Progress Energy

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The Honorable Matthew M. Carter II
Chairman
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Test Year Notification Pursuant to Rule 25-6.140, F.A.C.

Dear Chairman Carter:

Progress Energy Florida ("PEF" or the "Company") is committed to meeting its customers' growing needs for reliable, affordable electric service from clean and efficient generation resources consistent with the energy policy goals established by the Florida Legislature, the Governor, and this Commission ("PSC" or the "Commission"). To continue meeting those responsibilities, the Company has determined that it must file an application for a permanent base rate increase, effective January 1, 2010.

Although we have managed to maintain our base rates at essentially the same levels as they were twenty-five years ago, our cost management efforts and customer growth can no longer keep pace with our necessary capital and Operation & Maintenance ("O&M") requirements to deliver reliable electric service and to meet the energy goals of this State. We are mindful of the impact of any increases to customers' bills at this time. As such, we will also be filing next week with the Commission a request to reduce our fuel rate by an amount sufficient to achieve a $207 million reduction in fuel charges to customers, and to defer the recovery of $200 million of Levy nuclear pre-construction costs, which the Commission had authorized to be collected this year. The proposals, if accepted by the Commission, decrease 2009 customers' bills by an average of $15.08 per month, 1,000 kilowatt-hours (kWh) residential --- or 11 percent --- starting with the first billing cycle for April 2009. Commercial and industrial customers would see similar savings. These measures will mitigate the costs of electric service to our customers during these tough economic times that we and our customers both face. In the meantime, however, we must still fulfill our obligation to provide them with efficient, clean, and reliable power for their energy needs now and in the future.

As you know, the Florida Legislature and Governor have set forth a comprehensive set of energy goals for the State of Florida that encourage public utilities

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to (1) add and expand nuclear power generation; (2) further diversify their fuel resources and reduce their dependence on fossil fuels; (3) increase generation efficiency through repowering projects and capital and maintenance improvements; (4) increase renewable energy resources; and (5) reduce greenhouse gas (GHG) and other emissions. Further, the regulatory policies and rules of the Federal Energy Regulatory Commission ("FERC"), the North American Electric Reliability Corporation ("NERC"), and the Commission, require the Company to enhance electric grid reliability and make its transmission and distribution systems less susceptible to storm damage.

Through these energy policy goals and requirements the Florida Legislature, the Governor, and this Commission have made clear their intent to provide for a different energy future, one in which Florida utility customers have even more reliable electric service produced by cleaner, more efficient resources, including more stable and affordable fuel prices.

Although the ongoing economic conditions make the timing unfortunate and the decision difficult, the Company must continue to invest now to ensure that the necessary infrastructure improvements are made to attain these state energy policy goals and requirements.

The Company is moving forward with its "Balanced Solution" strategy that includes investment in state-of-the-art power plants to achieve State energy-policy goals while continuing to meet customer needs for reliable power. This aspect of the Company's strategy includes the Company's investment in the steam generator replacement project at its existing nuclear power plant, Crystal River Unit 3 ("CR3"), later this year. This project ensures that Progress Energy Florida customers will continue to receive the benefits of CR3's efficient performance. As you know, CR3 is currently the Company's only nuclear generation unit, providing the Company's customers with base load, around-the-clock, energy generation from the lowest-cost fuel source currently available to the Company. CR3 operations have saved customers hundreds of millions of dollars in annual fuel costs compared to the Company's next most efficient base load alternative. With the completion of the project in 2010, customers will continue to realize fuel savings from the operation of CR3 far into the future. But to achieve these continued fuel savings, the Company must incur the costs of the steam generator replacement project. This is one of the major factors necessitating an increase in the Company's base rates.

The Company also is in the final stages of repowering its oil-fired Bartow steam power plant, with cleaner burning, state-of-the-art combined cycle, natural gas-fired technology to meet customer needs for additional, reliable power generation. This project satisfies the Power Plant Efficiency Improvements Policy recommended by the Governor's Action Team on Energy and Climate Change as part of Florida's Energy and Climate Change Action Plan. When completed and in-service in June 2009, the repowered plant will generate more than twice the amount of power as the 1950s 500-megawatt oil-fired plant, but will produce significantly lower sulfur dioxide and nitrogen oxide emissions than the existing facility. It will also reduce the Company's reliance on foreign oil sources and will increase the efficiency of the Company's energy production. Depending on fuel prices, PEF also could realize reduced fuel costs when the repowered, gas-fired units come on line.

