PROGRESS ENERGY FLORIDA

DOCKET NO. 080001-EI

Fuel and Capacity Cost Recovery
January through December 2009

DIRECT TESTIMONY OF JOSEPH MCCALLISTER

August 29, 2008

Q. Please state your name and business address.

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

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

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

Q. Have you previously filed testimony before this Commission?

A. Yes I have.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide PEF's Risk Management Plan for 2009, outline PEF's hedging objectives and activities for projected burns for 2009, outline PEF's actual hedging results for natural gas and fuel oil for January 2008 through July 2008 and hedging results since the inception of PEF's hedging program, and to summarize PEF's economy purchase and sales savings for January 2008 through July 2008.

Q. Are your sponsoring any exhibits to your testimony?

A. Yes, I am sponsoring the following exhibits:

- Exhibit No. ___ (JM-1P) – 2009 Risk Management Plan.
- Exhibit No. ___ (JM-2P) – Unrealized Hedge Values for 2009.

Q. Has PEF developed its Risk Management Plan for fuel procurement in 2009 in accordance with the Resolution of Issues proposed by Staff and approved by the Commission in Order No. PSC-02-1484-FOF-EI, Docket No. 011605-EI?

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

Q. What are the objectives of PEF's hedging activities?

A. The objectives of PEF's hedging activities are to reduce overall fuel price risk and volatility.

Q. Describe PEF's hedging activities for 2009.

A. PEF continues to execute its long-term hedging strategy for projected natural gas and fuel oil annual burns. PEF executes its hedging strategy by entering into fixed price physical and financial transactions over time for a portion of its projected annual natural gas, heavy oil and light oil burns for future periods. Given the on-going volatility in natural gas and fuel oil prices, executing fixed price physical and financial transactions over time is an effective method to reduce the fuel portfolio's overall exposure to price risk and volatility and the potential impacts on customers. PEF targets hedging between [redacted] of its 2009 forecasted annual natural gas and heavy oil burns over time. Included in the natural gas burn projections are estimates of usage at gas tolling purchased power facilities where PEF has the responsibility for purchasing the natural gas. With respect to light oil, PEF will hedge at least [redacted] of its forecasted annual light oil burns over time for 2009. Light oil has lower annual hedging targets than natural gas and heavy oil because light oil fuel burns can experience greater deviations from forecasts. The volumes that are hedged over time are based on periodic forecasts and actual hedge percentages will vary from forecasted hedge percentages based on the variations between forecasted burns and actual burns. PEF's hedging activities for 2009 are consistent with hedging activities executed in prior years. The hedging program is well managed and independently monitored and does not involve price speculation or trying to out guess the market. Hedging activities may not result in actual fuel costs savings; however, hedging does achieve the objective of reducing the impacts of fuel price risk and volatility experienced by customers. As of August 22, 2008, PEF has hedged approximately [redacted] of its current 2009 forecasted annual natural gas burns, [redacted] of its forecasted annual heavy oil burns and [redacted] of its forecasted annual light oil burns. PEF will continue to layer in additional hedges for 2009 throughout the remainder of 2008 and during 2009 consistent with its on-going strategy.

Q. Based on the hedges that PEF has entered for the projected natural gas, and heavy and light fuel oil burns for 2009, what is the current estimated value of these transactions?

A. Based on closing market prices as of August 22, 2008, the estimated unrealized mark-to-market value of the hedges that PEF has executed to date for 2009 is approximately [redacted]. This is summarized and attached to my prepared testimony as Exhibit No. ___ (JM-2P). The unrealized mark-to-market value for 2009 will fluctuate over time based on changes in natural gas and fuel oil market prices and as additional hedges are entered into. As a result, actual realized hedging results for 2009 will result in either net gains or net losses and will be determined based on prevailing prices at the time the hedge transactions settle.

Q. What were the results of PEF's hedging activities for January through July 2008?

A. The Company's natural gas and fuel oil hedging activities for January through July 2008 have resulted in hedge gains of approximately $239.5 million. The details of these transactions and the results were provided per PSC Order 08-0316 on August 15, 2008. For the period January 2002 through July 2008, PEF's natural gas and fuel oil hedging activities have provided net gains of approximately $600.7 million. Although PEF's hedging activity has achieved significant net savings to date, the primary objective is to reduce price risk and volatility and there will be periods where hedging will not produce fuel savings.

