BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 060001-EI

FUEL AND CAPACITY COST RECOVERY
FINAL TRUE-UP

JANUARY 2005 through DECEMBER 2005

MARCH 1, 2006

DIRECT TESTIMONY & EXHIBIT OF:

ALBERT W. PITCHER

Progress Energy

PROGRESS ENERGY FLORIDA

DOCKET NO. 060001-EI

DIRECT TESTIMONY OF
ALBERT W. PITCHER

March 1, 2006

Q. Please state your name and business address.

A. My name is Albert W. Pitcher. My business address is: 1715 Georgia Ave NE, St. Petersburg, Florida 33703-4320.

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

A. I recently retired as Vice President of Coal Procurement for Progress Fuels Corporation (PFC). I am currently self-employed as a consultant.

Q. Please describe your educational background and professional experience.

A. I received a Bachelor of Business Administration Degree in Accounting from the University of Cincinnati in 1971. I began my professional career with Arthur Anderson and Company as a staff auditor. I was employed by Cincinnati Gas & Electric Company in various auditing and accounting functions from 1972 until 1976. I began my career with Florida Power Corporation (FPC), now known as Progress Energy Florida (PEF), as a staff auditor in the Audit Services Department in August of 1976. In 1977, I joined Electric Fuels Corporation (EFC), then a wholly owned subsidiary of FPC, as Manager of Accounting. I served in this capacity and that of EFC's

Controller until 1984. At that time, I became Vice President of Sales, charged with the responsibility of selling coal to utilities and industrial customers in the Eastern United States, from both EFC's affiliated mining operations and third-party sources. In September of 2002, following the change of EFC's name to PFC, I assumed the position of Vice President of Coal Procurement. In this capacity, I was responsible for the procurement and transportation of over six million tons of coal delivered annually to PEF's Crystal River plant site. I retired from PFC December 1, 2005.

Q. Are you sponsoring any exhibits with your testimony?

A. Yes, I am sponsoring the following exhibit:

- Exhibit No._____(AWP-1), which is a recommendation related to PFC's August 2004 competitive solicitation.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address issues raised by the Office of Public Counsel (OPC) regarding certain contracts for the purchase of coal from PFC's Marketing and Trading Division (PFC/M&T) for delivery in 2005 and 2006. Based on pleadings and an affidavit filed by OPC in last year's fuel cost recovery docket (No. 050001-EI), it is my understanding that OPC is questioning contracts that resulted from solicitations conducted by PFC's procurement division on PEF's behalf in April and August-September 2004. Although OPC's consultant admits that PFC conducted a thorough solicitation in April 2004, OPC apparently alleges that PFC acted imprudently because it did not award contracts to the lowest bids received in response to that solicitation. In addition, OPC questions a contract awarded to PFC/M&T as a result of the August-September 2004 solicitation because PFC's Procurement Division did not formally issue a Request for Proposals (RFP) and the contract price was higher than prices paid to other suppliers for coal delivered to the Crystal River Plant during certain months reported in PEF's 423 Fuel Report Forms.

Q. Please summarize your testimony.

A. At all times at issue, PFC strictly observed Progress Energy's Standards of Conduct designed to prevent self-dealing. PFC's Procurement Division conducted the solicitations at issue in a reasonable and prudent manner to ensure that all resulting purchases were made at competitive market prices. Although some of the bids submitted in response to the April 2004 solicitation offered prices that were lower than those offered by the winning bidders, PFC's rejection of the lower bids was reasonable and prudent because those lower bids offered coal that either cannot be burned at Crystal River or cannot be reliably and efficiently delivered to Crystal River. In addition, PFC's decision not to formally issue a RFP when it re-entered the market in August 2004 was reasonable and prudent in light of prevailing market conditions. The informal solicitation that PFC conducted in lieu of a formal RFP was a comparable alternative that resulted in competitive bids and valid market prices. Indeed, for both the April and August-September 2004 solicitations, the prices included in the PFC/M&T contracts at issue are consistent with or lower than the prices included in contracts awarded to other suppliers as a result of the same solicitations.

Q. Is it unusual for there to be substantial differences in coal prices reported in a particular 423 report?

A. Not at all, particularly in the volatile markets PFC has experienced during the past four years. It is important to understand that the monthly 423 reports provide the prices paid for coal <u>delivered</u> during the month in question. In any given month, coal is delivered to Crystal River under contracts agreed upon at different times, sometimes spanning a period of years, and under different market conditions. For that reason, prices reported on the 423 Form for coal delivered in any given month may vary widely.

