BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

PETITION FOR INCREASE IN RATES BY PROGRESS ENERGY FLORIDA, INC. — DOCKET NO. 090079-EI

PETITION FOR LIMITED PROCEEDING TO INCLUDE BARTOW REPOWERING PROJECT IN BASE RATES, BY PROGRESS ENERGY FLORIDA, INC. — DOCKET NO. 090144-EI

PETITION FOR EXPEDITED APPROVAL OF THE DEFERRAL OF PENSION EXPENSES, AUTHORIZATION TO CHARGE STORM HARDENING EXPENSES TO THE STORM DAMAGE RESERVE, AND VARIANCE FROM OR WAIVER OF RULE 25-6.0143(1)(C), (D), AND (F), F. A. C., BY PROGRESS ENERGY FLORIDA, INC. — DOCKET NO. 090145-EU

VOLUME 9
Pages 1167 through 1296

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PROCEEDINGS: HEARING

COMMISSIONERS PARTICIPATING:
CHAIRMAN MATTHEW M. CARTER, II
COMMISSIONER LISA POLAK EDGAR
COMMISSIONER KATRINA J. McMURRIAN
COMMISSIONER NANCY ARGENZIANO
COMMISSIONER NATHAN A. SKOP

DATE: Wednesday, September 23, 2009

TIME: Commenced at 2:16 p.m.
Concluded at 5:02 p.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: RAY D. CONVERY
Court Reporter
(850) 222-5491

PARTICIPATING: (As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

NUMBER:		ID.	ADMTD.
36		1212	1212
37		1213	1213
39		1270	1270
83			1224
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275	Excerpt from NARUC Manual	1190	1225
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P R O C E E D I N G S

(Transcript follows in sequence from Volume 8.)

CHAIRMAN CARTER: We are back on the record, and when we last left, Mr. Rehwinkel, you were on cross-examination. Thank you for -- you ended at a perfect time. So I'm trying to keep us on task. You're recognized, sir.

MR. REHWINKEL: Thank you. I appreciate your accommodation, Mr. Chairman.

CROSS EXAMINATION (continued)

BY MR. REHWINKEL:

Q Mr. Robinson, I'd like to ask you, do you ever rely on industry comparisons when testifying on depreciation matters?

A I rely on comparisons, yes, not necessarily as a primary factor. Like I said earlier this morning, that if you have situation where you have no data, certainly that's a compelling reason to look at industry information, but as I started off saying, yes, I do make comparisons from time to time as -- I guess you would say a sanity check or that sort of thing.

Q But is it your testimony that it is not an appropriate tool for depreciation setting if you have sufficient data for the company that your testimony relates to?

A Yes, and I think the key word is "sufficient." You know, you certainly could -- you could maybe have data, an account with data that produces something that seems totally irrational and you would look to industry data to see whether it makes any sense, and in that context it tends to be situations where you have limited retirement data and you get a life maybe of 75 or 100 years that just makes no sense. You typically don't have it on the other end. It's never a case -- it's rarely a case that you have so much data that you indicate a shorter life.

That's pretty obvious, that if the property is experiencing a shorter life, there's drivers there that's driving that and that's -- that activity has occurred, and unless there's some compelling reason to say what's not going to occur anytime in the future, you would be more inclined to rely on that company data that's experiencing that kind of information.

Q Well, haven't you criticized witnesses in the past for using information that -- or for making recommendations that were on -- out of line with what industry ranges for lives would be?

A Yes, I've definitely done that because people -- individuals have come up with -- as I mentioned just in my last response was, just because you do a statistical analysis and you get a life that says -- let's say it's an account that might have a 50-year life and they come up with something that's, say, 70 or 80 years, and you go, "Wait, that just doesn't seem reasonable," so that's where you would go and say, well, is it a fact that there may be factors -- that there was unrecorded retirements or just not a lot of retirements yet, and that would be an issue where we would look at that and say, well, is it rational to believe that that type of account would have that kind of life.

But it rarely -- it's, I would say almost without exception, it would be unlikely that you would have a situation where you would have that much data that would demonstrate that the property is being turned over very rapidly unless there was some compelling reason, a changeout or something that would drive a real short life, but I don't think you'll ever find any place where I've criticized somebody for using too short a life.

Q Isn't it true that your testimony is that the substantiating factors for your net salvage proposals are set forth in Section 8 of your study?

A Yes. That's the statistical analytical data of the historical analysis where we look at the range of data, three-year rolling averages, roll averages or look at recent experience, and also we perform a forecast analysis to identify that level, end-of-life cost removal that's anticipated.

Q Isn't it true that even though you provided some 30 years of historical data, that you only relied on the most recent bands of data for your specific factors for net salvage?

A No, that's not true. We look at a range of data to see what's there. Certainly our policy and practice has been one of looking at the whole range of data, relying, in various cases, on more recent experience that demonstrates that -- where that data is moving, recognizing that the forecast is likely substantially greater, and so it's one of gradualism, if you will, considering recent data and more focused on the recent data, in which case we don't do an arithmetic average.

Secondly, we rarely go to the forecast data, but we consider all those factors in the estimation of that salvage factor.

Q Okay. I think way back at the beginning of that answer I had asked you if you relied on it and you said you looked at it, so my question to you is, for your net salvage recommendations, isn't it true that you relied upon the most recent bands of data for your specific factors that support your net salvage?

A In some cases. I wouldn't say all cases, but often, yes, as I just explained, as we tend to focus on what's occurred in more recent periods as opposed to something maybe 30 years ago.

Q Okay. And say, for example, for Account 365, you utilized or relied upon the most recent bands of data for that net salvage figure, isn't that correct?

A Yes, if you look at Account 3 -- whoops, I've got the wrong page.

If you look at Account 365 on page 8-116 and 8-117, you'll see that the overall average is approximately negative 20 percent. In the early years, back in the '70s, there was a fair amount of positive salvage with some exceptions since maybe the late '80s mid- to late '80s. Many of the years are negative, and we've estimated that a negative 45 percent, recent rolling bands were negative 40, negative 60, and the future forecast is a negative 143.

So yes, we relied on that recent experience to indicate that's a great probability that that's going to be level salvage that's going to be occurring in the future and specifically during the period of time in which these depreciation rates would be in place.

Q I think in a prior answer you used the term *gradualism*, did you not?

A Yes, just in a prior response. I'm indicating that we're looking at all the data, looking certainly at the more recent data, and ultimately, as we progress through, say, this study, the next study or whatever, if we do multiple studies, I'm not saying that we would ever get to the forecast 143 percent, but certainly that weighs in on the consideration of the estimate of net salvage.

Q Now, isn't it true that your study does not contain any discussion with respect to Account 365 of how gradualism applied to your proposal, does it?

A Well, there's discussion, yes, in the testimony that talks about looking at ranges and how we, you know, view the salvage.

Q Okay, let me ask my question again, and again, please try to give me a yes or no and then --

A I thought I did.

Q At the beginning.

With respect to Exhibit 84 -- and again, that's your study, Exhibit 84, correct?

A Okay.

Q With respect to Exhibit 84, there is no discussion of how gradualism plays a part in your determination of the net salvage figure for Account 365, is there?

A There is no specific discussion in that exhibit. In Section 4 there are references to the overall averages, the three-year averages, et cetera. That's in Section 4. And certainly the testimony that was filed with that -- and wait a second, back up.

The study does -- pages 3-10, 11, 12, 13 and 14 have discussions about net salvage and how it's viewed in the context of estimated future net salvage.

Q That's a general discussion about gradualism, is it not?

A It covers the concept of net salvage and estimates, yes.

Q So the answer would be yes, and then that explanation you gave?

A Yes.

Q Okay, so just to be clear, that discussion does not discuss how you arrived at your recommendation for net salvage for Account 365 using gradualism?

A Specific, no, not specific to Account 365, but it sets out the process that is used in all accounts. It is a standard process that's uniformly applied in the process of reviewing historical data and factors considered in estimating net salvage.

Q Okay. Now, I think in response to an earlier question you indicated that for some accounts you used all the historical data for all three bands and some you used the most recent, isn't that correct?

A I said there could be variation depending upon the property account. The majority of them would probably be focused on the more recent experience. That's rather consistent with what we've laid out here in Section 3.

Q But some you used all the historical data and some you used the most recent, correct?

A I think -- yes. I think by and large the overwhelming majority would have been more recent data. We would certainly have to look at the individual accounts, but it's pretty obvious, if you're a depreciation expert and you look at the data, you can see what is being considered. It doesn't -- you know, if you're in that practice and you know anything about depreciation, it's fairly obvious.

Q Okay. And the general discussion of gradualism that you reference in Section 3 would not tell someone when you used gradualism and when you didn't to get from -- to derive your net salvage numbers with respect to any specific account, would it?

A Yes, it would, because the basic principle is one of looking at the range of data, the trends, the gradualism. And certainly, like I said, when you look at the data, it doesn't take very long to recognize what were the driving factors.

Q So just to be clear, you have testified that you did not rely on the full band of historical data for your net salvage analysis, is that correct?

A That is correct. We did not rely on an arithmetic approach to estimating anything in depreciation in the way of lives or net salvage.

Q Can you point to me where in your study where you state that -- and when I say study, I mean Exhibit 84 -- where in your study did you state that you only relied on the more recent bands of historical activity?

A Section 3 lays out the salvage analysis.

Q Okay, so that's where it's stated. Can you read to me from that section where it states that?

A Well, on page -- that's page 3-10, "Net salvage experience is studied for --"

Q And read slow for the court reporter.

A "Net salvage experience is studied for a period of years to determine the trends which have occurred in the past. These trends are considered together with any changes that are anticipated in the future to --" pardon me -- "to determine the future net salvage factor for the remaining depreciation purposes. The net salvage percentage is determined by relating the total positive or negative salvage to the book cost of the property. Many retired assets generate little if any positive salvage; conversely, many of the company's asset properties generate negative salvage at the end of their life as a result of cost removal."

And then it goes on here to discuss the method using for the estimated return on cost.

Q And you're reading on 3-11, now?

A 3-11. Okay, then on the bottom of 3-12, I discuss the circumstance where you need to look at the forecast analysis because if you're looking at property that's retired less than average age -- average age is less than average service life, the future net salvage or negative net salvage would typically be understated. So this is where we take into consideration and look at the recent experience and also we do the forecast to identify what the end of life will be.

Yeah, I guess that's --

Q So that's your answer?

A Right.

Q Okay, so is it your testimony here today that the Commission could turn to each of your salvage summaries in Section 8 of your study and determine specifically how you arrived at each of your proposals?

A It is my -- yes, it is my testimony that a depreciation expert can turn to the study, look at the range of data and rather quickly visualize and interpret what we estimated in the way of net salvage and to either agree or disagree with that estimate.

Q Well, can you turn to, let's say, 353.1, which I think is on 8-74, the summary of it, anyway?

A Excuse me, where?

Q I'm sorry, Account 353.1, Station Equipment.

A What page?

Q In 8, Section 8.

A Oh.

Q I'm sorry. That's 8-74, I believe, 73 and 74.

A Okay.

Q Okay. What is the net salvage you propose for account 353.1?

A Zero percent.

Q And the data in 8-73 and 74 is correct to the best of your knowledge?

A Yes.

Q Wouldn't you agree that the recent bands, all of the recent bands are negative six percent to negative 23 percent for that account?

A Yes.

Q And is your testimony that the Commission, the Commissioners or anyone else could look at that data and arrive at a zero percent net salvage value?

A I believe they could if they were knowledgeable in depreciation analysis. And why I say that is, for a considerable number of years the company experienced a positive salvage for that account, and, as you mentioned, the last three bands were negative. The overall average is 19, just about 20 percent, and going back to the concept of gradualism, the negative net salvage forecast is negative 27, so from a professional analysis point of view, you're saying, well, it's turned from a positive salvage to a negative salvage in being conservative, and, you know, gradualism.

Certainly we said -- well, it certainly isn't -- we don't believe it's appropriate to be positive because it's now turned negative, but -- it's already negative but it's not severely negative for a long duration of time, and that was the basis for the estimate of zero percent.

Q Okay, so everything you just told me, that's all on the pieces of paper that are in Exhibit 84?

A It's there, black and white. It's in data. One can see it. I would anticipate that anyone that is investigating this study would be knowledgeable in depreciation analysis, and if they look and see that I've estimated zero percent, to me -- maybe I'm reading things into it, but to me it's rather obvious that, well, you've experienced positive salvage, it's now turned negative, so certainly zero would be a reasonable, gradual approach in the middle of that estimate.

Q Did you use the word *guesstimated*?

A No.

Q Oh, you said "estimated"?

A Estimated.

Q Okay. That's the way I heard it.

A Sorry.

Q So the last question on that particular account, you're saying the professionals would look at this data and read your section in -- Section 3 and they'd know to stop at zero in their gradualism approach to analyzing your data?

A Personally I believe it's rather obvious, and I expect that parties that would be involved in the review and analysis of depreciation would be equally knowledgeable about depreciation and be able to look at that data. I would expect them to be able -- they may not concur with my same answer, but I could tell them -- I could write them, you know, three -- a six-page -- a six-page discussion and they still may not agree, but it's -- if the data is there to look at, all the calculations are there, so I view that that it's rarely identifiable and easy to either accept or reject the estimate.

Q So is it your testimony that anybody that didn't arrive at zero would be someone that wasn't knowledgeable about depreciation?

A No, I didn't say that. I said that they could either accept or reject my estimate based upon the range of data that's there.

Q Okay. Let me ask you, if you would, please, to go back to Section 8, or if you're still there, turn to pages 132 and 133 in that section, and this would be Account 369.1, Services-Overhead, and let me know when you're there.

A Okay.

Q Okay. What net salvage are you proposing for Account 369.1?

A Negative 50.

Q Okay. And what are the -- and isn't it true that the most -- that the three most recent band results for that account are positive 2.67 and positive 2.67?

A Yes.

Q Okay. And can you describe for me how someone can get from those recent band results to negative 50 percent net salvage?

A Well, "recent" doesn't necessarily mean in the last three, but certainly if you look at this account, it's ranged from -- over the life of the account, it's ranged from negative 22s, going way back into the '70s, it's been as high as over negative 300 -- negative 500 percent in the mid-'90s. Certainly the last couple of years have been moderated. The overall average is negative, almost negative 90 percent. The forecast is negative 281 percent.

So the range, again, the range of the data, certainly I would concur that the last three bands are relatively positive or minorly positive, but the overwhelming data here shows me that that seems unlikely that that's going to continue.

Q Okay. So is it your testimony, just like on the prior account, 353.1, that the Commission could look at Section 8, Section 3 of your study and determine how you got to a negative 50 percent net salvage?

A Yes. And I guess as a sidebar I would say, for instance, if you pulled the TECO study that I talked about this morning, it doesn't even calculate the overall averages that I saw, so -- but -- that's besides the point, maybe, but our information in this report is equal to or greater than any -- in studies, other studies that have been filed before this Commission and I think the data speaks for itself that clearly shows that negative 50 percent is a reasonable estimate for negative net salvage for this account.

Q So is it your testimony that the Commission should look at depreciation and determine it based on the way TECO was done or the way you propose it?

