BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 060658-EI

In the Matter of:

PETITION ON BEHALF OF CITIZENS OF THE STATE OF FLORIDA TO REQUIRE PROGRESS ENERGY FLORIDA, INC. TO REFUND CUSTOMERS $143 MILLION.
____/

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VOLUME 2

Pages 153 through 355

PROCEEDINGS:	HEARING
BEFORE:	CHAIRMAN LISA POLAK EDGAR COMMISSIONER MATTHEW M. CARTER, II COMMISSIONER KATRINA J. MCMURRIAN
DATE:	Monday, April 2, 2007
TIME:	Commenced at 1:30 p.m. Concluded at 5:38 p.m.
PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	JANE FAUROT, RPR Official FPSC Reporter (850) 413-6732
APPEARANCES:	(As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

NUMBER:		ID.	ADMTD.
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P R O C E E D I N G S

(Transcript follows in sequence from Volume 1.)

CHAIRMAN EDGAR: We will go back on the record. And I believe when we left off that, Mr. Burnett, it was time for you to call your first witness.

MR. BURNETT: Yes, ma'am. Thank you. PEF calls Steven Fetter.

May I proceed, Madam Chairman?

CHAIRMAN EDGAR: Yes, sir.

STEPHEN M. FETTER

was called as a witness on behalf of Progress Energy Florida, Inc., and having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. BURNETT:

Q Good afternoon, Mr. Fetter. Will you please introduce yourself to the Commission and provide your address.

A My name is Stephen M. Fetter, and my address, business address, is 1489 West Warm Springs Road, Number 110, Henderson, Nevada 89014.

Q Mr. Fetter, who do you work for and what is your position?

A I have my own energy advisory firm called Regulation Unfettered, and I am the president.

Q Have you filed prefiled direct testimony and exhibits in this proceeding?

A Yes, I have.

Q And do you have a copy of those in front of you?

A Yes.

Q Do you have any changes to make to your prefiled testimony or your exhibits?

A There is one small change. On Page 10, Line 6, the verb tense "is" should be "are".

Q Any other changes, Mr. Fetter?

A No.

Q With those changes noted, if I asked you the same questions in your prefiled testimony today, would you give the same answers that are reflected therein?

A Yes, I would.

MR. BURNETT: Madam Commissioner, we request that the prefiled testimony of Mr. Fetter be entered into the record as if it were read today.

CHAIRMAN EDGAR: The prefiled testimony will be entered into the record as though read.

IN RE: PETITION ON BEHALF OF CITIZENS OF THE STATE OF FLORIDA TO REQUIRE PROGRESS ENERGY FLORIDA, INC. TO REFUND CUSTOMERS $143 MILLION

FPSC DOCKET NO. 060658

DIRECT TESTIMONY OF

STEVEN M. FETTER

I. INTRODUCTION AND QUALIFICATIONS

Q: Please state your name and business address.

A. My name is Steven M. Fetter, and my business address is 1489 West Warm Springs Road, Suite 110, Henderson, NV 89014.

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

A. I am President of Regulation UnFettered, an energy advisory firm I started in April 2002. Prior to that, I was employed by Fitch, Inc. ("Fitch"), a credit rating agency based in New York and London. Prior to that, I served as Chairman of the Michigan Public Service Commission ("Michigan PSC").

Q. Please describe your service on the Michigan Public Service Commission.

A. I was appointed as a Commissioner to the three-member Michigan PSC in October 1987 by Democratic Governor James Blanchard. In January 1991, I was promoted to Chairman by incoming Republican Governor John Engler, who reappointed me in July 1993. During my tenure as Chairman, timeliness of commission processes was a major focus and my colleagues and I achieved the goal of eliminating the agency's case backlog for the first time in 23 years.

Q. Please briefly describe your role as president of Regulation UnFettered.

A. I formed a utility advisory firm to use my financial, regulatory, legislative and legal expertise to aid the deliberations of regulators, legislative bodies, and the courts, and to assist them in evaluating regulatory issues. My clients include investor-owned and municipal electric, natural gas and water utilities, state public utility commissions and consumer advocates, non-utility energy suppliers, international financial services and consulting firms, and investors.

Q. Please briefly describe Fitch's business during your tenure there.

A. Fitch is the third largest full service credit rating agency in the United States – after its two major competitors, Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's") — and the largest European rating agency. Like S&P and Moody's, Fitch performs credit ratings of corporate obligations, asset-backed transactions, and government and municipal debt. Bond ratings represent the rating agencies' independent judgment based upon financial data provided by the bond issuer as well as additional quantitative and qualitative information gathered from third-party sources.

Q. What was your role during your employment with Fitch?

A. I was Group Head and Managing Director of the Global Power Group within Fitch. In that role, I served as group manager of the combined 18-person New York and Chicago utility team and was also responsible for interpreting the impact of regulatory, legislative, and political developments on utility credit ratings. I was employed by Fitch from October 1993 until April 2002. In April 2002, I left Fitch to start Regulation Unfettered. Shortly after I resigned, Fitch retained me as a consultant for a period of approximately six months.

Q. Was there any aspect of your experience at the Michigan PSC that particularly relates to your testimony in this proceeding?

A. Yes. During my six years at the Michigan PSC, my colleagues and I sought to effectuate policies that were fair to all stakeholders and which would encourage regulated utilities to provide customers with reliable utility service in a cost-effective manner. We also sought to ensure that the financial health of the state's utilities would remain sufficient for them to be able to provide reliable service to all consumers, and also that investors would maintain their interest in providing necessary funding on a timely basis upon reasonable terms.

Achieving these goals requires regulators to successfully strike a difficult balancing of interests. Investors provide financing to a utility so that company management can construct and maintain infrastructure adequate to ensure that customers will receive reliable service. In return, regulators must take timely action to provide an appropriate capital markets-based return to investors along with providing reimbursement of company expenditures that are prudently made. A failure to carry out these regulatory responsibilities in a consistent and predictable manner will ultimately be detrimental to both investors and customers, as investors will choose to take their funds elsewhere. Similarly, a regulatory or legislative determination that a utility should financially support certain public policy mandates without receiving timely recovery for prudent expenditures made in those efforts would undoubtedly lead investors to look to other jurisdictions where they believe their investments will be treated more fairly.

I believe that the circumstances surrounding my regulatory and utility rating experience that I have described above are relevant to the issues before the Florida Public Service Commission ("Commission" or "FPSC") in this proceeding, and I will further elaborate upon these points within the remainder of my testimony.

Q. Please describe your other prior professional experience related to the utility industry.

A. During my time on the Michigan PSC, I served as Chairman of the Board of Directors of the National Regulatory Research Institute ("NRRI") at Ohio State University, the regulatory research arm of the 50 state and District of Columbia public utility commissions. In 2003, I was appointed by the President of the National Association of Regulatory Utility Commissioners ("NARUC") to serve as a public member of the NRRI Board – the 20-member governing board includes ten state public utility commissioners. I was reappointed to the NRRI Board for a three-year term in June 2005. I also have served on the Keystone Center Energy Board (a nonprofit public policy board that brings together diverse stakeholders related to the regulated utility industry as well as appointed and elected federal and state policymakers to discuss challenges facing the sector), after having participated in the Keystone Center Dialogues on Financial Markets and Energy Trading and on Regional Transmission Organizations. In February 2002, I was appointed to the Board of Directors of CH Energy Group, Inc. ("CHG"), the parent company of Central Hudson Gas & Electric in Poughkeepsie, New York. I currently serve as Chairman of the CHG Governance and Nominating

Committee, having previously served as Chairman of the Audit Committee and the Compensation and Succession Committee.

Q. Have you previously sponsored testimony before regulatory and legislative bodies?

A. Since 1990, I have on numerous occasions testified before the U.S. Senate, the U.S. House of Representatives, the Federal Energy Regulatory Commission ("FERC"), and various state legislative and regulatory bodies on the subjects of credit risk within the utility sector, electric and natural gas utility restructuring, utility securitization bonds, fuel and purchased power and other energy adjustment mechanisms, and nuclear energy. I have previously filed testimony before the FPSC on behalf of Florida Municipal Power Agency, JEA, Reedy Creek Improvement District and City of Tallahassee in support of their application for approval of the Taylor Energy Center in Docket No. 060635.

My full educational and professional background is attached in PEF Exhibit No. ________ (SMF-1).

II. SUMMARY

Q. What is the purpose of your testimony in this proceeding?

A. My testimony responds to the petition filed by the Florida Office of Public Counsel ("OPC") seeking an order from the Commission that Progress Energy Florida, Inc. ("PEF" or "Company") should refund to customers approximately $143 million, representing allegedly excessive fuel cost recovery charges and related costs associated with its coal purchasing dating back eleven years. My testimony does not address the factual assertions in OPC's Petition or the testimony of Mr. Sansom.

My testimony addresses, and seeks to be helpful to the Commission, concerning: (a) the appropriate standard, as a matter of regulatory policy, that a regulatory body should apply in analyzing such a petition; (b) the importance that the investment community attaches to regulatory finality and certainty in the recovery of fuel costs; (c) the potential impact on utility cost of capital, and ultimately utility rates, that a departure from those basic principles would produce; and (d) when and subject to what exceptions the recovery of fuel costs should be treated as final as a matter of regulatory policy. My opinions are drawn from my background as both a state utility regulator and as a former member of the financial community arriving at independent credit ratings for utilities' bonds and other financial investments.

Q: **What are the standards that you believe are appropriate in this case as a matter of regulatory policy and why?**

A: There are number of concepts which, within this proceeding, I see as being connected.

First, it is a widely-accepted, historic regulatory principle, as well as the practice of utility commissions around the country, that judgments made by a utility's management should not be deemed imprudent if, at the time they were made, they fell within a range of reasonable business judgments. This is so even if the regulator believes it would have made a different decision. Regulators should not substitute their judgment for that of utility management so long as the judgment of management was within a range of reasonable business judgment at the time the judgment was made.

The various public service commissions around the country do not <u>manage</u> the utilities they regulate. That is neither their role nor do they have the time and resources to do so, even if they wished to. In addition, and even more fundamentally, there is usually no single "right" business judgment on an issue. Management decisions in complex areas are rarely "black and white." Rather, there is a range of decision-making that prudent, equally-informed managements could make. Different, reasonable managers may make different decisions on the same information, yet all those decisions can be reasonable and prudent. Absent a management decision clearly falling outside this range, there is no basis upon which the regulator should substitute its judgment for that of the utility's management. If they do, the regulator effectively takes over management of the investor-owned utility, which is not the regulator's role.

Second, determining whether utility management's judgments fell within the range of reasonable business judgment must scrupulously avoid "20-20 hindsight" review, by which I mean treating circumstances that occurred after a decision was made as if they were known at the time the decision was made. Once the future arrives and is therefore known, it is easy to fall into the trap of thinking it was more predictable than it was at the time a decision was made. But doing so does not meet the principle enunciated above that management decisions should be assessed based on information known to management at the time.

I would emphasize that I am not suggesting that I know of any circumstances that indicate that PEF's coal procurement decisions could be shown to be "wrong" *even if* judged by later events now known. My testimony, as indicated previously, addresses bedrock principles involved in utility regulation around the country. Other witnesses address the bases for the Company's procurement decisions and the prudence thereof.

Third, as a matter of fundamental regulatory fairness, utility regulators should not and do not hold utilities within long-term or "perpetual" jeopardy related to major fuel procurement decisions, at least absent the concealment of material facts. This is particularly so where, as here, the utility has regularly provided information to the regulatory Staff and OPC over the years as to its coal procurement practices, decisions and data, not to mention publicly-available information. As I understand it, PEF and Progress Fuels Corp. provided large amounts of information to the Commission and OPC concerning their coal procurement practices and decisions and all information was available for review and even audit. These included frequent face-to-face meetings with Commission Staff and OPC. The Commission approved those costs for pass-through to customers. In my 20 years of experience I have never seen a regulatory body expose a utility to such long-term uncertainty related to such major costs previously and undisputedly incurred and collected.

There is no need for the Commission to change the existing regulatory process used to authorize the recovery of fuel costs from utility customers. That process is efficient, open and provides a full and adequate opportunity for the prudence of such costs to be scrutinized as needed on a "real-time" basis – *i.e.*, during the authorization of the costs being passed on – while the facts are "fresh" and so that the utility can make appropriate adjustments going forward to the extent, if any, the regulator indicates concern over any aspect of the utility's decision-making. I believe the Commission can take comfort that the process has worked well and continues to work well. Moreover, there is no reason to think that the process requires major revisions to ensure its continued responsiveness to regulatory and utility decision-making.

OPC's suggestion of how the process should work is one that, as discussed herein, would effectively drag the process down to a snail's pace, if not to a halt. OPC effectively contends that the utility has the burden of affirmatively providing "all" information about their fuel procurement decisions without regard to whether questions have been raised or information sought by the Commission or OPC in addition to that normally provided. As I discuss herein, this would place utilities in the untenable position of having to affirmatively provide the Commission with every detail of the utilities' fuel procurement decisions, lest they "guess wrong" about what "issues" the Commission or OPC would later raise as allegedly bearing on prudence.

The only significant shortcoming in the existing state of affairs is ambiguity – perhaps not previously recognized — about the point in the process at which regulatory finality attaches. As this proceeding illustrates, it is undesirable to have a fuel cost recovery process in which there is both no clearly articulated point at which finality attaches <u>and</u> no process and timeframe in place to achieve such finality. Regulatory approval of such major utility costs "subject to prudence review," or similar terms, with no regulatory process in place to conduct such review and establish regulatory finality, is highly undesirable. The appropriate point at which to achieve such finality, subject to certain conditions that I suggest below, is no later than the true-up process, not years later.

The process should remain a streamlined one and not require as a normal or routine matter the utility to affirmatively present as part of its cost recovery showing the details of its procurement decisions, including elaboration of why it did not purchase other fuels from other suppliers. Such a procedure would render the process unnecessarily complex and burdensome with little, if any, benefit to the customer or the Commission. The existing process provides for appropriate and adequate disclosure, with the Commission and OPC possessing the right to seek additional information from the utility, including an audit of its records.

I do suggest, however, that the effect of the process be better articulated on a going forward basis so that important regulatory goals of efficiency, finality, and fairness to all stakeholders ~~is~~ are served. Specifically, I suggest that the Commission declare that the approval of fuel costs upon "true-up" be final, thus establishing a reliable, reasonable point after which the prudence of fuel costs will not be subject to further review, absent concealment of material facts by the utility during the initial approval and true-up process. I further suggest that "concealment" be defined to mean: (a) the affirmative misstatement of facts materially affecting prudence; or (b) the failure of the utility to provide material facts and documents requested by the Commission or OPC during the initial approval and true-up process.

Finally, I discuss why I believe this process does not differ in substance from that which the Commission has implicitly used for years. It is absurd as a matter of regulatory policy to suggest, as OPC implicitly does, that the Commission has approved hundreds of millions of dollars of fuel cost recovery over the decades for all Florida utilities subject to its jurisdiction, yet has never determined the prudence of those costs being passed on to customers.

Although orders authorizing fuel cost recovery have routinely recited that approval is "subject to prudence review," or words to that effect, it appears to me that the existing process actually reflects the prudence review typically employed by other state utility regulatory bodies leading up to a final true-up point. The recital that cost recovery is then subject to "prudence review" is best understood from a regulator's perspective as reserving the right to revisit those prudence determinations only in the case of concealment of information by the utility.

Q: Do you suggest by your testimony that the Florida Public Service Commission does not subscribe to the desirability of regulatory finality or the principles prohibiting "second-guessing" utility management judgments or the use of "hindsight review"?

A: No, I do not. As I indicate later in this testimony, the Florida Commission has long been regarded by the investment community as one that has fostered and maintained a fair and constructive regulatory climate. I know of nothing the Commission has done in this proceeding to indicate that it in fact disagrees with or would not follow any of these principles. I do note that at the December 19, 2006 Agenda Conference several Commission members indicated questions as to what changes, if any, should be made to the approval process for fuel costs in order to achieve finality. I respond to those questions within this testimony. I offer all of the testimony set forth herein because I believe it is important for the Commission's analysis of the claims advanced by OPC.

Q: Are these principles important to potential investors in utilities?

A: Very much so. Investors depend on the fact that utility regulators subscribe to the above concepts as a key ingredient in providing capital to regulated utilities at a reasonable cost and upon a timely basis. Each of the principles I have described is important to the creation and maintenance of an environment of regulatory certainty and fairness that is strongly valued by the financial community.

Q: What is the general perception of the investment community of the Florida regulatory climate as it relates to regulatory certainty and fairness?

A: Florida is highly-regarded by the investment community as providing a regulatory climate that encourages investment in Florida investor-owned utilities at reasonable cost. However, a departure from the regulatory principles I discuss above would be perceived as adversely affecting Florida's regulatory climate, potentially leading to increased costs of capital for Florida investor-owned utilities, which would translate into increased utility rates.

III. OPC'S PETITION FOR A $143 MILLION CUSTOMER REFUND FOR ACTIONS DATING BACK MORE THAN A DECADE IS BEYOND THE NORM OF REGULATORY PROCESSES AND AN FPSC ORDER ADOPTING SUCH VIEW WOULD VIOLATE FUNDAMENTAL TENETS OF REGULATORY FAIRNESS

Q. Can you explain why you feel that the OPC's petition for relief is inappropriate?

A. Yes I can. The threshold problem arises from its attempt to seek re-examination of decisions made over the course of more than a decade in the past. I have been involved with utility regulation for almost twenty years, first as a state regulator, later as a bond rater, and now as a consultant to utility companies, public service commissions, consumer advocates, and investors. The breadth of my experience has provided a wide-ranging view of utility regulation from virtually all stakeholder perspectives. I cannot recall any petition for relief seeking to re-examine utility management decisions of such complexity, for such a long period of time, and in which so much information was provided to, and accessible to, the regulator near the time the decisions were being made.

The inconsistency with basic regulatory principles is particularly exacerbated here by the fact that, as detailed in the testimony of Company witnesses, (a) the Company regularly went through fuel cost recovery proceedings at the FPSC with OPC involvement in which no information concerning the Company's coal procurement was concealed or unavailable to the FPSC or OPC; (b) the Company regularly briefed the Commission Staff and OPC on fuel procurement between fuel adjustment proceedings; (c) all of the Company's coal procurement records, detailing its decision-making, were open and accessible to the FPSC and OPC; and (d) the Company made regular, required filings with the FERC and the FPSC setting out in detail its coal procurement costs. To treat as available for re-examination many millions of dollars in costs incurred and recovered under such circumstances is contrary to basic principles of finality as a matter of regulatory policy, and is unprecedented in my 20 years of experience.

Q: How is the principle concerning substitution of regulatory judgment for management judgment involved here?

A: It is potentially implicated in any proceeding that purports to judge the prudence of past utility management actions. It is particularly implicated in any proceeding in which those actions involve complex actions as well as actions that span long periods of time, both of which OPC's petition injects into this proceeding. I am aware that OPC insists that it does not seek to have the Commission substitute its judgment for any prudent decisions of the Company's management. However, in my experience, acknowledging the principle and adhering to it are not always the same thing.

PEF's decisions regarding coal procurement had to fall within a range of reasonable behavior, measured by circumstances at the time. Neither the Commission nor OPC made claims of imprudent behavior on the part of the Company when the events at issue in OPC's filing were occurring, even with the extensive information provided to and available to the Commission and OPC at the time. This strongly suggests that the Commission and OPC did not "miss something" at the time, but that, judged under the circumstances existing at the time, PEF's procurement decisions were prudent and fell within a range of reasonable business judgment.

Q: How is the principle concerning "hindsight" review involved here?

A: Similar to the principle just discussed, it is potentially implicated in any proceeding that purports to judge the prudence of past utility management actions and especially so in a proceeding involving complex past actions taken over a long period of time. I am also aware that OPC insists that it does not seek to have the Commission employ "hindsight review" in this proceeding. Again, however, in my experience, acknowledging the principle and adhering to it are not always the same thing.

Q. Can you explain further your mention of 20-20 hindsight?

A. Yes I can. When I was a regulator, I admit that at times the thought of revisiting a previously-made decision seemed pretty attractive. But upon further reflection, my ultimate conclusion was always that such second-guessing would be wrong. For example, utility management decisions are made based upon the information available and the circumstances existing at the time. While the prudence review process necessarily involves a certain degree of looking back, it is important for regulators to put themselves into the shoes of the management decision-maker at the time a decision was made, so as to be able to assess whether it fell within a reasonable range of discretion measured by circumstances at the time they were made. It is not appropriate for regulators to attempt to match up what they would have decided was the right course of action at the time with what management actually did. Thus, regulators should not substitute their view for management's view; rather the proper administrative path is for regulators to determine a range of reasonable judgment that provides management with appropriate leeway to run the company without fear that every decision will be penalized after-the-fact.

Q. Does the openness with which PEF carried out its coal activities impact upon your decision?

A. Yes, very much so. It is my understanding that PEF management met regularly with Commission Staff and OPC representatives and made ongoing filings charting its current and projected resource supply plans, and made available for the asking any and all information pertaining to fuel procurement decisions.

Ironically, this very proceeding illustrates the availability of that information. As I understand it, this proceeding arose because, although belatedly, OPC requested from PEF a copy of any RFP used in the company's 2004 coal procurement. During that information evaluation, OPC saw that the company had received proposals for Powder River Basin ("PRB") coal at a lower delivered cost than the coal actually purchased, prompting OPC to seek further information as to why the seemingly-cheaper coal was not purchased. In response to these inquiries, PEF provided information as to the cost of PRB coal and information as to why it had not purchased it.

Q. Why is timeliness such an important matter in regulatory decision-making?

A. Timeliness is important because the utility business is highly capital-intensive and requires substantial and ongoing infusions of cash from equity and debt investors. The institutional investors providing such capital – pension funds, insurance companies, mutual funds and the like — expect a fair return on their investment received on a timely basis. Accordingly, a major part of an investor's due diligence prior to providing funding to a utility is analysis and assessment of the regulatory environment within which that utility operates. Part of that regulatory analysis by current and potential investors includes, as I learned while serving as chairman of the Michigan PSC and later as head of the Fitch utility ratings practice, close tracking and scrutiny of pending regulatory and judicial proceedings up until the point when all appeals have been concluded and a final enforceable order has been rendered. Acceptance of OPC's claim in this matter would turn the key investment goal of regulatory finality, and thus certainty, on its head.

Q: Are major changes in the fuel adjustment approval process used by the Commission required in order to adequately address these issues?

A: No. The existing process is consistent with that used by many state commissions and works well in making all necessary information available to the Commission and OPC on a "real-time" basis, meaning at or near the time the fuel procurement decisions are made and approved for pass-through. There is no need to impose on the utility an affirmative threshold burden, as simplistically suggested by OPC, to in effect present exhaustive and detailed information as to what fuel the utility did not purchase from each offered source and why. Such information should of course be available to the Commission and OPC in the event they wish to review it, just as it is now.

Fuel decisions for a major utility like PEF can be complex and involve numerous judgments. Requiring the utilities subject to this Commission's jurisdiction to provide as part of its affirmative "case" in fuel adjustment or true-up proceedings a delineation of all the facts and decisions involved in its fuel purchases, including procurement strategies not appropriate for the circumstances, would inundate the Commission with information it rarely, if ever, would need or would have the resources to process.

Q: **But doesn't such a process create a risk that the Commission will make fuel cost recovery decisions without needed information to determine the prudence of the utility's decisions?**

A: No. To the contrary, the process assures the full <u>availability</u> of all information. It merely strikes a reasonable, common sense balance about what information the utility should present affirmatively as a matter of course in seeking cost recovery complemented by the right of the Commission and OPC to seek further information should they wish to have it in any proceeding. The process does <u>not</u> permit a utility to conceal or withhold information if the Commission or OPC believes additional information is necessary for their review and analysis and makes a request for such information.

Q: **Can you elaborate on why such a balance, as you put it, is reasonable from a regulatory perspective?**

A: Yes. Neither this Commission nor any with which I am familiar have required such exhaustive information as a threshold, routine matter in approving as prudent utility fuel costs. For the regulatory process to work, rather than becoming bogged down in information with little, if any, relevance, regulators must rely on a reasonable balance of information affirmatively *presented* by the utility complemented by additional information which is *available* for further detail or elaboration. This is a reasonable approach for a number of reasons.

For example, the regulator knows that, by definition, the utility's purchase of certain fuel (that for which recovery is sought) means that the utility did not purchase other fuel. The regulator also knows whether information concerning fuel not purchased has been affirmatively presented. Obviously, if the regulator wishes to know more about the utility's decision-making process in not purchasing other fuel, all it need do is ask. Moreover, it can, if it chooses, audit or otherwise obtain from the utility all documents pertaining to a utility's decision-making.

In addition, the utility's decision-making about fuel procurement will often involve managerial judgments that the Commission will defer to, absent imprudence. I do not know any commission that has come up with the formula for a "black and white" quantitative standard as to what constitutes prudence in fuel procurement decisions. This is, of course, wise because any such standard would fail to afford utilities adequate discretion and judgment to make the best overall fuel procurement decisions for the utility and its customers at the time those purchases need to be made. When utilities present information in fuel procurement proceedings, they do so believing they have made prudent decisions. Unless one is going to indulge the unreasonable assumption that utilities are intentionally acting in bad faith, the utilities should have no reason to think that there is anything that they need to "disclose" to the Commission about fuel not purchased. Their request for cost recovery constitutes the utility's claim that they have purchased fuel prudently, and advises the regulator of the type of fuel, its quantity and what the utility has agreed to pay for it. OPC's view, if accepted, would place utilities in the position of having to second guess their own decisions – decisions that they obviously regard as prudently made — speculate on what the Commission or OPC would regard as imprudent, and also speculate correctly in order to unilaterally provide the appropriate information. The only feasible solution in the face of such an untenable predicament is simply to turn over the fuel procurement process to the regulator, a concept that strikes at the heart of management of an investor-owned utility company.

