

COMMONWEALTH OF VIRGINIA

COUNTY OF ARLINGTON

AFFIDAVIT

Robert L. Sansom, after first being duly sworn, deposes and states:

1. My name is Robert L. Sansom. I am President of Energy Ventures Analysis, Inc., an economic consulting firm that specializes in the evaluation of markets for coal and other fossil fuels. I have served as a consultant and expert witness on matters involving conditions in coal markets, transportation of coal, solicitations for coal supplies, coal contracts, and prices for coal for 30 years. In that time, I have personally reviewed hundreds of contracts and many solicitations for the purchase and sale of coal. I submitted testimony before the Florida Public Service Commission in 1988 and in 2004. My educational background and professional experience are summarized on Exhibit 1 to this Affidavit (attached).
2. I have been retained by the Florida Office of Public Counsel to review certain transactions involving Progress Energy Florida, Inc. ("PEF") (through its affiliate, Progress Fuels Corporation, ("PFC") to whom PEF looks to supply its coal needs at its Crystal River generating station) and the Marketing and Trading structure within Progress Fuels Corporation.
3. For purpose of preparing this Affidavit I have reviewed the following:
 - a. Progress Energy Florida, Inc.'s FPSC Form 423-1 for the months of January 2005-June 2005, inclusive.

- b. Requests For Proposals (RFPs) to supply term contract coal to Crystal River Units 1& 2 and Crystal Units 4&5 during 2005 and 2006, issued by Progress Fuels Corporation in May of 2004.
- c. Progress Fuels Corporation's "Master Bidders' List," containing the names of potential suppliers to whom, according to PEF, the RFPs identified above were communicated.
- d. Documents and workpapers prepared by Progress Fuels Corporation in the course of evaluating responses to the RFPs identified above.
- e. A contract between Progress Fuels Corporation, as purchaser, and Progress Fuels Corporation, in its own capacity and as agent for others, dated November 17, 2004.
- f. Fall 2004 correspondence to the management of Progress Energy Florida, Inc. from Mr. Al Pitcher, Vice President of Progress Fuels Corporation, sent after the completion of the RFPs identified above and associated contract awards, in which he stated his reasons for not issuing a formal solicitation for the remaining balance of coal needed to supply the Crystal River units in 2005-2006.
- g. Documents prepared by Progress Fuels Corporation in the course of evaluating the four to five supplier contacts (informal emails and telephone calls) made by Mr. Pitcher to prospective suppliers of additional coal needed in 2005 and 2006. Mr. Pitcher contacted Progress Fuels Corporation's own Marketing and Trading section and three to four South American coal suppliers.
- h. A contract between Progress Fuels Corporation, as purchaser, and Progress Fuels Corporation, in its own capacity and as agent for others, for additional quantities

of term coal supply for Crystal River Units 4&5 during calendar years 2005 and 2006, dated January 1, 2005.

- i. A summary of Fall 2001 FPC information relied on by FPC to purchase additional coal on a “spot” basis.
 - j. The transcript of the deposition of Mr. Al Pitcher, conducted by the Florida Office of Public Counsel on October 21, 2005, together with all of the exhibits to the deposition, including, but not limited to, the bid evaluation documents mentioned above.
 - k. Progress Energy Florida’s Answers to Citizens’ Second Set of Interrogatories, dated October 4, 2005.
 - l. Progress Energy Florida, Inc.’s Answers to Citizens’ Third Set of Interrogatories, dated October 28, 2005.
 - m. Public information on various domestic and international coal and transportation markets in 2004 and 2005.
 - n. To date, I have not had the opportunity to review FPC’s coal supply and transportation contracts other than the two affiliate coal supply contracts cited, FPC/PFC and coal supplier correspondence, and FPC inventory and actual projected burn data.
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4. For purposes of this Affidavit, I have considered the following facts, which I believe are not in dispute:
- a. Progress Energy Florida, Inc., and Progress Fuels Corporation are subsidiaries of the same corporate entity, Progress Energy, Inc. Progress Fuels Corporation is thus an affiliate of Progress Energy Florida, Inc. Progress Fuels Corporation is in

the business of mining and selling coal. In the 1970's, Progress Energy Florida, Inc. and Progress Fuels Corporation entered long term contracts pursuant to which Progress Fuels Corporation supplies the full needs of Progress Energy Florida, Inc. for coal at its Crystal River plant site, where PEF owns and operates four large coal-fired generators. To fulfill the contracts, Progress Fuels Corporation may supply coal that it mines and/or markets, or it can purchase the coal from other entities. Because Crystal River Units 4&5 must burn coal of a certain quality to meet requirements of environmental regulations ("compliance coal"), and Crystal River Units 1&2 can burn coal of lesser quality (that is, coal containing higher sulfur content than that burned in 4&5), Progress Energy Florida, Inc. and Progress Fuels Corporation entered separate contracts for the supply of coal to Units 1&2 and Units 4&5.