A I didn't say that. I just -- my comment was just that the information that we showed here is no different than other studies that were presented to this Commission, but I stand on the fact that the information in this exhibit clearly supports the estimated negative 50 percent that we estimated. It's quite obvious that it's not unreasonable.

MR. REHWINKEL: Okay. Well, Mr. Chairman, those are all the questions I have on Mr. Robinson's direct. Thank you, Mr. Robinson.

CHAIRMAN CARTER: Thank you, Mr. Rehwinkel.

Ms. Bradley?

MS. BRADLEY: No questions.

CHAIRMAN CARTER: Ms. Kaufman?

MS. KAUFMAN: Thank you, Mr. Chairman. I do have a couple of questions.

/ / / / /

CROSS EXAMINATION

BY MS. KAUFMAN:

Q Good afternoon, Mr. Robinson. How are you?

A Good afternoon.

Q I am Vicki Kaufman. I'm here on behalf of Florida Industrial Power Users Group and we met over the phone as well at your deposition, right?

A Yes.

Q I just have a follow-up question or two in regard to a couple of things that Mr. Rehwinkel asked you, and just so that I understand, he directed you to the depreciation rule, 256 dash -- 25-6.0436.

A Okay.

Q And he asked you what was and was not included in your depreciation study. Do you remember that line of questions?

A In general, yes.

Q Okay. And you referred several times to your work papers that I think you said you provided to staff as a result of their discovery response -- I mean, request?

A Yes.

Q Okay. By those work papers, do you mean the handwritten notes, the yellow handwritten notes that we discussed in your deposition?

A Well, we had handwritten notes, there was statistics runs, there were all the database that was used for the depreciation, an electronic database, all the electronic tables; all the underlying support for the preparation of the depreciation study.

Q The electronic tables were provided?

A There was, if I recall correctly, there was probably an electronic copy of the report, but there were electronic copies of the tables that are in Section 2 that are the summation and the calculation of all the depreciation. There were runs in there, what we call statistics runs, which show all the planned activity, additions, retirements, balances, average age calculations, percent growth. All those type statistical calculations were in there, but there were the handwritten notes that you spoke of, a rather extensive list of items that were provided.

Q Okay, so it was more than just the handwritten notes? That's all I was trying to understand.

A Oh, most definitely. Yeah, they were provided in response to OPC 99, OPC 192, OPC 97, OPC 7, Staff 6, Question 34. That's what I've got written down here.

Q Okay. And everything that you referred to related to a request that a party in this case asked you for, correct?

A That's correct.

Q Now, you mentioned several times the Tampa Electric depreciation study during your discussion with Mr. Rehwinkel, correct?

A Yes.

Q Did I hear correctly that the first time you looked at that study was over this past weekend?

A It was subsequent to the deposition. It was one of those checks to say, okay, if there's a concern about what was filed, I believe that the depreciation study as filed provides all the detail and support for the study in compliance with the rule --

Q Mr. Robinson, excuse me, let me just interrupt you. I simply wanted to ask you if the first time you looked at the Tampa Electric depreciation study was in the couple of days following your deposition.

A Yes, and I was explaining why.

Q You didn't consult that study in preparing any of the materials in this case, did you?

A No. That study probably didn't exist.

Q Are you familiar with the NARUC Depreciation Manual? Is that what that book is?

A Yes.

Q I've never actually seen the entire book.

A It came out -- it was prepared by a NARUC subcommittee and it came out in 1996.

Q Well, I just -- I have an excerpt from there --

A This was a rewrite of the manual that was issued three or four or five times prior.

MS. KAUFMAN: Mr. Chairman, for ease of the record, I'm sure you don't -- well, I think you don't want the whole book, so I have an exhibit that I'd like to distribute, which is an excerpt.

CHAIRMAN CARTER: Okay. And your number?

MS. KAUFMAN: I know we're in the 270s.

CHAIRMAN CARTER: 275, Interstate 275, head to St. Petersburg.

MS. KAUFMAN: And we can just call it Excerpt from NARUC Manual, if that works?

CHAIRMAN CARTER: Okay. Excerpt from NARUC Manual.

(Exhibit No. 275 marked for identification.)

BY MS. KAUFMAN:

Q And, Mr. Robinson, if you want to look in the actual book, I'm going to be looking at -- starting on page 146.

A Okay.

Q Wait until everybody gets it.

CHAIRMAN CARTER: You may proceed.

BY MS. KAUFMAN:

Q If you would look at the third paragraph under Selecting Retirement Dates -- well, let me ask you this first: In your opinion, is the NARUC Manual a reliable source for depreciation experts?

A Yes, it's well-referenced. It certainly considers a lot of different items, and it's really not a textbook that says that, "This is the way you do it," necessarily. It in various cases will lay out some different approaches, some of which may be really antiquated, but it does give you a background of information that's used by many parties.

Q Is it a source that you ever consult?

A Sure.

Q And actually you talk about it on page 5 of your direct, don't you?

A Yes.

Q Take a look at the third paragraph on page 146, and would you read the very first sentence that says, "As indicated"?

A Oh, "As indicated in the above discussion, the final retirement date is the most important factor in the determination of a depreciation rate for the lifespan of properties."

Q Do you agree with that statement in the manual?

A I agree that it's a critical component. Is there a more important component? I can't think of one, but there are other components that are as important as well, but certainly that's -- a final retirement is a very important component.

Q I think we can agree on that. Great.

I wanted -- well, let me ask you this: You are recommending that the Commission approve higher depreciation rates for Progress Energy, correct?

A Overall, yes.

Q And am I right that the magnitude of your overall recommendation is about a $97 million increase in depreciation?

A For the future test year?

Q Yes.

A Yes, I believe it's 97 -- it's 97.355 million.

Q So the company, based on your recommendation, is asking the Commission to include in the revenue requirements for the 2010 test year about $97 million that relates to additional depreciation expense?

A That's the snapshot in time as of 12/31/09. Their actual revenue requirement is likely -- well, I haven't seen the actual revenue requirement schedules. I don't know if that's the exact number that's in there or not. They would have applied the proposed depreciation rates, and in this case, since we've done a *pro forma* future test year calculation, it may be the same. I don't know for certain.

Q Certainly pretty close to 97 million, wouldn't you agree?

A I would think so. I would think so.

Q And just to be clear, that's an additional -- well, that's a portion of the revenue request the company's making that, if it's granted, obviously, the ratepayers are going to be responsible for, correct?

A Yes, and the depreciation recommendation is based upon the standard application of the remaining life method to recover the unrecovered cost over the remaining life to -- from cost-causing customers.

Q I understand that's your position. I'm clear on that.

A Well, that's through the world.

Q Well, you would agree that there are other witnesses that take a different view, correct, in the case?

A Oh, but what I'm claiming is that this is based upon a detailed study of their useful life and the recovery of that cost from customers.

Q I want to talk to you for a moment about -- we got off the track a little bit there, but I do want to talk to you about the determination of the lifespan of the units, which I think we've agreed is a pretty important input to the final depreciation rates, and let me ask you this: I'm correct, am I not, that Progress did not ask you to render an opinion about the lifespan of its assets, is that right?

A Not specifically. They asked me to perform a depreciation study relative to the various -- or the company's plant in service by, you know, each of the property groups. So as part of that task, we needed to develop depreciation rates for each and every depreciable plant account, which includes the production account.

Certainly we weren't tasked with the specific task of, well, you need to determine the proper retirement date for these plants. That's all part of the study process in which we obtain that information through interaction with the company.

Q And that's my point. The company provided you with the lifespans that you then used in your depreciation study, correct?

A Well, they provided us with terminal dates, and as part of that, we, certainly we had different conference calls --

MS. KAUFMAN: Mr. Chairman, I really would wonder if you could direct the witness to try to do our yes-or-no protocol. It would go faster.

THE WITNESS: Yes.

CHAIRMAN CARTER: You can answer yes or no or you don't know. Do that, but then you would be able to explain your answer.

MS. KAUFMAN: Thank you. I appreciate that, Mr. Chairman.

BY MS. KAUFMAN:

Q Mr. Robinson, really all I was trying to find out is, isn't it true that essentially the company provided you with their view of what the retirement lives would be and you incorporated that into the study that Mr. Rehwinkel talked to you about?

A Yes, but we didn't just blindly take it. We had discussions, and what they discussed and demonstrated that -- those numbers seemed to -- or those dates seemed reasonable, and it wasn't something that we said, well, gee, why is -- you know, is it irrational that you've selected this specific date? And so yes, we've -- the data was provided by the company.

Q That was my question.

If you would turn to your direct testimony, sir, page 3, line 18?

Are you there?

A Yes.

Q Okay. And we talked about this some at your deposition. You're talking about the fact that you performed this study and you had discussions to identify prior and prospective factors that affect plant in service. Do you see that?

A Yes.

Q Am I right that when we took your deposition, I think it was actually Tuesday, you couldn't provide any specifics regarding prior factors that affect Progress's plants?

A I would -- excuse me. I don't know. I would have to re-look at the deposition, but it would be my belief that I probably didn't have maybe a specific list of items that you were inquiring about. As I've said, I had a general knowledge of discussions with the company, for instance, the changes at CR 4 and 5, those kind of things, but I didn't have a, quote, unquote, "specific list of items."

Q So your testimony is that when I asked you about this on September 15th, you did not have a specific list of items, correct?

A I did have not a specific list of items, but I did have the knowledge and general understanding of the production facilities and how the company has an ongoing extensive effort in identifying what their needs are.

Q But you didn't have any specific factors, right?

A I did not have a specific list.

Q Now, if you would turn to page 13, line 15, of your testimony, and the question begins on line 8, and then your answer goes on some and actually goes over to page 14, but I want to take a look at line 15 where you're talking about requirements of governmental authorities. Do you see that?

A Yes.

Q And I'm also correct, am I not, that when I asked you what requirements you were referring to there, you couldn't give me any specifics about that, either?

A I don't think that's entirely true. I think I referenced the Clean Air Act and other general items that would affect the company's operating plants, if my recollection is correct.

Q Do you have your deposition with you?

A No, I don't.

Q I think Mr. Rehwinkel will be kind enough to hand you a copy.

A I don't know where that discussion might --

Q I'll show you, sir.

If you'd turn to page 95 of your deposition, and the question begins on line 12, and I asked you: "Do you have any specific information about how the requirements of those governmental authorities have affected Progress?"

And your answer was, "As I said, there's no specific identification of what drives that within the property. It could be a highway relocation, it could be a requirement by a community that they need something changed."

Was that your answer?

A Yes, but -- I said I didn't have a specific list or a specific identification, but this was just a general reference. It could be I was thinking mass property at the time.

Now, the sense that we're talking about generation facilities, you know, certainly the Clean Air Act would be a situation that could be -- well, it definitely is a requirement for a public authority that would drive changes.

Q Well, when you told me on line 16 and 17, you gave the example of highway relocation, but there was no specific highway relocation that you were referring to, correct?

A No, that's correct. That's correct.

Q And on line 17 and 18, you talk about requirement by a community that they need something changed, and there was no specific community requirement that you were referring to there, correct?

A No. And this was -- as I said, this was the context, and I don't know where we were coming from at the time, but this certainly was -- my reference here was certainly in the context of more mass property, and now we've talking here today -- just before this we were talking about generating facilities. So that's just another illustrative item that's considered in the estimate of -- when we're talking about retirement dates, and these are factors that's considered by the company in their ongoing process of analyzing that property and determining what -- their useful life of their property and when they need to change their property out.

Q Yeah, I understand, sir. And just to be clear, so the record's clear, the reference to the requirements of governmental authorities is one that you raised on page 13, line 15, of your testimony, correct?

A Most definitely.

Q I think I might have asked you this in your deposition. Did you review any of the manufacturers' information on any of the plants that are included in your depreciation study?

A No.

Q And just to close the loop and go back to the rule for one second, did you review -- the depreciation rule that we talked about in the beginning, did you review that rule before you prepared your study?

A I've had that copy of the rule, not this specific copy, but I've had that copy of the rule for five years, that I've looked at at various times.

Q Did you review it before you prepared the study that is your exhibit to your testimony?

A Yeah, somewhere along the way I remember seeing it. I don't know -- when specifically, I don't know, but yeah, I've seen it numerous times.

MS. KAUFMAN: That's all I have. Thank you, Mr. Chairman.

CHAIRMAN CARTER: Thank you, Ms. Kaufman.

Commissioner Skop?

COMMISSIONER SKOP: Thank you, Mr. Chairman.

Good afternoon, Mr. Robinson.

THE WITNESS: Good afternoon.

COMMISSIONER SKOP: I just had a few follow-up questions to those that you were asked by Mr. Rehwinkel and Ms. Kaufman.

In response to some -- a line of questioning from Ms. Kaufman, you mentioned detailed depreciation studies. Do you remember that?

THE WITNESS: In what context, sir?

COMMISSIONER SKOP: Just that detailed depreciation studies that were performed, they're very detailed by nature.

THE WITNESS: I guess I don't understand the question.

COMMISSIONER SKOP: Okay, let me just get to the question, then.

With respect to depreciation studies, one of which you performed as part of your exhibits to your prefiled testimony, are these depreciation studies inherently subjective by nature, to the extent that parameters such as depreciation rates, useful life and net salvage value must be assumed by the preparer of the study either individually or in consultation with others?

THE WITNESS: Well, let me -- they are -- yes, they are the product of an individual -- typically not done as a, quote, unquote, "team." It is normally an individual that is explicitly responsible for performing the depreciation study.

COMMISSIONER SKOP: Excuse me, I don't believe that was my question. I asked if they were inherently subjective by nature by virtue of the extent -- the parameters that I mentioned must be selected or assumed by the preparer of the study, so I'm asking if these studies are subjective by nature, a yes or no to that.

THE WITNESS: What, in the sense of whether -- nature in the sense of storms, nature in the sense of what?

COMMISSIONER SKOP: Let me restate my question very slowly and very succinctly.

You performed a detailed depreciation study as part of your prefiled testimony, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: And in that study, as I believe it was indicated on line 3 of your -- I mean, page 3 of your prefiled testimony, in response to a question that Ms. Kaufman directed to you, you mentioned that you consulted with Progress with respect to some of the parameters that might be used in that study, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. My question is, are depreciation studies inherently subjective by nature to the extent that parameters such as depreciation rates, useful life and net salvage value must be selected or assumed by the preparer of the study?

THE WITNESS: The net salvage, yes. The net salvage factors and the average service lives are the two key components that must be estimated by the preparer to drive the other calculations.

COMMISSIONER SKOP: Okay, so in that regard the result is somewhat subjective, based on the parameters or values that are selected, is that correct?

THE WITNESS: Yes. It's -- depreciation is generally recognized as an art, not as a science. It's not an arithmetic exercise. It's not case of adding up three numbers and dividing by three. There is a professional assessment that is completed to look at available data and make estimates of useful life and net salvage.

COMMISSIONER SKOP: Okay, and so in that same regard -- and again, I'm not questioning the analysis, I'm just looking at what variables impact the analysis. So with respect to the study that was performed, if another consultant performed a depreciation study, would it be likely that the results would be different?

