties included costs of $55 million at December 2004 which were excluded from capitalized costs being amortized. This includes $48 million in costs related to acquisitions and capitalized interest on probable reserves of $7 million.

C. Joint Ownership of Generating Facilities

PEF is entitled to shares of the generating capability and output of Crystal River Unit No. 3 (CR3) equal to its ownership interest. PEF also pays its ownership share of additional construction costs, fuel inventory purchases and operating expenses. PEF's share of expenses for the jointly owned facility is included in the appropriate expense category. The co-owner of Intercession City Unit P-11 (P11) has exclusive rights to the output of the unit during the months of June through September. PEF has that right for the remainder of the year. PEF's ownership interest in CR3 and P11 is listed below with related information at December 31, ($ in millions):

Facility	Company Ownership Interest	Plant Investment	Accumulated Depreciation	Construction Work in Progress
2004				
Crystal River Unit No. 3	**91.78%**	**$ 889**	**$ 443**	**$ 9**
Intercession City Unit P-11	**66.67%**	**22**	**7**	**8**
2003				
Crystal River Unit No. 3	91.78%	$ 875	$ 442	$ 46
Intercession City Unit P-11	66.67%	22	6	6

D. Asset Retirement Obligations

The asset retirement costs related to nuclear decommissioning of irradiated plant, net of accumulated depreciation, totaled $36 million and $37 million for regulated operations at December 31, 2004 and 2003, respectively. The ongoing expense differences between SFAS No. 143 and regulatory cost recovery are being deferred to the regulatory liability. Funds set aside in PEF's nuclear decommissioning trust fund for the nuclear decommissioning liability totaled $463 million at December 31, 2004 and $433 million at December 31, 2003. Net unrealized gains on the nuclear decommissioning trust fund were included in regulatory liabilities.

PEF's expense recognized for the disposal or removal of utility assets that are not SFAS No. 143 asset removal obligations, which are included in depreciation and amortization expense, were $77 million, $72 million and $68 million in 2004, 2003 and 2002, respectively.

PEF recognizes removal, non-nuclear decommissioning and dismantlement costs in regulatory liabilities on the Consolidated Balance Sheets (See Note 8A). At December 31, 2004, such costs consist of removal costs of $1,005 million, decommissioning costs for nonirradiated areas at nuclear facilities of $61 million and amounts previously collected for dismantlement of fossil generation plants of $144 million. At December 31, 2003, such costs consist of removal costs of $945 million, decommissioning costs for nonirradiated areas at nuclear facilities of $62 million and amounts previously collected for dismantlement of fossil generation plants of $143 million.

PEF has identified but not recognized ARO liabilities related to electric transmission and distribution and telecommunications assets as the result of easements over property not owned by PEF. These easements are generally perpetual and only require retirement action upon abandonment or cessation of use of the property for the specified purpose. The ARO is not estimable for such easements, as PEF intends to utilize these properties indefinitely. In the event PEF decides to abandon or cease the use of a particular easement, an ARO would be recorded at that time.

The Company's nonregulated AROs relate to coal mine operations, synthetic fuel operations and gas production of Progress Fuels Corporation. The related asset retirement costs, net of accumulated depreciation, totaled $10 million and $5 million at December 31, 2004 and 2003, respectively.

The following table shows the changes to the asset retirement obligations. Additions relate primarily to additional reclamation obligations at coal mine operations of Progress Fuels.

(in millions)	Regulated	Nonregulated
Asset retirement obligations as of January 1, 2003	$ 303	$ 10
Additions	–	11
Accretion expense	16	1
Deductions	–	(2)
Asset retirement obligations as of December 31, 2003	**319**	**20**
Additions	**–**	**6**
Accretion expense	**18**	**2**
Deductions	**–**	**(7)**
Asset retirement obligations as of December 31, 2004	**$ 337**	**$ 21**

The cumulative effect of initial adoption of this statement related to nonregulated operations was $2 million of pre-tax expense, which is included in other, net on the Company's Consolidated Statements of Income for the year ended December 31, 2003. Pro forma net income has not been presented for prior years because the pro forma application of SFAS No. 143 to prior years would result in pro forma net income not materially different from the actual amounts reported.

E. Insurance

PEF is a member of Nuclear Electric Insurance Limited (NEIL), which provides primary and excess insurance coverage against property damage to members' nuclear generating facilities. Under the primary program, PEF is insured for $500 million at its nuclear plant, CR3. In addition to primary coverage, NEIL also provides decontamination, premature decommissioning and excess property insurance with a limit of $1.1 billion.

Insurance coverage against incremental costs of replacement power resulting from prolonged accidental outages at nuclear generating units is also provided through membership in NEIL. PEF is insured thereunder, following a twelve-week deductible period, for 52 weeks in the amount of $4.5 million per week at CR3. An additional 71 weeks of coverage is provided at 80% of the above weekly amount. For the current policy period, PEF is subject to retrospective premium assessments of up to approximately $6.5 million with respect to the primary coverage, $5.2 million with respect to the decontamination, decommissioning and excess property coverage, and $5.5 million for the incremental replacement power costs coverage, in the event covered losses at insured facilities exceed premiums, reserves, reinsurance and other NEIL resources. Pursuant to regulations of the U.S. Nuclear Regulatory Commission, PEF's property damage insurance policies provide that all proceeds from such insurance be applied, first, to place the plant in a safe and stable condition after an accident and, second, to decontaminate, before any proceeds can be used for decommissioning, plant repair or restoration. PEF is responsible to the extent losses may exceed limits of the coverage described above.

PEF is insured against public liability for a nuclear incident up to $10.76 billion per occurrence. Under the current provisions of the Price Anderson Act, which limits liability for accidents at nuclear power plants, PEF, as an owner of a nuclear unit, can be assessed for a portion of any third-party liability claims arising from an accident at any commercial nuclear power plant in the United States. In the event that public liability claims from an insured nuclear incident exceed $300 million (currently available through commercial insurers), PEF would be subject to pro rata assessments of up to $101 million for each reactor owned per occurrence. Payment of such assessments would be made over time as necessary to limit the payment in any one year to no more than $10 million per reactor owned. Congress could possibly approve revisions to the Price Anderson Act during 2005, that could include increased limits and assessments per reactor owned. The final outcome of this matter cannot be predicted at this time.

Under the NEIL policies, if there were multiple terrorism losses occurring within one year, NEIL would make available one industry aggregate limit of $3.2 billion, along with any amounts it recovers from reinsurance, government indemnity or other sources up to the limits for each claimant. If terrorism losses occurred beyond the one-year period, a new set of limits and resources would apply. For nuclear liability claims arising out of terrorist acts, the primary level available through commercial insurers is now subject to an industry aggregate limit of $300 million. The second level of coverage obtained through the assessments discussed above would continue to apply to losses exceeding $300 million and would provide coverage in excess of any diminished primary limits due to the terrorist acts.

PEF self-insures its transmission and distribution lines against loss due to storm damage and other natural disasters. Pursuant to a regulatory order, PEF is accruing $6 million annually to a storm damage reserve and may defer any losses in excess of the reserve (See Note 3 and 8A).

7. CURRENT ASSETS

RECEIVABLES

At December 31, receivables were comprised of the following:

	Florida Progress		Progress Energy Florida	
(in millions)	**2004**	2003	**2004**	2003
Trade accounts receivable	**$ 438**	$ 410	**$ 195**	$ 187
Unbilled accounts receivable	**93**	135	**66**	59
Notes receivable	**97**	62	**–**	–
Other receivables	**12**	15	**7**	6
Unbilled other receivables	**28**	11	**–**	–
Allowance for doubtful accounts receivable	**(19)**	(15)	**(2)**	(2)
Total receivables	**$ 649**	$ 618	**$ 266**	$ 250

Income tax receivables and interest income receivables are not included in this classification. These amounts are in prepayments and other current assets on the Consolidated Balance Sheets.

INVENTORY

At December 31, inventory was comprised of the following:

	Florida Progress		Progress Energy Florida	
(in millions)	**2004**	2003	**2004**	2003
Fuel for production	**$ 103**	$ 90	**$ 103**	$ 90
Inventory for sale	**228**	167	**–**	–
Materials and supplies	**187**	192	**176**	178
Total inventory	**$ 518**	$ 449	**$ 279**	$ 268

8. REGULATORY MATTERS

A. Regulatory Assets and Liabilities

As a regulated entity, PEF is subject to the provisions of SFAS No. 71. Accordingly, PEF records certain assets and liabilities resulting from the effects of the ratemaking process, which would not be recorded under GAAP for nonregulated entities. The utility's ability to continue to meet the criteria for application of SFAS No. 71 may be affected in the future by competitive forces and restructuring in the electric utility industry. In the event that SFAS No. 71 no longer applied to PEF's operations, related regulatory assets and liabilities would be eliminated unless an appropriate regulatory recovery mechanism was provided. Additionally, these factors could result in an impairment of utility plant assets as determined pursuant to SFAS No. 144.

PEF has regulatory assets (liabilities) at December 31 as follows:

(in millions)	2004	2003
Deferred fuel cost - current (Note 8B)	**$ 89**	$ 204
Deferred fuel cost – long-term (Note 8B)	**79**	–
Storm deferral (Note 3)	**291**	–
Income taxes recoverable through future rates (Note 14)	**49**	42
Loss on reacquired debt (Note 1D)	**31**	33
Other	**74**	51
Total long-term regulatory assets	**524**	126
Deferred energy conservation cost - current	**(8)**	(7)
Non-ARO cost of removal (Note 6D)	**(1,210)**	(1,150)
Deferred impact of ARO (Note 1D)	**(26)**	(8)
Net nuclear decommissioning trust unrealized gains (Note 6D)	**(99)**	(105)
Storm reserve (Note 3)	–	(41)
Other	**(27)**	(11)
Total long-term regulatory liabilities	**(1,362)**	(1,315)
Net regulatory assets (liabilities)	**$ (757)**	$ (992)

Except for portions of deferred fuel and deferred storm costs, all assets earn a return or the cash has not yet been expended, in which case the assets are offset by liabilities that do not incur a carrying cost. The utility expects to fully recover these assets and refund the liabilities through customer rates under current regulatory practice.

B. Retail Rate Matters

On November 9, 2004, the FPSC approved PEF's under-recovered fuel costs of $156 million for 2004, of which PEF plans to defer $79 million until 2006 to mitigate the impact on customers resulting from the need to also recover hurricane-related costs. Therefore, $79 million of deferred fuel cost has been classified as a long-term asset. As of December 31, 2004, PEF was under-recovered in fuel costs by $168 million. The additional $12 million over and above the $156 million approved by the FPSC will be included in PEF's 2005 fuel filing.

On June 29, 2004, the FPSC approved a Stipulation and Settlement Agreement, executed on April 29, 2004, by PEF, the Office of Public Counsel and the Florida Industrial Power Users Group. The stipulation and settlement resolved the issue pending before the FPSC regarding the costs PEF will be allowed to recover through its Fuel and Purchased Power Cost Recovery clause in 2004 and beyond for waterborne coal deliveries by the Company's affiliated coal supplier, Progress Fuels Corporation. The settlement sets fixed per ton prices based on point of origin for all waterborne coal deliveries in 2004, and establishes a market-based pricing methodology for determining recoverable waterborne coal transportation costs through a competitive solicitation process or market price proxies in 2005 and thereafter. The settlement reduces the amount that PEF will charge to the Fuel and Purchased Power Cost Recovery clause for waterborne transportation by $11 million beginning in 2004.

On November 3, 2004, the FPSC approved PEF's petition for Determination of Need for the construction of a fourth unit at PEF's Hines Energy Complex. Hines Unit 4 is needed to maintain electric system reliability and integrity and to continue to provide adequate electricity to its ratepayers at a reasonable cost. Hines Unit 4 will be a combined cycle unit with a generating capacity of 461 MW (summer rating). The estimated total in-service cost of Hines Unit 4 is $286 million, and the unit is planned for commercial operation in December 2007. If the actual cost is less than the estimate, customers will receive the benefit of such cost under runs. Any costs that exceed this estimate will not be recoverable absent extraordinary circumstances as found by the FPSC in subsequent proceedings.

PEF RATE CASE SETTLEMENT

The FPSC initiated a rate proceeding in 2001 regarding PEF's future base rates. In March 2002, the parties in PEF's rate case entered into a Stipulation and Settlement Agreement (the Agreement) related to retail rate matters. The Agreement was approved by the FPSC in April 2002. The Agreement is generally effective from May 2002 through December 2005, provided, however, that if PEF's base rate earnings fall below a 10% return on equity, PEF may petition the FPSC to amend its base rates.

The Agreement provides that PEF will reduce its retail revenues from the sale of electricity by an annual amount of $125 million. The Agreement also provides that PEF will operate under a Revenue Sharing Incentive Plan (the Plan) through 2005, and thereafter until terminated by the FPSC, that establishes annual revenue caps and sharing thresholds. The Plan provides that retail base rate revenues between the sharing thresholds and the retail base rate revenue caps will be divided into two shares – a 1/3 share to be received by PEF's shareholders, and a 2/3 share to be refunded to PEF's retail customers, provided, however, that for the year 2002 only, the refund to customers was limited to 67.1% of the 2/3 customer share. The retail base rate revenue sharing threshold amounts for 2004, 2003 and 2002 were $1.370 billion, $1.333 billion and $1.296 billion, respectively, and will increase $37 million in 2005. The Plan also provides that all retail base rate revenues above the retail base rate revenue caps established for each year will be refunded to retail customers on an annual basis. For 2002, the refund to customers was limited to 67.1% of the retail base rate revenues that exceeded the 2002 cap. The retail base revenue caps for 2004, 2003 and 2002 were $1.430 billion, $1.393 billion and $1.356 billion, respectively, and will increase $37 million in 2005. Any amounts above the retail base revenue caps will be refunded 100% to customers. At December 31, 2004, $9 million has been accrued and will be refunded to retail customers by March 2005. The 2003 revenue sharing amount was $18 million, and was refunded to customers by April 30, 2004. Approximately $5 million was originally returned in March 2003 related to 2002 revenue sharing. However, in February 2003, the parties to the Agreement filed a motion seeking an order from the FPSC to enforce the Agreement. In this motion, the parties disputed PEF's calculation of retail revenue subject to refund and contended that the refund should be approximately $23 million. In July 2003, the FPSC ruled that PEF must provide an additional $18 million to its retail customers related to the 2002 revenue sharing calculation. PEF recorded this refund in the second quarter of 2003 as a charge against electric operating revenue and refunded this amount by October 2003.

The Agreement also provides that beginning with the in-service date of PEF's Hines Unit 2 and continuing through December 2005, PEF will be allowed to recover through the fuel cost recovery clause a return on average investment and depreciation expense for Hines Unit 2, to the extent such costs do not exceed the Unit's cumulative fuel savings over the recovery period. Hines Unit 2 is a 516 MW combined-cycle unit that was placed in service in December 2003. In 2004, PEF recovered $36 million through this clause related to Hines Unit 2.

In addition, PEF suspended retail accruals on its reserves for nuclear decommissioning and fossil dismantlement through December 2005. Additionally, for each calendar year during the term of the Agreement, PEF will record a $63 million depreciation expense reduction, and may at its option, record up to an equal annual amount as an offsetting accelerated depreciation expense. No accelerated depreciation expense was recorded during 2004 and 2003. In addition, PEF is authorized, at its discretion, to accelerate the amortization of certain regulatory assets over the term of the Agreement.

Under the terms of the Agreement, PEF agreed to continue the implementation of its four-year Commitment to Excellence Reliability Plan and expected to achieve a 20% improvement in its annual System Average Interruption Duration Index by no later than 2004. If this improvement level was not achieved for calendar years 2004 or 2005, PEF would have provided a refund of $3 million for each year the level is not achieved to 10% of its total retail customers served by its worst performing distribution feeder lines. PEF achieved this improvement level in 2004.

In January 2005, in anticipation of the expiration of its Stipulation and Settlement approved by the FPSC in 2002 to conclude PEF's then-pending rate case, PEF notified the FPSC that it intends to request an increase in its base rates, effective January 1, 2006. In its notice, PEF requested the FPSC to approve calendar year 2006 as the projected test period for setting new base rates. The request for increased base rates is based on the fact that PEF has faced significant cost increases over the past decade and expects its operational costs to continue to increase. These costs include the costs associated with completion of the Hines 3 generation facility, extraordinary hurricane damage costs including capital costs which are not expected to be directly recoverable, the need to replenish the depleted storm reserve and the expected infrastructure investment necessary to meet high customer expectations, coupled with the demands placed on PEF as a result of strong customer growth. On February 7, 2005, the FPSC acknowledged receipt of PEF's notice and authorized minimum filing requirements and testimony to be filed May 1, 2005.

C. Regional Transmission Organizations and Standard Market Design

In 2000, the Federal Energy Regulatory Commission (FERC) issued Order No. 2000 regarding regional transmission organizations (RTOs). This Order set minimum characteristics and functions that RTOs must meet, including independent transmission service. In July 2002, the FERC issued its Notice of Proposed Rulemaking in Docket No. RM01-12-000, Remedying Undue Discrimination through Open Access

Transmission Service and Standard Electricity Market Design (SMD NOPR). If adopted as proposed, the rules set forth in the SMD NOPR would have materially altered the manner in which transmission and generation services are provided and paid for. In April 2003, the FERC released a White Paper on the Wholesale Market Platform. The White Paper provided an overview of what the FERC intended to include in a final rule in the SMD NOPR docket. The White Paper retained the fundamental and most protested aspects of SMD NOPR, including mandatory RTOs and the FERC's assertion of jurisdiction over certain aspects of retail service. The FERC has not yet issued a final rule on SMD NOPR. The Company cannot predict the outcome of these matters or the effect that they may have on the GridFlorida proceedings currently ongoing before the FERC.

The Florida Public Service Commission (FPSC) ruled in December 2001 that the formation of GridFlorida by the three major investor-owned utilities in Florida, including PEF, was prudent but ordered changes in the structure and market design of the proposed organization. In September 2002, the FPSC set a hearing for market design issues; this order was appealed to the Florida Supreme Court by the consumer advocate of the state of Florida. In June 2003, the Florida Supreme Court dismissed the appeal without prejudice. In September 2003, the FERC held a Joint Technical Conference with the FPSC to consider issues related to formation of an RTO for peninsular Florida. In December 2003, the FPSC ordered further state proceedings and established a collaborative workshop process to be conducted during 2004. In June 2004, the workshop process was abated pending completion of a cost-benefit study currently scheduled to be presented at a FPSC workshop on May 25, 2005, with subsequent action by the FPSC to be thereafter determined.

PEF has $4 million invested in GridFlorida related to startup costs at December 31, 2004. PEF expects to recover these startup costs in conjunction with the GridFlorida original structure or in conjunction with any alternate combined transmission structure that emerges.

D. Energy Delivery Capitalization Practice

PEF has reviewed its capitalization policy for its Energy Delivery business unit. That review indicated that in the areas of outage and emergency work not associated with major storms and allocation of indirect costs, PEF should revise the way that it estimates the amount of capital costs associated with such work. PEF has implemented such changes effective January 1, 2005, which include more detailed classification of outage and emergency work and result in more precise estimation and a process of retesting accounting estimates on an annual basis. As a result of the changes in accounting estimates for the outage and emergency work and indirect costs, a lesser proportion of PEF's costs will be capitalized on a going forward basis. PEF estimates that the impact in 2005 will be that approximately $30 million of costs that would have been capitalized under the previous policies will be expensed. Pursuant to SFAS No. 71, PEF has informed the state regulators having jurisdiction over them of this change and that the new estimation process will be implemented effective January 1, 2005. The Company has also requested a method change from the IRS.

9. GOODWILL AND OTHER INTANGIBLE ASSETS

The Company accounts for goodwill and other intangible assets in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." The changes in the carrying amount of goodwill, by reportable segment, are as follows:

(in millions)	Energy and Related Services	Other	Total
Balance as of January 1, 2003	$ 11	$ –	$ 11
Divestitures	(1)	–	(1)
Acquisition	–	7	7
Balance as of December 31, 2003	**$ 10**	**$ 7**	**$ 17**
Impairment loss	**(8)**	**–**	**(8)**
Purchase accounting adjustment	**–**	**(7)**	**(7)**
Balance as of December 31, 2004	**$ 2**	**$ –**	**$ 2**

In connection with a review of strategic alternatives regarding the Fuels' coal mining business, the Company performed an impairment test of the goodwill of the coal mining business in the fourth quarter of 2004. As a result of the impairment test, the Company recorded an impairment loss of $8 million to write off all of the goodwill of the coal mining business. The Company used a probability-weighted discounted cash flow analysis to perform the assessment.

In December 2003, $7 million in goodwill was acquired based on a preliminary purchase price allocation as part of the Progress Telecommunications Corporation partial acquisition of EPIK and was reported in the Other segment. As discussed in Note 5, the Company revised the preliminary EPIK purchase price allocation as of September 2004, and the $7 million of goodwill was reallocated to certain tangible assets acquired based on the results of valuations and appraisals.

The Company has $10 million and $9 million of net amortizable intangible assets at December 31, 2004 and 2003, respectively. The Company's intangibles are primarily acquired customer contracts that are amortized over their respective lives. Amortization expense recorded on intangible assets for the years ended December 31, 2004 and 2003, and estimated annual amortization expense for intangible assets for 2004 through 2008 are not material to the results of operations. PEF has no intangible assets at December 31, 2004 or 2003.

10. IMPAIRMENT OF LONG-LIVED ASSETS AND INVESTMENTS

Effective January 1, 2002, the Company adopted SFAS No. 144, which provides guidance for the accounting and reporting of impairment or disposal of long-lived assets. The statement supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." In 2003 and 2002, the Company recorded impairments and other charges of approximately $15 million and $300 million, respectively.

Due to the reduction in coal production at the Kentucky May Coal Mine, the Company evaluated its long-lived assets in 2003. Fair value was determined based on discounted cash flows. As a result of this review, the Company recorded asset impairments of $15 million on a pre-tax basis during the fourth quarter of 2003.

The 2002 amount includes an estimated impairment of assets held for sale of $67 million related to Railcar Ltd., (See Note 4C). In 2002, the Company also initiated an independent valuation study to assess the recoverability of the long-lived assets of PTC. Based on this assessment, the Company recorded asset impairments of $215 million on a pre-tax basis and other charges of $18 million on a pre-tax basis in the third quarter of 2002. This write-down constitutes a significant reduction in the book value of these long-lived assets. The long-lived asset impairments include an impairment of property, plant and equipment, construction work in process and intangible assets. The impairment charge represents the difference between the fair value and carrying amount of these long-lived assets. The fair value of these assets was determined using a valuation study heavily weighted on the discounted cash flow methodology, using market approaches as supporting information.

11. EQUITY

A. Common and Preferred Stock

Common stock at December 31, 2004 and 2003 consisted of the following

(in millions except share data)	2004	2003
Florida Progress		
Common stock without par value, 250,000,000 shares authorized; 98,616,658 shares outstanding in 2004 and 2003	**$ 1,712**	**$ 1,699**
Progress Energy Florida		
Common stock without par value, 60,000,000 shares authorized; 100 shares outstanding in 2004 and 2003	**$ 1,081**	**$ 1,081**

From time-to-time the Company and its subsidiaries may receive equity contributions from and pay dividends to Progress Energy. The Company received equity contributions from Progress Energy of $13 million, $168 million and $220 million during 2004, 2003 and 2002, respectively. The Company paid dividends to Progress Energy of $340 million, $301 million and $303 million during 2004, 2003 and 2002, respectively.

The authorized capital stock of the Company includes 10 million shares of preferred stock, without par value, including 2 million shares designated as Series A Junior Participating Preferred Stock. No shares of the Company's preferred stock are issued or outstanding.

The authorized capital stock of PEF includes three classes of preferred stock: 4 million shares of Cumulative Preferred Stock, $100 par value; 5 million shares of Cumulative Preferred Stock, without par value; and 1 million shares of Preference Stock, $100 par value. No shares of PEF's Cumulative Preferred Stock, without par value, or Preference Stock are issued or outstanding. All Cumulative Preferred Stock series are without sinking funds and are not subject to mandatory redemption.

Preferred stock outstanding at December 31, 2004 and 2003 consisted of the following (in millions, except share data and par value):

4.00% - 39,980 shares outstanding (redemption price $104.25)	**$**	**4**
4.40% - 75,000 shares outstanding (redemption price $102.00)		**8**
4.58% - 99,990 shares outstanding (redemption price $101.00)		**10**
4.60% - 39,997 shares outstanding (redemption price $103.25)		**4**
4.75% - 80,000 shares outstanding (redemption price $102.00)		**8**
Total Preferred Stock of PEF	**$**	**34**

B. Stock-Based Compensation

EMPLOYEE STOCK OWNERSHIP PLAN

Progress Energy sponsors the Progress Energy 401(k) Savings and Stock Ownership Plan (401(k)) for which substantially all full-time nonbargaining unit employees and certain part-time nonbargaining employees within participating subsidiaries are eligible. Effective January 1, 2002, Florida Progress is a participating subsidiary of the 401(k), which has matching and incentive goal features, encourages systematic savings by employees and provides a method of acquiring Progress Energy common stock and other diverse investments. The 401(k), as amended in 1989, is an Employee Stock Ownership Plan (ESOP) that can enter into acquisition loans to acquire Progress Energy common stock to satisfy 401(k) common stock needs. Qualification as an ESOP did not change the level of benefits received by employees under the 401(k). Common stock acquired with the proceeds of an ESOP loan is held by the 401(k) Trustee in a suspense account. The common stock is released from the suspense account and made available for allocation to participants as the ESOP loan is repaid. Such allocations are used to partially meet common stock needs related to Progress Energy matching and incentive contributions and/or reinvested dividends.

Florida Progress' matching and incentive goal compensation cost under the 401(k) is determined based on matching percentages and incentive goal attainment as defined in the plan. Such compensation cost is allocated to participants' accounts in the form of Progress Energy common stock, with the number of shares determined by dividing compensation cost by the common stock market value at the time of allocation. The 401(k) common stock share needs are met with open market purchases, with shares released from the ESOP suspense account and with newly issued shares. Costs for incentive goal compensation are accrued during the fiscal year and typically paid in shares in the following year; while costs for the matching component are typically met with shares in the same year incurred. Florida Progress' matching and incentive cost which was and will be met with shares released from the suspense account totaled approximately $5 million, $4 million and $2 million for the years ended December 31, 2004, 2003 and 2002, respectively. Matching and incentive costs totaled approximately $7 million, $11 million and $10 million for the years ended December 31, 2004, 2003 and 2002, respectively. PEF's matching and incentive cost which was and will be met with shares released from the suspense account totaled approximately $5 million, $4 million and $2 million for the year ended December 31, 2004, 2003 and 2002, respectively. Matching and incentive costs totaled approximately $7 million, $10 million and $9 million for the years ended December 31, 2004, 2003 and 2002, respectively.