Q. Please explain the relationship between PFC and PEF during your tenure at PFC.

A. PFC and PEF are affiliate companies and are, through various companies, owned by Progress Energy, Inc. Under long-standing coal supply agreements, PFC procured and delivered all of the coal required for PEF's Crystal River Units 1, 2, 4 and 5, which comprise all of PEF's coal-fired generating units. These agreements have been in effect since 1976 for

Units 1 & 2, and since 1984 for Units 4 & 5. The agreements were terminated effective January 1, 2006. During that time-period, PFC had a regulated Procurement Division, which procured coal for PEF, and from 1984, a Marketing & Trading (M&T) Division which sold coal mined by PFC subsidiaries and various third parties to utilities throughout the Eastern United States, including PEF. At all times during my tenure as Vice President of Coal Procurement, PFC's Procurement and M&T Divisions observed the Progress Energy's Standards of Conduct in all transactions. Consistent with the Standards of Conduct, PFC's Procurement Division treated PFC/M&T like any other supplier. PFC's M&T was given no preferential treatment or competitive advantage.

Q. Please describe the April 2004 solicitation that you mentioned previously.

A. In April 2004, PFC issued an RFP on behalf of PEF. The RFP solicited bids for "A" coal (i.e., greater than 1.5 lbs/mmBtu SO2 but less than 2.1 lbs/mmBtu) to be burned at Crystal River Units 1 & 2, and "D" coal (i.e., less than 1.2 lbs/mmBtu SO2) for Units 4 & 5. PFC received fourteen bids for Crystal River Units 1 and 2 and twenty-three bids for Units 4 and 5.

In accordance with PFC's standard practice, PFC evaluated the bids based upon the "cash cost" and an "evaluated cost" delivered to the Crystal River Plant. PFC's standard practice is to purchase based upon the cash cost, but PFC also uses the evaluated cost to provide a complete picture of the bids submitted. The delivered cash price incorporates the commodity cost ($/ton) offered by the bidder, as well as PFC's cost for transporting the coal to the Crystal River Plant. The evaluated cost uses all of the factors of the cash cost plus a value above the plant specifications for ash ([redacted]/1.0% above 10%), BTU ([redacted]/100 BTU above or below 12000), sulfur (based upon current SO2 allowance prices), which is below the 1.20# SO2 maximum allowed, moisture ([redacted]/1.0% above 8%), and volatile ([redacted] below 31%). Because coals have different heat input values, the delivered costs are converted to dollars per mmBtu so the offers can be evaluated on an equal basis.

The April 2004 solicitation resulted in the purchase of 4.3 million tons of coal for both Crystal River Units 1 & 2 and 4 & 5. The resulting contracts were for two years (2005 and 2006). PFC awarded three contracts for Crystal River Units 1 & 2 at delivered cash costs ranging from [redacted]/mmBtu to [redacted]/mmBtu and commodity costs ranging from [redacted]/ton to [redacted]/ton. PFC also awarded three contracts for Units 4 & 5 at delivered cash costs ranging from [redacted]/mmBtu to [redacted]/mmBtu and commodity costs ranging from [redacted]/ton to [redacted]/ton. In all cases, PFC purchased the lowest price products based upon the tonnage needed.

Q. Did PFC receive any bids that quoted prices lower than the bids that PFC ultimately accepted?

A. Yes, but these bids were rejected because they either offered coal that PEF could not burn or coal that could not be efficiently or reliably delivered to the Crystal River Plant. Specifically, nine bids offered coal at delivered "cash costs" that were lower than the costs for the bids that PFC accepted for the Unit 4 & 5 contracts. However, eight of these bids offered sub-bituminous coal that the Crystal River Units are not authorized to burn under existing environmental permits. The other bid offered western coal that cannot be efficiently and reliably transported to Crystal River due to the rail congestion on the western railroads. For these reasons, PFC rejected these bids and awarded contracts to the lowest bidders who offered coal that PEF could actually burn and that could be reliably and efficiently transported to the Crystal River Plant.

Q. Do you agree with OPC's criticism of PFC's decision not to issue a formal RFP when it re-entered the market in August 2004?

A. No. The decision by PFC's Procurement Division to not issue a formal RFP was reasonable and prudent in light of the prevailing market conditions. The informal solicitation that PFC conducted in lieu of a formal RFP was a comparable alternative that resulted in competitive bids and contract prices that are consistent with reliable market indicators for the time-period in question. PFC/M&T was awarded a contract because it was the lowest price bidder.