- b. Progress Fuels Corporation owns or holds ownership positions in the following corporate entities, all of which are also engaged in the mining and/or marketing of coal: Diamond May Coal Company ("Diamond May"), Kentucky May Coal Company, Inc. ("Kentucky May"), Powell Mountain Coal Company, Inc. ("Powell Mountain"), and Kanawha River Terminals, Inc. ("Kanawha River Terminals"). Because of these corporate relationships, Diamond May, Kentucky May, Powell Mountain, and Kanawha River Terminals, like Progress Fuels Corporation, are affiliated with Progress Energy Florida.
- c. In May of 2004 Progress Fuels Corporation took steps to secure a supply of coal to meet the operating requirements of Crystal River Units 1,2, 4, and 5 during calendar years 2005 and 2006. Progress Fuels Corporation issued formal

solicitations, or Requests For Proposals, to potential suppliers on its “Master Bidders List.” The list contains the names of some seventy potential suppliers. Progress Energy received 37 proposals from 20 bidders. After evaluating all of the proposals, Progress Fuels Corporation entered five contracts for a total of 4.5 million tons of coal to be delivered to Units 1,2, 4, and 5 during 2005-2006. One of these contracts was awarded to Progress Fuels’ own “Marketing and Trading” organization.

- d. Following the completion of these RFPs, PFC proceeded to secure additional coal for delivery in 2005-2006. According to a September 14, 2004, PFC memorandum, PFC awarded to Progress Fuels Corporation Marketing and Trading “M&T” a two year term contract for the shipment of Central Appalachia (CAPP) coal. No other CAPP producer was solicited by any method (written, telephone, or email); nor did PFC contact any supplier of western Powder River Basin (PRB) coal. PFC contacted four South American coal vendors by telephone and email, but there was no written solicitation. At the time, world coal market prices were at high levels. PFC awarded a contract to one South American vendor. The contract awarded to PFC et. al. is dated January 1, 2005 and calls for 480,000 tons per year to be shipped from river docks in West Virginia via the Ohio and Lower Mississippi Rivers to a New Orleans terminal (formerly IMT), then transshipped across the Gulf of Mexico to Crystal River Units 4 and 5.
- e. An internal September 2004 FPC document refers to this award as a “spot” purchase which it manifestly was not. PFC failed to contact any other CAPP coal

producer/sales company despite its own “Master Bidders List” which includes over 40 CAPP producers. This performance is inexplicable.

- f. PEF contends that it did not want to issue a formal solicitation for the second procurement effort because “it would add stress to pricing” (Pitcher deposition p. 47). In my opinion there is no basis for PEC’s statement (particularly as a precursor to an award to an affiliate) as it is well established that for buyers of CAPP term coal, public solicitations are effective in procuring least cost coal.

CONCLUSIONS

Based on my experience and expertise in coal markets, coal solicitations, and coal contracts, my review of the documents and materials identified above, and my review of the facts that I have delineated, I conclude the following:

1. To ensure that it has identified the most favorable price for term coal that is available at a particular time, it is necessary for a purchaser to explore the market of potential suppliers thoroughly. If the coal is purchased from a large supply region like CAPP, this can be done only through a solicitation that is provided to a number of potential suppliers sufficient to reflect accurately the conditions prevailing in the market.
2. Because of the conflicts of interest inherent in a situation in which the purchaser of coal is also a potential supplier of that coal, and the opportunities for favoritism that such “self-dealing” transactions entail, it is particularly important that a regulated utility considering a purchase from an affiliated company first conduct a thorough and active solicitation of the market. In the absence of such a solicitation, the utility will be unable to demonstrate to

regulators that the price paid to the affiliate was the most favorable available under the market conditions that prevailed at the time. Given that Progress Energy Florida, Inc. effectively delegated the role of securing the entire supply of coal to its four Crystal River coal-fired generating units to Progress Fuels Corporation, an affiliated company; given that Progress Fuels Corporation is in the business of selling coal to (among others) Progress Energy Florida, Inc.; and given that the suppliers of coal with whom Progress Fuels Corporation routinely deals include—not only its own Marketing and Trading section—but several subsidiaries and/or companies in which it has an ownership interest, the need for a thorough and active solicitation sufficient to establish the lowest market price and thereby demonstrate arms-length transactions was even more important.