As a sophisticated, professional regulatory body with its own professional Staff, and with OPC similarly skilled, it is not as if the utility is the only participant in the process with any information or knowledge about fuel markets and other associated matters. Quite the opposite is the case. Those to whom the cost recovery request is presented have substantial expertise in the area. They are qualified and able to conduct further inquiry if they wish. It is the utility's responsibility to provide information in response to those requests. The process should function, and has historically functioned, essentially as a "conversation" between knowlegable participants, not as a one-sided "speech" by the utility to the regulator (and OPC), as a silent, passive audience.

Such an approach best fulfills the goals of regulatory timeliness and efficiency by ensuring that the process addresses and finalizes fuel cost recoveries on a "real-time" or "near real-time" basis. Simply stated, while a utility may maintain written records for longer periods of time than human memory can preserve information, such records are not always an optimal means of reconstructing decisions if a utility is subject to prudence review substantially later than the time when the costs were incurred. This is particularly the case where judgments were complex or involved the exercise of managerial judgment. The closer to the actual point in time when the costs were incurred that the prudence review occurs, the better the information available and the better the process.

In addition, such "real-time" prudence review can provide a utility with important guidance for future actions if, contrary to the utility's expectations, the regulator concludes that a different decision should have been made, either as a matter of prudence or simply by suggesting other considerations the utility should consider in the future. When such review occurs significantly later, this valuable information is lost, along with the fundamental fairness owed the utility.

Q: What do you consider to be the appropriate timeframe within which prudence review should occur for fuel procurement decisions?

A: Prudence review should occur during the regulatory process of authorizing the recovery of fuel costs and should be finalized by the completion of the "true-up" proceeding. This makes sense for the reasons I have just discussed. I would hasten to add, however, that this does not appear to me to be a significant deviation from the Commission's historic practice nor would it impose unreasonable administrative burdens on the Commission.

Q: Please explain.

A: It appears to me that, in practice, the Commission has effectively conducted what I regard as prudence review in its historic process of approving cost recovery and then truing up the recovery with actual costs. As I understand it, the utilities engage in regular dialogue with the Commission Staff and with OPC about fuel procurement decisions, provide data as required by the Commission and the FERC, and make all detailed and additional information available upon the request of either the Commission or OPC. This is what I regard, and what I believe is generally regarded around the country, as the type of process that reflects a regulatory determination that the costs have been prudently incurred, absent affirmative misrepresentations or concealment of material information.

Q: But, isn't it true that Commission cost recovery orders routinely contain language indicating that the costs are approved, even after true-up, subject to prudence review or words to that effect? Doesn't that indicate that the Commission has not effectively conducted prudence review in the fashion you indicate?

A: Yes, the orders typically so state. However, that begs the question of what is in fact meant by "subject to prudence review" or similar words.

Q: Please explain.

A: I find it hard to believe that the Commission has historically regarded fuel procurement costs, once approved and passed on to the customer, as ***not*** having been subjected to prudence review. This is particularly compelling in light of the fact that, despite this routine statement in orders, the Commission has never established a process by which any other "prudence review" predictably occurs. In fact, as I understand it, no further "prudence review" typically ever occurs.

I am confident that the Commission does not regard itself as having allowed utilities (not just PEF) to recover hundreds of millions of dollars in fuel costs over the decades, yet would say to those customers, "We have required you to pay these costs for many years, but we have never considered whether they are prudent."

Rather, it appears to me that the Commission has indeed conducted prudence review by the time the fuel costs are ultimately trued-up. No other conclusion makes regulatory sense or squares with the process that has been in place for years. On this backdrop, what makes sense to me is to read the statement that cost recovery is approved "subject to prudence review" to mean subject to revisitation under certain limited circumstances. In my view, the real issue should be what circumstances would support revisiting prior cost approvals, not whether fuel costs long ago the subject of regulatory filings and proceedings and thereafter passed-through to customers were in effect, prudent.

Q: What circumstances should authorize revisiting prudence review?

A: As I have already indicated, I believe that sound regulatory policy dictates that such prior approvals should be subject to revisitation only when it can be shown that the utility has concealed materials facts. By that I mean: (a) affirmative misstatement of material facts affecting prudence; or (b) the failure of the utility to provide material facts and documents requested by the Commission or OPC during the initial approval and true-up process.

Q: Why do you believe this should be the appropriate standard?

A: I believe this is appropriate for at least three reasons.

First, it recognizes that the process by which fuel costs are recovered is an interactive dialogue as I have previously discussed. It does injury to the process of fuel cost pass-through if prior conclusions can be revisited at any time, absent a utility affirmatively having concealed information during that process.

Second, absent specific rules (of which there are none) about what must be affirmatively presented in a fuel cost recovery proceeding, the magnitude of the dollars at risk would leave utilities no practical choice but to "dump" every detail of their fuel procurement decisions into the cost recovery dialogue and process, thus inundating the regulator with information rarely, if ever, actually needed.

Third, it provides utilities and the investment community a reasonably concrete basis upon which to determine whether millions of dollars in prior fuel cost recoveries can be safely assumed to be final.

Q. Why is regulation so important to an investor's decision to provide capital to a utility company?

A. Regulation has always garnered the attention of Wall Street, but, years ago, seemingly only during the days leading up to a commission's rate case decision. This began to change around the time that Fitch hired me in 1993 to serve in the role of analyst of regulatory, legislative, and political factors that could have an impact upon a utility's financial strength. When California announced its ultimately ill-fated restructuring plan in 1994, the entire financial community, especially Fitch and its rating agency competitors S&P and Moody's, took much greater notice of regulators and how they carried out their responsibilities, not only with regard to rate-setting, but even more importantly the manner in which they undertook to change the way the utility industry had operated for over 100 years.

S&P highlighted the continuing importance of regulation to the financial community in two recent reports. In a report entitled "New York Regulators' Consistency Supports Electric Utility Credit Quality," S&P offered general thoughts on the importance of regulation that apply within but also far beyond the borders of New York State:

> Regulation defines the environment in which a utility operates and greatly influences a company's financial performance. A utility with a marginal financial profile can, at the same time, be considered highly creditworthy as a result of supportive regulation. Conversely, an unpredictable or antagonistic regulatory environment can undermine the financial position of utilities that are operationally very strong.
>
> To be viewed positively, regulatory treatment should be timely and allow consistent performance over time, given the importance of financial stability as a rating consideration. Also important is the transparency of regulatory policies...[1]

Earlier, S&P had discussed how changing circumstances within the utility industry have elevated the importance of regulatory policies:

> In recent years, [S&P's] emphasis on the decisions by state commissions has been less pronounced simply because so many jurisdictions have been working through multiyear restructuring transition periods. During this time, rates were frequently frozen, and companies and customers have been adjusting (albeit with limited success) to the opportunity that customers have to choose alternate power suppliers.
>
> But the confluence of the approaching end of these transition periods and the growing need in certain regions of the country for significant resource additions is quickly returning the regulatory arena to center stage. In assessing the regulatory environment in which a utility operates, [S&P's] analysis is guided by certain principles, most prominently consistency and predictability, as well as efficiency and timeliness. For a regulatory scheme to be considered supportive of credit quality, commissions must limit uncertainty in the recovery of a utility's investment. They must also eliminate, or at least greatly reduce, the issue of rate-case lag that may prove detrimental if a utility needs rate relief.[2]

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[1] S&P Research: "New York Regulators' Consistency Supports Electric Utility Credit Quality," August 15, 2005.

[2] S&P Research: "U.S. Utility Regulation Returns to Center Stage," April 14, 2005.

Q. Where does Florida regulation fit within the view of the financial community?

A. Based upon my knowledge of and interaction with Florida regulators over the past twenty years, Florida regulation is perceived by the financial community as being very constructive and sensitive to the concerns of both equity and debt investors.

Q. Isn't such positive status for the FPSC good for investors and not so good for consumers?

A. No, not at all. Actually the opposite is true. The lower the regulatory risk within a jurisdiction, the lower the cost of capital a utility has to pay to attract needed investment. Those lower costs then get factored into the rates that customers pay. So a positive investment climate is good for all stakeholders within the process.

IV. POTENTIAL NEGATIVE IMPACT ON FLORIDA'S CONSTRUCTIVE REGULATORY ENVIRONMENT

Q. Can you briefly describe the credit ratings process?

A. Credit ratings reflect a credit rating agency's independent judgment of the general creditworthiness of an obligor or the creditworthiness of a specific debt instrument. While credit ratings are important to both debt and equity investors for a variety of reasons, their most important purpose is to communicate to investors the credit strength of a company or the underlying credit quality of a particular debt security issued by that company.

Corporate credit ratings analysis considers both qualitative and quantitative factors to assess the financial and business risks of fixed-income issuers. A credit rating is an indication of an issuer's ability to service its debt, both principal and interest, on a timely basis. Ratings can also be used by contractual counterparties to gauge both the short-term and longer-term health and viability of a company.

Q. Can you provide a brief discussion on why credit ratings are important for regulated utilities and their customers?

A. Yes. It is a well-established fact that a utility's credit ratings have a significant impact as to whether that utility will be able to raise capital on a timely basis and upon favorable terms. As respected economist Charles F. Phillips stated in his treatise on utility regulation:

> Bond ratings are important for at least four reasons: (1) they are used by investors in determining the quality of debt investment; (2) they are used in determining the breadth of the market, since some large institutional investors are prohibited from investing in the lower grades; (3) **they determine, in part, the cost of new debt, since both the interest charges on new debt and the degree of difficulty in marketing new issues tend to rise as the rating decreases**; and (4) they have an indirect bearing on the status of a utility's stock and on its acceptance in the market.[3] [Emphasis supplied.]

Thus, the lower a regulated utility's credit rating, the more the utility will have to pay to raise funds from investors to carry out its capital-intensive operations – and, as noted by Dr. Phillips, credit ratings can also affect the amount of money that utilities can raise from equity investors at any point in time. In turn, the ratemaking process factors the cost of capital for both debt and equity into the rates that consumers are required to pay.

3 Phillips, Charles F., Jr., The Regulation of Public Utilities, Arlington, Virginia: Public Utilities Reports, Inc., 1993, at p. 250. See also Public Utilities Reports Guide: "Finance," Public Utilities Reports, Inc., 2004 at p. 6-7 ("Generally, the higher the rating of the bond, the better the access to capital markets and the lower the interest to be paid.").

Thus, a utility with strong credit ratings is not only able to access the capital markets on a timely basis at reasonable rates, it also is able to share the benefit from those attractive interest rate levels with customers through lower utility rates.

Q. Please describe the factors used by the rating agencies.

A. The most important qualitative factors include regulation, management and business strategy, and access to energy, gas and fuel supply with recovery of associated costs. On the quantitative side, financial performance continues to be a very important element in credit rating analysis. Credit rating agencies and fixed-income analysts utilize key analytical ratios to understand the credit profile of a utility.

Q. Since regulatory response to the OPC petition will be such a key factor in this case, can you share your thoughts on the importance of "regulation" within the credit ratings process?

A. Yes. Regulation is a key factor in assessing the credit profile of a utility because a state public utility commission determines rate levels (recoverable expenses including depreciation and operations and maintenance, fuel cost recovery, and return on investment) and the terms and conditions of service.

Since the announcement of California's restructuring plan in 1994, regulation has become an even more important variable as the nature of a utility's responsibilities in providing energy services to customers has undergone dramatic change. In some states, industry restructuring was the result of plans formulated by the state legislature. In other states, the regulators, rather than the legislators, have determined the nature and pace of restructuring. And, of course, in states like Florida, restructuring has not moved very far forward at all.

With such divergence among the states, before major energy investors will be willing to put forward substantial sums of money, they will want to gain comfort that regulators understand the economic requirements and the financial and operational risks of a rapidly-evolving industry and that their decision-making will be fair and will have a significant degree of predictability.

For these reasons, rating agencies look for the consistent application of sound economic regulatory principles by the commissions. If a regulatory body were to encourage a company to make investments based upon an expectation of the opportunity to earn a reasonable return, and then did not apply regulatory principles in a manner consistent with such expectations, investor interest in providing funds to such utility would decline, debt ratings would likely suffer, and the utility's cost of capital would increase.

Q. Can you discuss how Florida's current positive regulatory climate affects PEF's credit ratings in a manner that lowers the rate impact on the Company's customers?

A. Yes I can. S&P views the Company's credit profile as improving, citing in July 2006 Florida's "historically supportive regulation" as a beneficial factor. S&P cautioned, however, that a weakness was the need for "[s]ignificant rate increases for rising fuel costs," and noted that the consolidated utility's outlook could be lowered to Stable if "under recovered fuel costs [at the Progress Energy Carolina affiliate] are unfavorably resolved."[4]

Moody's cites Florida's "constructive regulatory environment," but similarly cautions that "[a]ny change in the regulatory environment which could limit recovery of fuel costs" could change the rating in a downward direction.[5]

Fitch agrees that Florida represents a "historically favorable" state regulatory environment, but also warns that its "Stable Rating Outlook incorporates Fitch's expectations that ... fuel and operating costs will be recovered from customers on a timely basis."[6]

Q. You have described unanimity among the three rating agencies with regard to how they look at Florida regulation and their shared concerned about current fuel cost recovery. Can you offer a view as to how they would react if the commission were to validate the OPC's theory about coal procurement and costs?

A. Yes, I can. In a word, they would be stunned. The major current concern of the financial community about the utility industry is the rapid run-up in fuel and purchased power costs and whether companies will receive timely and complete recovery for prudent actions related to those challenges. The idea that a state public utility commission, especially one so favorably viewed by investors, would take the unprecedented step of putting into play fuel costs going back as long as a decade ago, with the potential of a $143 million disallowance, is inconceivable. These were not steps taken behind closed doors that are just now coming to light. PEF has carried on

4 S&P Research Update: Progress Energy's, Units' 'BBB' Ratings Affirmed; Outlook Revised To Positive," July 25, 2006.
5 Moody's Credit Opinion: "Progress Energy Florida, Inc.," September 1, 2006.
6 Fitch Press Release: "Fitch Upgrades Progress Energy and Utility Subsidiaries; Outlook Stable," November 3, 2006.

its coal procurement processes with all information accessible to Commission Staff and OPC. If the FPSC were to reopen the matter, it would create a regulatory environment within which no issue is ever finally resolved. If that were to occur, I would expect that investors would react to such uncertainty by requiring higher returns on equity and higher interest payments on debt issuances, potentially for all of the state's utilities. Those costs would then get factored into the rates that utility customers have to pay. Even worse, investors might just choose to forgo higher returns in the more volatile environment and just take their funds and invest in other states – where fairness, consistency and predictability would be more certain.

Q. Does this conclude your testimony?

A. Yes, it does.

BY MR. BURNETT:

Q Mr. Fetter, do you have a summary of your prefiled testimony?

A Yes, I do.

Q Will you please summarize that for the Commission?

A Yes. Madam Chairman and Commissioners, I am providing testimony in this proceeding in an effort to assist this Commission on matters of regulatory policy. I offer my opinions based upon my experience as chairman of a state utility commission, head of the utility ratings practice at a major credit rating agency, and as someone who has both operated under and analyzed fuel adjustment mechanisms.

I want to start with the widely accepted regulatory principle that utility management decisions are not imprudent if they fall within a range of reasonable business judgment. It would be very rare for there to be a single right business judgment on an issue, especially when the issue is a complex one. Rather, the norm would be that a range of decisions exist that an informed management could make and which would represent a reasonable and prudent decision. As this Commission knows, it is not a Public Service Commission's job to manage the utilities they regulate. Thus, when it comes to prudence reviews, commissions must guard against substituting their after-the-fact judgment for the decisions management made at an earlier time.

Second, hindsight review must be avoided. This is well understood but easier said than done. It is easy to fall into the trap of thinking that what occurred was more predictable than it was at the time a past decision was made. One should be particularly careful when information relied upon occurred or was revealed after the time that a decision was made.

Third, regulatory certainty and finality with respect to fuel costs are very important to the financial community. Regulatory policy decisions impacting the timeliness and certainty of fuel cost-recovery can affect a utility's credit ratings. This is especially true when the issue is framed as OPC has done here as reaching back over ten years with approximately $143 million at stake. A negative result under the unprecedented circumstances at issue here hold out the potential to affect both investors and customers since a weakening of Progress Energy's credit profile increases the utility's cost of capital, which then gets flowed through into the rates that customers pay.

There is no reason for this to occur. I understand that Progress Energy makes regular required filings with the FERC and this Commission setting out in detail its coal procurement costs. The utility's records are open and accessible to the Commission and OPC, and, in fact, Commission audits have been undertaken and discovery has occurred regarding utility fuel decisions. Also, the utility regularly goes through fuel cost-recovery proceedings leading ultimately to hearings where costs are passed through to customer bills. Moreover, the utility has regularly briefed the Commission and OPC about its fuel procurement in between fuel adjustment hearings.

This is the way the process should work and finality should attach at the true-up process absent some material concealment. In this way, a reasonable balance is struck between what fuel procurement information is affirmatively presented before and during the proceeding, and what information is available for further detail or elaboration upon request. Indeed, despite frequent statements that costs have been approved subject to prudence review, there is no regulatory process in place by which any other prudence review can occur.

I find it hard to believe that this Commission has for more than a decade passed on fuel costs for customers to pay without determining that such costs were appropriate. Rather, it appears to me that the Commission with staff support has, in fact, conducted prudence review by the time the fuel costs are ultimately trued up. No other conclusion makes regulatory sense. To suggest otherwise imposes impossible burdens. No utility should remain under perpetual prudence review with customers having paid costs that may or may not have been appropriate.

In sum, if the Commission were to reconsider fuel costs that have previously been trued up for cost-recovery going back more than ten years, it would create a regulatory environment within which no issue is ever finally resolved. I expect that investors would react to such uncertainty by requiring higher returns on equity and higher interest payments on debt instruments, not only for Progress Energy but potentially for all of the state's investor-owned utilities. Such a process would be unfair to both investors and customers and, thus, would represent bad regulatory policy.

Thank you very much.

MR. BURNETT: Thank you, Mr. Fetter.

We tender Mr. Fetter for cross-examination.

CHAIRMAN EDGAR: Mr. Twomey.

MR. TWOMEY: Thank you, Madam Chair.

CROSS EXAMINATION

BY MR. TWOMEY:

Q Mr. Fetter, good afternoon.

A Good afternoon.

Q Mr. Fetter, I assume you are being compensated to testify in this proceeding, is that correct?

A Yes, I am.

Q And if I may ask, what is your total compensation for your testimony and appearing here?

A I am compensated at the rate of $580 an hour.

Q What is the -- 580?

A $580 an hour.

Q And what do you expect your total billings to be?

A I haven't calculated it. At this point, I think it is somewhere around 35 or $40,000.

Q Okay, sir. Thank you.

At Page 7 of your testimony, at Line 19, you say, "I would emphasize that I'm not suggesting that I know of any circumstances that indicate that PEF's coal procurement decisions could be shown to be 'wrong,' even if judged by later events now known," correct?

A That is what that sentence says.

Q Okay. Let me ask you this. Wouldn't it also be true, or isn't it true that you don't -- do you know of facts and circumstances that you can conclude that the company is correct in what it has done?

A As I note elsewhere in my testimony, I am not testifying on the facts regarding their coal procurement. I am testifying with regard to regulatory policy.

Q Okay. Thank you. Then it would be true that you don't -- you don't know either way, then, whether their behavior in their coal purchasing practices have been either prudent or imprudent, is that correct?

A I'm not testifying on that issue.

Q Okay. Now, Page 13, the question at Line 16 is how is the principle concerning substitution of regulatory judgment for management judgment involved here? And you say in the first sentence, "It is potentially implicated in any proceeding that purports to judge the prudence of past utility management actions." And my question to you is that function purporting to judge a utility's past practices is inherent in regulation, is it not?

A Yes, it is.

Q Okay. So you are not critical of that fact?

A The fact that --

Q The fact that commissions of necessity have to go back and judge a company's prudence in their past actions, their management decisions?

A No, that is a key part of their job.

Q Okay. Now, part of your testimony is that it is important for investors to have confidence in the finality of Commission decisions, correct?

A That is an important asset among the financial community.

Q And you mentioned that you were with -- was it Fitch?

A Fitch Investors Service.

Q Did you have an occasion to know what the Florida Commission's -- let me ask you first. Fitch, does it not, keep -- does it not rank state commissions?

A You are asking does it not or does it?
Q Does it?
A It does not.
Q It does not. It has not ranked state commissions?
A Fitch does not.
Q Are you aware whether its competitors in bond ratings rank commissions?
A To the best of my knowledge, they do not.
Q Okay. So you wouldn't know, then, how -- or would you know how Florida is viewed vis-a-vis the other 49 states?
A Yes, I do. I have my own opinion, and there is also a regulatory information service that provides information on issues like that.
Q Isn't it true that over the better part of the last two decades that Florida, the Florida Commission has been viewed as supportive?
A It has been viewed as issuing constructive decisions with regard to investor issues.
Q And if I read your testimony correctly, you suggest, don't you, that having a supportive commission with constructive decisions can benefit consumers by lowering the cost of debt, is that correct?
A Without a doubt.
Q Okay. Isn't there also a danger, Mr. Fetter, that if commissions are too constructive that the customers can bear a

burden if equity costs are too high; that is, if equity awards are too high?

A I'm not sure I understand your question.

Q Well, is there a risk that if a commission is number one in the country in being supportive of utilities, and awards higher, the highest equity ratings in the country, that customers could be harmed in that fashion?

A Well, if the rankings I referred to earlier were just lining up commissions based on ROEs authorized, then I think your theory would play out. But it's a -- the rankings reflect sensitivity to issues like that, but also timeliness and how their administrative processes are carried out. And so, you know, there is a trade-off where a highly ranked commission will, in most cases, help the utilities that it regulates get a stronger credit rating, which would reduce the costs that bondholders require in order to make investments within a jurisdiction.

Q On the debt side?

A On the debt side.

Q I've got you. And, lastly, I'll stop with, I noticed in your vitae that you lobbied the Michigan Legislature to exempt the Michigan Commission from the Open Meetings Act?

A Yes, I did.

MR. TWOMEY: Okay. I was just curious about that. Thanks.

That's all, Madam Chair.

CHAIRMAN EDGAR: Thank you.

Mr. McWhirter.

CROSS EXAMINATION

BY MR. McWHIRTER:

Q Mr. Fetter, you can't see me; just consider this a voice from above. Oh, you can see me.

What did you say the name of your company is?

A Regulation Unfettered.

Q I see. Can you give us a brief description of how you came by that name?

A Well, I was born and given a name, Steven Fetter, and when I was going -- I actually started publishing regulatory commentary pieces while at Fitch under the title Regulation Unfettered. And when I went out on my own, I decided that I owned the name Regulation Unfettered as opposed to Fitch owning it, and I called my company that to indicate that through my activities and testimony I would help to explain regulation to all interested parties.

Q The connotation of regulation unfettered to me is that you think less regulation is better rather than more regulation, or do you think more regulation is better? What is the connotation you want to give to the people whom you consult with by that name?

A That name has nothing to do with deregulation or restructuring.

Q Do you provide consulting services to -- primarily to utilities and rating agencies or do you provide it to consumer groups, as well?

A I have been hired by consumer groups and by Commissions.

Q What consumer groups have hired you in the past?

A The Maine Public Counsel and the Vermont Public Counsel.

Q And what utilities have employed you in the last three years?

A Progress Energy Florida, Georgia Power. If you want me to give you all the names, it will take awhile, but I'm willing to, if you would like.

Q Go ahead.

A Entergy, Consolidated Edison, Public Service of Indiana, Pacific Gas and Electric, Arizona Public Service, Central Vermont Public Service, Detroit Edison, Nevada Power, Sierra Pacific Power, Great Plains Energy, Southwest Gas, Baltimore Gas and Electric, Pepco, Delmarva.

Q I think that is sufficient, Mr. Fetter. It seems to me that you predominately provide consulting services and testimony for utilities as opposed to consumer groups. Would that be a fair analysis?

A I listen to whoever calls, and if I agree with the position they want me to put forward, I agree to sign on with them. And that is what happened with the consumer advocates I worked with, as well as the commissions I worked with, as well as the utilities I have worked with.

Q When you provide consulting services, do I understand from your last answer that they ask you what they want you to talk about and you testify if you agree with that?

A They usually raise an issue and either ask my opinion of it or indicate the position that they feel, and I consider whether I could support what they want said. And if I can't, I either don't work for them or I indicate to what degree I can support what they say, and then they decide whether that's sufficient for them to retain me.

Q In your opinion, as a matter of regulatory policy, should fuel purchase contracts be confidential or open to public scrutiny?

A I believe to the extent that they can be open without jeopardizing the competitive nature of that sector, I think that is a positive thing. To the extent that it would skew the market place on those issues, I think protection of confidential information is appropriate.

Q Can you give me some hypothetical examples of where you find the boundaries to be for what you just said?

A I'm not sure I understand what kind of hypothetical you would want.

Q Well, you said fuel purchase contracts should be confidential if it -- what was the rest of what you said, if they should not interfere with the competitive marketplace? Is that a fair --

A Yes, if it would skew the marketplace by being 100 percent open.

Q I see. Well, what kind of information and under what circumstances would the marked be screwed by -- skewed by -- I'm sorry about that -- skewed by opening the fuel purchase information to public scrutiny?

A Where two entities, whether they be utilities or industrial manufacturers, are both interested in procuring the same commodity, I think it would not be in the interest of setting of a fair market if not only those two parties, but all parties knew what offers were on the table and what terms and conditions of service were on the table.

Q Well, isn't that how the stock market operates and how most of the Oasis, open access bulletin boards work? You publish what the price is and people are able to purchase at an exchange rate openly available price for the commodity?

A No, that is not how it operates.

Q How do they operate?

A A stock exchange puts out an equity for purchase, and serves as basically, the clearing agent, and it's publicly posted. It changes by every three or four seconds, and a purchaser can determine whether to attempt to buy a publicly listed stock.

Q How about the commodity markets, do they work in the same fashion?

A I think some commodity markets do and others don't.

Q Do you find it against regulatory policy for commodity markets to give current and future prices for commodities, spot market and future prices?

A I'm sorry. Do I find that it violates what?

Q Does it interfere with -- or does it skew the competitive marketplace if people know what the current and future market prices are for a commodity?

A It can.

Q How would it be not in the public interest for people to know what the present current price for a commodity is?