THE WITNESS: Yes, there's a high probability that there would be some difference. It's unlikely that they would be identical. It's the matter of interpretation of the data and how much of a difference.

If you said that we should take current

depreciation rates and reduce them to substantially and recommended net salvage factors, for instance, that were rather extensively outside the range just by taking an arithmetic average, or relying on some other company's data, it certainly makes, it in my professional opinion, unreliable in the sense that they were basing information based upon company data that has nothing to do with this company or just maybe doing an arithmetic average or looking at the low end of the spectrum and saying, well, gee, there was the low number, so that's the number we'll use.

COMMISSIONER SKOP: Okay, thank you.

And then with respect to your rebuttal testimony, am I correct to understand that any discussion of theoretical depreciation reserve surplus will be in your rebuttal testimony?

THE WITNESS: That's correct.

COMMISSIONER SKOP: And three additional questions.

If I could turn your attention to page 23 of your prefiled testimony, lines 10 through 16. Do you see that?

THE WITNESS: Yes, I do.

COMMISSIONER SKOP: Okay. With respect to the account 343 which is the prime movers, you indicated that the -- on lines 14 through 16 that the primary driver behind the depreciation rate changes would be the investment on the Bartow plant, is that correct?

THE WITNESS: That's a big part of it, yes.

COMMISSIONER SKOP: Okay. And if I could also turn your attention back to page 31 of your prefiled testimony and lines 22 and lines 23. And I believe in response to Ms. Kaufman's question you indicated that as a result of your depreciation analysis, that there would be an increase of approximately $97 million in depreciation charges that would need to be recovered as of the test year, is that correct?

THE WITNESS: That's correct.

COMMISSIONER SKOP: Okay. And then if I could just ask you finally to turn to page -- or Exhibit MRM-2, and I don't have a specific page, but it's the letter dated 5 March 2009, from AUS Consultants to Mr. Garrett of Progress Energy. Do you see that?

THE WITNESS: No, I don't seem to have that.

CHAIRMAN CARTER: EMR-2?

THE WITNESS: I have a cover sheet for EMR-2, but for some reason I don't have EMR-2.

COMMISSIONER SKOP: Well, we can hold in place and have your counsel provide you a copy.

THE WITNESS: Oh, this is the cover, the

letter of transmittal of the depreciation study.

COMMISSIONER SKOP: Okay, and so you have that letter dated 5 March 2009 before you, is that correct?

THE WITNESS: Correct.

COMMISSIONER SKOP: Do you see the first sentence in the second paragraph of that letter, starting with, "Summary schedules"?

THE WITNESS: "Summary," yes.

COMMISSIONER SKOP: Can you briefly read that sentence as well as the second sentence for me, please?

THE WITNESS: "Summary schedules have been prepared to illustrate the impact of instituting the recommended annual depreciation rates as the basis for the company's annual depreciation expense as compared to the present -- rates presently utilized. The application of the present rates to the depreciable plant in service as of December 31, 2007, results in annual depreciation expense of 279,642,546."

COMMISSIONER SKOP: Thank you.

Can you briefly comment on the significance of those two sentences to the extent that some attempt is being made to illustrate the impact and what the significance of that may be for a prior year?

THE WITNESS: That's strictly the historical results at 2007, and that just shows -- what we do is we prepare a depreciation schedule that shows the impact of the depreciation, proposed depreciation rate changes, and so we apply those to the plant in service balance as of historic, and also we later on provide that calculation based upon the future test year, and it shows that if you take the historical rates and apply them to plant in service and you take the proposed rates and apply them, that's the impact of the depreciation expense rate, the depreciation rate change.

COMMISSIONER SKOP: Okay. And is that statement merely used to illustrate the change in depreciation, or would it also allude to the ramifications of making such a change on financial statements?

THE WITNESS: This is merely the snapshot presentation of what change in annual expense do the changes in individual rates drive.

COMMISSIONER SKOP: Okay, but if the rates were changed or adoption of the rates were changed and retroactively applied, could that theoretically impact --

THE WITNESS: Oh, I see where you're coming from, sir.

This is kind of different from a normal study. We typically only do historical. In some jurisdictions we do a *pro forma*, as we do here in Florida. We're forward-looking to 2009. Normally the reference to the historical is the date of the study, where in Florida and Pennsylvania and several other cases we had a future test year calculation to recognize the pending additions of substantial plant. And so the truer comparison really is the future test year. We're not talking about going retrospectively back to the historic level, because revenue requirements will be driven by the future test year number. In other cases where they're doing a historic test year, that would be the driver on the historic data.

COMMISSIONER SKOP: Okay, and that was my point was to try to get a better understanding, because I believe that the historical test year would have been 2008, but when I saw it go back to 2007, I was taking a -- trying to understand that a little bit better.

THE WITNESS: Yes. 2007 is in there because that's the historic information that we have that's on the company's books and records, and as well the baseline for the depreciation analysis because the 2008 and 2009 data are -- while some of it is actual, principally when we did the study, the bulk of it was all budgeted data, so we were -- needed to develop a future test year calculation and roll that forward and get plant in service by account and remaining lives and develop rates for each account on a *pro forma* basis.

COMMISSIONER SKOP: And -- very well, and, like I say, I just was trying to get a high level understanding of some of the discussion in terms of the sensitivity of the various studies as it relates to the input variables selected, and then drill down into granularity, like Mr. Rehwinkel, but again, I think it's important to have a comprehensive understanding as to the significance of the testimony. So I appreciate your time. Thank you.

THE WITNESS: Yes, sir, I apologize that I was not catching on there.

CHAIRMAN CARTER: Ms. Evans?

MS. EVANS: No questions.

CHAIRMAN CARTER: Mr. Wright?

MR. WRIGHT: Thank you, Mr. Chairman. Just a couple of questions.

CHAIRMAN CARTER: You're recognized.

CROSS EXAMINATION

BY MR. WRIGHT:

Q Good afternoon, Mr. Robinson. I'm Scheff Wright and I represent the Florida Retail Federation in this case. I really just have a couple of questions for you.

You work for AUS Consultants, you're a director and principal for AUS Consultants, correct?

A Yes, I've been with AUS Consultants for -- and its predecessor -- since 1971.

Q Congratulations. Good for you.

Is that the same company that I hear about in other contexts that prepares analyses of rates of return, studies of earnings per share growth, dividend growth, all that stuff?

A We have a publication. That may be what you're referring to. It's called the *AUS Monthly* that we -- yeah, rates of return and all the statistics relative to -- that's kind of a rate return group and a spinoff of that.

Q Thank you. And that's the publication that's sometimes used by rate of return witnesses in proceedings like this, correct?

A That's correct.

Q Do you or your colleagues within AUS ever use that in these kind of proceedings?

A Well, from a depreciation standpoint -- no, from a depreciation standpoint, no, because, other than the fact of having net plant and maybe plant per customer, there's not a lot of -- really no depreciation statistics in there, but our rate of return people often refer to it because that's a synopsis of -- a gathering of all the information relative to various operating companies of which they're getting less and less, but --

Q But the second part of your answer was the answer to the question I was asking?

A Yeah.

Q And would it be your position that those reports are as good and accurate as AUS can make them?

A Well, I can't honestly speak -- as an AUS employee, I would say definitely yes, but given that I'm not part of the development process and part of that, I can only verify for our effort as a company to provide good product, and, you know, be valid and accurate.

Q All right, thank you.

MR. WRIGHT: That's all I had, Mr. Chairman. Appreciate it.

CHAIRMAN CARTER: Thank you, Mr. Wright.

Staff?

MS. KLANCKE: Mr. Chairman, I would like to address the exhibits of this witness first.

With respect to Staff's Composite Exhibit, Exhibit No. 36, I'd like to note for the record that staff no longer wishes to include PEF's Response for Staff's 11th Request for Production of Documents No. 60, contained in Item No. 13 of Exhibit No. 36.

CHAIRMAN CARTER: So take out No. 60?

MS. KLANCKE: No. 60.

CHAIRMAN CARTER: Okay.

MS. KLANCKE: With that change, it is my understanding that the parties have agreed to the entry of Exhibit 36 into the record.

CHAIRMAN CARTER: Is that the understanding of the parties?

MR. WRIGHT: Yes, sir.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit No. 36 marked for identification and admitted into the record.)

MS. KLANCKE: In addition, it is my understanding that the parties have agreed to the entry of Exhibit No. 37 into the record as well.

CHAIRMAN CARTER: Okay hang on a second. Let's all get over there.

Are there any --

MS. KLANCKE: There are no changes.

CHAIRMAN CARTER: No changes? Is that the understanding of the parties on Exhibit No. 37?

MR. WALLS: Yes, sir.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit No. 37 marked for identification and admitted into the record.)

MS. KLANCKE: In addition, I have a few brief cross-examination questions for the witness.

CHAIRMAN CARTER: You are recognized.

CROSS EXAMINATION

BY MS. KLANCKE:

Q Good afternoon, Mr. Robinson.

A Good afternoon.

Q My name is Caroline Klancke, and we met telephonically during your deposition.

A Yes.

Q Earlier today in Mr. Rehwinkel's cross-examination of you, you stated that you were aware that this Commission requires electric companies to file depreciation studies once every four years from the -- at least once every four years from the submission date of the previous study unless otherwise required by this Commission, is that correct?

A Yes. And I believe that's listed right in the requirements.

Q In the rule?

A In the rule, yeah.

Q Are you aware that in Florida depreciation studies have not historically triggered rate proceedings, and conversely, revenue rate proceedings have not triggered depreciation studies?

A As I understand it, that's the general -- yes, as I understand it, that's the general rule, except that the last two cases -- the prior case for Progress Energy, which was settled, happened to be linked to a case, but it's my understanding that depreciation studies are usually independent of a rate case.

Q And you prepared PEF's 2005 depreciation study, is that correct?

A That's correct.

Q And as you stated just now, that study was settled as part of a stipulation, is that correct?

A That's correct.

Q Prior to 2005, PEF also reached a rate case settlement in 2002, is that correct?

A That's before my presence on the -- with the client. It's my general understanding that's the case.

Q As part of that 2002 settlement, PEF was allowed to reduce depreciation expense by approximately 69.5 million each year of the stipulation with the ability to reverse all or part of that amount, is that correct?

A That's any understanding, yes.

Q To your knowledge, did PEF reverse any of that annual depreciation expense credit?

A I'm not aware, but as a matter of fact, I believe that was booked to detail accounts in the early part of 2006.

Q In the instant proceeding, PEF is opposed to the creation of an annual depreciation expense credit, is that correct?

A That's correct, but that's a totally different circumstance. 2002 was a rate settlement. Certainly when you do a rate settlement there are many things that come into play with that decision to accept certain parameters. That doesn't necessarily mean that the company would have otherwise. If it would have been litigated, they would have accepted that reduction as part of a litigated case. It was part of the settlement. So you do things in settlements that you normally -- oftentimes do not occur under different circumstances.

Q That's fair enough.

Mr. Robinson, I'd like you to refer to Table 5-F of your Exhibit EMR-2, and in particular page 2 of 74. Please let me know when you are there.

A 2 of 74?

Q 2-74.

A I'm there.

Q I'd like you to look at the estimated book reserve at 12/31/09. It's in Column G. Do you see that?

A The book reserve, yes.

Q Book depreciation reserve 12/31/09 in Column G.

A Yes.

Q If we look down that column, we see several accounts with negative reserve amounts. Do you see those?

A Yes.

Q The first of these negative reserve amounts is for Avon Park Steam for Account 311. Do you see that?

A Yes.

MS. KLANCKE: At this time I would like co-counsel to pass out a document. I'd like to note for the clarity of the record that this is Staff's 20th -- PEF's Response to Staff's 29th Set of Interrogatories, No. 336. This is included in Item No. 7 of Exhibit 36 which we have previously discussed.

CHAIRMAN CARTER: Okay.

MS. KLANCKE: This is purely for cross-examination purposes, and does not require --

CHAIRMAN CARTER: Hang on a second. Do you have it?

THE WITNESS: I was looking for my pencil.

That exhibit number is going to be what, or it's not an exhibit?

MS. KLANCKE: It is contained in Staff's Composite Exhibit No. 36, but that is for ease of reference.

CHAIRMAN CARTER: You may proceed.

BY MS. KLANCKE:

Q From your response to staff's 29th set of discoveries, No. 336, which I just had passed out, I understand that this amount for Avon Park Steam is an error, is that correct?

A Yes.

Q And that information can be gleaned from looking at 336 and in the response in Section A, is that correct?

A That is correct.

Q What is the correct book reserve for Account 311 for Avon Park Steam as of 12/31/09?

A It was apparently $5,410,811.

Q Was it negative?

A Yes.

Q There are also negative reserve amounts -- turning back to page 2-74 and keeping this response in front of you, there are also negative reserve amounts for Bartow, Accounts 312, 314 and 316, denoted in this page. Do you see that?

A Yes.

Q These negative reserves are a result of the Bartow plant retiring and it was not fully recovered, is that correct?

A That's -- yes, that is the typical case. If you have a plant that comes to the end of life and you have a cost removal component typically that's charged against the reserve, and -- or it could just be retirement, if you don't have it fully reserved at the time, there often could be a modest, small amount -- and this is a relatively small amount of money -- that resides in that reserve account for that particular location. That's a common problem that exists -- or an issue, not a problem, but is a common issue that exists when you try to segment account level rates down into small subcomponents.

Normally in group depreciation you apply a depreciation rate and the reserve continues to flow according to whatever's the product of the transactions. But if you segment it down to the point of individual plants or units within a property group, there's going to be a point in time at the end, it's not going to be identical. You know, you're not going to have a situation that you have necessarily down to the dollar that's retired -- accrued before you have it retired. So you could have a situation where you didn't have it all accrued, and it's usually a relatively modest amount.

Q So the answer to my question was yes, correct?

A I said yes.

Q Do these negative reserves create a positive rate base component that is included in the calculation of revenue requirements?

A Yes, because that amount hasn't been recovered, and the way that we address the -- for instance, Bartow, we distributed that reserve to the other sites or the other plants within those property accounts and recovered those dollars over the remaining life of the remaining property group.

Q Okay. So that I understand, these negative reserve amounts are associated with plant that is no longer serving the public, is that correct?

A That's true. That's no different than, for illustration, let's say we have a pole, a single pole. It was placed into service in 2000. It has a 29-year life. At 2009 a vehicle hit that pole and it was retired. There would be a residual unrecovered component that would end up in the reserve.

This is no different. It just so happens this is a production plant as opposed to a mass property item.

Q Okay. But with respect to Bartow Steam Accounts 312, 314 and 316, if you'll turn to Response C to Interrogatory 336, it specifies, quote, "The plant balance forecasted in Answer B will not be providing service to the public, as it was retired in June, 2009." Do you see that?

A Correct, yes.

Q And that is correct, is it not?

A That is correct, it was retired. And it goes right back to my pole illustration. That pole that was retired no longer is in service. It's the function of group depreciation. You retire it. What's the unresidual, unrecovered component gets recovered over the remaining life of that asset, over that property group, standard group depreciation concepts with remaining life technique.

You're always -- it's rare -- it would be an accident of history, an accident of coincidence if you have anything that is retired that is exactly recovered. It just doesn't happen.