Q. What has been the savings generated through economy purchase and sales activity for January 2008 through July 2008?

A. During the period January 2008 through July 2008, PEF has made economic energy purchases and wholesale power sales to third parties that resulted in additional savings of approximately [redacted] and [redacted], respectively.

Q. Does this conclude your testimony?

A. Yes.

Progress Energy Florida, Inc.
Risk Management Plan for
Fuel Procurement and Wholesale Power Purchases
For 2009

As required by Order No. PSC-02-1484-FOF-EI in Docket No. 011605-E1, Progress Energy Florida, Inc.'s (PEF) is submitting its 2009 Risk Management Plan for review by the Florida Public Service Commission. The Risk Management Plan includes the required items as outlined in Attachment A of Order No. PSC-02-1484-FOF-EI and specifically items 1 through 9, and items 13 through 15 as set forth in Exhibit TFB-4 to the prefiled testimony of Todd F. Bohrmann of Docket No. 011605-EI.

PEF's current fuel burn and economy purchase and sales activity projections for 2009 are as follows:

<u>Coal</u>
Based on current projections, PEF is forecasted to burn approximately [redacted] tons of coal in 2009. PEF's forecasted coal requirements for 2009 will be purchased primarily under term coal supply agreements. The coal supply will be delivered to PEF's plants via railroad and barge transportation agreements. Spot purchases will be made as needed.

<u>Heavy Oil</u>
Based on current projections, PEF is forecasted to burn approximately [redacted] barrels of heavy oil in 2009. PEF's forecasted heavy oil requirements for 2009 will be purchased primarily under term supply agreements with flexible volume provisions at indexed market prices. Spot market purchases will be made as needed.

<u>Light Oil</u>
Based on current projections, PEF is forecasted to burn approximately [redacted] barrels of light oil in 2009. PEF's forecasted light fuel oil requirements for 2009 will be purchased under term supply agreements with flexible volume provisions at indexed market prices. Spot market purchases will be made as needed.

<u>Natural Gas</u>
Based on current projections, PEF is forecasted to burn approximately [redacted] of natural gas in 2009 that is comprised of approximately [redacted] at PEF's generating plants and [redacted] at gas tolling purchased power facilities where PEF has the responsibility to purchase the natural gas. PEF's

forecasted natural gas requirements for 2009 will be purchased primarily under term supply agreements that are based on market index pricing. In addition, daily and monthly purchases of natural gas will be made. The procurement and management of the above fuels and power optimization activities are performed by the Fuel and Power Optimization Department (FPO).

Economy Power Purchases and Sales

Based on current projections, PEF is forecasted to purchase approximately [redacted] of economy power and sell approximately [redacted] of economy power in 2009. PEF actively seeks to purchase and sell economy power as opportunities arise based on market prices versus dispatch costs, and available market power and transmission.

Item 1. Identify the company's overall quantitative and qualitative Risk Management Plan Objectives.

PEF's overall Risk Management Plan Objectives for 2009 are to effectively manage its overall fuel and purchased power costs for its customers by engaging in competitive fuel procurement practices and activities, performing active asset optimization and portfolio management activities, and continuing to execute the company's hedging program to reduce the potential impacts of fuel risk and price volatility.

Item 2. Identify the minimum quantity of fuel to be hedged for 2009 and the activities to be executed.