A Let me use an example of a hypothetical utility company that wants to procure a certain fuel at a certain amount on certain timing, but because of that location of that utility it is under kind of unusual transportation conditions. And so, therefore, there may not be as many competitors able to provide that supply. So if all information, including the difficulties of transporting that fuel were known in the open marketplace, then another, not only a utility, but a manufacturer, anyone could step in and say, listen, we will give you the same terms that the hypothetical utility offered, but transportation wise we will create a smoother transition of delivery of that fuel to us. So in that case, the hypothetical utility with the unusual conditions would probably have to pay more, and that cost would appropriately be flowed through to customers if that was the only choice the utility had.

Q But then competition would come into play, and it would tend to reduce the cost to people who could provide the cheapest transportation, wouldn't it?

A It depends on how many competitors could meet the unusual conditions of that utility.

Q Tell me your opinion about a regulated utility dealing with an affiliated nonregulated company. Can you give me the parameters as to circumstances when purchases of commodities from an affiliated nonregulated company should be confidential?

A I would think the Commission should have the ability to gain information so that it can tell whether the regulated utility and its customers are being treated appropriately.

Q You indicated that -- are you familiar with how long it takes to process a fuel recovery case in Florida?

A I generally know the process of setting of a fuel factor, and then at some point after the end of the year there is a filing, and then a true-up.

Q But do you know that it's generally about 80 days from the date that the forecasted prices are filed with the

Commission that it must make a decision with respect to setting the factor for the forthcoming year? Are you aware of that circumstance in Florida?

A I didn't know the 80 days.

Q Well, presume that or assume that for hypothetical purposes. Do you think 80 days would give intervenors an adequate time to fully explore the cost of the commodities that are being purchased for the forthcoming year when, say, $2 billion worth of fuel is being purchased by a utility?

A I would think that 80 days would give enough time for notice to be provided by intervenors who had issues.

Q Do you think that intervenors would have enough time within that stretch to discover the salient facts, employ experts, and file countervailing testimony to the proposed fuel factor?

A My experience as explored by the previous questioner related to executive branch service, legislative service, and then serving on a commission. And it was my belief that if a law is in place or a rule or regulation is in place and that the public interest would be better served by an amendment, then stakeholders who have an interest should take steps to approach the decision-maker to modify that process. And so, as I said, I view 80 days as certainly sufficient time for issues to be raised that would be of interest to the Commission. And if there is a legislative deadline that does not allow the smooth operation of an effectuation of public policy, then I, as an interested stakeholder, would certainly attempt to take steps to smooth out that process.

Q You, as a stakeholder, can take steps to smooth out the process. What does that mean?

A I might approach the legislature. I might approach the Commission if it was under by rule.

Q You being a consumer or you being a what?

A Someone who has an interest in that law or rule or regulation.

Q What should be the time limit then for that consumer to come in and make his concerns known to the legislature or the Commission?

A I'm not sure what you mean by a time limit.

Q Well, you indicated that from a rating agency's viewpoint, rating agencies wanted decisions to be administratively final and not subject to later unsettling changes in the fuel costs that were passed through to the customers. Didn't I understand your testimony to say that?

A Well, not only rating agencies, but any entity that is investing their own funds in a utility, they want certainty and finality with regard to regulatory decisions which are made on a timely basis.

Q Now, with respect to the process in Florida, are you familiar with the true-up process concept, is that generally done throughout the United States?

A True-ups are very common across the U.S.

Q And what that means is if they come in with a forecast of their estimated prices, and the prices come in higher during the forthcoming year, then the utility can collect the higher prices, what its actual costs, out-of-pocket costs have been, is that correct?

A Or lower.

Q And it goes the other way, too.

A Sure.

Q If the prices go down?

A Sure. That is the whole idea of the true-up.

Q Now, in Florida that process, we generally deal with the two preceding years when you come in for a fuel true-up. Have you found that fact that the Commission can go back for two years to true-up costs to be unsettling to the financial community?

A I think that that is better understood than the idea that there have been no -- very few prudency determinations over the past 20 or 30 years. So I think a two to three-year window with notice is something that rating agencies could understand would be -- might be reasonable within the processes of a particular state.

Q So you think the Commission without disturbing rating agencies could go back three years, is that it?

A As I said, with notice and timeliness and reasonable processes.

Q Well, tell me first of all what you mean by notice?

A That as soon as is reasonable for a party to object to a fuel determination, either a forecast or actual expenditures, that that party put not only the Commission on notice, but the utility that they are challenging on notice.

Q In order to challenge it, then, a consumer group would have to have the opportunity to go in and examine confidential information, wouldn't it?

A Or they could, through discovery, gain information that would allow them to put a challenge on the public record, and then it would be up to the Commission to set processes so that all parties could fairly put forth their positions on a timely basis.

Q What if an unlawful act was discovered, I would imagine -- would you think it would disturb rating agencies if they found that an unlawful act that occurred five years ago, sets as a daisy chain markup that resulted in unfettered profits to the utility, do you think that the rating agencies would be concerned about going back to set aside those unlawful transactions?

A Well, you realize I was head of the Fitch group during the Enron era, so I think rating agencies could appreciate the situation where if a hypothetical utility did an unlawful act that that might be punished at a later time upon it being learned that that occurred.

Q So, you think you could go back for three years with appropriate process and notification for lawful purchases and further for unlawful purchases, is that, in summary, your opinion for good regulatory policy?

A Well, how far you go back and the measure of unlawfulness, I would say there has to be some parity there. But I think, as I note in my testimony, concealment, fraud, I don't think there would be an expectation on the rating agency's part that activities like that should not be able to be acted upon once they come to public notice.

Q So, in essence, you would say a rule of reasonableness in our application of regulatory policy as to how far you can go back on fuel prices would be a good policy to recommend to this Commission?

A No, I don't think I said a rule of reasonableness. I said to the extent that the two to three-year is an ongoing process that everyone understands and that notice can be provided, you know, that seems to make sense. Fraud or concealment going further back than that, I have a comfort level with that. But, you know, when you say rule of reasonableness, then I think it creates this ambiguity and fog which allows some parties to say I am going to go back and challenge 10 or 11 or 15 years. I don't view that going back under those conditions would be appropriate, as I testify within my filed testimony.

Q What if a utility built a boiler and charged consumers extra for the cost of that boiler in their base rates in order that it could burn a certain kind of fuel, and then when that fuel came available at a lower price, failed to acquire that fuel. Would you think that -- where would that fall in your ambit of a reasonable period of examination plus an opportunity to go beyond that in the event of criminal or other untoward action?

A That sounds like the type of issue that should be subject to a multi-day hearing with substantial filings for the Commission to learn all relevant information. It's not a hypothetical that I can offer an answer to based on a 10 to 15-second rendition of your hypothetical facts.

Q I see. One in which you would have some 212 exhibits, and so forth, to examine?

A It might even have more exhibits than that.

MR. McWHIRTER: I have no further questions.

CHAIRMAN EDGAR: Thank you.

Mr. Brew.

MR. BREW: Yes. Thank you.

CROSS EXAMINATION

BY MR. BREW:

Q Good afternoon, Mr. Fetter.

A Good afternoon.

Q Do I understand your testimony generally to be discussing your views of general regulatory policies as applied to the Florida Commission's fuel practices?

A My views with regard to Florida processes, as well as my views based on what I think is appropriate regulatory policy across other jurisdictions.

Q Okay. Good. With respect to the Florida processes, would you say that you are generally familiar with it or specifically familiar with it?

A I'd say generally familiar.

Q Generally, did you look at any documents in past Florida fuel cases?

A I looked at some of the 423 filings and Schedule A filings, which are filed monthly, I believe, before this Commission. It's my understanding that there are quarterly meetings where utilities brief the Commission staff.

Q No, what did you look at?

A I'm sorry?

Q What did you look at?

MR. BURNETT: May the witness finish his answer, please? I don't believe Mr. Fetter was finished.

CHAIRMAN EDGAR: Mr. Fetter, did you have additional information that you would like to share on that question?

THE WITNESS: Yes. Thank you, Madam Chairman. It is my understanding that there are quarterly meetings where the state's utilities are able to brief Commission staff and interested stakeholders. I reviewed Mr. Windham's deposition where he discussed that he follows these filings, feels that it is his role to see if there are things that might implicate prudence or imprudence, and he's in a position where he can provide information to the Commission or others on Commission staff.

I found from what I learned about the processes that they were not very much different than -- when I was in Michigan we had certain processes where staff had an ongoing role to garner information with regard to prudence, and then provide it through channels so that the commission wouldn't be caught short with regard to prudence issues. And so it seemed to me that what's going on in this state is that all these filings that I referred to are not just going on a shelf, but they are being reviewed towards the end goal of deciding whether there should be activities related to finding an imprudent disallowance.

BY MR. BREW:

Q Is that it?

A I'm sorry?

Q Is that it? Are you finished?

A Yes.

Q Okay. Let's talk specifics. The last fuel docket, 06000-EI (sic), did you look at any of the filings in that docket?

A Which one?

Q The last fuel docket, 06000-EI?

A As I said, I looked at some 423 and Schedule A filings. Whether it was in that docket or not, I couldn't say for sure.

Q How many issues did staff address in their prehearing statement in that docket?

A I'm sorry?

Q In the last fuel filing, how many issues did staff address in their prehearing statement? Ten, 50, 100, do you know?

A Did staff what?

Q Address in their prehearing statement.

A I'm not sure.

Q Did you look at it?

A I didn't look at what issues staff raised.

Q And you wouldn't know whether the level of issues that staff had and the parties had to address in that docket was, say, typical of what goes on in a fuel case?

A No, I didn't review what issues were raised.

Q All right. Could I refer you to your testimony at Page 5, where you describe the purpose of your testimony. Do you see it?

A I'm there.

Q And you say at the end on Lines 23 and 24, that your testimony does not address the factual assertions in OPC's petition or the testimony of Mr. Sansom, do you see that?

A Yes.

Q Assume for me a moment that the Commission finds that the factual assertions raised by OPC and Mr. Sansom were accurate. Is it your testimony that there should be no relief for consumers?

A It's my testimony that going back ten or eleven years with a determination of relief would be inappropriate.

Q Let's take the last fuel docket, were you in attendance when Mr. McGlothlin gave his opening statement?

A Yes, I was.

Q Good. For last year, if the Commission were to find that OPC's statements were substantially accurate, would you agree that a $29 million adjustment would be appropriate to fuel costs?

A I mean, the Commission has to weigh the evidence and make a determination of what's appropriate.

Q Please don't fight my question. I asked if the Commission finds those facts, are you saying that there should be relief or no relief?

A If they find what facts?

Q If they find the facts as alleged by OPC regarding excessive coal costs in that year.

A If they find that there was imprudent behavior within that year, then the Commission should take action to remedy that situation.

Q Thank you. You mentioned your work in other states. And, specifically, I thought I heard you say that one of your clients recently was Public Service of Indiana, is that right?

A Yes.

Q Does Indiana have a fuel clause?

A Yes.

Q Do they currently have a subdocket, Docket 38707-FAC-68-S1?

A I don't know.

Q Would you accept that subject to check?

A Subject to check.

Q And would you also accept that that is a subdocket to look at the hedging costs of Duke Energy?

A If that is what you tell me, I'll accept it subject to check.

Q Okay. A couple of years ago did Indiana have a prudence case in a fuel subdocket associated with the extended outage of the D.C. Cook Nuclear Power Plant?

A I wasn't involved in that case.

Q You weren't involved in that case. Would you accept, subject to check, that Docket 38702-FAC-39 was that subdocket in Indiana?

A Subject to check, I'll accept that.

Q Mr. Fetter, on Page 24 of your testimony.

A I'm there.

Q Good. You quote extensively from a report that you say is entitled, "New York Regulators' Consistency Supports Electric Utility Credit Quality." Do you see that?

A Yes.

Q Did the New York Commission formally have a fuel adjustment clause before it entered into restructuring, do you know?

A Say again?

Q Before it entered into restructuring, did the New York Utilities have fuel clauses subject to the New York PSC's review?

A I'm not sure.

Q Okay. You have done work recently for Consolidated Edison of New York, though, right?

A A couple of years ago.

Q Okay. Would you accept that the New York Commission conducted a prudence proceeding in the 1980s, Case 28598, addressing the coal costs of Niagara Mohawk Power Company?

A Would I accept that --

Q That such a docket occurred?

A I don't know if such a docket occurred.

Q Would you accept that docket subject to check?

A That that existed?

Q Yes.

A That docket? Subject to check, I'll accept that such a docket existed.

Q And would you also accept that in that docket the New York Commission went back at least eight years with respect to coal-related costs passed through the fuel clause?

A I'm sure there were circumstances which led to such an unusual decision.

Q But you are not disputing the fact that a separate coal related fuel docket occurred?

A I'm accepting subject to check anything you want to say.

Q Okay. That's fine. Did Missouri conduct a prudence proceeding related to fuel costs associated with their blowing up of the Hawthorn coal plant?

A I don't know.

Q Okay. More generally, in your experience, Mr. Fetter, states that have fuel clauses, would you say it's unusual for them to create subdockets when circumstances occur that require more time to consider than the normal F.A.C process normally allows?

A I think the states take whatever procedural steps are necessary.

MR. BREW: Thank you. That's all I have.

CHAIRMAN EDGAR: Thank you.

Ms. Bradley.

CROSS EXAMINATION

BY MS. BRADLEY:

Q Mr. Fetter, are you aware that the Florida PSC is created by the Legislature here?

A Is your microphone on? I'm sorry.

Q Actually, it's not. That might help. Let me try again. Are you aware that the Florida PSC is created by the Legislature here?

A I believe it is.

Q Is that true of Michigan, as well?

A In Michigan it's created by the legislature.

Q And are you aware that the PSC has only the powers granted them by the Legislature?

A Delegated authority, yes.

Q Okay. Are you aware of what their primary responsibility or directive from the Legislature is here?

A I don't know the exact terms that the Legislature would describe it, but I have a sense of what the delegation of authority to a public utility commission would be.

Q Now, in your testimony you talk about deference given to management decisions of the utility, but would you agree that if approval of a management decision conflicts with the primary directive or responsibility that the Legislature has given the PSC, that they have a duty to follow that legislative directive?

A Well, when I say deference, I'm saying that the Commission should not substitute its own judgment for management decision-making. But if management makes a decision that is at odds with the law, then I think the Public Service Commission should take steps with regard to that management decision.

Q When you say take steps, you mean they can regulate that, take whatever is necessary to correct that?

A Within law and rule.

MS. BRADLEY: All right. No further questions.

CHAIRMAN EDGAR: Mr. Burgess.

MR. BURGESS: Thank you, Madam Chair.

CROSS EXAMINATION

BY MR. BURGESS:

Q Mr. Fetter, my name is Steve Burgess. I'm here on behalf of the Office of Public Counsel.

A Hello, sir.

Q Hello. And I need to first -- I thought I had a good handle on your testimony on this, and I'm not sure whether I might have been confused a little bit by some of your answers. As I understand it, what you're saying, correct me if I'm wrong, please, is that the determination of prudence should be considered in the true-up proceeding, and anything subsequent is off limits with regard to that, short of concealment with your two standards for concealment, is that right?

A I'm saying that true-up is an appropriate time at which to create finality.

Q Well, I'm trying to understand what you are advising the Commission in this case. You're saying that it should consider any transactions that occurred and were subject to true-up hearings to be -- to have the issue of prudence adjudicated, is that your point?

A I'm saying what I have seen in the information I have reviewed in this case is that staff tracks the company's filings, is in a position to channel information with regard to prudence or imprudence issues for further consideration, and that from the structure I see that a true-up proceeding would be the appropriate point during which such issues would be reviewed and finality and certainty was reached.

Q Short of a demonstration, a later demonstration of concealment as you've defined it?

A Concealment and fraud, I think, are bad things, and no entity regulated or not should benefit from doing such acts.

Q Right, and I appreciate that. Now, when you were responding to Mr. McWhirter, you also discussed unlawful acts. Now, there could be unlawful acts that are not within the definitions that you presented as far as concealment, is that right?

A Yeah, like if I cross the street and get a jaywalking ticket.

Q Well, I assume you are talking about material unlawful acts. If unlawful acts were demonstrated later, that that would be grounds for opening issues in addition to your concealment?

A You added the word material. That is precisely the type of differentiation that I was concerned with. Just using the word unlawful could lead to such misunderstandings and ambiguity.

Q Right. But you are agreeing that it might be beyond concealment, beyond the two standards of concealment; that is, a fraudulent statement or a refusal to provide information that was asked?

A Like I said, there has to be a certain degree of parity. You can't take an unlawful relatively non-material act from 15 years ago and say the whole ballgame is open again.

Q And with regard to the questions that you were being asked, subject to check, and, of course, you didn't -- not having looked at that information, you're willing to accept them. But if that is so, if those were accurate descriptions of fuel dockets in those other various jurisdictions about which Mr. Brew was asking, wouldn't it be correct that rating agencies would be aware that this type of evaluation takes place across the country with regard to fuel evaluation?

A No, I think the circumstances referred to were very unusual. I'm certain there were certain circumstances underlying those situations. And if I could just read from a rating agency report with regard to this very docket and how surprised at least one rating agency would be. It's a Fitch Ratings Report dated December 28th, 2006, entitled, "Florida Power Corporation Doing Business as Progress Energy Florida." And it states on Page 2, "While the FPSC already approved fuel purchases in those years in prior annual fuel filings, a full hearing on the matter will be held in the spring of 2007. The outcome of this matter cannot be determined at this time, but in Fitch's view the fact that the costs were already approved by the FPSC lessens the risk of an adverse decision. However, PEF's existing credit metrics could likely withstand an adverse outcome within the current ratings, but an adverse decision would indicate a more challenging regulatory environment in Florida."

Q Yes. But before you started reading that you said something to the effect you are certain that in those cases that Mr. Brew asked you about there were certain specific instances that made it unusual. But when you were answering the question you said you didn't know anything about them?

A Based on my 20 years experience with utility regulation, you know, I'm willing to base my reputation on the fact that in Niagara Mohawk issues eight years old did not spring anew out of the blue. And if that is the case, I'm sure Mr. Brew will brief it as such.

Q But your concern here is more than just issues eight years old. Your concern, as I understand it, is any issue that is raised subsequent to the true-up proceeding, unless there is concealment. Now, that puts it -- there is a wide range between what I just described and eight years, is there not?

A Well, my understanding is that OPC and others have been able to track these issues for 20 years. If they had problems, they could have made challenges. I think it's important, and my advice to the Commission would be not to create an environment of gotcha, where entities that feel that something is wrong can benefit by just sitting on their hands and waiting not only years, but in a case like this, a decade before coming forward.

Q May I get an answer to my question? Your suggestion to the Commission is that any issue of prudence should not be raised subsequent to the true-up proceeding short of a demonstration of concealment. And I asked, isn't there a wide range between that and an eight-year-old case?

A And what I'm saying is the Commission should put weight on the fact that parties should have an obligation to take steps, challenging steps contemporaneous with the events at issue.

Q And I am going to ask a third time if I can get an answer to my question. You were being asked by Mr. Brew about cases that were -- wherein he asked you were you aware of these cases wherein subdockets were created and examinations were made subsequent to the initial fuel determination. And I'm asking you is there a difference between -- is there a significant difference between the standard you're suggesting, that is, nothing can be examined short of a demonstration of concealment following the true-up determination and eight years later?

See, you keep going back to eight years and reasonableness. And I'm asking you are some of these issues to where they may not be the full ten years and eight years you are speaking of, but around the country are there not jurisdictions that regularly examine the issue of prudence beyond the standards that you are recommending that this Commission adopt?

MR. BURNETT: Objection, compound, confusing, vague, ambiguous, asked and answered and a mischaracterization of evidence.

MR. BURGESS: May I respond to the objection? The witness has been asked -- was asked a specific question. We started off when I asked him about these cases that he was asked about by Mr. Brew and what he knew about them. He said he was certain that they couldn't be -- that there couldn't be cases that weren't involving very specific circumstances. And I said, how do you know that? And he started talking about conditions that were eight years old. And I asked him, isn't there a vast difference between going back eight years and the standard he is talking about. Isn't there some significant ground in between, and he has not answered that question yet.

MR. BURNETT: Same objection.

CHAIRMAN EDGAR: Mr. Burgess, I'm going to allow you to try again. I am going to ask you, though, to -- for my benefit, if not the witness', to ask the questions in a little shorter questions, because I am having a hard time following them as well, quite frankly.

And to the witness, please try to answer the question that is asked. You can start with a yes or no, that is always helpful if, indeed, it can be answered that way.

Mr. Burgess.

BY MR. BURGESS:

Q Let me ask -- I'm going to move on to another area.

Mr. Fetter, as I understand your standard, then, in this case, and you have been asked this, if the Commission finds imprudence, but does not find concealment, it should say case closed, is that right?

A I believe in answer to Mr. Brew's questions I talked about a reasonable cycle period, so I think your statement is wrong.

Q Okay. So you think that even if there has been a true-up proceeding, that if a subsequent finding of imprudence is found by the Commission, that it should make an adjustment, am I right about that?

A What I said before is if you have information that you knew before the true-up occurred, and you did not raise it, and then you attempted to bring it up after the true-up proceeding -- I know when I was sitting as a Chairman, I would not be very happy that the party did that, and so I might not allow it to be considered.

Q So that there are cases, there are circumstances here if the Commission finds imprudence, but does not find concealment, that it should just say to the public, we have found imprudent expenditures, but we intend for you to bear them?

A No. They probably would say that the challenges were not timely made, and they should have been raised at an earlier time based on the information that the parties had in their possession.

Q One of the issues before the Commission in this docket is whether there has been any imprudence, is that right?

A Say again.

Q Is one of the issues before the Commission today whether there is any imprudence on the part of Progress Energy?

A That's my understanding.

Q Okay. And if they find imprudence without finding concealment, I'm trying to understand, are you saying that the customers should have to bear that cost?

A And as I said --

Q May I get an answer and then a full explanation?

A Well, I believe it is the same question I just answered, but I'm willing to answer it again.

CHAIRMAN EDGAR: Mr. Burgess, why don't you ask the question again.

BY MR. BURGESS:

Q You've just agreed that one of the issues before the Commission today is whether Progress Energy has been imprudent in its fuel procurement practices. If they make the finding to that issue yes, are you saying that short of a finding of concealment that the customers should have to bear that cost?

A And I said every administrative agency, just like every court, has to have processes so that cases don't go on forever, and there is finality and certainty, not only for the litigants, but also for entities that are affected by the litigation. And if the Commission finds that the processes were abused by the parties making the challenges, I believe that they can make a judgment totally apart. They could -- they could not even make a determination on prudence if they feel that the parties through whether statute of limitations or the legal concept of laches had sat on their rights, then I think that is within their purview.

Q Is it your understanding that the recommendations that you are providing to the Commission; that is, that the fuel costs should be considered prudent if there was not a challenge to it during the true-up, short of a subsequent finding of concealment, is it your understanding that that standard that you are recommending to the Commission is the current law in the state of Florida?

A What I'm saying -- certainly there is ambiguity. But what I'm saying is from what I have seen of the processes, including the deposition of Mr. Windham, the information about substantial filings on an ongoing basis monthly, quarterly meetings, that what is in place is a model for review where, by the time of true-up, issues, challenges could have been raised. And if they have not been raised, then I think nothing is on the table.

Q When you were making a determination as to your recommendations to the Commission, did you examine what you understood to be the documents that defined the current law on the subject?

A When I first did my testimony I had not looked at the Maxine Mine decision, and I believe the Supreme Court affirmation, but I did subsequently. And then after reading Mr. Bohrmann's deposition with his mention of Order Number 12645, I believe, I did read that order, and I found two interesting things within that order.

Q When you read 12465 -- well, let me backup and say is it your understanding from taking a look at that, that Order Number 1265 (sic) defines the boundaries of procedure for the fuel adjustment process for the state of Florida?

A It comments upon them, but there is also comment within that order about the appropriateness of a future rulemaking to codify the conditions, and it's my understanding that such rulemaking has never occurred.

Q So is it your understanding, then, that that means that that order is of no effect?

A Well, from my experience as a Commissioner in Michigan and from interacting with commissioners throughout the country, it's my understanding that one commission cannot bind a future commission. And so I think with this order being out there and not having gone through a rulemaking process, then the decision of appropriateness should be within the minds of the three individuals who are hearing this case, rather than deferring to an order from --

Q 24.

A -- 23, 24 years ago.

Q Would you agree that parties, that interested parties and parties whose interests are affected by Public Service Commission decisions should be entitled to rely on the law as expressed by the Public Service Commission?

A They can read this decision. They can see in this decision that not only does it refer to the appropriateness of a rulemaking, and so, you know, if they want to make decisions about legal rights, that should be a red flag to them that such rulemaking never occurred. And they also would see a statement within that order that even back then, 24 years ago, the Commission sitting at that time said the appropriate limitation of our jurisdiction is based on whatever statute of limitations or other jurisdictional limitations applies to our actions as a matter of law.

Q Whatever statute of limitations exists. Would you agree that it also said that we, therefore, accept any relevant proof the utility choses to present at true-up, but we will not adjudicate the question of prudence nor consider ourselves bound to do so until all relevant facts are analyzed and placed before us. We will feel free to revisit any transaction until we explicitly determine the matter to be fully and finally adjudicated?

A That is what those five individuals wrote at the same time they wrote that it would be appropriate to codify those conditions in a rulemaking.

Q Do you agree that they also said we see no justification in limiting our ability to scrutinize past transactions?

A That is a sentence that comes a couple before the discussion of statute of limitations or other jurisdictional limitations.

Q So you agree they did say that.

A Could you -- could you say the sentence again?

Q Yes. We see no justification in limiting our ability to scrutinize past transactions.

A And then modified by the sentence I read about statute of limitations limiting their jurisdiction.

Q Would you agree as well that the principles of this case were tested subsequently in the Maxine Mine case that you have had an opportunity to examine?

A I did read that decision.

Q And would you agree that in the Maxine Mine case the Public Service Commission held a hearing in September of 1983 and issued an order in June of 1984?

A June 22nd, 1984.

Q And would you agree that they required refunds of fuel revenues that were collected in 1980, 1981 and 1982?

A Yes.

