PROGRESS ENERGY FLORIDA

DOCKET NO. 060001-EI

Fuel and Capacity Cost Recovery
January through December 2007

DIRECT TESTIMONY OF JOSEPH MCCALLISTER

Q. Please state your name and business address.

A. My name is Joseph McCallister. My business address is 410 South Wilmington Street, Raleigh, North Carolina 27601.

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

A. I am employed by Progress Energy Carolinas in the capacity of Director, Gas & Oil Trading.

Q. Have you previously filed testimony before this Commission in this ongoing docket?

A. No, I have not. I was recently appointed the responsibilities for the procurement and trading of natural gas and oil on behalf of Progress Energy Florida (Progress Energy or the Company).

Q. Please briefly describe your educational background and business experience.

A. I obtained a Bachelor of Science in Business Administration majoring in Accounting from Ohio State University in 1987. I was recently appointed the Director, Gas and Oil Trading for Progress Energy Carolina's. I joined Progress Energy Service Company LLC in November 2003. Prior to my current position, I served as Director of Portfolio and Market Risk Assessment in the Enterprise Risk Management Group. Subsequent to my tenure with Progress Energy, I spent approximately 10 years in various positions at energy trading and asset generation based companies. Previous management experiences include gas and power scheduling, real time operations, gas storage asset management, integration and commercial optimization of generation, fuel and load portfolios, contract management, and corporate planning.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present and address PEF's Risk Management Plan for fuel procurement in 2007. In addition, I will address the Company's actions to mitigate price volatility through its hedging strategies.

Q. Has PEF developed its Risk Management Plan for fuel procurement in 2007 in accordance with the Resolution of Issues proposed by Staff and approved by the Commission in Order No. PSC-02-1484-FOF-EI, Docket No. 011605-EI?

A. Yes. PEF's Risk Management Plan was prepared in accordance with the Resolution of Issues approved by the Commission and is attached to my prepared testimony as Exhibit No. ___ (JM-1P). Certain confidential information in the exhibit has been redacted, consistent with the Company's request for confidential classification of this information.

Q. What are the objectives of PEF's hedging plans for 2007?

A. The objectives of PEF's natural gas, heavy (No. 6 or residual) fuel oil, and light (No. 2 or distillate) fuel oil hedging plans are as follows:

1) Mitigate price risk and volatility, 2) provide price certainty to smooth out prices over time, 3) maintain a diverse portfolio of volumes and prices over time, and 4) where the potential exists and is consistent with our first three objectives, to provide ratepayer savings through lower natural gas and oil costs.

Q. Please describe the hedging activities Progress Energy plans for 2007 for its natural gas requirements.

A. PEF executes physical and financial natural gas hedging in accordance with the Company's approved natural gas hedging strategy. PEF has and will continue to utilize physical fixed price agreements and financial products, including fixed price swaps and options to hedge natural gas prices. As of July 31, 2006, the Company has hedged approximately 41% of its 2007 projected natural gas usage. The weighted average fixed priced paid for physical purchases and fixed priced financial swaps executed for 2007 is approximately $6.47/MMBtu.

Q. Please describe the hedging activities PEF plans for oil in 2007?

A. The Company has been and continues to use financial products including fixed price swaps and options to hedge its projected heavy oil requirements. As of July 31, 2006, the Company has hedged approximately 36.2% of its 2007 projected heavy oil usage at an equivalent fixed price of $7.56/MMBtu.

Q. What is PEF's time frame for hedging forward prices of natural gas and oil?

A. The Company's current hedging strategy now extends for a current plus 4 year period.

Q. What were the results of PEF's hedging activities during the January through July 2006 period?

A. The Company's hedging activities produced customer savings of approximately $87.7 million for natural gas and heavy oil. For the seven-month period from January through July 2006, PEF hedged approximately 69.4% of its natural gas consumption and approximately 68.5% of its heavy oil consumption.

Q. Does this conclude your testimony?

A. Yes, it does.

Docket No. 060001-EI
Progress Energy Florida
Witness: Joseph McCallister
Exhibit No.__(JM-1P)
Filed September 1, 2006

Progress Energy Florida, Inc.
Risk Management Plan
Fuel Procurement and Wholesale Power Purchases

I. Objective

The objective of Progress Energy Florida, Inc.'s, (PEF) Risk Management plan is to provide the mechanisms to manage PEF's overall fuel costs and wholesale power purchases to provide reliable service to PEF's customers. As a result, this should ultimately reduce the number of mid-course corrections to the fuel factor portion of the customer's bill. The risk management plan allows for the use of various tools to reduce price volatility of natural gas and oil using approved products to hedge either financially and/or physically.