Q Fair enough.

In this proceeding you are not proposing a depreciation rate for those accounts, Account 312, 314 or 316 for Bartow, is that correct?

A That is correct. As I previously mentioned, we took those limited residual dollars, distributed them to the other properties within that plant account, and those residual amounts are being recovered over the average remaining life of the remaining property within those property groups.

Q So your proposal is for the company to earn on plant that is not serving the public, is that correct, in this instance?

A Yes, that's true in that context, but again, keep in mind, we're talking about group depreciation methods. It is a standard process to recover unrecovered cost over the average remaining life of property. Each and every property group experiences that same identical circumstance.

Q Okay, just a few more questions.

I would like to turn your attention back to Mr. Rehwinkel's cross-examination. During his cross-examination, you stated that the backup or support for your depreciation study was your work papers that were filed in response to discovery. Do you remember that?

A Yes.

Q Would you agree with me that over 160

interrogatories or requests for production of documents were sent from staff regarding your filed depreciation study, subject to check?

A There was a bunch of them, yes.

Q It could be fairly characterized as a bunch.

Also in response to Mr. Rehwinkel's cross-examination questions, you stated that after your deposition you compared your depreciation study with the one that was approved for TECO in 2008. Do you remember that?

A Yes.

Q Would you agree, subject to check, that that was the depreciation study that was filed in Docket No. 070284-EI?

A I don't have the docket number, but it was a recent docket.

Q Do you recall stating that the Commission approved TECO's depreciation study in that docket?

A I was informed that that was the case.

Q Are you aware that in this docket the Commission approved the staff-recommended depreciation rates, recovery schedules and reserve transfers rather than those TECO had proposed?

A I was not -- I was informed that it was approved by the Commission. I was looking at that document for the -- in the context of seeing what was in that document as compared to what was contained in your document as far as the issue of the Commission rules and what needs to be -- just to verify that, yes, our study in fact does have equal or more detail in our study than that particular study.

Q Fair enough.

MS. KLANCKE: Mr. Chairman, I have no further questions for this witness at this time.

CHAIRMAN CARTER: Thank you.

Commissioners, anything further from the bench?

Redirect?

MR. WALLS: Just one question.

CHAIRMAN CARTER: Okay.

REDIRECT EXAMINATION

BY MR. WALLS:

Q Mr. Robinson, you were asked about the $97 million increase in depreciation expense. Do you recall that?

A Yes.

Q What would be the impact of $2.5 billion in plant additions on depreciation expense requirements?

A Well, certainly it would depend. That's hard to say, because it depends on where those 2.5 billion dollars went, and which -- a lot of that's going to be CR 4 and 5 and other components of production. So that would be a major contributing factor to that calculation.

It's hard to delineate or specifically identify the cause-and-effect relationship because it's made up of many components within the various lives of property accounts, but clearly 2.5 billion of new assets is going to have a contributing factor.

MR. WALLS: No further questions.

CHAIRMAN CARTER: Exhibits?

MR. WALLS: Yes, we have Exhibits 83 and 84 and --

CHAIRMAN CARTER: Are there any objections?

MR. WALLS: -- Exhibit --

CHAIRMAN CARTER: Whoa, whoa, whoa, whoa.

MR. WALLS: There's one more. Exhibit 273.

CHAIRMAN CARTER: No, no, hold on. Hold it. Hold the phone.

83 and 84, are there any objections?

Okay. Without objection, show it done.

(Exhibit Nos. 83 and 84 admitted into the record.)

CHAIRMAN CARTER: Now you're recognized, Mr. Walls.

MR. WALLS: There was one further exhibit, Exhibit 273.

CHAIRMAN CARTER: 273, are there any objections? That's the errata.

Without objection, show it done.

(Exhibit No. 273 admitted into the record.)

CHAIRMAN CARTER: Mr. Rehwinkel is not here. He had -- I know 274 was his. We'll just wait for him to come back and we'll talk to him about that. I don't know if he wants to move that in or not or a motion. We'll deal with that at an appropriate time.

Ms. Kaufman, you've got 275.

MS. KAUFMAN: Yes, Mr. Chairman. I would move 275.

CHAIRMAN CARTER: Are there any objections?

MR. WALLS: No, no objections.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit No. 275 admitted into the record.)

CHAIRMAN CARTER: Perfect timing, Mr. Rehwinkel.

MR. REHWINKEL: I'm not going to move that exhibit, Mr. Chairman.

CHAIRMAN CARTER: Okay. Thank you, sir, thank you very kindly.

Anything further on direct for this witness?
Thank you sir. You may be excused.
Call your next witness.
MR. WALLS: We call Mr. Sullivan.
CHAIRMAN CARTER: Also, while Mr. Sullivan is coming, just kind of a by way of letting you guys know, I did promise you an afternoon break. My goal is to -- if we can get to 5:00, because that's when we're going to change out court reporters, if you guys can hang on that long.
Of course, to any of the parties, if you need a break before then, just give me -- let me know and we'll be able to do that. Okay? Any burning issue, or you guys need to huddle or something like that, we can do that, but my goal is to stop at 5:00 for a break, a court reporter break, and in fact we're going to change out court reporters at that point in time and then we'll go for the duration. Okay.
Anything further on preliminary matters?
Okay, Mr. Walls.
Whereupon,
THOMAS R. SULLIVAN
was called as a witness on behalf of Progress Energy Florida, having been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. WALLS:

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

A Yes. My name is Thomas R. Sullivan. My business address is 410 South Wilmington Street, Raleigh, North Carolina.

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

A I hold the position of Treasurer at Progress Energy Florida, or PEF. I am also Vice-President and Treasurer and Chief Risk Officer of Progress Energy Service Company. Progress Energy, Inc., is the holding company that owns Progress Florida Corporation, the parent of PEF, and Progress Energy Service Energy.

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

A Yes, I did.

Q And do you have your prefiled direct testimony and exhibits with you?

A Yes, I do.

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

A No, I do not.

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

A Yes.

MR. WALLS: We request that the prefiled direct testimony be entered in the record as if it was read.

CHAIRMAN CARTER: The prefiled testimony of the witness will be inserted into the record as though read.

In re: Petition for increase in rates by Progress Energy Florida, Inc.
Docket No. 090079-EI

DIRECT TESTIMONY OF THOMAS R. SULLIVAN

Q. Please state your name and business address.

A. My name is Thomas R. Sullivan and my business address is 410 S. Wilmington Street, PEB 19A3, Raleigh, North Carolina, 27601.

Q. What is your position with Progress Energy Florida?

A. I hold the position of Treasurer at Progress Energy Florida, Inc. ("PEF" or the "Company"). I am also Vice President – Treasurer and Chief Risk Officer of Progress Energy Service Company. Progress Energy, Inc. is the holding company that owns Florida Progress Corporation, the parent of PEF, and Progress Energy Service Company.

Q. Would you please briefly outline your qualifications and professional experience?

A. I came to Carolina Power & Light Company as Manager – Financial Operations in November 1997 and was later promoted to Vice President and Treasurer of Progress Energy in 2001. I am responsible for all capital raising activities for Progress Energy and its subsidiaries. As Treasurer and Chief Risk Officer, I have responsibility for Financial Operations, Corporate Insurance, Financial Analysis, Investment Management, and Enterprise Risk Management. My responsibilities require that I have a detailed understanding of the capital markets and study the reports and publications of rating agencies, banks, investment bankers, and others on the capital markets in general and public utilities in particular. In doing so, I rely not only on my own experience and personal knowledge, but also on the experience and knowledge of these other market participants.

Prior to joining Carolina Power & Light Company, my seventeen years of business experience included serving as Director - Treasury Capital Markets at Visa International Service Association, Assistant Treasurer of LB Credit Corporation, various financial positions within Signal Capital Corporation, and fixed income analyst at Liberty Mutual Insurance Company.

I have a bachelor's degree from St. Lawrence University and a master's degree in business administration from Northeastern University.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to explain the capital structure PEF requires to ensure that PEF maintains continuous access to capital markets to obtain capital at a reasonable cost when that capital is needed to meet our customers' energy needs. As Treasurer, I am responsible for PEF maintaining continuous capital market access throughout the business cycle, including times of volatile capital markets. To do so, I must maintain PEF's capital structure in a manner which supports our target credit rating. Importantly, I must account for the impact of rating agency adjustments for long-term purchase power contracts ("PPAs") to preserve the Company's target credit rating and, thus, financial health. I will explain that maintaining PEF's targeted credit rating in the event of these rating agency adjustments is essential when the Company is faced with increasing capital expenditures for environmental compliance, reliability measures, and base load, nuclear and other generation to meet customer demand for clean, reliable power. Similarly, I will explain the importance of cash flow to our financial health during PEF's current capital expenditure program to satisfy customer energy needs and meet federal and state energy policy objectives.

Q. Do you have any exhibits to your testimony?

A. Yes, I have the following exhibits to my direct testimony:

- Exhibit No. ___(TRS-1), Moody's Industry Outlook – U.S. Electric Utility Sector, January 2008;
- Exhibit No. ___ (TRS-2), Regulated Utilities - Capital Consequences, Dan Ford, CFA, Lehman Brothers, June 3, 2008;
- Exhibit No. ____ (TRS–3), Moody's Global Infrastructure Special Comment, "Near-Term Bank Credit Facility Renewals Expected To Be More Challenging for U.S. Investor-Owned Electric and Gas Utilities," January, 2009;
- Exhibit No. ____ (TRS-4), Bank Consolidation Diagram, St. Petersburg Times, February 22, 2009;
- Exhibit No. ___ (TRS-5), "Challenges in Energy Financing," Michael G. Haggarty, Vice President/Senior Credit Officer, Moody's Investors Service, 36th Annual Public Utility Research Center Conference, February 5, 2009;
- Exhibit No. ___ (TRS-6), Transcript and certain testimony and exhibits from the proceeding In the Matter of Credit and Capital Issues Affecting the Electric Power Industry before the Federal Energy Regulatory Commission (FERC), January 13, 2009;

- Exhibit No. ____ (TRS-7), Schedule of Key Credit Ratios;
- Exhibit ____ (TRS-8), "A Fresh Look at U.S. Utility Regulation," Standard & Poors, January 29, 2004;
- Exhibit No. ___ (TRS-9), Standard & Poor's Methodology for Imputing Debt for U.S. Utilities Power Purchase Agreements, May 7, 2007;
- Exhibit No. ___ (TRS-10), Standard & Poor's, U.S. Utilities Ratings Analysis Now Portrayed in The S&P Corporate Ratings Matrix, November 30, 2007;
- Exhibit No. ___ (TRS–11), Standard & Poor's Ratings Direct - Progress Energy Florida credit report, February 4, 2009; and
- Exhibit No. ___ (TRS-12), Moody's Investors Service Credit Opinion: Progress Energy Florida, Inc., August 28, 2008.

These exhibits are true and accurate.

Q. What are the current long and short-term credit ratings for PEF?

A. The following table summarizes the credit ratings for PEF for each of the three major rating agencies which currently rate PEF's debt.

	S&P	Moody's	Fitch
Senior Unsecured	BBB+	A3	A
Senior Secured	A-	A2	A+
Short-term debt	A-2	P-2	F-1

Q. What is PEF's target credit rating?

A. The target, long-term credit rating for PEF is mid-single A from each of the three rating agencies that perform credit analysis on PEF -- Standard & Poor's Rating Service ("S&P"), Moody's Investors Service ("Moody's") and Fitch Ratings ("Fitch"). This long-term rating generally correlates to the top tier for short-term debt ratings which are A-1, P-1 and F-1 for S&P, Moody's and Fitch, respectively. As you can see, PEF has not achieved its target credit rating consistently from all three credit rating agencies.

Q. Why is it important to obtain a consistent, target credit rating from all three rating agencies?

A. First, the ratings methodologies used by each of the three agencies are not the same. As such, some investors may value one rating agency's approach over another. Having a consistent rating across all three rating agencies helps ensure PEF is viewed favorably regardless of an investor's preference among the rating agencies.

Second, investors distinguish between companies with split ratings versus companies who have the same rating across all rating agencies. The lower rating in a split rated company will result in a higher cost of debt for that company. In essence, the lowest credit rating from the rating agencies becomes the more critical rating when the company seeks access to capital in the capital markets.

Q. Why is it important for PEF to obtain a mid-single "A" long-term rating?

A. A mid-single A long-term credit rating is a strong credit rating. A strong credit rating is important because it provides PEF access to low-cost debt under all capital market conditions, including difficult market conditions like the conditions we face now. PEF must have continuous access to low-cost debt because the electric utility industry is a capital intensive industry. As with any capital intensive industry, the ability to maintain and expand assets to meet current and future business needs necessitates frequent access to the capital markets.

In particular, our industry requires capital market access through all phases of the economic cycle. We cannot easily adjust our capital expenditure programs when poor economic conditions would otherwise dictate us doing so because we have a statutory obligation to serve our customers. We must continue to provide reliable electric service to new and existing customers. This means we must continually acquire funds to maintain our existing generation, transmission, and distribution systems and to fund the expansion of our system to meet the demands of a growing customer base and growing customer demand for energy.

Additionally, we face increasing costs to meet federal and state environmental and energy policy requirements. For example, we continue to incur increasing compliance costs to meet new environmental standards. We also face additional federal and state transmission and distribution reliability standards, such as the storm hardening programs in Florida, that require additional capital investment in our system. Important too is our efforts to potentially add new nuclear generation to PEF's fleet of base load generation assets to add reliable base load power to meet customer energy needs with a clean, carbon-free energy source. Nuclear generation is part of our balanced solution that is consistent with state energy policies encouraging nuclear development. Toward this goal, the Florida Public Service Commission (the "Commission" or "PSC") approved last year PEF's Determination of Need to build two 1,100 MW nuclear units in Levy County, Florida. PEF continues to move forward with its plans to construct these units, but in doing so, the capital expenditures required for a project of this size and duration has become a concern among members of the financial community including rating agencies, banks, and bond and equity investors.

These unique capital requirements require a strong credit rating like our target mid-single A rating. A strong credit rating will reduce the risk to a manageable level that PEF may not have continuous access to the capital markets to fund its capital obligations or to fund them at a reasonable cost to our customers. I believe a mid-single A credit rating reduces that risk to a reasonable level and best positions PEF to have sufficient access to the capital markets under all market conditions.

Q. What indications have you seen that the financial community is concerned with the impact of nuclear generation projects on utilities pursuing plans for such projects?