Q And would you agree that that ability, that that jurisdiction of the Commission, that decision of the Commission, was challenged by Gulf Power Company before the Florida Supreme Court?

A That is my understanding.

Q Would you agree that the Florida Supreme Court agreed with the Public Service Commission, and stated that the fuel adjustment proceeding is a continuous proceeding and operates to a utility's benefit by eliminating regulatory lag. This authorization to collect fuel costs close to the time they are incurred should not be used to divest the Commission of the jurisdiction and power to review the prudence of these costs. The order was predicated on adjustments for 1980, 1981 and 1982, we find them permissible?

A And what I found most interesting about that decision --

Q May I get an answer? Is that your understanding of what the court said in that ruling?

A Can you direct me to the sentences you are reading so I can make sure that you are reading them appropriately?

Q Yes. It's 487 So.2d 1037, under Footnote 3, or under Headnote 3, Description Headnote 3.

A And you want to say it again, or do you want me to read it, or --

Q Do you disagree with how I read it, or do you want me to read it again?

A No, I didn't have it in front of me when you said it.

Q Do you agree that the Supreme Court held that the fuel adjustment proceeding is a continuous proceeding and operates to a utility's benefit by eliminating regulatory lag. This authorization to collect fuel costs close to the time they are incurred should not be used to divest the Commission of the jurisdiction and power to review the prudence of these costs. This order was predicated on adjustments for 1980, 1981 and 1982. We find them permissible.

A The Supreme Court using its standard of review made that finding.

Q Would you agree that that has not been -- that that Supreme Court case has not been overturned?

A To my understanding it hasn't been overturned.

Q Would you agree that that means, then, that that is the law of the land on this subject?

A That decision related to certain facts. Those facts being that notwithstanding that there appeared to be imprudent actions during the 1970s, the Commission limited its remedy to three years immediately preceding during the time of their proceeding of 1980, 1981, 1982, and so I find the decision of the Commission back then and as affirmed by the Supreme Court as not inconsistent with what I'm saying about contemporaneous review and notice to the party that's being challenged.

Q So would you agree, then, that the Supreme Court agreed that the Commission can go back at least three years beyond the years in which it had before it at the time it began its examination?

A Based on the -- based on the factual circumstances of that case.

Q And would you agree that parties should be able to rely on that law in conducting their affairs with regard to Public Service Commission cases?

A Based on the factual circumstances of that case.

Q Now, I understand that you have said that you have not explored, yourself, all the factual disputes or the factual disputes associated with this. Would you know of the circumstances involving Progress Energy or its predecessor, Florida Power Corp, its licensing under the Clean Air Act in 1996?

A I'm sorry, I lost the question.

Q Do you have any knowledge of how Florida Power Corp brought forward its licensing application under the Clean Air Act in 1995 -- 1996?

MR. BURNETT: Objection; vague and ambiguous.

MR. BURGESS: It seems pretty clear to me, does he have any awareness of how it made its presentation.

CHAIRMAN EDGAR: I'll allow.

MR. BURNETT: For what units?

BY MR. BURGESS:

Q For Units CR4 and CR5.

A No, I don't.

Q So if there was a shift in what Power -- in what Florida Power Corp could burn, based on that, from what they originally constructed those plants to burn, you are not aware of that?

A That is not the subject of my testimony.

Q If there were a shift, would that be something you would examine when you were a public service commissioner to determine whether it was a prudent decision?

A If parties raised it in a proceeding, it would be looked at.

Q You speak of -- you speak in your testimony on several occasions of conversations that are held during the process between Progress Energy and PSC staff and Office of Public Counsel, correct?

A Can you direct me to that?

Q Yes, I can. You mention it in Page 13, Line 7; Page 15, Line 13; and Page 19, Line 17.

A Okay. I'm at Page 13, Line 7, the Commission regularly briefed the Commission staff and OPC on fuel procurement between fuel adjustment proceedings. As I said or testified to earlier today, it's my understanding that there would be quarterly meetings at which there were briefings.

Q Okay. And I am just asking you, do you agree that you spoke of conversations that were continuous and taking place between the parties outside the actual fuel adjustment proceedings?

A That's what I have testified to, at least on Page 13. If you want me to -- you want to give me the other citations?

Q Page 15, Line 13; Page 19, Line 17.

A It helps to do one at a time.

Q Yes. Page 15 --

A Page 15, line what?

Q Line 13.

A And Page 19.

Q Page 19, Line 17.

A On Page 19, I have conversation in quote marks, so that would be kind of more theoretical communication going back and forth. The earlier two citations would refer to the quarterly briefings.

Q Do you know if in any of these conversations or briefings Florida Power Corporation alerted the PSC staff to a shift in the fuel that it could burn in CR4 and CR5?

A I don't know.

Q You were asked at your deposition some questions by Ms. Bennett about docket -- and when you were a Public Service Commissioner in the State of Michigan.

A I have a question. If we are going to a new topic could I take a break? Is that allowed?

CHAIRMAN EDGAR: We can take a break. Let's take about ten minutes.

(Recess.)

CHAIRMAN EDGAR: Okay. We will go back on the record. And, Mr. Burgess, if you will continue your questioning.

MR. BURGESS: Thank you, Madam Chair. And for your information as well as that of the witness, I just have one more line of questions.

BY MR. BURGESS:

Q And that is with regard to information that was asked by Ms. Bennett during your deposition. It had to do with the Docket Number U7830 when you were a Michigan Public Service Commissioner.

A Yes, sir.

Q And am I correct in understanding that with regard to Consumers Power Company, the Midland -- the Midland production plant was -- a large part of it was disallowed after there was some discontinuance of the construction, is that correct?

A It was a nuclear plant, and it was abandoned and turned into a cogeneration plant. And there was a significant disallowance related to the nuclear construction.

Q Was the disallowance that the Michigan Public Service Commission made because of a finding of imprudence?

A Yes.

Q And there was a question that you were asked at your deposition and you accepted subject to check. Have you gone back and checked that order?

A No, I haven't read that order.

Q Okay. So am I correct -- well, do you recall that it was a request of recovery of $2.1 billion by Consumers Power Company?

A It was a long time ago and a lot of figures, but if that's what the order says, I will accept it subject to check.

Q The point that I do want to address, actually, is at the time, though, you would have known that your disallowance could and probably would have an impact on the company's credit worthiness bond rating, is that correct?

A Actually, as I noted at my deposition, it was a very unusual situation because had the Commission, prior to my time, not stepped in with extraordinary relief, Consumers Power would have gone into bankruptcy. And so the Commission stepped in with extraordinary relief to maintain the company out of bankruptcy and set in place certain conditions that the company had to live up to as it worked its way back from its very weakened financial state.

And I think the 7830 orders -- basically, I was at the Commission for a little over six years, and these issues were, basically, with me and my colleagues every day of those six years. And so the orders that were referred to at my deposition were after the extraordinary relief was in place and while the conditions were also in place. And so, as I noted, it was a very unusual situation where the Commission was more involved in Consumers Power's affairs than both we would have liked and, also, what would be normal for a Commission.

Q Nevertheless, isn't that case an example of where, even if as a Commissioner you may believe it could have a detrimental effect on the bond rating, your obligation to the public may call for a disallowance if you make a finding of prudence -- of imprudence?

A I guess the differentiation I see is where -- there the issue was this abandonment of the nuclear plant. And so, clearly, everyone was on notice from basically the day the first shovel went into the ground until it was laid down, and then over the course of ten or so years until the issues were finally resolved.

As compared to what I note in my testimony, you know, not only any dollar disallowance, but if this Commission were to go back ten or eleven years, I would view it, and I think many would view it, as unprecedented. And I think it could affect the way this Commission, its positive reputation, not only among the financial community but also among their colleagues, I hear positive things.

And so, it is like the double-whammy of, you know, not only the dollar figure, but also the way the Commission is viewed with regard to not only this utility but also every regulated utility. It would be concern on the part of the financial community as to what direction regulatory policy is taking within the state of Florida.

Q Thank you. And I have just one more question with some trepidation of going back on my representation that I only had one more line of questioning. But with regard to what we were discussing earlier about rulemaking for the Commission order setting the procedure for a fuel adjustment process. Do you know anything about the Florida statutory requirement for rulemaking with regard to fuel adjustment, the fuel adjustment process?

A No, I don't.

MR. BURGESS: Thank you.

Thank you very much, Mr. Fetter. I appreciate it.

THE WITNESS: Thank you, sir.

CHAIRMAN EDGAR: Thank you. Are there questions from staff?

MS. BENNETT: Yes, there are just a few.

CROSS EXAMINATION

BY MS. BENNETT:

Q Mr. Fetter, would you agree that a role of a public service commissioner is to strike a fair balance between the interests of all stakeholders to the regulatory process?

A Yes, I would.

Q And would you agree that the term "stakeholders" includes both shareholders and ratepayers?

A Among others. It includes basically anyone who would have an interest in a decision at this body.

Q Would you agree that one of the principle roles of regulatory commissions is to conduct prudence reviews of the utilities and their jurisdictions?

A Yes.

Q Do you agree that at times the utility's definition of prudence may be different than a regulator's definition of prudence?

A I guess saying definition complicates it. I think it would be easier to say that a utility might take an action that it viewed as prudent, and a regulator might later feel that putting themselves in the shoes of the utility management, and only considering facts known to a utility management at that time, the regulator might feel that the actions taken by the utility did not fall within a range of reasonable behavior. So there might be a disagreement.

Q Okay. While you served on the Michigan Commission, did you ever vote to disallow recovery of expenses by a utility?

A Yes, I did.

Q For instance, as Mr. Burgess was discussing, while serving as chair of the Michigan Public Service Commission, you considered the prudence of 2.1 billion expended by the investor-owned utility, Consumer Power Company, for an abandoned construction project, is that correct?

A As I said, with regard to the number, I'm taking it subject to check, but, yes, that's true.

Q And while the utility was seeking full recovery of the $2.1 billion, the Michigan Public Service Commission only allowed recovery of approximately 760 million, is that correct?

A Subject to check, I'll accept that number.

Q In the past year you have filed testimony as an expert witness before the Arkansas Public Service Commission regarding fuel adjustment clauses, is that correct?

A Yes, I did.

Q And in that testimony you stated if the costs for fuel and power supply are not prudently incurred, there should be a process to allow challenge of such improper action, followed by the ability of the regulatory body to order disallowances and prevent inappropriate recovery. Is that also correct?

A From what I recall, that sounds like what I might have written.

Q And would you agree with your testimony today that -- I'm sorry, let me rephrase that.

Would you agree that your testimony before the Arkansas Public Service Commission is true and accurate today?

A As I noted at my deposition, when we discussed this phrase, elsewhere in my Entergy Arkansas testimony I incorporate the concept of timeliness. So adding timeliness to what you've just read, it reflects my view.

Q Would you agree that it is generally understood by rating agencies that one of the principle roles of regulatory commissions is to conduct prudence reviews of the expenditures and actions of utilities within their jurisdiction?

A Yes.

Q In your direct testimony on Page 6, and I will give you a minute to get there, Lines 20 through 22?

A I'm there.

Q You testified that regulators should not substitute their judgment for that of utility management so long as the judgment of management was within a range of reasonable business judgment at the time the judgment was made, is that correct?

A That's what I testify to.

Q And you agree with that testimony today?

A Yes, I do.

Q But isn't it true that during your term as Chairman of the Michigan Public Service Commission, the Commission considered the appropriate disposition of approximately $1.5 billion of proceeds for the transfer of a portion of Consumer Power Company's investment in the unfinished Midland nuclear power plant to the Midland Cogeneration Venture Limited Partnership?

A As I noted at the deposition, and as I noted earlier here today, that was a case so unusual that I don't think it has occurred anywhere else. And that was a case where in exchange for extraordinary relief to keep the utility out of the bankruptcy, the Commission set a list of conditions. And one of the conditions was the ability to have an impact on how proceeds coming into the utility would be utilized to strengthen the financial strength of the utility as opposed to being able to be used for unregulated activities.

Q Okay. Isn't it true that the Michigan Public Service Commission in that case required CMS Energy to return approximately 1.5 billion in proceeds, plus an additional 14.1 million in cash to Consumers Power Company?

A Like I said at deposition, you know, that sounds like the path taken. I can't confirm the numbers, but subject to check, I think that sounds like something I would have done with my colleagues.

Q And isn't it true that you and your colleagues also ordered Consumer Power Company to use those proceeds to retire utility debt and to increase spending on capital additions to improve the reliability of the utility's electric system?

A That sounds like a good thing to do.

MS. BENNETT: I have no further questions.

CHAIRMAN EDGAR: Mr. Burnett.

MR. BURNETT: No redirect, Madam Chairman.

And, if appropriate, we would move into evidence SMF-1 as Exhibit 33.

CHAIRMAN EDGAR: Exhibit 33 will be entered into the record.

(Exhibit 33 admitted into evidence.)

CHAIRMAN EDGAR: And the witness is excused. Thank you.

THE WITNESS: Thank you very much.

MR. BURNETT: May he be dismissed from the proceeding?

CHAIRMAN EDGAR: He may be dismissed.

MR. BURNETT: Thank you.

CHAIRMAN EDGAR: Thank you.

And you may call your next witness.

MR. WALLS: Thank you, Madam Chairman. We call Donna Davis.

DONNA M. DAVIS

was called as a witness on behalf of Progress Energy Florida, and having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. WALLS:

Q Ms. Davis, will you please introduce yourself to the Commission and provide your address?

A My name is Donna Davis. My address is 100 East David Avenue, Raleigh, North Carolina.

Q And who do you work for and what is your position?

A I work for a firm, Comensura, who is contracting services for Progress Energy Service, and my title is Mines

Controller.

Q Have you filed prefiled direct testimony and exhibits in this proceeding?

A Yes, I have.

Q And do you have those in front of you?

A Yes, I do.

Q Do you have any changes to make to your prefiled testimony and exhibits?

A No, I do not.

Q If I asked you the same questions in your prefiled testimony today, would you give the same answers that are in your prefiled testimony?

A Yes, I would.

MR. WALLS: At this time we request that the prefiled testimony be moved into the evidence as if it were read in the record today, and I would note that there is both direct and confidential direct testimony.

CHAIRMAN EDGAR: The prefiled direct testimony will be entered into the record as though read.

IN RE: PETITION ON BEHALF OF CITIZENS OF THE STATE OF FLORIDA TO REQUIRE PROGRESS ENERGY FLORIDA, INC. TO REFUND CUSTOMERS $143 MILLION

FPSC DOCKET NO. 060658

DIRECT TESTIMONY OF

DONNA M. DAVIS

I. INTRODUCTION AND QUALIFICATIONS

BACKGROUND, EMPLOYMENT, AND PFC RESPONSIBILITIES

Q: Please state your name and business address.

A: My name is Donna M. Davis. My business address is 100 East Davie Street, Raleigh, North Carolina 27601.

Q: Ms. Davis, by whom are you currently employed?

A: I am currently employed by Industrial Staffing through Comensura ("Comensura") as a Mines Controller for Progress Fuels Corp. ("PFC") in Raleigh, North Carolina.

Q: How long have you been employed by Comensura?

A: Since December 1, 2005. I became an employee of Comensura, providing services to PFC upon my retirement from PFC.

Q: Please explain how you provide services to PFC as a Comensura employee.

A: My understanding is that Comensura is a vendor management company. It handles payroll, withholding taxes, and other employee related administrative matters. The only company to whom I provide services is Progress Fuels.

Q: What are your current responsibilities as a Mines Controller?

A: I am responsible for the financial supervision of the PFC coal mines and oversight for the third party synfuel plants, as well as general accounting activities, as needed.

Q: You indicated that prior to becoming employed by Comensura you were employed by PFC. For how long were you employed by PFC?

A: I was employed by PFC for about 21 years, from December 3, 1984, until November 30, 2005.

Q: Was Progress Fuels Corp. previously known by another name?

A: Yes, until approximately December 2001 it was known as Electric Fuels Corp. In this testimony I refer to both Electric Fuels Corp. and PFC as "PFC" for convenience.

Q: Before becoming employed by PFC how were you employed?

A: I was employed by Tampa Electric Company or "TECO" from 1970 until 1984 in a number of accounting capacities. While I cannot recall all the positions I held with TECO in my initial years of employment, I eventually became the Supervisor of Special Accounting.

Q: Would you please summarize your responsibilities at TECO?

A: My accounting responsibilities involved general fuel accounting and financial and data filings with the Florida Public Service Commission ("FPSC") and the Federal Energy Regulatory Commission ("FERC"), as well as regulatory audits of that information. This included, among other responsibilities, the preparation of TECO's Form 423 filings with the FERC and any audits of those filings. Form 423 filings provide information as to the prices paid by regulated electric utilities for fuel used in generating electricity, including purchases of coal. As I indicated, I ultimately became Supervisor of Special Accounting. In that position I had overall supervisory responsibility for those filings and audits, among other general accounting responsibilities.

Q: What is your educational background?

A: I have a BA from the University of South Florida and an MBA from Tampa University in Tampa, Florida.

Q: Please summarize the nature of the responsibilities you held at PFC during the course of your employment.

A: Generally stated, from 1984 to 2005 I held positions involving the accounting and reporting of PFC's regulated business and the reporting of fuel costs to the Florida Public Service Commission and FERC. In 2004 I also became responsible for the accounting of PFC's non-regulated coal activities. During the period 1996-2002, which is the period covered by this testimony, I held the position of Director of Regulatory and Administrative Services.

Q: Describe your responsibilities at PFC during the period 1996 through 2002, when you held the position of Director of Regulatory and Administrative Services.

A: During that time period, in which I was based in St. Petersburg, Florida, I had overall supervisory responsibility for all regulatory filings by PFC at the FPSC relating to fuel costs and fuel cost recovery. I was responsible for, and had supervisory authority over, the contract administration, financial accounting and regulatory reporting and auditing for all PFC coal procurement contracts and coal transportation and delivery for regulated entities such as Progress Energy Florida ("PEF," previously known as Florida Power Corp.). This included coal procurement for Crystal River Units 1, 2, 4 and 5 ("CR1," "CR2," "CR4," "CR5"). I participated in all quarterly and other briefings of the FPSC Staff concerning coal procurement and coal transportation and delivery during this time frame. I also oversaw all regulatory audits and audit inquiries by the FPSC involving PFC's coal procurement practices, including PFC Requests for Proposals ("RFPs") for coal supply, as well as PFC's spot purchases of coal.

Q: During that same period, did you regularly interact with Dennis G. Edwards?

A: Yes. Mr. Edwards was PFC's Vice President for Coal Procurement. He was the person primarily responsible for coal procurement and related transportation and delivery for PFC. I worked closely with Mr. Edwards, spoke with him regularly, and was routinely copied on his communications with PFC management concerning coal procurement and coal transportation and delivery.

Q: As a result of your responsibilities during that period and your working relationship with Mr. Edwards, are you personally familiar with the business procedures, practices and routines used by PFC and Mr. Edwards in the procurement of coal for CR1, CR2, CR4, and CR5 during that period?

A: Yes, I am. I worked closely with Mr. Edwards as he was the PFC buyer for the coal and transportation purchased for delivery to Crystal River. Those costs would be accounted for by myself and my staff, and we were responsible for reporting those costs to PEF as well as the FPSC and FERC. Mr. Edwards and I constantly reviewed the coal costs of other utilities using a data base provided by RDI, which compiled costs reported by FERC and the public information filed by the utilities in Florida to the FPSC. Any cost procurement and transportation that was to be passed on to PEF and ultimately to the ratepayer from PFC was reviewed by both Mr. Edwards and myself, and I reviewed any other accounting cost that would be charged such as payroll and other overhead. Mr. Edwards and I would discuss his selections of coal and transportation suppliers and he copied me on all coal and transportation purchases.

Q: Are you familiar with the business records generated by Mr. Edwards and PFC relating to coal procurement during that period?

A: Yes.

Q: Is Mr. Edwards still employed by PFC?

A: No, he retired in early 2003.

Q: What period of time does your testimony primarily address?

A: My testimony primarily addresses the period 1996 through the end of 2002, before Mr. Edwards retired from PFC, and primarily the coal procurement decisions for CR4 and CR5 since those decisions are the subject of this proceeding. Other witnesses address fuel procurement in the period from 2003 on.

II. SUMMARY OF TESTIMONY

Q: What is the purpose of your testimony?

A: My testimony has four principal purposes.

First, I will explain the PFC coal procurement process and resulting decisions affecting Crystal River Units 4 and 5 during the period 1996 through the end of 2002 when I was Director of Regulatory and Administrative Services and worked with Mr. Edwards. An accurate understanding of the process used and the decisions made will demonstrate that FPC and PEF acted reasonably and prudently in their coal procurement decisions under the circumstances existing at the time.

Second, I will explain the processes and decisions involved in PFC purchasing synfuel for CR4 and CR5 during that time frame. An accurate understanding of those processes and decisions will demonstrate that PFC's purchases of synfuel were not driven by a desire to generate federal income tax credits for what Mr. Sansom calls "affiliates" of PFC, but to purchase the lowest cost fuel available for CR4 and CR5, and thus for PEF's ratepayers, which is what we did.

Third, I will discuss and illustrate how PFC's coal (and synfuel) procurement decisions during this time were regularly discussed with FPSC Staff, OPC, and the Florida Industrial Power Users Group ("FIPUG"), and that PFC's records concerning all such procurement processes and decisions were maintained as an "open book" available to the FPSC for review and audit.

Finally, I will discuss and refute Mr. Sansom's assertion that TECO was purchasing Powder River Basin ("PRB") coal during this time period at a lower cost than the cost for bituminous coal incurred by PFC for CR4 and CR5.

Q: Please give a brief summary of your testimony.

A: Although my testimony covers more than this summary, I would summarize the principal points as follows.

First, throughout the period 1996 through the end of 2002 PFC's practice was to first evaluate for purchase the coal meeting PFC's quality specifications that was offered at the lowest delivered cost. That is the cost to purchase the coal together with the cost to transport it to the Crystal River Energy Complex. This is the cost passed directly on to ratepayers in the fuel adjustment proceedings, and keeping this cost as low as possible was a major PFC priority.

Second, PFC purchased coal throughout this period using a competitive solicitation process and by spot purchases in which the delivered cost of all coal offers were compared.

Third, sub-bituminous coal, including PRB coal, was always included in our RFP solicitations, of which there were three solicitations (1996, 1998, and 2001) for CR4 & CR5 during the time period covered by my testimony. PFC's RFP specifications included specifications for sub-bituminous coal as well as bituminous coal. Sub-bituminous producers would have been considered had they offered coal to PFC on the spot market, but to the best of my knowledge none did so.

Fourth, PFC would also compare coals using an "evaluated cost" (sometimes called a "busbar cost") basis when coals that had not been previously used at CR4 and CR5 (such as sub-bituminous coal) were offered and presented either the lowest delivered cost or appeared to be potentially cost competitive. The evaluated cost analysis used a computer model that is widely used in the electric power industry. The model evaluates the probable cost impact on the utility plant of burning a specified type of coal compared to a coal whose cost impact on the plant is known. Such an analysis was not generally a factor when the only competitive offers were for the type of bituminous coal with which CR4 and CR5 had long experience. Those were the coals against which other coals were modeled. In addition, bituminous coal does not generally vary significantly in quality.

Fifth, sub-bituminous coal was not the lowest cost coal offered on a delivered or evaluated cost basis and was generally not even competitive. The one occasion in which sub-bituminous coal was arguably competitive was in May 2001 when PRB sub-bituminous coal was the lowest cost coal on an evaluated cost basis, but even then only for contracts of durations different from that which PFC ultimately contracted.

Sixth, PFC examined the use of sub-bituminous coal regularly, including an ongoing comparison of PFC's costs to those of TECO, which burned such coal at its Gannon plant. PFC determined that TECO was paying more for sub-bituminous coal than for bituminous coal and therefore inferred that TECO was purchasing sub-bituminous coal for reasons other than minimizing the delivered cost of coal. Further, PFC determined that CR4 and CR5 regularly generated electricity at a lower cost per mmBtu and per Kwh than the TECO plants that were burning sub-bituminous coal.

Seventh, contrary to Mr. Sansom's testimony, PFC never favored synfuel producers or marketers in which PFC held a financial interest. Like all other types of coal, when synfuel was the lowest cost coal product offered it was purchased from the entity making the lowest offer. The fact that PFC purchased synfuel with some frequency from companies in which PFC had an interest is explained by the fact that those companies were the largest producers of synfuel in the country, frequently made the lowest cost offer, and on a number of occasions provided the *only* offer, despite wide publication of PFC's interest in receiving proposals to purchase coal and synfuel. PEF's ratepayers benefited from purchases of the lowest cost synfuel. We saw no reason to avoid purchasing from whatever supplier offered the lowest cost synfuel simply to avoid purchasing from entities in which PFC had an interest. This was consistent with my understanding of with the FPSC's policies concerning purchases from affiliated entities as well.

Finally, PFC met frequently with the FPSC Staff, FIPUG, and OPC to brief them and answer questions from them concerning our coal procurement policies. All of our records of coal procurement were always open to the FPSC and OPC and were subject to audit. Given the level of information PFC provided them, I believe the fact that the Staff and OPC had no issues with our coal procurement actions during this time period reflects that they properly regarded those practices as reasonable and prudent, which they were.

Q: Are you sponsoring any exhibits with your testimony?

A: Yes, I am. First, I am sponsoring all of Mr. Edwards' monthly reports on coal procurement in Composite Exhibit No. ___ (DMD-9) to this testimony.