Meanwhile, continued growth since the Company's last base rate proceeding in 2005 has required additional investment in the transmission and distribution facilities necessary to ensure that customers continue to receive reliable electric power. The Company's customer base grew at around 2 percent a year in 2006 and 2007, and despite lower growth expectations, the fact is there are more customers today than in the Company's last base rate proceeding and those customers need safe, reliable electric service. As a result, the Company has made and will continue to make substantial capital and operation and maintenance (O&M) investments in its transmission and distribution systems to meet its existing and future customers' needs for reliable electric service.

Investment in the Company's transmission system is also driven by the FERC's and NERC's enhanced transmission reliability requirements. Based on directives in the Federal Energy Policy Act of 2005 (EPAct), the FERC in 2006 certified NERC as its Electric Reliability Organization and granted NERC the authority to draft new and enhanced reliability standards. The NERC was further given the authority to enforce these previously voluntary standards through reliability reporting and monetary penalties for noncompliance with the NERC standards. The NERC responded by enhancing electric reliability planning and construction standards, imposing reporting obligations, and establishing penalties for noncompliance with its reliability standards.

The Company has augmented its existing transmission capital and O&M projects to ensure that the Company remains in compliance with the NERC reliability standards. Transmission reliability initiatives include changing out wood transmission poles for concrete poles, transmission line bonding and grounding, and bushing, cap, and insulator replacements, among other investments, that will better ensure PEF's compliance with the NERC standards. Additional O&M reliability related expenditures include additional transmission line inspection, additional transmission substation maintenance, and additional vegetation management. These multi-million-dollar transmission capital and O&M investment requirements to comply with the NERC reliability standards and meet customer reliability and growth obligations comprise another major factor necessitating a base rate increase.

Further transmission system reliability improvements and, more significantly, reliability improvements in the Company's distribution system are required to implement the Company's storm hardening plan. Following the devastating hurricanes of 2004 and 2005 this Commission required the Florida investor owned utilities to undertake plans to strengthen and secure the electric power grid against potential storm damage. The Commission's storm hardening orders and rule require the Company to prepare a storm hardening plan, update it annually, and report to the Commission on the Company's storm hardening efforts. The Company initiated storm-hardening efforts in 2007 and 2008, consistent with its storm-hardening plans and the Commission's orders and rule. The Company will make additional transmission and distribution capital and O&M investments in 2009 and 2010 to comply with the orders and rule.

The Company's storm hardening plan includes, for example, additional pole inspections and maintenance, additional planning and engineering to account for extreme winds, flooding and storm surges, and additional reporting obligations, all at additional cost to PEF. In addition, as a result of its increased inspection efforts and to harden its system, PEF expects to continue to aggressively replace wood poles identified for replacement and to remove potentially damaging trees as the Company has done in 2007 and 2008 without an additional base rate increase. The Company cannot sustain and enhance the reliable delivery of power across its distribution system for its expanded customer base in accordance with its storm hardening plan in 2010 and beyond, however, without an increase in the Company's base rates. The Company estimates its distribution capital and O&M requirements will also require millions of dollars in additional base rate revenue requirements.

In addition to the steam generator replacement, the Company is currently expanding the nuclear power production capability from its existing CR3 nuclear power plant with an uprate project during the Company's planned 2009 and 2011 nuclear refueling outages. When completed, this uprate project will add approximately 180 megawatts of clean, low cost, nuclear energy production to the Company's system.

Further, the Company joins the Florida Legislature and Governor in the commitment to develop new nuclear generation in Florida with the Company's on-going capital investment in the potential future addition of the Company's Levy Units 1 and 2 nuclear power plants. Expanded and additional nuclear generation fulfills the State energy policy goals of meeting the future energy needs of Floridians with clean, carbon-free, low-cost fuel sources. The Company's continued commitment to this State energy policy depends, however, on sustaining the Company's financial strength and flexibility throughout the Company's capital expenditure program, especially given the uncertain and difficult economic conditions affecting the State, the Company, and the Company's customers.