Q. Please explain the circumstances that led up to the decision by PFC's Procurement Division to re-enter the market in August 2004.

A. During August and September 2004, PFC reviewed its open positions (i.e. the need for additional coal) and determined that PEF had an open position for water delivered coal totaling 600,000 tons for 2005 and 550,000 tons for 2006. These open positions were different than previously determined because of changes in the delivery mode of one supply contract, the desire to increase plant inventories, and reduced deliveries during 2004 due to an active hurricane season. From April to September 2004, coal market pricing remained extremely strong, with coal commodity prices increasing from approximately $45 to $50 per ton to approximately $60 to $70 per ton. In early August 2004, various factors culminated which affected both the quantity and price of coal available, including: continued trucking issues in both Kentucky and West Virginia; continued discussions regarding the difficulty of obtaining mining permits; strong commodity pricing; and entrance of four major utilities (Tennessee Valley Authority [TVA], South Carolina Electric & Gas, South Carolina Public Service and Constellation) into the market for large tonnage through formal RFPs. Accordingly, PFC decided to quickly re-enter the marketplace to "close out" its 2005 and 2006 open positions by informally soliciting offers for water-delivered coal. The goal was to enter into contracts for the needed coal before it was firmly tied up under the four large outstanding RFPs from other utilities.

Q. How could PFC contract for coal that was the subject of a response to one of the outstanding RFPs from other utilities?

A. First, these utilities had entered the market place, but their "RFP due date" had not occurred. Second, responses to RFP's are typically made "subject to prior sale." This is especially true in today's volatile market. It was PFC's intent to enter the market and act quickly before the other utilities had a chance to respond. Once PFC would inform a supplier of its desire to purchase, they would remove their bid from the other RFP's due to the "subject to prior sales" clause. In this market place it is truly "first-come, first served."

Q. Why was the August-September solicitation limited to water-delivered coal?

A. At that time, PEF's open position was limited to water-delivered coal because it had sufficient supplies of rail-delivered coal under contract.

Q. Please describe the August-September 2004 solicitation.

A. In August and September 2004, I conducted an informal solicitation by contacting five vendors to determine their ability to supply water-delivered coal and at what price. PFC received six bids from three reliable water delivered suppliers. After the bids were evaluated, PFC awarded contracts to the two lowest cost suppliers. PFC/M&T provided the lowest bid and was awarded a two year contract for 480,000 tons per year. The next lowest bidder, Coal Marketing Company (CMC), was awarded a contract for 450,000 tons (150,000 tons in year one and 300,000 tons in year two).

Q. Why did PFC decide not to issue a formal RFP when it re-entered the marketplace in August 2004?

A. A formal RFP was not practicable at the time because of the marketplace issues discussed previously in my testimony and their affect on the quantity and price of coal available. Coal prices were increasing and several major utilities had already entered the market. To issue a formal RFP at that time would have potentially placed PFC in a position where it would not have been able to purchase the required coal because an RFP would have alerted the other utilities to its needs. PFC concluded that the best way to secure the most inexpensive coal in the quantities needed was to quickly secure it before commitments were made to the other utilities with outstanding solicitations.

Q. How did you choose the specific suppliers that you contacted?

A. As a result of continuing contacts with suppliers, I knew that domestic water-delivered coal was in very short supply and that virtually all of the reliable suppliers of domestic water-delivered coal did not have coal to sell.

I contacted all of the reliable suppliers of water-delivered coal on PFC's master bid list except for those whom I knew did not have coal based on previous contacts with them. This included PFC/M&T and four suppliers of South American coal (CMC, Guasare, Drummond and Glencore). Only two other suppliers of water-delivered coal (Central Coal and Massey Energy) had responded to PFC's April RFP and I knew that neither of those suppliers had coal available.

Q. How did PFC evaluate the bids received in response to the August-September 2004 solicitation?

A. PFC used the same methodology that it used for all coal purchases. PFC evaluated the bids based on both the "cash cost" and "evaluated cost" to the Crystal River Plant. However, as was usual practice, it purchased based upon the cash cost of the products offered. To ensure that the bids were consistent with prevailing market conditions, PFC also compared the bid's commodity price to current market commodity prices reported by United Power, Inc. and Henwood Energy Services, Inc. The United Power and Henwood reports are widely recognized in the industry as reliable market indicators.

Q. What were the results of PFC's evaluation of the bids received in response to your informal solicitation in August-September 2004?