This composite exhibit represents business records prepared at or near the time of the events recorded in the records, which records it was a regular practice for Mr. Edwards to keep to perform his and my responsibilities. I am also sponsoring the following exhibits, which I discuss in my testimony, that were prepared by me or under my supervision or control, or they represent business records prepared at or near the time of the events recorded in the records, which records it was a regular practice for me or those who worked with me to keep to perform our responsibilities:

- Exhibit No. ____ (DMD-1); which are the coal procurement policies applicable to coal procurement decisions for CR4 and CR5 during the period of time addressed in my testimony;
- Exhibit No. ____ (DMD-2), which is a typical PFC bidder list from 1996 to 2002;
- Exhibit No. ____ (DMD-3), which is a typical RFP for CR4 and CR5 from 1996 to 2002;
- Exhibit No. ____ (DMD-4), which is the estimated Powder River Basin Origin Transportation Market cost;
- Exhibit No. ____ (DMD-5), which is a composite exhibit of the 1998 RFP response list and Kennecott's declination letter in response to that RFP;
- Exhibit No. ____ (DMD-6), which is the May 2001 RFP;
- Exhibit No. ____ (DMD-7), which is the bidder list for the May 2001 RFP;
- Exhibit No. ____ (DMD-8), which are the evaluations of the bid responses to the May 2001 RFP;

- Exhibit No. ____ (DMD-10), which is the report of FERC Form 423 TECO costs for 1996-2005;
- Exhibit No. ____ (DMD-11), which are cost comparisons with TECO on a generated cost per Kwh basis from 1996 to 2002;
- Exhibit No. ____ (DMD-12), which are cost comparisons with TECO on a generated cost per million Btu basis from 1996 to 2002;
- Exhibit No. ____ (DMD-13), which is a 1996 analysis of PRB and bituminous compliance coals;
- Exhibit No. ____ (DMD-14), which is a February 9, 1998 memo from Dennis Edwards to Mr. Cumbie;
- Exhibit No. ____ (DMD-15), which is a 1999 estimate of the cost of PRB coal at Crystal River by 2003;
- Exhibit No. ____ (DMD-16), which are agendas for the meetings between PFC, PEF, the Commission Staff, and other interested parties, including OPC, regarding PFC's coal procurement activities;
- Exhibit No. ____ (DMD-17), which are outlines for the meetings between PFC, PEF, the Commission Staff, and other interested parties, including OPC, regarding PFC's coal procurement activities;
- Exhibit No. ____ (DMD-18), which is a composite exhibit of the results of internal audits for the years 1999-2005 with respect to PFC's coal procurement for the Company;
- Exhibit No. ____ (DMD-19), which is the report of FERC Form 423 PEF costs for 1996-2005; and

- Exhibit No. ____ (DMD-20), which is the Staff comparison of the waterborne costs for PEF, TECO, and Gulf from 1995 to 2000.

All of these exhibits are true and correct.

III. PURPOSE OF PFC

Q: What is the purpose of PFC?

A: During the period covered by my testimony, PFC provided fuel procurement services, among other things, to PEF. These services included the procurement of coal to fuel PEF's coal fired generating plants, including CR1, CR2, CR4, and CR5. PFC contracted directly with coal suppliers and with transportation providers, such as railroads, water transport (barge) companies, and transloading facilities, such as International Marine Terminals (IMT) for transportation services.

Q: Did PFC have objectives that it sought to meet in procuring coal for CR4 and CR5?

A: Yes. We had three principal objectives.

Q: What were those principal objectives?

A: First, to ensure an adequate, reliable supply of coal for the operation of CR4 and CR5. Second, to ensure that the coal supply met the utility's quality specifications. Third, to purchase coal at the lowest cost possible, consistent with achieving the first two objectives.

V. ACHIEVING THE OBJECTIVES

Adequate Supply

Q: Briefly explain how PFC achieved the first objective.

A: In the fall of each year the utility would provide PFC with data showing the amount of coal burned at CR4 and CR5 in the past year and the utility's estimate of the amount of coal needed for burns and inventory target levels the next year. This information was also updated regularly during the course of the year, but this was the starting point for our coal procurement decisions. After determining the amount of coal already under contracts that extended into the next year, we would calculate the amount of coal that PFC needed to procure for the coming year. This is discussed in somewhat more detail later in this testimony.

Quality Assurance/Specifications

Q: Briefly explain how PFC achieved the second objective.

A: PEF and PFC established detailed specifications (commonly referred to as "specs") for the quality of coal that it desired to operate CR4 and CR5. Those specs changed little if any in the years covered by my testimony. The specs covered a variety of characteristics, including sulfur content, ash content, moisture content, and so on. PFC incorporated these specifications in all RFPs. Some of these criteria were more critical than others in the judgment of the utility. Those that were somewhat less critical could be satisfied by the average quality of a number of shipments, while others, such as sulfur content, had to be satisfied on a per shipment basis. Responses to RFPs that did not meet these specifications were disqualified.

Q: Did these specifications include bituminous coal?

A: Yes.

Q: Did the specifications also include sub-bituminous coal?

A: Yes, they included separate specifications for sub-bituminous coal.

Q: How were the "specs" for bituminous coal developed?

A: The "specs" for bituminous coal were based on PEF's operating experience burning bituminous coal in those units. Those units had operated since their inception in the early 1980's on Eastern bituminous coal, largely coal mined in the Central Appalachian Region ("CAPP Coal"). The specs described the physical and chemical characteristics that the utility had found from experience would provide the most efficient, highest output operation of the units. I would note that, while CR4 and CR5 are each "nameplate" rated to produce 665 MW of electric energy, in fact they have historically operated on a bituminous coal supply meeting these specs just described to produce approximately 750 to 770 MW a piece.

Q: Do you know how the specs for sub-bituminous coal were developed?

A: No, although I know that they have been the same since the early 1980's, so I assume in reviewing the original contract that they were based on the original design of the boiler. I can say that PFC used the sub-bituminous coal specs provided to it by PEF in all RFPs.

Q: What specs did PFC use for coal quality in the spot market?

A: The same specs as used in RFPs were used to evaluate the potential purchase of bituminous and sub-bituminous coal. Spot contracts were for durations of one year or less.

Q: Did satisfaction of the specs by a coal producer ensure that the coal would function in a desirable fashion in the units?

A: Yes, as to bituminous coal because those specs were based on long term operating experience with such coal. Bituminous coals that met those specs were very much a "known quantity." The answer was not necessarily "yes" as to sub-bituminous coals, however, since operating experience with such coal at CR4 and CR5 did not exist. The specs used were thought to describe sub-bituminous coal that could be burned as efficiently as possible by the units, but the actual performance of such coals was not known. Because there had been no occasion since the construction of CR4 and CR5 when such coals were cost-competitive, and indeed since sub-bituminous coals were generally not offered to PFC, sub-bituminous coal had not been the subject of actual operating experience or testing in the units.

Lowest Cost

Q: How did PFC achieve the third primary objective?

A: PFC used a competitive RFP and spot purchase process to obtain the lowest cost coal available meeting the utility's quality specifications. There were a number of steps in this process.

Q: Did the FPSC establish any requirements or guidelines in this regard?

A: Yes. The FPSC has established by orders that electric utilities' purchases of fuel, including coal, should be made using a "competitive solicitation" process and that spot purchases be made at market price. As I recall, that began with a "generic" order to that effect issued in 1983 Order No. 12645, which applied to all regulated Florida electric utilities. Over the years following 1983 the FPSC issued additional orders tailored to PEF and PFC. We adhered to each of those orders as they were issued. FPSC Order No. 13220 (1984); Order No. 20605 (1986); and Order No. 22401 (1990).

Q: Did the FPSC dictate exactly how a utility was to go about complying with these directives?

A: No. The FPSC expressly declined to do that, leaving that to the sound judgment of utility management. The FPSC has also declined to dictate what documentation the utility should adopt or maintain concerning that process. The FPSC has found that to be a "utility management decision." Order No. 22401.

Q: Did PFC adopt any fuel procurement policies directed to the procurement of coal?

A: Yes. PFC established written coal procurement policies and procedures in 1987 to comply with the FPSC guidelines and good business practices. Those policies were followed throughout my tenure with PFC and as far as I know are still in place and followed. The policies necessarily included the exercise of judgment at various points; the policies provided an overall framework for analysis and procedures, not a straightjacket for decision making. Those policies are contained in Exhibit No. ___ (DMD-1) to my testimony.

Q: Did PFC follow those policies during your tenure at PFC?

A: Yes.

VI. HOW THE PROCESS WORKED

Q: Was the coal procurement process at PFC a single step process?

A: No. It involved a number of steps.

Step 1: Identifying Coal Supply Needs.

Q: Without going into great detail, what was the first step in that procurement process?

A: As I indicated earlier, the first step each year was to identify the utility's coal supply needs for CR4 and CR5 for the coming year. In the fall of each year, PEF provided PFC with coal tonnage needs for CR Units 1, 2, 4 and 5 for the coming year. This was based on, among other things, the utility's actual "amount of coal burned" during the preceding year and the expected coal to be burned in the coming year, as well as inventory target levels. We were also kept advised on a monthly basis of the coal burned each month and the expected burn for the following month.

All of this information was stated separately for (a) CR4 and CR5 and (b) CR1 and CR2. While all four units are coal fired, CR1 and CR2 burn coal with a higher sulfur content than CR4 and CR5. The latter units are designed to burn coal with lower sulfur content, commonly referred to as "compliance coal."

Q: Was that all the information that PFC needed to determine what amount of coal needed to be purchased by PFC in the coming year?

A: No. This told us how much coal PEF would need, but we then had to take into account what existing coal supply contracts were already in force that would continue in force in the coming year. The difference between (a) the utility's projected coal needs for the coming year, and (b) the tonnage already under contract for the next year yielded the amount of new coal that PFC needed to procure. As I explained, we also took into account any changes in the amount of coal that the utility desired to maintain in on-site inventory at Crystal River and at IMT in New Orleans. In addition, if the existing contracts had price reopeners, PFC might need to issue an RFP for the same type of coal under contract or initiate a review of market prices for similar coals in order to negotiate the price for the remaining contract term.

Q: Can you give us an approximate idea of how much "new" coal needed to be procured each year during the period 1996-2002?

A: During that period the annual "burns" of coal at CR4 and CR5 were approximately 3.25 million to 3.7 million tons per year. Typically, approximately 2 million to 2.5 million tons were under contact. As a result, the new coal procurement needs for those units on an annual basis ranged between 750,000 tons and 1.7 million tons.

The amount under contract was impacted significantly each year until early 2002 by two long term (20 year) contracts entered into in the early 1980's when long term contract commitments were deemed desirable to ensure the availability of coal supply, particularly for base load plants such as CR4 and CR5. Such a contract duration was a standard term in utility coal contracts at the time. In fact, the Florida Department of Environmental Protection ("DEP") required proof of the existence of a long term coal supply under contract as part of DEP's approval of the siting of the units. The Massey contract was submitted to DEP as proof of compliance with that requirement, and DEP approved the siting of the units. The Massey and Powell Mountain contracts were also entered into during a period of coal price stability.

Q: What was the tonnage covered by the Massey and Powell Mountain contracts?

A: Each was a nominal 1 million ton/year contract. Each gave PFC the option to buy 10% to 15% more or less that the nominal tonnage when the contact price differed from the market price. Each of these contracts expired in the spring of 2002.

They accounted for roughly 60 to 66% of the annual needs of CR4 and CR5, subject to the ability of PEF to purchase 10% to 15% less if the contract price exceeded market.

Q: Was assuring an adequate supply of coal that would operate efficiently and as expected in Units 4 and 5 of particular importance?

A: Yes. Units 4 and 5 are "base load" plants, meaning they generate electricity around the clock to meet PEF's constant or "base load" statewide customer needs for electricity. They are not "peakers" or other plants that operate only to meet spikes in demand. Assuring an adequate and reliable performing fuel supply for baseload plants is therefore critical to ensuring that the "lights come on" whenever PEF's 1.6 million customers "flip the switch."

Step Two: Balancing Contract Durations

Q: What was the next step in the procurement process?

A: To achieve a prudent mixture of coal supply contracts by having an appropriate balance of long term, medium term, and "spot" supply contracts. This is consistent with FPSC policies and orders.

Q: What do you mean by the term "spot" contracts?

A: Within PFC we use the term "spot" contract to describe contracts having a duration of one year or less. This can include purchases for a single month or even a single shipment.

Q: Please explain what you mean by having a "balance" of contracts.

A: As is common in the industry, we contracted with various coal consulting services, including EVA, that provided forecasts as to future conditions in the coal markets over various periods of time ranging from the short term to the much longer term. We took those into account in evaluating how much of our coal supply we wanted to be on medium term contracts (such as 18 months to three years) and how much we wanted to purchase on a spot basis during a year.

For example, if we believed, based on an evaluation of market forecasts, that the price of coal would move downward during a year and coal on the spot market would be abundant, we may opt to maximize our flexibility to take advantage of such drops by entering into fewer contracts for a year or more in order to be able to purchase in the spot market. However, even in such a situation we may choose to hedge against the forecast proving inaccurate by putting some portion of our coal supply under contract. Because, as discussed in more detail later, the coal market was generally soft during the 1990's and through the year 2000, we issued three RFPs for CR4 and CR5 – in 1996, 1998 and 2001 – during the period covered by my testimony.

Q: What was the long term component of the contract mix?

A: During the period 1996-2002 the Powell Mountain and Massey contracts provided the long term component of this mixture. No other long term contracts of similar duration were sought or entered into. PEF would exercise its contractual right to purchase the contractual minimum under these long term contracts during periods in which other coal was at a more economical delivered price to CR4 and CR5. During much of the period 1996-2002 PFC was purchasing the contract minimums under the Massey and Powell Mountain contracts.

Having arrived at a determination of what balance of longer, shorter and spot contracts seem most prudent, PFC would turn to the next step in the process.

Step Three: Creating a Competitive Solicitation Document And List of Recipients

Q: Please describe this third step in the procurement process.

A: Having identified the needed supply of coal from new contract purchases, and if it was determined that an RFP, rather than spot purchases, was appropriate, an RFP was drawn up. A list of potential coal suppliers, usually exceeding 100 in number, was maintained and updated, with coal suppliers being regularly added to the list of prospective proposers. The list was the result of such information as (a) known coal mining companies identified by knowledge of the industry and various industry data, publications and the like; (b) previous responders to an RFP; and (c) entities that had contacted us to express an interest in being included in RFPs. If a company wanted to be added to the list, all that was necessary was for them to contact PFC and request to be added. A typical such list is Exhibit No. ___ (DMD-2) to my testimony.

Q: Did PFC send the RFPs to producers of sub-bituminous coal?

A: Yes. To the best of my knowledge, during the period covered by my testimony four companies comprised the bulk of the sub-bituminous producers. They were Arch Coal, Peabody Coal, Triton Coal, and Kennecott Coal. Arch later purchased Triton. Those companies were routinely included in all RFPs. A typical bid solicitation sheet showing the producers that were regularly solicited for proposals is Exhibit No. ___ (DMD-2) to my testimony.

Q: Was there a way that a coal producer who may not have been sent an RFP could learn of the RFP and make a proposal?

A: Yes. Our RFPs regularly appeared in widely read coal industry publications. We affirmatively provided information concerning our RFPs to those publications so as to achieve even broader dissemination of our RFPs than even the lengthy list of producers to whom the RFP went. Coal Outlook, Coal Daily, Energy Argus Daily, US Coal Review and McCloskey Coal Report are just a few of the publications we used and which could have reported our RFPs. It was not unusual for prospective coal suppliers who had not received the RFP from us to contact us, request an RFP, and submit a proposal.

Q: **What about spot purchasing? Was there a way in which sub-bituminous coal producers could make offers on the spot market to PFC?**

A: Yes. PFC was a substantial purchaser in the spot market. In our experience most suppliers assumed we were more or less always open to spot purchases. In addition, the same coal industry publications routinely publicized companies purchasing in the spot market, which would have included PFC.

Q: **Describe the contents of the RFPs that were used.**

A: We used a relatively standardized form of RFP, although the substantive contents would change with the needs of the company. Examples of the RFPs used by PFC during the period 1996-2002 appear in Exhibit No. ___ (DMD-3) to my testimony.

Typically, and among other things, the RFP would state:

- the minimum annual tons desired, delivered in monthly, ratable amounts;
- the duration of the desired contract, which may include soliciting proposals for more than one time period;
- "required coal specifications" for ***both*** bituminous and sub-bituminous coal;
- that proposers should identify both their "typical" quality compared to the specifications and their "guaranteed" quality;
- that PFC was "indifferent" as to the origin of the coal;
- that both rail and barge loading origins would be considered;
- that rail deliveries were to be quoted FOB the mine loading point; and barge deliveries should be quoted FOB the barge.

Step Four: Evaluating The Responses

A. Delivered Price

Q: Once responses to an RFP were received, how were they evaluated?

A: Our primary basis for comparison was which proposal, if accepted, would involve the lowest "delivered cost" or "delivered price." These terms are interchangeable.

Q: What do you mean by "delivered cost"?

A: "Delivered cost" was the cost calculated by PEF based on (a) the FOB mine price specified in the proposal, plus (b) the cost of transporting the coal to the Crystal River Complex.

Q: Why was this the primary basis for comparison?

A: PEF's ratepayers pay for fuel purchases on a cost pass-through basis under FPSC orders. In the case of coal, the amount that ratepayers pay through this "fuel adjustment" charge is the delivered price of coal. We therefore sought to ensure that PEF's ratepayers paid for the lowest delivered price of coal by emphasizing lowest delivered price in our coal procurement policies and procedures.

B. Mine Price

Q: Where would PFC obtain the FOB mine price?

A: That would come directly from the proposal.

C. Transportation Costs

Q: **What were PFC's transportation options for getting coal to Crystal River?**

A: Transportation of coal to Crystal River could be by rail or by water. The complex was served by a CSX rail line. Water deliveries were by barge. The FPSC had directed PEF and thus PFC to maximize the use of rail deliveries. We did this every year. The 1 million (nominal) tons of coal under the Powell Mountain long term contract were delivered by rail. The similar tonnage under the long term Massey contract were shipped by water. I would note that maintaining waterborne transportation provides an alternative transport system in the event of rail strikes or other surface transportation disruptions, as well as providing a means to negotiate the most favorable rates from both forms of transportation. Also in Order No. 21847 (1986) the Commission again reaffirmed the desirability of maintaining alternative transportation routes for the purposes of increasing reliability and enhancing price competition.

Q: **Can you give us an idea of how important transportation charges were to the overall cost of coal procurement?**

A: Transportation charges were a very significant portion of the total delivered price of coal from all potential sources. In the case of sub-bituminous coal, it was by far the greatest portion of the total delivered price, significantly exceeding the FOB mine price at all times.

Q. Did PFC have a preference for whether coal for CR4 and CR5 was delivered by rail or by water?

A. PFC generally tried to maximize the use of rail transport, as directed by the FPSC. Because CR4 and CR5 burn what is called "compliance coal," and because it was harder to obtain rail transport for compliance coal, we generally emphasized the use of water for compliance coal for CR4 and CR5.

(i) Rail

Q: Could all of PEF's coal for CR4 and CR5 have been delivered by rail?

A: No, even if we had wanted to do that, it was neither possible nor desirable from a transportation charge perspective.

Q: Please explain.

A: CSX Transport, which is also the only railroad company operating in Florida, maintains a single ("one way") rail line between Dunnellon and Crystal River. As a result, it is not possible to run more than one train at a time between Dunnellon and Crystal River. Moreover, the rail spur at the Crystal River Energy Complex is a loop. This imposes an inherent limitation on the number of train sets that can run into the complex, which makes it physically impossible to meet the transport needs of the complex, or of CR4 and CR5, entirely or principally by rail.

Q: What about sub-bituminous coal? What were the transportation options for shipping that kind of coal to Crystal River?

A: My understanding was that rail delivery of sub-bituminous coal to Crystal River was cost prohibitive and that the only realistic option was rail transport from the mine to water and then by waterborne delivery to Crystal River. I understand that another witness testifying on behalf of PEF will address this in detail. In my basic working understanding, however, this was a result of (a) the distance from the Powder River Basin in Wyoming and Montana to Crystal River; (b) the fact that no single railroad company could provide rail service from Wyoming and Montana to Crystal River; and (c) the substantially greater amount of sub-bituminous coal that would have to be shipped compared to bituminous coal due to the lower Btu content of sub-bituminous coal.

Q: How was the rail transportation cost determined?

A: PFC had negotiated rail rates with CSX, which is the only railroad operating into Crystal River.

(ii) Waterborne

Q: How was the water transportation cost determined?

A: For water transportation, PEF would use (until 2005) the "waterborne proxy" rates established by the FPSC for PEF's water transportation and water transportation related costs. The waterborne proxy rates included various components, namely (a) truck transportation to an upriver dock, transloading to barges, and river barge transportation rates for transport on the Ohio and Mississippi rivers; (b) transloading costs, for transferring the coal to storage or transferring coal from a river barge to a Gulf barge at IMT in New Orleans; and (c) cross-Gulf barge rates for ultimate delivery to Crystal River.

Q: Please explain the waterborne proxy.

A: The waterborne proxy was established by the FPSC in order to eliminate the need to thereafter constantly calculate PFC's "actual" waterborne transport charges. The Commission felt that cost-plus pricing had led to lingering suspicions that it resulted in higher cost due to affiliate transactions and that a market proxy could be established. The proxy established in 1993 was based on PFC's actual costs in 1992 and was thereafter annually escalated or de-escalated by FPSC specified indices linked to certain market escalators. Once established by FPSC order, the proxy became the cost that PFC was required to use to calculate waterborne transportation rates. All parties to the FPSC proceeding establishing the waterborne proxy, including the FPSC, understand that by its very nature the proxy may deviate from PFC's actual costs, be the deviation up or down. The proxy was replaced in 2004 by a stipulated charge (which stipulation included OPC), and in 2005 by market based rates to the extent that market based rates existed.

Q: How did PFC use the waterborne proxy in calculating the water transportation component of delivered cost for sub-bituminous coal?

A: The waterborne proxy was developed by combining the cost of discrete stages of water transportation (e.g., river barge rates from upriver docks to the IMT terminal in New Orleans). This also lent itself to being used to calculate the waterborne proxy rate applicable to each transport stage as necessary to reflect the actual stages involved in particular transports. PFC therefore used the applicable rates from the waterborne proxy for the portions that applied to the route that would be taken to Crystal River by sub-bituminous coal.

Q: Has the FPSC recognized such a stage approach in any order?

A: Yes, in 1994 the FPSC approved PFC's use of such an approach in calculating the appropriate proxy rate for the shipment of imported coal which might be purchased at IMT, which did not use any part of the river stage of the full waterborne proxy. The FPSC sanctioned the use of 50.2% of the full waterborne proxy to reflect the stages that included transloading at IMT and cross-Gulf transportation from IMT to Crystal River. Although the circumstances that gave rise to the FPSC's order involved imported coal, the actual methodology employed in the order was based on the portion of the waterborne proxy that would be involved in the purchase of any kind of coal at IMT. In 2004 the FPSC approved a waterborne proxy for foreign (imported) coal FOB Barge by calculating the portion of the transport activities included in the waterborne proxy that were actually involved in transporting foreign coal to Crystal River for 2001 to 2003, less the transloading component, which cost the foreign coal supplier absorbed.

Q: Can you illustrate how PFC calculated delivered cost for sub-bituminous coal?

A: Yes. An example appears as Exhibit No. ___ (DMD-4) to my testimony. This is a calculation of the estimated transportation cost of coal originating in the Powder River Basin in 1997. In this estimate, the three transportation cost components were the mine to the river (here, the Cora dock on the Mississippi), the river dock to IMT, and the movement of the coal from IMT across the Gulf to Crystal River, including all transloading charges.

In Exhibit No. ___ (DMD-4), the first leg of the trip was estimated based on information obtained from the marketplace for such mine to river rail costs. The second leg, the trip from the Cora dock on the Mississippi to IMT, is a conservative estimate of the relative percentage of the waterborne proxy for the river to IMT movement to the shorter movement on the river to IMT for PRB coal.

The ratio of the miles from the Cora dock to IMT to the miles from the Ceredo dock to IMT (995 ÷ 1564) was multiplied times the original waterborne proxy rate from the Ceredo dock ($7.71), which is the further river dock from IMT under the waterborne proxy, to provide an "implied" original Cora waterborne proxy rate ($4.97). To arrive at the escalation of this rate from the origin of the waterborne proxy in 1992 to get a 1997 "market" rate, the percentage escalation from the original total base river waterborne cost (which was the average of the costs from all docks from which PFC purchased coal plus the waterway user tax) of $7.32 to the 1997 river waterborne proxy rate of $8.30 was first determined (13.4%). This percentage increase was then applied to the "implied" Cora to IMT 1992 river rate of $4.91 to get the 1997 Cora to IMT implied waterborne proxy rate of $5.57.

Once the river part of the waterborne proxy was determined, it was added to the market estimate of the mine to river cost plus transloading costs ($14.00) and the estimated IMT and Gulf waterborne proxy rates ($12.70) to obtain a total estimated transportation cost from the PRB to Crystal River of $32.27/ton. To get the delivered cost number, the dollar per ton price FOB mine must be added to the $32.27/ton estimated transportation cost.

B Evaluated Cost/Busbar Cost

Q: Was any cost basis other than delivered cost ever used to compare and evaluate responses to RFPs?

A: Yes. We would employ what we called the "evaluated cost" of coal, which was sometimes also referred to as the "busbar cost."

Q: Explain what you mean by an "evaluated" or "busbar" cost.

A: The physical and chemical characteristics of coal can have an impact on the operation of the boilers and other operating aspects of the utility plant in which it is burned. This impact can add an operating and maintenance expense and capital costs that will ultimately be passed on to ratepayers during rate adjustments, apart from the fuel adjustment charges that are periodically passed through. The "evaluated cost" or "busbar cost" analysis was a way of estimating such costs.

Q: By the way, could you explain the reference to "busbar" as used in "busbar cost."

A: Yes, although I am not an expert in how it is calculated. My working understanding is that the busbar is essentially the physical point in the utility generating plant that marks the end of the generating system and the beginning of the transmission system. The term "busbar cost" is, in my understanding, used to describe what cost impact certain coals will have on the cost of burning the coal and thus ultimately generating electricity up to the point at which the generation system ends. I understand that other witnesses may address the calculation of this cost more knowledgeably.

Q: Who performed the evaluated cost or busbar cost analysis?

A: When we requested such an evaluation, our request went to the utility, which then performed the evaluation with us and produced the results. The results were expressed as a cost in ¢/MM Btu higher or lower than (or the same as) the historically established and known cost impact on the plant of coal meeting the utility's "ideal" physical and chemical specifications.

Q: You indicated that you are not an expert in how evaluated or busbar cost is determined, but that you have a working understanding of it. What is your understanding of how it is done?