II. Fossil Fuel and Purchased Power Future Needs

A. Fossil Fuel

1. Coal
   - PEF plans to burn approximately 6.3 million tons of coal in 2007 and 6.1 million tons in 2008.

2. Heavy (No. 6 or Residual) Oil
   - PEF plans to burn approximately 8.9 million bbls. of heavy oil in 2007 and 8.3 million bbls. in 2008.

3. Light (No. 2 or Distillate) Oil
   - PEF plans to burn approximately 1.1 million bbls. of light oil in 2007 and 0.8 million bbls. in 2008.

4. Natural Gas
   - PEF plans to purchase approximately 88.6 Bcf in 2007 and approximately 100.3 Bcf in 2008 for consumption in PEF's generating plants as well as plants unrelated to PEF under purchase power natural gas tolling agreements.

B. Purchased Power - PEF plans to purchase approximately 0.7 million MWH in 2007 and 0.8 million MWH in 2008, and sell approximately 0.3 million MWH in 2007 and 0.4 million MWH in 2008 on the economy wholesale market.

III. Risk Management Profile

A. Risk Identification
* The primary risks PEF has identified with procurement of fossil fuels and purchased power are:

1. Coal

- Plant availability due to unscheduled outages.
- Supply or transport problems due to labor disputes, weather, or other unforeseen delays.
- Coal quality errors.
- Financial strength of suppliers.
- Changes in laws regulating mining, transportation or burning of coal.
- Price volatility.

2. Oil (Heavy and Light)

- Differences between forecasted/scheduled requirements and actual requirements due to economic changes, overall power demand, weather changes, change in price relationships between competing fuels, plant availability (maintenance/unexpected shutdowns or startups), out-of-economic plant dispatch (e.g., due to transmission system constraints), and power market changes.
- Differences between forecasted/scheduled deliveries and actual deliveries due to supply or transport problems, and loading and unloading delays.
- Fuel quality problems such as blending errors, off-spec deliveries, changes in SO2 values, and changes in plant fuel handling capability.
- Changes in laws, regulations, and plant permits that may affect the amount, cost, testing requirements or quality of oil required.
- Impact of regulatory, management, internal and external audit reviews.
- General industry changes that impact overall availability, cost, and quality of fuel oil.
- Price volatility and fuel oil market related factors.

3. Natural Gas

- Imbalance penalties with interstate pipelines as a result of over/under burns based on differences between forecasted /scheduled gas and actual requirements due to, but not limited to, changes in weather, plant availability, and alert day tolerances.
- Deliveries by interstate pipelines and suppliers impacted by force majeure events, such as pipeline disruptions, production outages, hurricanes, and weather related events.

- Natural gas storage level deviation from expected norms.
- Crude oil prices.
- Degree-day deviations from expected monthly norms.
- Defaults by suppliers.
- Price risk based on volatility in the natural gas industry.
- Contractual disputes regarding payment and deliveries.

4. Purchased Power

- Default risk – inability of the supplier to obtain adequate resources to deliver the power per contract or agreement.
- Directional price risk – e.g., purchased power contracts in which the price of the purchased power is tied to an index.
- Physical risk – inability of electrical grid to reliably support power transfer.
- Credit risk – inability of contract counterparty to deliver per contract resulting in purchase of higher cost purchased power.
- Basis risk – e.g., supplier(s) can experience adverse weather as compared with PEF's service territory.

B. Risk Quantification

- Quantification of various risks, including stop-loss limits and Value-at-Risk (VaR) calculations, are included in Regulated Commercial Operations and Regulated Fuels Risk Management Guidelines.

C. Risk Management (Daily Management Activities)

1. Coal

- Review actual conditions and adjust delivery schedules as needed.
- Maintain contacts with plants and suppliers.
- Monitor market prices and spot market options.
- Monitor supplier's financial strength.
- Build flexibility on volume terms into agreements.
- Develop alternative supply sources whenever possible.

2. Oil

- Monitor actual conditions and consumption levels versus forecasted levels and update forecasts frequently as conditions change. Adjust delivery schedules as needed.
- Monitor actual delivery status and maintain frequent contact with suppliers and receiving plants to anticipate problems and take corrective action.
- Keep current on market prices and activity. Utilize contract price options, inventory, and spot market options as appropriate.
- Hedge heavy oil to reduce price volatility for the ratepayers.
- Continue to scrutinize a supplier's financial strength in order to assess ongoing creditworthiness.