PEF's target hedge percentages for calendar year 2009 burns are to hedge between [redacted] of its forecasted annual natural gas and heavy oil burns. Included in the natural gas burn projections are estimates of burns at PEF's owned generation facilities and gas tolling purchased power facilities where PEF has the responsibility for purchasing the natural gas. The natural gas volumes associated with tolling purchased power agreements are included in PEF's natural gas usage forecasts and the annual hedge targets for natural gas. With respect to light oil, PEF will hedge at least [redacted] of its forecasted annual light oil burns over time for 2009. Light oil has lower annual hedging targets than natural gas and heavy oil because actual light oil fuel burns can experience greater deviations. PEF's hedging activities that will be executed both for 2009 and periods beyond 2009 are consistent with hedging activities executed in prior years under PEF's long-term hedging strategy. As part of its hedging strategy and activity, PEF has executed hedging transactions for periods through [redacted] for natural gas, through [redacted] for No. 6 oil and through [redacted] for No. 2 oil. The annual hedging targets for each of the respective periods provide the basis for executing the company's long-term strategy of layering in fixed price transactions over time for a portion of forecasted annual fuel burns, allow PEF to monitor fuel re-forecast updates and allow PEF to move from one calendar period to another effectively. The volumes that are hedged over time are based on periodic forecasts and actual hedge percentages at any given time can vary from target percentages based on changes in forecasted burns and actual burns that do and will occur. The hedging program is well managed and independently monitored and does not involve speculation or trying to "out guess" the market. The results of the hedging activities may not result in net fuel costs savings but will achieve the objective of reducing the impacts of fuel price risk and volatility experienced by PEF's customers over time. The annual hedge targets for each of the respective periods are included in PEF's Risk Management Guidelines in Attachment A.

Item 3. <u>Identify and quantify each risk, general and specific, that the utility may encounter with its fuel procurement.</u>

PEF has identified specific and general risks associated with the procurement of fuels and power optimization activities. The specific risks include fuel price risk and volatility, supplier performance and default, product availability and changes in forecasted volumes. The general risks include unforeseen extended plant outages, weather related events such as hurricanes, and business continuity. Described below are the specific and general risks that PEF is exposed to and the activities that PEF undertakes to reduce the overall exposure to these known risks. In addition, the processes that PEF has in place to monitor and quantify these risks is also described.

<u>Price and Volatility Risk</u>
PEF's customers are exposed to the risk that fuel prices can change and be volatile which could result in significant increases in fuel costs. For natural gas, heavy oil and light oil, the physical fuel is procured under standard industry contracts and are based on published market index pricing that exist at the time the fuel is delivered. The published market index prices paid by PEF for the these fuels will fluctuate with daily changes in market prices until the respective first of the month market index or daily-published market index price settle and the product is delivered. For coal, PEF executes standard industry supply agreements to fix and/or collar the price of the underlying coal. Absent hedging as defined by Order No. PSC-02-1484-FOF-EI (the Hedging Order), and entering into fixed price coal supply contracts, the projected costs for coal, natural gas, heavy oil and light oil fuel purchases could increase due to rising and volatile market prices over time.

PEF manages and reduces fuel price risk and volatility for its forecasted natural gas and fuel oil burns by executing standard industry fixed price physical and financial swap and option agreements over time for a portion of its forecasted annual burns. As outlined above, PEF enters into standard industry supply agreements to fix the price of the underlying coal. As a result of these actions, PEF reduces its overall risk of fuel prices and volatility for its customers.

With respect to monitoring and quantifying price and volatility risk, Enterprise Risk Management Group (ERM) independently monitors and reports on the percentage of projected fuel burns that have been hedged and bought under physical and financial agreements as compared to the established annual hedged and procurement targets for each respective product and period. In addition, the company performs periodic fuel and purchased power cost forecasts, which incorporate any updates needed for financial and physical hedge positions, commodity prices, unit maintenance schedules, load forecasts and other operating parameters. The updated fuel and purchased power forecasts are point in time estimates and are summarized and published to ensure there is a regular review of projected fuel and purchased power costs. Lastly, as needed, ERM performs standard statistical stress tests, portfolio analysis and Value at Risk calculations to determine potential impacts of changing and volatile prices.

Supplier Performance and Default Risk

Supplier performance and default risk represent the risk of financial loss that PEF could incur if a supplier defaults on a physical or financial obligation and is not able to fulfill the terms of an agreement. The estimated aggregate dollar amount of supplier performance and default risk for the portfolio is based on the volume, duration and prices of the agreements as compared to the current estimated market value of the agreements.

PEF reduces supplier performance risk by conducting business with a number of approved suppliers, executing agreements within contract approval limits and credit parameter limits, monitoring delivery performance of suppliers and, if possible, incorporating contractual provisions that allow for non-performance remedies in the case of default. In addition, PEF maintains on-site inventories for coal, heavy oil and light oil to further reduce this risk. For activities associated with hedging under financial agreements, the Credit function within ERM monitors all open positions and reviews the estimated market exposures for each third party company on a daily basis to ensure that PEF has the appropriate collateral balances as compared to contractual thresholds to monitor PEF's exposure.