The Company must maintain a strong financial position capable of attracting the capital necessary to expand facilities to meet the needs of the Company's customers. The Company is currently undertaking the largest capital expenditure program in its history, and likely the history of this State, but one that is absolutely necessary to fulfill the State's long-term energy policy goals while continuing to provide customers safe, reliable, and efficient electric service. At the same time, we are cognizant of the difficult economic conditions facing the State and the impact those conditions have had on our customers. Those same economic conditions and the ongoing turbulence in the financial markets have adversely affected the Company as well.

The resulting constriction of the capital market and restrictions on credit make it difficult even for financially strong companies to obtain needed capital. In such uncertain and volatile economic conditions access to the debt and equity markets is essential. To ensure the Company has the access to the debt and equity capital it needs, the Company must maintain a reasonable return on its capital investment, a strong capital structure, and a strong credit rating. The importance of these financial objectives to the Company's capital expenditure program, including the development of expanded and additional nuclear generation, cannot be stressed enough. The Company must be able to attract the substantial capital investment it needs at a reasonable cost to ensure that the Company meets the expectations of the Florida Legislature and Governor as well as the expectations of customers. The Company cannot achieve these goals if it does not receive the reasonable cost of equity, and a realistic opportunity to earn that cost of equity return that the capital markets will require to invest in the Company. This too, is a major factor requiring additional revenue requirements beyond what is available to the Company under its existing base rates.

We recognize that the economic downturn has been particularly hard in Florida, and we know that any increase is unwelcome and difficult for customers. We are actively seeking ways to manage our costs without sacrificing the reliable electric service our customers demand and regulators expect. Given the reduced number of new customers in recent months, we have reduced our workforce in those areas. We have also implemented additional measures to control our increasing employee benefits and health care costs. And, we will continue to look for other ways to implement cost-saving measures while continuing to provide our customers with the reliable electric service they demand. But even with these and other cost-savings measures, the need for a general base rate increase is clear, given that we are operating under general base rates that have remained relatively the same for our customers for over twenty-five (25) years.

As this Commission is aware, PEF is currently operating under a Stipulation and Settlement approved by the Commission in Order No. PSC-05-0945-S-EI, which resolved the Company's then-pending base rate proceeding. This Stipulation and Settlement followed an earlier Stipulation and Settlement, approved by the Commission in Order No. PSC-02-0655-AS-EI, that provided for a permanent base rate reduction together with a revenue-sharing provision. As a result of these two Stipulations, PEF has not had a general base rate increase since 1993. In fact, PEF lowered its base rates beginning in 2002, producing more than $500 million in direct savings to customers over the four-year term of the 2002 Stipulation. Further, the revenue-sharing provision of the 2002 Stipulation yielded another $50 million in revenue-sharing benefits to customers.

In the 2005 Stipulation, as this Commission knows, PEF froze its already lowered base rates for four more years. The only exception to this base-rate freeze for customers was a limited increase beginning in 2008 to account only for the revenue requirements necessary for new generation units added to PEF's system in 2003 and 2007 to meet customer power needs. As a result of this agreement, PEF absorbed the cost of the third unit at our Hines facility, a 500-megawatt, natural gas-fired, combined cycle plant that began operation in 2005, without any increase in its base rates.

PEF further absorbed other cost increases as a result of its base rate Stipulations without an increase in base rates. The Company also absorbed the inflationary increases in its labor, material, and equipment costs of operation. Further, increased costs of health care, property insurance, and liability insurance that far exceeded inflation were also absorbed by the Company for a period of almost twenty years without a general increase in base rates. In addition, during the most recent four years, since the Company's last base rate case proceeding in 2005, the Company's construction labor and material costs have increased dramatically, as has its bad debt write-offs.

As a result, PEF has provided its customers a sustained period of relatively flat base rates for more than a quarter of a century while other consumer costs for goods and services --- and the Company's own costs of providing electric service --- have continued to rise. In fact, PEF's residential base rates have increased by only one (1) percent since 1984 while, in sharp contrast, the Consumer Price Index has increased by 106 percent, the price of housing has increased 113 percent, the price of food has increased 115 percent, and the price of medical care has increased 253 percent. PEF's cost of providing customers electric service has increased dramatically, but our customers nevertheless have experienced a prolonged period of relatively stable base rates.