STOCK OPTION AGREEMENTS

Pursuant to the Progress Energy's 1997 Equity Incentive Plan and 2002 Equity Incentive Plans as amended and restated as of July 10, 2002, Progress Energy may grant options to purchase shares of common stock to directors, officers and eligible employees. For the years ended December 31, 2004, 2003 and 2002 approximately 28 thousand, 3.0 million and 2.9 million common stock options were granted, respectively. Of these amounts, approximately 1.0 million and 0.8 million options, respectively, were granted to officers and eligible employees of Florida Progress and PEF in 2003 and approximately 0.5 million and 0.4 million options, respectively, were granted in 2002. No stock options were granted to officers and employees of Florida Progress and PEF in 2004. The Company expects to begin expensing stock options on July 1, 2005 by adopting new FASB guidance on accounting for stock-based compensation that was issued (See Note 2). In 2004, however, Progress Energy made the decision to cease granting stock options and intends to replace that compensation program with other programs. Therefore, the amount of stock option expense expected to be recorded in 2005 is below the amount that would have been recorded if the stock option program had continued.

The pro forma information presented in Note 1 regarding net income and earnings per share is required by SFAS No. 148. Under this statement, compensation cost is measured at the grant date based on the fair value of the award and is recognized over the vesting period. The pro forma amounts presented in Note 1 have been determined as if the Company had accounted for its employee stock options under SFAS No. 123.

OTHER STOCK-BASED COMPENSATION PLANS

Progress Energy has additional compensation plans for officers and key employees that are stock-based in whole or in part. The Company participates in these plans. The two primary active stock-based compensation programs are the Performance Share Sub-Plan (PSSP) and the Restricted Stock Awards program (RSA), both of which were established pursuant to Progress Energy's 1997 Equity Incentive Plan and were continued under the 2002 Equity Incentive Plan, as amended and restated as of July 10, 2002.

Under the terms of the PSSP, officers and key employees are granted performance shares on an annual basis that vest over a three-year consecutive period. Each performance share has a value that is equal to, and changes with, the value of a share of Progress Energy's common stock, and dividend equivalents are accrued on, and reinvested in, the performance shares. The PSSP has two equally weighted performance measures, both of which are based on Progress Energy's results as compared to a peer group of utilities. Compensation expense is recognized over the vesting period based on the expected ultimate cash payout and is reduced by any forfeitures.

The RSA program allows Progress Energy to grant shares of restricted common stock to officers and key employees of Progress Energy. The restricted shares generally vest on a graded vesting schedule over a minimum of three years. Compensation expense, which is based on the fair value of common stock at the grant date, is recognized over the applicable vesting period and is reduced by any forfeitures.

The total amount expensed by the Company for other stock-based compensation under these plans was $2 million, $9 million and $5 million in 2004, 2003 and 2002, respectively. The total amount expensed by PEF for other stock-based compensation under these plans was $2 million, $7 million and $4 million in 2004, 2003 and 2002, respectively.

C. Accumulated Other Comprehensive Loss

Components of accumulated other comprehensive loss for Florida Progress and PEF at December 31, 2004 and 2003 are as follows:

	Florida Progress		Progress Energy Florida	
(in millions)	**2004**	2003	**2004**	2003
Loss on cash flow hedges	**$ (5)**	$ (9)	**$ –**	$ –
Minimum pension liability adjustments	**(7)**	(9)	**–**	(4)
Foreign currency translation and other	**5**	1	**–**	–
Total accumulated other comprehensive loss	**$ (7)**	$ (17)	**$ –**	$ (4)

12. DEBT AND CREDIT FACILITIES

A. Debt and Credit

At December 31, the Company's (including PEF's) long-term debt consisted of the following (maturities and weighted-average interest rates at December 31, 2004):

(in millions)	Rate	**2004**	2003
Progress Energy Florida, Inc.			
First mortgage bonds, maturing 2008-2033	5.60%	**1,330**	1,330
Pollution control obligations, maturing 2018-2027	1.67%	**241**	241
Medium-term notes, maturing 2005-2028	6.76%	**337**	379
Draws on revolving credit agreement, expiring 2006	2.95%	**55**	–
Unamortized premium and discount, net		**(3)**	(3)
		1,960	1,947
Florida Progress Funding Corporation (See Note 17)			
Debt to affiliated trust, maturing 2039	7.10%	**309**	309
Progress Capital Holdings, Inc.			
Medium-term notes, maturing 2006-2008	6.84%	**140**	165
Unsecured note with parent, maturing 2011	6.45%	**500**	500
Miscellaneous notes		**1**	1
		641	666
Current portion of long-term debt		**(49)**	(68)
Total long-term debt		**$ 2,861**	$ 2,854

In February 2005, PEF used proceeds from money pool borrowings to pay off $55 million of RCA loans and in January 2005, PEF used proceeds from the issuance of commercial paper to pay off $170 million of RCA loans.

At December 31, 2004, PEF had committed lines of credit which are used to support its commercial paper borrowings. The 3-year credit facility is included in long-term debt. The 364-day credit facility is included in short-term obligations and had $170 million of outstanding borrowings at December 31, 2004, at an interest rate of 3.13%. No amount was outstanding under the committed lines of credit at December 31, 2003. PEF is required to pay minimal annual commitment fees to maintain its credit facilities.

The following table summarizes PEF's credit facilities:

(in millions) Description	Total	Outstanding	Available
364-Day (expiring 3/29/05)	$ 200	$ 170	$ 30
3-Year (expiring 4/01/06)	200	55	145
Less: amounts reserved(a)			(123)
Total credit facilities	$ 400	$ 225	$ 52

(a) To the extent amounts are reserved for commercial paper outstanding, they are not available for additional borrowings.

At December 31, 2004, PEF had $123 million of outstanding commercial paper and other short-term debt classified as short-term obligations. The weighted-average interest rate of such short-term obligations at December 31, 2004 was 2.80%. At December 31, 2003, PEF had no outstanding commercial paper and other short-term debt classified as short-term obligations.

The combined aggregate maturities of Florida Progress long-term debt for 2005 through 2008 are approximately, in millions, $49, $163, $124 and $127, respectively. PEF's aggregate maturities of long-term debt for 2005 through 2008 are approximately, in millions, $48, $103, $89 and $82, respectively. There are no long-term debt maturities in 2009 for PEF or Florida Progress.

B. Covenants and Default Provisions

FINANCIAL COVENANTS

PEF's credit line contains various terms and conditions that could affect PEF's ability to borrow under these facilities. These include a maximum debt to total capital ratio, an interest test, a material adverse change clause and a cross-default provision. PEF's credit line requires a maximum total debt to total capital ratio of 65.0%. Indebtedness as defined by the bank agreement includes certain letters of credit and guarantees which are not recorded on the Balance Sheets. At December 31, 2004, PEF's total debt to total capital ratio was 50.8%.

PEF's 364-day and 3-year credit facility have a financial covenant for interest coverage. The covenant requires PEF's EBITDA to interest expense to be at least 3 to 1. For the year ended December 31, 2004, this ratio was 7.93 to 1.

MATERIAL ADVERSE CHANGE CLAUSE

The credit facility of PEF includes a provision under which lenders could refuse to advance funds in the event of a material adverse change (MAC) in the borrower's financial condition.

CROSS-DEFAULT PROVISIONS

PEF's credit lines include cross-default provisions for defaults of indebtedness in excess of $10 million. PEF's cross-default provisions only apply to defaults of indebtedness by PEF and not to other affiliates of PEF. The credit lines of Progress Energy include a similar provision. Progress Energy's cross-default provisions only apply to defaults of indebtedness by Progress Energy and its significant subsidiaries, which includes PEF, Florida Progress, Progress Fuels and Progress Capital.

In the event that either of these cross-default provisions were triggered, the lenders could accelerate payment of any outstanding debt. Any such acceleration would cause a MAC in the respective company's financial condition. Certain agreements underlying the Company's indebtedness also limit the Company's ability to incur additional liens or engage in certain types of sale and leaseback transactions.

OTHER RESTRICTIONS

PEF's mortgage indenture provides that it will not pay any cash dividends upon its common stock, or make any other distribution to the stockholders, except a payment or distribution out of net income of PEF subsequent to December 31, 1943. At December 31, 2004, none of PEF's retained earnings were restricted.

In addition, PEF's Articles of Incorporation provide that no cash dividends or distributions on common stock shall be paid, if the aggregate amount thereof since April 30, 1944, including the amount then proposed to be expended, plus all other charges to retained earnings since April 30, 1944, exceed (a) all credits to retained earnings since April 30, 1944, plus (b) all amounts credited to capital surplus after April 30, 1944, arising from the donation to PEF of cash or securities or transfers amounts from retained earnings to capital surplus. At December 31, 2004, none of PEF's retained earnings was restricted.

PEF's Articles of Incorporation also provide that cash dividends on common stock shall be limited to 75% of net income available for dividends if common stock equity falls below 25% of total capitalization, and to 50% if common stock equity falls below 20%. On December 31, 2004, PEF's common stock equity was approximately 54.4% of total capitalization.

C. Secured Obligations

PEF's first mortgage bonds are secured by its mortgage indenture. PEF's mortgage constitutes a first lien on substantially all of its fixed properties, subject to certain permitted encumbrances and exceptions. The PEF mortgage also constitutes a lien on subsequently acquired property. At December 31, 2004, PEF had approximately $1.571 billion in aggregate principal amount of first mortgage bonds outstanding including those related to pollution control obligations. The PEF mortgage allows the issuance of additional mortgage bonds upon the satisfaction of certain conditions.

D. Guarantees of Subsidiary Debt

See Note 17 on related party transactions for a discussion of obligations guaranteed or secured by affiliates.

E. Hedging Activities

PEF uses interest rate derivatives to adjust the fixed and variable rate components of its debt portfolio and to hedge cash flow risk of fixed rate debt to be issued in the future. See discussion of risk management and derivative transactions at Note 16.

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

At December 31, 2004 and 2003, there were miscellaneous investments, consisting primarily of investments in company-owned life insurance and other benefit plan assets, with carrying amounts of approximately $73 million and $66 million, respectively, included in miscellaneous other property and investments. At PEF, these investments had carrying amounts of $34 million and $33 million at December 31, 2004 and 2003, respectively. The carrying amount of these investments approximates fair value due to the short maturity. The carrying amount of the Company's long-term debt, including current maturities, was $2,910 million and $2,922 million at December 31, 2004 and 2003, respectively. The estimated fair value of this debt, as obtained from quoted market prices for the same or similar issues, was $3,121 million and $3,105 million at December 31, 2004 and 2003, respectively. The carrying amount of PEF's long-term debt, including current maturities, was $1,960 million and $1,947 million at December 31, 2004 and 2003, respectively. The estimated fair value of this debt, as obtained from quoted market prices for the same or similar issues, was $2,080 million and $2,061 million at December 31, 2004 and 2003, respectively.

External trust funds have been established to fund certain costs of nuclear decommissioning (See Note 6D). These nuclear decommissioning trust funds are invested in stocks, bonds and cash equivalents. Nuclear decommissioning trust funds are presented on the Consolidated Balance Sheets at amounts that approximate fair value. Fair value is obtained from quoted market prices for the same or similar investments.

14. INCOME TAXES

Deferred income taxes have been provided for temporary differences. These occur when there are differences between book and tax carrying amounts of assets and liabilities. Investment tax credits related to regulated operations have been deferred and are being amortized over the estimated service life of the related properties. To the extent that the establishment of deferred income taxes under SFAS No. 109 is different from the recovery of taxes by PEF through the ratemaking process, the differences are deferred pursuant to SFAS No. 71. A regulatory asset or liability has been recognized for the impact of tax expenses or benefits that are recovered or refunded in different periods by the utility pursuant to rate orders.

Accumulated deferred income tax assets (liabilities) at December 31 are (in millions):

Florida Progress	2004	2003
Current portion of deferred income tax asset		
Unbilled revenue	$ 35	$ 18
Other	33	42
Net current portion of deferred income tax asset	$ 68	$ 60
Noncurrent deferred income tax asset (liability):		
Accumulated depreciation and property cost differences	$ (400)	$ (359)
Investments	49	(17)
Supplemental executive retirement plans	19	19
Other post-employment benefits (OPEB)	65	64
Other pension plans	(89)	(85)
Goodwill	34	46
Deferred storm costs	(113)	–
Storm damage reserve	–	16
Premium on reacquired debt	(12)	(13)
State NOL carry forward	23	28
Federal and state income tax credit carry forward	494	437
Miscellaneous other temporary differences, net	57	25
Valuation allowance	(27)	(29)
Total noncurrent deferred income tax asset	100	132
Less amount included in other assets and deferred debits	161	172
Net noncurrent deferred income tax liability	$ (61)	$ (40)

Progress Energy Florida	2004	2003
Current portion of deferred income tax asset		
Unbilled revenue	$ 35	$ 18
Other	7	21
Net current portion of deferred income tax asset	$ 42	$ 39
Noncurrent deferred income tax asset (liability):		
Accumulated depreciation and property cost differences	$ (389)	$ (368)
Other post-employment benefits (OPEB)	63	62
Other pension plans	(89)	(85)
Deferred storm costs	(113)	–
Storm damage reserve	–	16
Miscellaneous other temporary differences, net	39	17
Total noncurrent deferred income tax liability	$ (489)	$ (358)

The Company's total deferred income tax liabilities were $997 million and $824 million at December 31, 2004 and 2003, respectively. Total deferred income tax assets were $1,165 million and $1,016 million at December 31, 2004 and 2003, respectively. Total noncurrent income tax liabilities on the Consolidated Balance Sheets at December 31, 2004 and 2003 include $2 and $7 million, respectively, related to contingent tax liabilities on which the Company accrues interest that would be payable with the related tax amount in future years.

PEF's total deferred income tax liabilities were $620 million and $476 million at December 31, 2004 and 2003, respectively. Total deferred income tax assets were $173 million and $157 million at December 31, 2004 and 2003, respectively. Total noncurrent income tax liabilities on the Balance Sheets at December 31, 2004 and 2003 include none and $5 million, respectively, related to contingent tax liabilities on which the company accrues interest that would be payable with the related tax amount in future years.

The Company's federal income tax credit carry forward at December 31, 2004 consists of $484 million of alternative minimum tax credit with an indefinite carry forward period and $9 million of general business credit with a carry forward period that will begin to expire in 2022. The Company's alternative minimum tax credit carry forward at December 31, 2004 includes $3 million that would be limited if a change in ownership were to occur with respect to certain indirect wholly owned subsidiary companies.

As of December 31, 2004, the Company had a state net operating loss carry forward of $2 million that will begin to expire in 2007.

The Company decreased its valuation allowance during 2004 by $2 million and established additional valuation allowances of $3 million and $5 million during 2003 and 2002, respectively, due to the uncertainty of realizing certain future state tax benefits. The Company decreased its 2004 beginning-of-the-year valuation allowance by $8 million for a change in circumstances related to net operating losses. The Company believes it is more likely than not that the results of future operations will generate sufficient taxable income to allow for the utilization of the remaining deferred tax assets.

The Company establishes accruals for certain tax contingencies when, despite the belief that the Company's tax return positions are fully supported, the Company believes that certain positions may be challenged and that it is probable the Company's positions may not be fully sustained. The Company is under continuous examination by the Internal Revenue Service and other tax authorities and accounts for potential losses of tax benefits in accordance with SFAS No. 5. At December 31, 2004 and 2003, respectively, the Company had recorded $60 million and $56 million of tax contingency reserves, excluding accrued interest and penalties, which are included in current Taxes Accrued on the Consolidated Balance Sheets. At December 31, 2004 and 2003, PEF had recorded $7 million of tax contingency reserves, excluding accrued interest and penalties, which are included in other current liabilities on the Balance Sheets. Considering all tax contingency reserves, the Company does not expect the resolution of these matters to have a material impact on its financial position or result of operations. All tax contingency reserves relate to capitalization and basis issues and do not relate to any potential disallowances of tax credits from synthetic fuel production (See Note 21E).

Reconciliations of the Company's effective income tax rate to the statutory federal income tax rate are:

Florida Progress	**2004**	2003	2002
Effective income tax rate	**13.3%**	(32.6)%	(304.8)%
State income taxes, net of federal benefit	**(6.1)**	(2.5)	(10.3)
AFUDC amortization	**(0.5)**	(0.7)	(4.1)
Federal tax credits	**24.4**	63.5	311.3
Investment tax credit amortization	**1.2**	1.8	11.3
Progress Energy tax allocation benefit	**2.7**	3.8	35.2
Other differences, net	**—**	1.7	(3.6)
Statutory federal income tax rate	**35.0%**	35.0%	35.0%

Progress Energy Florida	**2004**	2003	2002
Effective income tax rate	**34.2%**	33.1%	33.6%
State income taxes, net of federal benefit	**(3.5)**	(3.5)	(3.4)
Investment tax credit amortization	**1.2**	1.4	1.3
Progress Energy tax allocation benefit	**2.5**	2.7	3.8
Other differences, net	**0.6**	1.3	(0.3)
Statutory federal income tax rate	**35.0%**	35.0%	35.0%

Income tax expense (benefit) applicable to continuing operations is comprised of (in millions):

Florida Progress	2004	2003	2002
Current - federal	$ 46	$ 6	$ 43
State	31	18	23
Deferred - federal	(16)	(123)	(220)
State	15	(5)	(13)
Investment tax credit	(6)	(6)	(6)
Total income tax expense (benefit)	$ 70	$ (110)	$ (173)

Progress Energy Florida	2004	2003	2002
Current - federal	$ 55	$ 145	$ 172
State	9	27	29
Deferred - federal	98	(16)	(29)
State	18	(3)	(3)
Investment tax credit	(6)	(6)	(6)
Total income tax expense (benefit)	$ 174	$ 147	$ 163

Florida Progress and each of its wholly-owned subsidiaries have entered into a Tax Agreement with Progress Energy (See Note 1D). The Company's intercompany tax payable was approximately $72 million and $17 million at December 31, 2004 and 2003, respectively. Progress Energy Florida's intercompany tax payable was approximately $21 million and $16 million at December 31, 2004 and 2003, respectively.

Florida Progress, through its subsidiaries, is a majority owner in two entities and a minority owner in four entities that owns facilities that produce synthetic fuel as defined under the Internal Revenue Code (Code). The production and sale of the synthetic fuel from these facilities qualifies for tax credits under Section 29 if certain requirements are satisfied (See Note 21E).

15. BENEFIT PLANS

The Company and some of its subsidiaries (including PEF) have a non-contributory defined benefit retirement (pension) plan for substantially all full-time employees. The Company also has supplementary defined benefit pension plans that provide benefits to higher-level employees. In addition to pension benefits, the Company and some of its subsidiaries (including PEF) provide contributory other postretirement benefits (OPEB), including certain health care and life insurance benefits, for retired employees who meet specified criteria. The Company uses a measurement date of December 31 for its pension and OPEB plans.

The components of the net periodic benefit cost for the years ended December 31 are:

	Pension Benefits			Other Postretirement Benefits		
(in millions)	2004	2003	2002	2004	2003	2002
Service cost	$ 22	$ 21	$ 19	$ 4	$ 5	$ 5
Interest cost	48	46	44	14	16	15
Expected return on plan assets	(77)	(62)	(76)	(1)	(1)	(1)
Net amortization	1	3	(7)	5	5	4
Net cost/(benefit) recognized by Florida Progress	$ (6)	$ 8	$ (20)	$ 22	$ 25	$ 23
Net cost/(benefit) recognized by PEF	$ (8)	$ 5	$ (22)	$ 21	$ 24	$ 22

The net periodic cost for other postretirement benefits decreased during 2004 due to the implementation of FASB Staff Position 106-2 (See Note 2).

Prior service costs and benefits are amortized on a straight-line basis over the average remaining service period of active participants. Actuarial gains and losses in excess of 10% of the greater of the obligation or the market-related value of assets are amortized over the average remaining service period of active participants. The Company uses fair value for the market-related value of assets.

Reconciliations of the changes in the plans' benefit obligations and the plans' funded status are:

	Pension Benefits		Other Postretirement Benefits	
(in millions)	**2004**	2003	**2004**	2003
Obligation at January 1	**$ 780**	$ 714	**$ 224**	$ 236
Service cost	**22**	21	**4**	5
Interest cost	**48**	46	**14**	15
Plan amendments	**2**	–	**–**	–
Benefit payments	**(42)**	(41)	**(17)**	(15)
Actuarial loss (gain)	**39**	40	**15**	(17)
Obligation at December 31	**849**	780	**240**	224
Fair value of plan assets at December 31	**919**	849	**20**	18
Funded status	**70**	69	**(220)**	(206)
Unrecognized transition obligation	**–**	–	**28**	31
Unrecognized prior service cost (benefit)	**(14)**	(18)	**6**	7
Unrecognized net actuarial loss	**117**	111	**30**	15
Minimum pension liability adjustment	**(14)**	(11)	**–**	–
Prepaid (accrued) cost at December 31, net – Florida Progress	**$ 159**	$ 151	**$ (156)**	$ (153)
Prepaid (accrued) cost at December 31, net – PEF	**$ 192**	$ 183	**$ (150)**	$ (148)

The 2003 OPEB obligation information above has been restated due to the implementation of FASB Staff Position 106-2 (See Note 2).

The Florida Progress net prepaid pension cost of $159 million and $151 million at December 31, 2004 and 2003, respectively, is included in the Company's Consolidated Balance Sheets as prepaid pension cost of $238 million and $223 million, respectively, which is included in other assets and deferred debits, and accrued benefit cost of $79 million and $72 million, respectively, which is included in accrued pension and other benefits. The PEF net prepaid pension cost of $192 million and $183 million at December 31, 2004 and 2003, respectively, is included in the Balance Sheets as prepaid pension cost of $234 million and $220 million, respectively, and accrued benefit cost of $42 million and $37 million, respectively, which is included in accrued pension and other benefits. For Florida Progress, the defined benefit pension plans with accumulated benefit obligations in excess of plan assets had projected benefit obligations totaling $80 million and $74 million at December 31, 2004 and 2003, respectively. Those plans had accumulated benefit obligations totaling $77 million and $73 million, respectively, and no plan assets. For PEF, the defined benefit pension plans with accumulated benefit obligations in excess of plan assets had projected benefit obligations totaling $41 million and $38 million at December 31, 2004 and 2003, respectively. Those plans had accumulated benefit obligations totaling $39 million and $37 million, respectively, and no plan assets. For Florida Progress, the total accumulated benefit obligation for pension plans was $797 million and $736 million at December 31, 2004 and 2003, respectively. For PEF, the total accumulated benefit obligation for pension plans was $718 million and $659 million at December 31, 2004 and 2003, respectively. Accrued other postretirement benefit cost is included in accrued pension and other benefits in the respective Balance Sheets of Florida Progress and PEF.

Florida Progress and PEF recorded a minimum pension liability adjustment of $14 million and $7 million, respectively, at December 31, 2004, with a corresponding charge of $7 million to a regulatory asset and, for Florida Progress, a pre-tax charge of $7 million to accumulate other comprehensive loss, a component of common stock equity. Florida Progress and PEF recorded a minimum pension liability adjustment of $11 million and $6 million, respectively, at December 31, 2003, with a corresponding pre-tax charge to accumulated other comprehensive loss, a component of common stock equity.

Reconciliations of the fair value of plan assets are:

	Pension Benefits		Other Postretirement Benefits	
(in millions)	**2004**	2003	**2004**	2003
Fair value of plan assets January 1	**$ 849**	$ 687	**$ 18**	$ 16
Actual return on plan assets	**108**	199	**1**	1
Benefit payments	**(42)**	(41)	**(18)**	(15)
Employer contributions	**4**	4	**19**	16
Fair value of plan assets at December 31	**$ 919**	$ 849	**$ 20**	$ 18

In the table above, substantially all employer contributions represent benefit payments made directly from Company assets. The remaining benefits payments were made directly from plan assets. The OPEB benefit payments represent the net Company cost after participant contributions. Participant contributions represent approximately 10% of gross benefit payments.

The asset allocation for the Company's plans at the end of 2004 and 2003 and the target allocation for the plans, by asset category, are as follows:

	Pension Benefits			Other Postretirement Benefits		
	Target Allocations	Percentage of Plan Assets at Year End		Target Allocations	Percentage of Plan Assets at Year End	
Asset Category	2005	**2004**	2003	2005	**2004**	2003
Equity – domestic	48%	**47%**	49%	–	–	–
Equity – international	15%	**21%**	22%	–	–	–
Debt – domestic	12%	**9%**	11%	100%	**100%**	100%
Debt – international	10%	**11%**	11%	–	–	–
Other	15%	**12%**	7%	–	–	–
Total	100%	**100%**	100%	100%	**100%**	100%

With regard to its pension assets, the Company sets strategic allocations among asset classes to provide broad diversification to protect against large investment losses and excessive volatility, while recognizing the importance of offsetting the impacts of benefit cost escalation. In addition, the Company employs external investment managers who have complementary investment philosophies and approaches. Tactical shifts (plus or minus five percent) in asset allocation from the strategic allocations are made based on the near-term view of the risk and return tradeoffs of the asset classes. The Company's OPEB assets are invested solely in fixed income securities.

In 2005, the Company expects to make no required contributions to pension plan assets and $1 million of discretionary contributions to OPEB plan assets. The expected benefit payments for the pension benefit plan for 2005 through 2009 and in total for 2010-2014, in millions, are approximately $43, $45, $47, $51, $55 and $337, respectively. The expected benefit payments for the OPEB plan for 2005 through 2009 and in total for 2010-2014, in millions, are approximately $17, $19, $20, $21, $22 and $126, respectively. The expected benefit payments include benefit payments directly from plan assets and benefit payments directly from Company assets. The benefit payment amounts reflect the net cost to the Company after any participant contributions. The Company expects to begin receiving prescription drug-related federal subsidies in 2006 (See Note 2), and the expected subsidies for 2006 through 2009 and in total for 2010-2014, in millions, are approximately $2, $2, $2, $2 and $14, respectively. PEF represents a significant majority of the Company's expected benefit payments and expected subsidies to be received. The expected benefit payments above do not include the potential effects of a 2005 voluntary early retirement program (see Note 22).

The following weighted-average actuarial assumptions were used in the calculation of the year-end obligation:

	Pension Benefits		Other Postretirement Benefits	
	2004	2003	**2004**	2003
Discount rate	**5.90%**	6.30%	**5.90%**	6.30%
Rate of increase in future compensation				
Bargaining	**3.50%**	3.50%	–	–
Supplementary plans	**5.25%**	5.00%	–	–
Initial medical cost trend rate for pre-Medicare benefits	–	–	**7.25%**	7.25%
Initial medical cost trend rate for post-Medicare benefits	–	–	**7.25%**	7.25%
Ultimate medical cost trend rate	–	–	**5.00%**	5.25%
Year ultimate medical cost trend rate is achieved	–	–	**2008**	2009

The Company's primary defined benefit retirement plan for nonbargaining employees is a "cash balance" pension plan as defined in Emerging Issues Task Force Issue No. 03-4. Therefore, effective December 31, 2003, the Company began to use the traditional unit credit method for purposes of measuring the benefit obligation of this plan. Under the traditional unit credit method, no assumptions are included about future changes in compensation and the accumulated benefit obligation and projected benefit obligation are the same.