With respect to monitoring and quantifying the level of supplier performance and default risk in fuel agreements, ERM independently calculates, monitors and reports on the amount of default risk associated with coal, natural gas and fuel oil financial and physical agreements. The review is based on contractual volumes, duration and prices as compared to the current estimated value of the open positions in the agreements that have yet to be delivered or financially settled. See Attachment B for PEF's estimated Portfolio Default Exposure Report as of July 31, 2008.

Credit Risk

On a daily basis, PEF's Credit function within ERM calculates, monitors, and reports on the Company's overall credit risk. The Credit function utilizes standard industry practices of credit evaluation and has specific criteria that are used to measure credit risk and ensure counterparties credit is monitored and reviewed. For activities associated with hedging under financial agreements, the Credit function monitors all open positions and reviews the mark-to-market exposures for each third party company to ensure that based on the current market value of open hedge positions and the credit quality of the third party companies to monitor PEF collateral needs as compared to the contractually established exposure thresholds. For further background, with respect to financial transactions, prior to executing any financial transaction with a third party company, two activities take place. First, PEF and the third party company must execute an International Swap Dealer Agreement (ISDA). The ISDA is a standard industry contract that is used by industry participants to enter into Over the Counter bi-lateral transactions (OTC transactions). All ISDA agreements are negotiated by the Contract Services Group and reviewed by the Credit, FPO and Accounting to ensure the appropriate terms and conditions are included. As part of the process of setting up a new financial agreement, a credit evaluation is performed on the third party company by the Credit function. There are universal principles of credit strength that are evaluated before credit is granted. Among these principles are company size, industry characteristics and trends, profitability, liquidity, cash flow, interest and fixed charge coverage and capital structure. In addition, both external (third party) and internal evaluation models are used to evaluate third party companies' credit. PEF evaluates counterparties using a consistent analytical approach and the credit ratings are based on both external ratings and the evaluation of key counterparty attributes identified as leading indicators for financial performance. The credit rating process includes obtaining counterparty background information and financial statements, identifying any existing Standard & Poor's (S&P) and/or Moody's ratings for the counterparty, and performing a financial statement analysis. The financial statement analysis includes, but is not limited to, a review of revenue trends, metric calculations and trends evaluation for Free Funds from Operations, Total Debt to Tangible Net Worth, Funded Debt to Capital, Interest Coverage, Operating Cash Flow and Liquidity. If the counterparty is a bank, the Tier I, Tier II and Total Capital Ratios are either researched or calculated and compared to Basel I and most recently Basel II minimums because capital adequacy and liquidity are of paramount importance to the company's counterparty credit analysis. In addition, standard company financial numbers are entered into the Company's proprietary credit model, which generates a score that helps validate existing agency ratings and provides a means to determine any necessary internal rating adjustments.

Once the credit evaluation is complete, a credit rating is assigned to the third party company and, if appropriate, a credit line is extended. The assigned credit rating and credit limit dictate the size and duration of financial hedging transactions that PEF can enter into with a third party company.

As described, on a daily basis the Credit function independently monitors, calculates and reports on collateral exposure. In addition, with respect to monitoring agreements that require the posting of margin based on established contractual thresholds, the company may ask for margin or send out margin to the third party company to ensure exposures are within established contractual thresholds. See Attachment C for the PEF's collateral report as of July 31, 2008.

Product Availability and Changes in Forecasted Volumes

PEF must have access to needed physical fuel supplies, adequate product delivery capabilities and inventory to meet projected fuel requirements. Without access to needed fuel supply and inventory, PEF is exposed to the risk of not being able to economically and reliably dispatch the generation fleet.