PEF has been able to maintain relatively stable base rates over this sustained time period because of its superior cost management, cost-reduction measures, and efficiency improvements. Customer and sales growth cannot and did not offset the growth in PEF's capital investment needs and costs of operation. Indeed, since 1993 when PEF last had a general base rate increase, PEF has invested $4.5 billion in an additional 3,000 megawatts of generation, additional transmission and substation facilities, and other capital improvements to continue to provide its growing customer base with safe, reliable, efficient electric service.

Since our last base rate proceeding in 2005, the Company has, for example, managed its growth in personnel costs through an early-retirement program that went into effect in 2005. The Company continues to carefully monitor and control its staffing needs to provide reliable, efficient customer service. Additionally, the Company benchmarks against other companies in the industry to ensure health care and other benefits costs are comparable.

In the customer service area, the Company has added Web site and voice-activated software to provide more efficient customer service while maintaining or reducing customer service staffing. The Company will continue to manage its costs to ensure that the Company is providing reliable electric service at the most efficient cost but it cannot continue to do so without a general base rate increase.

By 2010, we will be serving approximately 65,000 more customers than we were in 2005, when base rates were set, but retail energy sales will be lower by an estimated 350 thousand megawatt-hours. Put simply, our sales are not going to cover our increasing costs of serving our expanded customer base with the capital investments we are making and must make.

Through this period, our customers have recognized and rewarded us for our superior customer service. In the most recent J.D. Power & Associates survey of business customers, PEF placed eighth out of 24 utilities in the South Region and ahead of Tampa Electric Company and Florida Power & Light Company. Also, in its most recent, interim report on residential customer satisfaction, PEF was rated seventh out of 13 Southeast utilities and ahead of Tampa Electric Company and Florida Power & Light Company. We have scored in either the first or second quartile in customer satisfaction for the last six (6) years and in customer service for the last nine (9) years according to the J.D. Power & Associates survey of residential customers. We have earned the PA Consulting Group's ServiceOne award twice and the EEI Edison Award as the top investor-owned utility in the country. We also are the only utility to earn the J.D. Power & Associates Founder's Award, which recognizes outstanding customer service. All of these awards have been earned in the last four years, and they reflect our Company's commitment to providing outstanding service to our customers.

These awards are attributable in part to the superior results we have achieved in transmission and distribution reliability. Over the last five years, the average duration of a transmission-related outage has decreased 23.4 percent, the average frequency of outage events has decreased by 7.9 percent, and the time required for circuits to be re-energized following an outage has decreased 20.6 percent. Similarly, through strategic investments in the distribution system, we have reduced customer system average outage minutes by more than 39 percent over the last ten years and we have maintained a system average interruption index (a measure of customer minutes out over an entire year) below 80 since 2004. Meanwhile, we have improved employee safety to the point we have been at or near the top quartile in the industry since 2003, improving to the top decile in the industry in 2007. From 2001 to 2007, we have reduced our OSHA injury rate by 75 percent. These measures demonstrate our ability to safely deliver reliable power to our customers.

During the same period, we have also achieved outstanding performance in producing reliable, efficient power from our generation fleet. Our nuclear generation performance has exceeded a 90 percent capacity factor for years, outpacing the industry average nuclear generation performance, and providing our customers with the highest possible energy production from the cleanest, lowest-cost fuel source available to the Company. Our fossil and other generation production fleet have performed equally well, achieving exemplary generation performance at industry leading O&M

costs per megawatt-hour (MWh) generated. Our generation fleet's equivalent availability rates, which measure the availability of the units in the fleet when they are needed to economically serve customer load, have consistently exceeded the NERC average. As a result, we have consistently demonstrated our ability to provide our customers with reliable energy generation at the lowest possible cost.

We effectively and efficiently provide our customers with the reliable electric service they demand while fulfilling the State's energy goals developed by the Florida Legislature, the Governor, and this Commission for energy efficiency and renewable energy. The Company is committed to investing in cost-effective energy efficiency programs as part of its Balanced Solution.

