PROGRESS ENERGY FLORIDA

DOCKET NO. 070001-EI

Fuel and Capacity Cost Recovery
January through December 2008

DIRECT TESTIMONY OF JOSEPH MCCALLISTER

REDACTED

September 4, 2007

Q. Please state your name and business address.

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

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

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

Q. Have you previously filed testimony before this Commission?

A. Yes I have.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to outline PEF's Risk Management Plan for fuel procurement in 2008, outline PEF's hedging activities and objectives for 2008, and summarize PEF's actual hedging results for the period January through July 2007.

Q. Has PEF developed its Risk Management Plan for fuel procurement in 2007 in accordance with the Resolution of Issues proposed by Staff and approved by the Commission in Order No. PSC-02-1484-FOF-EI, Docket No. 011605-EI?

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

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

A. The objectives of PEF's hedging activities are to reduce fuel price risk and volatility, and provide greater price certainty to PEF's customers by locking in fixed prices over time for a portion of its forecasted natural gas, heavy oil and light oil fuel requirements. PEF utilizes approved physical and financial agreements to meet these objectives.

Q. Describe PEF's hedging activities for 2008.

A. PEF executed its hedging strategy and objectives for 2008 consistent with prior years by entering into fixed price physical and financial transactions over time for natural gas, heavy oil and light oil. Given the volatility of natural gas and fuel oil prices, executing fixed price transactions over time provides an effective method to reduce the overall price risk and volatility associated with these fuels while providing greater price certainty for our customers. Based on current forecasts as of August 1, 2007, PEF has hedged approximately [redacted] of its forecasted natural gas requirements, [redacted] of its forecasted heavy oil requirements and [redacted] of its forecasted light oil requirements for 2008.

Q. What were the results of PEF's hedging activities for January through July 2007?

A. The Company's natural gas and fuel oil hedging activities for January through July 2007 have resulted in realized hedge losses of approximately $3.1 million. For the period 2003 through 2006, PEF's natural gas and fuel oil hedging activities have provided net fuel savings of approximately $380 million to its customers. Although PEF's hedging activity has achieved significant net fuel savings to date, the primary objective is to reduce price risk and volatility. As a result, there will be periods when realized hedge losses occur.

Q. Does this conclude your testimony?

A. Yes.

Docket No. 070001-EI
Progress Energy Florida
Witness: Joseph McCallister
Exhibit No.__(JM-1P)

Progress Energy Florida, Inc.
Risk Management Plan
Fuel Procurement and Wholesale Power Purchases
For 2008

I. Objectives

Progress Energy Florida, Inc.'s ("PEF") Risk Management Plan objectives for 2008 are to manage overall costs through prudent and competitive fuel procurement and wholesale power purchase activities, provide reliable service by minimizing fuel supply risks, and reduce price risk and volatility. PEF's risk management activities reduce the impact of fuel price volatility to the fuel and purchased power portion of the customer fuel bill.

II. Fuel Procurement and Economy Power Projections

Based on current forecasts, PEF fuel burns and economy purchase and sales activity are as follows:

1. Coal
   PEF forecast to burn approximately [redacted] tons of coal in 2008.

2. Heavy Oil
   PEF forecast to burn approximately [redacted] barrels of heavy oil in 2008.

3. Light Oil
   PEF forecast to burn approximately [redacted] barrels of light oil in 2008.

4. Natural Gas
   PEF forecast to burn approximately [redacted] in 2008 in PEF's generating plants and under purchase power natural gas tolling agreements where PEF has the responsibility to purchase the natural gas.

5. Economy Purchases and Sales
   PEF forecast to purchase approximately [redacted] MWhrs and sell approximately [redacted] MWhrs in 2008 on the spot economy wholesale market.

III. Independent Oversight, Guidelines, and Audit Services

The company has independent oversight processes and structures to ensure the identification of key risks, and independent controls for monitoring and reporting on fuel procurement and wholesale power activities. The key components are described in detail below.

1. Independent Oversight
The Company's Board of Directors has established a Risk Management Policy that directs the Risk Management Committee (RMC) to oversee PEF's financial risks. The RMC members are as follows:
    - Chief Financial Officer – Progress Energy Inc. (Chair)
    - President and Chief Operating Officer
    - SVP Corporate Relations & General Counsel – Progress Energy, Inc.
    - SVP Financial Services
    - Treasurer and Chief Risk Officer (CRO)
    - SVP Power Operations

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

The company has an established Treasury, Risk and Transaction Oversight Subcommittee (The Subcommittee) which is chaired by the Treasurer and CRO to provide additional independent oversight on the activities of the Regulated Commercial Operations and Regulated Fuels Departments. The Subcommittee reviews and recommends risk and credit guidelines and policies that require the identification of key risks and exposures within Regulated Commercial Operations and Regulated Fuels, and reviews proposed transactions and strategies. The Subcommittee submits guidelines, policies, proposed transactions and strategies to the RMC for review and discussion as required by corporate governance.