PEF manages and reduces this risk by entering into standard industry physical supply contracts as well as needed pipeline, railroad, barge and trucking agreements for the purchase and delivery of coal, natural gas, heavy oil and light oil that provide the supply and flexibility to meet projected burns. In addition, PEF maintains on-site inventory for coal, heavy oil and light oil to provide fuel supplies to support on-going operations and ensure supplies for unexpected delivery delays, storm curtailments, and events that could affect fuel supply availability. PEF holds off-site high deliverability natural gas storage capacity that will provide additional access for a portion of its natural gas needs in events that cause natural gas supplies to be curtailed due to storms. In addition, PEF's onshore gas supplies will continue to increase in 2009 as additional supply becomes available to PEF via (1) supply agreements that will be flow into the Southeast Supply Header and (2) an increase in LNG volumes under an existing agreement. Lastly, PEF actively monitors actual fuel burns versus forecasted fuel burns and makes any procurement adjustments to account for changes in weather, fuel-switching capabilities, outages, and purchased power on a short-term basis as needed.

With respect to monitoring and quantifying the level of risk associated with ensuring adequate fuel supply, ERM independently monitors and reports on the amount of fuel procured versus projected burns. In addition, the front office performs analysis and reports to quantify the amount of fuel needed to support projected burns and inventory needs. Lastly, the company performs periodic re-forecast for fuel burns and purchased power and produces summary reports for review and monitoring of projected fuel burns.

General Risks

PEF is subject to unforeseen and extended plant outages that could occur during peak demand periods. To manage this potential risk, PEF maintains the required capacity reserve margins and maintains demand side load management protocols. Secondly, PEF is subject to weather events such as hurricanes. As detailed above, PEF reduces the overall risks associated with storms and other potential fuel delivery curtailments and delays by maintaining on-site inventories, off-site inventories and continuing to diversify its natural gas supply to more secure onshore locations. Lastly, PEF is subject to events that could require FPO employees to perform required work functions at locations other than their normal work location. With respect to this risk, the FPO Department has business continuity plans in place that are reviewed and tested periodically to address this risk.

Item 4. Describe the company's oversight of its fuel procurement activities.

The Board of Directors of the company has established a Risk Management Policy that directs the Risk Management Committee (RMC) to oversee Progress Energy's financial risks. The RMC is comprised of senior executives from varying functional areas. The RMC is responsible for administering necessary risk management guidelines and policies, and monitoring compliance with these guidelines and policies. In addition, the RMC is responsible for identifying and monitoring corporate financial risks, recommending aggregate market and credit risk allocations as needed for Board of Directors approval, approving risk management guidelines and controls, approve trading products, reviewing credit exposures, and reviewing fuel hedging and procurement activities.

To assist the RMC with its oversight role, the company has an established Treasury, Risk and Transaction Oversight Subcommittee (the TRT). The TRT is chaired by the Treasurer and Chief Risk Officer (CRO) and includes management members of Accounting, Legal, Treasury, Finance, ERM, Corporate Planning, Tax, and FPO. The TRT develops, reviews, and recommends Risk Guidelines for the identification and oversight of key risks associated with Fuels and Power Optimization, and financial and corporate credit activities. In addition, the TRT reviews fuel procurement and hedging activities, and proposed transactions and strategies as required. The TRT submits guidelines, policies, transactions, and strategies to the RMC for approval as required by corporate governance. The company has identified risks types, which include, but are not limited to, commodity risk, credit risk, business risk, liquidity risk and operational risk. PEF has included the Company's Risk Management Policy, the Company's Risk Management Committee Guidelines and the TRT Oversight Subcommittee Guidelines as Attachment D, E and F.

With respect to day-to-day independent oversight and controls for the FPO activities, the company uses the "three-office" structure which includes FPO (Front Office), ERM (Middle Office) and Accounting (Back Office) to provide the necessary independent oversight and monitoring of its fuel procurement, power optimization and hedging activities.

The "three-office" structure is an accepted industry practice with the Front Office, Middle Office, and Back Office each functioning as independent departments, which ensures the required segregation of duties, and the existence of independent oversight and controls over key activities. In addition, the Contract Services and Legal organizations provide critical contractual support to ensure that the Front Office contracts are reviewed and contain legal provisions to reduce risks that could affect the company. In addition, the IT Enterprise Application Solution Support organization provides on-going support related to trading system operations and functioning. Treasury and Disbursement Services provide appropriate support when disbursing funds to counterparties via checks, wires or automated clearinghouse payments. All of these support organizations are independent from the Front Office.