Progress Fuels Corporation maintains an extensive list of potential suppliers. Progress Fuels Corporation conducted a thorough solicitation of the market when in 2004 it took its initial steps to secure the first portion of the 2005-2006 needs at Crystal River. However, based on the evaluations of bids that PEF performed and that were included in the documentation provided to the Office of Public Counsel during discovery, it appears that Progress Fuels Corporation did not award any portion of the contracts for supply to the bidder(s) that offered the lowest price coal on a “delivered” basis, even though Progress Fuels asserts that is the criterion on which it based its decision. I have seen no documentation that explains why Progress Fuels did not purchase the cheaper coal when it appears, based on Progress Fuels’ own bid evaluations,

that it had the opportunity to do so. If there is an explanation, it has not been provided in PEF's answers to OPC's interrogatories on the subject or in the documents produced by Progress Energy Florida, Inc. to OPC during discovery that have been provided to me. (I have deliberately refrained from identifying in this Affidavit the specific bidders to which I refer and from including any comparison of their bid prices with those that Progress Fuels Corporation accepted in the interest of shielding information that Progress Energy Florida, Inc. has designated as confidential.)

3. Subsequently, when Progress Fuels Corporation decided to limit the universe of potential suppliers for the remaining balance of 2005-2006 needs to the recipients of a total of four to five e-mails and/or telephone calls, the only one of which for CAPP coal was placed to Progress Fuels Corporation's own Marketing and Trading Section, Progress Fuels Corporation fell far short of the measures necessary to ensure that it secured the best available price under prevailing market conditions. Especially in light of the sizable quantity of coal involved, and the fact that Progress Fuels Corporation was proposing a contract having a term of two years, the extremely limited and informal procedure utilized by Progress Fuels Corporation was inadequate to solicit the market effectively. I conclude this even if the proposal that Progress Fuels Corporation received from its Marketing and Trading section was the lowest of the proposals that Progress Fuels Corporation received and considered after contacting the four other potential suppliers. Further, I regard Progress Fuels Corporation's attempt to justify the narrow scope of its inquiries with the

argument that to have issued an RFP at the time would have increased the price because other buyers were in the market at the time as having no credibility. Robust competition among numerous bidders who have been informed that the buyer is consulting the entire market does not increase prices: it lowers them. This is as true of coal markets as it is of markets for other commodities.

Further Affiant sayeth naught.

Robert L. Sansom

Before me, the undersigned authority, personally appeared ROBERT L. SANSOM, who is personally known to me, or who has produced _____ as identification and who being duly sworn deposes and says that the foregoing Affidavit is true and correct to the best of his knowledge, information and belief.

Notary Public
State of
My Commission Expires:

EXPERIENCE OF
DR. ROBERT L. SANSOM

Education

- π Robert Sansom graduated (B.S.) from U.S. Air Force Academy in 1964.
- π In 1965, Dr. Sansom received a Masters degree in economics from Georgetown University.
- π In 1968/69, he received a B. Phil and D. Phil in economics from Oxford University.

Honors

- π Dr. Sansom was a Fulbright Scholar, Rhodes Scholar, and White House Fellow.

Experience

- π From 1968 to 1969, Dr. Sansom was a White House Fellow assigned to Assistant to the President for National Security Affairs.
- π From 1969 to 1971, he was on Dr. Henry Kissinger's National Security Council staff.
- π From 1971 to 1972, he was Deputy Assistant Administrator for Planning and Evaluation for the Environmental Protection Agency.
- π From 1972 to 1974, he was Assistant Administrator for Air and Water Programs at the Environmental Protection Agency.
- π From 1974 to 1980, Dr. Sansom was President of Energy and Environmental Analysis, Inc.
- π From 1981 to the Present, Dr. Sansom has been President of Energy Ventures Analysis, Inc.

Sansom has been active in energy and environmental consulting since 1974 and throughout the period has focused on the coal, natural gas and electric utilities industries and on related environmental issues.

- π coal, gas, and oil production, markets and prices,
- π coal and gas contracts and procurement,
- π coal suitability and the environmental effects of coal combustion,
- π electric power markets and projects, and
- π coal transportation.

Electric Power Markets

Dr. Sansom analyzes and testifies on electric power markets and prices. In several cases (PEPCO, PP&L, NIPSCO, Entergy, Sierra Pacific, AEPCO, Bonneville Power Administration, for example), Sansom has examined power pricing and power transactions. EVA's analysis employs public and proprietary data and models at the NERC or NERC subregion level and develops forward pricing curves. Sansom presented testimony before FERC in 1996 on Order 888A: promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services.

Coal Markets and Coal Property Transactions

Coal market studies by EVA's coal group cover all the major coal producing and using regions of the United States. Clients include the major U.S. coal companies, major U.S. utilities, and groups such as EPRI and the National Mining Association.

EVA maintains large data bases on all U.S. mines and utility coal users. For clients it utilizes its proprietary coal production cost models and tracks and forecasts demand and prices for U.S. and international steam and metallurgical coals.