A. All three rating agencies view the addition of nuclear generation as increasing the business risk profile of a utility. For example, Moody's states in its January 2008 Industry Outlook for the US Electric Utility Sector, see Exhibit No. ___(TRS-1), Moody's Industry Outlook – U.S. Electric Utility Sector, January 2008, p. 12:

Although Moody's generally maintains a favorable view towards nuclear generation, companies that are actively pursuing new nuclear generation will experience a significant increase to their overall business and operating risk profile. This increase is primarily attributed to the long-term approval process and construction cycle risks associated with building a new nuclear facility and the inability to accurately predict all-in costs (and the ultimate impact to consumers) at this time, thereby raising recovery overhang risk. Regardless of whether or not federal loan guarantees will be commercially available ……, utility companies interested in new nuclear generation *plants should have sufficient financial strength to weather possible delays and cost over-runs.*

The importance of financial strength for utilities pursuing nuclear generation development plants noted by Moody's is important to equity investors as well as rating agencies. As explained by Dan Ford, CFA and Lehman Brothers utility sector analyst, see Exhibit No. ___ (TRS-2), Regulated Utilities - Capital Consequences, Dan Ford, CFA, Lehman Brothers, (Sector View – Capital Consequences, June 3, 2008), p. 15: *"In 1970, almost all utilities had a credit rating of single A or better. Going into this cycle, less than one-third are A or better."* Also, at p. 5, Mr. Ford sums up, *"Overall, we believe the most likely winners will be those firms coupling attractive valuation with the best balance sheets, best regulatory circumstances and most disciplined project management skills."*

Rating agencies and equity investors, therefore, expect utilities with plans for nuclear development or other large generation and/or transmission development projects to have strong credit ratings to offset the risks they perceive exists with such projects. In fact, the three other utilities located in the Southeastern United States currently planning to build similar nuclear plants to PEF's Levy nuclear units, FPL Group, SCANA Corp., and Southern Company, are all rated A or A- by S&P.

Q. Are there any other reasons why a mid-single A long-term credit rating is important to PEF and its customers?

A. Yes. Another important reason for having a mid-single A long-term rating is that this rating generally equates to a strong short-term credit rating. All three rating agencies explain that since both the short-term and long-term ratings are based on the same credit characteristics, a correlation exists between the long-term and short-term rating.

Having a strong short-term credit rating (A-1, P-1 and F-1, respectively) provides greater access to the commercial paper market than lower short-term credit ratings. This is particularly true during difficult market conditions. When PEF cannot access the commercial paper markets it is forced to borrow under its backup credit facilities, which is usually a higher cost source of borrowing.

The commercial paper market is a low-cost source of short-term liquidity. Having access to the commercial paper market is critical to minimizing borrowing costs to our customers. A strong short-term rating means greater access to a broader group of commercial paper investors and, therefore, greater access to the relatively lower cost source of capital in the commercial paper market.

Additionally, the sub-prime mortgage crisis and the resulting impact on the credit markets further emphasizes the importance of having a strong balance sheet and cash flow. While these recent market conditions are truly unique, there have been other, less dramatic occasions when events have disrupted access to the capital markets. Having a top tier short-term rating and consistent long-term credit ratings will improve PEF's access during volatile market conditions and lower its cost of borrowing.

Q. Can you provide some market information you have seen that explains how constrained the capital markets may be for both short- and long-term utility liquidity needs?

A. Yes. In a recent January 2009 Special Comment issued by Moody's on near-term bank credit facilities for United States Investor-Owned Utilities, Michael Haggarty, Moody's

Vice President and Senior Credit Officer, explained that the 2008 economic and financial market events materially changed the banking environment for utilities going forward. Bank and other financial institution failures, government intervention in financial institutions, and large-scale mergers led to a significant contraction in the credit market that is available to utilities. See Exhibit No. ___ (TRS-3), Moody's Global Infrastructure Special Comment, "Near-Term Bank Credit Facility Renewals Expected To Be More Challenging for U.S. Investor-Owned Electric and Gas Utilities," January, 2009. Simply put, there are fewer banks and financial institutions and they have less credit to provide utilities and others in search of credit facilities. This is dramatically demonstrated by Exhibit No. ___ (TRS-4) to my testimony, which compares the number of financial institutions and their value in billions of dollars in January 2007 and February 2009. As shown there, there were 22 major banks with a combined value in excess of $1.9 trillion in January 2007; by February 2009 there were 16 with a combined value of just $349 billion. The information in Exhibit No. ___ (TRS-4) is consistent with other industry information I have reviewed regarding the extent of the impact of the financial crises on available credit.

The impact on available credit has been significant. As Mr. Haggarty points out, banks will be less inclined to lend credit or price credit facilities on the previously experienced competitive terms as they focus on their own balance sheets. As a result, broad "repricing" of bank credit has commenced, which will lead to sharply higher pricing for bank credit facilities. See Exhibit No. ___ (TRS-3), Moody's Global Infrastructure Special Comment, p. 3. This is particularly important to Investor-Owned Utilities that face "Key Challenges" that Mr. Haggarty outlined in a presentation at the Public Utility Research Center Conference in February 2009, such as the potential for significant environmental legislation and sizeable infrastructure investment plans, among others. As Mr. Haggarty explained there, maintaining unfettered access to capital markets is key for utilities facing these challenges. See Exhibit No. ___ (TRS-5), "Challenges in Energy Financing," Michael G. Haggarty, Vice President/Senior Credit Officer, Moody's Investors Service, 36th Annual Public Utility Research Center Conference, February 5, 2009. Mr. Haggarty's comments are consistent with others that I have reviewed in the industry and I agree with them. PEF faces those same challenges, for example potential significant environmental legislation and sizeable infrastructure investment plans including base load nuclear generation, and maintaining unfettered access to the capital markets, including bank or other financial institution credit facilities, will be a key to PEF's success.

Q. Why do you believe a consistent, mid-single A credit rating will strengthen PEF's access to capital and lower its cost of borrowing?

A. The market upheavals and resulting economic downturn has created economic conditions where credit has been constrained, as liquidity has tightened on both a long- and short-term basis, and where uncertainty has further gripped the markets. Utility debt and equity markets are experiencing more regular and wider volatility as a result. The spread between government-backed treasury securities and utility bonds increased dramatically, and currently fluctuates at spreads greater than those experienced in the last decade or more, and remains volatile today. Similarly, utility stocks have fallen dramatically, remain volatile, and have not achieved price stability. The volatility and uncertainty in the markets for utility debt and equity issuances, it seems, will be with us for some time.

Under such conditions, debt and equity utility investors require compensation for the market volatility and uncertainty before they will invest in utility bonds and utility stock. Utilities with stronger credit ratings, such as the single A rating targeted by PEF, can expect to pay a lower premium to these investors for this volatility and market risk than utilities with weaker credit ratings. Indeed, faced with the market volatility and uncertainty, utilities with lower investment grade ratings face a greater risk of a potential downgrade and, consequentially, weak or restricted access to the capital markets and even higher cost of capital. In these economic conditions, utilities like PEF must maintain a strong capital structure and strengthen their credit ratings to compete for the debt and equity capital they will need at a reasonable cost.

Q. Is there industry support for the view that a single A credit rating improves access to capital and lowers borrowing costs?

A. Yes. Other market participants have reached the same conclusion. The Federal Energy Commission (FERC) held a hearing on January 13, 2009 on credit and capital issues affecting the electric power industry as a result of current market conditions. The Morgan Stanley Managing Director and Head of Energy & Utilities Global Risk Capital Markets, in addressing these issues before FERC, pointed out, using market evidence, that the yield on 10-year treasuries compared to 10-year, A-rated utility bond have increased dramatically, to a range of spreads between 300 to 400 basis points. Over the same time period, he provided market information that utility stocks were down significantly, evidencing the increased cost of equity capital for utilities to attract equity investors. He further concluded that, to attract debt investors in the current uncertain, volatile economic conditions, utilities will need to compensate investors for the volatility and liquidity risks, and provide them with an excess return. This necessarily requires higher bond spreads like those we have seen recently.

Paul Bowers, Executive Vice President and CFO of the Southern Company, speaking also on behalf of the Edison Electric Institute, and Gary Brown, Chairman of the New York Public Service Commission, also speaking on behalf of the National Association of Regulatory Utility Commissioners (NARUC) Electricity Committee, reached similar conclusions from their different perspectives. Mr. Bowers explained that the benefits of Southern Company's A credit rating was borne out during the uncertain, volatile economic conditions experienced in 2008. He observed that BBB-rated utilities were issuing long-term debt at an average rate about 300 basis points higher than the Southern Company and other utilities with even lower credit ratings were not able to access commercial paper and other short-term credit markets. He believed utilities must regain and maintain a strong credit rating, such as a single A rating, to weather the volatile economic conditions and obtain capital when needed. Similarly, Mr. Brown testified that the basis point premium between BBB debt and single A debt may indicate that single A debt is currently cheaper for ratepayers. He further agreed there was an even brighter line between the cost of utility debt for investment grade and non-investment grade utilities. As he explained, a utility does not want to be at the lower end of the BBB range. The transcript of the FERC hearing, and certain presentations and exhibits are included as Exhibit No. ____ (TRS-6) to my testimony.

As these market participants and market observers have confirmed, a strong capital structure and strong credit rating is necessary to obtain access to the capital markets in volatile, uncertain markets and to obtain needed capital at reasonable costs to utilities and their customers. We are in such market conditions now and, as these participants and observers further confirmed, no one can say when the volatility and uncertainty will yield to a more stable, certain investment environment.

Q. Are PEF's credit metrics and ratings acceptable to you?

A. No, PEF's credit metrics are weak for the current rating. Both S&P and Moody's have indicated in recent reports (S&P in its February 4, 2009 report, see Exhibit No. ___ (TRS-11), and Moody's in its August 28, 2008 report, see Exhibit No. ___ (TRS-12) to my testimony), that a lack of improvement in credit metrics could result in ratings being lowered. In addition, the ratings are not consistent across all three rating agencies and this adversely impacts PEF's cost of borrowing. As I explained earlier, investors distinguish between companies with split ratings versus companies who have the same rating across all rating agencies, placing greater emphasis on the lower rating in a split rated company in making their investment decisions. This emphasis on the lower credit rating will result in a higher cost of debt for that company compared to a company with a consistent, stronger credit rating across all three rating agencies.

A consistent, strong credit rating is important to PEF when the capital expenditures that PEF must incur to keep up with customer demand for safe, reliable energy are taken into account along with the cost of compliance with new environmental standards and this Commission's decision approving PEF's nuclear generation plans to meet its future load requirements. This capital expenditure undertaking may increase PEF's business risk profile and further signals the importance of a consistent, strong credit rating to PEF's needs for capital at a reasonable cost to fund these capital expenditures. PEF, therefore, needs to further strengthen its financial profile in the near term so that PEF can enter this period of growing capital expenditures with sufficient access to both the short-term and long-term capital markets at a reasonable cost. This is especially important in light of the current, volatile market conditions in which debt and equity investors are demanding premiums for the volatility and uncertainty in the markets. Recent market experience, both of PEF and other participants in the marketplace as made clear by Exhibits No. ___ (TRS-3) through Exhibit No. ____ (TRS-6) to my testimony, resoundingly points to the need for a strong, consistent single A credit rating to better ensure access to both the short-term and long-term debt markets at a reasonable cost to fulfill PEF's capital needs.

Q. What will lead to an improvement in PEF's credit metrics and consistency in PEF's credit ratings?

A. PEF has requested an increase of about $500 million of annual revenue requirements to satisfy its obligation to continue to provide safe, reliable power and comply with federal and state environmental, system reliability, and energy policy requirements and goals. This means PEF's operating cash flow will increase by $300 million to meet these objectives. This positive operating cash flow improves PEF's credit metrics. See Exhibit No. ____ (TRS–7) Schedule of Key Credit Ratios. An improvement in PEF's credit metrics enhances PEF's credit risk profile and increases the chances of consistent ratings across all three rating agencies and a top tier short-term credit rating.

Q. Does the market recognize the importance of positive operating cash flow to the utility's credit risk profile?

A. Yes, it does. In the same research report on investor objectives noted above, see Exhibit No. ___ (TRS-2), Regulated Utilities - Capital Consequences, Dan Ford, CFA, Lehman Brothers, June 3, 2008, p. 25, Mr. Ford emphasizes the importance of cash flow by analyzing the relationship between free cash flow (Cash from operations less capital expenditures) and the equity risk premium (Earnings Yield – 10-year bond rate). He asserts that historically the equity risk premium and pre-dividend free cash flow are demonstrated to be inversely related. In other words, when the utility sector's capital expenditures exceeded its pre-dividend cash flow, equity investors required a higher risk premium when compared with periods of time when cash flow exceeded capital expenditures. What this means is that adequate cash flow to cover large capital expenditure projects is essential to reducing the utility's perceived risk to investors and, thus, maintaining access to capital at a reasonable cost.

The credit rating agencies also stress the importance of positive cash flow to a utility's credit risk profile. S&P, for example, made this clear in one of its utility reports, explaining that "importantly," credit analysis "incorporates the cash-flow effect of a [regulatory] decision," noting further that S&P "places much emphasis on cash flow protection measures when assessing credit quality," including closely looking at rate case decisions or settlements to determine their impact on bondholders. See Exhibit ____ (TRS-8), "A Fresh Look at U.S. Utility Regulation," Standard & Poors, January 29, 2004, p. 2. Whether the perspective is from the equity investors' or bondholders' viewpoint, cash flow is essential to their evaluation of the risk of investment in the utility. A positive cash flow impact reduces that risk, enhances the credit profile of the utility, and is more likely to lead to a lower cost of capital for the utility and its customers.

Q. Are there any other factors that you consider when evaluating PEF's target long-term credit rating of mid-single A?

A. Yes, off-balance sheet obligations must be taken into consideration when evaluating PEF's financial strength and therefore its ability to achieve its target credit rating.

Q. Do all three rating agencies consider off-balance sheet obligations including long-term power supply contracts when evaluating a company's credit profile?

A. Yes, all three rating agencies consider off-balance sheet obligations when assessing a company's credit quality. It is also true that all three rating agencies view long-term power supply contracts (PPAs) as long-term fixed payments, which are essentially debt-like in nature, much like a long-term lease on property, plant and equipment. And, S&P actually imputes debt associated with PPAs when assessing PEF's credit quality.

Q. How many megawatts of supply does PEF have from long-term power supply contracts?

A. PEF has a substantial amount of purchase power commitments relative to its total generation mix. As of December 31, 2008, PEF had 489 MWs of purchased power with other utilities and 786 MWs with certain cogenerators (QFs). These contracts include purchases from cogenerators in accordance with federal energy policy goals encouraging cogeneration under the Public Utilities Regulatory Policy Act ("PURPA") and purchases from renewable energy suppliers, like solid waste to energy facilities, in accordance with state energy policy encouraging renewable energy.

Q. Describe S&P's method for imputing debt associated with PEF's PPAs.

A. As stated in their May 7, 2007 report entitled "Standard & Poor's Methodology For Imputing Debt For U.S. Utilities' Power Purchase Agreements," S&P determines the imputed debt by taking the net present value of capacity payments using a discount rate equivalent to the company's average cost of debt. A risk factor is then applied to the net present value of the capacity payments to determine the amount of imputed debt. See Exhibit No. ___ (TRS-9), Standard & Poor's Methodology for Imputing Debt for U.S. Utilities Power Purchase Agreements, May 7, 2007.

The risk factor used by S&P for PEF is 25 percent. Using projected capacity payments for existing PPA contracts, S&P would add $711 million of imputed debt to PEF's balance sheet as of the December 31, 2010. In addition to adding $711 million of off-balance obligations, S&P would also calculate the imputed interest expense associated with the imputed debt. For the forecast test year 2010, the imputed interest expense is $41 million.