<u>Front Office</u>
PEF has a very structured procurement process where Request for Proposals are issued periodically to procure needed competitive fuel supply. As noted above, the fuel procurement activity is supported by the Contract Services and Legal functions. Front Office management is responsible for ensuring employees are authorized before they are allowed to trade commodities on the company's behalf. In addition, there is a corporate approval matrix, which provides the required approvals for fuel related procurement activity based on estimated costs and duration of fuel related contracts. PEF has included the Risk Management Guidelines and Credit Risk Management Guidelines in Attachments A and G.

<u>Middle Office</u>
ERM monitors Front Office activity by quantifying, monitoring, and reporting risks associated with fuel procurement, power optimization and hedging activities. ERM is accountable to the enterprise for independent oversight, measurement, and reporting of Front Office activities to management. ERM monitors and reports on Front Office activities and will report immediately any non-compliance as required within the reporting and control limit structures as defined by the Risk Management Guidelines. Lastly, ERM publishes credit limit and exposure reports to ensure that counterparty credit limits are monitored and adhered to and administers margin activity as required under agreements with counterparties to reduce credit and default risk.

<u>Back Office</u>

Accounting is also independent from Front Office and performs the following control functions, among other things, on a daily, weekly or monthly basis: deal validation, volume and price actualization, transaction confirmations, close accounting, general ledger balance sheet account reconciliations, settlements/cash transfers, processing payments/receipts, accounting for hedging activities and derivatives, and performing certain compliance activities as defined and/or required by various regulatory agencies (e.g. Securities and Exchange Commission, Financial Accounting Standards Board, Federal Energy Regulatory Commission, Public Service Commission). Related to accounting for hedging activities and derivatives, Progress Energy's FAS No. 133 policy is followed. This policy is reviewed and updated at least annually.

Item 5. <u>Describe that the utility provides its fuel procurement activities with independent and unavoidable oversight.</u>

As described in Item 4, the Company has a robust independent oversight culture with needed processes and structures in place to ensure the identification, monitoring, and reporting of risks, and independent controls for monitoring and reporting on fuel procurement, power optimization, and hedging activities. The key components of the oversight functions and processes are described below.

<u>RMC</u>
The Company's Board of Directors has established a Risk Management Policy that directs the RMC to oversee PEF's financial risks. The RMC members are as follows:

- Chief Executive Officer of Progress Energy
- Chief Financial Officer – Progress Energy Inc. (Chair)
- SVP Corporate Relations & General Counsel – Progress Energy, Inc.
- SVP Financial Services
- Treasurer and CRO
- SVP Power Operations

The RMC assesses and monitors financial risks. This includes reviews of hedging and fuel procurement as well as market and credit risk exposures. In addition, the RMC approves the Risk Management and Credit Risk Management Guidelines including approval for any new products and strategies.

<u>TRT</u>
The company has an established TRT Subcommittee which is chaired by the Treasurer and CRO to provide additional independent oversight on the

activities of the FPO. The TRT reviews and recommends risk and credit guidelines and policies that require the identification of risks, activities, and exposures within FPO, and reviews of proposed transactions and strategies. The TRT submits guidelines, policies, proposed transactions and strategies to the RMC for review and discussion as required by corporate governance.

ERM

The Company has an independent ERM section, which is overseen by the Director of ERM who reports to the Treasurer and CRO. The ERM group is comprised of a Corporate Credit function section and a Risk Analytics and Reporting function. ERM's credit function provides independent credit evaluation of trading and procurement counterparties, performs credit reviews of the company's suppliers and customers, and assists in drafting and reviewing credit language in various agreements, and monitors and reports on credit exposures daily. ERM's Risk Analytics and Reporting function independently reports on fuel procurement and hedging activities and performs independent analysis as required. ERM independently prepares credit and risk summary reports, validates positions, performs mark-to-market calculations, administers margin activity with counterparties, and performs independent reviews of company activities as required.

Guidelines

As part of the overall risk management structure and oversight process at the company, the Risk Management Guidelines and Credit Risk Management Guidelines have been established and are reviewed, updated and approved by the RMC at least annually.

