**Progress Energy**

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COMMISSION
CLERK

January 25, 2013

**VIA HAND DELIVERY**

Ms. Ann Cole, Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: *Petition for approval for an accounting order to record in a regulatory asset or liability the unrealized and realized gains and losses resulting from financial accounting requirements related to interest rate derivative agreements, Progress Energy Florida, Inc.;* ***Dkt# 120303-EI***

Dear Ms. Cole:

Please find enclosed Progress Energy Florida, Inc.'s ("PEF") responses to Staff's First Data Request in the above referenced docket.

Thank you for your assistance in this matter. Please call me at (727) 820-4692 should you have any questions.

Sincerely,

Dianne M. Triplett

Dianne M. Triplett

DMT/lmr
Attachments

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FPSC-COMMISSION CLERK

# PROGRESS ENERGY FLORIDA, INC.'S RESPONSES TO STAFF'S DATA REQUEST #1
# DOCKET NO. 120303-EI

**Q1. Per the Company's 2011 Form 10-K (Section 18.D.), a $21 million loss, net of tax, on interest rate derivatives was reported for 2011. A loss of $7 million was reported for 2010. Please reconcile and explain the differences between these amounts and the $239,000 gain for 2010 and $811,000 loss for 2011 that were cited at the January 8, 2013, meeting.**

Response:

The $21 million net-of-tax loss represents total realized and unrealized amounts recorded to Accumulated Other Comprehensive Income (AOCI) during 2011. This amount represents the **effective** portion of the related hedges. The $239,000 gain and $811,000 loss represent the **ineffective** portions of the related hedges. These amounts were recorded directly to interest expense while the effective portion is being amortized to interest expense over the life of the associated debt. Subsequent to the January 8, 2013 meeting, PEF has determined that the referenced $811,000 loss was partially offset by a gain of $401,000 resulting in a 2011 net pre-tax loss of $410,000. The $410,000 did not appear in the Form 10-K table due to amounts being rounded to the millions. If the $410,000 had been presented in the table, it would have appeared in the 2011 column of the table section labeled "Amount of Pre-tax Gain or (Loss) Recognized in Income on Derivatives(b)". The explanation for the 2010 amounts is similar.

**Q2. Please explain how the effective portion of the gain/loss on interest rate hedges is currently accounted for citing the specific FERC accounts utilized.**

Response:

During the term of the hedge, the following entries are recorded for the effective portion of unrealized gains/losses:

Unrealized gain:

| | | |
|---|---|---|
| Acct. 176 Derivative instrument assets – hedges | xxx | |
| Acct. 219 Accumulated other comprehensive income | | xxx |

Unrealized Loss:

| | | |
|---|---|---|
| Acct. 219 Accumulated other comprehensive income | xxx | |
| Acct. 245 Derivative instrument liabilities – hedges | | xxx |

Upon settlement of the hedge, the above entries are reversed and the following entries are recorded for the effective portion of realized gains/losses:

Realized gain:

| | | |
|---|---|---|
| Acct. 143 Accounts Receivable (from counterparty to hedge) | xxx | |
| Acct. 219 Accumulated other comprehensive income | | xxx |

Realized Loss:

| | | |
|---|---|---|
| Acct. 219 Accumulated other comprehensive income | xxx | |
| Acct. 232 Accounts Payable (to counterparty to hedge) | | xxx |

Over the life of the debt, the realized gains/losses are amortized to the interest expense associated with the debt issuance:

Amortization of Realized Gain:

| | | |
|---|---|---|
| Acct. 219 Accumulated other comprehensive income | xxx | |
| Acct. 427 Interest Expense | | xxx |

Amortization of Realized Loss:

| | | |
|---|---|---|
| Acct. 427 Interest Expense | xxx | |
| Acct. 219 Accumulated other comprehensive income | | xxx |

**Q3. How is the effective portion of the gain/loss on interest rate hedges currently utilized in the calculation of the interest rate of the associated debt instrument? Provide examples for debt that actually has been issued. (See MFR Schedule D-4a)**

Response: The effective portion of the gain/loss on interest rate hedges is amortized to interest expense over the life of the associated debt. Please refer to the attached copy of MFR Schedule D-4a, page 5 of 6, which was submitted on March 20, 2009 in Docket No. 090079-EI. For example, refer to Line 13, FPC 5.65% due 2018, issued on 6/18/08. The attached schedule, page 1 of 2, provides the calculation that makes up col. J, total interest expense of $14,490,000 for this particular debt issuance as follows:

- Coupon rate interest expense of $15,145,136 (for 2008)
- Less the ineffective portion of the gain recorded immediately in June 2008 of $411,796
- Less the amortization of the $4,487,073 effective portion of the gain over ten years of $243,050 (for 2008).

**Q4. Please explain how the ineffective portion on the gain/loss of interest rate hedges is currently accounted for citing the specific FERC accounts utilized.**

Response:

The ineffective portion of the gain/loss is recorded directly to interest expense.

Assume: Derivative asset of $1,000,000 with effective gain portion of $975,000 and ineffective portion of $25,000

| | | |
|---|---|---|
| Acct. 176 Derivative instrument assets – hedges | 1,000,000 | |
| Acct. 219 Accumulated other comprehensive income | | 975,000 |
| Acct. 427 Interest Expense | | 25,000 |

**Q5. How is the ineffective portion of the gain/loss on interest rate hedges currently utilized in the calculation of the interest rate of the associated debt instrument? Provide examples for debt that actually has been issued. (See MFR Schedule D-4a)**

Response: PEF records the ineffective portion immediately. See PEF's response to Data Request No. 3.

**Q6. Are both the effective and ineffective portions of the gain/loss on interest rate hedges currently amortized to interest expense over the life of the associated debt? If not, please explain how they are treated.**

Response:

No, only the effective portion is amortized to interest expense over the life of the associated debt. The ineffective portion is recorded directly to interest expense. See PEF's response to Data Request No. 4.

**Q7. Under the Company's proposal, please explain how the effective portion of the gain/loss on interest rate hedges would be accounted for citing the specific FERC accounts to be utilized.**

Response:

See PEF's response to Data Request No. 2. The only difference would be the replacement of Acct. 219 Accumulated other comprehensive income with either Acct. 182.3 Other regulatory assets (in the case of a loss) or Acct. 254 Other Regulatory Liabilities (in the case of a gain).

**Q8. Under the Company's proposal, how would the effective portion of the gain/loss on interest rate hedges be utilized in the calculation of the interest rate of the associated**

**debt instrument? Please use the same debt as provided in response to Data Request No. 3. (See MFR Schedule D-4a)**

Response: There would be no change in the way the effective portion of the gain/loss on interest rate hedges is utilized in the calculation of the interest rate on the associated debt instrument. See PEF's response to Data Request No. 3.

**Q9. Under the Company's proposal, please explain how the ineffective portion of the gain/loss on interest rate hedges would be accounted for citing the specific FERC accounts to be utilized.**

Response:

The ineffective portion would be treated the same as the effective portion; it would be amortized to interest expense over the life of the associated debt. See PEF's response to Data Request No. 7 & 2.

**Q10. Under the Company's proposal, how would the ineffective portion of the gain/loss on interest rate hedges be utilized in the calculation of the interest rate of the associated debt instrument? Please use the same debt as provided in response to Data Request No. 5. (See MFR Schedule D-4a)**

Response: The ineffective portion would be treated the same as the effective portion; it would be amortized to interest expense over the life of the associated debt. See the attachment to PEF's response to Data Request No. 3.

**Q11. Under the Company's proposal, would both the effective and ineffective portions of the gain/loss on interest rate hedges be amortized to interest expense over the life of the associated debt? If not, please explain how they would be treated.**

Response:

Yes.

**Q12. Under the Company's proposal, is it correct that interest rate hedging losses would be recorded as a regulatory asset to be included in rate base for ratemaking purposes and would earn the overall rate of return?**

Response:

Unrealized gains and losses would be netted against the associated derivative asset or liability, with no rate base effect. Regulatory asset amounts for realized hedging losses would be included in rate base. However, this addition to rate base is completely offset by the decrease in cash paid to the counterparty. Similarly, regulatory liability amounts for realized hedging gains would be a reduction to rate base, and this reduction to rate base is completely offset by the increase in cash received from the counterparty.