The Company's commitment to energy efficiency has resulted in an innovative, cost-effective DSM program that ranks among the largest and most successful DSM program in the country. The Company moved forward with 39 new measures for its demand-side management (DSM) plan ahead of the Commission's schedule for revisions to the Company's DSM goals. With PEF's expanded DSM program, PEF expects to reduce the need for an additional 527 winter megawatts of peak demand load from direct load control and 418 winter megawatts from energy efficiency, for a total of 945 winter megawatts load reduction. This is in addition to more than 1,500 megawatts of demand reduction that PEF and its customers have achieved through DSM programs. This is the equivalent of avoiding the construction of almost five (5) new 500-megawatt generation plants. In just the first year of our DSM expansion, we increased energy savings by thirty-eight (38) percent over 2006 levels.

The Company is also committed to aggressively pursuing investments in future renewable energy generation. Through its recent renewable energy purchase power agreements, the Company will add up to 267 Megawatts of new renewable generation to its system. This renewable energy generation is in addition to the Company's current contracts with five renewable energy providers for more than 173 megawatts of renewable energy. No other Florida utility has as much renewable energy under contract. PEF is a leader among Florida utilities in encouraging renewable energy resources, and it will continue to make the investments necessary to promote to the extent possible the development of further renewable energy resources in Florida.

To continue our achievements in delivering reliable, efficient electric service to our customers and meeting the federal and State energy policy requirements and policies, we must increase our base rates. As a result, based on our preliminary analyses of our needs beginning in 2010, a permanent base rate increase, of approximately $475-550 million, effective January 1, 2010, is unavoidable.

PEF also believes that it may not be able to continue to provide reliable, efficient, electric service to its customers without a corresponding base rate increase on a limited and/or interim basis in 2009, prior to the Commission issuing a final order in PEF's general base rate proceeding. In 2009, the Company will incur substantial, committed expenses, such as completion of the Bartow repowering mentioned above. Meanwhile, the Company faces substantial decreased sales and statutorily required cash contributions to support PEF's pension fund that are driven by the impacts of the recent financial and credit crises on the economy, both unforeseen events.

With respect to our petition for a general base rate increase, we request that calendar year 2010 be approved as the test year for the Company's next general base rate proceeding. A projected 2010 test year will best fulfill the purpose of a test year, which is to set rates based on costs and revenues that are representative of the period when new rates will be in effect. Compared to a 2008 historic test year, which is the most recent potential historic test year, the costs and revenues of a projected 2010 test year are clearly more representative of the period new rates will be in effect, particularly with respect to the Bartow Repowering and CR3 steam generator replacement projects. A projected test year is also more consistent with addressing cost of service and rate design issues in the period when new rates will be in effect. Consistent with its request for a 2010 test year, PEF also requests approval to use the Company's 2009 budget for the "prior year" and the Company's 2008 actual results for the "historical year" in the preparation of its Minimum Filing Requirements (MFRs) for the base rate proceeding.

In addition, with respect to the Company's request for interim rate relief, the Company requests Commission approval of a fiscal year test period ending December 31, 2008, and will supplement this request as additional actuals are recognized and further degrade the financial integrity of PEF during the pendency of the proceeding.

In view of the expiration of the most recent Stipulation and Settlement and the Company's revenue requirement needs, it is imperative that the Company's base rate proceeding is completed on a schedule that permits the new rates to be effective January 1, 2010. Pursuant to Rule 25-6.140(1)(d), F.A.C., PEF is not eligible under Section 366.06(4), Florida Statutes, to request that its petition be processed as a matter of proposed agency action. PEF requests, then, that the Commission establish the filing date for the Company's MFRs and direct testimony as March 20, 2009, and the date by which the Commission's final decision will be rendered as November 1, 2009.

Thank you in advance for your assistance regarding the foregoing requests. We look forward to your response.

Sincerely,

Jeffrey J. Lyash
President and Chief Executive Officer
Progress Energy Florida, Inc.

cc: Honorable Lisa P. Edgar, Commissioner
Honorable Katrina McMurrian, Commissioner
Honorable Nancy Argenziano, Commissioner
Honorable Nathan Skop, Commissioner
Dr. Mary A. Bane, Executive Director
Patrick L. Imhof, General Counsel
Charles Hill, Deputy Executive Director
Timothy J. Devlin, Director, Division of Economic Regulation
Ann Cole, Director, Division of the Commission Clerk
Apryl Lynn, Director, Division of Administrative Services
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