3. Natural Gas

- Monitor plant gas burns versus forecasted gas burns. If gas burn is projected to be out of tolerance on the pipeline, reschedule gas and re-allocate gas to different plants, or possible switching to alternative fuels.
- Use fuel oil, where applicable, to maintain load.
- Build additional optionality into seasonal/term contracts by specifying the use of a daily or a monthly market index (with the right to select either one), include take or release triggers on volumes to allow added flexibility, as well as the right to mutually agree to a fixed price.
- Implement term contracts that allow swing volumes.
- Hedge natural gas to reduce price volatility for the ratepayers.
- Evaluate zero cost collars for physical natural gas requirements in lieu of, or in conjunction with, fixed-price natural gas.
- Evaluate the premium cost of purchasing a call option for a percentage of the utility's monthly natural gas requirements.
- Use physical fuel oil inventory, where applicable, to dispatch at lowest fuel price. Logistics of physical fuel oil inventory levels must also be managed with this alternative.
- Re-market any excess gas supplies and /or capacity, separately or bundled, on a daily basis.
- Continue to scrutinize a supplier's financial strength in order to assess ongoing creditworthiness.

4. Purchased Power

- PEF assesses each supplier's ability to deliver power based on historical reliability as a supplier (default risk) and credit ratings.
- Utilize both fixed price contracts (next day purchases) and variable price contracts tied to a specific counterparty's incremental cost.

- Utilize firm transmission paths where available for reliable purchased power.

5. Portfolio Management

    - PEF will manage its risks associated with meeting its forecasted load requirements by maintaining a generation fleet with the capability of fuel switching, contracting for a diverse fuel supply and transportation portfolio, and the use of sales and purchases of energy to and from outside sources.

D. Acceptable Level of Risk

1. Oil and Coal - The amount of risk considered acceptable is based on past experiences with what has been successful and evaluating the risk profile of any problems or opportunities based on this experience.

2. Natural Gas - Decisions regarding acceptable risk are based on the circumstances at the time natural gas is purchased. The circumstances at the time may include scenarios involving all or a part of the following: force majeure events, fuel oil inventories, competitive fuel pricing, supply constraints, and forward pricing trends. For example, if PEF views a strong directional market trend for natural gas based on industry reports, events in the marketplace, demand, and storage levels, PEF would consider implementing the risk management tools identified for managing natural gas risk.

3. Purchased Power- Considerations for purchasing power on a long term and mid-term basis include, but are not limited to the following:
    - Price curves – directional price risk associated with fuel and power.
    - Plant outages.
    - Load forecast.
    - Physical risk associated with transfer capability of transmission system.
    - Credit worthiness of potential supplier(s).
    - Default risk of potential supplier(s).
    - Basis risk – e.g., supplier(s) can experience adverse weather as compared with PEF's service territory.

IV. Fuel Procurement and Wholesale Purchased Power Plans for 2007

1. Coal
   - The current physical procurement hedging strategy targets 95-115% of forecasted coal burn to be under contract for 2007 and 65-95% to be under contract for 2008.

2. Oil
   - The majority of the fuel oil is covered by term supply with flexible volume provisions and market based pricing. The spot market is utilized as a supplemental source of supply.

3. Natural Gas
   - Approximately [redacted] of the natural gas requirements for 2007 are currently covered by long-term (greater than 3 years) contracts. PEF will be initiating an RFP in second half of [redacted] to contract for additional gas requirements for [redacted] under term contracts. The remaining natural gas requirements for [redacted] will be covered by short term and spot market contracts.

4. Purchased Power
   - Long-term firm purchased power is usually solicited by a request-for-proposal from credible counterparties. Mid-term purchased power is usually solicited via a survey of credible counterparties by requesting bids for the nomination and terms for the product needed.
   - Short-term firm purchased power is obtained through market assessment of bids and offers and negotiation with credible counterparties.

V. Guidelines

1. The Board of Directors has established a Risk Management Policy which directs the Risk Management Committee (RMC) to oversee PEF's management of financial risks. The Risk Management Policy states the RMC shall regularly report on activities related to and carried out under the Policy to the Chief Executive Officer (CEO), the Board of Directors, and the Finance Committee. The CEO is ultimately responsible for the company's management of risk.

2. The Risk Management Committee Guidelines identify the roles, responsibilities, and decision making process of the RMC and its agents.

3. PEF's Regulated Commercial Operations and Regulated Fuels Risk Management Guidelines provide a methodology to assess, report, and mitigate risk associated with trading and marketing activities and procurement for the regulated fleet. In addition, there is a product approval process to provide a structure to validate that all significant product risks have been identified and integrated into the risk control structure.

4. Regulated Commercial Operations and Regulated Fuels Credit Risk Guidelines provide a methodology to evaluate, measure, mitigate, and report credit risk associated with utility trading, marketing, procurement activities, and credit governance and oversight on an enterprise-wide basis.