**Q13. Is it correct that interest rate hedging losses are currently not included in rate base and do not earn a return?**

Response: Unrealized gains/losses: Currently interest rate derivative assets and liabilities are included in rate base and earn a return. The offsetting unrealized gains and losses are recorded in common equity (AOCI) and therefore are a component of the weighted average cost of capital. Prospectively, unrealized gains and losses recorded in regulatory assets and liabilities will offset the derivative assets and liabilities, resulting in no rate base impact.

Realized gains/losses: Currently realized gains increase common equity, thereby increasing the weighted average cost of capital, and rate base is increased as well by the amount of cash received from the counterparty. Realized losses decrease common equity, thereby decreasing the weighted average cost of capital, and rate base is decreased by the amount of cash paid to the counterparty. Prospectively, realized losses will serve to increase rate base and will be offset by the cash paid to the counterparty, and realized gains will serve to decrease rate base and will be offset by the cash received from the counterparty.

**Q14. Please provide a copy of the GAAP required documentation for an actual gain and an actual loss on interest rate hedges.**

Response:

Please see the attachment. The first 15 pages represent the "SFAS No. 133 Interest Rate Derivative Evaluation Package" which contains the documentation required by GAAP. This package provides the required documentation for a $75 million hedge which represents one of three hedge transactions for debt to be issued in 2011. The other two hedge transactions had similar documentation. Due to a movement in the expected debt issuance date and related hedging instrument amendments, for each of the original three hedges there were two hedge de-designations and re-designations. Each re-designation required new documentation packages. Also, note that the prospective effectiveness test in Section K must be performed at least quarterly for each hedge.

The next 5 pages include the effectiveness measurements which are also required by GAAP. Due to the de-designations and re-designations discussed above, five separate effectiveness measurements had to be performed for each original hedge. Those five measurements resulted in a net ineffectiveness recorded of $410,628 loss. The amounts in the "Ineffectiveness" columns can be added together to arrive at the $410,628 loss. In order to perform these calculations, PEF must access an external website to populate the "hypothetical" amounts in the attached pages. A screen print for one of these amounts is included in the final page of the attachment.

While the attached documents will no longer be required by GAAP, PEF will continue to document the rationale for entering into the hedges as well as the calculation of both the unrealized and realized gains and losses.

**Q15. Under the Company's proposal, what documentation would be kept to verify the prudence of the hedging transactions?**

Response:

The decision to enter into interest rate hedges is made by the Treasury Department, which would maintain documentation of its decision to hedge and the reasons therefore. In addition, PEF will continue to track and record both unrealized and realized gains and losses.

**Q16. Please provide a schedule that shows what the Company actually booked related to interest rate hedges for each of the past 5 years and what the Company would have booked each year for the same transactions had the requested treatment been in place the past 5 years. For purposes of this response, show all applicable FERC accounts.**

Response:

Please see the attachment.

**Docket No. 120303**
**PEF's Response to Staff's First Data Request Nos. 3, 5, 8 and 10**

**June 18, 2008 Settlement related to 10-Year $500 million First Mortgage Bonds issued June 18, 2008**

| Counterparty | (Gain)/Loss |
|---|---|
| Wachovia | ($1,442,461) |
| Wachovia | (1,885,572) |
| Bank of Tokyo | (1,570,836) |
| Subtotal (Gain)/Loss | (4,898,869) |
| Ineffective Portion | 411,796 |
| Remaining (Gain)/Loss to be amortized | (4,487,073) |
| Monthly Amortization (120 months) | ($37,392) |

Interest Expense (MFR D-4a, page 5 of 6, Line 13, Col. J):

| | Current Process | | | | Future Process | | | |
|---|---|---|---|---|---|---|---|---|
| | Coupon Rate Int Exp | Ineffective Portion (gain)/loss | Effective Portion (gain)/loss | Total Int Exp | Coupon Rate Int Exp | Ineffective Portion * (gain)/loss | Effective Portion (gain)/loss | Total Int Exp |
| Jun 18-30, 2008 | $1,020,136 | ($411,796) | ($18,696) | $589,644 | $1,020,136 | ($1,716) | ($18,696) | $999,724 |
| Jul-2008 | 2,354,167 | | (37,392) | 2,316,774 | 2,354,167 | (3,432) | (37,392) | 2,313,343 |
| Aug-2008 | 2,354,167 | | (37,392) | 2,316,774 | 2,354,167 | (3,432) | (37,392) | 2,313,343 |
| Sep-2008 | 2,354,167 | | (37,392) | 2,316,774 | 2,354,167 | (3,432) | (37,392) | 2,313,343 |
| Oct-2008 | 2,354,167 | | (37,392) | 2,316,774 | 2,354,167 | (3,432) | (37,392) | 2,313,343 |
| Nov-2008 | 2,354,167 | | (37,392) | 2,316,774 | 2,354,167 | (3,432) | (37,392) | 2,313,343 |
| Dec-2008 | 2,354,167 | | (37,392) | 2,316,774 | 2,354,167 | (3,432) | (37,392) | 2,313,343 |
| | $15,145,136 | ($411,796) | ($243,050) | $14,490,290 | $15,145,136 | ($22,306) | ($243,050) | $14,879,781 |

* Note, the Ineffective portion will no longer be tracked. It will be included with the effective portion and amortized over the life of the associated debt. The ineffective portion is listed separately in this example for demonstration purposes.

SCHEDULE D-4a

Long-Term Debt Outstanding

Page 5 of 6

FLORIDA PUBLIC SERVICE COMMISSION

Company: PROGRESS ENERGY FLORIDA INC.

Docket No. 090079-EI

Explanation: Provide the specified data on long-term debt issues on a 13-month average basis for the test year, prior year and historical base year. Arrange by type of issue (i.e. first mortgage bonds)

Type of data shown:
_ Projected Test Year Ended 12/31/2010
_ Prior Year Ended 12/31/2009
X Historical Test Year Ended 12/31/2008
Witness: Sullivan

In Thousands ($000)