PEF's Risk Management Guidelines provide the methods to assess, quantify, report, and monitor the activities associated with fuel procurement contracts, fuel hedging activities, and power activities. In addition, these Guidelines outline approved products, approved periods, and risk parameters such as reporting and control limits for margin capital, credit exposure, Value-At-Risk (VAR), and annual hedging targets. PEF's Credit Risk Management Guidelines provide the methodology to evaluate, measure, mitigate, and report credit associated with FPO activities. In addition, the Credit Risk Management Guidelines outline specific contract duration criteria for counterparties based on standard industry credit metrics and methods.

Audit Services

Audit Services provides independent assurance and consulting services that ensure compliance, effective corporate governance, adherence to established procedures and operational effectiveness for all major areas of the company. With respect to FPO activities, Audit Services performs periodic audits that focus on items such as compliance with established procedures, off premise activity, payment terms under fuel contracts, and other trading and procurement activities.

Item 6. <u>Describe the utility's corporate risk policy regarding fuel procurement activities.</u>

The utility risk policy requires the oversight of the company's business and financial risks. As described in detail in items 4, 5, 7 and 9, the company has developed management oversight functions and processes, specific guidelines, approval processes and procedures that must be followed with respect to fuel procurement, power optimization and hedging activities.

Item 7. <u>Verify that the utility's corporate risk policy clearly delineates individual and group transaction limits and authorizations for all fuel procurement and hedging activities.</u>

The utility has guidelines and procedures in place that outlines individual and group limits and authorizations for procurement and hedging activities. These guidelines and procedures are outlined in detail in responses to items 4, 5, and 9.

Item 8. <u>Describe the utility's strategy to fulfill its risk management objectives.</u>

The Company's strategy to fulfill its risk management objectives are executed by having a well defined fuel procurement approach, active and real-time power optimization and portfolio management activities, and an established hedging program governed by independent controls, appropriate organizational design and oversight, deal approval requirements, credit and risk management guidelines, and documented procedures.

One of the components of PEF's Risk Management Plan is to procure fuel in a competitive manner and to hedge prices for a portion of forecasted burns over time. Examples of executing these components of the program are the periodic Request for Proposals (RFP's) issued by PEF to solicit competitive bids for coal, natural gas and fuel oil supply as required to support fuel forecasts. Also performed is the execution of fixed price physical and financial natural gas and fuel oil agreements to lock in prices for a portion the company's forecasted burns over time. In addition, the Power Optimization and Portfolio management sections actively monitor the dispatch of the generation fleet, purchased power and actively seek opportunities to execute economy purchases and sales.

In addition to the commercial activities being performed to fulfill the objectives of the Risk Management Plan, for the plan to be deemed successful, the activities must be governed by independent oversight, segregation of duties and effective guidelines, procedures and internal controls. The Company has established controls, guidelines, procedures and organizations to support and independently monitor fuel procurement, hedging and power optimization activities.

The Risk Management Plan is executed through the efforts of experienced professionals who ensure the program's activity is conducted and executed in a manner consistent with the company's overall strategy, guidelines and business practices. As noted in items 4 and 5, the company has a robust oversight culture and processes that includes oversight by the RMC and TRT, periodic audits by Audit Services, and independent reporting and credit monitoring by ERM to ensure adherence to established guidelines and procedures.

Item 9. Verify that the utility has sufficient policies and procedures to implement its strategy.

PEF maintains sufficient guidelines and procedures to implement its strategy. Please see Attachment H for a listing of all the applicable guidelines and procedures.

Item 13. Describe the utilities reporting system for fuel procurement activities.

The Company utilizes multiple systems and applications to assist in evaluating and executing fuel procurement transactions. Descriptions of the primary systems, software and other tools are provided below.

Forecasted fuel burns are prepared by the Company using a production cost simulation model called GenTrader. Fuel and other commodity price forecasts, load forecasts, purchased power deal information, generating unit operating characteristics, maintenance schedules, and other pertinent data are input into GenTrader which then simulates the system and computes a projected fuel burn requirement.

Zai*net is a software application used by the company to capture natural gas physical procurement transactions as well as financial natural gas, heavy oil and light oil transactions. In addition to deal capture, Zai*net is used for deal valuation, position management, mark-to-market calculations and settlements. Zai*net is integrated with the Gas Management System (GMS) which is a natural gas scheduling tool used to match supply and deliveries. Once volumes are updated in GMS with actual volumes, there is a process, which systematically updates the physical deals in Zai*net.