The U.S. coal market is regionalized with the reach of a particular coal mine limited by its transportation costs to various markets, its competition as well as the quality of its coal and its production cost. EVA addresses these issues in its market studies on a regional and international basis with analyses sold to clients on a job-specific basis or through its COALCAST subscription coal service.

In coal property and coal company valuations for buyers and sellers, EVA employs its market, cost of mining, and coal contract expertise using discounted cash flow and comparable transactions methods.

Coal and Transportation Contracts

Major U.S. coal transactions occur pursuant to coal and rail transportation contracts between buyers and sellers. Sansom has reviewed over 300 long-term coal contracts and many coal transportation contracts. He has advised utilities and coal companies on coal and rail transportation contract terms and conditions. His expertise is frequently sought and utilized in contract disputes.

Electric Utility Audits

EVA is often hired by Public Utility Commissions to conduct prudency audits of utility coal procurement practices and wholesale power transactions. Sansom has participated in such utility audits in Ohio, Delaware, Florida, Utah, Wyoming, California, Oregon, and Washington, and before FERC.

Natural Gas And Oil Markets

Dr. Sansom has been engaged in analysis of natural gas markets, including mid-stream processing and NGL fractionation. He has examined U.S. and Canadian natural gas production. Other work has addressed world oil markets and OPEC's role therein. Dr. Sansom has examined the role of natural gas combined cycle and coal gasification technologies as base load generating capacity.

Coal Suitability and the Environmental Effects of Coal Use

Sansom's original involvement in the coal industry was in response to the adverse environmental effects of coal use. He has been active in studies on sulfur dioxide, nitrous oxides, particulates, air toxins, and CO₂ emissions. EVA has estimated the cost of specific environmental control technologies at plant sites and the cost of national environmental programs for clients such as the U.S. Environmental Protection Agency, EPRI, and the Department of Energy. It has advised electric utilities on how to comply with acid rain and legislation. Coal suitability involves how a particular coal burns in a particular boiler and how that coal's emissions are treated before discharge to the atmosphere. EVA's studies have included examination of the performance of most U.S. coals used in a broad range of U.S. combustors, including pulverized coal, cyclone, and CFB furnaces.

International Coal and Utility Experience

Sansom has been active in international coal since the mid-1970's, analyzing overseas coal markets and inter-fuel competition. In 1989 Sansom testified in an international arbitration involving a large Canadian coal producer and the Japanese steel industry. Sansom has

testified in international arbitrations involving independent power projects in the Philippines and Turkey.

Western Coal, Utility, and Transportation Experience

EVA has broad experience in the western U.S. Sansom's western coal and coal transportation expertise is the basis for his testimony on the Powder River Basin, the fastest growing producing region in the United States.

Expert Testimony

Sansom's expert testimony most often addresses coal contracts, coal markets, coal transportation and the prudence of coal procurements. Since 1998, Sansom has testified in the following court and arbitration cases:

			<u>On Behalf of</u> <u>Party</u> <u>Regulatory Body</u>	<u>Court or</u> <u>Year</u>	<u>Other</u>
A	CMS Energy	Luzon Power	1998	Hong Kong, China	
A	Otter Tail Power/Minnkota Pwr Coop/NW Pub Svc	Knife River Coal Company	1998	Chicago, IL	
C	Cedar Bay Generating	Florida Power & Light	1999	State Court Florida	
A	Seminole Electric Coop, Inc.	Mt. Vernon Transfer Terminal	2000	Washington, D.C.	
A	CMS Energy	Adams Affiliates, Inc. & Cottonwood Partnership	2001	Chicago, IL	
A	Government of Turkey	PSE&G	2003-2005	Washington, D.C.	
C	Peabody Coal Company/ Indianapolis P&L	John Wasson	2004	U.S. District Court Southern Indiana	
PSC	Peabody Western Coal Co.	Mohave/So Cal Edison	2004	California PSC	
PSC	CSX	Tampa Electric Co	2004	Florida PSC	
A	Marysville Fractionation Partnership	Kinetic Resources	2005	Detroit, MI	
A	Dearborn Industrial Generation	Duke/Flour Daniel	2005	Detroit, MI	

- A Arbitration
- C Court
- PSC Public Service Commission

Arbitration

Sansom has served as an Arbitrator in three coal contract disputes between utilities and coal suppliers.

Publications

"Gas Turbine Mania: The Merchant Power Plant Shakeout", Public Utilities Fortnightly, June 15, 2002.

"Looking Past California: The Emerging Shape of the Generation Sector", Public Utilities Fortnightly, June 1, 2001, pp. 44-50.

"Refinery Permit Delays Evaluated", Oil and Gas Journal, April 23, 1979, pp. 78-82.