The following weighted-average actuarial assumptions were used in the calculation of the net periodic cost:

	Pension Benefits			Other Postretirement Benefits		
	2004	2003	2002	**2004**	2003	2002
Discount rate	**6.30%**	6.60%	7.50%	**6.30%**	6.60%	7.50%
Rate of increase in future compensation						
Bargaining	**3.50%**	3.50%	3.50%	–	–	–
Nonbargaining	–	4.00%	4.00%	–	–	–
Supplementary plan	**5.00%**	4.00%	4.00%	–	–	–
Expected long-term rate of return on plan assets	**9.25%**	9.25%	9.25%	**5.00%**	5.00%	5.00%

The expected long-term rates of return on plan assets were determined by considering long-term historical returns for the plans and long-term projected returns based on the plans' target asset allocation. For pension plan assets, those benchmarks support an expected long-term rate of return between 9.0% and 9.5%. The Company has chosen to use an expected long-term rate of 9.25%. The OPEB expected long-term rate of return of 5.0% reflects that the OPEB assets are invested solely in fixed income securities.

The medical cost trend rates were assumed to decrease gradually from the initial rates to the ultimate rates. Assuming a 1% increase in the medical cost trend rates, the aggregate of the service and interest cost components of the net periodic OPEB cost for 2004 would increase by $1 million, and the OPEB obligation at December 31, 2004, would increase by $13 million. Assuming a 1% decrease in the medical cost trend rates, the aggregate of the service and interest cost components of the net periodic OPEB cost for 2004 would decrease by $1 million and the OPEB obligation at December 31, 2004, would decrease by $12 million.

16. RISK MANAGEMENT ACTIVITIES AND DERIVATIVES TRANSACTIONS

Under its risk management policy, the Company and PEF may use a variety of instruments, including swaps, options and forward contracts, to manage exposure to fluctuations in commodity prices and interest rates. Such instruments contain credit risk if the counterparty fails to perform under the contract. The Company and PEF minimize such risk by performing credit reviews using, among other things, publicly available credit ratings of such counterparties. Potential non-performance by counterparties is not expected to have a material effect on the consolidated financial position or consolidated results of operations of the Company or PEF.

A. Commodity Derivatives

GENERAL

Most of the Company's and PEF's commodity contracts either are not derivatives or qualify as normal purchases or sales pursuant to SFAS No. 133. Therefore, such contracts are not recorded at fair value.

ECONOMIC DERIVATIVES

Derivative products, primarily electricity forward contracts, may be entered into for economic hedging purposes. While management believes these derivatives mitigate exposures to fluctuations in commodity prices, these instruments are not designated as hedges for accounting purposes and are monitored consistent with trading positions. The Company manages open positions with strict policies that limit its exposure to market risk and require daily reporting to management of potential financial exposures. Gains and losses from such contracts were not material during 2004, 2003 or 2002, and the Company did not have material outstanding positions in such contracts at December 31, 2004 or 2003.

In 2004, PEF entered into derivative instruments related to its exposure to price fluctuations on fuel oil purchases. At December 31, 2004, the fair values of these instruments were a $2 million long-term derivative asset position included in other assets and deferred debits and a $5 million short-term derivative liability position included in other current liabilities. These instruments receive regulatory accounting treatment. Gains are recorded in regulatory liabilities and losses are recorded in regulatory assets.

CASH FLOW HEDGES

The Company's subsidiaries designate a portion of commodity derivative instruments as cash flow hedges under SFAS No. 133. The objective for holding these instruments is to hedge exposure to market risk associated with fluctuations in the price of natural gas for the Company's forecasted sales. In the normal course of business, Progress Fuels through an affiliate, Progress Ventures, Inc. (PVI), enters natural gas cash flow hedging instruments, which PVI offsets with third party transactions. Progress Fuels accounts for such contracts as if it were transacted with a third party and records the contract using mark-to-market or accrual accounting, as applicable. At December 31, 2004, Progress Fuels is hedging exposures to the price variability of natural gas through December 2005.

The total fair value of these instruments at December 31, 2004 and 2003 was a $9 million and a $14 million liability position, respectively. The ineffective portion of commodity cash flow hedges was not material in 2004 and 2003. At December 31, 2004, there were $5 million of after-tax deferred losses in accumulated other comprehensive income (OCI). The entire amount is expected to be reclassified to earnings during the next 12 months as the hedged transactions occur. As part of the divestiture of Winchester Production Company, Ltd. assets in 2004, $7 million of after-tax deferred losses were reclassified into earnings due to discontinuance of the related cash flow hedges (See Note 4A). Due to the volatility of the commodities markets, the value in OCI is subject to change prior to its reclassification into earnings.

B. Interest Rate Derivatives – Fair Value or Cash Flow Hedges

The Company and PEF manage its interest rate exposure in part by maintaining its variable-rate and fixed rate-exposures within defined limits. In addition, the Company and PEF also enter into financial derivative instruments, including, but not limited to, interest rate swaps and lock agreements to manage and mitigate interest rate risk exposure.

The Company and PEF use cash flow hedging strategies to hedge variable interest rates on long-term debt and to hedge interest rates with regard to future fixed-rate debt issuances. The Company and PEF held no interest rate cash flow hedges at December 31, 2004 or 2003. At December 31, 2004, an immaterial amount of after-tax deferred losses in OCI, related to previously terminated hedges at PEF, is expected to be reclassified to earnings during the next 12 months as the hedged interest payments occur.

The Company and PEF use fair value hedging strategies to manage its exposure to fixed interest rates on long-term debt. At December 31, 2004 and 2003, the Company and PEF had no open interest rate fair value hedges.

The notional amounts of interest rate derivatives are not exchanged and do not represent exposure to credit loss. In the event of default by a counterparty, the risk in these transactions is the cost of replacing the agreements at current market rates.

17. RELATED PARTY TRANSACTIONS

The Parent's subsidiaries provide and receive services, at cost, to and from the Company and its subsidiaries, in accordance with agreements approved by the U.S. Securities and Exchange Commission (SEC) pursuant to Section 13(b) of the PUHCA. Services include purchasing, human resources, accounting, legal, transmission and delivery support, engineering materials, contract support, loaned employees payroll costs, constructions management and other centralized administrative, management and support services. The costs of the services are billed on a direct-charge basis, whenever possible, and on allocation factors for general costs which cannot be directly attributed. Billings from affiliates are capitalized or expensed depending on the nature of the services rendered. Amounts receivable from and/or payable to affiliated companies for these services are included in receivables from affiliated companies and payables to affiliated companies on the Consolidated Balance Sheets.

Progress Energy Service Company, LLC (PESC) provides the majority of the affiliated services under the approved agreements. Services provided by PESC during 2004, 2003 and 2002 to Florida Progress amounted to \$199 million, \$190 million and \$173 million, respectively, and services provided to PEF were \$165 million, \$153 million and \$161 million, respectively. Based on a standard review by the Office of Public Utility Regulation within the SEC the method for allocating certain PESC governance costs changed and retroactive reallocations for 2002 and 2001 charges were recorded in 2003. The net after-tax impact of the reallocation on 2003 was an increase in expenses of \$5 million at Florida Progress and a reduction of expenses at PEF by \$1 million. PEF and an affiliated utility also provide and receive services at cost. Services received by PEF during 2004, 2003 and 2002 amounted to \$52 million, \$35 million and \$72 million, respectively. Services provided by PEF during 2004, 2003 and 2002 amounted to \$16 million, \$7 million and \$16 million, respectively.

Progress Fuels sells coal to PEF for insignificant profits. These intercompany revenues and expenses are eliminated in consolidations; however, in accordance with SFAS No. 71 profits on intercompany sales to regulated affiliates are not eliminated if the sales price is reasonable and the future recovery of sales price through the ratemaking process is probable. Sales, net of insignificant profits, of \$331 million, \$346 million and \$329 million for the years ended December 31, 2004, 2003 and 2002, respectively, are included in fuel used in electric generation on Florida Progress' Consolidated and PEF's Statements of Income.

The Company and its subsidiaries participate in money pools, operated by Progress Energy, to more effectively utilize cash resources and to reduce outside short-term borrowings. The money pools are also used to settle intercompany balances. The weighted-average interest rate for the money pools was 1.72%, 1.47% and 2.18% at December 31, 2004, 2003 and 2002, respectively. Amounts payable to the money pool are included in notes payable to affiliated companies on the Balance Sheets. Net interest expense related to money pool borrowings was \$7 million for 2004 and \$5 million for Florida Progress for 2003 and 2002. PEF recorded insignificant interest expense related to the money pool for the three years presented.

As a part of normal business, Progress Energy and certain subsidiaries enter into various agreements providing financial or performance assurances to third parties. These agreements are entered into primarily to support or enhance the creditworthiness otherwise attributed to a subsidiary on a stand-alone basis, thereby facilitating the extension of sufficient credit to accomplish the subsidiaries' intended commercial purposes. As of December 31, 2004 Progress Energy and certain subsidiaries issued guarantees of \$140 million supporting obligations under coal brokering operations and other agreements of subsidiaries. Progress Energy and certain subsidiaries also purchased \$33 million of surety bonds and authorized the issuance of standby letters of credit by financial institutions of \$40 million. Florida Progress has fully guaranteed the medium term notes outstanding for Progress Capital, a wholly owned subsidiary of Florida Progress. At December 31, 2004, management does not believe conditions are likely for significant performance under these agreements. To the extent liabilities are incurred as a result of the activities covered by the guarantees, such liabilities are included in the Consolidated Balance Sheets.

In April 2000, Progress Ventures, Inc. (PVI), a wholly owned subsidiary of Progress Energy, purchased a 90% interest in an affiliate of Progress Fuels that owns a synthetic fuel facility located at the Company-owned mine site in Virginia. In May 2000, PVI purchased a 90% ownership interest in another synthetic fuel facility located in West Virginia. The purchase agreements contained a provision that would require PVI to sell, and the respective Progress Fuels affiliate to repurchase, the 90% interest had the share exchange among Florida Progress, Progress Energy and CP&L not occurred. Progress Fuels has accounted for the transactions as a sale for tax purposes and, because of the repurchase obligation, as a financing for financial reporting purposes in the pre-acquisition period and as a transfer of assets within a controlled group as of the acquisition date. At the date of acquisition, assets of $8 million were transferred to Progress Energy. At December 31, 2004 and 2003, the Company has a note receivable of $28 million and $37 million from PVI that has been recorded as a reduction to equity for financial reporting purposes. Payments included insignificant amounts of interest for the three years presented.

PVI enters into derivative transactions on behalf of Progress Fuels, which are discussed further with the derivatives transactions (See Note 16A). PVI recorded $33 million, $28 million and $9 million of realized and unrealized gains for these derivative transactions in 2004, 2003 and 2002, respectively.

Progress Fuels sells coal feedstock to PVI to be used in its two synthetic fuel operations and is also the sales agent and operator of the facilities. The amount of revenue for sales and services during 2004, 2003 and 2002 was $134 million, $182 million and $197 million, respectively.

During 2003, in order to more effectively utilize cash resources, Progress Fuels and the two PVI synthetic fuel operations began to participate in a money pool with cash management functions provided by Progress Fuels. Amounts payable to the money pool of $61 million and $34 million are included in notes payable to affiliated companies on the Consolidated Balance Sheets. Interest related to the money pool was insignificant for the three years presented.

A Progress Fuels subsidiary sells coal feedstock to an equity investment. The amount of revenue during 2004, 2003 and 2002 was $150 million, $117 million and $101 million, respectively.

Long-term debt, affiliate on the Florida Progress' Consolidated Balance Sheet consists of $500 million for Progress Fuels' unsecured note with Parent and $309 million of debt to an affiliated trust (See Note 12A). Progress Fuels recorded interest expense related to the unsecured note with Parent of $32 million for 2004 and 2003. The annual interest expense to the affiliated trust is $21 million and is reflected in the Consolidated Statements of Income.

Florida Progress Funding Corporation (Funding Corp.) $309 million 7.10% Junior Subordinated Deferrable Interest Notes (Subordinated Notes) are due to FPC Capital I (the Trust) (See Note 12A). The Trust was established for the sole purpose of issuing $300 million Preferred Securities and using the proceeds thereof to purchase from Funding Corp. its Subordinated Notes. The Company has fully and unconditionally guaranteed the obligations of Funding Corp. under the Subordinated Notes (the Notes Guarantee). In addition, the Company has guaranteed the payment of all distributions related to the $300 million Preferred Securities required to be made by the Trust, but only to the extent that the Trust has funds available for such distributions (Preferred Securities Guarantee). The Preferred Securities Guarantee, considered together with the Notes Guarantee, constitutes a full and unconditional guarantee by the Company of the Trust's obligations under the Preferred Securities. The Subordinated Notes and the Notes Guarantee are the sole assets of the Trust. The Subordinated Notes may be redeemed at the option of Funding Corp. at par value plus accrued interest. The proceeds of any redemption of the Subordinated Notes will be used by the Trust to redeem proportional amounts of the Preferred Securities and common securities in accordance with their terms. Upon liquidation or dissolution of Funding Corp., holders of the Preferred Securities would be entitled to the liquidation preference of $25 per share plus all accrued and unpaid dividends thereon to the date of payment.

The Company and each of its wholly owned subsidiaries have entered into a Tax Agreement with Progress Energy (See Note 14).

18. FINANCIAL INFORMATION BY BUSINESS SEGMENT

The Company's principal business segment is PEF, a utility engaged in the generation, purchase, transmission, distribution and sale of electricity primarily in Florida. The other reportable business segments are Progress Fuels' Energy & Related Services and Rail Services. The Energy & Related Services segment includes coal and synthetic fuel operations, natural gas production and sales, river terminal services and off-shore marine transportation. Rail Services' operations include railcar repair, rail parts reconditioning and sales, railcar leasing and sales, providing rail and track material, and scrap metal recycling. The Other category consists primarily of PTC, the Company's telecommunications subsidiary and the holding company, Florida Progress Corporation and eliminations. PTC markets wholesale fiber-optic based capacity service in the Eastern United States and also markets wireless structure attachments to wireless communication companies and governmental entities. The Company allocates a portion of its operating expenses to business segments.

The Company's significant operations are geographically located in the United States with limited operations in Mexico and Canada. The Company's segments are based on differences in products and services, and therefore no additional disclosures are presented. Intersegment sales and transfers consist primarily of coal sales from the Energy and Related Services segment of Progress Fuels to PEF. The price Progress Fuels charges PEF is based on market rates for coal procurement and for water-borne transportation under a methodology approved by the FPSC. Rail transportation is also based on market rates plus a return allowed by the FPSC on equity in transportation equipment utilized in transporting coal to PEF. The allowed rate of return is currently 12%. No single customer accounted for 10% or more of unaffiliated revenues.

Segment net income (loss) for 2004 includes a gain on the sale of certain gas properties and assets of $56 million ($31 million after-tax) and a long-lived asset impairment on goodwill at Diamond May of $8 million before and after tax included in the Energy and Related Services segment. Segment net income (loss) for 2003 includes a long-lived asset impairment on certain assets at Kentucky May Mining Company of $15 million ($10 million after-tax) included in the Energy and Related Services segment. Segment net income (loss) for 2002 includes an estimated impairment on the assets held for sale of Railcar Ltd., of $67 million pre-tax ($45 million after-tax) included in the Rail Services segment and an asset impairment and other charges related to PTC totaling $233 million on a pre-tax basis ($144 million after-tax) included in the Other segment. The Company's business segment information for 2004, 2003 and 2002 is summarized below.

(in millions)	Utility	Energy and Related Services	Rail Services	Other	Consolidated
Year Ended December 31, 2004					
Unaffiliated revenues	**$ 3,525**	**$ 1,223**	**$ 1,130**	**$ 57**	**$ 5,935**
Intersegment revenues	**–**	**331**	**1**	**(332)**	**–**
Total revenues	**3,525**	**1,554**	**1,131**	**(275)**	**5,935**
Depreciation and amortization	**281**	**80**	**21**	**11**	**393**
Total interest charges, net	**114**	**20**	**27**	**19**	**180**
Gain on sale of assets	**–**	**54**	**–**	**–**	**54**
Impairment of goodwill and long-lived assets	**–**	**8**	**–**	**–**	**8**
Income tax expense (benefit)	**174**	**(106)**	**15**	**(13)**	**70**
Income (loss) from continuing operations	**333**	**137**	**16**	**(12)**	**474**
Total segment assets	**7,924**	**855**	**596**	**311**	**9,686**
Capital and investment expenditures	**482**	**157**	**40**	**6**	**685**
Year Ended December 31, 2003					
Unaffiliated revenues	$ 3,152	$ 982	$ 846	$ 28	$ 5,008
Intersegment revenues	–	346	1	(347)	–
Total revenues	3,152	1,328	847	(319)	5,008
Depreciation and amortization	307	66	20	6	399
Total interest charges, net	91	22	29	21	163
Impairment of goodwill and long-lived assets	–	15	–	–	15
Income tax expense (benefit)	147	(246)	2	(13)	(110)
Income (loss) from continuing operations	295	166	(1)	(17)	443
Total segment assets	7,280	977	586	350	9,193
Capital and investment expenditures	526	310	103	11	950

Year Ended December 31, 2002					
Unaffiliated revenues	$ 3,062	$ 690	$ 714	$ 34	$ 4,500
Intersegment revenues	–	329	5	(334)	-
Total revenues	3,062	1,019	719	(300)	4,500
Depreciation and amortization	295	34	20	12	361
Total interest charges, net	106	22	33	22	183
Impairment of goodwill and long-lived assets	–	–	67	214	281
Income tax expense (benefit)	163	(207)	(19)	(110)	(173)
Income (loss) from continuing operations	323	122	(47)	(168)	230
Total segment assets	6,678	794	529	137	8,138
Capital and investment expenditures	535	121	8	42	706

Geographic Data

	U.S.	Canada	Mexico	Consolidated
2004				
Consolidated revenues	**$ 5,807**	**$ 112**	**$ 16**	**$ 5,935**
2003				
Consolidated revenues	$ 4,891	$ 103	$ 14	$ 5,008
2002				
Consolidated revenues	$ 4,393	$ 93	$ 14	$ 4,500

19. OTHER INCOME AND OTHER EXPENSE

Other income and expense includes interest income and other income and expense items as discussed below. The components of other, net as shown on the Statements of Income for fiscal years 2004, 2003 and 2002 are as follows:

(in millions)	**2004**	2003	2002
Other income			
Nonregulated energy and delivery services income	**17**	14	17
AFUDC equity	**7**	12	2
Other	**3**	1	4
Total other income – Progress Energy Florida	**$ 27**	$ 27	$ 23
Other income – Florida Progress	**13**	5	6
Total other income – Florida Progress	**$ 40**	$ 32	$ 29
Other expense			
Nonregulated energy and delivery services expenses	**$ 11**	$ 11	$ 15
Donations	**8**	9	10
Other	**3**	–	5
Total other expense – Progress Energy Florida	**$ 22**	$ 20	$ 30
Loss from equity investments	**12**	15	14
Other expense – Florida Progress	**5**	5	5
Total other expense – Florida Progress	**$ 39**	$ 40	$ 49
Other, net	**$ 1**	$ (8)	$ (20)

Nonregulated energy and delivery services include power protection services and mass market programs (surge protection, appliance services and area light sales) and delivery, transmission and substation work for other utilities.

20. ENVIRONMENTAL MATTERS

The Company and PEF are subject to federal, state and local regulations addressing hazardous and solid waste management, air and water quality and other environmental matters.

HAZARDOUS AND SOLID WASTE MANAGEMENT

The provisions of the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, authorize the EPA to require the cleanup of hazardous waste sites. This statute imposes retroactive joint and several liabilities. The Company and PEF are periodically notified by regulators such as the EPA and various state agencies of its involvement or potential involvement in sites, other than MGP sites, that may require investigation and/or remediation. The Company and PEF are also currently in the process of assessing potential costs and exposures at other environmentally impaired sites. For all sites the assessments are developed and analyzed, the Company and PEF will accrue costs for the sites to the extent the costs are probable and can be reasonably estimated.

Various organic materials associated with the production of manufactured gas, generally referred to as coal tar, are regulated under federal and state laws. The principal regulatory agency that is responsible for a specific former manufactured gas plant (MGP) site depends largely upon the state in which the site is located. There are several MGP sites to which the Company, through PEF, has some connection. In this regard, PEF and other potentially responsible parties (PRPs), are participating in, investigating and, if necessary, remediating former MGP sites with several regulatory agencies, including, but not limited to, the U.S. Environmental Protection Agency (EPA) and the Florida Department of Environmental Protection (FDEP).

The Florida Legislature passed risk-based corrective action (RBCA, known as Global RBCA) legislation in the 2003 regular session. Risk-based corrective action generally means that the corrective action prescribed for contaminated sites can correlate to the level of human health risk imposed by the contamination at the property. The Global RBCA law expands the use of the risk-based corrective action to all contaminated sites in the state that are not currently in one of the state's waste cleanup programs. The FDEP has developed the rules required by the RBCA statute, holding meetings with interested stakeholders and hosting public workshops. The rules have the potential for making future cleanups in Florida more costly to complete. The Global RBCA rule was adopted at the February 2, 2005 Environmental Review Commission hearing. The effective date of the Global RBCA rule is expected to be announced in April 2005. The Company and PEF are in the process of assessing the impact of this matter.

The Company and PEF have filed claims with the Company's general liability insurance carriers to recover costs arising out of actual or potential environmental liabilities. Some claims have been settled and others are still pending. The Company and PEF cannot predict the outcome of this matter.

<u>PEF</u>

At December 31, 2004 and 2003, PEF's accruals for probable and estimable costs related to various environmental sites, which are included in other liabilities and deferred credits and are expected to be paid out over many years, were:

(in millions)	**2004**	2003
Remediation of distribution and substation transformers	**$ 27**	$ 12
MGP and other sites	**18**	6
Total accrual for environmental sites	**$ 45**	$ 18

PEF has received approval from the FPSC for recovery of costs associated with the remediation of distribution and substation transformers through the Environmental Cost Recovery Clause (ECRC). Under agreements with the FDEP, PEF is in the process of examining distribution transformer sites and substation sites for potential equipment integrity issues that could result in the need for mineral oil impacted soil remediation. Through 2004 PEF has reviewed a number of distribution transformer sites and substation sites. PEF expects to have completed its review of distribution transformer sites by the end of 2007 and has completed the review of substation sites in 2004. Should further sites be identified, PEF believes that any estimated costs would also be recovered through the ECRC clause. In 2004, PEF accrued an additional $19 million, due to identification of additional sites requiring remediation, and spent approximately $4 million related to the remediation of transformers. PEF has recorded a regulatory asset for the probable recovery of these costs through the ECRC.

The amounts for MGP and other sites, in the table above, relate to two former MGP sites and other sites associated with PEF that have required or are anticipated to require investigation and/or remediation costs. In 2004, PEF received approximately $12 million in insurance claim settlement proceeds and recorded a related accrual for associated environmental expenses. The proceeds are restricted for use in addressing costs associated with environmental liabilities. Expenditures for the year were less than $1 million.

These accruals have been recorded on an undiscounted basis. PEF measures its liability for these sites based on available evidence including its experience in investigating and remediating environmentally impaired sites. This process often includes assessing and developing cost-sharing arrangements with other PRPs. Because the extent of environmental impact, allocation among PRPs for all sites, remediation alternatives (which could involve either minimal or significant efforts), and concurrence of the regulatory authorities have not yet advanced to the stage where a reasonable estimate of the remediation costs can be made, at this time PEF is unable to provide an estimate of its obligation to remediate these sites beyond what is currently accrued. As more activity occurs at these sites, PEF will assess the need to adjust the accruals. It is anticipated that sufficient information will become available in 2005 to make a reasonable estimate of PEF's obligation for one of the MGP sites.

FLORIDA PROGRESS CORPORATION

In 2001, FPC established a $10 million accrual to address indemnities and retained an environmental liability associated with the sale of its Inland Marine Transportation business. In 2003, the accrual was reduced to $4 million based on a change in estimate. During 2004, expenditures related to this liability were not material to the Company's financial condition. As of December 31, 2004, the remaining accrual balance was approximately $3 million and is included in other liabilities and deferred credits. FPC measures its liability for this site based on estimable and probable remediation scenarios.

Certain historical sites are being addressed voluntarily by FPC. An immaterial accrual has been established to address investigation expenses related to these sites. At this time, the Company cannot determine the total costs that may be incurred in connection with these sites.

RAIL

Rail Services is voluntarily addressing certain historical waste sites. At this time, the Company cannot determine the total costs that may be incurred in connection with these sites.

AIR QUALITY

Congress is considering legislation that would require reductions in air emissions of NOx, SO_2, carbon dioxide and mercury. Some of these proposals establish nationwide caps and emission rates over an extended period of time. This national multi-pollutant approach to air pollution control could involve significant capital costs which could be material to the Company and PEF's consolidated financial position or results of operations. However, the Company and PEF cannot predict the outcome of this matter.

The EPA is conducting an enforcement initiative related to a number of coal-fired utility power plants in an effort to determine whether changes at those facilities were subject to New Source Review requirements or New Source Performance Standards under the Clean Air Act. The Company was asked to provide information to the EPA as part of this initiative and cooperated in supplying the requested information. The EPA initiated civil enforcement actions against other unaffiliated utilities as part of this initiative. Some of these actions resulted in settlement agreements calling for expenditures by these unaffiliated utilities, in excess of $1.0 billion. These settlement agreements have generally called for expenditures to be made over extended time periods, and some of the companies may seek recovery of the related cost through rate adjustments or similar mechanisms. The Company and PEF cannot predict the outcome of this matter.

In 2003, the EPA published a final rule addressing routine equipment replacement under the New Source Review program. The rule defines routine equipment replacement and the types of activities that are not subject to New Source Review requirements or New Source Performance Standards under the Clean Air Act. The rule was challenged in the Federal Appeals Court and its implementation stayed. In July 2004, the EPA announced it will reconsider certain issues arising from the final routine equipment replacement rule. The comment period closed on August 30, 2004. The Company and PEF cannot predict the outcome of this matter.