| | (A) | (B) | (C) | (D) | (E) | (F) | (G) | (H) | (I) | (J) |
|---|---|---|---|---|---|---|---|---|---|---|
| Line No. | Description, Coupon Rate | Issue Date | Maturity Date | Principal Amt Sold (Face Value) | 13-Month Average Principal Amt Outstanding | Discount (Premium) on Principal Amt Sold | Issuing Expenses on Principal Amt Sold | Life (Years) | Annual Amortization* | Interest Expense (Coupon Rate) |
| 1 | First Mortgage Bonds | | | | | | | | | |
| 2 | | | | | | | | | | |
| 3 | FPC 6.875 2008 | 2/9/93 | 02/01/08 | 80,000 | 12,308 | 1,070 | 756 | 15.0 | 9 | 458 |
| 4 | FPC 6.65% 2011 | 7/18/01 | 07/15/11 | 300,000 | 300,000 | 429 | 3,183 | 10.0 | 356 | 19,950 |
| 5 | FPC PCB VAR 2002A 2027 | 8/20/02 | 01/01/27 | 108,550 | 108,550 | - | 2,357 | 24.3 | 384 | 5,512 |
| 6 | FPC PCB VAR 2002B 2022 | 7/24/02 | 01/01/22 | 100,115 | 100,115 | - | 2,082 | 19.4 | 372 | 5,151 |
| 7 | FPC PCB VAR 2002C 2014 | 8/13/02 | 01/01/18 | 32,200 | 32,200 | - | 758 | 15.3 | 136 | 1,673 |
| 8 | FPC 4.8% 2013 | 2/21/03 | 03/01/13 | 425,000 | 425,000 | 1,513 | 4,586 | 10.0 | 597 | 20,400 |
| 9 | FPC 5.9% 2033 | 2/21/03 | 03/01/33 | 225,000 | 225,000 | 572 | 3,013 | 30.0 | 119 | 13,275 |
| 10 | FPC 5.10% Due 2015 | 11/21/03 | 12/01/15 | 300,000 | 300,000 | 594 | 3,473 | 12.0 | 340 | 15,300 |
| 11 | FPC 4.50% Due 2010 | 05/16/05 | 06/01/10 | 300,000 | 300,000 | 915 | 3,292 | 5.0 | 726 | 13,500 |
| 12 | FPC 5.8% Due 2017 | 09/12/07 | 09/15/17 | 250,000 | 250,000 | 672 | 2,999 | 10.0 | 363 | 14,918 |
| 13 | FPC 5.65% Due 2018 | 06/18/08 | 06/15/18 | 500,000 | 268,231 | 1,805 | 5,559 | 10.0 | 399 | 14,490 |
| 14 | FPC 6.35% Due 2037 | 09/12/07 | 09/15/37 | 500,000 | 500,000 | 660 | 5,706 | 30.0 | 246 | 32,069 |
| 15 | FPC 6.4% Due 2038 | 06/18/08 | 06/15/38 | 1,000,000 | 538,462 | 4,220 | 13,136 | 30.0 | 313 | 33,290 |
| 16 | | | | | | | | | | |
| 17 | Subtotal | | | 4,120,865 | 3,360,865 | 12,449 | 51,868 | | 4,359 | 189,985 |
| 18 | | | | | | | | | | |
| 19 | Other Long Term Debt | | | | | | | | | |
| 20 | FPC 6.87 2008 (Sebring) | 04/20/93 | 04/01/08 | 30,700 | 585 | - | 281 | 15.0 | 6 | 32 |
| 21 | FPC 6.75 2028 | 2/13/98 | 02/01/28 | 150,000 | 150,000 | 437 | 5,528 | 30.0 | 200 | 10,125 |
| 22 | FPC Floating Senior Note | 12/13/05 | 11/14/08 | 450,000 | 276,923 | - | 1,555 | 3.0 | 388 | 10,339 |
| 23 | | | | | | | | | | |
| 24 | Subtotal | | | 630,700 | 427,508 | 437 | 7,364 | | 592 | 20,496 |
| 25 | | | | | | | | | | |
| 26 | Reacquired Debt and Other Unallocated Expenses | | | | | | | | 4,302 | |
| 27 | | | | | | | | | | |
| 28 | Total | | | | 3,788,373 | 12,886 | 59,232 | - | 9,253 | 210,481 |
| 29 | | | | | | | | | | |
| 30 | Less Temporary Cash Investments | | | | 215,006 | | | | | |
| 31 | Less Unamortized Premium, Discount and Issuance Expense (L+M) | | | | 66,429 | | | | | |
| 32 | Net | | | | 3,506,938 | | | | | |
| 33 | Embedded Cost of Long-term Debt | | | | 6.27% | | | | | |
| 34 | | | | | | | | | | |
| 35 | * Prorated for bonds not outstanding entire year | | | | | | | | | |

Supporting Schedules:

Recap Schedules:

# SFAS No. 133 Interest Rate Derivative Evaluation Package Cover Sheet

| | |
|---|---|
| **Progress Energy Legal Entity** | PEF |
| **Derivative Reference Number**<br>(entity-year-number-deal type-designation) | PEF-2011-11-IR-CFH [Treasury Trade Ticket PEF-11-01] |
| **Zai*Net Reference Number(s)** | N/A<br>**NOTE: THE FOLLOWING TERMS ARE USED HEREIN [indicated by quotation marks within the document].**<br>**Applicable PGN Entity: PEF**<br>**Defined Range: 5/3/11 – 8/1/11**<br>**Instrument Effective Date: 7/15/11**<br>**Subject Hedging Instrument: PEF-11-01**<br>**Trade Date: 5/3/11** |

| **Transaction Description** | | | |
|---|---|---|---|
| Counterparty | | Royal Bank of Scotland | |
| Trade Date | | 5/3/11 | |
| Effective Date | | 7/15/11 | |
| Maturity Date | | 7/15/21 (for computation purposes) | |
| Interest Rate Basis | | 3 month LIBOR | |
| Reset Frequency | | See Section L | |
| Payment Frequency | | See Section L | |
| Day Count | | Callable? (Yes or No) | |
| Brief Description of Instrument | Forward Starting Swap | | |
| Swap ☐ | Option ☐ | NYMEX Futures ☐ | Collar ☐ |
| Firm Commitment (OTC) ☐ | | Other (describe) | |
| Price | See Section L | Notional | $75 million |
| Term | Mandatory termination on Effective above | Other | |

| | **Item** | **Yes** | **No** | **Comment** |
|---|---|---|---|---|
| A | Summary of Accounting Treatment | ☒ | ☐ | |
| B | Derivative Criteria Analysis | ☒ | ☐ | |
| C | Embedded Derivatives Analysis | ☒ | ☐ | |
| D | 10% Stress Test for 2nd Review | ☒ | ☐ | |
| E | Cash Flow Hedge Documentation | ☒ | ☐ | |
| F | Fair Value Hedge Documentation | ☐ | ☒ | |
| G | Shortcut Method Analysis | ☐ | ☒ | |
| H | Matched Terms Method Analysis | ☐ | ☒ | |

# SFAS No. 133 Derivative Evaluation Package

| | | | | |
|---|---|---|---|---|
| I | FIN 45 Analysis | ☒ | ☐ | |
| J | FIN 46R Analysis | ☒ | ☐ | |
| K | Regression Tests (Cash Flow & Fair Value hedges) | ☒ | ☐ | DV01 analysis rather than regression |
| L | Final Contract (or confirm if executed under master agreement) | ☒ | ☐ | |
| M | Business Analysis Package | ☐ | ☒ | |
| N | Other (Describe) | ☒ | ☐ | Treasury Memo |

## FORM 133 – IR

***Purpose: To document the initial evaluation (or redesignation) of non-pre-approved interest rate derivative transactions in accordance with SFAS No. 133 and Progress Energy Policy ACT–SUBS–00074.***

### A. Summary of Accounting Treatment

| | Yes | No | N/A |
|---|---|---|---|
| SFAS No. 133 Accounting Treatment: | | | |
| Accrual (not a derivative under SFAS No. 133) | ☐ | ☐ | ☒ |
| Cash Flow Hedge | ☒ | ☐ | ☐ |
| Fair Value Hedge | ☐ | ☐ | ☒ |
| MTM – No further documentation required | ☐ | ☐ | ☒ |
| | | | |
| *SFAS No. 133 Approval Signatures* | | | |

| | | | | |
|---|---|---|---|---|
| Trade Date (1) | 5/3/11 | | | (1) If Form SFAS 133-C is completed more than 2 business days after trade date, 2nd review is required. |
| Preparer | J. Bass/s/ | Date (1) | 5/5/11 | |
| Reviewer | W. Stallings /s/ | Date | 6/3/11 | |
| 2nd Reviewer Needed? (2) | | Yes<br>☐ | No<br>☒ | (2) 2nd review also required if 10% change in prices would cause $20 million change in fair value (see section D) |
| 2nd Reviewer | | Date | | |

| | Yes | No | N/A |
|---|---|---|---|
| Does contract include guarantees under FIN 45? | ☐ | ☒ | ☐ |
| Have FIN 45 guarantees been communicated to SEC Reporting and the applicable legal entity? | ☐ | ☐ | ☒ |
| | | | |
| *FIN 46R Accounting Treatment and Approval Signatures* | | | |

# SFAS No. 133 Derivative Evaluation Package

| | Yes | No | N/A |
|---|---|---|---|
| Significant Variable Interest per FIN No. 46? | ☐ | ☒ | ☐ |
| Is PGN affiliate the Primary Beneficiary? | ☐ | ☐ | ☒ |
| | | | |

| | | | | |
|---|---|---|---|---|
| AP&R Reviewer | J. Bass/s/ | Date | 5/5/11 | |

| | | | |
|---|---|---|---|
| Has transaction been input into AP&R derivative log? | ☒ | ☐ | ☐ |

## B. Derivative Criteria Analysis

| | Yes | No |
|---|---|---|
| Based on the four criteria below, is the contract a derivative financial instrument under SFAS No. 133? | ☒ | ☐ |
| | **Response:** | |
| 1. Does the contract have a notional amount or payment provision? | ☒ | ☐ |
| 2. Does the contract have an underlying? | ☒ | ☐ |
| 3. Does the contract have a zero or minimal net investment? | X | ☐ |
| 4. Does the contract provide for net settlement? | ☒ | ☐ |
| | | |