A: My understanding is that it was done using a computerized model created by the Electric Power Research Institute's ("EPRI") model. We used the results provided by the utility in comparing the evaluated or busbar cost of various proposals.

Q: **Was it always necessary to calculate an evaluated cost or busbar cost in comparing responses to RFPs?**

A: No, not always. If the "short list" of proposers was comprised of suppliers with whose coal we had substantial experience or on which we had previously done a busbar analysis, it was generally unnecessary.

Q: **What kind of situations would provide a reason to believe that using an evaluated or busbar cost comparison would provide additional cost information that would be useful in evaluating proposals?**

A: It was most commonly used when we received proposals for coals of a type that the utility had not previously used and which had different chemical or physical properties from the coal with which the utility had extensive, historic operational experience (CAPP coal). When the only proposals received were for types of coal, typically CAPP coal, with which the utility had such extensive historic experience, there was no need to go beyond determining the delivered cost since the evaluated costs were known. It was also not necessary to do such additional evaluations when non-CAPP coal was already highly non-competitive on a delivered cost basis. In such situations there was no reason to believe that further evaluations using the evaluated or busbar cost would affect which proposal was the lowest cost proposal.

Q: Can you give us an example of a type of coal that as to which an evaluated cost or busbar cost analysis could provide important information?

A: Yes. Sub-bituminous coal is such a coal.

Q: Were evaluated or busbar cost comparisons done on spot purchases?

A: No, it was not practical to subject short term spot purchases to such modeling. One reason for this is that the tonnage had an impact on the busbar costs – the more tons the facility has to handle and operate with, the higher the cost typically. Spot purchases generally involved lower tonnage and shorter time periods than contract purchases.

Q: Can you give us an idea of how many responses to RFPs PFC might get from sub-bituminous coal producers during the time period covered by your testimony?

A: Yes. It is first important to keep in mind that the only RFPs that PFC issued for CR4 and CR5 during the time period covered by my testimony were in 1996, 1998 and May 2001. At all other times PFC met the tonnage needs of CR4 and CR5 (above that already under contract) by purchases in the spot market. In response to the 1998 RFP Kennecott, a major PRB coal producer, expressly declined to make a proposal, and we received no proposals from any other sub-bituminous coal supplier. Please see Composite Exhibit No. ___ (DMD-5) to my testimony, which includes the 1998 RFP response list and Kennecott's declination letter. In the May 2001 RFP proposals were received from two sub-bituminous producers (Triton and Arch), each of which was the lowest evaluated cost proposal for certain possible contract durations but not others. This is discussed later in this testimony.

C. *Short Listing*

Q: Now, once the responsive proposals were examined on a delivered or evaluated cost (where used) basis, what did PFC do?

A: The initial evaluation resulted in the creation of a "short list." This was usually the 3 to 5 proposals with the lowest delivered cost, or lowest evaluated cost if calculated. Bidders who did not make the short list were notified and advised that we would include them on future proposals and welcomed their continued interest. The short list proposers were then the group with whom PEF negotiated to obtain the best price. The contract was then eventually entered into with the proposer(s) offering the best lowest ultimate price.

VII. SUB-BITUMINOUS COAL EVALUATIONS 1996-2002

Q: During 1996-2002 was sub-bituminous coal competitive with other types of coal on either a delivered or evaluated cost basis?

A: No. During this period the FOB mine price for sub-bituminous coal was substantially lower than that of bituminous coals, including CAPP coal. However, the transportation cost for getting such coal to Crystal River from the mine, typically located in Wyoming, was the vast bulk of the delivered cost and rendered it non-competitive on a delivered cost basis. Sub-bituminous proposals, when made, typically did not make the "short list," except arguably in the May 2001 RFP. I would note again that Kennecott, a sub-bituminous producer, expressly declined to bid for our business in response to the 1998 RFP, and that we received no bids from other PRB producers in response to that solicitation. I can recall receiving no sub-bituminous coal proposal in response to an RFP prior to 2001.

Q: **What about spot purchases?**

A: To my knowledge during the 1996 through 2002 time period we never received an offer for a spot sale of sub-bituminous coal.

Q: **You mentioned an occasion in which sub-bituminous coal was arguably competitive. Please explain.**

A: In May of 2001 we issued an RFP that went, as usual, to many coal producers, including sub-bituminous producers. There was a major upward spike in coal prices after two decades or more of highly stable prices, and we wanted to try to lock in our coal contracts earlier in light of these uncertainties. A copy of the May 2001 RFP and the bidder list is Exhibit No. ___ (DMD-6) and Exhibit No. ___ (DMD-7) to my testimony, respectively.

PFC was attempting to evaluate what this market situation indicated, if anything, in terms of longer term price increases or instability. We therefore requested proposals for contracts of 1, 2, 3 and 5 years so that we could examine different scenarios as we evaluated the unusual situation and possible future market conditions.

We received proposals from sub-bituminous and bituminous coal producers, as well as for South American coal. We did an evaluated cost analysis on all proposals. The results of those analyses appear in Exhibit No. ___ (DMD-8) to this testimony.

Sub-bituminous coal proposals were not the lowest on an evaluated cost basis for the 1 year and 3 year analyses. A PRB response (Arch Coal) was the only one proposing a 2 year contract. Two PRB proposals (both from Triton coal, for different Btu PRB coals) were the lowest on an evaluated cost basis for a 5 year contract.

PFC did not ultimately deem a 5 year agreement prudent. Although the coal markets had undergone an abrupt spike in prices in 2001, PFC was not comfortable signing a contract of such duration in light of the uncertainty as to what the 2001 market conditions indicated, if anything, for the future direction of the market. PFC therefore negotiated with the lowest cost proposer for a 3 year contract, which was a proposal for high Btu imported coal, which negotiations ultimately resulted in a one year contract with that proposer.

Q: Just so we are clear, PFC signed a one year contract for imported bituminous coal in May 2001?

A: Correct.

Q: Was sub-bituminous proposal the lowest proposal on an evaluated cost basis for a 1 year contract?

A: No.

Q: Do all the PFC records reflecting the details of the evaluations done on responses to RFPs in the 1996-2002 time period still exist?

A: No, some were discarded well prior to the commencement of this proceeding (and anything remaining we found after the proceeding commenced was maintained), and in the absence of any indication that there was any potential for a question to arise as to the fuel procurement decisions made under those RFPs. These materials were destroyed within time frames consistent with PFC's records retention policy.

Q: Does the fact that those particular documents are no longer available affect your testimony?

A: No, it does not. First, they involve only the three RFPs issued during that time period, in 1996, 1998 and 2001, which were the only RFPs issued during the 1996-2002 time period. Second, we have the key document for the 2001 RFP, which is Exhibit No. ___ (DMD-8), which shows that no sub-bituminous coal was the lowest cost offer for the 1 year contract period selected by PFC. Finally, my recollection of the events to which I testify herein is not dependent on having such records, but is an independent recollection. While having the actual records might permit me to add additional detail, I have no reason to believe it would materially affect my testimony or contradict it.

Q: Before moving to the next topic, could you describe the nature of the coal market generally during the 1990's and how it generally affected PFC's procurement environment?

A: Generally speaking the 1990's were characterized by a "soft" coal market, meaning coal was abundant and relatively inexpensive. It was basically a "buyer's market." In addition, those producers who responded to our RFPs tended to respond with bituminous coal with high Btus and high quality specifications. As a result, PFC tended to utilize more short term and spot purchases as a strategy for maximizing our ability to purchase high quality coal at low prices. The general nature of the market and PFC's strategy and responses to it are reflected in the monthly reports provided by Mr. Edwards to his superior(s). Those reports are contained in Composite Exhibit No. ____ (DMD-9) to this testimony.

C. Monitoring PRB Usage By Others And Forecasting Its Eventual Competitiveness

Q: Did PFC familiarize itself with PRB usage by other Southeastern utilities?

A: Yes. Through the period 1996 through 2002 PFC was aware that TECO, our most geographically proximate "competitor," and The Southern Company were using sub-bituminous PRB coal in some plants.

Q: **Why did PFC look at such information?**

A: Whenever we saw a generating utility in our region using such coal, we attempted to determine why such coal might make economic sense for them to use, even though it did not appear economic for PEF. It was a means of quality assurance, if you will, to make sure we were not missing something, even though we had no reason to think we were.

Q: **What did you conclude as to TECO?**

A: We could find no basis to believe that TECO's purchases of PRB coal were based on purchasing the lowest cost coal. This is borne out by data reported by TECO on FERC Form 423. This data shows that TECO's purchases of PRB coal were never the cheapest, and often among the most expensive, coal TECO purchased on a delivered cost basis to the transfer facility. This is illustrated in Exhibit No. ____ (DMD-10) to this testimony, which contains that FERC information.

Our assessment was that even though PRB coal was not the lowest cost coal available to TECO, TECO was purchasing such coal for emissions control purposes in order to address specific emissions needs of TECO and Hillsborough County where TECO's Gannon plant is located. At that time there was a considerable amount of press coverage regarding TECO's SO_2 emissions and Hillsborough County being (or being in danger of becoming) a "non-attainment" area for SO_2 emissions. My non-expert understanding of a non-attainment area is that it is an area that has been designated by the federal Environmental Protection Agency as consistently failing to meet federal air quality standards for particular substances, such as SO_2.

Q: Did PFC collect or generate any other data that bears on this conclusion?

A: Yes. We also regularly compared PEF's and TECO's coal costs, measured on a generated cost per Kwh basis, using information reported by both utilities to the FPSC for fuel adjustment purposes. On this basis PEF's costs were consistently lower than those of TECO during the period 1996-2002. This information appears in Exhibit No. ___ (DMD-11) to this testimony.

We made a similar comparison using a generated cost per million Btu basis. PEF's coal costs measured on this basis also compared favorably, and were frequently lower than, those of TECO during the period 1996 to 2002. This information appears in Exhibit No. ____ (DMD-12) to this testimony.

Q: What did PFC conclude as to what all this information indicated?

A: Basically, we never found a basis for concern that we were not procuring coal on a lowest cost basis.

Q: Are there other indications that PFC was evaluating potential purchases of sub-bituminous coal during the 1996-2002 time period?

A: Yes. Even though sub-bituminous coal had not proved itself competitive economically, PFC continued to monitor it for potential future use. This is illustrated, for example, in a 1996 exercise done by Mr. Edwards (Exhibit

No. ____ (DMD-13)) which estimated (among other things) the delivered cost of 8,800 Btu PRB coal through McDuffie Terminal in Mobile, Alabama.

In addition, Exhibit No. ___ (DMD-4), created in 1997 or 1998, illustrates PFC's attempts to fairly estimate the cost of transporting PRB coal to Crystal River using the waterborne proxy rates, coupled with estimated rail charges from the Western mines to the Mississippi River.

Also, in Mr. Edwards' February 9, 1998, memo to Mr. Cumbie (Exhibit No. ___ (DMD-14)), Mr. Edwards discussed his thoughts on the cost of switching all "compliance" (so called "D" coal) to rail delivery and all non-compliance ("A" coal) to water delivery. In that memo Mr. Edwards observes that:

> I believe we should recognize that we will, in all likelihood, be using Powder River Basin coals at [CR] 4 & 5 by about 2000 (my guess.) Since those coals, and others like South American, best move to Crystal River by water and are generally "compliance" grade, we would likely switch back to "D" water at this time in any event.

That memo is Exhibit No. ___ (DMD-14) to this testimony.

In 1999 PFC estimated that PRB would potentially be the lowest cost coal, using a 50/50 CAPP/PRB blend, by 2003. See Exhibit No. ___ (DMD-15) to this testimony.

These all illustrate that PFC was very open to the idea that at some point in the next several years PRB coal may become the coal of choice on a lowest cost basis. I would also note that the last mentioned exhibit (Exhibit No. ___ (DMD-15)) further indicates that PFC was well aware of the original boiler design for CR4 and CR5.

D. Previously Untested Types of Coal.

Q: Had sub-bituminous coal been the lowest cost coal on an evaluated cost basis, what policies or practices would PFC have employed before contracting for it?

A: As I have discussed, sub-bituminous coal had not previously been burned in CR4 and CR5. As a result, PFC's and PEF's standard procedures would have required that the coal offered be subjected to a "test burn" before a contract was finalized. This did not occur during the period 1996-2002 because sub-bituminous coal was not the lowest priced coal and therefore the need to conduct such a test evaluation was never presented.

Q: Wasn't the purpose of the evaluated cost calculation done with the EPRI model to determine the impact of the coal on the cost of operating the plant?

A: Yes, but the evaluated cost calculation done by the EPRI model is still only a computer model that is useful to give an indication of the *estimated* impact. My understanding is that before a previously unused coal would actually be contracted for, the utility would desire to test it to confirm, with actual field experience, the effects on the operation of CR4 and CR5.

Q: What function did the evaluated cost analysis and EPRI modeling serve then?

A: Had they suggested that sub-bituminous coal was the lowest cost coal on an Evaluated Cost basis, the model would have served the purpose of placing that coal into active contention for testing and eventual purchase. It did not so indicate during the period covered by my testimony, however.

Q: Can you point to any example of such a process being followed during your tenure at PFC?

A: Yes. This was the procedure followed in evaluating whether to purchase "Petcoke" in 1999 and synfuel in the late 1990's. In both instances, when it appeared that these fuels, previously untested at CR4 and CR5, were potentially the lowest cost coals, PFC and PEF arranged for test burns to determine the actual field performance of these new fuels.

Q: What is your understanding of what occurred concerning sub-bituminous coal after 2002?

A: My understanding is that beginning in late 2003 to early 2004, PRB coal began to emerge as the lowest, or potentially lowest, cost coal, and that PEF began testing it in accordance with the policies and practices I just described. I recall that as a result Mr. Pitcher began actively considering sub-bituminous coal, preparing to test burn such coal, and directing others to evaluate transportation costs for sub-bituminous coal.

VIII. SYNFUEL

Q: Did PFC purchase synfuel purchases for CR4 and CR5 during your tenure?

A: Yes.

Q: How did PFC evaluate whether to purchase synfuel and from what supplier?

A: PFC evaluated synfuel on the same basis as all other coal offers. That was to determine what the lowest delivered cost and evaluated cost offers of coal, including synfuel, were and to purchase fuel meeting the utility's specifications at the lowest such cost. As I have indicated, in the case of synfuel, the utility also tested synfuel before authorizing substantial purchases.

Q: Are you familiar with the testimony of Mr. Sansom in this proceeding in which he contends that PFC favored the purchase of synfuel from producers in which EFC had a financial interest?

A: Yes, I have read his testimony.

Q: Is he correct in this regard?

A: No he is not.

Q: Did PFC favor or give preference to synfuel produced or marketed by companies in which PFC (or EFC before it) had an equity interest?

A: No, it did not.

Q: Are you aware that Mr. Sansom asserts that it is "statistically impossible" for PFC to purchase as much synfuel as it did from such companies absent such favoritism?

A: Yes, I have read his testimony.

Q: Is there an explanation for the amount of synfuel that PFC purchased from such companies?

A: Yes. It was not unusual for PFC to purchase synfuel from entities marketing synfuel produced by companies in which PFC had some equity interest for the simple reason that those companies were by far the largest producers of synfuel in the country. In fact, on a number of occasions such companies were the *only ones offering* synfuel on a spot purchase basis. Therefore, but for them PFC would have had to purchase coal at a higher cost to ratepayers than the synfuel it purchased.

Q: How did synfuel prices compare generally to coal prices?

A: Generally, synfuel was priced $1 to $2 per ton below the market price of bituminous CAPP coal, yet it had an equivalent heating value.

Q: How did this impact PEF's ratepayers?

A: Obviously, it benefited them. They paid in effect $1 to $2 less per ton through the fuel adjustment proceedings.

Q: Just to be clear, did PFC also purchase synfuel from other synfuel suppliers having no direct or an indirect connection with Progress Energy?

A: Yes, as I said we purchased from the proposer, be it synfuel or coal, offering the lowest price and which met the utility's quality specifications. As a result, we purchased synfuel from producers having no connection with PFC when producers in which PFC had a financial interest were not the lowest cost product offered.

Q: How does the amount of tax credits generated for Progress Energy, the holding company for PFC, by sales of synfuel to PFC compare to Progress Energy's overall tax credits from synfuel sales to others?

A: The tax credits from synfuel sales to PFC for Crystal River were minimal compared to the tax credits generated from sales of synfuel to other utilities and industrial customers. This is because tax credits were not available on sales from a company with a majority equity position in a synfuel producer to an affiliated company. The synfuel producers in which PFC held a majority equity position sold their synfuel coal product to utilities other than PEF and industrial customers.

New River Synfuel LLC, the synfuel producer that sold 80 percent of the synfuel purchased for CR4 and CR5 between 2000 and 2005, is a synfuel producer in which PFC held only a 10 percent equity position. Even New River Synfuel LLC, however, sold more synfuel to other utilities and industrial customers than it did to Crystal River. The total tax credits claimed by New River Synfuel LLC for the period 2000 to 2005 for all synfuel sales to all utilities and other customers were [redacted]. The total tax credits claimed by New River Synfuel LLC for the same period for synfuel sales to Crystal River were [redacted], with operating losses of [redacted], for a net total tax credit claim of [redacted].

When the [redacted] net tax credit claimed on New River synfuel sales to Crystal River from 2000 to 2005 is compared to the $1.25 billion value of all synfuel tax credits claimed on all synfuel sales by Progress Energy over the same time period --- which Mr. Sansom says at page 26, lines 9-10 of his testimony was reported by Argus Coal Daily --- the insignificance of the tax credits on synfuel sales to Crystal River is self evident. They account for less than [redacted] percent of the total tax credits. As a result, there is no basis in fact for anyone to suggest that synfuel tax credits influenced in any way the purchasing decisions for CR4 and CR5.

Q: Are you familiar with something referred to as "twist" arrangements involving synfuel?

A: Yes. A "twist" arrangement is where PFC has stepped into the middle of a coal contract. Someone has a contract for coal and PFC steps in the middle and the coal is made into synfuel and sold to the end user as synfuel at a $1 to $2 discount. As a result of such an arrangement, the end user, in the case of Crystal River, the ratepayers, benefit as they have paid less than they would have paid had PFC not done the twist deal.

As I have explained, for the New River synfuel that was delivered to Crystal River, PFC received a 10% portion of the tax credit associated with synfuel. However, in all cases the ratepayer was obtaining fuel (synfuel) at a cost below the cost the ratepayer would have paid had the original coal contract price been paid, which coal contract price itself, it should be remembered, reflected the lowest cost coal at the time the coal supply contract was entered into. Such an arrangement was therefore a "win-win" situation in which the ratepayer benefited.

IX. REGULAR DIALOGUE WITH FPSC STAFF AND OPC.

Q: Did PFC provide the FPSC Staff with information concerning its coal procurement activities during the period 1996-2002?

A: Yes, of course. We maintained a regular dialogue with the FPSC Staff on coal procurement practices and results during the entire period 1996 (and before) through the present. These meeting typically occurred quarterly and were generally referred to as "Staff Update Meetings." They were used to bring the Staff up to date on PFC fuel procurement activities since the last such meeting, to share information with Staff about how we saw coal procurement going forward, including our expected coal sources, costs and challenges. OPC representatives were in attendance. The meetings were always open to OPC.

In the meetings we answered Staff and OPC questions and provided post-meeting information and further answers where the information necessary to answer questions was not on hand at the meeting or required research. PEF maintained agendas for each of these meetings. They are Composite Exhibit No. ___ (DMD-16) to this testimony.

PEF also created outlines for the meetings, which outlines were not handed out at the meeting, but used as notes for the PEF representatives to guide their presentation. Those outlines reflect with reasonable accuracy the information provided at the meetings. Those outlines are Composite Exhibit No. ___ (DMD-17) to this testimony.

Q: Are there any other examples of PFC sharing information or making information available to the Staff in connection with coal procurement?

A: Yes. Pursuant to an order of the FPSC PFC and PEF were required to conduct an internal audit annually to compare PFC's revenue requirements under full regulatory treatment relative to the revenue requirements using an equity amount of 55% of net long term assets (the latter being called the "short-cut method"). These audits specifically focused on revenues associated with the purchase of coal since coal purchases were treated as part of the "regulated" portion of PFC's business.

This audit was conducted annually and its results provided to the FPSC. In connection with this FPSC mandated audit, PFC maintained and made available to FPSC all records relating to coal procurement. This underscores and illustrates how all of PFC's records regarding coal purchase transactions were open to the FPSC.

Copies of the results of these internal audits for the years 1999-2005 are Composite Exhibit No. ___ (DMD-18) to this testimony. Similar audit results for the years prior to 1999 have been destroyed in compliance with PFC's Document Retention Policy.

Q: Are there any other examples of such information being shared with the FPSC?

A: PEF participated in all the FPSC's fuel adjustment dockets and provided all data concerning fuel procurement policies and practices required or requested by the FPSC at that time. Between January 1996 and 2005, PEF went through 14 such fuel adjustment dockets.

X. SANSOM

Q: I want to return to one topic briefly for elaboration. Are you familiar with Mr. Sansom's testimony in which he asserts that TECO was purchasing PRB coal at a lower cost than the bituminous coal that PFC was purchasing? (Sansom Testimony at p. 41 and Sansom Ex. RS-21)

A: Yes, I have read his testimony.

Q: Do you agree with him in this regard?

A: No, I do not.

Q: Please explain your answer.

A: I would make a number of points in response to Mr. Samson's testimony on this point.

I would note initially that information from which Mr. Sansom draws his conclusion is the data reported by each utility in FERC Form 423, which I discussed earlier in my testimony. I have reviewed that same data, as I regularly did in my duties at PFC. This information for TECO is attached as Exhibit No. ___ (DMD-10) to this testimony. Similar information for PFC and PEF is attached as Exhibit No. ___ (DMD-19) to this testimony.

My first point is that the data reveals that Mr. Sansom is comparing TECO *spot* purchases of sub-bituminous coal to PFC's annual total of *all* (contract and spot) coal deliveries for CR4 and CR5 each year. This is an "apples to oranges" comparison because it includes deliveries of coal under various PFC contracts whose prices were established in years prior to the year in which the delivery occurred – i.e., the year of contracting.

Second, I think it is very noteworthy that the sub-bituminous coal delivered cost shown for TECO is *higher* than the delivered cost shown for TECO spot purchases of bituminous coals during the same period. As I have previously indicated, this suggests strongly that TECO may have been purchasing sub-bituminous coal for reasons other than price.

Third, he fails to account for the actual delivered cost of coal to CR4 and CR5. The delivered cost to TECO's transfer facility at Davant, Louisiana, which is what is reflected in the FERC Form 423, does not include a transfer charge while PEF's does include a transfer charge. I know this from having worked in fuel accounting matters at both TECO and PFC and having prepared the Form 423s for both companies. This can also be derived from Exhibit No. ____ (DMD-20) to my testimony, which is the Staff comparison of the waterborne costs for PEF, TECO, and Gulf from 1995 to 2000.

Fourth, TECO's transportation charges to final delivery in Tampa, which comprise the bulk of the delivered cost for sub-bituminous coal, are not the same as those of PEF. I also know this from having worked at both TECO and PEF. PEF's water transport charges were the "waterborne proxy" set by FPSC Orders. TECO's water transport charges were not calculated using that proxy and were in fact capped, rather than set by proxy, by FPSC Order. Moreover, because of different channel depths at Port Tampa where TECO's barges offloaded, and Crystal River, TECO was able to use much larger barges capable of hauling greater quantities of coal than the barges that PEF could use to deliver to Crystal River.

Fifth, I would also note that the spot TECO purchase of sub-bituminous coal that Mr. Sansom uses for 1998 was from Kennecott, a producer that declined to bid for PFC business in 1998.

Finally, as I have previously testified, I would note that PEF compared favorably to TECO in comparative coal costs measured on both a generated cost per MM Btu and generated cost per Kwh basis. See Exhibits Nos. (DMD-11) and (DMD-12) to this testimony.

As a result, Mr. Sansom's comparisons are misleading, "apples to oranges" comparisons and therefore do not support the assertion or implication that sub-bituminous coal was the lowest delivered cost coal for CR4 and CR5 during the 1996-2002 time period.

Q: Does this conclude your testimony?

A: Yes.

BY MR. WALLS:

Q Ms. Davis, do you have a summary of your testimony?

A Yes, I do.

Q Will you please summarize your prefiled testimony for the Commission?

A Yes. During the years 1996 through 2002, I was responsible for reporting to this Commission and FERC the coal and transportation costs incurred by Progress Fuels Corporation. As a result, I was familiar with, participated in PFC's coal procurement practices. Our coal procurement policy and practices from 1996 through 2002 were consistent with the Commission guidelines set.

PFC issued RFPs for Crystal River 4 and 5 for one or more years, for 1996, 1998 and 2001. We maintained a bidder list of over 100 bidders. This bidder list always included coal suppliers or coal brokers, with domestic, foreign, and PRB subbituminous coal. Also, our RFPs were published in the coal publications, and we were known in the industry to be on a spot basis from month-to-month. PFC's RFPs were sent to all bidders on the bidder list. PFC's RFPs always included specifications for bituminous and subbituminous coal. PFC expressed an expectation for coal quality, but stated only coals exceeding the sulfur requirement for Crystal River 4 and 5 would not be considered. All other coals were considered and evaluated.

PFC did evaluate coals in response to the RFPs based on a delivered cost and an evaluated busbar cost basis when the coal offered differed from the preferred quality specification. We conducted the RFPs the same way in '96, '98, and 2001.

PFC received several bids from PRB suppliers in response to the 2001 RFP. PFC did not receive any response for the PRB suppliers in response to the 1996 or the 1998 RFP.

PFC also received numerous spot purchase offers from time to time from a variety of coal suppliers. It is well known in the industry that PFC purchased coal pursuant to spot offers month-to-month. Subbituminous coal suppliers would have been considered had they offered coal on the spot market, but to the best of my knowledge, none of these did during my time frame.

PFC was aware of PRB coals throughout the '96 to 2002 time period and examined it regularly. We understood that PRB coals were different from bituminous coals, and there might be a potential for derates and additional costs if they were used.