In 1997, the EPA's Mercury Study Report and Utility Report to Congress concluded that mercury is not a risk to the average person in America and expressed uncertainty about whether reductions in mercury emissions from coal-fired power plants would reduce human exposure. Nevertheless, the EPA determined in 2000 that regulation of mercury emissions from coal-fired power plants was appropriate. In 2003, the EPA proposed alternative control plans that would limit mercury emissions from coal-fired power plants. The final rule was released on March 15, 2005. The EPA's rule establishes a mercury cap and trade program for coal-fired power plants that requires limits to be met in two phases, in 2010 and 2018. The Company and PEF are reviewing the final rule. Installation of additional air quality controls is likely to be needed to meet the mercury rule's requirements. Compliance plans and the cost to comply with the rule will be determined once the Company and PEF complete their review.

In conjunction with the proposed mercury rule, the EPA proposed a MACT standard to regulate nickel emissions from residual oil-fired units. The agency estimates the proposal will reduce national nickel emissions to approximately 103 tons. As proposed, the rule may require the company to install additional pollution controls on its residual oil-fired units, resulting in significant capital expenditures. PEF has eight units that are affected, and they currently do not have pollution controls in place that would meet the proposed requirements of the nickel rule. The EPA expects to finalize the nickel rule in March 2005. Compliance costs will be determined following promulgation of the rule.

In December 2003, the EPA released its proposed Interstate Air Quality Rule, currently referred to as the Clean Air Interstate Rule (CAIR). The final rule was released on March 10, 2005. The EPA's rule requires 28 states and the District of Columbia, including Florida, to reduce NOx and SO_2 emissions in order to attain preset state NOx and SO_2 emissions levels. The Company and PEF are reviewing the final rule. Installation of additional air quality controls is likely to be needed to meet the CAIR requirements. Compliance plans and the cost to comply with the rule, will be determined once the Company and PEF complete the review of the final rule.

WATER QUALITY

As a result of the operation of certain control equipment needed to address the air quality issues outlined above, new wastewater streams may be generated at the affected facilities. Integration of these new wastewater streams into the existing wastewater treatment processes may result in permitting, construction and treatment requirements imposed on PEF in the immediate and extended future.

After many years of litigation and settlement negotiations the EPA adopted regulations in February 2004 to implement Section 316(b) of the Clean Water Act. These regulations became effective September 7, 2004. The purpose of these regulations is to minimize adverse environmental impacts caused by cooling water intake structures and intake systems. Over the next several years these regulations will impact the larger base load generation facilities and may require the facilities to mitigate the effects to aquatic organisms by constructing intake modifications or undertaking other restorative activities. PEF currently estimates that from 2005 through 2009 the range of its expenditures to meet the Section 316(b) requirements of the Clean Water Act will be $65 million to $85 million.

OTHER ENVIRONMENTAL MATTERS

The Kyoto Protocol was adopted in 1997 by the United Nations to address global climate change by reducing emissions of carbon dioxide and other greenhouse gases. In 2004, Russia ratified the Protocol, and the treaty went into effect on February 16, 2005. The United States has not adopted the Kyoto Protocol, and the Bush administration has stated it favors voluntary programs. A number of carbon dioxide emissions control proposals have been advanced in Congress. Reductions in carbon dioxide emissions to the levels specified by the Kyoto Protocol and some legislative proposals could be materially adverse to the Company's consolidated financial position or results of operations if associated costs of control or limitation cannot be recovered from customers. The Company favors the voluntary program approach recommended by the administration and continually evaluates options for the reduction, avoidance and sequestration of greenhouse gases. However, the Company and PEF cannot predict the outcome of this matter.

Progress Energy has announced its plan to issue a report on the Progress Energy's activities associated with current and future environmental requirements. The report will include a discussion of the environmental requirements that the Company and PEF currently face and expect to face in the future, as well as an assessment of potential mandatory constraints on carbon dioxide emissions. The report will be issued by March 31, 2006.

21. COMMITMENTS AND CONTINGENCIES

A. Purchase Obligations

At December 31, 2004, the following table reflects the Company's contractual cash obligations and other commercial commitments in the respective periods in which they are due.

(in millions)	2005	2006	2007	2008	2009	Thereafter
Fuel	$ 1,571	$ 1,023	$ 270	$ 102	$ 116	$ 684
Purchased power	334	342	354	364	331	4,086
Construction obligations	51	–	–	–	–	–
Other purchase obligations	44	38	36	22	20	93
Total	$ 2,000	$ 1,403	$ 660	$ 488	$ 467	$ 4,863

FUEL AND PURCHASED POWER

The Company has entered into various long-term contracts for oil, gas and coal. The Company's payments under these commitments were $1,620 million, $1,157 million and $891 million in 2004, 2003 and 2002, respectively. PEF's payments totaled $372 million, $208 million and $94 million in 2004, 2003 and 2002, respectively. The Company's estimated annual payments for firm commitments of fuel purchases and transportation costs under these contracts make up the fuel line in the previous table. PEF's future payments under these contracts at December 31, 2004 are $375 million, $258 million, $125 million, $102 million and $116 million for 2005 through 2009, respectively, and $684 million thereafter.

Progress Fuels had two coal supply contracts with PEF through 2005, which require PEF to buy and Progress Fuels to supply substantially all of the coal and transportation requirements of four of PEF's generating units. These contracts are renewable annually. Either party may terminate the contract with six months notice. In connection with these contracts, Progress Fuels has entered into several contracts with outside parties for the purchase of coal. The annual obligations for coal purchases and transportation under these contracts are $358 million and $286 million for 2005 and 2006, respectively, with no obligations thereafter. The total cost incurred for these commitments in 2004, 2003 and 2002 was $301 million, $284 million and $289 million, respectively.

PEF has long-term contracts for approximately 489 MW of purchased power with other utilities, including a contract with The Southern Company for approximately 414 MW of purchased power annually through 2015. Total purchases, for both energy and capacity, under these agreements amounted to $129 million, $124 million and $109 million for 2004, 2003 and 2002, respectively. Total capacity payments were $56 million, $55 million and $50 million for 2004, 2003 and 2002, respectively. Minimum purchases under these contracts, representing capital-related capacity costs, at December 31, 2004 are $60 million, $63 million, $65 million, $66 million and $67 million for 2005 through 2009, respectively, and $244 million thereafter.

PEF has ongoing purchased power contracts with certain cogenerators (qualifying facilities) for 821 MW of capacity with expiration dates ranging from 2005 to 2025. These purchased power contracts provide for capacity and energy payments. Energy payments are based on the actual power taken under these contracts. Capacity payments are subject to the qualifying facilities meeting certain contract performance obligations. In most cases, these contracts account for 100% of the generating capacity of each of the facilities. All commitments have been approved by the FPSC. Total capacity purchases under these contracts amounted to $248 million, $244 million and $235 million for 2004, 2003 and 2002, respectively. Minimum expected future capacity payments under these contracts at December 31, 2004 are $271 million, $279 million, $289 million, $298 million and $263 million for 2005 through 2009, respectively, and $3.8 billion thereafter. The FPSC allows the capacity payments to be recovered through a capacity cost recovery clause, which is similar to, and works in conjunction with, energy payments recovered through the fuel cost recovery clause.

On December 2, 2004, PEF entered into precedent and related agreements with Southern Natural Gas Company (SNG), Florida Gas Transmission Company (FGT), and BG LNG Services, LLC, for the supply of natural gas and associated firm pipeline transportation to augment PEF's gas supply needs for the period from May 1, 2007 to April 30, 2027. The total cost to PEF associated with the agreements is approximately $3.3 billion. The transactions are subject to several conditions precedent, which include obtaining the Florida Public Service Commission's approval of the agreements, the completion and commencement of operation of the necessary related expansions to SNG's and FGT's respective natural gas pipeline systems, and other standard closing conditions. Due to the conditions in the agreements, the estimated costs associated with these agreements are not included in the contractual cash obligations table above.

CONSTRUCTION OBLIGATIONS

PEF has purchase obligations related to various plant capital projects at the Hines Complex. Total payments under these contracts were $97 million, $137 million and $130 million for 2004, 2003, and 2002, respectively. Future obligations under these contracts are $51 million for 2005.

OTHER PURCHASE OBLIGATIONS

PEF has long-term service agreements for the Hines Complex. Total payments under these contracts were $11 million, $3 million and $1 million for 2004, 2003 and 2002, respectively. Future obligations under these contracts are $6 million, $18 million, $11 million, $16 million and $14 million for 2005 through 2009, respectively, with approximately $93 million payable thereafter.

PEF has various purchase obligations and contractual commitments related to the purchase and replacement of machinery. At December 31, 2004, no purchases have been made under these contracts. Future obligations under these contracts are $34 million, $20 million and $25 million in 2005, 2006 and 2007, respectively, and $6 million in 2008 and 2009.

The Company incurred expenses related to various other purchase obligations allocated from PESC of $6 million for 2004 and 2003 and $5 million for 2002.

B. Other Commitments

The Company has certain future commitments related to synthetic fuel facilities purchased that provide for contingent payments (royalties). The related agreements and amendments require the payment of minimum annual royalties of which the Company's share is approximately $13 million through 2007. As a result of the amendment, Company recorded a liability (included in other liabilities and deferred credits on the Consolidated Balance Sheets) and a deferred asset (included in other assets and deferred debits in the Consolidated Balance Sheets), each of approximately $37 million and $47 million at December 31, 2004 and 2003, representing the minimum amounts due through 2007, discounted at 6.05%. At December 31, 2004 and 2003, the portions of the asset and liability recorded that were classified as current were approximately $13 million. The deferred asset will be amortized to expense each year as synthetic fuel sales are made. The maximum amounts payable under these agreements remain unchanged. Actual amounts paid under these agreements were none in 2004, $1 million in 2003 and $24 million in 2002. Future expected royalty payments are approximately $13 million for 2005 through 2007. The Company has the right in the related agreements and their amendments that allow the Company to escrow those payments if certain conditions in the agreements are met. The Company has exercised that right and retained 2004 and 2003 royalty payments of approximately $20 million and $22 million, respectively, pending the establishment of the necessary escrow accounts. Once established, these funds will be placed into escrow.

C. Leases

The Company leases transportation equipment, office buildings, computer equipment, and other property and equipment with various terms and expiration dates. The Company generally requires the subsidiaries to pay all executory costs such as maintenance and insurance. Some rental payments include minimum rentals plus contingent rentals based on mileage. These contingent rentals are not significant. Rent expense under operating leases totaled $45 million, $40 million and $49 million during 2004, 2003 and 2002, respectively. These amounts include rent expense allocated from PESC to the Company of $12 million for 2004, 2003 and 2002. PEF's rent expense totaled $14 million, $17 million and $16 million during 2004, 2003 and 2002, respectively. These amounts include rent expense allocated from PESC to PEF of $10 million for 2004, 2003 and 2002.

In addition, PTC has entered into capital leases for equipment. Assets recorded under capital leases totaled $2 million and $4 million at December 31, 2004 and 2003, respectively. Accumulated amortization was not significant. These assets were written down in conjunction with the impairments of PTC recorded during the third quarter of 2002 (See Note 10). PEF does not have any capital leases.

Minimum annual rental payments, excluding executory costs such as property taxes, insurance and maintenance, under long-term noncancelable leases at December 31, 2004 are:

		Operating Leases	
(in millions)	Capital Leases	Florida Progress	Progress Energy Florida
2005	$ 2	$ 22	$ 11
2006	2	19	9
2007	1	36	28
2008	1	37	30
2009	1	36	29
Thereafter	8	170	132
	$ 15	$ 320	$ 239
Less amount representing imputed interest	(5)		
Present value of net minimum lease payments under capital lease	$ 10		

FPC, excluding PEF, is also a lessor of land, buildings, railcars and other types of properties it owns under operating leases with various terms and expiration dates. The leased buildings and railcars are depreciated under the same terms as other buildings and railcars included in diversified business property. Minimum rentals receivable under noncancelable leases for 2005 through 2009, in millions is $31, $22, $13, $8 and $6, respectively and $16 million thereafter. Rents received under operating leases totaled $63 million, $46 million and $53 million for 2004, 2003 and 2002, respectively.

PEF is the lessor of electric poles, streetlights and other facilities. Rents received are based on a fixed minimum rental where price varies by type of equipment and totaled $63 million, $56 million and $52 million for 2004, 2003 and 2002, respectively. Minimum rentals receivable (excluding streetlights) under noncancelable leases for 2005 through 2009, in millions is $5, $1, $1, $1 and $1, respectively, and $8 million thereafter. Streetlight rentals were $40 million, $38 million and $34 million for 2004, 2003 and 2002 respectively. Future streetlight rentals would approximate 2004 revenues.

D. Guarantees

To facilitate commercial transactions of the Company's subsidiaries Progress Energy and certain wholly owned subsidiaries enter into agreements providing future financial or performance assurances to third parties (See Note 17). At December 31, 2004, Progress Fuels had issued guarantees on behalf of third parties with an estimated maximum exposure of approximately $10 million. These guarantees support synthetic fuel operations. At December 31, 2004, management does not believe conditions are likely for significant performance under these agreements.

In connection with the sale of partnership interests in Colona (See Note 4B), Progress Fuels indemnified the buyers against any claims related to Colona resulting from violations of any environmental laws. Although the terms of the agreement provide for no limitation to the maximum potential future payments under the indemnification, the Company has estimated that the maximum total of such payments would not be material.

E. Claims and Uncertainties

OTHER CONTINGENCIES

1. Franchise Litigation

Three cities, with a total of approximately 18,000 customers, have litigation pending against PEF in various circuit courts in Florida. As previously reported, three other cities, with a total of approximately 30,000 customers, have subsequently settled their lawsuits with PEF and signed new, 30-year franchise agreements. The lawsuits principally seek (1) a declaratory judgment that the cities have the right to purchase PEF's electric distribution system located within the municipal boundaries of the cities, (2) a declaratory judgment that the value of the distribution system must be determined through arbitration, and (3) injunctive relief requiring PEF to continue to collect from PEF's customers and remit to the cities, franchise fees during the pending litigation, and as long as PEF continues to occupy the cities' rights-of-way to provide electric service, notwithstanding the expiration of the franchise ordinances under which PEF had agreed to collect such fees. The circuit courts in those cases have entered orders requiring arbitration to establish the purchase price of PEF's electric distribution system within five cities. Two appellate courts have upheld those circuit court decisions and authorized the cities to determine the value of PEF's electric distribution system within the cities through arbitration.

Arbitration in one of the cases (with the 13,000-customer City of Winter Park) was completed in February 2003. That arbitration panel issued an award in May 2003 setting the value of PEF's distribution system within the City of Winter Park (the City) at approximately $32 million, not including separation and reintegration and construction work in progress, which could add several million dollars to the award. The panel also awarded PEF approximately $11 million in stranded costs, which, according to the award, decrease over time. In September 2003, Winter Park voters passed a referendum that would authorize the City to issue bonds of up to approximately $50 million to acquire PEF's electric distribution system. While the City has not yet definitively decided whether it will acquire the system, on April 26, 2004, the City Commission voted to proceed with the acquisition. The City sought and received wholesale power supply bids and on June 24, 2004, executed a wholesale power supply contract with PEF. On May 12, 2004, the City solicited bids to operate and maintain the distribution system and awarded a contract in January 2005. The City has indicated that its goal is to begin electric operations in June 2005. On February 10, 2005, PEF filed a petition with the Florida Public Service Commission to relieve the Company of its statutory obligation to serve customers in Winter Park on June 1, 2005, or at such time when the City is able to provide retail service. At this time, whether and when there will be further proceedings regarding the City of Winter Park cannot be determined.

Arbitration with the 2,500-customer Town of Belleair was completed in June 2003. In September 2003, the arbitration panel issued an award in that case setting the value of the electric distribution system within the Town at approximately $6 million. The panel further required the Town to pay to PEF its requested $1 million in separation and reintegration costs and $2 million in stranded costs. The Town has not yet decided whether it will attempt to acquire the system; however, on January 18, 2005, it issued a request for proposals for wholesale power supply and to operate and maintain the distribution system. Proposals are due in early March 2005. In February 2005, the Town Commission also voted to put the issue of whether to acquire the distribution system to a voter referendum on or before October 2, 2005. At this time, whether and when there will be further proceedings regarding the Town of Belleair cannot be determined.

Arbitration in the remaining city's litigation (the 1,500-customer City of Edgewood) has not yet been scheduled. On February 17, 2005, the parties filed a joint motion to stay the litigation for a 90-day period during which the parties will discuss potential settlement.

A fourth city (the 7,000-customer City of Maitland) is contemplating municipalization and has indicated its intent to proceed with arbitration to determine the value of PEF's electric distribution system within the City. Maitland's franchise expires in August 2005. At this time, whether and when there will be further proceedings regarding the City of Maitland cannot be determined.

As part of the above litigation, two appellate courts reached opposite conclusions regarding whether PEF must continue to collect from its customers and remit to the cities "franchise fees" under the expired franchise ordinances. PEF filed an appeal with the Florida Supreme Court to resolve the conflict between the two appellate courts. On October 28, 2004, the Court issued a decision holding that PEF must collect from its customers and remit to the cities franchise fees during the interim period when the city exercises its purchase option or executes a new franchise agreement. The Court's decision should not have a material impact on the Company.

2. DOE Litigation

Pursuant to the Nuclear Waste Policy Act of 1982, the predecessors to PEF entered into contracts with the U.S. Department of Energy (DOE) under which the DOE agreed to begin taking spent nuclear fuel by no later than January 31, 1998. All similarly situated utilities were required to sign the same standard contract.

DOE failed to begin taking spent nuclear fuel by January 31, 1998. In January 2004, PEF filed a complaint with the United States Court of Federal Claims against the DOE, claiming that the DOE breached the Standard Contract for Disposal of Spent Nuclear Fuel (SNF) by failing to accept SNF from PEF facilities on or before January 31, 1998. Damages due to DOE's breach will likely exceed $100 million. Approximately 60 cases involving the Government's actions in connection with SNF are currently pending in the Court of Federal Claims.

DOE and the PEF parties have agreed to a stay of the lawsuit, including discovery. The parties agreed to, and the trial court entered, a stay of proceedings, in order to allow for possible efficiencies due to the resolution of legal and factual issues in previously-filed cases in which similar claims are being pursued by other plaintiffs. These issues may include, among others, so-called "rate issues," or the minimum mandatory schedule for the acceptance of SNF and high level waste (HLW) by which the Government was contractually obligated to accept contract holders' SNF and/or HLW, and issues regarding recovery of damages under a partial breach of contract theory that will be alleged to occur in the future. These issues are expected to be presented in the trials that are scheduled to occur by April 2005. Resolution of these issues in other cases could facilitate agreements by the parties in the PEF lawsuit, or at a minimum, inform the Court of decisions reached by other courts if they remain contested and require resolution in this case. The trial court has continued this stay until June 24, 2005.

With certain modifications and additional approval by the NRC, including the installation of onsite dry storage facilities at PEF's nuclear unit, Crystal River Unit No. 3 (CR3), PEF's spent nuclear fuel storage facilities will be sufficient to provide storage space for spent fuel generated on PEF's system through the expiration of the operating license for CR3.

In July 2002, Congress passed an override resolution to Nevada's veto of DOE's proposal to locate a permanent underground nuclear waste storage facility at Yucca Mountain, Nevada. In January 2003, the State of Nevada, Clark County, Nevada and the City of Las Vegas petitioned the U.S. Court of Appeals for the District of Columbia Circuit for review of the Congressional override resolution. These same parties also challenged EPA's radiation standards for Yucca Mountain. On July 9, 2004, the Court rejected the challenge to the constitutionality of the resolution approving Yucca Mountain, but ruled that the EPA was wrong to set a 10,000-year compliance period in the radiation protection standard. EPA is currently reworking the standard but has not stated when the work will be complete. DOE originally planned to submit a license application to the NRC to construct the Yucca Mountain facility by the end of 2004. However, in November 2004, DOE announced it would not submit the license application until mid-2005 or later. Also in November 2004, Congressional negotiators approved $577 million for fiscal year 2005 for the Yucca Mountain project, approximately $300 million less than requested by DOE but approximately the same as approved in 2004. The DOE continues to state it plans to begin operation of the repository at Yucca Mountain in 2010. PEF cannot predict the outcome of this matter.

3. <u>Advanced Separation Technologies (AST)</u>

In 1996, Florida Progress sold its 80% interest in AST to Calgon Carbon Corporation (Calgon) for net proceeds of $56 million in cash. In 1998, Calgon filed a lawsuit against Florida Progress and the other selling shareholder and amended it in April 1998, alleging misstatement of AST's 1996 revenues, assets and liabilities, seeking damages and granting Calgon the right to rescind the sale. The lawsuit also accused the sellers of failing to disclose flaws in AST's manufacturing process and a lack of quality control.

All parties filed motions for summary judgment in July 2001. The summary judgment motions of Calgon and the other selling shareholder were denied in April 2002. The summary judgment motion of Florida Progress was withdrawn pending a legal challenge to portions of the report of Calgon's expert, Arthur Andersen, which had been used to oppose summary judgment. In September 2003, the United States District Court for the Western District of Pennsylvania issued final orders excluding from evidence in the case that portion of Arthur Andersen's damage analysis based on the discounted cash flow methodology of valuation. The Court did not exclude Arthur Andersen's use of the guideline publicly traded company methodology in its damage analysis. Florida Progress filed a renewed motion for summary judgment in October 2003, which is pending. Because the motion has now been outstanding for over a year, a ruling on the motion is expected at any time.

Florida Progress believes that the aggregate total of all legitimate warranty claims by customers of AST for which it is probable that Florida Progress will be responsible for under the Stock Purchase Agreement with Calgon is approximately $3 million, and accordingly, accrued $3 million in the third quarter of 1999 as an estimate of probable loss.

The Company cannot predict the outcome of this matter, but will vigorously defend against the allegations.

4. <u>Synthetic Fuel Tax Credits</u>

At December 31, 2003, Florida Progress, through its subsidiaries, was a majority-owner in three entities and a minority owner in three entities that own facilities that produce synthetic fuel as defined under the Internal Revenue Code (Code). In June 2004, Progress Fuels sold, in two transactions, a combined 49.8 percent partnership interest in Colona Synfuel Limited Partnership, LLLP (Colona), one of its majority owned synthetic fuel operations. The Company is now a minority owner in Colona, but continues to consolidate Colona in accordance with FASB Interpretation No. 46R. Florida Progress, through its subsidiaries, is currently a majority owner in two synthetic fuel entities and a minority owner in four synthetic fuel entities, including Colona. The production and sale of the synthetic fuel from these facilities qualifies for tax credits under Section 29 of the Code (Section 29) if certain requirements are satisfied, including a requirement that the synthetic fuel differs significantly in chemical composition from the coal used to produce such synthetic fuel and that the fuel was produced from a facility that was placed-in-service before July 1, 1998. The amount of Section 29 credits that the Company is allowed to claim in any calendar year is limited by the amount of the Company's regular federal income tax liability. Synthetic fuel tax credit amounts allowed but not utilized are carried forward indefinitely as deferred alternative minimum tax credits. All majority-owned and minority-owned entities received private letter rulings (PLRs) from the Internal Revenue Service (IRS) with respect to their synthetic fuel operations. However, these PLR's do not address the placed–in-service date determinations. The PLRs do not limit the production on which synthetic fuel credits may be claimed. Total Section 29 credits generated to date are approximately $918 million, of which $432 million has been used to offset regular federal income tax liability and $481 million are being carried forward as deferred alternative minimum tax credits. Also $5 million has not been recognized due to the decrease in tax liability from the 2004 hurricane damage. The current Section 29 tax credit program expires at the end of 2007.

IMPACT OF HURRICANES

For the year ended December 31, 2004, the Company's synthetic fuel facilities sold 4.9 million tons of synthetic fuel and the Company recorded $127 million of Section 29 tax credits. The amount of synthetic fuel sold and tax credits recorded in 2004 was impacted by hurricane costs which reduced the Company's projected 2004 regular tax liability.

For the nine months ended September 30, 2004, the Company's synthetic fuel facilities sold 4.6 million tons of synthetic fuel, which generated an estimated $119 million of Section 29 tax credits. Due to the anticipated decrease in the Company's tax liability as a result of expenses incurred for the 2004 hurricane damage, the Company estimated that it would be able to use in 2004, or carry forward to future years, only $72 million of these Section 29 tax credits. As a result, the Company recorded a charge of $47 million related to Section 29 tax credits at September 30, 2004.

On November 2, 2004, PEF filed a petition with the FPSC to recover $252 million of storm costs plus interest from customers over a two-year period. Based on a reasonable expectation at December 31, 2004, that the FPSC will grant the requested recovery of the storm costs, the Company's loss from the casualty is less than originally anticipated. As of December 31, 2004, the Company estimates that it will be able to use in 2004, or carry forward to future years, $127 million of these Section 29 tax credits. Therefore, the Company recorded tax credits of $55 million for the quarter ended December 31, 2004, which the Company now anticipates can be used. For the year ended December 31, 2004, the Company's synthetic fuel facilities sold 4.9 million tons of synthetic fuel, which generated an estimated $132 million of Section 29 tax credits. As of December 31, 2004, the Company anticipates that approximately $5 million of tax credits related to synthetic fuel sold during the year could not be used and have not been recognized.

The Company believes its right to recover storm costs is well established, however, the Company cannot predict the outcome of this matter. If the FPSC should deny PEF's petition for the recovery of storm costs in 2005, there could be a material impact on the amount of 2005 synthetic fuels production and results of operations.

IRS PROCEEDINGS

In September 2002, all of Florida Progress' majority-owned synthetic fuel entities at that time, including Colona, and two of the Company's minority owned synthetic fuel entities were accepted into the IRS's Pre-Filing Agreement (PFA) program. The PFA program allows taxpayers to voluntarily accelerate the IRS exam process in order to seek resolution of specific issues.

In February 2004, subsidiaries of the Company finalized execution of the Colona Closing Agreement with the IRS concerning their Colona synthetic fuel facilities. The Closing Agreement provided that the Colona facilities were placed in service before July 1, 1998, which is one of the qualification requirements for tax credits under Section 29 of the Code. The Closing Agreement further provides that the fuel produced by the Colona facilities in 2001 is a "qualified fuel" for purposes of the Section 29 tax credits. This action concluded the PFA program with respect to Colona.

In July 2004, Progress Energy was notified that the IRS field auditors anticipate taking an adverse position regarding the placed-in-service date of the Company's four Earthco synthetic fuel facilities. Due to the auditors' position, the IRS has decided to exercise its right to withdraw from the PFA program with Progress Energy. With the IRS's withdrawal from the PFA program, the review of he Company's Earthco facilities is back on the normal procedural audit path of the Company's tax returns. Through December 31, 2004, based on its ownership percentage, the Company has used or carried forward $550 million of tax credits generated by Earthco facilities.

If these credits were disallowed, Florida Progress' one time exposure for cash tax payments would be $64 million (excluding interest), and earnings and equity would be reduced by $550 million, excluding interest.