Q. What is the impact on PEF's credit profile when S&P makes these adjustments for off-balance sheet debt?

A. The ultimate effect is to weaken critical financial ratios which adversely impact PEF's credit quality. The direct impact is an increase in PEF's leverage and an increase in its interest expense for purposes of determining PEF's financial ratios.

Q. Does this amount change each year?

A. Yes, assuming we don't enter into any other PPAs, the amount of imputed debt is projected to decline over time, as the termination date of the contracts approach.

Q. What is S&P's imputed debt impact on PEF's capital structure when imputing debt associated with long-term PPAs?

A. The following table shows PEF's projected capital structure for year-end 2010. Off-balance sheet (OBS) obligations of $711 million related to PPAs are a standard adjustment when calculating off-balance sheet liabilities.

	2010 *(with adjustments)*		2010 *(without adjustments)*	
Short-term Debt	152,504	1.47%	152,504	1.58%
Long-term Debt	4,633,358	44.77%	4,633,358	48.07%
OBS Obligations	711,330	6.87%	-	-
Preferred Stock	33,497	.32%	33,497	0.35%
Common Equity	4,819,359	46.56%	4,819,359	50.00%
Total Capital	10,350,048	100.00%	9,638,718	100.00%

Q. How does S&P's treatment of these contracts affect your financial policy?

A. Our financial policy must take S&P's adjustments into consideration if we are to achieve our target debt rating for PEF. This means that when developing target capital structure ratios, we must consider the impact of off-balance sheet items, in particular long-term power supply agreements, due to their material impact on PEF's leverage. If we ignored long-term purchase power contracts as off-balance sheet obligations we would be setting target leverage ratios which would be inconsistent with S&P's view of our leverage.

Q. What leverage ratio is necessary for PEF to achieve a single A rating by S&P?

A. S&P rates PEF's business risk profile as "Excellent" and based on the adjusted financial ratios S&P considers PEF's financial risk profile as "Aggressive." S&P's published guidelines state that a company with an "Excellent" business risk profile must have, at a minimum, an "Intermediate" financial risk profile in order to have an "A" rating. To achieve an "Intermediate" financial risk profile PEF should have a debt ratio no more than 50%, a Funds from Operations (FFO) to Interest Expense ratio greater than 3.0x, and an FFO to Debt ratio of at least 25%. See Exhibit No. ___ (TRS-10), Standard & Poor's, U.S. Utilities Ratings Analysis Now Portrayed in The S&P Corporate Ratings Matrix, November 30, 2007.

As shown above, the effect of off-balance sheet obligations changes PEF's projected 2010 leverage ratio from 50% to 53.1%, well above the maximum of 50%. In addition, PEF's FFO/Interest and FFO/Debt on an adjusted basis are 3.6x and 16.6%, respectively. Therefore, according to S&P's methodology, the three key ratios for PEF do not support a strong mid A rating and in the case of FFO/Debt, the ratio is below the minimum end of the range for a single "A" rating before taking into consideration our base revenue request.

Q. Has the Commission ever recognized the effect of off-balance sheet obligations like PPAs on a utility's capital structure?

A. Yes, Rule 25-22.081(1)(g) requires utilities to include a discussion of the potential for increases or decreases in its cost of capital should a purchase power agreement with a non-utility generator be made. In addition, the PSC recognized the impact of long-term PPAs when comparing the cost of building generation with the cost of executing a long-term power supply contract. See Progress Energy Florida, Inc. Order No. PSC-04-

1168-FOF-EI, dated November 23, 2004. More importantly to S&P's view of PEF's current capital structure, PEF's current rate stipulation incorporates the effect of off-balance sheet adjustments in its determination of its capital structure ratios.

Q. How should PEF's rates be adjusted for the effect of imputed debt associated with long-term PPAs?

A. PEF's weighted average cost of capital (WACC) should reflect the effect of imputed debt associated with long-term PPAs by recognizing on a proforma basis the amount of equity necessary to offset the effect of imputed debt. This approach is consistent with the recognition of PPAs in determining capital structure ratios under PEF's current rate stipulation and settlement agreement.

PEF's projected 2010 capital structure reflects a 50% common equity ratio, before taking long-term purchase power contracts into account. PEF would need approximately $711 million of additional equity in its capital structure to maintain a 50% equity ratio <u>after</u> recognizing imputed debt associated with these contracts as off-balance sheet adjustments made by S&P. PEF's WACC should be adjusted to properly reflect the additional equity necessary to offset the additional imputed debt.

Q. What is the benefit to the Company and the customer in recognizing the imputed debt associated with long-term PPAs?

A. Recognizing the imputed debt associated with long-term PPAs in this base rate proceeding would be a positive development for PEF's credit profile. I would expect S&P to view the Commission's recognition of these contracts as imputed debt and adjusting PEF's WACC as enhancing PEF's credit quality. Indeed, S&P's February 4, 2009 credit report recognizes the importance of constructive regulatory actions in Florida which they view as supportive of credit quality. S&P cites fuel and storm recovery actions along with other rate agreements which have supported PEF's credit quality. See Exhibit No. ___ (TRS–11) Standard & Poor's Ratings Direct - Progress Energy Florida credit report, February 4, 2009, p. 2. Further "supportive" decisions by this Commission with respect to PEF's "credit quality" will improve PEF's credit quality and possibly its long-term credit rating, and, thus, reduce PEF's cost of borrowing as bond investors would consider PEF to have lower credit risk.

Q. What is the risk to the Company and customers if the Commission does not recognize any imputed debt associated with long-term PPAs?

A. The risk to the Company and customers is that PEF's credit quality will suffer due to the lack of recognition of these contracts. As stated earlier, S&P considers the addition of long-term PPAs as increasing financial risk and makes adjustments to PEF's credit ratios to reflect this additional risk. The result of this is higher debt costs to PEF, weaker access to the capital markets, and an overall weaker credit profile which puts PEF at greater risk of a downgrade. S&P stated in its May 28, 2008, credit report:

...if credit protection measures do not improve over the near term such that adjusted FFO to interest coverage exceeds 3.6x and adjusted FFO to total debt exceeds 16%, the outlook will be revised to negative and ratings may be lowered.

See Exhibit No. ___ (TRS–11) Standard & Poor's Ratings Direct - Progress Energy Florida credit report, February 4, 2009, p. 3.

An unfavorable outcome in PEF's current base rate proceeding, including a reversal of the favorable treatment of long-term PPAs in the Company's capital structure under its existing rate case stipulation and settlement agreement approved by this Commission in Order No. PSC-05-0945-S-EI, would have a negative impact on PEF's credit profile and could result in a downgrade. Such an unfavorable outcome certainly eliminates the possibility of improving PEF's short-term credit ratings and long-term rating from S&P. A downgrade would further increase PEF's borrowing costs and further weaken its access to the capital markets.

Q. Has the Commission ever approved proforma adjustments to a utility's capital structure for ratemaking purposes?

A. Yes, as noted above, this Commission approved PEF's existing rate case stipulation and settlement agreement in Order No. PSC-05-0945-S-EI. That stipulation and settlement agreement includes a proforma equity adjustment to PEF's capital structure for ratemaking purposes to account for S&P's methodology of calculating the imputed debt of PEF's long-term PPA's. Additionally, that same rate case stipulation and settlement agreement recognizes another proforma adjustment for certain costs incurred during PEF's 1997 Crystal River nuclear outage. This other proforma adjustment was approved by the Commission in Order No. PSC-97-0840-S-EI.

Q. Does this conclude your testimony?

A. Yes, it does.

BY MR. WALLS:

Q And, Mr. Sullivan, do you have a summary of your prefiled direct testimony?

A Yes.

Q Would you provide it to the Commission, please?

A Yes, I will.

Good afternoon, Commissioners. As the treasurer of Progress Energy Florida, one of my primary responsibilities is maintaining continuous and cost-effective capital markets access through all phases of the business cycle. To maintain continuous access to the capital markets, a solid investment grade rating is required. We target a mid-single-A rating, and we expect that our target credit rating will support the investment necessary to meet our customers' energy needs now and in the future.

Achievement and maintenance of this rating requires a capital structure, among other credit metrics, supportive of that rating. The financial reality for PEF and other utilities is the impact of the rating agency adjustments, specifically in our case a materially impactful adjustment for the long-term purchase power contracts. Consideration of the impacts of these adjustments are imperative to our target credit rating. That rating is critical to support continued investment for environmental compliance, reliability measures and base load generation to meet customer demands for clean, reliable power.

Similarly, the cash flows generated from our rate request are important to our financial health and continued execution of PEF's capital expenditure program to satisfy customer energy needs and state and federal energy policy objectives.

This concludes my summary, and I'm happy to take any questions.

MR. WALLS: We tender Mr. Sullivan for cross.

CHAIRMAN CARTER: Thank you.

Mr. Rehwinkel?

MR. REHWINKEL: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. REHWINKEL:

Q Good afternoon, Mr. Sullivan.

A Good afternoon.

Q My name is Charles Rehwinkel. I'm with the Office of Public Counsel, and I think I just have a few questions for you about your testimony.

Am I correct that you're here advocating the imputation of equity related to purchase power agreements?

A That is how we're proposing it be handled. The adjustment is a rating agency adjustment based upon the imputation of debt associated with purchase power contracts.

Q Okay. Now, the -- what's the amount of the equity imputation that you're proposing?

A I believe it was $711 million.

Q Okay. Now, can you identify an investment in plant or assets that that equity represents?

A No, because it doesn't represent plant and assets, it represents purchase power contracts that we're required to meet reserve margins and serve our load.

Q Okay. Can you identify any shareholders that own stock in the company that equity would represent?

A Well, again, they own the equity, the common equity of the company that includes all assets, tangible and intangible.

Q Okay, so does the imputed equity represent any retained earnings account?

A No, it does not.

Q Who at Standard & Poor's wrote the guidance that requires -- that you say supports the imputation of equity?

A I'm sorry, did you just say who wrote it?

Q Yes.

A I'm not sure the exact analyst, but they have a group, a power group that produces most of their industry literature.

Q What are the names of the people that are in that group?

A Jon Whitlock, who is currently the head of the group and our lead analyst and also a former Florida analyst. Tod Shipman is your backup analyst, and then again usually members of the Credit Committee will participate in our meetings with them.

Q Okay. So are these individuals that you named the ones who are responsible for the guidance on the PPA adjustment?

A Yes, because they represent the organization within S&P that's responsible for this area.

Q Okay. Were any of those individuals that you named, were any of them appointed to their positions by the Governor the State of Florida?

A Not to my knowledge.

Q Were any of them nominated to their position by the Public Service Commission Nominating Commission?

A Not to my knowledge.

Q Do any of them hold a position under the State of -- under the laws of the State of Florida?

A Not to my knowledge, and I don't know why they would.

Q Are any of them testifying -- any of the individuals that you identified with Standard & Poor's testifying in this docket today or in this matter at all?

A I'm sorry, could you repeat the question?

Q Are any of the members or the employees of Standard & Poor's that you mentioned testifying in this docket?

A No, they are not.

MR. REHWINKEL: That's all the questions I have, Mr. Chairman.

CHAIRMAN CARTER: Thank you, Mr. Rehwinkel.

Ms. Bradley?

MS. BRADLEY: Thank you.

CROSS EXAMINATION

BY MS. BRADLEY:

Q Would you agree that, generally speaking, a regulated industry is considered more or considered less of a credit risk than a non-regulated utility?

A I think, in general, that would be the perception, but I think it depends on the regulatory jurisdiction you're talking about.

Q In other words, it depends on how strong or how weak the regulation is?

A Well, I think you're talking about a constructive regulatory environment that all stakeholders feel that they participate in the process.

Q And it would be fair to say that Florida's generally thought of as a strong regulatory?

A Historically that has been the case, yes.

Q Generally speaking, is it also true that a monopoly is generally considered less of a credit risk than an industry that has to compete with others?

A Not necessarily. Again, and I think pointing to bankruptcies in the regulated utility industry would probably be the reason that I couldn't agree with that statement, the most recent one being PG&E.

Q I'm sorry?

A The most recent bankruptcy of a public utility was Pacific Gas & Electric.

Q But generally speaking, monopolies are considered less of a risk?

A No, I wouldn't say generally they are.

Q Did you attend any of the customer service hearings?

A No, I did not. I did watch a couple of them via some internal communication we have within the company, but I did not attend those, no.

Q Did you hear the testimony of the stockbrokers and the investors who came and testified that they would look for a monopoly and a regulated industry when they were investing?

A I was not aware of that testimony, no.

MS. BRADLEY: All right, no further questions.

CHAIRMAN CARTER: Thank you, Ms. Bradley.

Ms. Kaufman?

MS. KAUFMAN: Mr. Chairman, if it's all right with you, I'd like Mr. Wright to precede me.

CHAIRMAN CARTER: Okay, and let me do this then. Ms. Evans, any questions?

MS. EVANS: No, Your Honor.

CHAIRMAN CARTER: Okay. We'll go to Mr. Wright and then we'll come back to Ms. Kaufman.

Mr. Wright, you're recognized.

MR. WRIGHT: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. WRIGHT:

Q Good afternoon, Mr. Sullivan.

A Good afternoon.

Q We haven't met, unfortunately, but I'm Scheff Wright and I represent the Florida Retail Federation in this case. I think I really just have one question for you.

In response to the few questions that Mr. Rehwinkel asked you, I think you said that the shareholders own the equity of the company but that the imputed equity associated with the power purchase agreements doesn't represent retained earnings. Is that what you said?

A No, that is not what I said.

Q Okay. Would you tell me what you did say?

A Could you rephrase in a question, please, as opposed to taking bits and parts of what I said?

Q Mr. Rehwinkel asked you whether the $711 million is imputed -- well, let's back up.

The $711 million is imputed debt by a certain Standard & Poor's methodology, is that true?

A That is correct.

Q And to offset that, you're asking the Commission to set rates based on an imputed $711 million of equity on the other side of the balance sheet?

A That is correct, yes.

Q Mr. Rehwinkel I think asked you whether that represents, that $711 million represents any investment in plant or assets?

A Yes; and I said no, it does not.

Q Okay. Is the amount an asset *per se*, is it an asset in and of itself?

A No, because, as is stated in the testimony, it is a financial adjustment made in the case we're talking specifically about here, Standard & Poor's.

Q Thank you.

MR. WRIGHT: That was all the questions I had, Mr. Chairman.

CHAIRMAN CARTER: Thank you, Mr. Wright.

Ms. Kaufman, you're recognized.

MS. KAUFMAN: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MS. KAUFMAN:

Q Good afternoon, Mr. Sullivan. I'm Vicki Kaufman, here on behalf of the Florida Industrial Power Users Group. Nice to meet you in person.

If I understand, at least a portion of your testimony has to do with the fact that you want to ensure that PEF retains access to the capital markets, correct?

A I think my testimony states we want to target a specific credit rating that allows us timely and cost-effective access to the capital markets.

Q And you have a chart in your testimony, and we talked about it a little bit at your deposition, on page 4, lines 17 through 20, correct?

A I will get to that. I'm there.

Q And am I correct that that chart shows the current ratings for your different types of debt, correct?

A That's correct.

Q And am I also correct that the one that you're striving to change is the triple B plus?