## C. Embedded Derivatives

| | | |
|---|---|---|
| | | |
| C.1 Does the contract contain any of the following features? If Yes, evaluate if the feature is an embedded derivative under section B, using Form 133-C as a supplement as necessary.<br>**NOT APPLICABLE --- INSTRUMENT IS A DERIVATIVE** | **Yes** | **No** |
| Any payments tied to indices | ☐ | ☐ |
| Any payments indexed to interest rates | ☐ | ☐ |
| Leverage factors | ☐ | ☐ |
| Links or references to equity interests | ☐ | ☐ |
| Early exercise rights | ☐ | ☐ |
| Prepayment options | ☐ | ☐ |
| “Make-whole” provisions | ☐ | ☐ |
| Warrants | ☐ | ☐ |
| Payments denominated in other than the payer’s | ☐ | ☐ |

| | | |
|---|---|---|
| functional currency | | |
| Conversion rights | ☐ | ☐ |
| Repurchase rights | ☐ | ☐ |
| Puts | ☐ | ☐ |
| Calls | ☐ | ☐ |
| Cashless exercise rights | ☐ | ☐ |
| Rights to cancel/extend | ☐ | ☐ |
| Caps or collars | ☐ | ☐ |
| Incentive payments or “sweeteners” | ☐ | ☐ |
| C.2 Is an embedded derivative present? | **Yes** | **No** |
| | ☐ | ☐ |
| | **Response:** | |

## D. 10% Stress Test for 2nd Review threshold

| Component | $ Amount | Data Source |
|---|---|---|
| Total Contract volume (A) | | |
| Contract price (B) | | |
| Expected Contract value (A x B) | $ 75 Million | Used notional amount --- extremely conservative |
| Expected Contract value * 10% | $7.5 million | |
| Is 10% of Expected Contract value greater than $20 million? | **Yes** | **No** |
| | ☐ | ☒ |
| If Yes, then 2nd review is required | | |

## E. Cash Flow Hedge Documentation

| | Yes | No |
|---|---|---|
| Is this section applicable? If Yes, provide a description of the required documentation items below in sufficient detail so that the hedged election, intent and accounting methods can be followed by an independent third-party. | ☒ | ☐ |

| | |
|---|---|
| **Hedged Item**<br>The description of the hedged item must be specific enough so that it is readily apparent when the hedged transaction occurs. | 3rd $75 million of 10-year fixed-rate debt issued by “Applicable PGN Entity” in “Defined Range.” |

# SFAS No. 133 Derivative Evaluation Package

| | | |
|---|---|---|
| **Hedged Risk** | Risk of changes in benchmark interest rate (LIBOR) -- variability of 20 semi-annual interest payments | |
| **Hedging Instrument** | **Counterparty** | **Trade Date** |
| | Royal Bank of Scotland | 5/3/11 |
| | **Description:** Forward Starting Swap | |
| **Is the Hedged Item a Forecasted Transaction?**<br>If Yes, the documentation of a hedged forecasted transaction should include reference to the timing (i.e., the estimated date), the nature, and amount (i.e. the hedged quantity or amount) of the forecasted transaction. If No, skip this and the next question. | **Yes** | **No** |
| | ☒ | ☐ |
| | **Response:** See Treasury Memo in Section N | |
| **Is the Hedged Forecasted Transaction Probable of Occurring?**<br>If Yes, document the basis for the conclusion, including an assessment of the creditworthiness of the counterparty to the hedged forecasted transaction. If the likelihood that the counterparty to the forecasted transaction will not default ceases to be probable, an entity would be unable to conclude that the forecasted transaction is probable. | **Yes** | **No** |
| | ☒ | ☐ |
| | **Response:** Refer to the Treasury memo at Section N, which documents the factors underlying PGN's forecast of the debt issuance. In addition, the specified range provides adequate "cushion" for a change in dates; and only 75% of the expected issuance is hedged (including prior hedges). [Note: 75% is higher than most interest rate hedged positions. But, in this case the expected debt issuance date is only two months away and this is highly predictable.] Based on those factors, we concluded that the forecasted transaction is probable. The probability will be monitored and documented on an ongoing basis, no less frequently than quarterly. | |
| **Is the Hedged Item a Portfolio of Transactions?**<br>If Yes, in order for a group of individual transactions to be aggregated as one hedged transaction in a cash flow hedge, the individual transactions in the portfolio must share the same risk exposure for which they are designated as being hedged. If a forecasted transaction does not share the risk exposure for which the group of items is being hedged, it should not be part of the group being hedged. | **Yes** | **No** |
| | ☐ | ☒ |
| | **Response:** | |

# SFAS No. 133 Derivative Evaluation Package

| | |
|---|---|
| **Hedging Objective and Strategy for Accomplishing Such Objective** | The purpose of entering into this forward starting swap is to limit interest rate exposure on an anticipated fixed-rate debt issuance. This hedge complies with the general principles established in the corporate Risk Management Policy and with Treasury Risk Management Guidelines. See Section N for a Treasury memo with information specific to this transaction. |

| | | |
|---|---|---|
| | | |
| | **Yes** | **No** |
| Does the contract qualify for the Shortcut Method under section G? If Yes, document N/A for next 3 items. If No, complete the next three items in detail. | ☐ | ☒ |

| | |
|---|---|
| **Effectiveness Testing Methodology**<br>This description needs to be explicit and consistent for all transactions of the same type. The method used for assessing hedge effectiveness and measuring ineffectiveness must be documented with sufficient specificity so that a third party could perform the measurement based on the documentation and arrive at the same result.<br>If the likelihood that the counterparty to the derivative will not default ceases to be probable, an entity would be unable to conclude that the hedging relationship in a cash flow hedge is expected to be highly effective in achieving offsetting cash flows. | **Initial Effectiveness Assessment**<br>Based upon the initial assessment documented in Section K, the hedge is expected to be highly effective.<br>**Prospective Effectiveness Assessment**<br>Refer to the Initial Effectiveness Assessment in Section K. We believe that assessment establishes that the hedge will be effective on a prospective basis since the changes in value of "Subject Hedging Instrument" and the hypothetical derivatives are based on the same variable, i.e., a change in the LIBOR. [Note that this is different than a commodity situation where there are locational differences between the hedging instrument and the hedged item, and different factors affect pricing at the locations.] However, we will repeat that test at the end of each quarter to establish that the DV01 values continue to indicate that future changes in LIBOR will result in changes that are highly correlated.<br>**Retrospective Effectiveness Assessment**<br>At the end of each quarter, we will perform a retrospective effectiveness assessment to determine that the actual fair values have changed in a highly correlated manner. That assessment will be based on the changes in fair value since hedge inception. Changes between .80 and 1.25 are considered highly effective. The assessment uses the fair value of the "Subject Hedging Instrument" and the fair value of the hypothetical instrument corresponding to the most likely debt issuance date. |

| | |
|---|---|
| **Methodology for Measuring and Recognizing Ineffectiveness** | **<u>If "Instrument Effective Date" is regarded as the best estimate for the debt issuance</u>**<br>The perfect hedge will be "Subject Hedging Instrument" since its effective date and the expected debt issuance date are the same.<br>**<u>If a date other than "Instrument Effective Date" (Date X) is regarded as the best estimate for the debt issuance</u>**<br>The perfect hedge will be a hypothetical derivative entered into at "Trade Date" (with no value) for a Date X debt issuance date. The change in value of "Subject Hedging Instrument" since "Trade Date" will be compared to the change in value of that hypothetical derivative to determine the effective and ineffective portions under FAS 133.<br>**<u>Actual debt issuance date (Actual Date)</u>**<br>The perfect hedge will be a hypothetical derivative entered into at "Trade Date" (with no value) for a debt issuance on Actual Date. The change in value of "Subject Hedging Instrument" since "Trade Date" will be compared to the change in value of that hypothetical derivative to determine the effective and ineffective portions under FAS 133. |
| **Methodology for Reclassifying Amounts Held in OCI to Income** | Amounts in OCI will be amortized to interest expense on a straightline basis over the life of the related debt. |
| **Financial Statement Line Item Affected When Recorded in Income** | Interest expense |