On October 29, 2004, Progress Energy received the IRS field auditors' report concluding that the Earthco facilities had not been placed in service before July 1, 1998, and that the tax credits generated by those facilities should be disallowed. The Company disagrees with the field audit team's factual findings and believes that the Earthco facilities were placed in service before July 1, 1998. The Company also believes that the report applies an inappropriate legal standard concerning what constitutes "placed in service." The Company intends to contest the field auditors' findings and their proposed disallowance of the tax credits.

Because of the disagreement between the Company and the field auditors as to the proper legal standard to apply, the Company believes that it is appropriate and helpful to have this issue reviewed by the National Office of the IRS, just as the National Office reviewed the issues involving chemical change. Therefore, the Company is asking the National office to clarify the legal standard and has initiated this process with the National Office. The Company believes that the appeals process, including proceedings before the National Office, could take up to two years to complete, however, it cannot control the actual timing of resolution and cannot predict the outcome of this matter.

In management's opinion, the Company is complying with all the necessary requirements to be allowed such credits under Section 29, and, although it cannot provide certainty, it believes that it will prevail in these matters. Accordingly, while the Company has adjusted its synthetic fuel production for 2004 in response to the effects of the hurricane damage on its 2004 tax liability, it has no current plans to alter its synthetic fuel production schedule for future years as a result of the IRS field auditors' report. However, should the Company fail to prevail in these matters, there could be a material liability for previously taken Section 29 tax credits, with a material adverse impact on earnings and cash flows.

PROPOSED ACCOUNTING RULES FOR UNCERTAIN TAX POSITIONS

In July 2004, the FASB stated that it plans to issue an exposure draft of a proposed interpretation of SFAS No. 109, "Accounting for Income Taxes," that would address the accounting for uncertain tax positions. The FASB has indicated that the interpretation would require that uncertain tax benefits be probable of being sustained in order to record such benefits in the financial statements. The exposure draft is expected to be issued in the first quarter of 2005. The Company cannot predict what actions the FASB will take or how any such actions might ultimately affect the Company's financial position or results of operations, but such changes could have a material impact on the Company's evaluation and recognition of Section 29 tax credits.

PERMANENT SUBCOMMITTEE

In October 2003, the United States Senate Permanent Subcommittee on Investigations began a general investigation concerning synthetic fuel tax credits claimed under Section 29 of the Code. The investigation is examining the utilization of the credits, the nature of the technologies and fuels created, the use of the synthetic fuel, and other aspects of Section 29 and is not specific to the Company's synthetic fuel operations. Progress Energy is providing information in connection with this investigation. The Company cannot predict the outcome of this matter.

SALE OF PARTNERSHIP INTEREST

In June 2004, the Company through its subsidiary, Progress Fuels, sold, in two transactions, a combined 49.8% partnership interest in Colona Synfuel Limited Partnership, LLLP, one of its synthetic fuel facilities. Substantially all proceeds from the sales will be received over time, which is typical of such sales in the industry. Gain from the sales will be recognized on a cost recovery basis. The Company's book value of the interests sold totaled approximately $3 million. The Company received total gross proceeds of $10 million in 2004. Based on projected production and tax credit levels, the Company anticipates receiving approximately $24 million in 2005, approximately $31 million in 2006, approximately $32 million in 2007 and approximately $8 million through the second quarter of 2008. In the event that the synthetic fuel tax credits from the Colona facility are reduced, including an increase in the price of oil that could limit or eliminate synthetic fuel tax credits, the amount of proceeds realized from the sale could be significantly impacted.

IMPACT OF CRUDE OIL PRICES

Although the Internal Revenue Code Section 29 tax credit program is expected to continue through 2007, recent unprecedented and unanticipated increases in the price of oil could limit the amount of those credits or eliminate them altogether for one or more of the years following 2004. This possibility is due to a provision of Section 29 that provides that if the average wellhead price per barrel for unregulated domestic crude oil for the year (the "Annual Average Price") exceeds a certain threshold value (the "Threshold Price"), the amount of Section 29 tax credits are reduced for that year. Also, if the Annual Average Price increases high enough (the "Phase Out Price"), the Section 29 tax credits are eliminated for that year. For 2003, the Threshold Price was $50.14 per barrel and the Phase Out Price was $62.94 per barrel. The Threshold Price and the Phase Out Price are adjusted annually for inflation.

If the Annual Average Price falls between the Threshold Price and the Phase Out Price for a year, the amount by which Section 29 tax credits are reduced will depend on where the Average Annual Price falls in that continuum. For example, for 2003, if the Annual Average Price had been $56.54 per barrel, there would have been a 50% reduction in the amount of Section 29 tax credits for that year.

The Secretary of the Treasury calculates the Annual Average Price based on the Domestic Crude Oil First Purchases Prices published by the Energy Information Agency (EIA). Because the EIA publishes its information on a three month lag, the Secretary of the Treasury finalizes its calculations three months after the year in question ends. Thus, the Annual Average Price for calendar year 2003 was published in April 2004.

Although the official notice for 2004 is not expected to be published until April of 2005, the Company does not believe that the Annual Average Price for 2004 will reach the Threshold Price for 2004. Consequently, the Company does not expect the amount of its 2004 Section 29 tax credits to be adversely affected by oil prices.

The Company cannot predict with any certainty the Annual Average Price for 2005 or beyond. Therefore, it cannot predict whether the price of oil will have a material effect on it synthetic fuel business after 2004. However, if during 2005 through 2007, oil prices remain at historically high levels or increase, the Company's synthetic fuel business may be adversely affected for those years and, depending on the magnitude of such increases in oil prices, the adverse affect for those years could be material and could have an impact on the Company's results of operations and synthetic fuel production plans.

5. Other Legal Matters

Florida Progress and PEF are involved in various other claims and legal actions arising in the ordinary course of business, some of which involve claims for substantial amounts. Where appropriate, accruals have been made in accordance with SFAS No. 5, "Accounting for Contingencies," to provide for such matters. Florida Progress and PEF believe the ultimate disposition of these matters will not have a material adverse effect upon either Company's consolidated and PEF's financial position or results of operations.

22. SUBSEQUENT EVENTS

Sale of Progress Rail

On February 18, 2005, Progress Energy announced it has entered into a definitive agreement to sell Progress Rail to One Equity Partners LLC, a private equity firm unit of J.P. Morgan Chase & Co. Gross cash proceeds from the transaction will be $405 million, subject to working capital adjustments. The sale is expected to close by mid-2005, and is subject to various closing conditions customary to such transactions. Proceeds from the sale are expected to be used to reduce debt. The Company expects to report Progress Rail as a discontinued operation in the first quarter of 2005. The carrying amounts for the assets and liabilities of the discontinued operations disposal group included in the Consolidated Balance Sheets at December 31, are as follows:

(in millions)	**2004**	2003
Total current assets	**$ 378**	$ 373
Total property, plant & equipment (net)	**202**	184
Total other assets	**28**	64
Total current liabilities	**156**	114
Total long-term liabilities	**3**	3
Total capitalization	**449**	504

Cost Management Initiative

On February 28, 2005, as part of a previously announced cost management initiative, the executive officers of Progress Energy approved a workforce restructuring. The restructuring is expected to be completed in September of 2005. In addition to the workforce restructuring, the cost management initiative includes a voluntary enhanced retirement program.

In connection with the cost management initiative, the Company expects to incur one-time pre-tax charges of approximately $54 million. Approximately $9 million of that amount relates to payments for severance benefits, and will be recognized in the first quarter of 2005 and paid over time. The remaining approximately $45 million will be recognized in the second quarter of 2005 and relates primarily to post-retirement benefits that will be paid over time to those eligible employees who elect to participate in the voluntary enhanced retirement program. The total cost management initiative charges could change significantly depending upon how many eligible employees elect early retirement under the voluntary enhanced retirement program and the salary, service years and age of such employees.

23. SUPPLEMENTAL INFORMATION FOR OIL AND GAS PRODUCING ACTIVITIES (UNAUDITED)

The following supplemental unaudited information regarding the Company's oil and gas activities is presented pursuant to disclosure requirements of SFAS No. 69 "Disclosures About Oil and Gas Producing Activities."

A. Capitalized Costs

The aggregate amounts of costs capitalized for oil and gas producing activities, and related aggregate amounts of accumulated depreciation, depletion and amortization (See Notes 4A and 5B), at December 31 follows:

(in millions)	**2004**	2003
Capitalized Costs -		
Proved Properties being amortized	**$ 281**	$ 352
Unproved Properties not being amortized	**55**	60
	336	412
Less - Accumulated depreciation, depletion, and amortization	**(52)**	(35)
Net Capitalized Costs	**$ 284**	$ 377

B. Costs Incurred

There were no oil or gas exploration costs for the years ended 2004, 2003 and 2002. The following costs (in millions) were included in oil and gas producing activities during the years ended December 31,

(in millions)	**2004**	2003	2002
Property acquisition	**$ 7**	$ 169	$ 141
Development	**95**	105	16
Total Costs Incurred	**$ 102**	$ 274	$ 157

C. Results of Operations

The following summarizes the results of operations for the Company's oil and gas producing activities:

(in millions)	**2004**	2003	2002
Revenues - Sales	**$ 151**	$ 107	$ 36
Less:			
Production (lifting) costs	**28**	16	7
Depreciation, depletion, and amortization, and valuation provisions	**41**	33	11
Pretax Operating Income	**82**	58	18
Income tax expenses	**33**	19	6
Results of operations from producing activities (excluding corporate overhead and interest costs)	**$ 49**	$ 39	$ 12

D. Estimated Quantities of Oil and Gas Reserves

At December 31, 2004, the Company had proved oil and gas reserves of 247 Bcfe estimated by Netherland Sewell & Associates, Inc., an independent engineering firm. These reserves are located entirely within the United States. Estimated net quantities of proven oil and gas reserves at December 31 for each of the last three years were as follows in Bcfe. Reserve quantities stated in Bcfe use an energy conversion factor of six units of gas for every one unit of oil.

January 1, 2002	69
Acquisitions	87
Extensions and discoveries	62
Production	(13)
December 31, 2002	205
Acquisitions	189
Extensions and discoveries	65
Production	(25)
Sales	(76)
December 31, 2003	**358**
Acquisitions	**12**
Extensions and discoveries	**58**
Production	**(30)**
Sales	**(151)**
December 31, 2004	**247**
Proved Developed Reserves included above:	
At December 31, 2002	179
At December 31, 2003	225
At December 31, 2004	**137**

E. Standardized Measure of Discounted Future Net Cash Flows (SMOG)

The following standardized disclosures required by FASB do not represent the results of operations based on its historical financial statements. In addition to requiring different determinations of revenue and costs, the disclosures exclude the impact of interest expense and corporate overhead. The following table sets forth, at December 31, 2004, the proven reserves and the present value, discounted at an annual rate of 10%, of future net revenues (revenues less production and development cost) attributable to these reserves.

(in millions)	2004 Proved Developed	2004 Proved Un-developed	2004 Total Proved	2003 Proved Developed	2003 Proved Un-developed	2003 Total Proved	2002 Proved Developed	2002 Proved Un-developed	2002 Total Proved
Future Cash Inflows	**$ 806**	**$ 648**	**$ 1,454**	$ 1,283	$ 781	$ 2,064	$ 480	$ 419	$ 899
Less:									
Future production costs	**277**	**182**	**459**	357	203	560	138	100	238
Future development costs	**24**	**133**	**157**	40	122	162	7	58	65
Future income tax expense at 36%	**182**	**120**	**302**	319	164	483	121	94	215
Future Net Cash Flows	**323**	**213**	**536**	567	292	859	214	167	381
Less: annual discount	**120**	**115**	**235**	300	195	495	79	83	162
Standardized measure of discounted future net cash flows	**$ 203**	**$ 98**	**$ 301**	$ 267	$ 97	$ 364	$ 135	$ 84	$ 219

For purposes of determining the above cash flows, estimates were made of quantities of proved reserves and the periods during which they are expected to produce. Future cash flows were computed by applying year-end prices to estimated annual future production from our proved oil and gas reserves. The year-end prices for crude oil and natural gas used in the estimation were $45.64 per Bbl and $6.21 per MMbtu, based on a December 31, 2004, Henry Hub spot market price. Future development and production costs were computed by applying year-end costs expected to be incurred in producing and further developing the proved reserves. The estimated future net cash flows were computed by application of a 10% per annum discount factor. The calculations assume the continuation of existing economic, operating and contractual conditions. Other assumptions of equal validity could give rise to substantially different results.

For the years ended, December 31, 2003 and 2002, $166 million of the increase to the SMOG was due to acquisition of reserves. For the years ended, December 31, 2004 and 2003, $166 million of the change was due to the sale of reserves and $53 million was due to increased development costs.

24. QUARTERLY FINANCIAL DATA (UNAUDITED)

Summarized quarterly financial data for Florida Progress is as follows:

(in millions)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year ended December 31, 2004				
Operating revenues	**$ 1,308**	**$ 1,495**	**$ 1,670**	**$1,462**
Operating income	**103**	**181**	**260**	**157**
Net income	**55**	**135**	**148**	**136**
Year ended December 31, 2003				
Operating revenues	$ 1,215	$ 1,207	$ 1,391	$ 1,195
Operating income	126	122	193	64
Net income	92	114	174	67

In the opinion of management, all adjustments necessary to fairly present amounts shown for interim periods have been made. Results of operations for an interim period may not give a true indication of results for the year. Certain reclassifications have been made to previously reported amounts to conform to the current year's presentation. Fourth quarter 2004 includes a goodwill impairment charge related to the Company's coal mining business of $8 million before and after tax (See Note 9) and a $31 million after-tax gain on the sale of natural gas assets (See Note 4A). Fourth quarter 2004 also includes the recording of $47 million of Section 29 tax credits (See Note 21E). Third quarter 2004 includes the reversal of $55 million of Section 29 tax credits (See Note 21E). Fourth quarter 2003 includes an impairment related to Kentucky May of $15 million ($10 million after-tax) (See Note 10).

Summarized quarterly financial data for PEF is as follows:

(in millions)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year ended December 31, 2004				
Operating revenues	**$ 784**	**$ 860**	**$ 1,029**	**$852**
Operating income	**103**	**157**	**244**	**114**
Net income	**50**	**84**	**140**	**61**
Year ended December 31, 2003				
Operating revenues	$ 728	$ 767	$ 904	$ 753
Operating income	135	116	184	93
Net income	71	62	115	49

In the opinion of management, all adjustments necessary to fairly present amounts shown for interim periods have been made. Results of operations for an interim period may not give a true indication of results for the year.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE BOARDS OF DIRECTORS OF FLORIDA PROGRESS COPORATION AND FLORIDA POWER ORPORATION d/b/a PROGRESS ENERGY FLORIDA, INC.

We have audited the consolidated financial statements of Florida Progress Corporation and its subsidiaries (Florida Progress) and the financial statements of Florida Power Corporation d/b/a Progress Energy Florida, Inc. (PEF) as of December 31, 2004 and 2003, and for each of the three years in the period ended December 31, 2004, and have issued our reports thereon dated March 7, 2005 (which express an unqualified opinion and include an explanatory paragraph concerning the adoption of a new accounting principle in 2003); such reports are included elsewhere in this Form 10-K. Our audits also included the financial statement schedule of Florida Progress and PEF listed in Item 15. These financial statement schedules are the responsibility of Florida Progress' and PEF's management. Our responsibility is to express an opinion based on our audits. In our opinion, such financial statement schedules, when considered in relation to the basic financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/s/ Deloitte & Touche LLP

Raleigh, North Carolina
March 7, 2005

FLORIDA PROGRESS CORPORATION
Schedule II - Valuation and Qualifying Accounts
For the Years Ended
(in millions)

Description	Balance at Beginning of Period	Additions Charged to Expense	Other Additions	Deductions (a)	Balance at End of Period
Valuation and qualifying accounts deducted in the balance sheet from the related assets:					
DECEMBER 31, 2004					
Uncollectible accounts	**$ 15**	**$ 10**	**$ –**	**$ (6)**	**$ 19**
Fossil dismantlement Reserve	**143**	**1**	**–**	**–**	**144**
Nuclear refueling outage reserve	**2**	**10**	**–**	**–**	**12**
DECEMBER 31, 2003					
Uncollectible accounts	$ 28	$ 12	$ –	$ (25)	$ 15
Fossil dismantlement reserve	142	1	–	–	143
Nuclear refueling outage reserve	10	8	–	(16) (b)	2
DECEMBER 31, 2002					
Uncollectible accounts	$ 26	$ 14	$ –	$ (12)	$ 28
Fossil dismantlement reserve	141	1	–	–	142
Nuclear refueling outage reserve	–	10	–	–	10

(a) Deductions from provisions represent losses or expenses for which the respective provisions were created. In the case of the provision for uncollectible accounts, such deductions are reduced by recoveries of amounts previously written off.
(b) Represents payments of actual expenditures related to the outages.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA
Schedule II - Valuation and Qualifying Accounts
For the Years Ended
(in millions)

Description	Balance at Beginning Of Period	Additions Charged to Expense	Other Additions	Deductions (a)	Balance at End of Period
Valuation and qualifying accounts deducted in the balance sheet from the related assets:					
DECEMBER 31, 2004					
Uncollectible accounts	**$ 2**	**$ 5**	**$ –**	**$ (5)**	**$ 2**
Fossil dismantlement Reserve	**143**	**1**	**–**	**–**	**144**
Nuclear refueling outage reserve	**2**	**10**	**–**	**–**	**12**
DECEMBER 31, 2003					
Uncollectible accounts	$ 2	$ 5	$ –	$ (5)	$ 2
Fossil dismantlement reserve	142	1	–	–	143
Nuclear refueling outage reserve	10	8	–	(16) (b)	2
DECEMBER 31, 2002					
Uncollectible accounts	$ 3	$ 3	$ –	$ (4)	$ 2
Fossil dismantlement reserve	141	1	–	–	142
Nuclear refueling outage reserve	–	10	–	–	10

(a) Deductions from provisions represent losses or expenses for which the respective provisions were created. In the case of the provision for uncollectible accounts, such deductions are reduced by recoveries of amounts previously written off.
(b) Represents payments of actual expenditures related to the outages.

Item 1. FINANCIAL STATEMENTS

FLORIDA PROGRESS CORPORATION
CONSOLIDATED INTERIM FINANCIAL STATEMENTS
June 30, 2005

UNAUDITED CONSOLIDATED STATEMENTS of INCOME

	Three Months Ended June 30		Six Months Ended June 30	
(in millions)	**2005**	2004	**2005**	2004
Operating revenues				
Utility	**$ 908**	$ 860	**$ 1,756**	$ 1,644
Diversified business	**425**	350	**792**	635
Total operating revenues	**1,333**	1,210	**2,548**	2,279
Operating expenses				
Utility				
Fuel used in electric generation	**313**	276	**615**	545
Purchased power	**144**	139	**275**	260
Operation and maintenance	**288**	152	**477**	312
Depreciation and amortization	**71**	72	**141**	141
Taxes other than on income	**66**	64	**133**	126
Diversified business				
Cost of sales	**394**	301	**727**	564
Depreciation and amortization	**24**	21	**47**	41
Gain on the sale of assets	**-**	-	**(5)**	(1)
Other	**20**	21	**48**	41
Total operating expenses	**1,320**	1,046	**2,458**	2,029
Operating income	**13**	164	**90**	250
Other income (expense)				
Interest income	**1**	1	**2**	2
Other, net	**18**	(3)	**17**	(7)
Total other income (expense)	**19**	(2)	**19**	(5)
Interest charges				
Interest charges	**48**	43	**95**	84
Allowance for borrowed funds used during construction	**(2)**	(1)	**(4)**	(2)
Total interest charges, net	**46**	42	**91**	82
(Loss) income from continuing operations before income taxes and minority interest	**(14)**	120	**18**	163
Income tax benefit	**6**	8	**11**	13
(Loss) income from continuing operations before minority interest, net of tax	**(8)**	128	**29**	176
Minority interest in subsidiaries' loss, net of tax	**9**	1	**17**	-
Income from continuing operations	**1**	129	**46**	176
Discontinued operations, net of tax	**(9)**	6	**(36)**	14
Net (loss) income	**$ (8)**	$ 135	**$ 10**	$ 190

See Notes to Interim Financial Statements.

FLORIDA PROGRESS CORPORATION
UNAUDITED CONSOLIDATED BALANCE SHEETS

(in millions) **ASSETS**	**June 30 2005**	December 31 2004
Utility plant		
Utility plant in service	**$ 8,399**	$ 8,387
Accumulated depreciation	**(3,357)**	(2,978)
Utility plant in service, net	**5,042**	5,409
Held for future use	**1**	8
Construction work in progress	**561**	420
Nuclear fuel, net of amortization	**67**	45
Total utility plant, net	**5,671**	5,882
Current assets		
Cash and cash equivalents	**23**	24
Receivables, net	**537**	476
Receivables from affiliated companies	**72**	40
Deferred income taxes	**65**	60
Inventory	**367**	341
Deferred fuel cost	**93**	89
Assets of discontinued operations	**-**	590
Prepayments and other current assets	**122**	33
Total current assets	**1,279**	1,653
Deferred debits and other assets		
Regulatory assets	**439**	524
Nuclear decommissioning trust funds	**473**	463
Diversified business property, net	**653**	576
Miscellaneous other property and investments	**103**	95
Other assets and deferred debits	**514**	492
Total deferred debits and other assets	**2,182**	2,150
Total assets	**$ 9,132**	$ 9,685
CAPITALIZATION AND LIABILITIES		
Common stock equity		
Common stock without par value	**$ 1,726**	$ 1,712
Retained earnings	**986**	976
Accumulated other comprehensive loss	**(19)**	(7)
Total common stock equity	**2,693**	2,681
Preferred stock of subsidiaries - not subject to mandatory redemption	**34**	34
Minority interest	**36**	32
Long-term debt, affiliate	**440**	809
Long-term debt, net	**2,294**	2,052
Total capitalization	**5,497**	5,608
Current liabilities		
Current portion of long-term debt	**48**	49
Accounts payable	**327**	333
Payables to affiliated companies	**73**	71
Notes payable to affiliated companies	**391**	431
Short-term obligations	**261**	293
Customer deposits	**141**	135
Liabilities of discontinued operations	**-**	152
Other current liabilities	**394**	406
Total current liabilities	**1,635**	1,870
Deferred credits and other liabilities		
Noncurrent income tax liabilities	**59**	64
Accumulated deferred investment tax credits	**33**	36
Regulatory liabilities	**1,128**	1,362
Asset retirement obligations	**278**	358
Other liabilities and deferred credits	**502**	387
Total deferred credits and other liabilities	**2,000**	2,207
Commitments and contingencies (Note 14)		
Total capitalization and liabilities	**$ 9,132**	$ 9,685

See Notes to Interim Financial Statements.

FLORIDA PROGRESS CORPORATION
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)		
Six Months Ended June 30,	**2005**	2004
Operating activities		
Net income	**$ 10**	$ 190
Adjustments to reconcile net income to net cash provided by operating activities:		
Discontinued operations, net of tax	**36**	(14)
Charges for voluntary enhanced retirement program	**93**	-
Depreciation and amortization	**205**	196
Deferred income taxes and investment tax credits, net	**(99)**	(151)
Tax levelization	**45**	23
Deferred fuel cost	**36**	26
Other adjustments to net income	**51**	6
Cash provided/(used) by changes in operating assets and liabilities:		
Receivables	**(43)**	(113)
Receivables from affiliated companies	**(16)**	(2)
Inventory	**(43)**	(27)
Prepayments and other current assets	**(26)**	(2)
Accounts payable	**79**	49
Payables to affiliated companies	**2**	51
Other current liabilities	**(60)**	193
Regulatory assets and liabilities	**(54)**	6
Other	**(13)**	11
Net cash provided by operating activities	**203**	442
Investing activities		
Utility property additions	**(253)**	(230)
Diversified business property additions	**(112)**	(85)
Nuclear fuel additions	**(34)**	–
Proceeds from sales of subsidiaries and other investments, net of cash divested	**435**	84
Other	**(11)**	(13)
Net cash provided by (used in) investing activities	**25**	(244)
Financing activities		
Issuance of long-term debt, net	**297**	1
Net (decrease) increase in short-term obligations	**(32)**	231
Retirement of long-term debt	**(426)**	(26)
Net change in intercompany notes	**(57)**	(309)
Dividends paid to parent	–	(78)
Other	**19**	7
Net cash used in financing activities	**(199)**	(174)
Cash used by discontinued operations:		
Operating activities	**(26)**	(4)
Investing activities	**(4)**	(8)
Financing activities	**-**	-
Net (decrease) increase in cash and cash equivalents	**(1)**	12
Cash and cash equivalents at beginning of period	**24**	15
Cash and cash equivalents at end of period	**$ 23**	$ 27

See Notes to Interim Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA, INC.
INTERIM FINANCIAL STATEMENTS
June 30, 2005

UNAUDITED STATEMENTS of INCOME

(in millions)	Three Months Ended June 30 2005	Three Months Ended June 30 2004	Six Months Ended June 30 2005	Six Months Ended June 30 2004
Operating revenues	**$ 908**	$ 860	**$ 1,756**	$ 1,644
Operating expenses				
Fuel used in electric generation	**313**	276	**615**	545
Purchased power	**144**	139	**275**	260
Operation and maintenance	**288**	152	**477**	312
Depreciation and amortization	**71**	72	**141**	141
Taxes other than on income	**66**	64	**133**	126
Total operating expenses	**882**	703	**1,641**	1,384
Operating income	**26**	157	**115**	260
Other income (expense)				
Other, net	**24**	-	**27**	(1)
Total other income (expense)	**24**	-	**27**	(1)
Interest charges				
Interest charges	**34**	29	**68**	60
Allowance for borrowed funds used during construction	**(2)**	(1)	**(4)**	(2)
Total interest charges, net	**32**	28	**64**	58
Income before income taxes	**18**	129	**78**	201
Income tax expense	**8**	45	**24**	67
Net income	**$ 10**	$ 84	**$ 54**	$ 134
Preferred stock dividend requirement	**-**	-	**1**	1
Earnings for common stock	**$ 10**	$ 84	**$ 53**	$ 133

See Notes to Interim Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA, INC.
UNAUDITED BALANCE SHEETS

(in millions)	June 30	December 31
ASSETS	**2005**	2004
Utility plant		
Utility plant in service	$ 8,399	$ 8,387
Accumulated depreciation	(3,357)	(2,978)
Utility plant in service, net	5,042	5,409
Held for future use	1	8
Construction work in progress	561	420
Nuclear fuel, net of amortization	67	45
Total utility plant, net	5,671	5,882
Current Assets		
Cash and cash equivalents	10	12
Receivables, net	306	266
Receivables from affiliated companies	37	16
Deferred income taxes	48	42
Inventory	281	279
Deferred fuel cost	93	89
Prepayments and other current assets	96	12
Total current assets	871	716
Deferred debits and other assets		
Regulatory assets	439	524
Nuclear decommissioning trust funds	473	463
Miscellaneous other property and investments	46	46
Prepaid pension costs	194	234
Other assets and deferred debits	48	59
Total deferred debits and other assets	1,200	1,326
Total assets	$ 7,742	$ 7,924
CAPITALIZATION AND LIABILITIES		
Common stock equity		
Common stock without par value	$ 1,096	$ 1,081
Retained earnings	1,293	1,240
Total common stock equity	2,389	2,321
Preferred stock - not subject to mandatory redemption	34	34
Long-term debt, net	2,152	1,912
Total capitalization	4,575	4,267
Current liabilities		
Current portion of long-term debt	48	48
Accounts payable	212	262
Payables to affiliated companies	90	80
Notes payable to affiliated companies	-	178
Short-term obligations	261	293
Customer deposits	141	135
Other current liabilities	193	161
Total current liabilities	945	1,157
Deferred credits and other liabilities		
Noncurrent income tax liabilities	458	489
Accumulated deferred investment tax credits	33	35
Regulatory liabilities	1,128	1,362
Asset retirement obligations	256	337
Other liabilities and deferred credits	347	277
Total deferred credits and other liabilities	2,222	2,500
Commitments and contingencies (Note 14)		
Total capitalization and liabilities	$ 7,742	$ 7,924

See Notes to Interim Financial Statements.

FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA, INC.
UNAUDITED STATEMENTS of CASH FLOWS

(in millions)

Six Months Ended June 30,	**2005**	2004
Operating activities		
Net income	**$ 54**	$ 134
Adjustments to reconcile net income to net cash provided by operating activities:		
Charges for voluntary enhanced retirement program	**90**	-
Depreciation and amortization	**158**	155
Deferred income taxes and investment tax credits, net	**(55)**	1
Deferred fuel cost	**36**	26
Other adjustments to net income	**39**	–
Cash provided/(used) by changes in operating assets and liabilities:		
Receivables	**(42)**	(48)
Receivables from affiliated companies	**5**	1
Inventory	**(15)**	(11)
Prepayments and other current assets	**(24)**	2
Accounts payable	**32**	33
Payables to affiliated companies	**10**	54
Other current liabilities	**5**	82
Regulatory assets and liabilities	**(54)**	6
Other	**5**	7
Net cash provided by operating activities	**244**	442
Investing activities		
Property additions	**(253)**	(230)
Nuclear fuel additions	**(34)**	–
Proceeds from sales of assets	**42**	–
Other	**(4)**	–
Net cash used in investing activities	**(249)**	(230)
Financing activities		
Issuance of long-term debt, net	**297**	1
Net (decrease) increase in short-term obligations	**(32)**	231
Retirement of long-term debt	**(57)**	(1)
Net change in intercompany notes	**(204)**	(363)
Dividends paid to parent	**-**	(78)
Dividends paid on preferred stock	**(1)**	(1)
Net cash provided by (used in) financing activities	**3**	(211)
Net (decrease) increase in cash and cash equivalents	**(2)**	1
Cash and cash equivalents at beginning of period	**12**	10
Cash and cash equivalents at end of period	**$ 10**	$ 11

See Notes to Interim Financial Statements.

FLORIDA PROGRESS CORPORATION AND FLORIDA POWER CORPORATION
d/b/a PROGRESS ENERGY FLORIDA, INC.
NOTES TO INTERIM FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

A. Basis of Presentation

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Because the accompanying consolidated interim financial statements do not include all of the information and footnotes required by GAAP for annual statements, they should be read in conjunction with the audited financial statements and notes thereto included in Florida Progress' (the Company) and Progress Energy Florida's (PEF) Form 10-K for the year ended December 31, 2004.

In accordance with the provisions of Accounting Principles Board (APB) Opinion No. 28, "Interim Financial Reporting," GAAP requires companies to apply a levelized effective tax rate to interim periods that is consistent with the estimated annual effective tax rate. The intra-period tax allocation, which will have no impact on total year net income, maintains an effective tax rate consistent with the estimated annual effective tax rate. For the three months ended June 30, 2005 and 2004, the Company's income tax expense was increased by $39 million and decreased by $11 million, respectively. For the six months ended June 30, 2005 and 2004, the Company's income tax expense increased by $45 million and $23 million, respectively. The income tax provisions for the Company differ from amounts computed by applying the federal statutory tax rate to income before income taxes, primarily due to the recognition of synthetic fuel tax credits.

PEF's income tax expense was increased by $8 million for the three and six months ended June 30, 2005 in order to maintain an effective tax rate consistent with the estimated annual rate.

PEF collects from customers certain excise taxes levied by the state or local government upon the customer. PEF accounts for excise taxes on a gross basis. For the three months ended June 30, 2005 and 2004, gross receipts tax and franchise taxes of approximately $38 million and $37 million, respectively, are included in electric operating revenues and taxes other than on income on the Statements of Income. For the six months ended June 30, 2005 and 2004, gross receipts tax and franchise taxes of approximately $73 million and $69 million, respectively, are included in electric operating revenues and taxes other than as income on the Statements of Income.

The amounts included in the consolidated interim financial statements are unaudited but, in the opinion of management, reflect all normal recurring adjustments necessary to fairly present Florida Progress' and PEF's financial position and results of operations for the interim periods. Due to seasonal weather variations and the timing of outages of electric generating units, especially the nuclear-fueled unit, the results of operations for interim periods is not necessarily indicative of amounts expected for the entire year or future periods.

In preparing financial statements that conform with GAAP, management must make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses reflected during the reporting period. Actual results could differ from those estimates. Certain reclassifications for 2004 have been made to conform to the 2005 presentation.

B. Stock-Based Compensation

The Company and PEF measure compensation expense for stock options as the difference between the market price of Progress Energy's common stock and the exercise price of the option at the grant date. The exercise price at which options are granted by Progress Energy equals the market price at the grant date, and accordingly, no compensation expense has been recognized for stock option grants. For purposes of the pro forma disclosures required by SFAS No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure – an Amendment of FASB Statement No. 123" (SFAS No. 148), the estimated fair value of the Company's and PEF's stock options is amortized to expense over the options' vesting period. The following table illustrates the effect on net income and earnings per share if the fair value method had been applied to all outstanding and unvested awards in each period:

(in millions) FLORIDA PROGRESS CORPORATION	Three Months Ended June 30 **2005**	2004	Six Months Ended June 30 **2005**	2004
Net (loss) income, as reported	**$ (8)**	$ 135	**$ 10**	$ 190
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	**-**	1	**1**	2
Pro forma net (loss) income	**$ (8)**	$ 134	**$ 9**	$ 188

(in millions) PROGRESS ENERGY FLORIDA, INC.	Three Months Ended June 30 **2005**	2004	Six Months Ended June 30 **2005**	2004
Net income, as reported	**$ 10**	$ 84	**$ 54**	$ 134
Deduct: Total stock option expense determined under fair value method for all awards, net of related tax effects	**-**	1	**1**	2
Pro forma net income	**$ 10**	$ 83	**$ 53**	$ 132

The Company and PEF expect to begin expensing stock options during the third quarter of 2005 (See Note 2).

C. Consolidation of Variable Interest Entities

Florida Progress and PEF consolidate all voting interest entities in which they own a majority voting interest and all variable interest entities for which they are the primary beneficiary in accordance with FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities – an Interpretation of ARB No. 51" (FIN No. 46R). A subsidiary of Florida Progress is the primary beneficiary of and consolidates Colona Synfuel Limited Partnership LLLP (Colona), a synthetic fuel production facility that qualifies for federal tax credits under Section 29 of the Internal Revenue Code. As of June 30, 2005, Colona's total assets were $30 million. None of Florida Progress' consolidated assets are collateral for Colona's obligations.

Florida Progress and PEF have interests in several variable interest entities for which they are not the primary beneficiary. These arrangements include investments in approximately five limited partnerships, limited liability corporations and venture capital funds. The aggregate maximum loss exposure at June 30, 2005, that Florida Progress could be required to record in its consolidated income statement as a result of these arrangements totals approximately $13 million. The aggregate maximum loss exposure at June 30, 2005, that PEF could be required to record in its income statement as a result of these arrangements totals approximately $6 million. The creditors of these variable interest entities do not have recourse to the general credit of Florida Progress or PEF in excess of the aggregate maximum loss exposure.

2. IMPACT OF NEW ACCOUNTING STANDARDS

FASB EXPOSURE DRAFT ON ACCOUNTING FOR UNCERTAIN TAX POSITIONS, AN INTERPRETATION OF SFAS NO. 109, "ACCOUNTING FOR INCOME TAXES"

On July 14, 2005, the Financial Accounting Standards Board (FASB) issued an exposure draft of a proposed interpretation of SFAS No. 109, "Accounting for Income Taxes" (SFAS No. 109), that would address the accounting for uncertain tax positions. The proposed interpretation would require that uncertain tax benefits be probable of being sustained in order to record such benefits in the consolidated financial statements. The Company currently accounts for uncertain tax benefits in accordance with SFAS No. 5, "Accounting for Contingencies" (SFAS No. 5). Under SFAS No. 5, contingent losses are recorded when it is probable that the tax position will not be sustained and the amount of the disallowance can be reasonably estimated. The exposure draft has a 60-day public comment period ending September 12, 2005. As currently drafted, the proposed interpretation would apply to all uncertain tax positions and be effective for the Company on December 31, 2005.

As discussed in Note 14, the Internal Revenue Service (IRS) field auditors have recommended that the Section 29 tax credits generated by the Company's Earthco facilities, totaling $595 million through June 30, 2005, be disallowed. The Company disagrees with the field audit team's findings and has requested that the National Office of the IRS review this issue. The Company has not yet determined how the proposed interpretation would impact its various income tax positions, including the status of the Earthco tax credits. Depending on the provisions of the FASB's final interpretation and the Company's facts and circumstances that exist at the date of implementation, including the Company's assessment of the probability of sustaining any currently recorded and future tax benefits, the proposed interpretation could have a material adverse impact on the Company's financial position and results of operations.

STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 123 (REVISED 2004), "SHARE-BASED PAYMENT" (SFAS NO. 123R)

In December 2004, the FASB Issued SFAS No. 123R, which revises SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123) and supersedes Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." The key requirement of SFAS No. 123R is that the cost of share-based awards to employees will be measured based on an award's fair value at the grant date, with such cost to be amortized over the appropriate service period. Previously, entities could elect to continue accounting for such awards at their grant date intrinsic value under APB Opinion No. 25, and the Company made that election. The intrinsic value method resulted in the Company and PEF recording no compensation expense for stock options granted to employees (See Note 1B).

As written, SFAS No. 123R had an original effective date of July 1, 2005 for the Company. In April 2005, the SEC delayed the effective date for public companies, which resulted in a required effective date of January 1, 2006 for the Company. The SEC delayed the effective date due to concerns that implementation in mid-year could make compliance more difficult and make comparisons of quarterly reports more difficult. The Company is planning to implement SFAS No. 123R during the third quarter of 2005, effective as of July 1, 2005. The Company will implement the standard using the required modified prospective method. Under that method, the Company will record compensation expense under SFAS No. 123R for all awards it grants after the effective date, and it will record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the effective date. In 2004, Progress Energy made the decision to cease granting stock options and replaced that compensation with alternative forms of compensation. Therefore, the amount of stock option expense expected to be recorded in 2005 is below the amount that would have been recorded if the stock option program had continued. Assuming a July 1, 2005 effective date, the Company and PEF expect to record less than $1 million of pre-tax expense for stock options in 2005.

FASB INTERPRETATION NO. 47, "ACCOUNTING FOR CONDITIONAL ASSET RETIREMENT OBLIGATIONS"

On March 30, 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations," an interpretation of SFAS No. 143, "Accounting for Asset Retirement Obligations." The interpretation clarifies that a legal obligation to perform an asset retirement activity that is conditional on a future event is within the scope of SFAS No. 143. Accordingly, an entity is required to recognize a liability for the fair value of an asset retirement obligation that is conditional on a future event if the liability's fair value can be reasonably estimated. The interpretation also provides additional guidance for evaluating whether sufficient information is available to make a reasonable estimate of the fair value. The interpretation is effective for Florida Progress and PEF no later than December 31, 2005. Neither Florida Progress nor PEF has yet determined the impact of the interpretation on its financial position, results of operations or liquidity.

3. DIVESTITURE

Progress Rail Divestiture

On March 24, 2005, the Company completed the sale of Progress Rail to One Equity Partners LLC, a private equity unit of J.P. Morgan Chase & Co. Gross cash proceeds from the sale are estimated to be approximately $430 million, consisting of $405 million base proceeds plus an estimated working capital adjustment. Proceeds from the sale were used to reduce debt.

Based on the estimated gross proceeds associated with the sale of $430 million, the Company recorded an estimated after-tax loss on disposal of $41 million during the six months ended June 30, 2005. The Company anticipates adjustments to the loss on the divestiture during the third quarter of 2005 related to employee benefit settlements and the finalization of the working capital adjustment and other operating estimates.

The accompanying consolidated interim financial statements of Florida Progress have been restated for all periods presented to reflect the operations of Progress Rail as discontinued operations. Interest expense has been allocated to discontinued operations based on the net assets of Progress Rail, assuming a uniform debt-to-equity ratio across the Company's operations. Interest expense allocated for the three months ended June 30, 2004 was $4 million.

Interest expense allocated for the six months ended June 30, 2005 and 2004 was $4 million and $8 million, respectively. The Company ceased recording depreciation upon classification of the assets as discontinued operations in February 2005. After-tax depreciation expense recorded by Progress Rail during the three months ended June 30, 2004 was $3 million. After-tax depreciation during the six months ended June 30, 2005 and 2004 was $3 million and $6 million, respectively. Results of discontinued operations were as follows:

(in millions)	Three Months Ended June 30		Six Months Ended June 30	
	2005	2004	**2005**	2004
Revenues	**$ –**	$ 285	**$ 358**	$525
Earnings before income taxes	**$ –**	$ 13	**$ 7**	24
Income tax expense	**–**	7	**2**	10
Net earnings from discontinued operations	**–**	6	**5**	14
Estimated loss on disposal of discontinued operations, including income tax benefit of $0 and $21 for the three and six month ended June 30, 2005, respectively	**(9)**	–	**(41)**	–
(Loss) earnings from discontinued operations	**$ (9)**	$ 6	**$ (36)**	$ 14

In connection with the sale, Progress Fuels and Progress Energy provided guarantees and indemnifications of certain legal, tax and environmental matters to One Equity Partners LLC. See discussion of the Company's guarantees at Note 14A. The ultimate resolution of these matters could result in adjustments to the loss on sale in future periods.

The major balance sheet classes included in assets and liabilities of discontinued operations in the Consolidated Balance Sheet as of December 31, 2004 are as follows:

(in millions)	
Accounts receivable	$ 172
Inventory	177
Other current assets	15
Total property, plant and equipment, net	199
Total other assets	27
Assets of discontinued operations	$ 590
Accounts payable	$ 113
Accrued expenses	37
Total long-term liabilities	2
Liabilities of discontinued operations	$ 152

In February 2004, the Company sold the majority of the assets of Railcar Ltd., a subsidiary of Progress Rail, to The Andersons, Inc. for proceeds of approximately $82 million.

Winter Park Divestiture

As discussed in Note 5, PEF certain electric distribution assets to the City of Winter Park, Florida on June 1, 2005.

4. ACQUISITIONS

In May 2005, Winchester Production Company, Ltd., an indirectly wholly owned subsidiary of Progress Fuels Corporation, acquired an interest in approximately 11 natural gas producing wells and proven reserves of approximately 25 billion cubic feet equivalent from a privately-owned company headquartered in Texas. In addition to the natural gas reserves, the transaction also included a 50% interest in the gas gathering systems related to these reserves. The total cash purchase price for the transaction was $46 million.

5. REGULATORY MATTERS

PEF Retail Rate Matters

On July 14, 2005, the Florida Public Service Commission (FPSC) issued an order authorizing PEF to recover $232 million, including interest, of the costs it incurred and previously deferred related to PEF's restoration of power to customers associated with the four hurricanes in 2004. The ruling will allow PEF to include a charge of approximately $3.27 on the average residential monthly customer bill beginning August 1, 2005. The ruling by the FPSC approved the majority of the Company's request with two exceptions: the reclassification of $8 million from operation and maintenance expense (O&M) to utility plant and reclassification of $17 million as normal O&M expense. As a result of these adjustments, approximately $17 million was charged to O&M expense in June 2005, representing the retail portion of these adjustments.

The amount included in the original petition requesting recovery of $252 million in November 2004 was an estimate, as actual total costs were not known at that time. The Company currently estimates that it has incurred an additional $18 million in costs in excess of the amount requested in the petition. The difference between the actual costs and the amount requested will be trued-up in September 2005, subject to FPSC approval, and the impact will be included in customer bills beginning January 1, 2006.

On June 1, 2005, Florida Governor Jeb Bush signed into law a bill that would allow utilities to petition the FPSC to use securitized bonds to recover storm related costs. PEF intends to ask the FPSC for approval to issue securitized debt. This arrangement would benefit the Company by providing immediate cash recovery of the hurricane costs and would benefit the customer by providing a longer recovery period, which will reduce the price impact on monthly bills. Assuming FPSC approval, PEF expects the process to take six to nine months to complete.

On June 1, 2005, the City of Winter Park, Florida (the City) acquired PEF's electric distribution system that serves the City for approximately $42 million. PEF transferred the distribution system to the City on June 1, 2005, and recognized a pre-tax gain of approximately $25 million on the transaction, which is included in other, net on the Consolidated Statements of Income. This amount is subject to adjustment pending accumulation of the final capital expenditures incurred since arbitration. The Company also recorded a regulatory liability of $8 million for stranded cost revenues which will be amortized to revenues over the next six years in accordance with the provisions of the transfer agreement with the City.

On April 29, 2005, PEF submitted minimum filing requirements, based on a 2006 projected test year, to initiate a base rate proceeding regarding its future base rates. In its filing, PEF has requested a $206 million annual increase in base rates effective January 1, 2006. PEF's request for an increase in base rates reflects an increase in operational costs with (i) the addition of Hines 2 generation facility into base rates rather than the Fuel Clause as was permitted under the terms of existing Stipulation and Settlement Agreement (the Agreement) (ii) completion of the Hines 3 generation facility, (iii) the need, in light of recent history, to replenish PEF's depleted storm reserve on a going-forward basis by adjusting the annual accrual, (iv) the expected infrastructure investment necessary to meet high customer expectations, coupled with the demands placed on PEF's system due to strong customer growth, (v) significant additional costs including increased depreciation and fossil dismantlement expenses and (vi) general inflationary pressures.

Hearings on the base rate proceeding are scheduled from September 7 through September 16, 2005, and a final decision is expected by the end of 2005. Although the Company cannot predict the outcome of this matter, an adverse outcome could negatively impact the Company's and PEF's financial condition and results of operations.

The FPSC requires that PEF perform a depreciation study no less than every four years. PEF filed a depreciation study with the FPSC on April 29, 2005, as part of the Company's base rate filing, which will increase depreciation expense by $14 million beginning in 2006 if approved by the FPSC. The Company cannot predict the outcome or impact of this matter. PEF reduced its estimated removal costs to take into account the estimates used in the depreciation study. This resulted in a downward revision in the PEF estimated removal costs, a component of regulatory liabilities, and equal increase in accumulated depreciation of approximately $401 million.

The FPSC requires that PEF update its cost estimate for fossil plant dismantlement every four years. PEF filed an updated fossil plant dismantlement study with the FPSC on April 29, 2005, as part of the Company's base rate filing. The new study calls for an increase in the annual accrual of $10 million beginning in 2006. PEF's retail reserve for fossil plant dismantlement was approximately $133 million at June 30, 2005. Retail accruals on PEF's reserves for fossil plant dismantlement were previously suspended through December 2005 under the terms of PEF's existing Agreement. The Company cannot predict the outcome or impact of this matter.

The FPSC requires that PEF update its cost estimate for nuclear decommissioning every five years. PEF filed a new site-specific estimate of decommissioning costs for the Crystal River Nuclear Plant Unit No. 3 (CR3) with the FPSC on April 29, 2005 as part of the Company's base rate filing. PEF's estimate was based on prompt decommissioning. The estimate, in 2005 dollars, is $614 million and is subject to change based on a variety of factors including, but not limited to, cost escalation, changes in technology applicable to nuclear decommissioning and changes in federal, state or local regulations. The cost estimate excludes the portion attributable to other co-owners of CR3. The NRC operating license held by PEF for CR3 currently expires in December 2016. An application to extend this license 20 years is expected to be submitted in the first quarter of 2009. As part of this new estimate and assumed license extension, PEF reduced its ARO liability by approximately $88 million. Retail accruals on PEF's reserves for nuclear decommissioning were previously suspended through December 2005 under the terms of the Agreement and the new study supports a continuation of that suspension. The Company cannot predict the outcome or impact of this matter.

6. COMPREHENSIVE INCOME

Florida Progress Corporation (in millions)	Three Months Ended June 30, 2005	2004
Net (loss) income	**$ (8)**	$ 135
Other comprehensive loss:		
Reclassification adjustments included in net income:		
Change in cash flow hedges (net of tax expense of $2 and $1, respectively)	**2**	2
Changes in net unrealized losses on cash flow hedges (net of tax benefit of $0 and $3, respectively)	**–**	(6)
Foreign currency translation adjustment and other	**1**	–
Other comprehensive loss	**$ 3**	$ (4)
Comprehensive (loss) income	**$ (5)**	$ 131

Florida Progress Corporation (in millions)	Six Months Ended June 30, 2005	2004
Net income	**$ 10**	$ 190
Other comprehensive loss:		
Reclassification adjustments included in net income:		
Change in cash flow hedges (net of tax expense of $2 and $2, respectively)	**3**	4
Foreign currency translation adjustment included in discontinued operations	**(5)**	–
Minimum pension liability adjustment included in discontinued operations (net of tax expense of $1)	**1**	–
Changes in net unrealized losses on cash flow hedges (net of tax benefit of $7 and $10, respectively)	**(12)**	(18)
Foreign currency translation adjustment and other	**1**	1
Other comprehensive loss	**$ (12)**	$ (13)
Comprehensive (loss) income	**$ (2)**	$ 177

Comprehensive income and net income for PEF for the three months ended June 30, 2005 and 2004 were $10 million and $84 million, respectively. Comprehensive income and net income for PEF for the six months ended June 30, 2005 and 2004 were $54 million and $134 million, respectively.

7. DEBT AND CREDIT FACILITIES AND FINANCING ACTIVITIES

Changes to the Company's and PEF's debt and credit facilities since December 31, 2004, discussed in Note 12 to the Financial Statements in Item 8 of the Company's and PEF's 2004 Form 10-K, are described below.

In January 2005, PEF used proceeds from the issuance of commercial paper to pay off $170 million of revolving credit agreement (RCA) loans. PEF subsequently used money pool borrowings to reduce commercial paper. In February 2005, PEF used proceeds from money pool borrowings to pay off $55 million of RCA loans.

On March 28, 2005, PEF entered into a new $450 million five-year RCA with a syndication of financial institutions. The RCA will be used to provide liquidity support for PEF's issuances of commercial paper and other short-term obligations. The RCA will expire on March 28, 2010. The new $450 million RCA replaced PEF's $200 million three-year RCA and $200 million 364-day RCA, which were each terminated effective March 28, 2005. Fees and interest rates under the $450 million RCA are to be determined based upon the credit rating of PEF's long-term unsecured senior non-credit enhanced debt, currently rated as A3 by Moody's Investor Services (Moody's) and BBB by Standard and Poor's (S&P). The RCA includes a defined maximum total debt to capital ratio of 65%. The RCA also contains various cross-default and other acceleration provisions, including a cross-default provision for defaults of indebtedness in excess of $35 million. The RCA does not include a material adverse change representation for borrowings or a financial covenant for interest coverage, which had been provisions in the terminated agreements.

On May 16, 2005, PEF issued $300 million of First Mortgage Bonds, 4.50% Series due 2010. The net proceeds from the sale of the bonds were used to reduce the outstanding balance of commercial paper.

On July 1, 2005, PEF paid at maturity $45 million of its 6.72% Medium-Term Notes, Series B with short-term debt proceeds.

On July 28, 2005, PEF filed a shelf registration statement with the SEC to provide an additional $1.0 billion of capacity in addition to the $450 million remaining on PEF's current shelf registration statement. The shelf registration statement will allow PEF to issue various securities, including First Mortgage Bonds, Debt Securities and Preferred Stock.

8. BENEFIT PLANS

The Company and some of its subsidiaries (including PEF) have a noncontributory defined benefit retirement (pension) plan for substantially all full-time employees. The Company also has supplementary defined benefit pension plans that provide benefits to higher-level employees. In addition to pension benefits, the Company and some of its subsidiaries (including PEF) provide contributory other postretirement benefits (OPEB), including certain health care and life insurance benefits, for retired employees who meet specified criteria. The components of the net periodic benefit cost for the three and six months ended June 30 are:

Three Months Ended June 30,	Pension Benefits		Other Postretirement Benefits	
(in millions)	**2005**	2004	**2005**	2004
Service cost	**$ 6**	$ 5	**$ 1**	$ 1
Interest cost	**13**	12	**4**	4
Expected return on plan assets	**(19)**	(18)	**-**	-
Net amortization	**-**	1	**1**	1
Net cost recognized by Florida Progress	**$ -**	$ -	**$ 6**	$ 6
Net cost/(benefit) recognized by PEF	**$ (1)**	$ (1)	**$ 5**	$ 6

Six Months Ended June 30,	Pension Benefits		Other Postretirement Benefits	
(in millions)	**2005**	2004	**2005**	2004
Service cost	**$ 12**	$ 11	**$ 2**	$ 3
Interest cost	**25**	23	**7**	8
Expected return on plan assets	**(38)**	(36)	**-**	-
Net amortization	**-**	1	**2**	2
Net cost/(benefit) recognized by Florida Progress	**$ (1)**	$ (1)	**$ 11**	$ 13
Net cost/(benefit) recognized by PEF	**$ (2)**	$ (2)	**$ 11**	$ 12

In addition, in the second quarter of 2005 the Company and PEF recorded costs for special termination benefits related to the voluntary enhanced retirement program (see Note 10) of approximately $86 million and $83 million, respectively, for pension benefits and $7 million for other postretirement benefits. For the Company, these charges resulted in a $49 million decrease in prepaid pension cost, which is included in other assets and deferred debits, and a $44 million increase in pension and OPEB liabilities, which are included in other liabilities and deferred credits on the Consolidated Balance Sheets. For PEF, these charges resulted in a $47 million decrease in prepaid pension cost and a $43 million increase in pension and OPEB liabilities, which are included in other liabilities and deferred credits on the Balance Sheets.