The GMS is a software application used by the company to match supply, transport and deliveries for natural gas purchases, sales and transport activity and the administration of associated contracts. The system is integrated with Zai*net as outlined above, which provides for greater efficiency and controls for gas related activities.

Fuelworx is a software application used by the company to capture and track physical procurement activity for coal and fuel oil. The system assists with administering contract terms and conditions, maintaining inventory levels, capturing fuel consumption information, and issuing monthly closeout processes, including invoicing, and settlements.

Front Office, ERM and Accounting utilize other programs such as Business Objects, and Excel to summarize, evaluate and report on fuel procurement transactions, and counterparty credit evaluations. In addition, ERM maintains an Oracle database that stores market prices for various commodities and locations. Lastly, ERM's Analytics group utilizes Matlab, a computer programming language, to calculate VAR and run other scenarios as needed by the business units.

Lastly, the company has agreements with vendors to provide real time pricing feeds to monitor real-time natural gas, fuel oil and power market prices.

Item 14. <u>Verify the utility's reporting system and other tools consistently and comprehensively identifies, measures and monitors all forms of risk associated with fuel procurement activities.</u>

As outlined in the response to item 13, the company utilizes several applications to ensure procurement and hedging activities are captured, measured, monitored, confirmed, accounted for and reported on. The company uses standard industry reporting templates, valuation techniques and applications. The current applications utilized by the company provide the necessary functionality for capturing deals, summarizing fuel positions, calculating mark-to-market valuations, calculating credit and collateral exposures, generating confirmations, supporting billing and payment requirements, and maintaining needed historical information such as prices and trade data.

Item 15. <u>If the utility has current limitations in implementing certain hedging techniques that would provide a net benefit to ratepayers, provide the details of a plan detailing the resources, policies, and procedures for acquiring the ability to use effectively the hedging techniques.</u>

PEF does not believe that there are any current limitations to effectively execute its hedging strategy.

Attachment A

"PEF Fuels & Power Optimization Risk Management Guidelines"

(25 pages)

REDACTED

Exhibit No. ___ (JM-1P)
Docket No. 080001-EI

Attachment B

REDACTED

Regulated Fuels Hedging Portfolio
Total Estimated Default Exposure by commodity

all figures as of: 7/31/2008
Progress Energy Florida, Inc.
$ in millions

Commodity	[redacted] Total
Gas	[redacted]
Fixed Price Physical	
Index Physical	
Fixed Swaps	
Financial Options	
Oil	
Fixed Swaps No.6	
Financial Options No.6	
Fixed Swaps No.2	
Coal	
Fixed Priced	
Collar Priced	
PEF Total	

Notes

[redacted]

Progress Energy

Attachment C

"ISDA Collateral Summary"

(1 page)

REDACTED

Exhibit No. ___ (JM-1P)
Docket No. 080001-EI

Attachment D

"Risk Management Policy"

(2 pages)

REDACTED

Exhibit No. ___ (JM-1P)
Docket No. 080001-EI

Attachment E

"Risk Management Committee Guidelines"

(5 pages)

REDACTED

Exhibit No. ___ (JM-1P)
Docket No. 080001-EI

Attachment F

"PEF – Treasury, Risk & Transaction
Oversight Committee"

(3 pages)

REDACTED

Exhibit No. ___ (JM-1P)
Docket No. 080001-EI

Attachment G

"Progress Energy Florida Regulated
Commercial Operations and Regulated Fuels
Credit Risk Management Guidelines"

(13 pages)

REDACTED

Exhibit No. ___ (JM-1P)
Docket No. 080001-EI

Attachment H

"Progress Energy Florida Guidelines and Procedures"

(1 page)

REDACTED

Exhibit No. ___ (JM-1P)
Docket No. 080001-EI

REDACTED

PEF Unrealized Hedge Values as of August 22, 2008

	1/1/2009	2/1/2009	3/1/2009	4/1/2009	5/1/2009	6/1/2009	7/1/2009	8/1/2009	9/1/2009	10/1/2009	11/1/2009	12/1/2009	Total*	
PEF Gas Net	[redacted]													1
PEF No.6 Oil Net														2
PEF No. 2 Oil Net														3
Total														4

* Values subject to change based on changes in market prices and positions.