## F. Fair Value Hedge Documentation

| | Yes | No |
|---|---|---|
| Is this section applicable? If Yes, provide a description of the required documentation items below in sufficient detail so that the hedge election, intent and accounting methods can be followed by an independent third-party. | ☐ | ☒ |

# SFAS No. 133 Derivative Evaluation Package

| | | |
|---|---|---|
| | | |
| **Hedged Item**<br>The description of the hedged item must be specific enough so that the hedged item can be readily identified. | | |
| **Hedged Risk** | | |
| **Hedging Instrument** | **Counterparty** | **Trade Date** |
| | | |
| | **Description:** | |
| **Is the Hedged Item a Portfolio of Transactions?**<br>If Yes, in order for a group of individual transactions to be aggregated as one hedged transaction in a cash flow hedge, the individual transactions in the portfolio must share the same risk exposure for which they are designated as being hedged. If a forecasted transaction does not share the risk exposure for which the group of items is being hedged, it should not be part of the group being hedged. | **Yes** | **No** |
| | ☐ | ☐ |
| | **Response:** | |
| **Hedging Objective and Strategy for Accomplishing Such Objective** | | |
| | | |
| | **Yes** | **No** |
| Does the contract qualify for the Shortcut Method under section G? If Yes, document N/A for next 3 items. If No, complete the next three items in detail. | ☐ | ☐ |

| | |
|---|---|
| **Effectiveness Testing Methodology**<br>This description needs to be explicit and consistent for all transactions of the same type. The method used for assessing hedge effectiveness and measuring ineffectiveness must be documented with sufficient specificity so that a third party could perform the measurement based on the documentation and arrive at the same result.<br>If the likelihood that the counterparty to the derivative will not default ceases to be probable, an entity would be unable to conclude that the hedging relationship in a cash flow hedge is expected to be highly effective in achieving offsetting cash flows. | |
| **Methodology for Measuring and Recognizing Ineffectiveness** | |
| **Financial Statement Line Item Affected When Recorded in Income** | |

## G. Shortcut Method Analysis

| | | |
|---|---|---|
| | | |
| | **Yes** | **No** |
| G.1 DIG Issue E4 indicates the shortcut method may only be used for an interest rate swap. The shortcut method may not be applied in a cash flow hedge of a forecasted transaction, even if an entity determines that all critical terms of the hedging instrument and the hedged forecasted transaction are matched. Does the contract meet this requirement for consideration of the use of the shortcut method? If No, proceed to section H. | ☐ | ☒ |
| | | |

| | | | |
|---|---|---|---|
| G.2 | For both cash flow and fair value hedges, do all of the following apply? If there are any No answers, the contract does not qualify for the shortcut method - proceed to section H. | **Yes** | **No** |
| | The notional amount on the swap equals the notional amount of the debt. | ☐ | ☐ |
| | The fair value of the swap at inception of the hedging relationship was zero (no upfront payments were made or received). | ☐ | ☐ |
| | The formula for computing net settlement is the same for each net settlement. | ☐ | ☐ |
| | The underlying debt is not prepayable (or if so, at or above fair value). | ☐ | ☐ |
| | The index on which the variable leg of the swap is based matches the benchmark interest rate designated as the interest rate risk being hedged for that hedging relationship. | ☐ | ☐ |
| | There are no special terms in either the debt or the swap that invalidate the assumption of ineffectiveness. | ☐ | ☐ |
| | | | |
| G.3 | For cash flow hedges, do all of the following also apply? If not a cash flow hedge, proceed to section G.3. If there are any No answers, the contract does not qualify for the shortcut method - proceed to section H. | **Yes** | **No** |
| | All interest payments on the debt are hedged, and no interest payments beyond the term of the swap are hedged. | ☐ | ☐ |
| | There is no floor or cap on the variable rate side of the swap unless the variable rate debt has a floor or cap. In that case, the swap must have a floor or cap on the variable interest rate that is comparable to the floor or cap on the variable-rate asset or liability. | ☐ | ☐ |
| | The repricing dates match those of the variable-rate asset or liability. | ☐ | ☐ |
| | | | |
| G.4 | For fair value hedges, do all of the following also apply? If not a fair value hedge, skip this section G.3. If there are any No answers, the contract does not qualify for the shortcut method - proceed to section H. | **Yes** | **No** |
| | The expiration date of the swap matches the | ☐ | ☐ |

| | | | |
|---|---|---|---|
| | maturity date of the interest-bearing asset or liability. | | |
| | There is no floor or cap on the variable rate side of the swap. | ☐ | ☐ |
| | The reset date on the floating rate side is frequent enough to assume that the variable payment or receipt is at a market rate. | ☐ | ☐ |
| | | | |
| G.5 | Was this Form 133-IR completed within 5 business days after execution of the contract? **If No, the contract does not qualify for the shortcut method or the matched terms method under section 1.14 of policy ACT-SUBS-00074.** The method for assessing effectiveness using an accepted long-haul method must be documented in section E or F above. | **Yes** | **No** |
| | | ☐ | ☐ |
| | | **Response:** | |
| | | | |
| | | **Yes** | **No** |
| Based on the responses to sections G.1 – G.5, does the contract qualify for the shortcut method? | | ☐ | ☐ |

## H. Matched Terms Method Analysis

| | | | |
|---|---|---|---|
| | | | |
| | | **Yes** | **No** |
| H.1 | SFAS No. 133 paragraph 65 states that if the critical terms of the hedging instrument and of the entire hedged asset or liability (as opposed to selected cash flows) or hedged forecasted transaction are the same, the entity could conclude that changes in fair value or cash flows attributable to the risk being hedged are expected to completely offset at inception and on an ongoing basis. Current interpretations of SFAS No. 133 require the critical terms to match exactly with no deviation. Do the critical terms listed in H.2 of the contact and the hedged item meet this criteria? If No, the contract must be documented using an accepted long-haul method for assessing effectiveness under section E or F above. If Yes, proceed to H.2 | ☐ | ☒ |
| | | | |
| H.2 | If the response to H.1 is Yes, document the critical terms of the derivative and the hedged item to | **Derivative** | **Hedged Item** |

| | | |
|---|---|---|
| confirm the terms match exactly. | | |
| Notional (derivative) and principal (debt) | | |
| Receive/pay rates (derivative) and interest rate basis (debt) | | |
| Contract term or remaining term | | |
| Pricing dates/reset dates | | |
| Settlement/payment dates (derivative) and maturity dates (debt) | | |
| Other special terms in either the derivative or the debt that impact effectiveness | | |
| | | |
| H.3 Was this Form 133-IR completed within 5 business days after execution of the contract? **If No, the contract does not qualify for the matched terms method under section 1.14 of policy ACT-SUBS-00074.** The method for assessing effectiveness using an accepted long-haul method must be documented in section E or F above. | **Yes**<br>☐<br>**Response:** | **No**<br>☐ |
| | | |
| | **Yes** | **No** |
| Based on the responses to sections H.1 – H.3, does the contract qualify for the matched terms method? | ☐ | ☐ |

## I. FIN 45 Analysis

| | | |
|---|---|---|
| Based on review of the contract and consideration of the questions below, does the contract contain guarantees or indemnifications within the scope of FIN 45 that are to be either recorded or disclosed? If Yes, notify SEC Reporting for disclosure. | **Yes**<br>☐ | **No**<br>☒ |
| Does the contract contain any of the following?<br>1. Clauses that contingently require the guarantor to make payments (either in cash, financial instruments, other assets, shares of its stock, or provision of services) to the guaranteed party based on changes in an underlying that is related to an asset, a liability, or an equity security of the guaranteed party? | **Yes**<br>☐<br>**Response:** | **No**<br>☒ |
| 2. Clauses that contingently require the guarantor to make payments (either in cash, financial instruments, other assets, shares of its stock, or provision of services) to the guaranteed party based on another entity's failure to perform under an obligating agreement (performance | **Yes**<br>☐<br>**Response:** | **No**<br>☒ |

| | | |
|---|---|---|
| guarantees)? | | |
| 3. Indemnification clauses that contingently require the indemnifying party (guarantor) to make payments to the indemnified party (guaranteed party) based on changes in an underlying that is related to an asset, a liability, or an equity security of the indemnified party? | **Yes**<br>☐ | **No**<br>☒ |
| | **Response:** | |
| 4. Indirect guarantees of the indebtedness of others? | **Yes**<br>☐ | **No**<br>☒ |
| | **Response:** | |
| If any of questions I.1 – I.4 are Yes, do the guarantees or indemnifications qualify for any of the scope exceptions in paragraphs 4, 6 and 7 of FIN 45? Common scope exceptions used by Progress Energy are guarantees of future performance and guarantees between common control entities. | **Yes**<br>☐ | **No**<br>☐ |
| | **Response:** | |