9. RISK MANAGEMENT ACTIVITIES AND DERIVATIVE TRANSACTIONS

The Company and PEF are exposed to various risks related to changes in market conditions. The Company's and PEF's parent, Progress Energy, has a risk management committee that includes senior executives from various business groups. The risk management committee is responsible for administering risk management policies and monitoring compliance with those policies by all subsidiaries. Under its risk management policy, the Company and PEF may use a variety of instruments, including swaps, options and forward contracts, to manage exposure to fluctuations in commodity prices and interest rates. Such instruments contain credit risk if the counterparty fails to perform under the contract. The Company and PEF minimize such risk by performing credit reviews using, among other things, publicly available credit ratings of such counterparties. Potential non-performance by counterparties is not expected to have a material effect on the consolidated financial position or consolidated results of operations of the Company or PEF.

A. Commodity Derivatives

GENERAL

Most of the Company's and PEF's commodity contracts either are not derivatives or qualify as normal purchases or sales pursuant to SFAS No. 133, "Accounting for Derivative and Hedging Activities" (SFAS No. 133). Therefore, such contracts are not recorded at fair value.

ECONOMIC DERIVATIVES

Derivative products, primarily electricity and natural gas contracts, may be entered into from time to time for economic hedging purposes. While management believes the economic hedges mitigate exposures to fluctuations in commodity prices, these instruments are not designated as hedges for accounting purposes and are monitored consistent with trading positions. The Company and PEF manage open positions with strict policies that limit exposure to market risk and require daily reporting to management of potential financial exposures. Gains and losses from such contracts were not material to results of operations during the three and six months ended June 30, 2005 and 2004. The Company and PEF did not have material outstanding positions in such contracts as of June 30, 2005 or December 31, 2004, other than those receiving regulatory accounting treatment, as discussed below.

PEF has derivative instruments related to its exposure to price fluctuations on fuel oil purchases. These instruments receive regulatory accounting treatment. Unrealized gains and losses are recorded in regulatory liabilities and regulatory assets, respectively. As of June 30, 2005, the fair values of these instruments were a $60 million short-term derivative asset position included in other current assets and a $22 million long-term derivative asset position included in other assets and deferred debits. At December 31, 2004, the fair values of these instruments were a $2 million long-term derivative asset position included in other assets and deferred debits and a $5 million short-term derivative liability position included in other current liabilities.

CASH FLOW HEDGES

The Company's nonregulated subsidiaries designate a portion of commodity derivative instruments as cash flow hedges under SFAS No. 133. The objective for holding these instruments is to hedge exposure to market risk associated with fluctuations in the price of natural gas for the Company's forecasted sales. In the normal course of business, Progress Fuels through an affiliate, Progress Ventures, Inc. (PVI), enters natural gas cash flow hedging instruments, which PVI offsets with third party transactions. Progress Fuels accounts for such contracts as if it were transacted with a third party and records the contract using mark-to-market accounting. As of June 30, 2005, Progress Fuels is hedging exposures to the price variability of natural gas through December 2006.

The total fair value of these instruments as of June 30, 2005, was a $2 million asset position and a $24 million liability position. The total fair value of these instruments as of December 31, 2004, was a $9 million liability position. The ineffective portion of commodity cash flow hedges was not material for the three and six months ending June 30, 2005 and 2004. As of June 30, 2005, there were $14 million of after-tax deferred losses in accumulated other comprehensive income (OCI) of which $9 million is expected to be reclassified to earnings during the next 12 months as the hedged transactions occur. Due to the volatility of the commodities markets, the value in OCI is subject to change prior to its reclassification into earnings.

B. Interest Rate Derivatives – Fair Value or Cash Flow Hedges

The Company and PEF manage their interest rate exposures in part by maintaining variable-rate and fixed rate-exposures within defined limits. In addition, the Company and PEF also enter into financial derivative instruments, including, but not limited to, interest rate swaps and lock agreements to manage and mitigate interest rate risk exposure.

The Company and PEF use cash flow hedging strategies to reduce exposure to changes in cash flow due to fluctuating interest rates. The Company and PEF held no interest rate cash flow hedges as of June 30, 2005 and December 31, 2004.

The Company and PEF use fair value hedging strategies to reduce exposure to changes in fair value due to interest rate changes. As of June 30, 2005 and December 31, 2004, the Company and PEF had no open interest rate fair value hedges.

10. SEVERANCE COSTS

On February 28, 2005, as part of a previously announced cost management initiative, Progress Energy approved a workforce restructuring which is expected to be completed in September 2005. In addition to the workforce restructuring, the cost management initiative included a voluntary enhanced retirement program. In connection with this initiative, the Company incurred approximately $113 million of pre-tax charges for severance and postretirement benefits during the six months ended June 30, 2005, as described below. Of this amount, $107 million was recorded by PEF.

The Company recorded $15 million of severance expense during the first quarter of 2005 for the workforce restructuring and implementation of an automated meter reading initiative at PEF. The workforce restructuring expense was computed based on the approximate number of positions to be eliminated. This amount included approximately $4 million of severance costs allocated from Progress Energy Service Company (PESC). During the second quarter of 2005, 692 of the Company's employees eligible for participation in the voluntary enhanced retirement program elected to participate, including 680 PEF employees. Consequently, in the second quarter of 2005, the Company decreased its estimated severance costs by $6 million due to the impact of the employees electing participation in the voluntary enhanced retirement program. This amount included approximately $2 million of decreased severance costs allocated from PESC. The severance expenses are primarily included in O&M expense on the Consolidated Statements of Income.

The accrued severance expense will be paid over time. The activity in the severance liability is as follows:

(in millions)	FPC	PEF
Balance as of January 1, 2005	$ 1	$ -
Severance costs accrued	11	10
Adjustments	(4)	(4)
Payments	(1)	-
Balance as of June 30, 2005	**$ 7**	**$ 6**

The Company recorded a $93 million charge in the second quarter of 2005 related to postretirement benefits that will be paid over time to eligible employees who elected to participate in the voluntary enhanced retirement program (see Note 8). In addition, the Company recorded approximately $10 million of charges for postretirement benefits and early retirement incentives allocated from PESC.

The cost management initiative charges are subject to revision in future quarters based on completion of the workforce restructuring and the potential additional impacts that the early retirements and outplacements may have on the postretirement plans. Such revisions may be significant and may adversely impact the Company's and PEF's results of operations in future periods. In addition, the Company expects to incur certain incremental costs for recruiting and staff augmentation activities that cannot be quantified at this time.

11. FINANCIAL INFORMATION BY BUSINESS SEGMENT

The Company's principal business segment is PEF, a utility engaged in the generation, transmission, distribution and sale of electricity primarily in Florida. The other reportable business segments are Progress Fuels' Energy & Related Services and Synthetic Fuels. The Energy & Related Services segment includes coal operations, natural gas production and sales, river terminal services and off-shore marine transportation. Synthetic Fuels' operations include the production and sale of coal-based solid synthetic fuel as defined under the Internal Revenue Code and the operation of synthetic fuel facilities for outside parties. See Note 14 for more information. The Other category consists primarily of Progress Telecommunications Corp (PTC), the Company's telecommunications subsidiary, and the holding company, Florida Progress Corporation. PTC markets wholesale fiber-optic based capacity service in the Eastern United States and also markets wireless structure attachments to wireless communication companies and governmental entities. The Company allocates a portion of its operating expenses to business segments.

Prior to 2005, Rail Services was reported as a separate segment. In connection with the divestiture of Progress Rail (see Note 3), the operations of Rail Services were reclassified to discontinued operations in the first quarter of 2005 and therefore are not included in the results from continuing operations during the periods reported. In addition, Synthetic Fuel activities were reported in the Energy & Related Services segment prior to 2005 and now are considered a separate reportable segment. These reportable segment changes reflect the current reporting structure. For comparative purposes, the prior year results have been restated to conform to the current presentation.

The Company's segments are based on differences in products and services, and therefore no additional disclosures are presented. All intersegment transactions are at cost except for coal sales from the Energy and Related Services segment to PEF. The price Progress Fuels charges PEF is based on market rates for coal procurement. Rail transportation is also based on market rates plus a return allowed by the FPSC on equity in transportation equipment utilized in transporting coal to PEF. The allowed rate of return is currently 12%. In accordance with SFAS No. 71, profits on intercompany sales between Energy and Related Services and PEF are not eliminated if the sales price is reasonable and the future recovery of sales price through the ratemaking process is probable. The profits for the periods presented were not significant. No single customer accounted for 10% or more of unaffiliated revenues.

The following summarizes the revenues and segment profits or losses for the reportable business segments. The combined segment profits and losses represents Florida Progress' total income from continuing operations.

(in millions)	PEF	Energy and Related Services	Synthetic Fuels	Other	Consolidated
Three Months Ended June 30, 2005:					
Revenues	**$ 908**	**$ 226**	**$ 182**	**$ 17**	**$ 1,333**
Intersegment revenues	**–**	**287**	**–**	**(287)**	**–**
Total revenues	**908**	**513**	**182**	**(270)**	**1,333**
Postretirement and Severance Charges	**93**	**4**	**–**	**–**	**97**
Segment profit (loss)	**$ 10**	**$ 12**	**$ 13**	**$ (34)**	**$ 1**

(in millions)	PEF	Energy and Related Services	Synthetic Fuels	Other	Consolidated
Three Months Ended June 30, 2004:					
Revenues	$ 860	$ 212	$ 121	$ 17	$ 1,210
Intersegment revenues	–	207	2	(209)	–
Total revenues	860	419	123	(192)	1,210
Postretirement and Severance Charges	–	–	–	–	–
Segment profit (loss)	$ 84	$ 17	$ 21	$ 7	$ 129

(in millions)	PEF	Energy and Related Services	Synthetic Fuels	Other	Consolidated
Six Months Ended June 30, 2005:					
Revenues	**$ 1,756**	**$ 409**	**$ 348**	**$ 35**	**$ 2,548**
Intersegment revenues	**–**	**547**	**–**	**(547)**	**–**
Total revenues	**1,756**	**956**	**348**	**(512)**	**2,548**
Postretirement and Severance Charges	**107**	**6**	**–**	**–**	**113**
Segment profit (loss)	**$ 53**	**$ 23**	**$ 13**	**$ (43)**	**$ 46**

(in millions)	PEF	Energy and Related Services	Synthetic Fuels	Other	Consolidated
Six Months Ended June 30, 2004:					
Revenues	$ 1,644	$ 347	$ 257	$ 31	$ 2,279
Intersegment revenues	–	444	6	(450)	–
Total revenues	1,644	791	263	(419)	2,279
Postretirement and Severance Charges	1	-	-	-	1
Segment profit (loss)	$ 133	$ 27	$ 47	$ (31)	$ 176

12. OTHER INCOME AND OTHER EXPENSE

Other income and expense includes interest income and other income and expense items as discussed below. The components of other, net as shown on the accompanying Consolidated Statements of Income for three ended June 30, 2005 and 2004, are as follows:

(in millions)	Three Months Ended June 30 2005	Three Months Ended June 30 2004	Six Months Ended June 30 2005	Six Months Ended June 30 2004
Other income				
Nonregulated energy and delivery services income	**4**	4	**8**	7
Gain on sale of distribution assets (see Note 5)	**25**	-	**25**	-
AFUDC equity	**4**	1	**7**	2
Other	**-**	-	**2**	2
Total other income – PEF	**$ 33**	$ 5	**$ 42**	$ 11
Other income – Florida Progress	**-**	1	**3**	2
Total other income – PEF and Florida Progress	**$ 33**	$ 6	**$ 45**	$ 13
Other expense				
Nonregulated energy and delivery services expenses	**$ 3**	$ 3	**$ 6**	$ 5
Donations	**3**	1	**6**	5
FERC Audit Settlement	**3**	-	**3**	-
Other	**-**	1	**-**	2
Total other expense – PEF	**$ 9**	$ 5	**$ 15**	$ 12
Loss from equity investments	**4**	4	**10**	7
Other expense – Florida Progress	**2**	-	**3**	1
Total other expense – PEF and Florida Progress	**$ 15**	$ 9	**$ 28**	$ 20
Other, net	**$ 18**	$ (3)	**$ 17**	$ (7)

Nonregulated energy and delivery services include power protection services and mass market programs such as surge protection, appliance services and area light sales, and delivery, transmission and substation work for other utilities.

FERC audit settlement includes amounts approved by the FERC on May 25, 2005, to settle the FERC Staff's Audit of PEF's compliance with the FERC's Standards of Conduct and Code of Conduct. In the settlement, PEF agreed to make certain operational and organizational changes and to provide its retail and wholesale customers a one-time credit of approximately $3 million which was recorded as other expense in the second quarter of 2005.

13. ENVIRONMENTAL MATTERS

The Company and PEF are subject to federal, state and local regulations addressing hazardous and solid waste management, air and water quality and other environmental matters. See Note 20 of the Company's and PEF's 2004 Annual Report on Form 10-K for a more detailed, historical discussion of these federal, state, and local regulations.

HAZARDOUS AND SOLID WASTE MANAGEMENT

The provisions of the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, authorize the EPA to require the cleanup of hazardous waste sites. This statute imposes retroactive joint and several liabilities. Some states, including Florida, have similar types of legislation. The Company and PEF are periodically notified by regulators such as the EPA and various state agencies of their involvement or potential involvement in sites that may require investigation and/or remediation. The Company and PEF are also currently in the process of assessing potential costs and exposures at other environmentally impaired sites. For all sites, as the assessments are developed and analyzed, the Company and PEF will accrue costs for the sites to the extent the costs are probable and can be reasonably estimated.

Various organic materials associated with the production of manufactured gas, generally referred to as coal tar, are regulated under federal and state laws. The principal regulatory agency that is responsible for a specific former manufactured gas plant (MGP) site depends largely upon the state in which the site is located. There are several MGP sites to which the Company, through PEF, has some connection. In this regard, PEF and other potentially responsible parties (PRPs), are participating in, investigating and, if necessary, remediating former MGP sites with several regulatory agencies, including, but not limited to, the U.S. Environmental Protection Agency (EPA) and the Florida Department of Environmental Protection (FDEP).

In Florida, a risk-based corrective action (RBCA, known as Global RBCA) rule was developed by the FDEP and adopted at the February 2, 2005, Environmental Review Commission hearing. Risk-based corrective action generally means that the corrective action prescribed for contaminated sites can correlate to the level of human health risk imposed by the contamination at the property. The Global RBCA rule expands the use of the risk-based corrective action to all contaminated sites in the state that are not currently in one of the state's waste cleanup programs and has the potential for making future cleanups in Florida more costly to complete. The effective date of the Global RBCA rule was April 17, 2005. The Company and PEF are in the process of assessing the impact of this rule.

The Company and PEF have filed claims with the Company's general liability insurance carriers to recover costs arising out of actual or potential environmental liabilities. Almost all claims have been settled and a few are still pending. While the Company and PEF cannot predict the outcome of these matters, the outcome is not expected to have a material effect on the Company's consolidated or PEF's financial condition or results of operations.

PEF

As of June 30, 2005 and December 31, 2004, PEF's accruals for probable and estimable costs related to various environmental sites, which are included in other liabilities and deferred credits and are expected to be paid out over one to fifteen years, were:

(in millions)	**June 30, 2005**	December 31, 2004
Remediation of distribution and substation transformers	**$ 22**	$ 27
MGP and other sites	**18**	18
Total accrual for environmental sites	**$ 40**	$ 45

PEF has received approval from the FPSC for recovery of costs associated with the remediation of distribution and substation transformers through the Environmental Cost Recovery Clause (ECRC). Under agreements with the FDEP, PEF is in the process of examining distribution transformer sites and substation sites for potential equipment integrity issues that could result in the need for mineral oil impacted soil remediation. PEF has reviewed a number of distribution transformer sites and all substation sites. PEF expects to have completed its review of distribution transformer sites by the end of 2007. Should further sites be identified, PEF believes that any estimated costs would also be recovered through the ECRC. For the three and six months ended June 30, 2005, PEF made no additional accruals and spent approximately $3 million and $5 million, respectively, related to the remediation of transformers. PEF has recorded a regulatory asset for the probable recovery of these costs through the ECRC.

The amounts for MGP and other sites, in the table above, relate to two former MGP sites and other sites associated with PEF that have required or are anticipated to require investigation and/or remediation. In 2004, PEF received approximately $12 million in insurance claim settlement proceeds and recorded a related accrual for associated environmental expenses, as these insurance proceeds are restricted for use in addressing costs associated with environmental liabilities. For the three and six months ended June 30, 2005, PEF made no additional accruals or material expenditures and received no insurance proceeds.

These accruals have been recorded on an undiscounted basis. PEF measures its liability for these sites based on available evidence including its experience in investigating and remediating environmentally impaired sites. This process often includes assessing and developing cost-sharing arrangements with other PRPs. Because the extent of environmental impact, allocation among PRPs for all sites, remediation alternatives (which could involve either minimal or significant efforts), and concurrence of the regulatory authorities have not yet advanced to the stage where a reasonable estimate of the remediation costs can be made, at this time PEF is unable to provide an estimate of its obligation to remediate these sites beyond what is currently accrued. As more activity occurs at these sites, PEF will assess the need to adjust the accruals. It is anticipated that sufficient information will become available in 2005 to make a reasonable estimate of PEF's obligation for one of the MGP sites.

Florida Progress Corporation

In 2001, FPC established an accrual to address indemnities and retained an environmental liability associated with the sale of its Inland Marine Transportation business. In 2003, the accrual was reduced to $4 million based on a change in estimate. As of June 30, 2005 and December 31, 2004, the remaining accrual balance was approximately $3 million. Expenditures related to this liability were not material to the Company's financial condition for the three and six months ended June 30, 2005. FPC measures its liability for these exposures based on estimable and probable remediation scenarios.

Certain historical sites are being addressed voluntarily by FPC. An immaterial accrual has been established to address investigation expenses related to these sites. At this time, the Company cannot determine the total costs that may be incurred in connection with these sites.

Progress Rail

On March 24, 2005, the Company closed on the sale of its Progress Rail subsidiary. In connection with the sale, the Company incurred indemnity obligations related to certain pre-closing liabilities, including certain environmental matters (see discussion under Guarantees in Note 14A).

AIR QUALITY

The Company and PEF are subject to various current and proposed federal, state, and local environmental compliance laws and regulations, which may result in increased planned capital expenditures and operating and maintenance costs. Significant updates to these laws and regulations and related impacts to the Company and PEF since December 31, 2004, are discussed below. Additionally, Congress is considering legislation that would require reductions in air emissions of NOx, SO_2, carbon dioxide and mercury. Some of these proposals establish nationwide caps and emission rates over an extended period of time. This national multi-pollutant approach to air pollution control could involve significant capital costs that could be material to the Company's and PEF's consolidated financial position or results of operations. However, the Company and PEF cannot predict the outcome of the matter.

The EPA is conducting an enforcement initiative related to a number of coal-fired utility power plants in an effort to determine whether changes at those facilities were subject to New Source Review (NSR) requirements or New Source Performance Standards under the Clean Air Act. The Company was asked to provide information to the EPA as part of this initiative and cooperated in supplying the requested information. The EPA initiated civil enforcement actions against other unaffiliated utilities as part of this initiative. Some of these actions resulted in settlement agreements calling for expenditures by these unaffiliated utilities in excess of $1.0 billion. These settlement agreements have generally called for expenditures to be made over extended time periods, and some of the companies may seek recovery of the related cost through rate adjustments or similar mechanisms. The Company and PEF cannot predict the outcome of this matter.

On March 10, 2005, the EPA issued the final Clean Air Interstate Rule (CAIR). The EPA's rule requires 28 states, including Florida, and the District of Columbia, to reduce NOx and SO2 emissions in order to attain state NOx and SO2 emissions levels. Installation of additional air quality controls is likely to be needed to meet the CAIR requirements. The Company and PEF preliminarily estimate compliance costs for PEF could be approximately $1.0 billion over ten years. PEF has joined a coalition of Florida utilities that has filed a challenge to CAIR as it applies to Florida. A petition for reconsideration and stay and a petition for judicial review of CAIR were filed on July 11, 2005. The Company and PEF cannot predict the outcome of this matter.

On March 15, 2005, the EPA finalized two separate but related rules: the Clean Air Mercury Rule (CAMR) that sets emissions limits to be met in two phases and encourages a cap and trade approach to achieving those caps, and a de-listing rule that eliminated any requirement to pursue a maximum achievable control technology (MACT) approach for limiting mercury emissions from coal-fired power plants. NOx and SO_2 controls also are effective in reducing mercury emissions. However, according to the EPA the second phase cap reflects a level of mercury emissions reduction that exceeds the level that would be achieved solely as a co-benefit of controlling NOx and SO_2 under CAIR. The Company is in the process of determining compliance plans and the cost to comply with the CAMR. Installation of additional air quality controls is likely to be needed to meet the CAMR's requirements. The de-listing rule has been challenged by a number of parties; the resolution of the challenges could impact the Company's final compliance plans and costs.

On June 24, 2005, the Court of Appeals for the District of Columbia Circuit rendered a decision in a suit regarding EPA's NSR rules. As part of the decision, the court struck down a provision excluding pollution control projects from NSR requirements. As a result of this decision, additional regulatory review of PEF's pollution control equipment proposals will be required adding time and cost to the overall project.

In conjunction with the proposed mercury rule, the EPA proposed a MACT standard to regulate nickel emissions from residual oil-fired units. The EPA withdrew the proposed nickel rule in March 2005.

On May 6, 2005, PEF filed a petition with the FPSC through the ECRC program for recovery of costs associated with the development and implementation of an integrated strategy to comply with the CAIR and CAMR. PEF is developing an integrated compliance strategy for the CAIR and CAMR rules because NOx and SO_2 controls also are effective in reducing mercury emissions. PEF estimates the program costs for 2005 to be approximately $2 million for preliminary engineering activities and strategy development work necessary to determine PEF's integrated compliance strategy. PEF projects approximately $62 million in program costs for 2006. These costs may increase or decrease depending upon the results of the engineering and strategy development work. Among other things; subsequent rule interpretations, equipment availability, or the unexpected acceleration of the initial NOx or other compliance dates could require acceleration of some projects and therefore result in additional costs in 2005 and 2006. PEF expects to incur significant additional capital and O&M costs to achieve compliance with the CAIR and CAMR through 2015 and beyond. The timing and extent of the costs for future projects will depend upon the final compliance strategy.

In a decision issued July 15, 2005, the U.S. Court of Appeals for the District of Columbia Circuit denied petitions for review filed by several states, cities and organizations seeking the regulation by the EPA of carbon dioxide emissions under the Clean Air Act. The court, in a 2-1 decision, held that the EPA Administrator properly exercised his discretion in denying the request for regulation.

WATER QUALITY

As a result of the operation of certain control equipment needed to address the air quality issues outlined above, new wastewater streams may be generated at the affected facilities. Integration of these new wastewater streams into the existing wastewater treatment processes may result in permitting, construction and treatment requirements imposed on PEF in the immediate and extended future.

Based on changes to the estimated time frame of expenditures since December 31, 2004, the Company has revised the estimated time period for expenditures to meet Section 316(b) requirements of the Clean Water Act. PEF currently estimates that from 2005 through 2010 the range of expenditures will be approximately $65 million to $85 million.

OTHER ENVIRONMENTAL MATTERS

The Kyoto Protocol was adopted in 1997 by the United Nations to address global climate change by reducing emissions of carbon dioxide and other greenhouse gases. The treaty went into effect on February 16, 2005. The United States has not adopted the Kyoto Protocol, and the Bush administration has stated it favors voluntary programs. A number of carbon dioxide emissions control proposals have been advanced in Congress. Reductions in carbon dioxide emissions to the levels specified by the Kyoto Protocol and some legislative proposals could be materially adverse to the Company's consolidated financial position or results of operations if associated costs of control or limitation cannot be recovered from customers. The Company favors the voluntary program approach recommended by the Bush administration and continually evaluates options for the reduction, avoidance and sequestration of greenhouse gases. However, the Company and PEF cannot predict the outcome of this matter.

Progress Energy has announced its plan to issue a report on the Progress Energy's activities associated with current and future environmental requirements. The report will include a discussion of the environmental requirements that the Company and PEF currently face and expect to face in the future with respect to its air emissions. The report is expected to be issued by March 31, 2006.

14. COMMITMENTS AND CONTINGENCIES

Contingencies and significant changes to the commitments discussed in Note 21 of the Company's 2004 Annual Report on Form 10-K are described below.

A. Guarantees

As a part of normal business, Florida Progress and certain subsidiaries, including PEF and Progress Fuels, enter into various agreements providing financial or performance assurances to third parties, which are outside the scope of FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN No. 45). Such agreements include guarantees, standby letters of credit and surety bonds. These agreements are entered into primarily to support or enhance the creditworthiness otherwise attributed to a subsidiary on a stand-alone basis, thereby facilitating the extension of sufficient credit to accomplish the subsidiaries' intended commercial purposes. As of June 30, 2005, management does not believe conditions are likely for significant performance under these agreements. To the extent liabilities are incurred as a result of the activities covered by the guarantees, such liabilities are included in the accompanying Consolidated Balance Sheets.

As of June 30, 2005, the Company has issued guarantees and indemnifications of certain legal, tax and environmental matters to third parties in connection with sales of businesses and for timely payment of obligations in support of its non-wholly owned synthetic fuel operations. Related to the sales of businesses, the notice period extends until 2012 for the majority of matters provided for in the indemnification provisions. For matters for which the Company has received timely notice, the Company's indemnity obligations may extend beyond the notice period. Certain environmental indemnifications related to the sale of synthetic fuel operations have no limitations as to time or maximum potential future payments. Other guarantees and indemnifications have an estimated maximum exposure of approximately $152 million. As of June 30, 2005, the Company has recorded liabilities related to guarantees and indemnifications to third-parties of $27 million. Management does not believe conditions are likely for significant performance under these agreements in excess of the recorded liabilities.

Securities of Affiliated Trust

The Company has guaranteed certain payments of an affiliated company, FPC Capital I (the Trust). Due to the nature of the relationship between the Trust and Florida Progress Funding Corporation, the Company has guaranteed the payment of all distributions related to the Trust's outstanding mandatorily redeemable preferred securities. As of June 30, 2005, the Trust had outstanding 12 million shares of the securities with a liquidation value of $300 million.

B. Insurance

PEF is a member of Nuclear Electric Insurance Limited (NEIL), which provides primary and excess insurance coverage against property damage to members' nuclear generating facilities. Under the primary program, PEF is insured for $500 million at its nuclear plant, CR3. In addition to primary coverage, NEIL also provides decontamination, premature decommissioning and excess property insurance with a limit of $1.75 billion.

C. Other Commitments

As discussed in Note 21B of the Company's annual report on Form 10-K for the year ended December 31, 2004, the Company has certain future commitments related to four synthetic fuel facilities purchased that provide for contingent payments (royalties). The Company has exercised its right in the related agreements to escrow those payments if certain conditions in the agreements were met. The Company previously accrued and retained 2004 and 2003 royalty payments of approximately $20 million and $22 million, respectively. In May 2005, these funds were placed into escrow upon establishment of the necessary escrow accounts.