PFC also examined other fuel sources for Crystal 4 and 5, such as synfuels, petcoke and foreign bituminous coals.

PFC did not favor any coal or coal supplier over another. We bought the lowest cost offered to us on an overall evaluated basis. We did evaluate coal shipped by water, including PRB and foreign coals, using the waterborne market proxy approved by this Commission. We applied the waterborne proxy to all coals that would be shipped to Crystal River in our coal evaluations during this period of '96 to 2002.

I do want to say that Mr. Sansom's reliance on TECO FERC Form 423 for PRB delivered prices do not include a cost to unload the coal at the terminal, store it, or load it onto a Gulf barge. Those terminals are included in PEF's Form 423 for delivered prices to IMT. I know this because I have prepared the forms for both Tampa Electric and Progress Energy Florida.

I have a few words to say about synfuels. Many utilities in the southeast and eastern United States were purchasing synfuels during the time period PFC was purchasing synfuels for Crystal River 4 and 5. PFC affiliates were involved in the production, marketing and sale of synfuels and did receive tax credits. PEF, however, was a very small customer of synfuels from PFC affiliates, and the tax credits from synfuel sales to PEF were an insignificant part of the total tax credits that PFC received. PFC affiliates sold many more tons of synfuels to other customers who, like PFC, purchased synfuels when it was cost-effective to do so.

I also want to express PFC and PEF met regularly with this Commission staff and other parties to tell them about what we were doing and to answer any questions they had. I know that because I was present at all of those meetings. Our records on coal procurement, in addition to what we filed with the staff were available at the asking, and we responded to any questions that they had. Our coal purchases have been audited every year, and we have answered any questions raised during those audits at our meetings, which would be two to four a year, with the staff, the Office of Public Counsel, and FIPUG, and many of the people present in here today.

To sum up, we cannot buy coal that is not offered to us. If our coal procurement practices are the same during this entire period of time, and they were, they were adequate to generate bids from PRB suppliers and foreign bituminous coal suppliers at certain times, and they did, then they must have been reasonable and prudent. I believe they were.

Thank you very much.

MR. WALLS: We tender Ms. Davis for cross-examination.

CHAIRMAN EDGAR: Thank you.

Mr. Twomey.

MR. TWOMEY: Madam Chair, I don't have any questions of Ms. Davis, but I have a request on behalf of all the intervenors. And that is that you consider allowing Public Counsel to cross first for each of the company's witnesses with our expectation that that will shorten the total time of cross.

Thank you.

CHAIRMAN EDGAR: Thank you, Mr. Twomey.

Mr. McGlothlin.

MR. McGLOTHLIN: Thank you.

CROSS EXAMINATION

BY MR. McGLOTHLIN:

Q Ms. Davis, at Page 3 and the top of Page 4 of your prefiled testimony, you state that from '84 to 2005 you held positions involving the accounting and reporting of PFC's regulated business and reported fuel costs to the Public Service Commission and FERC, and that in 2004 you also became responsible for the accounting of PFC's nonregulated coal activities, is that correct?

A That's correct.

Q PFC being Progress Fuels Corporation?

A That's correct.

MR. McGLOTHLIN: I'm going to distribute a document for some questions, and I ask that an exhibit number be assigned to it.

CHAIRMAN EDGAR: Thank you. That would be 213.

And what would you like to label it, Mr. Mcglothlin?

MR. McGLOTHLIN: Progress Fuels Corporation Organizational Chart.

(Exhibit 213 marked for identification.)

BY MR. McGLOTHLIN:

Q Ms. Davis, we have provided you with a one-page exhibit marked 213, and captioned Progress Fuels Corporation Energy Affiliates for Deliveries to FPC 2002. It's an excerpt from a staff document. Have you had a chance to look it over?

A Yes, sir.

Q Do you recognize this to be an organizational chart showing the corporate structure of Progress Energy and its subsidiaries?

A Yes, sir.

Q And focusing on Progress Fuels Corporation, by whom you were employed, would you take a moment and identify for us, and I'll ask you one at a time, the business of each entity that is involved there. For instance, under Progress Fuels Corporation, the first block to the left under Progress Fuels Corporation is Homeland Coal Company, Inc. Who is Homeland Coal Company, Inc.?

A Homeland Coal Company was a company which held an interest in Powell Mountain Joint Venture.

Q What is their business?

A The business would be for the mining and selling of coal.

Q And to whom did they sell coal?

A Anyone who would be in the market that would need the coal which they produced.

Q Would that include Florida Power Corporation?

A At one time. Homeland did not sell coal to Progress Fuels Corporation; Powell Mountain did.

Q So Powell Mountain Joint Venture would sell coal to Progress Fuels Corporation and Progress Fuels would buy as agent for the utility, is that correct?

A That's correct. They had a contract with the utilities, not as agent for.

Q All right. The next block over is Kentucky May Coal Company, Inc. Who is that entity?

A Kentucky May Coal Company, Inc. was purchased in 1985, and they were in the coal mining and terminal business.

Q And that's a subsidiary also of Progress Fuels Corporation?

A That is correct.

Q Were they in the business of selling coal to Progress Fuels Corporation?

A Yes, Kentucky May Coal at times have had a contract with Progress Fuels Corporation. They sold to many people.

Q And that was in Progress Fuels Corporation's capacity as procurer of coal for Florida Power Corporation, is that correct?

A Kentucky May did sell to Progress Fuels to sell to Florida Power Corporation.

Q The first subsidiary under Kentucky May Coal Company is Cincinnati Bulk Terminals. What is that entity?

A Cincinnati Bulk Terminals was, as is stated, a terminal. It also sold bulk commodity products, including some coal.

Q Did they sell of their own capacity or did they have an agent?

A Cincinnati Bulk Terminals purchased other coal and sold.

Q And did they sell to Progress Fuels Corporation?

A They sold a little to Progress Fuels over the years.

Q And that was in Progress Fuels Corporation's capacity of coal procurer for the utility, is that correct?

A That's correct.

Q What about Kanawha River Terminals, Inc.?

A Kanawha River Terminals is a terminal up on the Kanawha, and it sells coal and has terminaling services.

Q What do you mean by terminaling services?

A It would be where you transload coal onto barges for customers.

Q I see. On occasion would it transload coal that was being purchased and delivered to Florida Power Corporation?

A Yes. We discussed that at length during our '88 hearings.

Q Who is Black Hawk Synfuel LLC?

A Black Hawk is owned 10 percent by Kanawha River Terminals here, and it is a company which sells feed stock to New River Synfuel LLC.

Q And who is New River Synfuel LLC?

A New River Synfuel LLC, as I said, is -- Black Hawk owns 10 percent of it, another party owns 90 percent of it, and it produces synfuel.

Q Black Hawk, I believe you said, sells coal to New River Synfuel, I imagine for New River Synfuels' use in preparing the synfuel product, is that correct?

A That is correct.

Q Does New River Synfuel then sell the synfuel product back to Black Hawk?

A No, sir.

Q To whom does it sell synfuel?

A To many people up and down the river, the Ohio River, and to anybody who would request to buy synfuel.

Q Including Progress Fuels Corporation?

A Yes, we have sold -- we have purchased some from New River.

Q In Progress Fuels Corporation's capacity as a procurer of fuel for Florida Power Corporation?

A Yes. We discussed that quite extensively when this form was made back in the 2002 period.

Q Under Kanawha River Terminals, Inc., there is a block for Marmet Synfuel, LLC. What is that entity?

A That is a host plant, an investor-owned plant who makes synfuel.

Q And does Kanawha River Terminals then have an ownership interest in Marmet Synfuel, LLC?

A Let me restate that, sir. Marmet Synfuel actually is owned by Kanawha River Terminals, but it does not produce synfuel. There are two host plants, Calla and Imperial (phonetic), who Marmet Synfuel sells feed stock to to produce synfuel.

Q Are they shown on this organizational chart at all?

A They are not related to us.

Q I see. There is a block for Dixie Fuels Limited. Who is that entity?

A Dixie Fuel was a transportation supplier which we held a partnership in that delivered the coal from -- to the Crystal River plants.

Q And that is a subsidiary of Progress Fuels Corporation?

A It was a partnership at one time during this period.

Q A partnership in which Progress Fuels Corporation had a partnership interest?

A That's correct.

Q And did Progress Fuels Corporation contract with Dixie Fuels Limited to transport coal that Progress Fuels Corporation had purchased for the utility?

A Yes, sir.

Q For Florida Power Corporation?

A Yes, sir.

Q There is a block for Progress Rail Services Corporation. What is that entity?

A Progress Rail Corporation repaired rail cars. They had leased rail cars. There was a number of different things to do with rail cars that they were involved in.

Q And is that a subsidiary of Progress Fuels Corporation?

A Yes, it is.

Q Did Progress Rail Services Corporation contract with Progress Fuels Corporation to provide rail services to haul the coal being purchased for the utility?

A No, sir.

Q And what was the nature of Progress Fuel Services Corporation's business then?

A A maintenance agreement for the rail cars that Progress Fuels owned.

Q I see. With respect to Homeland Coal Company, Inc., Kentucky May Coal Company, Inc., Dixie Fuels Limited, and Progress Rail Services Corporation, was there any commonality to the administration or the physical offices among those entities?

A During what time frame?

Q Well, let's use the 2002 date to begin with.

A Well, all the companies were owned by Progress Fuels Corporation or either it was a partnership with Progress Fuels Corporation. Their books were done at different places. They were not all done at the same place, the accounting was not all done at the same place, but they were all either a partnership or owned by Progress Fuels. That would be their commonality.

Q What about their physical headquarters, any commonality there?

A The reason I am hesitating, I'm trying to remember about Homeland Coal Company, when that changed. At one time it was in St. Petersburg, their headquarters was, and Kentucky May, but Dixie was not. And Progress Rails' headquarters was in Alabama.

Q What about the officers of the corporations that we have talked about so far, were any individuals officers of more than one of any of these corporations at any point in time?

A Yes, sir.

Q Can you identify any officers who served either as president or vice president for more than one of these companies?

MR. WALLS: Object, as ambiguous to time frame.

CHAIRMAN EDGAR: Can you clarify?

MR. McGLOTHLIN: At any time frame.

CHAIRMAN EDGAR: Can the witness answer the question?

THE WITNESS: I would say our president might have been an officer on the companies at one time, all the companies at one time, but that would be the only one I could speak to.

BY MR. McGLOTHLIN:

Q And who was that?

A Mr. Rich Keller.

MR. McGLOTHLIN: If we can have another moment, please.

CHAIRMAN EDGAR: Okay. We are at Number 214.

Mr. McGlothlin, will you give us a title?

MR. McGLOTHLIN: Yes. Progress Energy, Inc., U-9C-3, March 2003.

(Exhibit 214 marked for identification.)

BY MR. McWHIRTER:

Q Ms. Davis, we've provided you a document which has been identified as 213 (sic). It is a Form U-9C-3 that Progress Energy filed with the Securities and Exchange Commission for March '03. Would you turn to Page 2 of 7, which is entitled Organizational Chart, and take a moment to review that, please.

A Where is the page number on here?

Q Top left.

A Okay. 2 of 14, is that what you said?

Q 2 of 7.

A 2 of 7.

Q And there is a caption that says, Item 1, Organization Chart.

A Mine in the right top corner says 1 of 14, and then continues.

Q If you're looking at that, then Page 4 of 14 is what corresponds.

A I'm sorry, I didn't hear you.

Q Page 4 of 14, which is also 2 of 7.

A Page 4 of 14, you said?

Q Yes. You will see Item 1, Organization Chart there.

A Yes.

Q If you will take a moment to review that, I want to ask you a few questions about it.

A Okay.

Q You've indicated your positions with Progress Fuels Corporation. What is your involvement, if any, with Progress Ventures, Inc.?

A Progress Ventures, Inc. an arm of Progress Fuels, but I don't have really any involvement with them.

Q It is related to Progress Fuels Corporation, though?

A (Indicating affirmatively.)

Q There are some entities listed here that differ from the 2002 organizational chart, and I want to ask you, if you can, to tell me the business each is in. CPL Synfuels, LLC, are you familiar with that entity?

A No, sir, I'm not familiar by that name.

Q Do you know it by another name?

A Unless it -- underneath that is Solid Fuels and Sandy River, so it may be what Progress Fuels calls the upper level company.

Q Did you say --

A It says holding company over in the far right-hand corner.

Q Okay. Who are Solid Fuel and Sandy River Synfuel?

A Solid Fuel and Sandy River are synfuel-producing companies owned by Progress Fuels and Progress Ventures.

Q And, if you know, did they sell synfuel to Progress Fuels Corporation for delivery to the utility?

A They sold a little bit during one year, I believe.

Q Okay. Under the item for Progress Fuels Corporation, you will see several entities listed, EFC Synfuel, LLC, who is that?

A That is the holding company for the companies listed underneath it.

Q All right. Ceredo Synfuel, LLC, who is that.

A That is the synfuel plant at Ceredo, West Virginia.

Q Did Ceredo Synfuel, LLC sell products to Progress Fuel Corporation?

A No, sir.

Q What about Sandy River Synfuel?

A I think during one year they sold a little bit, but normally they cannot sell because of their ownership interest.

Q And Solid Energy, LLC?

A Again, the same answer.

Q Kentucky May Coal Company is listed there, and that is one of the entities on the 2002 organizational chart, but the entities listed under KRT Holdings, Inc. differs somewhat. For instance, Coal Recovery V, LLC, what is that entity?

A Coal Recovery V is a company which held some patents to the synfuel plant at one time.

Q What about the Colona Newco, LLC?

A I'm not familiar with all of the names as they are listed. I work more with the operating companies.

Q All right.

A It says that Colona Newco is a holding company.

Q If Colona Newco is the holding company, then, would the Colona Synfuel Limited Partnership be one of the operating companies of which you are familiar?

A No, sir. It is not really the operating company. This would be the different layers of the companies from the operating company up to Colona Newco.

Q All right.

MR. McGLOTHLIN: Let's have the agenda passed out. We are going to distribute another document.

CHAIRMAN EDGAR: This will be Number 215. Mr. McGlothlin, for a title.

MR. McGLOTHLIN: March 14th, 2005, Agenda, New River Synfuel.

(Exhibit 215 marked for identification.)

BY MR. McGLOTHLIN:

Q Ms. Davis, you have been provided a copy of a document that has been marked as 215, proposed agenda, New River Synfuel LLC. Do you have that before you?

A Yes, sir.

Q You'll see on the first page under the cover sheet that it indicates that you were a participant on behalf of Black Hawk Synfuel LLC. Do you see that?

A Yes, sir.

Q And did you attend a meeting on March 14th for which this served as a proposed agenda?

A Yes, sir, I did.

Q And do I understand correctly that Mr. Weintraub was also there in a similar capacity on behalf of Black Hawk?

A Yes, sir.

Q The second page refers to a $4 spread for the Synfuel feed stock spread. Would you tell the Commissioners what that means?

A Yes, sir. That would be the difference in the cost of the feed stock and the amount of sale to the ultimate consumer.

Q In other words, the price of the product would be $4 above the cost of the raw material, is that correct?

A The sale would be $4 less than the raw material.

Q Number 6 refers to a $4 Infinity commission sales on purchase and sales, do you see that?

A Yes, sir.

Q Would you explain what that item involved?

A Are you referring to 6A, sir?

Q Yes, 6A, B, and C?

A It refers to the $4 differential between the cost of the feed stock and the sale to the ultimate consumer.

Q I'm sorry, could you speak up just a little bit? I'm having trouble.

A It refers to the $4 differential between the feed stock and the sale to the ultimate consumer.

Q Okay. But this is mentioned as specific to Infinity. Does it differ in any way from the discussion or the treatment of the synfuel feed stock spread that was discussed in Number 5?

A No, sir. The spread is what it is. It is just the difference in your feed stock cost and whatever the ultimate consumer pays. Most often that would be a $4 spread.

Q Was there a particular transaction between Infinity and either New River or Black Hawk that was the subject of this agenda?

A Would you repeat that question, please?

Q Yes. Was there a particular transaction, either existing or pending, between Infinity, on the one hand, and either New River or Black Hawk on the other, that was the subject of this item on the agenda?

A No, sir, I don't think it was a particular transaction. They were just overall looking at the $4 spread for Infinity. It was not one single transaction.

Q Was the $4 spread between the feed stock and the final price applicable generally to all of the synfuel transactions?

A It varied. It wasn't necessarily four, it could be three, it could be two, it could be five, it could be six.

Q And what would govern the determination of the spread in a particular transaction?

A The cost at which the synfuel could be sold.

Q Now, who is Infinity?

A It's a sales agent for Panther Coal, and I don't know if they have other coal companies. I think they did. That is the way I knew them; they were the sales agent for Panther.

Q And did Progress Fuels Corporation purchase coal from Infinity for delivery to Crystal River 4 and 5?

A During the time frame '96 to 2002, I do not recall any.

Q Was Infinity a participant or a bidder to any RFPs that Progress Fuels Corporation conducted on behalf of the utility?

A Not between '96 and 2002, during my time period.

Q Do you know whether they were at any point?

A I believe there was some mention in Mr. Pitcher's testimony that he could address.

Q And did Black Hawk purchase coal from Infinity for delivery to the synfuel production plant?

A Black Hawk would not purchase coal from Infinity. Black Hawk would purchase their coal from KRT.

Q KRT being --

A At cost.

Q Would any subsidiary or affiliate of Progress Fuels Corporation purchase coal from Infinity as feed stock for the synfuel production process?

A Yes, sir. They purchased from a lot of suppliers. That would have been one.

Q If you would, Ms. Davis, turn to DMD-15?

A Yes, sir.

Q And I will do the same. Would you identify this document captioned 2003 Compliance Coal Costs, which constitutes your DMD-15?

A Yes, sir. It was a document done by Mr. Edwards, who was my boss, on February the 9th, 1999. And it is labeled Exhibit Number DMD-15. It was comparing a forecast for Central Appalachian Powder River Basin 50/50 blend and South American coal, what he thought might be happening in 2003, four years into the future.

Q Right. And focusing on the Powder River Basin prediction, there is a reference to a transfer of 250 at McDuffie Terminal. Do you see that?

A Yes. sir.
Q What is McDuffie Terminal?
A McDuffie would be at Mobile, Alabama. It's a state terminal.
Q And that was the assumption that Mr. Carter used at the time he prepared this estimate, that it would be delivered through the McDuffie Terminal?
A Mr. Edwards at that time --
Q Mr. Edwards, I'm sorry.
A -- was projecting that it might move, and he was using his projections here, the McDuffie Terminal.
Q Now, if you would turn to DMD-5, Page 21?
A Yes, sir.
Q This is the letter from Kennecott Energy to which you refer in your prefiled testimony, do you not?
A Yes, I do.
Q It's dated 1998. Was that in conjunction with the RFP that the company issued in 1998?
A Yes, it was.
Q And in your testimony you say that Kennecott Energy declined to submit a bid, do you not?
A Yes, I do.
Q First of all, is it true that there is no copy of the RFP document that was provided to us in discovery for 1998, if you know?

A I'm sorry, sir. I don't know what was provided during discovery. I assume they provided everything.

Q All right. Would you read the second full paragraph of the letter?

A The full paragraph?

Q Yes.

A Our current coal portfolio is comprised of subbituminous Powder River Basin coals, with a heating value ranging from 8400 to 9400 Btu per pound, and a Colorado coal with a heating value of 10,500 Btu. We continue to pursue opportunities that might fit your future requirements and would appreciate remaining on your bid solicitation list.

Q Okay. Focusing first on the first sentence, would you agree with me that the sense of this sentence is that they do have some coal for sale of the properties or description provided in that sentence?

A I would agree that it says they have a current portfolio. I would not necessarily agree that it is for sale.

Q They provide a heating value ranging from 8400 to 9400 Btus per pound for Powder River Basin coals. Was there anything about that range of Btu content that would have not met the criteria of the '98 RFP, if you know?

A The Btu would have met the subbituminous minimum requirements.

Q What about the Colorado coal with the heating value of 10,500 Btus, would that have been an eligible coal in the 1998 RFP, if you know?

A The Btu would have met the requirements, whether it would have been eligible would have been another question.

Q I see. Is the term "portfolio" one that is commonly used by participants in an RFP?

A No, sir. I normally don't see that term. Normally I would see, you know, a bid, an actual bid.

Q The second sentence says we continue to pursue opportunities that might fit your future coal requirements and would appreciate remaining on your bid solicitation list. Would you agree with me that this conveys the sense that they are of the view that their current portfolio is not responsive to the RFP?

A Would you repeat that one more time, please?

Q Yes. Looking at the second sentence beginning with we continue, would you agree with me that the sense of that sentence is that they have formed the view, for whatever reason, that their current portfolio is not responsive to the RFP?

MR. WALLS: Objection, calls for speculation.

MR. McGLOTHLIN: I'm asking how she understands the letter that was written in response to the 1998 RFP, and she has characterized it as a decision of the company to decline the bid which might be equally speculation, so I'm probing that opinion that she has formed.

CHAIRMAN EDGAR: You may restate the question, and the witness is directed to attempt to answer it.

BY MR. McGLOTHLIN:

Q Ms. Davis, would you agree with me that the sentence we continue to pursue opportunities that might fit your future coal requirements, conveys the view that they have formed, for whatever reason, that the portfolio described is not responsive or acceptable to the utility?

A I think what I would agree is that they are not offering any coal, because they are saying they would continue to pursue opportunities. But there is no bid attached to it. There is nothing else there. And if I receive a -- when I send out a bid solicitation, I would -- I asked for them to respond with a price, a term, quantity, and received none of that.

Q But when they say we continue to pursue opportunities that might fit your future coal requirements --

A Perhaps they are saying they want to stay on the bid list for the next time.

Q But you disagree with my proposition, which is that this conveys the view that the portfolio they described in the first part of the paragraph does not conform or is not acceptable to the utility? You disagree with that?

A Would you repeat that one more time, please? Your question is confusing me somewhat.

Q I'll try. I submit to you that when Kennecott says on the one hand, here is what we have got, here is our portfolio and describes it.

A Correct.

Q And then follows that with the sentence that says we are continuing to look for opportunities that might fit your coal requirements, that means that they are of the view that for whatever reason, their current portfolio does not conform to what the utility is looking for?

A No, I don't agree with you, sir. Because when we sent the bid solicitation out, it said 8200. So, therefore, I think they are saying they have a current portfolio, but they are not offering it. And why they are not offering it, I have no idea. They didn't send in a bid. They didn't send in a tonnage. They didn't send in any kind of offer.

Q Turn to DMD-14, Page 2 -- well, Pages 1 and 2.

A Okay.

Q Would you identify this document?

A It was an interoffice memo from Mr. Dennis Edwards to a Mr. Bernie Cumbie (phonetic).

Q And if you will, turn to Page 2 and read the first sentence of the paragraph that falls below the summary of costs?

A In addition to these costs, I believe we should recognize that we will, in all likelihood, be using Powder

River Basin coals at 4 and 5 by about 2000, my guess.

Q And when was this prepared?

A February 9th, 1998.

Q Please turn to Page 42 of your prefiled testimony.

A Yes, sir.

Q At Line 11, you say this data shows that TECO's purchases of PRB coal were never the cheapest, and often one of the most expensive coals that TECO purchased on a delivered cost basis to the transfer facility. Do you see that line?

A Yes, I do.

Q If you know, what quality of bituminous coal was TECO purchasing at the time?

A Well, TECO volume purchases for Gannon and Big Bend at the transfer facility, so they would have bought low sulfur and high sulfur coal. And during this time they also bought this Powder River Basin coal for environmental purposes.

Q And you mentioned the high sulfur coal, that would be from the Illinois Basin origin?

A Illinois Basin, Central Appalachian, numerous places.

Q Would you agree with me that high sulfur coal will be priced differently than low sulfur Powder River Basin coal?

A Yes, sir, I have no objection to that. I'm just saying that the Powder River Basin coal was bought for environmental purposes, not for price.

Q You mentioned that TECO was buying both low sulfur and high sulfur coal for delivery to the terminal. What was the destination of the low sulfur bituminous coal?

A Gannon.

Q Okay. At Page 38, Ms. Davis.

A Yes, sir.

Q In the middle of the page you say to my knowledge, during the 1996 through 2002 time period we never received an offer for a spot sale of subbituminous coal. To your knowledge, did the company ever seek bids on spot basis from subbituminous producers?

A I think because we were known to be out in the industry -- by the industry to be out every month for spot sales by the Archies (phonetic), the Peabodys, the Amaxes, by the Rags, everybody knew we were out for coal. So, therefore, we were always seeking bids from anyone who had coal, foreign, subbituminous, or bituminous. It was industry knowledge.

Q But to your knowledge, did the company ever actively solicit spot proposals from producers of Powder River Basin coal?

A I would consider that actively, if you are out every month seeking bids from all of those suppliers.

Q In your testimony you discuss some comparisons of the delivered price of coals to TECO's terminal. In the course of conducting RFPs, or in the course of preparing your testimony, did you ever compare the delivered price of Powder River Basin coal delivered to Davant to the delivered price of CAPP coal, or that is Central Appalachian coal, or synfuel to IMT?

A Yes, sir. I looked at TECO's purchases each month, I looked at Gulf Power's purchases each month, and I looked at, of course, Progress Fuels because I produced those reports.

Q Can you point to anyplace in your testimony where you report or treat the comparison that I have just mentioned, the delivered price of Powder River Basin coal to Davant on the one hand, to the delivered price of Central Appalachian coal or synfuel to IMT?

A I know it's in my exhibits where I have charts that we did on TECO. I don't have a comparison if that's what you are asking for.

MR. McGLOTHLIN: That's what I'm asking for. Could I have a moment to review my notes? (Pause.)

BY MR. McGLOTHLIN:

Q Ms. Davis, I believe you are in a position to answer this question, so answer if you know. As Progress Fuels Corporation in its capacity of procuring coal for Progress Energy Florida evaluated bids submitted by producers of Powder River Basin coal, say, in 2003/2004 RFPs, is it true that in calculating the delivered price Progress Fuels Corporation attributed to the producers of the Powder River Basin coal what has been referred to as a market proxy transportation rate?

A Yes, sir, we did use a market proxy, the proxy that was approved by this Commission.