## J. FIN 46R Analysis

| | **Significant Variable Interest Under FIN 46R?** | |
|---|---|---|
| ***I.1 Application of FIN 46R to Contract*** | **Yes** | **No** |
| Briefly describe FIN 46R implications of contract below. It is expected that interest rate derivative instruments will not be significant variable interests in the counterparties with which Progress Energy contracts. | ☐ | ☒ |
| Instrument is with a major financial institution, Royal Bank of Scotland | | |
| | | |

# SFAS No. 133 Derivative Evaluation Package

## SECTION K
## Initial Effectiveness Assessment

### Treasury Trade PEF-11-01

The hedge is expected to be highly effective based on the results of the analysis described below.

*(Preparer - Right click on the spreadsheet below, select Worksheet Object/Open, and enter values into the yellow shaded cells)*

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**Derivative Instrument:**

Page K.2 shows the Bloomberg screen for PEF-11-01 at 5/3/11

The lower right hand corner of that screen shows the change in value that will result from one basis point change in the LIBOR rate --- a change of $ 67,404.00

**5/16/11 Debt Issuance - Hypothetical Derivative at the Hedge Designation Date of 5/3/2011**

Page K.3 shows the Bloomberg screen for a hypothetical forward starting swap that would be entered into as of 5/3/11 close of business for a 5/16/11 debt issuance.

The lower right hand corner of that screen shows the change in value that will result from one basis point change in the LIBOR rate --- a change of $ 67,593.00

**8/1/11 Debt Issuance - Hypothetical Derivative at the Hedge Designation Date of 5/3/2011**

Page K.4 shows the Bloomberg screen for a hypothetical forward starting swap that would be entered into as of 5/3/11 close of business for a 8/1/11 debt issuance.

The lower right hand corner of that screen shows the change in value that will result from one basis point change in the LIBOR rate --- a change of $ 67,339.00

**Summary:**

| | | PEF-11-01 |
|---|---|---|
| Based on the changes in value of PEF-11-01 compared to the hypothetical derivatives below, | | until |
| is expected to be highly effective regardless of when then debt is issued from | 5/16/11 | 8/1/11 |
| Projected debt issuance dates | 5/16/11 | 8/1/11 |
| Change in PEF-11-01 from one basis point change in the LIBOR rate | $ 67,404 | $ 67,404 |
| Change in hypothetical derivatives from one basis point change in the LIBOR rate | $ 67,593 | $ 67,339 |
| Percent change of hedge vs. hypothetical derivative | 99.7% | 100.1% |

**Purpose: (1) To determine retrospective effectiveness of PEF interest rate cash flow hedges de-designated as of 6/1/11.**
**(2) If effective for accounting purposes, to measure the amount of ineffectiveness to be recorded in income as of the de-designation (no amounts had previously been recorded in income).**

PEF had 3 interest rate instruments outstanding as a cash flow hedge for interest rates to be paid on debt expected to be issued on July 15, 2011. Due to certain hearings, etc. related to nuclear unit CR3 being down, on June 1, 2011 Treasury decided to wait until after the 10-Q is issued in mid-August to issue the PEF debt. Since that new debt issue date is beyond the range specified in the original hedge designation packages, PGN elected to de-designate the hedges as of June 1, 2011.

Effectiveness is assessed and measured below based on a new hypothetical for each hedge --- with the hypothetical entered into on the same dates as the respective hedging instruments with an effective date of 8/31/11, the new most likely debt issue date.

Since the likely new debt issue date is within two months of the end of the debt issue range, no amounts need to be reclassified from AOCI to income due to being "probable of not occuring."

**Preparer** Jim Bass/s/ 6/28/11
**Reviewer** Wayne Stallings /s/ 7/15/11

| A<br>PEF | B<br>FV of Derivative at 6/1/11 | B<br>FV of Hypothetical at 6/1/11 | Ineffectiveness Measurement (Deriv > Hypo) | Retrospective Effectiveness (.80 - 1.25) | |
|---|---|---|---|---|---|
| 10-05 | (5,477,934) | (5,422,478) | (55,456) | 101.0% | Effective for accounting purposes |
| 10-06 | (8,703,057) | (8,670,128) | (32,929) | 100.4% | Effective for accounting purposes |
| 11-01 | (2,197,550) | (2,176,792) | (20,758) | 101.0% | Effective for accounting purposes |
| | | | (109,143) | | |
| | C | C | | | |

A Treasury hedge number

B Refer to Bloomberg screens in this M drive folder.

C Note that totals are not used for ineffectiveness measurements --- ineffectiveness is determined on an instrument-by-instrument basis.

**Purpose: (1) To determine retrospective effectiveness of PEF interest rate cash flow hedges that were re-designated as of 6/1/11.**
**(2) If effective for accounting purposes, to measure the amount of ineffectiveness to be recorded in income for the period from 6/1/11 to 6/30/11**

**Note: Prospective effectiveness expectation will be established on a separate workpaper with all other PGN hedges.**

PEF had 3 interest rate instruments outstanding as a cash flow hedge for interest rates to be paid on debt expected to be issued on July 15, 2011. Due to certain hearings, etc. related to nuclear unit CR3 being down, on June 1, 2011 Treasury decided to wait until after the 10-Q is issued in mid-August to issue the PEF debt. Since that new debt issue date is beyond the range specified in the original hedge designation packages, PGN elected to de-designate the hedges as of June 1, 2011. Effectiveness measurement as of the 6/1/11 de-designation is on a separate workpaper. The hedging instruments were then re-designated as hedging an expected debt issuance between 8/1/11 and 12/30/11, with a most likely issue date of 8/31/11.

Effectiveness is assessed and measured below based on a new hypothetical for each hedge --- with the hypothetical entered into on 6/1/11, the hedge re-designation date, and with an effective date of 8/31/11, the new most likely debt issue date.

**Preparer** Jim Bass/s/ 7/5/11
**Reviewer** Wayne Stallings /s/ 7/15/11

| A | B | B | D | B | | |
|---|---|---|---|---|---|---|
| **PEF** | **FV of Derivative at 6/1/11** | **FV of Derivative at 6/30/11** | **Change in derivative value since re-designation** | **FV of Hypothetical at 6/30/11** | **Ineffectiveness Measurement (Deriv > Hypo)** | **Retrospective Effectiveness (.80 - 1.25)** |
| 10-05 | (5,477,934) | (4,622,360) | 855,574 | 829,243 | 26,331 | 103.2% Effective for accounting purposes |
| 10-06 | (8,703,057) | (7,008,493) | 1,694,564 | 1,658,529 | 36,035 | 102.2% Effective for accounting purposes |
| 11-01 | (2,197,550) | (958,451) | 1,239,099 | 1,243,653 | - | 99.6% Effective for accounting purposes |
| | | | | | 62,366 | |
| | C | | C | C | | |

| | |
|---|---|
| A | Treasury hedge number |
| B | Refer to Bloomberg screens in this M drive folder. |
| C | Note that totals are not used for ineffectiveness measurements --- ineffectiveness is determined on an instrument-by-instrument basis |
| D | Difference between prior two columns |

**Purpose: (1) To determine retrospective effectiveness of PEF interest rate cash flow hedges that were de-designated as of 7/15/11.**
**(2) If effective for accounting purposes, to measure the amount of ineffectiveness to be recorded in income at de-designation.**

PEF had 3 interest rate instruments outstanding as a cash flow hedge for interest rates to be paid on debt originally expected to be issued on July 15, 2011. As documented in separate workpapers, those hedges were re-designated as of 6/1/11 as hedging an expected debt issuance between 8/1/11 and 12/30/11, with a most likely issue date of 8/31/11. On 7/15/11, Treasury amended each of the prior hedges to change the effective date from 7/15/11 to 8/31/11, with corresponding changes in certain hedge terms. Therefore, Accounting hedges PEF-2011-13, PEF-2011-14 and PEF-2011-15 are being de-designated as of 7/15/11. [New hedging relationships with the amended hedges are documented in the normal manner.]