On May 15, 2005, the original owners of the Earthco synthetic fuel facilities filed suit in New York state court alleging breach of contract against the Progress Fuels Corporation subsidiaries that purchased the Earthco facilities (Progress Fuels subsidiaries). The plaintiffs also named Progress Energy, Inc. as a defendant. The plaintiffs' complaint is that periodic payments otherwise due to them under the sales arrangement with the Progress Fuels subsidiaries are, contrary to the sales agreement, being escrowed pending the outcome of the ongoing IRS audit of the Earthco facilities. The Progress Fuels subsidiaries believe that the parties' agreements allow for the payments to be escrowed in such event and also allow for the use of such escrowed amounts to satisfy any potential disallowance of tax credits that arises out of such an event. Currently, the escrowed amount in question attributable to the Earthco facilities currently owned by Florida Progress subsidiaries is $40 million, which reflects periodic payments that would have been paid to the plaintiffs beginning April 30, 2003 through July 31, 2005. This amount will increase as future periodic payments are made to the escrow which would otherwise have been payable to the plaintiffs. The Company and the Progress Fuels subsidiaries intend to vigorously defend their actions, but cannot predict the outcome of this matter.

D. Other Contingencies

1. Franchise Litigation

Two cities, Edgewood and Belleair, with a total of approximately 4,000 customers, have litigation pending against PEF in two circuit courts in Florida. As discussed below, proceedings against PEF by a third city, the City of Winter Park, were concluded during the second quarter of 2005. As previously reported, the lawsuits principally seek (1) a declaratory judgment that the cities have the right to purchase PEF's electric distribution system located within the municipal boundaries of the cities, (2) a declaratory judgment that the value of the distribution system must be determined through arbitration, and (3) injunctive relief requiring PEF to continue to collect from PEF's customers and remit to the cities, franchise fees during the pending litigation, as long as PEF continues to occupy the cities' rights-of-way to provide electric service, notwithstanding the expiration of the franchise ordinances under which PEF had agreed to collect such fees. The circuit courts in those cases have entered orders requiring arbitration to establish the purchase price of PEF's electric distribution system within five cities. Two appellate courts have upheld those circuit court decisions and authorized the cities to determine the value of PEF's electric distribution system within those cities, which orders have been upheld by the appellate courts.

Arbitration in the case by the City of Winter Park was completed in February 2003. That arbitration panel issued an award in May 2003 setting the value of PEF's distribution system within the City (13,000 customers) at approximately $32 million, not including separation and reintegration and construction work in progress, which could add several million dollars to the award. The panel also awarded PEF approximately $11 million in stranded costs, which, according to the award, decrease over time. In September 2003, Winter Park voters passed a referendum that would authorize the City to issue bonds of up to approximately $50 million to acquire PEF's electric distribution system. On April 26, 2004, the City Commission voted to proceed with the acquisition. The City sought and received wholesale power supply bids and on June 24, 2004, executed a wholesale power supply contract with PEF with a five-year term from the date service begins and a renewal option. On May 12, 2004, the City solicited bids to operate and maintain the distribution system and awarded a contract in January 2005. On February 10, 2005, PEF filed a petition with the Florida Public Service Commission (FPSC) to relieve the Company of its statutory obligation to serve customers in Winter Park on June 1, 2005, or at such time when the

City is able to provide retail service. On April 19, 2005, the FPSC voted to approve PEF's petition. On June 1, 2005, the City acquired PEF's electric distribution system that serves the City for approximately $42 million. PEF transferred the distribution system to the City on June 1, 2005 and recognized a pre-tax gain of $25 million on the transaction, which is included in other, net on the Consolidated Statements of Income. This amount is subject to true-up pending accumulation of the final capital expenditures since arbitration. PEF also recorded a regulatory liability of $8 million for stranded cost revenues which will be amortized to revenues over the next six years in accordance with the provisions of the transfer agreement with the City.

Arbitration with the 2,500-customer Town of Belleair (the Town) was completed in June 2003. In September 2003, the arbitration panel issued an award in that case setting the value of the electric distribution system within the Town at approximately $6 million. The panel further required the Town to pay to PEF its requested $1 million in separation and reintegration costs and $2 million in stranded costs. The Town has not yet decided whether it will attempt to acquire the system; however, on January 18, 2005, it issued a request for proposals for wholesale power supply and to operate and maintain the distribution system. In March 2005, PEF submitted a bid to supply wholesale power to the Town. The Town received several other proposals for wholesale power and distribution services. In February 2005, the Town Commission also voted to put the issue of whether to acquire the distribution system to a voter referendum. A referendum is scheduled to occur on November 8, 2005. At this time, whether and when there will be further proceedings regarding the Town of Belleair cannot be determined.

Arbitration in the remaining city's litigation (the 1,500-customer City of Edgewood) has not yet been scheduled. On February 17, 2005, the parties filed a joint motion to stay the litigation for a 90-day period during which the parties will discuss potential settlement. In April, the City Council voted to proceed with arbitration and on July 6, 2005, the circuit court referred the matter to arbitration, but did not set an arbitration date. The parties are engaged in settlement discussions and have reached a tentative agreement to resolve the case under which the City of Edgewood would sign a 30-year franchise agreement. At this time, whether and when there will be further proceedings regarding the City of Edgewood cannot be determined.

A fourth city (the 7,000-customer City of Maitland) is contemplating municipalization but has indicated its intent to enter into a new franchise agreement with PEF. Maitland's franchise expires in August 2005. At this time, whether and when there will be further proceedings regarding the City of Maitland cannot be determined.

As part of the above litigation, two appellate courts reached opposite conclusions regarding whether PEF must continue to collect from its customers and remit to the cities "franchise fees" under the expired franchise ordinances. PEF filed an appeal with the Florida Supreme Court to resolve the conflict between the two appellate courts. On October 28, 2004, the Court issued a decision holding that PEF must collect from its customers and remit to the cities franchise fees during the interim period when the city exercises its purchase option or executes a new franchise agreement. The Court's decision should not have a material impact on the Company.

2. DOE Litigation

Pursuant to the Nuclear Waste Policy Act of 1982, the predecessors to PEF entered into contracts with the U.S. Department of Energy (DOE) under which the DOE agreed to begin taking spent nuclear fuel (SNF) by no later than January 31, 1998. All similarly situated utilities were required to sign the same standard contract.

The DOE failed to begin taking spent nuclear fuel by January 31, 1998. In January 2004, PEF filed a complaint with the United States Court of Federal Claims against the DOE, claiming that the DOE breached the Standard Contract for Disposal of Spent Nuclear Fuel by failing to accept SNF from PEF facilities on or before January 31, 1998. Damages due to the DOE's breach will likely be significant, but have yet to be determined. Approximately 60 cases involving the Government's actions in connection with SNF are currently pending in the Court of Federal Claims.

The DOE and the PEF parties have agreed to a stay of the lawsuit, including discovery. The parties agreed to, and the trial court entered, a stay of proceedings, in order to allow for possible efficiencies due to the resolution of legal and factual issues in previously-filed cases in which similar claims are being pursued by other plaintiffs. These issues may include, among others, so-called "rate issues," or the minimum mandatory schedule for the acceptance of SNF and high level waste (HLW) by which the Government was contractually obligated to accept contract holders' SNF and/or HLW, and issues regarding recovery of damages under a partial breach of contract theory that will be alleged to occur in the future. These issues are expected to be presented in the trials or appeals that are scheduled to occur during 2005. Resolution of these issues in other cases could facilitate agreements by the parties in the PEF lawsuit, or at a minimum, inform the Court of decisions reached by other courts if they remain contested and require resolution in this case. In July 2005, the parties jointly requested a continuance of the stay through December 15, 2005, which the trial court generated.

With certain modifications and additional approval by the NRC, including the installation of onsite dry storage facilities at PEF's nuclear unit, Crystal River Unit No. 3 (CR3), PEF's spent nuclear fuel storage facilities will be sufficient to provide storage space for spent fuel generated on PEF's system through the expiration of the operating license for CR3.

In July 2002, Congress passed an override resolution to Nevada's veto of the DOE's proposal to locate a permanent underground nuclear waste storage facility at Yucca Mountain, Nevada. In January 2003, the State of Nevada, Clark County, Nevada and the City of Las Vegas petitioned the U.S. Court of Appeals for the District of Columbia Circuit for review of the Congressional override resolution. These same parties also challenged the EPA's radiation standards for Yucca Mountain. On July 9, 2004, the Court rejected the challenge to the constitutionality of the resolution approving Yucca Mountain, but ruled that the EPA was wrong to set a 10,000-year compliance period in the radiation protection standard. The EPA is currently reworking the standard but has not stated when the work will be complete. The DOE originally planned to submit a license application to the NRC to construct the Yucca Mountain facility by the end of 2004. However, in November 2004, the DOE announced it would not submit the license application until mid-2005 or later. Also in November 2004, Congressional negotiators approved $577 million for fiscal year 2005 for the Yucca Mountain project, approximately $300 million less than requested by the DOE but approximately the same as approved in 2004. The DOE has acknowledged that a working repository will not be operational until sometime after 2010, but the DOE has not identified a new target date. PEF cannot predict the outcome of this matter.

3. Advanced Separation Technologies (AST)

In 1996, Florida Progress sold its 80% interest in AST to Calgon Carbon Corporation (Calgon) for net proceeds of $56 million in cash. In 1998, Calgon filed a lawsuit against Florida Progress and the other selling shareholder and amended it in April 1998, alleging misstatement of AST's 1996 revenues, assets and liabilities, seeking damages and granting Calgon the right to rescind the sale. The lawsuit also accused the sellers of failing to disclose flaws in AST's manufacturing process and a lack of quality control.

All parties filed motions for summary judgment in July 2001. The summary judgment motions of Calgon and the other selling shareholder were denied in April 2002. The summary judgment motion of Florida Progress was withdrawn pending a legal challenge to portions of the report of Calgon's expert, Arthur Andersen, which had been used to oppose summary judgment. In September 2003, the United States District Court for the Western District of Pennsylvania issued final orders excluding from evidence in the case that portion of Arthur Andersen's damage analysis based on the discounted cash flow methodology of valuation. The Court did not exclude Arthur Andersen's use of the guideline publicly traded company methodology in its damage analysis. Florida Progress filed a renewed motion for summary judgment in October 2003, which is pending. A magistrate judge has recommended that the summary judgment motion be denied. Florida Progress has objected to this recommendation. A final ruling on the motion is expected at any time.

Florida Progress believes that the aggregate total of all legitimate warranty claims by customers of AST for which it is probable that Florida Progress will be responsible for under the Stock Purchase Agreement with Calgon is approximately $3 million, and accordingly, accrued $3 million in the third quarter of 1999 as an estimate of probable loss.

The Company cannot predict the outcome of this matter.

4. Synthetic Fuel Tax Credits

At December 31, 2003, Florida Progress, through its subsidiaries, was a majority-owner in three entities and a minority owner in three entities that own facilities that produce coal-based solid synthetic fuel as defined under the Internal Revenue Code (Code). In June 2004, Progress Fuels sold, in two transactions, a combined 49.8 percent partnership interest in Colona Synfuel Limited Partnership, LLLP (Colona), one of its majority owned synthetic fuel operations. The Company is now a minority owner in Colona, but continues to consolidate Colona in accordance with FASB Interpretation No. 46R. Florida Progress, through its subsidiaries, is currently a majority owner in two synthetic fuel entities and a minority owner in four synthetic fuel entities, including Colona. The production and sale of the synthetic fuel from these facilities qualifies for tax credits under Section 29 of the Code (Section 29) if certain requirements are satisfied, including a requirement that the synthetic fuel differs significantly in chemical composition from the coal used to produce such synthetic fuel and that the fuel was produced from a facility that was placed-in-service before July 1, 1998. The amount of Section 29 tax credits that the Company is allowed to claim in any calendar year is limited by the amount of the Company's regular federal income tax liability. Synthetic fuel tax credit amounts allowed but not utilized are carried forward indefinitely as deferred alternative minimum tax credits. All majority-owned and minority-owned entities received private letter rulings (PLRs) from the IRS with respect to their synthetic fuel operations. However, these PLR's do not address the placed–in-service date determinations. The PLRs do not limit the production on which synthetic fuel credits may be claimed. Total Section 29 credits generated to date are approximately $983 million, of which $436 million have been used to offset regular federal income tax liability and $529 million are being carried forward as deferred alternative minimum tax credits. Also $18 million has not been recognized due to the decrease in tax liability from the 2004 hurricane damage and loss on sale of Progress Rail. The current Section 29 tax credit program expires at the end of 2007.

The sale of Progress Rail in 2005 resulted in a capital loss for tax purposes. Capital losses that are not offset with capital gains generated in 2005 will be carried back to reduce the regular federal income tax liability in 2004. The estimated impact of the sale resulted in approximately $11 million in tax credits no longer being realized and reflected as a deferred tax asset.

IRS PROCEEDINGS

In September 2002, all of Florida Progress' majority-owned synthetic fuel entities at that time, including Colona, and two of the Company's minority owned synthetic fuel entities were accepted into the IRS's Pre-Filing Agreement (PFA) program in lieu of the ordinary IRS audit process. The PFA program allows taxpayers to voluntarily accelerate the IRS exam process in order to seek resolution of specific issues.

In February 2004, subsidiaries of the Company finalized execution of the Colona Closing Agreement with the IRS concerning their Colona synthetic fuel facilities. The Closing Agreement provided that the Colona facilities were placed in service before July 1, 1998, which is one of the qualification requirements for tax credits under Section 29 of the Code. The Closing Agreement further provides that the fuel produced by the Colona facilities in 2001 is a "qualified fuel" for purposes of the Section 29 tax credits. This action concluded the PFA program with respect to Colona.

In July 2004, Progress Energy was notified that the IRS field auditors anticipate taking an adverse position regarding the placed-in-service date of the Company's four Earthco synthetic fuel facilities. Due to the IRS auditors' position, the IRS has decided to exercise its right to withdraw from the PFA program with Progress Energy. With the IRS's withdrawal from the PFA program, the review of the Company's Earthco facilities is back on the normal procedural audit path of the Company's tax returns.

On October 29, 2004, Progress Energy received the IRS field auditors' preliminary report concluding that the Earthco facilities had not been placed in service before July 1, 1998, and that the tax credits generated by those facilities should be disallowed. The Company disagrees with the field audit team's factual findings and believes that the Earthco facilities were placed in service before July 1, 1998. The Company also believes that the report applies an inappropriate legal standard concerning what constitutes "placed in service." The Company intends to contest the field auditors' findings and their proposed disallowance of the tax credits.

Because of the disagreement between the Company and the field auditors as to the proper legal standard to apply, the Company believes that it is appropriate and helpful to have this issue reviewed by the National Office of the IRS, just as the National Office reviewed the issues involving chemical change. Therefore, the Company is asking the National office to review the issue and clarify the legal standard and has initiated this process with the National Office. The Company believes that the appeals process, including proceedings before the National Office, could take up to two years to complete, however, it cannot control the actual timing of resolution and cannot predict the outcome of this matter.

Through June 30, 2005, based on its ownership percentage, the Company has used or carried forward $595 million of tax credits generated by its Earthco facilities. If these credits were disallowed, Florida Progress' one time exposure for cash tax payments would be $67 million (excluding interest), and earnings and equity would be reduced by $595 million, excluding interest. These amounts have not been reduced for the use of any escrowed amounts to satisfy a potential disallowance of these tax credits (see Note 14C).

The Company believes that it is complying with all the necessary requirements to be allowed such credits under Section 29, and, although it cannot provide certainty, it believes that it will prevail in these matters. The

Company has no current plans to alter its synthetic fuel production schedule for 2005 or future years as a result of the IRS field auditors' report. However, should the Company fail to prevail in these matters, there could be a material liability for previously used or carried forward Section 29 tax credits, with a material adverse impact on earnings and cash flows.

As discussed in Note 8D of the Company's annual report on Form 10-K for the year ended December 31, 2004, PEF implemented changes in its capitalization policies for its Energy Delivery business unit effective January 1, 2005. As a result of the changes in accounting estimates for the outage and emergency work and indirect costs, a lesser proportion of PEF's costs will be capitalized on a prospective basis. The Company has requested a method change from the IRS. If the IRS does not grant the Company's request, the Company cannot predict how the IRS would suggest that the method change be applied. However, the application of the method change to past periods could be reflected in a cumulative adjustment to taxable income in 2005, which likely would have a material impact on income from synthetic fuel tax credits.

PROPOSED ACCOUNTING RULES FOR UNCERTAIN TAX POSITIONS

On July 14, 2005, the Financial Accounting Standards Board (FASB) issued an exposure draft of a proposed interpretation of SFAS No. 109, "Accounting for Income Taxes" (SFAS No. 109), that would address the accounting for uncertain tax positions. The proposed interpretation would require that uncertain tax benefits be probable of being sustained in order to record such benefits in the consolidated financial statements. The Company currently accounts for uncertain tax benefits in accordance with SFAS No. 5, "Accounting for Contingencies" (SFAS No. 5). Under SFAS No. 5, contingent losses are recorded when it is probable that the tax position will not be sustained and the amount of the disallowance can be reasonably estimated. The exposure draft has a 60-day public comment period ending September 12, 2005. As currently drafted, the proposed interpretation would apply to all uncertain tax positions and be effective for the Company on December 31, 2005.

As discussed above, the IRS field auditors have recommended that the Section 29 tax credits generated by the Company's Earthco facilities, totaling $595 million through June 30, 2005, be disallowed. The Company has not yet determined how the proposed interpretation would impact its various income tax positions, including the status of the Earthco tax credits. Depending on the provisions of the FASB's final interpretation and the Company's facts and circumstances that exist at the date of implementation, including the Company's assessment of the probability of sustaining any currently recorded and future tax benefits, the proposed interpretation could have a material adverse impact on the Company's financial position and results of operations.

PERMANENT SUBCOMMITTEE

In October 2003, the United States Senate Permanent Subcommittee on Investigations began a general investigation concerning synthetic fuel tax credits claimed under Section 29 of the Code. The investigation is examining the utilization of the credits, the nature of the technologies and fuels created, the use of the synthetic fuel, and other aspects of Section 29 and is not specific to the Company's synthetic fuel operations. Progress Energy provided information in connection with this investigation. The Company cannot predict the outcome of this matter.

IMPACT OF CRUDE OIL PRICES

Although the Internal Revenue Code Section 29 tax credit program is expected to continue through 2007, recent unprecedented increases in the price of oil could limit the amount of those credits or eliminate them entirely for one or more of the years following 2004. This possibility is due to a provision of Section 29 that provides that if the average wellhead price per barrel for unregulated domestic crude oil for the year (the Annual Average Price) exceeds a certain threshold value (the Threshold Price), the amount of Section 29 tax credits are reduced for that year. Also, if the Annual Average Price increases high enough (the Phase Out Price), the Section 29 tax credits are eliminated for that year. For 2004, the Threshold Price was $51.35 per barrel and the Phase Out Price was $64.47 per barrel. The Threshold Price and the Phase Out Price are adjusted annually for inflation.

If the Annual Average Price falls between the Threshold Price and the Phase Out Price for a year, the amount by which Section 29 tax credits are reduced will depend on where the Average Annual Price falls in that continuum. For example, for 2004, if the Annual Average Price had been $57.91 per barrel, there would have been a 50% reduction in the amount of Section 29 tax credits for that year.

The Secretary of the Treasury calculates the Annual Average Price based on the Domestic Crude Oil First Purchases Prices published by the Energy Information Agency (EIA). Because the EIA publishes its information on a three month lag, the Secretary of the Treasury finalizes its calculations three months after the year in question ends. Thus, the Annual Average Price for calendar year 2004 was published on April 6, 2005, and the Annual Average Price for 2004 did not reach the Threshold Price for 2004. Consequently, the amount of the Company's 2004 Section 29 tax credits was not adversely affected by oil prices.

The Company estimates that the 2005 Threshold Price will be approximately $52 per barrel and the Phase Out price will be approximately $65 per barrel, based on an estimated 2005 inflation adjustment. The monthly Domestic Crude Oil First Purchases price published by the EIA has recently averaged $5 to $6 lower than the corresponding monthly New York Mercantile Exchange (NYMEX) settlement price for light sweet crude oil. Through July 31, 2005, the average NYMEX contract settlement price for light sweet crude oil was $51.90 per barrel and the average futures price for the remainder of 2005 was $61.86 per barrel. The Company estimates that NYMEX settlement price would have to average approximately $69 per barrel for the remainder of 2005 for the Threshold Price to be reached.

The Company estimates that the 2006 Threshold Price will be approximately $52 per barrel and the Phase Out price will be approximately $66 per barrel, based on estimated inflation adjustments for 2005 and 2006. The monthly Domestic Crude Oil First Purchases price published by the EIA has recently averaged $5 to $6 lower than the corresponding monthly NYMEX settlement price for light sweet crude oil. As of July 31, 2005, the average NYMEX futures price for light sweet crude oil for calendar year 2006 was $63.17 per barrel. Based upon the estimated 2006 Threshold Price and Phase Out prices, if oil prices for 2006 remained at the July 31, 2005 average futures price level of $63.17 per barrel for the entire year in 2006, the Company currently estimates that the Section 29 tax credit amount for 2006 would be reduced by approximately 35% to 40%.

The Company cannot predict with any certainty the Annual Average Price for 2005 or beyond. Therefore, it cannot predict whether the price of oil will have a material effect on it synthetic fuel business after 2004. However, if during 2005 through 2007, oil prices remain at historically high levels or increase, the Company's synthetic fuel business may be adversely affected for those years and, depending on the magnitude of such increases in oil prices, the adverse affect for those years could be material and could have an impact on the Company's results of operations and synthetic fuel production plans.

In response to the historically high oil prices to date in 2005, the Company adjusted its planned production schedule for its synthetic fuel facilities by shifting some of its production planned for April and May 2005 to the second half of 2005. If oil prices rise and stay at levels high enough to cause a phase out of tax credits, the Company may reduce planned production or suspend production at some or all of its synthetic fuel facilities.

SALE OF PARTNERSHIP INTEREST

In June 2004, the Company, through its subsidiary Progress Fuels, sold in two transactions a combined 49.8% partnership interest in Colona Synfuel Limited Partnership, LLLP, one of its synthetic fuel facilities. Substantially all proceeds from the sales will be received over time, which is typical of such sales in the industry. Gain from the sales will be recognized on a cost recovery basis as the facility produces and sells synthetic fuel and when there is persuasive evidence that the sales proceeds have become fixed or determinable and collectability is reasonably assured. Based on projected production and tax credit levels, the Company anticipates receiving total gross proceeds of approximately $22 million in 2005, approximately $32 million in 2006, approximately $34 million in 2007 and approximately $10 million through the second quarter of 2008. Gain recognition is dependent on the synthetic fuel production qualifying for Section 29 tax credits and the value of such tax credits as discussed above. Until the gain recognition criteria are met, gains from selling interests in Colona will be deferred. It is possible that gains will be deferred in the first, second and/or third quarters of each year until there is persuasive evidence that no tax credit phase out will occur for the applicable calendar year. This could result in shifting earnings from earlier quarters to later quarters in a calendar year. In the event that the synthetic fuel tax credits from the Colona facility are reduced, including an increase in the price of oil that could limit or eliminate synthetic fuel tax credits, the amount of proceeds realized from the sale could be significantly impacted. As of June 30, 2005, a pre-tax gain on monetization of $6 million has been deferred. Assuming oil prices stay at current levels, the Company anticipates that this gain will be recognized later this year.

5. Other Legal Matters

Florida Progress and PEF are involved in various other claims and legal actions arising in the ordinary course of business, some of which involve claims for substantial amounts. Where appropriate, accruals and disclosures have been made in accordance with SFAS No. 5, "Accounting for Contingencies," to provide for such matters. Florida Progress and PEF believe the ultimate disposition of these matters will not have a material adverse effect upon either Company's consolidated financial position or results of operation.

Exhibit B(1)

PROGRESS ENERGY FLORIDA, INC.
PRELIMINARY PROJECTION OF SOURCES AND USES OF FUNDS
(In Millions)

	12 Months Ending December 31, 2006
OPERATING ACTIVITIES	$ 1,030
INVESTING ACTIVITIES:	
Construction Expenditures	(645)
Other Investing Activities	(10)
Total	(655)
FINANCING ACTIVITIES:	
Long-Term Debt (Repayments)/Issuance	(48)
Dividends Paid on Common Stock	(120)
Increase (Decrease) in Short-Term Debt	(205)
Preferred Dividends	(2)
Total	(375)
TOTAL INCREASE (DECREASE) IN CASH	$ 0

Exhibit B(2)

PROGRESS ENERGY FLORIDA, INC.
PRELIMINARY CONSTRUCTION EXPENDITURES FOR 2006
(In Millions)

BUDGET CLASSIFICATION	**PRELIMINARY BUDGET**
PRODUCTION PLANT	330
TRANSMISSION PLANT	100
DISTRIBUTION PLANT	215
GENERAL PLANT	-
TOTAL LESS AFUDC	**$ 645**

Exhibit C

PROGRESS ENERGY FLORIDA, INC.
CAPITAL STOCK AND LONG-TERM DEBT
As Of September 30, 2005

Title of Class	Shares Authorized	Shares Outstanding	Amount Outstanding
Common Stock without par value	60,000,000	100[1]	N/A
Cumulative Preferred Stock (Par Value $100):			
4.00% Series	40,000	39,980	$ 3,998,000
4.40% Series	75,000	75,000	7,500,000
4.58% Series	100,000	99,990	9,999,000
4.60% Series	40,000	39,997	3,999,000
4.75% Series	80,000	80,000	8,000,000
Total Cumulative Preferred Stock Outstanding			$ 33,496,000
First Mortgage Bonds:			
6-7/8% Series, due 2008			$ 80,000,000
4.50% Series, due 2010			300,000,000
6.65% Series, due 2011			300,000,000
4.80% Series, due 2013			425,000,000
5.10% Series, due 2015			300,000,000
5.90% Series, due 2033			225,000,000
Citrus County 2002, Series - A, Due 2027			108,550,000
Citrus County 2002, Series - B, Due 2022			100,115,000
Citrus County 2002, Series - C, Due 2018			32,200,000
Total First Mortgage Bonds Outstanding			$1,870,865,000

[1] All of the Company's outstanding shares of common stock are owned beneficially and of record by the Company's parent, Florida Progress Corporation.

Medium-Term Notes:

6.77%, due 2006	$	45,000,000
6.81%, due 2007		85,000,000
6.67%, due 2008		10,300,000
6.75%, due 2028		150,000,000
Total Medium-Term Notes Outstanding	$	290,300,000
Total Long-Term Debt Outstanding:		$2,161,165,000

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