A We want to reach mid-triple A on all of those, so it would be -- the A with Fitch, we're already there, the A-3 would be an A-2, and the triple B plus would be an A-2.

Q So you want to change the triple B plus and which other, I'm sorry?

A Moody's would go to an A-2, in their vernacular also, because, again, our target rating is a mid-triple A rating, which is, there's three different ratings within the A category, so we'd be shooting for the middle.

Q So it would be the senior unsecured S&P and Moody's?

A That's correct, yes.

Q And the other ratings are satisfactory to the company?

A The other ratings are all -- these are all related to each other, so again, if something -- the senior unsecured changed, that would ripple up through the senior secured and so forth.

Q But currently, for example, the fact that Fitch rates you as a senior unsecured A is fine with the company?

A Yes. Yes, we're happy with that rating.

Q A better way to say it.

Now, you talked with Mr. Rehwinkel and with Mr. Wright about the adjustment for purchase power agreements and the imputed $711 million, correct?

A Yes.

Q Are you familiar with the process here in Florida for the utilities to recover the costs of purchase power agreements through the cost recovery clauses?

A Yes, I am. In fact, I had to get very familiar with it because we went up to S&P to try to educate them about the various structure here. One of the things we learned is that their measurement for either including this debt or not is if there is legislative support, specifically. So we actually brought counsel with us and dumped everything out on the table to them about what is involved with Florida, and again, because there are other states in the U.S. that have legislative support, this falls just short of what they require.

Q You would agree with me, would you not, that before -- well, that in the process that we have in Florida, the companies recover through the fuel and purchase power capacity clause the costs of the PPAs, correct?

A Yes, we do have recovery of those.

Q And do you know of any instance where there has been a single dollar disallowed of any approved purchase power agreement here in Florida?

A My history would only go back to the time of our acquisition, but no, I'm not.

Q And in fact, before the contract is approved, the Commission reviews it and approves it for cost recovery, correct?

A That is usually a standard requirement of our purchase power contracts, yes.

Q So would you agree that there is a very low risk here in Florida that the company will not recover the costs of those contracts?

A I would agree, but unfortunately we couldn't convince S&P of that.

Q I think Mr. Rehwinkel asked you this, or perhaps Mr. Wright, but you don't have an S&P witness here that we can talk to about that, do you?

A No, and we talked about this, I believe, in our deposition also.

Q I'm assuming from some of the comments that you made previously that you must have regular discussions with both debt and equity investors in the company?

A Yes, we do. One of my primary -- other additional primary responsibilities is the main contact with the rating agencies.

Q Okay. Has any rating agency told you that Progress will be downgraded if, say, less than half of its revenue request is granted?

A They have not been that specific, but they have been specific relative to credit metrics, and those are all contained in, I believe, either 12 or 13 exhibits that we've included in my testimony or attached to my testimony.

I think one of the main differences, compared to few years ago, is the rating agencies have become much more transparent, they publish a lot more information, and certainly, by the list of things that we have here, that's a substantial difference in the way that they operate compared to a few years ago.

The other main difference is that they specifically state what their expectations are for the future relative to credit metrics and other expectations which, as I said, makes the whole process more transparent for everybody.

Q And I think that, if I understood your answer correctly, you're referring to numerous documents and articles that you've attached from the credit rating bureaus to your testimony?

A That's correct, yes.

Q Can you tell me what credit facilities Progress Energy presently has available to it?

A The facilities in terms of what?

Q Line of credit, the way that you access capital now.

A Well, we have over, just over two-billion-dollar revolving credit agreements that are composed of three different pieces. We currently have 200 million drawn on that facility, and we also some commercial paper outstanding at Florida and our parent company.

Q So am I correct, is that your main source of access to capital at the moment, the $200 billion revolving credit line?

A No, it is not.

Q Okay. What other sources of --

A Operating cash flow, and that is our primary source. The bank line was drawn on -- actually last October in response to the credit crisis.

Q And you drew down -- did you say 200 million?
A No, we drew 600 million. We've paid it down to 200 million, and primarily we've had that out to -- because of the collateral, cash collateral we have to have posted for the gas hedging portfolio here in Florida.
Q So is it correct that currently, after the paydown, you have about 1.8 left on the line of credit?
A That is the capacity available on the credit facility, yes.
Q Now, on page 23 of your testimony -- I'll have to get there.
A I'm there.
Q Let me get there. The computer is not always the fastest way to do this, I'll tell you.
You talk about -- this is at the beginning. It's actually in the middle, so let's go back to the prior page so we can see the question. I thought that you referred to the settlement agreement of your last rate case. Do you see that?
A Yeah. I believe it's in response to question Q.
Q Okay. And I think that you also mentioned the fact that it -- as part of the settlement, the imputation of the PPAs was recognized, is that correct?

A I don't believe I said that, no.

Q Was it part of the settlement, the treatment of the purchase power agreements?

A Not to my knowledge, no.

Q Has anybody at Standard & Poor's told you that if you receive this imputation adjustment that you're seeking, that they will increase your bond rating?

A No, they have not.

Q So the Commission, were they to make your adjustment, would certainly have no guarantee that that would occur, would they?

A There are no guarantees, just as we talked about in my deposition.

Q Are you aware of the recent Tampa Electric rate case?

A Yes, I am.

Q And are you aware that in that case a similar adjustment was suggested?

A Yes, I am.

Q And are you aware that the Commission denied that adjustment?

A Yes, I am.

Q Have you reviewed that order?

A I have not read the order. I'm just aware of the highlights, let's say, of --

Q Yes, but you're aware that a similar argument was made and that the Commission --

A Yes, I am.

Q -- denied it?

A Yes, I am.

MS. KAUFMAN: Thank you, Mr. Chairman. Thank you, Mr. Robinson.

CHAIRMAN CARTER: Thank you, Ms. Kaufman. Thank you.

Staff?

MS. FLEMING: Mr. Chairman, at this time we would like to ask for a break. We haven't heard back from all the parties regarding the documents we provided last night, and we would like to just -- I think it would help speed up the flow of staff's cross-examination if we could consult with the parties.

CHAIRMAN CARTER: What do you need, ten minutes?

MS. FLEMING: About five, ten minutes.

CHAIRMAN CARTER: Okay, everybody. We'll be back at ten after.

(Brief recess.)

ACTING CHAIRMAN EDGAR: Okay, if we could all gather, we are back on the record. And, Ms. Fleming, I think that when we broke, you were going to talk to us about exhibits.

MS. FLEMING: Yes, thank you.

At this time -- during the break staff had an opportunity to discuss with the parties Staff's Composite Exhibit No. 39, and I think the response that was objectionable was under Item 1, Interrogatory No. 235. In order to move the process along, staff will only request to move in the narrative portion of the Interrogatory Response 235 and not the Bates-stamped pages, the documents which are reports or studies associated with the response. The studies and reports associated with that response are already contained in the prefiled rebuttal testimony as exhibits of the witness, so we don't need those at this time. And I think with that, I think the parties can stipulate to Staff's Exhibit 35 -- or 39 in its entirety.

ACTING CHAIRMAN EDGAR: Okay, so let me ask, to the parties, is that your understanding?

MS. KAUFMAN: Yes, ma'am.

ACTING CHAIRMAN EDGAR: Okay, then let me see if I can -- yes, Mr. Wright.

MR. WRIGHT: That is my understanding. I just want to make sure what I'm pulling out of here. Would it be what I think is Bates-stamped 235 quintuple 01 through quadruple 019?

MS. FLEMING: That is correct.

MR. WRIGHT: Thank you, Madam Chairman. I just want to keep my exhibits straight.

ACTING CHAIRMAN EDGAR: As do we all, some moments easier than others.

Okay. So my understanding is that the request is to enter into the record Exhibit 39, excluding the pages of No. 235 that are the reports and studies, but including the narrative?

MS. FLEMING: That's correct.

ACTING CHAIRMAN EDGAR: Okay, then that will be entered into the record as we have described.

(Exhibit No. 39 marked for identification and admitted into the record.)

ACTING CHAIRMAN EDGAR: Ms. Fleming?

MS. FLEMING: Thank you. We do have some cross for this witness.

CROSS EXAMINATION

BY MS. FLEMING:

Q Good afternoon, Mr. Sullivan, I'm Katherine Fleming. We spoke during your deposition a couple of weeks ago.

A Yes, good afternoon.

Q You are the treasurer of Progress Energy Florida, correct?

A Yes, I am.

Q And as treasurer of Progress Energy Florida, or PEF, you are responsible for PEF maintaining continuous access to capital markets, correct?

A Amongst other things, yes.

Q And in order to do so, you must maintain PEF's capital structure in a manner which supports PEF's target credit rating, correct?

A That is one of the main components, yes.

Q Would you agree that company management makes the decisions about the relative debt and equity level maintained in PEF's capital structure?

A I think that they are a part of the decision-making process. Our Board of Directors also participates in that as they review our financial plan annually.

Q And could I ask you for the record to, if you could respond yes or no, and then explain?

A Certainly.

Q Thank you. So the decisions with respect to the company's capital structure, do those decisions have an impact on the company's credit rating?

A Yes, they do.

Q Would you agree that Standard & Poor's, or S&P, employs a consolidated rating methodology whereby it generally assigns a credit rating to each entity in an organization based upon the credit profile of the consolidated entity?

A Yes, that's correct.

Q And the reason S&P assigns a lower credit rating to PEF than the ratings assigned by Moody's and Fitch is due to the consolidated rating methodology employed by S&P that considers the credit profile of Progress Energy, Inc., and not just the credit profile of Progress on a stand-alone basis, is that correct?

A Yes. You have described the consolidated rating methodology employed by S&P.

Q And would you agree, at least with respect to S&P, PEF's credit rating will not improve until the credit metrics of both PEF and its parent company, Progress Energy, improve to a level necessary to support a stronger rating?

A Yes, that is true, and also you need to consider any other businesses we have in our structure because, again, it's consolidated, considering all subsidiaries.

Q If the Commission were to approve Progress's petition and grant the full amount of its requested rate increase, would you agree that there is no guarantee that S&P will upgrade PEF's credit rating to single A?

A Yes, I would agree that there's no guarantee because there is no guarantees in business, and the rating agencies do not provide guarantees based upon outcomes.

Q Would you agree that, prior to the acquisition of Progress -- of Florida Progress Corporation by Carolina Power & Light Company, that Florida Power Corporation had a double A credit rating from S&P?

A It's possible. I'm not sure at what point prior to the merger that happened, but it's possible.

MS. FLEMING: Just one moment.

At this time I'd like to hand out two exhibits. The first one is Staff's 13th Request for Production of Documents, No. 72, and Staff's 13th Request for Production of Documents, No. 76. These are contained in Exhibit 39, so we don't need an exhibit number. These are just for ease of reference.

BY MS. FLEMING:

Q Mr. Sullivan, can I have you first turn to the response to the 13th Request for POD, No. 72, please?

A Yes, I'm there.

Q Have you had a chance to look at this document?

A Yes, I have.

Q Could you please turn to page 2 of 3?

A Beginning with 72 at the top?

Q Yes, page 2 at the top of 3, or at the bottom right-hand corner is a Bates stamp number, Staff POD 13720004. Are you on that page?

A Yes, I am.

Q Okay. A moment ago I just asked you, prior to the acquisition of Florida Progress Corporation by Carolina Power & Light Company, that Florida Power Corporation had a double A credit from S&P. Do you see that on this sheet?

A Yes, I see at the time of this report they went from a rating to a rating, but yes, double A minus, A minus -- or, excuse me, A one plus were the ratings.

Q Okay. Thank you.

Now, this document that we're looking at, this is an S&P report that's dated November 20th, 2000, is that correct?

A Yes, that's correct.

Q And it's for CP&L Energy, is that correct?

A That is correct.

Q And I'm looking at the third paragraph, I believe. It starts with, "The rating actions."

A Uh-huh.

Q Could you take a moment to read that?

A I've completed it.

Q Okay. Would you agree that this report discusses the downgrade of Florida Power Corporation's corporate credit rating from double A minus to triple B plus, due to the imminent completion of the previously announced agreement by CPL to purchase Florida Progress and its affiliates?

A Yes, I would.

Q Could I now have you turn to the other handout that you were given? It's Staff's 13th Request for Production of Documents, No. 76.

A I have it.

Q Okay. And are you familiar with this document?

A Yes, I am.

Q Okay. And this is a Moody's Investors Service report dated August 23rd, 1999, is that correct?

A Yes.

Q And this is for Progress Energy Florida, is that correct?

A Yes, it is.

Q Would you please read aloud the first two sentences of the first paragraph of the text, please?

A "Moody's has --" beginning with, "Moody's has placed"?

Q Yes, please.

A "Moody's has placed the security ratings of Florida Progress Corporation and its electric utility, Florida Power Corporation, on review for possible downgrade. Ratings placed under review include the double A-3 secured rating assigned to debt issued by Florida Power Corporation and the A-2 senior unsecured rating assigned to debt issued by Progress Capital Holdings."

Q Thank you.

Now, looking down the page at the fourth paragraph, starting with, "Concern for ratings," could you please read that paragraph aloud?

A "Concern for ratings pressure from acquisition financing drives the review of the downgrade for FPC's securities and the negative outlook for CPL's ratings. While the two entities are roughly equal in size, Moody's is concerned that FPC, the higher-rated and therefore more liquid entity, may come under relatively greater pressure to service acquisition leverage."

Q Okay. So just for clarification, FPC stands for Florida Power Corporation, correct?

A Yes -- or, excuse me, FPC, as stated above, yes, Florida Power -- Florida Progress Corporation.

Q Progress Corporation.

A Uh-huh.

Q And Florida Power Corporation and PEF are the same entity, is that correct?

A Yes, that is the regulated utility.

Q And the name just changed after the acquisition of Florida Progress Corporation by CPL, is that correct?

A CPL became Progress Energy, Inc., yes.

Q Okay, thank you.

MS. FLEMING: Commissioners, at this time, for ease of reference, we are handing out PEF's Responses to Staff's 19th Set of Interrogatories, No. 205. This is contained in the composite exhibit.

BY MS. FLEMING:

Q Mr. Sullivan, have you had a chance to look at this document?

A Yes, I have.

Q And do you recall that we discussed this interrogatory response during your deposition?

A Yes, I do.

Q Okay, so for the record, this schedule, Interrogatory No. 205, shows the flow of funds between PEF and Progress Energy for the period of 2001 through 2009, is that correct?

A Yes, it is.

Q Has anything changed since the time that this interrogatory response was filed that would alter this response?

A No, not to my knowledge.

Q Okay. So looking at this response, would you agree that PEF paid Progress Energy approximately 1.144 billion in dividends over the period 2001 through 2008?

A Adding those numbers up, roughly I would agree with that number, yes.

Q And for this same period, 2001 through 2008, Progress Energy made no equity infusions in PEF -- to PEF, is that correct?

A Yes, that is correct. We did, however, make a -- as you can see, the dividending did cease from PEF in 2005. We were able to dividend some in 2006, but have not taken any since then.

Q Now, if Progress Energy had provided equity infusions during the period 2001 through 2008, would that have improved PEF's equity ratio over that period?

A It could possibly have had the effect of improving it, yes.