The final effectiveness is assessed and measured below --- with the hypothetical entered into on 6/1/11, the hedge re-designation date, and with an effective date of 8/31/11, the most likely debt issue date.

**Preparer** Jim Bass/s/ 7/26/11
**Reviewer** Wayne Stallings WWS 7/28/11 /s/

| | | | These two columns are used in the retrospective effectiveness test in the last column | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **A**<br>**PEF** | **E**<br>**FV of Derivative at 6/1/11** | **B**<br>**FV of Derivative at 7/15/11** | **D**<br>**Change in derivative value since re-designation** | **B**<br>**FV of Hypothetical at 7/15/11** | **D**<br>**Cumulative Ineffectiveness Measurement (Deriv > Hypo)** | **F**<br>**Ineffectiveness Recorded at 6/30/2011** | **D**<br>**Additional Ineffectiveness to Record at De-designation** | **Retrospective Effectiveness (.80 - 1.25)** | |
| 10-05 | (5,477,934) | (5,799,261) | (321,327) | (279,817) | (41,510) | 26,331 | (67,841) | 114.8% | Effective for accounting purposes |
| 10-06 | (8,703,057) | (9,334,461) | (631,404) | (559,667) | (71,737) | 36,035 | (107,772) | 112.8% | Effective for accounting purposes |
| 11-01 | (2,197,550) | (2,649,533) | (451,983) | (419,694) | (32,289) | - | (32,289) | 107.7% | Effective for accounting purposes |
| | | | | | (145,536) | 62,366 | (207,902) | | |
| | C | | C | C | | | | | |

A Treasury hedge number; related Accounting hedge re-designation packages at 6/1/11 were PEF-2011-13, -14 and -15.

B Refer to Bloomberg screens in this M drive folder.

C Note that totals are not used for ineffectiveness measurements --- ineffectiveness is determined on an instrument-by-instrument basis.

D Difference between prior two columns

E Refer to copy of prior workpaper, included in this folder as NOTE E

F Refer to copy of prior workpaper, included in this folder as NOTE F

**Purpose: To document accounting effect of the amendment of 3 PEF hedges.**

As documented elsewhere, in July 2011 PEF amended 3 interest rate hedges. For accounting purposes, the old hedging relationship was de-designated and a new hedging relationship was documented with the amended hedges representing the hedging instruments

The amendment of the hedges caused a change in value on 7/15/11 from 1) the value of the prior instruments to 2) the value of the amended instruments at the point of the amendment.

That change in value is not part of the old or the new hedging relationships. Therefore, the change in value will be reflected in earnings, treating the change in value the same as ineffectiveness.

**Preparer** Jim Bass/s/ 8/2/11
**Reviewer** Wayne Stallings WWS 10/5/11

| A<br>PEF | D<br>FV of instrument immediately before amendmen on 7/15/11 | B<br>FV of instrument immediately after amendment on 7/15/11 | Change to be recorded in earnings | |
|---|---|---|---|---|
| 10-05 & 11-02 | (5,799,261) | (5,697,313) | 101,948 | ws |
| 10-06 & 11-03 | (9,334,461) | (9,137,842) | 196,619 | ws |
| 11-01 & 11-04 | (2,649,533) | (2,547,379) | 102,154 | ws |
| | | | 400,721 | |
| | C | C | | |

A Treasury hedge number for pre-amended instrument & post-amended instrument. ws

B Refer to Bloomberg screens in this M drive folder. ws

C Note that the change is an instrument by instrument determination. ws

D Values taken from previously-reviewed schedule for dedesignation at 7/15/11. Copy included in this folder. ws

**Purpose: (1) To determine retrospective effectiveness of PEF interest rate cash flow hedges that were terminated 8/15/11 in conjunction with debt issuance.**
**(2) If effective for accounting purposes, to measure the amount of ineffectiveness to be recorded in income.**

PEF terminated 3 hedges on 8/15/11 in conjunction with the related debt issuance. These hedges were designated on 7/15/11 in conjunction with the amendment of 3 previous hedges, which were de-designated on that date.

Effectiveness is assessed and measured below based on a new hypothetical for each hedge --- with the hypothetical entered into on 7/15/11, the hedge designation date, and with an effective date of 8/15/11, the actual debt issue date.

**Preparer** Jim Bass/s/ 8/25/11
**Reviewer** Wayne Stallings WWS 10/5/11

| A<br>**PEF** | B<br>**FV of Derivative at 7/15/11** | E<br>**FV of Derivative at 8/15/11 EOD** | D<br>**Change in derivative value since designation** | F<br>**FV of Hypothetical at 8/15/11** | G<br>**Ineffectiveness Measurement (Deriv > Hypo)** | **Retrospective Effectiveness (.80 - 1.25)** |
|---|---|---|---|---|---|---|
| 11-02 | (5,697,313) | (8,779,926) | (3,082,613) | (2,902,931) | (179,682) ws | 106.2% Effective for accounting purposes |
| 11-03 | (9,137,842) | (15,234,236) | (6,096,394) | (5,805,862) | (290,532) ws | 105.0% Effective for accounting purposes |
| 11-04 | (2,547,379) | (6,988,342) | (4,440,963) | (4,354,507) | (86,456) ws | 102.0% Effective for accounting purposes |
| | | | | | (556,670) | |
| | | | C | C | | |

A Treasury hedge number

B From workpaper calculating change in value due to amendments at 7-15 --- see folder PEF Aug 2011 Debt Issue\Amendement -- change in value

C Note that totals are not used for ineffectiveness measurements --- ineffectiveness is determined on an instrument-by-instrument basis.