A. Exhibit No. __ (AWP-1) is my recommendation to management. It presents the results of PFC's evaluation of the initial three bids received from PFC/M&T, CMC and Guasare in response to the informal solicitation. When contacted for the informal September 24th solicitation, Drummond had no coal available. The delivered "cash cost" for the PFC/M&T and CMC bids were [redacted]/mmBtu and [redacted]/mmBtu, respectively. The delivered "cash cost" of the Guasare bid was approximately [redacted]/mmBtu higher than either the PFC/M&T or CMC bids. After I submitted my recommendation, PFC received a fourth bid from Glencore, but it also was rejected because the delivered "cash cost" was almost more than [redacted]/mmBtu higher than the PFC/M&T and CMC bids.

Q. How did the PFC/M&T and CMC bids compare to available market indicators.

A. As I noted previously, PFC also compared the delivered cash costs for PFC/M&T at [redacted]/mmBtu and CMC at [redacted]/mmBtu to the delivered cash cost that was calculated using current market commodity prices reported by United Power and Henwood. The delivered costs of the PFC/M&T and CMC bids were within a reasonable range of market as indicated by United Power and Henwood. The average delivered cost of the two indicators were [redacted]/mmBtu. The commodity prices for the PFC/M&T

and CMC bids ([redacted]/ton and [redacted]/ton respectively) were also within a reasonable range of market prices reported by United Power and Henwood, which ranged from [redacted]/ton to [redacted]/ton. This demonstrates that the August-September 2004 solicitation resulted in valid market prices.

Q. Does this conclude your testimony?

A. Yes

REDACTED

Pitcher, Al (PFC)

From: Pitcher, Al (PFC)
Sent: Wednesday, September 15, 2004 12:37 PM
To: Byone, Steve (Energy); Fox II, David M (Energy)
Cc: Crake, Kyle (Energy)
Subject: FW: Spot Barge Purchases 2005-2006
Importance: High

Below is an email sent to Kyle last evening. He and I have discussed and are ready to act pending discussion with you. Kyle is out of the office today and requested that I contact you. Please review and call is necessary. Kyle will contact Tom regarding this matter. Time is of the essence because there is an expiration of these offers.

A. W. Pitcher
Vice President-Coal Procurement
Progress Fuels Corporation
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E-mail al.pitcher@progressfuels.com

-----Original Message-----
From: Pitcher, Al (PFC)
Sent: Tuesday, September 14, 2004 6:49 PM
To: Crake, Kyle (Energy)
Subject: Spot Barge Purchases 2005-2006

The current coal market, both rail and barge, continues to be very strong because of lack of supply due to the trucking issues in both Kentucky and West Virginia and various environmental issues regarding permitting. There is no indication that any material decline in pricing will occur until late in 2005 or early 2006. In addition to the strong pricing, multiple utilities (TVA, South Carolina Gas & Electric, South Carolina Public Service, and Constellation) are currently in the market for large tonnage. Basically, many potential customers are chasing very few tons. TVA is seeking both rail and barge coal and this email concerns our Delta barge coal requirements for 2005 and 2006.

Based upon the above facts, it is my opinion that issuing an RFP for Delta barge coal, at this time to chase a very limited supply, is unwise. I have been calling various suppliers to determine availability for next year and I have found very few tons available and most of the companies want two year agreements (2005-2006). PFC's 2005 and 2006 open position for Delta barge delivered coal is approximately 600,000 tons and 550,000 tons respectively. These amounts are different than previously discussed because we have shifted the entire Massey Delta contract to rail delivery, because this is the most economical move for this coal, and our estimated beginning 2005 inventory at IMT will be higher due to delayed deliveries resulting from a very active hurricane season. Previous projections had Massey Delta contract split 50% rail and 50% water to balance logistics.

Based upon our 2005 and 2006 requirements, I recommend purchasing the following:

Progress Fuels Corporation-Marketing & Trading (M&T)	Up to 40,000 tons per month at a delivered price of [redacted] The term would be 1/1/2005-12/31/2006
CMC/Coal Marketing Company Ltd. (Colombian)	Up to 25,000 tons per month at a delivered price of [redacted] The term would be 1/12005-12/31/2006

See the attached evaluations. Three bids were considered and only one other bid was near competitive. The Guasare bid was approximately [redacted] higher, on a delivered basis, than the either the M&T or the Colombian bid.

Please note the CMC offer expires on Friday September 17. No time was given. Therefore, I am assuming the close of business.

A. W. Pitcher
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