VI. Processes (Front Office)

PEF's Oil Process Analysis, PEF's Natural Gas Process Analysis, and Coal Purchasing Procedures provide the procedures utilized to implement PEF's risk management plan. To date, "ZaiNet" is PEF's natural gas and power transaction software system utilized to track and verify natural gas and power transactions. ZaiNet is the system of record to track and verify natural gas, oil financial hedges, and power transactions. "FuelWorx" is the system used to track and verify coal and physical oil transactions.

VII. Risk Reporting (Middle Office)

Risk control generates reports and distributes to both the Regulated Fuels Group and senior management on a daily, weekly, and monthly basis. This is the primary mechanism to communicate group performance to management, the RMC, and the Board of Directors. The reports include all current positions and updates according to the markets. Market changes include pricing, correlation, volatility, etc. In addition, as conditions differ from day-to-day, Gas Scheduling updates deals with best-available information to correctly reflect how much gas is received and delivered at their respective delivery and receipt points.

A. Risk control manages all of the following activities:

1. Forward Curves - Forward curves provide prices for delivery of products at future dates. Forward curves provide the critical data necessary to calculate mark-to-market, value-at-risk, and stress testing. These curves are generated daily.

2. Market Pricing – Daily prices received from index providers are updated on a daily basis to settle or to mark all positions to the correct market price as of close of business.

3. Mark-to-Market (MTM) - MTM is a methodology utilized to value all physical and financial instruments, including those associated with assets. MTM measures unrealized gains and losses (forward positions) prior to contract settlement by calculating the difference between the transaction price and the forward curve.

4. Stress Testing - Stress testing is used to simulate extreme market conditions (e.g., hurricane), and the results are delivered in the daily reports.

VIII. Controls and Oversight

1. The Risk Management Committee (RMC) – The RMC oversees PEF's management of enterprise risks.

   Committee Members
   - Chief Financial Officer & President - Services Company (Chair)
   - President & Chief Operating Officer
   - Senior Vice President – Regulated Services
   - President – Progress Energy Ventures
   - Senior Vice President & General Counsel - Progress Energy, Inc.
   - Vice President – Treasurer & Chief Risk Officer (CRO)
   - *Note: RMC protocol prohibits the President - Progress Ventures from participating, discussing, or voting on regulated matters. Likewise, the SVP – Regulated Services is prohibited from participating, discussing, or voting on unregulated matters.*

   Committee Members Responsibilities
   - Identifies, assesses, and monitors corporate financial risks
   - Approves:
     (i) Risk guidelines for various company activities.
     (ii) New and existing trading, marketing, procurement and hedging products.
     (iii) Risk management objectives, risk tolerances, and limits employed throughout the organization.

(iv) Organization structure to ensure adequate segregation of duties.

- Reviews:
  (i) Aggregate market and credit capital for approval by the BOD.
  (ii) Summary positions and financial reports.
  (iii) Broad trading, marketing, hedging, and procurement strategies.
  (iv) General business conditions, market, and credit risk exposures.

- Presents to the CEO, BOD and Finance Committee:
  (i) Recommended aggregate market and credit limits and modifications for approval.
  (ii) Summary positions and financial reports.
  (iii) Summary of valuation methods, key controls, limit exceptions and violations.
  (iv) Special studies as requested.

- Creates sub-committees to provide greater attention to risk issues in various company activities

2. **Utility Commercial Operations Risk Sub-Committee** - The UCORSC objective is to review, and recommend risk guidelines and policies for the identification and oversight of key risks of Regulated Commercial Operations (RCO) and Regulated Fuels (RFD). .

Sub-Committee Members

- Treasurer & Chief Risk Officer (Chair)
- VP – Regulated Commercial Operations
- VP & General Counsel - Progress Energy Inc.
- VP – Regulated Fuels
- VP – Corporate Planning
- Controller – PEC
- Controller - PEF

Sub-Committee Responsibilities – Reviews, approves, and presents:

- Risk procedures of utility commercial business units.
- Market, credit, business, and operational risk exposures.
- New products for RMC approval.
- Analytic assumptions and methodologies.
- Key operational controls, limits, and monitoring methodologies.
- Credit exposure versus defined limits.
- Summary positions, risk exposures, and mitigation alternatives.
- Special studies requested.
- Risk guidelines, policies, models, and transactions to the RMC.

3. Auditing Department – Audit Services provides independent assurance and consulting services that ensure regulatory compliance, effective corporate governance, and operational excellence for all major activities including fuel procurement. Activities are audited based on relative priority rather than a fixed cycle. Within that framework, Audit Services' oversight of fuel procurement activities is addressed from the following perspectives:
    - Compliance
    - Trading and procurement
    - Operational