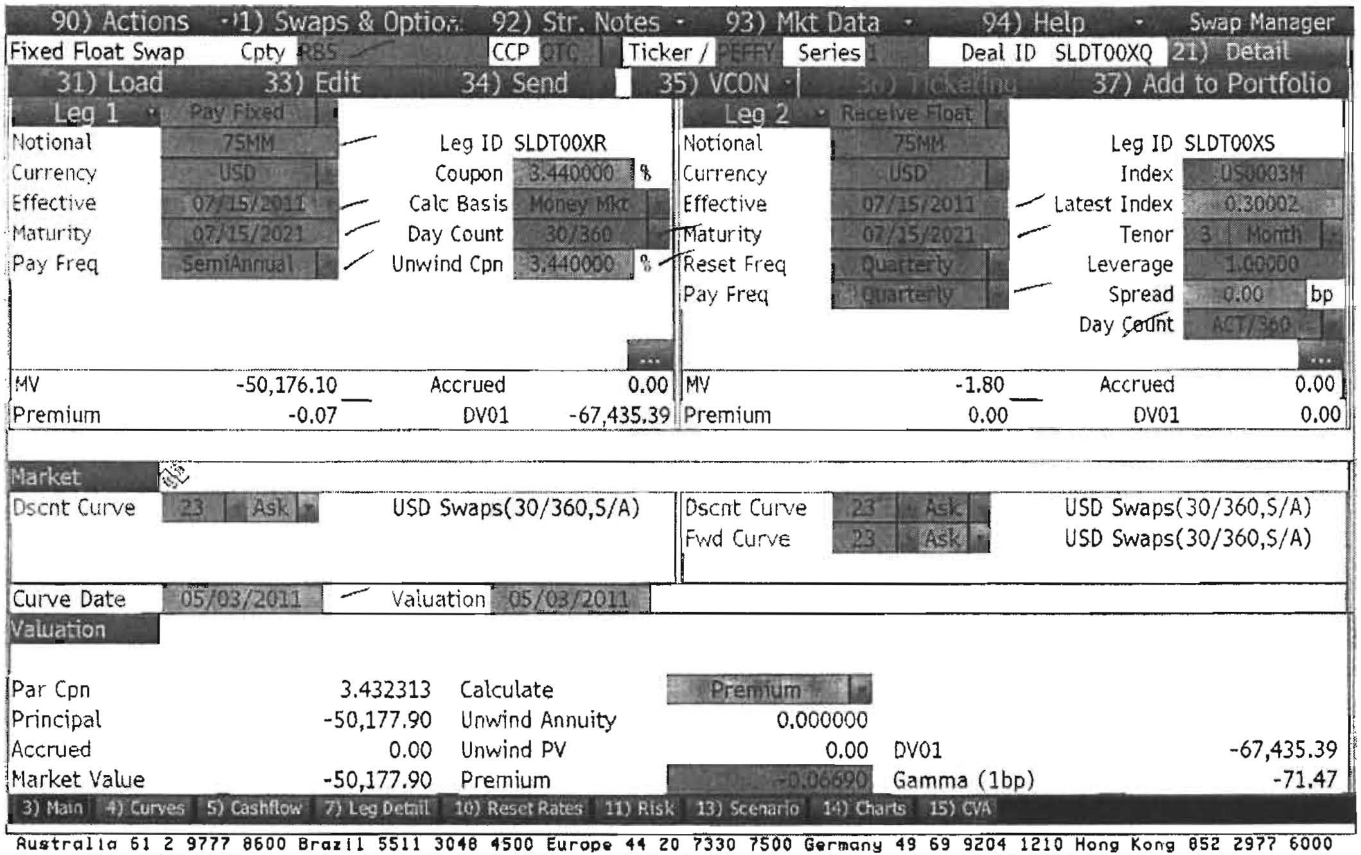
D Difference between prior two columns

E Refer to Bloomberg screens in this M drive folder --- NOTE: In order to eliminate the effects of intra-day price movements, we used the value of the amended hedges as if settled at end of day on 8/15, which is comparable to the hypothetical which is priced as if it is settled at end of day on 8/15. There is no intra-day issue at the 7/15 amendment date since both hypothetical and amended hedge were priced at end of day on 7/15.

F Refer to Bloomberg screens in this M drive folder.

G The absolute value of the derivative is greater than the hypothetical for each hedge -- therefore, ineffectiveness is difference between prior two columns (i.e., the amount by which the hedge "outperformed" the hypothetical).

`<HELP> for explanation.`                                                N119 Corp **SWPM**



Fixed Float Swap  Cpty RBS  CCP OTC  Ticker / PEFFY  Series 1  Deal ID SLDT00XQ

Leg 1 Pay Fixed

| | | | |
|---|---|---|---|
| Notional | 75MM | Leg ID | SLDT00XR |
| Currency | USD | Coupon | 3.440000 % |
| Effective | 07/15/2011 | Calc Basis | Money Mkt |
| Maturity | 07/15/2021 | Day Count | 30/360 |
| Pay Freq | SemiAnnual | Unwind Cpn | 3.440000 % |
| MV | -50,176.10 | Accrued | 0.00 |
| Premium | -0.07 | DV01 | -67,435.39 |

Leg 2 Receive Float

| | | | |
|---|---|---|---|
| Notional | 75MM | Leg ID | SLDT00XS |
| Currency | USD | Index | US0003M |
| Effective | 07/15/2011 | Latest Index | 0.30002 |
| Maturity | 07/15/2021 | Tenor | 3 Month |
| Reset Freq | Quarterly | Leverage | 1.00000 |
| Pay Freq | Quarterly | Spread | 0.00 bp |
| | | Day Count | ACT/360 |
| MV | -1.80 | Accrued | 0.00 |
| Premium | 0.00 | DV01 | 0.00 |

Market

Dscnt Curve 23 Ask USD Swaps(30/360,S/A)

Dscnt Curve 23 Ask USD Swaps(30/360,S/A)
Fwd Curve 23 Ask USD Swaps(30/360,S/A)

Curve Date 05/03/2011  Valuation 05/03/2011

Valuation

| | | | | | |
|---|---|---|---|---|---|
| Par Cpn | 3.432313 | Calculate | Premium | | |
| Principal | -50,177.90 | Unwind Annuity | 0.000000 | | |
| Accrued | 0.00 | Unwind PV | 0.00 | DV01 | -67,435.39 |
| Market Value | -50,177.90 | Premium | -0.06690 | Gamma (1bp) | -71.47 |

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000
SN 738552 H207-1045-0 04-May-2011 11:53:29

## Docket No. 120303
## PEF's Response to Staff's First Data Request No. 16

**ENTRIES AS RECORDED**

| | | | |
|---|---|---|---|
| **2007** | | | |
| | No ineffectiveness was recorded in 2007 | | |
| **2008** | | | |
| 2008-1. | Acct 176 Deriv instru assets - hedges | 1,275,461 | |
| | Acct 427 Interest on long-term debt | | 1,275,461 |
| | *To record ineffective portion of hedges - gain* | | |
| **2009** | | | |
| | No ineffectiveness was recorded in 2009 | | |
| **2010** | | | |
| 2010-1. | Acct 176 Deriv instru assets - hedges | 239,198 | |
| | Acct 427 Interest on long-term debt | | 239,198 |
| | *To record ineffective portion of hedges - gain* | | |
| **2011** | | | |
| 2011-1. | Acct 427 Interest on long-term debt | 410,628 | |
| | Acct 245 Deriv instru lia - hedges | | 410,628 |
| | *To record ineffective portion of hedges - loss* | | |

**ENTRIES AS PROPOSED**

| | | | |
|---|---|---|---|
| **2007** | | | |
| | No ineffectiveness was recorded in 2007 | | |
| **2008** | | | |
| 2008-1. | Acct 176 Deriv instru assets - hedges | 1,275,461 | |
| | Acct 245 Other regulatory liabilities | | 1,275,461 |
| | *To record ineffective portion of hedge gain in same manner as effective portion. $411,796 relates to 10-year debt and $863,665 relates to 30-year debt.* | | |
| 2008-2. | Acct. 245 Other regulatory liabilities | 37,900 | |
| | Acct 427 Interest on long-term debt (10-year) | | 22,306 |
| | Acct 427 Interest on long-term debt (30-year) | | 15,594 |
| | *To amortize 6.5 months of 2008 gain* | | |
| **2009** | | | |
| 2008-2. | Acct. 245 Other regulatory liabilities | 69,969 | |
| | Acct 427 Interest on long-term debt (10-year) | | 41,180 |
| | Acct 427 Interest on long-term debt (30-year) | | 28,789 |
| | *To amortize full year of 2008 gain* | | |
| **2010** | | | |
| 2010-1. | Acct 176 Deriv instru assets - hedges | 239,198 | |
| | Acct 245 Other regulatory liabilities | | 239,198 |
| | *To record ineffective portion of hedge gain in same manner as effective portion (10-year debt)* | | |
| 2008-2. | Acct. 245 Other regulatory liabilities | 69,969 | |
| | Acct 427 Interest on long-term debt (10-year) | | 41,180 |
| | Acct 427 Interest on long-term debt (30-year) | | 28,789 |
| | *To amortize full year of 2008 gain* | | |
| 2010-2. | Acct. 245 Other regulatory liabilities | 18,538 | |
| | Acct 427 Interest on long-term debt | | 18,538 |
| | *To amortize 9.3 months of 2010 gain* | | |
| **2011** | | | |
| 2011-1. | Acct 182.3 Other regulatory assets | 410,628 | |
| | Acct 245 Deriv instru lia - hedges | | 410,628 |
| | *To record ineffective portion of hedge loss in same manner as effective portion (10-year debt)* | | |
| 2008-2. | Acct. 245 Other regulatory liabilities | 69,969 | |
| | Acct 427 Interest on long-term debt (10-year) | | 41,180 |
| | Acct 427 Interest on long-term debt (30-year) | | 28,789 |
| | *To amortize full year of 2008 gain* | | |
| 2010-2. | Acct. 245 Other regulatory liabilities | 23,920 | |
| | Acct 427 Interest on long-term debt | | 23,920 |
| | *To amortize full year of 2010 gain* | | |
| 2011-2. | Acct 427 Interest on long-term debt | 15,399 | |
| | Acct 182.3 Other regulatory assets | | 15,399 |
| | *To amortize 4.5 months of 2011 loss* | | |