Q Now, in your direct testimony, specifically your Exhibit TRS-5 --

A I have that. That's a Moody's presentation.

Q And we discussed this a little bit in your deposition, and we talked about the key challenges facing investor-owned utilities that are in your table located on page 2. Do you recall that?

A Yes, I do.

Q And we discussed the fifth item that's in this table, correct?

A The fifth item being equity issuance opportunities?

Q Yes, "A missed opportunity to issue equity may prove costly," correct?

A Yes.

Q You agree that PEF's credit metrics would be stronger today if Progress Energy had made equity infusions to the utility over the period of 2001 through 2008?

A No, because we could have done the same thing through retaining dividends at the utility.

Q Now, you touched on this a little bit earlier with Ms. Kaufman, but in your testimony you addressed the purchase power agreements, correct?

A Yes, I did.

Q And you also discussed how the rating agencies consider off-balance obligations such as purchase power agreements when evaluating a company's credit profile, is that correct?

A Yes, it is.

Q Would you agree that any adjustment that increases revenue requirements would be a positive development for PEF's credit profile?

A Yes, it would, because it would have a positive impact on cash flow, all else being equal.

Q Now, during your deposition I asked you several series of questions about whether you conducted analyses. Do you recall that?

A I remember generally the line of questioning but not the specifics, yes.

Q Okay, well, we'll go through that.

You did not conduct any independent analysis of the reasonableness of the equity ratio that PEF has proposed the Commission to recognize for purposes of setting rates in this proceeding, is that correct?

A No, we did not.

Q You also did not conduct any independent analysis for purposes of this proceeding, is that correct?

A Yes, that's correct.

Q You are aware of -- that Dr. Vander Weide selected a group of companies for use in his return on equity analysis, is that correct?

A Yes, I am, or yes, that's correct.

Q You did not make a comparison of Progress

Energy's relative level of purchase power to the relative level of purchase power relied on by the companies in Dr. Vander Weide's proxy group, is that correct?

A No, I'm not aware of all of the PPA adjustments for that sample group.

Q So you did not conduct a comparison --

A I said no.

Q Okay.

A I said no, I did not.

Q And you did not conduct any analysis that shows how PEF's actual equity ratio compares to the actual equity ratios of other IOUs that rely on purchase power, is that correct?

A No, we did not, and don't believe that's necessary because the rating agencies are very transparent in exactly how they calculate it and how they impute it.

Q And you have not conducted any analysis that shows how PEF's equity ratio on an S&P adjusted basis compares to the equity ratios of other IOUs on an S&P adjusted basis that rely on purchase power, is that correct?

A No, we did not, because we compare it to the credit metrics that are published for our target credit rating.

Q Would you agree that PEF recovers the capacity payments associated with its purchase power contracts through the cost recovery class?

A As far as I've been involved with it, yes.

Q And would you agree that PEF recovers the full costs associated with its purchase power contracts through a cost recovery clause as well?

A Again, since the time of the acquisition, yes.

Q Now, PEF's proposed capital structure for the projected 2010 test year includes an adjustment that increases common equity by 711 million, is that correct?

A Yes.

MS. FLEMING: At this time I'd like to hand out another exhibit. It's PEF's Responses to Staff's 19th Set of Interrogatories, No. 252. This is already contained in Exhibit 42 that we'll move into the record at a later point.

BY MS. FLEMING:

Q Mr. Sullivan, have you had an opportunity to look at this document?

A Yes, I have.

Q Do you recall in your deposition you were asked a little bit about this response, and we asked you the annual revenue requirement that's associated with the 711 million imputed equity adjustment?

A Vaguely, yes.

Q Okay. And based on this response, the annual revenue requirement associated with the 711 million imputed equity adjustment is about -- we'll round at 27.4 million, is that correct?

A Yes, that's correct.

Q So -- just a few moments ago we were talking about the costs that are recovered through the clause dockets, the fuel costs for the purchase power agreements, so those costs that we have been discussing, the capacity payments and the fuel costs that are associated with purchase power that are recovered through the cost recovery clause, this 24.7 million is in addition to those costs that we were previously discussing, is that correct?

A Yes, that is the estimate based upon the $711 million adjustment.

Q When PEF initially petitioned this Commission for approval of these purchase power contracts, did it make the Commission aware that these contracts would potentially cost 27.4 million more than what was specified in the contracts?

A I can't answer that question because I don't know at what point the contracts were executed.

Q Okay, fair enough.

MS. FLEMING: At this time we're handing out another exhibit. It's already contained in Exhibit 39, but this is PEF's Responses to Staff's 19th Set of Interrogatories, No. 237.

BY MS. FLEMING:

Q Mr. Sullivan, have you had an opportunity to review this document?

A Yes, I have.

Q And you're familiar with this response?

A Yes, I am.

Q And did you prepare this response?

A Yes.

Q Okay. According to this response, reading from the first line, Progress Energy was one of eight utilities that joined NuStart Energy Development LLC in 2004, is that correct?

A Yes, it is.

Q What was the purpose of the NuStart Energy Development LLC?

A The purpose was to begin to develop plans and coordinate a potential renaissance in nuclear, new nuclear development.

Q And that's for -- do you recall your deposition just -- you expanded a little further on that?

A Not off the top of my head, no.

Q Well, I'll just read to you from your deposition on page 21, lines 24 through 25.

"The purpose for submitting a proposal to the --" it was "for the purpose of submitting a proposal to the DOE under the Nuclear Power 2010 Program for new nuclear plant licensing demonstration projects." Do you recall that?

A If it's in the testimony, yes.

Q It was in your deposition.

A Or deposition. If it's there, yes, I do.

Q Okay, so in November of 2005 Progress Energy announced its plans to pursue new nuclear generation at PEF, is that correct?

A Yes, in October of that year, that's correct. And that was the beginning of the internal discussion by the formation of our internal Base Load Steering Committee that began to take up the possibility of new nuclear along with other potential generation options.

Q Thank you. And you would agree that it was the management and the Board of Directors of PEF that decided to pursue two AP1000 units instead of a single nuclear unit at the Levy site, is that correct?

A I believe the decision was to -- at this early stage, the decision was to move forward and ultimately an AP1000 was selected as the technology, and then, again, we applied that technology to the Levy County situation.

Q And whose decision was it to build the two AP1000 nuclear units?

A Well, again, since the process is still continuing, that would have to go all the way up through our Board of Directors and through the regulatory processes in the state.

Q Thank you.

A As well as the federal level.

Q Now, if you could, please turn to page 8 of your testimony.

A I'm there.

Q And I'm looking specifically on lines 16 through 18 of your testimony where you identify other IOUs in the southeast that are currently planning to build similar nuclear plants to PEF's Levy nuclear units, is that correct?

A Yes, those are their stated plans.

Q And it's your testimony that each of these IOUs located in the southeast that are currently planning to build these similar nuclear units as those similar to the Levy plants are rated single A or single

A minus by S&P, is that correct?

A Yes, according to the testimony here, that's correct.

MS. FLEMING: Okay. Madam Chair, at this time I'd like to hand out another exhibit. This exhibit is not part of Staff's Composite Exhibit, so staff would ask that we get a hearing exhibit number, please.

ACTING CHAIRMAN EDGAR: Okay. I believe that will be 276. Title, Ms. Fleming?

MS. FLEMING: S&P March 2009 report.

ACTING CHAIRMAN EDGAR: S&P March -- you said 2009?

MS. FLEMING: Yes.

ACTING CHAIRMAN EDGAR: S&P March 2009 Report. Thank you.

(Exhibit No. 276 marked for identification.)

BY MS. FLEMING:

Q Mr. Sullivan -- oh, I'm sorry. I'll wait.

Mr. Sullivan, have you seen this report before?

A Yes, I have.

Q Okay. And this is an S&P report dated March 9th, 2009, is that correct?

A Yes, that's correct.

Q Could I have you turn to page 2 of the report, please?

A I'm there.

Q And under the heading, "Support for New Construction Varies from State to State," do you see that?

A Yes, I do.

Q In the first sentence of this paragraph the report mentions some of the companies -- some of the same companies that you identified in your testimony on page 8, is that correct?

A Yes, they are included in that list.

Q And just for clarification, Georgia Power is part of the Southern Company, is that correct?

A Yes, it is.

Q And South Carolina Electric & Gas is part of the SCANA, is that correct?

A Yes, it is.

Q Could you please read aloud the second and third sentences in this paragraph that starts with, "The states in which"?

A "The states in which these regulated utilities operate provide frameworks to support new nuclear construction, albeit in varying degrees. South Carolina and Florida, closely followed by Georgia, have transparent schemes supported by legislative backing.

These regulatory approaches in our opinion allow companies to mitigate credit risk and preserve balance sheet strength while building a large capital project."

Q Thank you. So would you agree with S&P that Florida has a recovery mechanism in place to mitigate credit risk and preserve balance sheet strength while a company builds a large capital project?

A I would say the framework is in place, and as long as we are prudent in our expenditures and those are reviewed and approved by the Commission, it would all work for everybody, yes.

Q Could I have you turn to page 4 of this document, please?

A I'm there.

Q Under the heading for credit risk, "Balance sheet size is important," do you see that?

A Yes, I do.

Q Could you please read the first two sentences under this paragraph aloud, please?

A "Given the new plant's large projected costs, how big the company's balance sheets are can be a significant factor in terms of how much credit risk we recognize. A new project that materially affects a company's size can introduce significantly more risk and necessitate that every other aspect of the company's business perform flawlessly to provide the necessary support to its credit profile, especially during the period when capital spending peaks and the financial profile becomes stressed."

Q Thank you. And now could I have you turn to the next page, page 5?

A I'm there.

Q And I'm looking at the table that's titled, "Utilities Proposed Nuclear Investment." Do you see that?

A Uh-huh.

Q Can you explain that table to me briefly?

A The table takes the dollar cost of the proposed nuclear investment and compares to it to the total assets of each of these companies as of September 30th, and the percentages are provided in the right-hand column.

Q So then by looking at this table, then, does this state that past proposed nuclear projects as a percentage of existing total -- total existing assets is larger than for the other two IOUs shown on this chart?

A Yes, that would be the case.

Q Okay, thank you.

MS. FLEMING: We have no further questions.

ACTING CHAIRMAN EDGAR: Anything from the bench? Commissioner Skop?

COMMISSIONER SKOP: Thank you, Madam Chairman.

Good afternoon, Mr. Sullivan. I have several questions for you with respect to your direct testimony, and I just want to get a better understanding as to the company's position so that I have a full understanding of it. If we could turn to page 2 of your prefiled testimony, lines 20 through 21, please?

THE WITNESS: Yes, I'm there.

COMMISSIONER SKOP: Okay. And in those lines they basically discuss the impact of rating agency adjustments for long-term PPAs which I think has been discussed substantially with you.

THE WITNESS: Yes, that's correct.

COMMISSIONER SKOP: And you would agree, would you not, that S&P's policy is different from Fitch's with respect to those adjustments, is that correct?

THE WITNESS: Yes, I do.

COMMISSIONER SKOP: All right. If I could next turn your attention to page 14 of your prefiled testimony, beginning with line 6, please?

THE WITNESS: Yes, I'm there.

COMMISSIONER SKOP: Okay. And on line 6 and then continued on lines 9 and 10, you basically state the cause and effect with respect to the credit metrics for Progress, is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: And can you briefly elaborate on those two thoughts, if you would?

THE WITNESS: These reports were generated after our annual visit to the rating agency which usually happens in the spring of every year. The agencies try to remain on a 12-month calendar to produce complete credit update reports on that type of periodic basis. The exhibits and -- that are referenced here are the reports from late in '08 and early in '09.

COMMISSIONER SKOP: Okay. And if I could next turn your attention to the exhibit mentioned on line 8 of that page, which is TRS-11, please?

THE WITNESS: Yes, I'm there.

COMMISSIONER SKOP: And do you recognize that Standard & Poor's direct rating report?

THE WITNESS: Yes, I do.

COMMISSIONER SKOP: And can you please turn to page 2 of that report at the last full paragraph, please?

THE WITNESS: Uh-huh.

COMMISSIONER SKOP: Okay. Starting with, "Standard & Poor's views the agreement along with other past rulings," do you see that, the one sentence?

THE WITNESS: I'm sorry, could you give me the paragraph again?

COMMISSIONER SKOP: Yes. It's the sentence that reads, "Standard & Poor's views the agreement along with other past rulings that allow for recovery of deferred --" excuse me -- "that allow for the recovery of deferred fuel costs and storm costs as supportive of credit quality." Do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. In terms of the credit quality you mentioned in specific relation to the imputed debt adjustment, how do you rationalize what is Standard & Poor's basic practice in imputing, you know, the 25 percent as they do versus the statement that they seem to inherently recognize the favorable cost recovery clauses and treatment that this Commission gives for the timely, prudent recovery of fuel-related expenses and purchase power expenses?

THE WITNESS: Again, I think the history has been talked about, given, for the most part, I think timely and complete recovery is a positive. I think they do get a little bit nervous as they look around parts of the country, and it certainly happened before the recession, due to the deregulation of some of the markets and the impact on ratepayers, ultimately.

So, as I said, I think they want to see it continue. Again, there's been no indication that it won't continue, but again, we are in unusual times right now and they're taking that into account.

COMMISSIONER SKOP: Okay. And if I could turn your attention to the next page of that document, please, beginning with the first full paragraph, starting with, "Progress has an aggressive financial profile," and, "credit protection measures weaken," do you see that?

WITNESS: Yes.

COMMISSIONER SKOP: Do you see that -- and that was on a year-to-year basis compared to 2007, is that correct?

THE WITNESS: Yes, it is.

COMMISSIONER SKOP: Okay. Do you see the statement that they made about reflecting increased deferred fuel costs?

THE WITNESS: Yes, that and the higher leverage from the capital, yes.

COMMISSIONER SKOP: Yes. Now, with respect to the increased deferred fuel costs, would those arise from the sharp spike in natural gas and other fuels that may have occurred during that time period?

THE WITNESS: I think overall full volatility over that time period, both up and down, drove that.

COMMISSIONER SKOP: Okay. And do you see the next full sentence where they talk about the recently approved fuel recoveries?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. And those are viewed as favorable to the extent that they support cash flow generation?

THE WITNESS: Yes. I think the issue is not so much one of the established reputation, but the magnitude of how much we have to float, if you will, between then and the recovery period, and in the market conditions up to pre this crisis that we're in, that really wasn't an issue, given the amount of liquidity that existed. That did become an issue last year.

COMMISSIONER SKOP: Okay. But all things being equal, the more fuel prices rise and the greater the fuel charges incurred, the greater that flotation is until funds are allowed to be recovered, is that correct?

THE WITNESS: That's correct, minus our hedging activities, yes.

(Brief pause at 5:02 p.m.)

(The transcript continues in sequence with Volume 10.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, RAY D. CONVERY, do hereby certify that I was authorized to and did stenographically report the foregoing proceedings at the time and place herein stated.

IT IS FURTHER CERTIFIED that the foregoing transcript is a true record of my stenographic notes.

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 28th day of September, 2009, at Tallahassee, Leon County, Florida.

Ray D. Convery

RAY D. CONVERY