Q And is it true that in arriving at what has been called an evaluated cost per million Btus, the Progress Fuels Corporation ascribed to Powder River Basin coal some penalty associated with expected impacts on boiler performance?

A They did a busbar analysis, yes, sir.

Q And during the busbar analysis, some quantification of predicted boiler performance was used that served to penalize or have a negative impact on the competitiveness of Powder River Basin coal?

A Not only that coal, but any coal that would be different.

Q That would be different than what?

A It could have been a new coal that we were buying from Colorado, it could have been anything we do a busbar on that we are not familiar with.

Q And that was done even though the Crystal River Units 4 and 5 were built with the assumption that they would be designed to and would burn a blend consisting of 50 percent Powder River Basin coal?

A I don't think the design had anything to do with it, sir. They did a busbar on any coal they were not familiar with.

MR. McGLOTHLIN: Those are all of my questions.

CHAIRMAN EDGAR: Thank you, Mr. McWhirter (sic).

Mr. Brew.

MR. BREW: No questions.

CHAIRMAN EDGAR: Ms. Bradley.

MS. BRADLEY: No questions.

CHAIRMAN EDGAR: Questions from staff?

MR. YOUNG: Yes, Madam Chairman.

CROSS EXAMINATION

BY MR. YOUNG:

Q Ms. Davis, good afternoon.

A Hello.

Q I will see if I can get you out of here before -- in 20 minutes?

A Okay. Great.

Q Or less than that. In your prefiled testimony you were Director of Regulatory and Administrative Services, correct?

A Yes, sir, I was.

Q And that involved -- can you explain that? What does a person who is Director of Regulatory and Administrative Services do?

A Yes, sir. I had people under me who did contract administration, who did analysis for the procurement of coal or transportation, who did the reporting of the purchases of the coal and transportation, not only to this Commission, but to the FERC. I was responsible to come up and work with staff, Public Counsel, and FIPUG numerous times during the years, and then annually, any questions that they might have in going over what all we were buying. I also was over our central file section, which is where we kept our records.

Q Okay. As Director of Regulatory and Administrative Services you worked closely with Mr. Edwards?

A Yes, sir, I did.

Q And that is Mr. Dennis G. Edwards, who was VP of Coal Procurement?

A Yes, sir.

Q As Vice-President of Coal Procurement, Mr. Edwards was responsible for coal procurement for the whole -- for all of Progress Energy Florida, correct?

A For coal procurement for Crystal River 1, 2, 4, and 5.

Q Okay. Thus, Mr. Edwards made the final decisions as relates to coal procurement for 1, 2, 4, and 5, CR1, 2, 4, and 5?

A Mr. Edwards made those decisions in conjunction with the folks at Florida Power Corporation at the time.

Q And you were -- in your prefiled testimony you stated that you worked closely with Mr. Edwards?

A Yes, I did.

Q He frequently copied on communications with PFC management concerning coal procurement and coal transportations?

A Yes, sir, I was.

Q As Director of Regulatory and Administrative Services for Progress Fuel Cooperation, you never personally discussed with other utilities the experience they had with burning PRB coal in their respective plants, correct?

A Not with other utilities.

Q To your knowledge, do you know if Mr. Edwards ever personally discussed with the other utilities the experience they had with burning PRB coal in their respective plants?

A I was personally not present if he did that.

Q So that would be a no? That's a no?

A You're saying with other utilities?

Q Yes, ma'am.

A That would be a no. I have no knowledge of that.

Q Okay. Ms. Davis, you never did any research concerning burning PRB coal in CR4 and 5, correct?

A No, sir, I did not.

Q To your knowledge, do you know if Mr. Edwards did any research on the effects of burning PRB in 4 and 5 -- I mean, PRB coal in Units 4 and 5?

A He looked at that coal quite often. He looked at it many, many times.

Q Ms. Edwards -- Ms. Davis, have you ever heard the term "derate" before?

A Yes, sir.

Q What is your understanding of the term "derate?" In a quick one to two-minute summary, what is your understanding of the term "derate?"

A You would get less kilowatt hours out of the unit.

Q Have you ever personally discussed the potential derate of CR4 and 5 as a result of using PRB coals?

A Yes, sir, I have, with Mr. Roy Potter.

Q Pardon me, can you repeat that?

A Yes, sir, I have, with Mr. Roy Potter.

Q Okay. Have you ever discussed it with Mr. Edwards?

A Not that I recall.

Q Now, dealing with the issues of bituminous coal, in PFC's October 1998 and May 2001 RFP, the coal procurement for CR4 and 5 had a minimum Btu content of 12,300, correct?

A Would you repeat that one more time, please?

Q In PFC's October 1998 RFP, and dealing with -- in May of 2001, the coal procurement for CR4 and 5, the RFP stated that they wanted 12,300 Btu minimum, correct?

A Can I look at that, please?

Q Yes, you may. If you can turn to DMD-3.

A Yes, sir. There it says it is a 12.3 minimum, that economic analysis will be based on this value.

Q Okay. And in 1998, did you receive any bids from foreign bituminous coal suppliers?

A Do you know what exhibit that is under?

Q Just general knowledge. Did you receive any bids from foreign bituminous coal suppliers?

A I think AMCI Export Corporation had a proposal in 1998, looking at my exhibit.

Q Strike that question, Ms. Davis. The 12,300 specification, how was that specification developed?

A As I stated in my deposition, I came with the company in '84 and that's -- I believe that has been as long as I can recall and before the specification on the bid solicitation that was agreed to by Progress Fuels and Florida Power at some point in time, if not at origin when the units were built.

Q Can you speak up? I can barely hear you. I'm sorry.

A Yes, sir. I said I know that the specification has been there since I have been at Progress Fuels Corporation, since 1984, and perhaps it was there even before, since the units were built.

MR. YOUNG: Okay. If I can have one minute, Madam Chairman. (Pause.)

BY MR. YOUNG:

Q Ms. Davis, if I can have you turn to DMD-9, submitted with your prefiled testimony.

A Yes, sir.

Q Do you recognize your DMD-9?

A Yes, sir.

Q What is DMD-9?

A DMD-9 are the letters that I have been copied on over the years for the different correspondence that Mr. Dennis Edwards would write up and put into the file. Co-offers, contract options, there are different kind of interoffice memos in here.

Q Okay. And at the bottom of Page DMD-9?

A Which page, there is 184?

Q I'm sorry, Page 167 of a 184-page document?

A 167, yes.

Q Okay. At the bottom of Page 167, do you see the paragraph that says with the remaining water delivered D requirements?

A Yes, sir.

Q The second sentence, can you please read that sentence for me?

A As you can see from the attached schedule, the South American bids were the most competitive. The Oxbow and AMCI coals were low fusion and not suitable for Crystal River 4 and 5.

Q Can you continue reading on. I'm sorry.

A We have evaluated the busbar effects of the Drummond and Glencore bids and have sent Drummond a draft agreement to review. I expect to complete an agreement with one of these suppliers.

Q Based on that, do you know -- can you recall the amount of coal that PFC purchased based on those RFPs and the returned bids?

A Not right offhand.

Q If you can turn to DMD-19?

A Just a moment, please.

Q And specifically looking at Page 4 of 10 on DMD-19.

A Okay. What would you like me to look at?

Q Looking at the -- reviewing the chart that says plant operator coal transactions annual formats.

I'm sorry. I'm talking too loud.

Please take a second to review that document and indicate any foreign coal that PFC might have purchased?

A For what years, sir?

Q For 1999.

A Yes, sir.

Q Isn't it true, Ms. Davis, that for 1999 PFC purchased roughly 99,000 tons of foreign bituminous coal?

A Yes, sir.

Q And the foreign bituminous coal, based on the 1998 RFP solicitation, was the best coal available, correct?

A I don't know if it was the best. It says we have evaluated the busbar effects of the Drummond and Glencore bids and have sent Drummond a draft agreement to review. I expect to complete an agreement with one of these suppliers. So I assume at this time Mr. Edwards expected for one of these suppliers to sign a contract with us.

Q Okay. Looking at that -- focusing on Page 4 of 10 under the 1999 spot contract, spot purchase.

A Yes, sir.

Q The second purchase, Progress Fuel Corporation, Diamond May coal, what was that -- what was that amount that was purchased?

A 304 tons on a spot basis, 305 rounded, 305,000.

Q And isn't Progress Fuel Corporation an affiliate of Progress Energy, Incorporated?

A Yes, sir.

Q So in 1999, you tested foreign bituminous coal, but only purchased a hundred -- less than 100,000 tons, correct?

A In 1999 there was only 100,000 purchased. I have no idea why Drummond and Mr. Edwards did not end up with an agreement looking at this document.

Q Okay. So who would we ask to provide us more information on that, Mr. Edwards?

A No, sir. I think we provided you the documents that we have on the bid. I have no documents on why they decided not to buy, and I don't believe there would be any or we would have produced them.

Q Going back dealing with PRB coal, you never obtained any studies or reports on the effects of burning PRB coal in

CR4, burning PRB coal, correct?

A During the time frame of '96 to 2002?

Q Yes, ma'am.

A Not that I'm aware of.

Q You never reviewed any -- you never reviewed or contacted any trade organizations requesting information concerning burning PRB coal, correct?

A I'm not sure of that, sir, he could have. I did not.

Q And to the best of your knowledge, Mr. Edwards did not either?

A To the best of my knowledge, I don't know.

Q So that is a no?

A No, sir, that is I don't know.

MR. YOUNG: Okay. No further questions, Madam Chairman.

CHAIRMAN EDGAR: Exhibits? Oh, I'm sorry. It is getting late. Redirect? I apologize.

MR. WALLS: Can I have just a moment?

CHAIRMAN EDGAR: You may.

MR. McWHIRTER: Before he starts, I had -- people my age have to step out of the room occasionally, and I had to step out, but I did have a couple of questions I would like to ask, if that's satisfactory.

CHAIRMAN EDGAR: Mr. McWhirter.

MR. McWHIRTER: Thank you very much. I won't be long. He said it was three hours? No.

CROSS EXAMINATION

BY MR. McWHIRTER:

Q Ms. Davis, you have Exhibit 213 for identification and 214, and there appears to be a significant difference in the structure of the affiliates. But as I read the two, 213 relates only to the affiliates of Florida Progress Corporation and down; whereas, 214 relates to -- it brings into play the North Carolina affiliate, as well.

Am I correct in assuming that these affiliate transactions were all in place in December of 2002 and didn't suddenly spring forward between December 31st, 2002, and the reporting date of March 31st, 2003? Was that question too long and laborious? Would you like me to break it up?

A Some of these companies, and I don't have the numbers of your exhibits, because mine are not numbered, but the exhibit that says affiliate companies 2003, could have been formed after the other exhibit that says waterborne transportation audit. When this audit was done by the Commission, these were the affiliates that were involved that were for deliveries to Florida Power Corp. They are not necessarily the same exhibits. And like I say, some of these exhibits on the others could have been formed after the merger.

Q Well, I'm just trying to get a handle on it for my own mind. Electronic Fuels (sic) and then the renamed Progress

Fuels had subsidiaries that dealt in synfuel, and they had mining companies that were subsidiaries to first Electronic Fuels and then Progress Fuels, and they did business with one another. Is that right?

A Electric Fuels Corporation did business with some of their subsidiaries which we looked at during cost plus and also during the 2002 Commission hearings quite extensively.

Q Well, did the subsidiaries sell fuel to Progress Fuels or did they just -- Progress Fuels acted as an intermediary to acquire fuel for the benefit of the utility company?

A Per the Commission ruling, we had a bid process. And they would bid with other suppliers to deliver, to sell coal to Progress Fuels. And that fuel that was purchased by Progress Fuels, through the bids solicitation process, was then delivered to Crystal River 4 and 5 and sold to Florida Power Corporation.

Q Well, did Progress Fuels and its predecessor, Electronic Fuels, did it act as broker or did it buy the fuel and then resell it to the utility?

A It bought the fuel from the Kentucky Mays or the Powell Mountains or any other supplier through the bid solicitation process set up by this Commission.

Q Can you explain why it is beneficial to the consumers to have an operation where subsidiaries sell to a subsidiary and that subsidiary sells to the utility as opposed to just the Progress Fuels acting as an intermediary and making the contacts with the sellers?

A Mr. McWhirter, if you recall, back in 1976 Electric Fuels was formed as a subsidiary of Florida Power Corporation.

Q Right.

A And this Commission at that time approved a contract between Florida Power Corporation and Electric Fuels. So it was sometime later when the other subsidiaries were formed, many years later. And they, like other suppliers, would sell coal through the bid solicitation process to Electric Fuels.

Q Well, it seems to be a fairly complex structure, and I'm trying to determine why it's in the best interest of consumers to have subsidiaries selling to one another. And I don't want to use the word daisy chain, but selling and then ultimately the utility buying from subsidiaries after the fuel has been resold many times. Why can't these subsidiaries just -- why can't Progress Fuels or its predecessor act as an agent for the sales?

MR. WALLS: Object; argumentative and speculative. Assumes facts not in evidence.

A Sir, the coal was sold at cost.

Q Well, what is this four dollars --

A If electric Fuels bought the coal at $25, they sold it to Florida Power for $25.

Q I see. So whatever Progress Fuels pays to the subsidiary, that same price without any markup is passed through to the utility company. Is that what you are saying?

A Yes, sir, I am.

Q You are not saying that?

A Yes, sir, I'm saying that.

Q Oh, you are saying that?

A Yes, sir.

Q Well, can you explain to me why the structure was set up that way? What is the benefit of it?

A Again, sir, the original structure was set up in 1976. Electric Fuels in 1984-'85 went out and got into other coal mining operations, and when they would -- they would bid like anyone else if Electric Fuels was going out to by some coal. And it was a contract that the Commission approved that costs would be passed on.

Q Did these mining companies and synfuel companies know what the bids were for other purchasers before they made their bid?

A No, sir, and that has been looked at by the Commission several times.

Q And they are all made simultaneously, and there is a Chinese wall between Progress and --

A There is definitely a Chinese wall.

Q Beg your pardon?

A There is a Chinese wall. The bids come in, they are in a sealed envelope, they are all opened at the same time. This staff themselves set up a quite extensive procedure that we had to follow.

Q Well, although the fuel cost has no markup, as I understand it, the parent company makes a capital investment and pays administrative costs for the operations of these companies, is that correct?

A There was a return on equity on some rail cars, and there was the administrative cost that was passed on just like it would have been in a base rates.

Q I'm sorry, I didn't quite catch that. You say that Progress --

A There was some equity on the rail cars that a return was earned on for the investment in the rail cars that Electric Fuels had made, and the administrative cost was no more than the administrative would have been if it was in base rates at the utility level.

Q So are you saying that what happens is they pay the cost that's bid for the fuel, but in addition to that they also pay for administrative cost plus a return on the investment and assets?

A 55 percent net of long-term assets.

Q I see. So, how is that administrative cost and return on assets treated in the fuel filings that Progress

Energy makes with this Commission?

A It is no longer treated that way, sir. I know they changed it since I have not been involved, and I'm not sure how it's handled today.

Q You are not sure how it is treated?

A Not today, sir. It's different today.

Q With respect to tax credits, who gets the benefit of the tax credits when synfuel is sold to the utility company?

A It depends, sir. Like for Black Hawk, we have a 10 percent ownership, so 10 percent of those tax credits would come to Progress Energy Corporation on a consolidated basis.

Q Do any portion of those tax credits flow through to the subsidiary electric utility or do they all go to the parent company?

A We file a consolidated return, so it's at the consolidated level.

Q You file a consolidated return?

A Yes, sir.

Q Are you familiar with the accounting procedure that the utility uses with this Commission when it reports the income tax that it has paid on its revenues?

A No, sir, I'm not.

Q All right. That would be something I would ask Mr. Portuondo?

A Yes, sir. That would have to be a utility question.

Q When these subsidiaries sell to Progress Fuels, are the prices open for review by the public or are those prices confidential?

A Prices are filed with the Commission under a two-year confidentiality agreement, which FIPUG and the Office of Public Counsel can request to see.

Q So there is a bid process, and are you telling me that all the bids are submitted simultaneously to Progress Fuels by all the bidders on a day certain?

A No, sir. When we have an RFP, the RFP goes out, and you have two to four weeks, normally around four weeks, to respond to the RFP. And the secretary collects all of those RFPs and keeps them in a sealed envelope at which time she would open them when the date on the RFP has come to fruition.

Q Under the procedure used by Progress Fuels, does it have to accept the lowest bid submitted that meets the RFP criteria or can it accept any of the bids submitted?

A No, sir. We follow the Commission guidelines on what we accept. They've set up guidelines that if we do not choose the lowest delivered price, that we need to look overall at other things that would affect it, like, is the supplier reliable, you know.

Q In the previous questions that were asked to you, you -- and in your testimony you say that you sent out RFPs to 90 different companies, including Kennecott that dealt exclusively in Powder River coal. From your studies, did you notice a marked difference in the price of Powder River coal as Mr. Sansom has testified to at some point in time from the Central Appalachian coal that was available to you?

A The price of the coal itself on a stand-alone basis is less than the price on a stand-alone basis of foreign or CAPP coal.

Q You were aware of the significant price differential that has been testified to earlier today?

A There is a large differential in the price, there is a large differential in the Btu, but that is not the only point you would consider. You have to consider transportation and the supplier, what kind of reserves they have. There is a lot of things that you would consider before you would make a selection.

Q Well, the bottom line is what has been referred to as the busbar cost of producing electricity out of the fuel that you purchase, is that right?

A If you look at the busbar price on the solicitation that we did have, it is at the same as the CAPP coal.

Q So those analyses went on. But as I understand it, there was a problem with the railroads up until about 2002 and 2003, and that problem was resolved which reduced the transportation cost significantly. Are you aware of that?

A I am aware that during the time I was involved, '96 to 2002, which most of the time that I was involved there was a problem with the railroad, but I did not have the details on it.

Q Were you aware of the impact that might have on the busbar cost?

A Well, transportation, number one, if you can't get it or if it is high, it would naturally have an effect on the price.

Q Did you make any extraordinary effort to go out and solicit the Powder River coal at that time, or just send out your normal RFP?

A Well, the RFP went out to over 100 people, and in some cases 135 people, so I didn't make any extraordinary efforts for any one individual out of that 135 people.

Q Now, on Page 40 of your testimony, you indicate that all the records reflecting details of evaluations before -- well, for the 1996 to 2002 time period have all been discarded, is that correct?

A The records have been discarded according to the record retention period, yes, sir.

Q I' m sorry. Would you say that again?

A The records have been destroyed, yes, sir, in accordance with the record retention policy that Progress Fuels has.

Q Is there any way that we can determine what your evaluation showed during that time period?

A I gave you the evaluation for 1998 and 2001 and '96. What records I have, I gave you evaluations. They were produced in discovery.

Q But all the other records have been destroyed?

A Prior to '96?

Q No, between 2006 -- '96 and 2002.

A I have given you all the records that we have, sir, through discovery that you have requested.

MR. McWHIRTER: I have no further questions, and I appreciate you accommodating me.

CHAIRMAN EDGAR: Thank you, Mr. McWhirter.

And now, Mr. Walls, redirect.

MR. WALLS: I will try to be very brief.

REDIRECT EXAMINATION

BY MR. WALLS:

Q Working backwards, Ms. Davis, you were asked some questions by Mr. McWhirter, and if you first look at the reference on Page 40 regarding the records of PEF, I believe he phrased the question as all the records were destroyed. If you look at Line 7, what does your answer say?

A No, some were discarded well prior to the commencement of this proceeding.

Q And have you, in fact, attached a number of documents regarding the evaluations and Mr. Edwards' review process of coals during the '96 to 2002 period in your exhibits?

A Yes, sir.

MR. McGLOTHLIN: Object to leading the witness on redirect.

THE WITNESS: I think I said that to Mr. McWhirter a few moments ago. I produced documents for '96, '98 and 2001.

BY MR. WALLS:

Q I believe you were also asked some questions by Mr. McWhirter about the return that EFC received. Can you explain on whose assets did EFC get authorization to get a return on?

A This Commission authorized us to earn 55 percent return on long-term assets invested in capital for the delivery of coal to Crystal River, and there were numerous hearings on that.

Q And I believe you were asked a number of questions by staff regarding the evaluation of PRB coals, and you were asked if you had any discussions with Mr. Edwards regarding derates. And you identified that you had discussions with Mr. Roy Potter. Who was Roy Potter?

A He was a manager of technical services. He was over all of our lab. He did all of the quality analysis for all the coal that went into Crystal River.

Q And what were your discussions, if you recall, with him regarding the characteristics of PRB coals?

A We would discuss at times, I would ask him about PRB coal, because he was very highly thought of in the analysis. And I would ask him why -- you know, why would we have a derate? And he would go over about the quality of the coal was much lower than what we normally burned, and it would have a derate on the boilers.

Q I believe Mr. McGlothlin asked you a question about Mr. Edwards' 2003 compliance coal cost document that you attached as DMD-15?

A Just a moment, please. Yes, sir.

Q And I believe he asked you questions about Mr. Edwards' evaluation of Powder River Basin and referred you to the McDuffie terminal. Do you see that?

A Yes, sir.

Q Do you recall those questions?

A Yes, sir.

Q Are you aware of any differences between the McDuffie terminal and the terminal in IMT?

A Yes. McDuffie is a state terminal, and I know we have looked at it a number of times, and there was a lot of things that we could get at IMT that we couldn't do at McDuffie. McDuffie was very busy. They didn't offer -- or they didn't offer priority berthing, which is real important to us.

Q And why is priority berthing important to you?

A For demurrage purposes. When a vessel comes in, we need to get it in and get it out. We have demurrage at IMT. We have demurrage on Dixie. You need to coordinate that. So you need to get your vessel in and out. Of course, the quicker you can get it, get the Dixie vessels out to Crystal River the more coal you can deliver to Crystal River.

Q And what is demurrage, can you explain that?

A It is a charge for the ship waiting over a specific amount of time.

Q Ms. Davis, you were asked a question about a document which has been marked 215. It was the proposed agenda for New River Synfuel LLC, March 14, 2005, agenda. Do you recall that?

A Yes, sir.

Q And can you tell the Commission whether that meeting on March 14th, 2005, had anything at all to do with Crystal River Units 4 and 5?

A Absolutely nothing.

Q I also believe you were asked questions about whether when you evaluated PRB coals and other coals, whether you applied the waterborne market proxy. Do you recall those questions?

A Yes, sir, we did.

Q And what was your understanding of the development of the waterborne market proxy?

A Back in 1992, the Commission wanted us to go on a --

us and TECO to go on a proxy rather than a cost basis for transportation. And they developed the waterborne market proxy for domestic coal, and then sometime later we were buying foreign coal again, and they developed a market proxy for foreign coal or distressed coal that would come into IMT.

Q And are PRB coals domestic coals?

A Yes, sir.

Q Now, when they developed this waterborne market proxy for foreign coals, how was that developed?

A What we did at the time, we worked with staff and mostly Office of Public Counsel. And what we did, is we came up with the cost of the IMT and Dixie charges as a percent of the total domestic charges and used that percent.

Q And was that use of the applicable portions of the waterborne market proxy to foreign coal shipments approved by the Commission?

MR. McGLOTHLIN: I'm going to object to the leading of the witness on redirect.

CHAIRMAN EDGAR: Can you rephrase?

MR. WALLS: Yes.

BY MR. WALLS:

Q Was that a use of certain portions of the waterborne proxy?

A Yes, sir.

Q And was that approved by the Commission?

A Yes, sir.

Q When the waterborne market proxy applied, what happened if PFC's waterborne transportation costs were actually higher than the market?

A Then we would lose money.

Q And was that a risk to PFC at the time the waterborne market proxy was developed?

A Yes. We all discussed that during our numerous meetings that we had, staff, Public Counsel, and ourselves, and the Commissioners during the hearings.

Q Were there any domestic or foreign coals purchased by PFC from 1996 to 2003 that the waterborne market proxy was not applied to as the transportation costs?

A No, sir, it was applied, or a portion of it was applied in all cases.

MR. WALLS: That's all the questions I have.

CHAIRMAN EDGAR: Now let's take up the exhibits.

MR. WALLS: Yes. I would like to move in evidence DMD-1 through DMD 20, which are Exhibits 34 through 53.

MR. McGLOTHLIN: I move 213, 214 and 215.

CHAIRMAN EDGAR: Okay. Let's go ahead and enter Exhibits 34 through 53.

(Exhibits 34 through 53 admitted into the record.)

CHAIRMAN EDGAR: And, Mr. Walls, any objections to Exhibits 213, 214 and 215?

MR. WALLS: No objections.

CHAIRMAN EDGAR: Okay. Those exhibits will then also be entered into the record.

(Exhibits 213, 214, and 215 entered into evidence.)

CHAIRMAN EDGAR: The witness is excused. Thank you.

MR. BURNETT: Madam Chairman, may she be dismissed from the proceeding?

CHAIRMAN EDGAR: She may.

MR. BURNETT: Thank you.

CHAIRMAN EDGAR: Okay. To state the obvious, we have covered in one day opening statements and three witnesses. We have approximately 18 witnesses to go in two days. So put your seat belts on, and we will see if we can move through it tomorrow at a little brisker pace. We will begin tomorrow at 9:30, and we look forward to seeing you all then. We are on break until tomorrow morning.

MR. BURNETT: Madam Chairman, I'm sorry, I know you hit the gavel and --

CHAIRMAN EDGAR: I did. Mr. Burnett.

MR. BURNETT: At the risk of our wrath, would you consider 8:30?

CHAIRMAN EDGAR: Mr. Burnett, I would consider it, and I rarely have wrath, but, no, we will begin at 9:30.

MR. BURNETT: Yes, ma'am. Thank you.

CHAIRMAN EDGAR: We are done for the day. Thank you.

(The hearing adjourned at 5:38 p.m.)

(Transcript continues in sequence with Volume 3.)

STATE OF FLORIDA)

: CERTIFICATE OF REPORTER

COUNTY OF LEON)

I, JANE FAUROT, RPR, Chief, Office of Hearing Reporter Services, FPSC Division of Commission Clerk and Administrative Services, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 12th DAY OF APRIL, 2007.

JANE FAUROT, RPR
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