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

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

PEF's Regulated Commercial Operations and Regulated Fuels Risk Management Guidelines (Risk Guidelines) provide the methods to assess, quantify, report, and monitor the activities associated with fuel procurement contracts, fuel hedging activities, and wholesale power activities. In addition, the Risk Guidelines outline approved products, approved periods, and risk parameters. Regulated Commercial Operations and Regulated Fuels Credit Risk Management Guidelines provide the methodology to evaluate, measure, mitigate, and report credit associated with Regulated Commercial Operations and Regulated Fuels activities. In addition, the Credit Risk Management Guidelines outline specific contract duration criteria for counterparties based on credit metrics.

3. <u>Audit Services</u>
Audit Services provides independent assurance and consulting services that ensure compliance, effective corporate governance, adherence to established procedures and operational effectiveness for all major areas of the company. With respect to Regulated Commercial Operations and Regulated Fuels, Audit Services performs periodic audits that focus, but are not limited to, compliance with established procedures, payment terms under fuel contracts, and trading and procurement activities.

IV. Identification of Primary Risks and Risk Management Activities

As part of the Risk Management Plan, PEF has identified the primary risks associated with the procurement of fuels and wholesale power activity for 2008. The primary risks are fuel prices and volatility, supplier performance and credit risk, product availability and changes in forecasted volumes. These primary risks and the activities that reduce PEF's exposure to these risks are outlined below.

1. <u>Price Risk and Volatility</u>
PEF's customers are exposed to fuel prices and volatility, which could result in significant increases in fuel prices and costs. For natural gas, heavy oil and light oil, the majority of physical fuel contracts executed by PEF are based on published market index pricing. The published market index prices paid by PEF will fluctuate with daily changes in market prices until the respective first of the month market index or daily-published market index price settles. As a result, the projected costs for natural gas, heavy oil and light oil fuel purchases will change and could be volatile as market prices change over time.

   PEF manages fuel price risk and volatility for its forecasted natural gas and fuel oil purchases by executing standard industry fixed price physical and financial swap and option agreements over time for a portion of its burn projections. This activity is executed under the approved hedging strategy. For coal, PEF enters into standard industry supply agreements to fix the price of the underlying coal. Because of these actions, PEF reduces its overall fuel price risk and volatility.

2. <u>Supplier Performance and Credit Risk</u>
Supplier performance and credit risk represent the risks of financial loss that PEF could incur if a supplier defaults on a supply obligation or is not able to fulfill the terms of an agreement. Supplier performance and credit risk can vary based on the terms and prices of the agreements, overall credit quality, and the current market value of the specific transaction under contract.

   PEF reduces supplier performance and credit risk by conducting business with a number of suppliers, executing agreements within approved contract approval limits and credit parameter limits, monitoring contracts and delivery performance of suppliers and, if possible, incorporating contractual provisions that allow for non-performance remedies. In addition, PEF maintains on-site inventory for coal, heavy oil and light oil.

3. Product Availability and Changes in Forecasted Volumes
PEF must have access to needed physical fuel supplies, adequate product delivery capabilities and on-site inventory to meet its projected fuel requirements. Without access to needed fuel supply, PEF is exposed to the risk of not being able to economically and reliably dispatch the generation fleet.

PEF manages and reduces this risk by executing contracts for the purchase of the appropriate amount of supply and transportation for all of its fuel types. Specifically, PEF enters into short-term and long-term standard industry physical supply contracts and needed pipeline, railroad, barge and trucking agreements for the purchase and delivery of coal, natural gas, heavy oil and light oil that provide the supply and flexibility to meet projected burns. In addition, PEF maintains on-site inventory for coal, heavy oil and light oil to provide supplies to support on-going operations and ensure supplies for unexpected delivery delays, storm curtailments, and events that could affect fuel supply availability. PEF also has off-site natural gas storage contracts beginning in 2008 that will provide access for a portion of its natural gas needs in the event that gas supplies are curtailed due to storms. In addition, PEF's onshore gas supplies continue to increase in 2008 as new supply contracts enter the portfolio. Lastly, PEF actively monitors actual fuel burns versus forecasted fuel burns and will make procurement adjustments to account for changes in weather, fuel-switching capabilities, outages, and purchased power.

V. Fuel Procurement and Wholesale Purchased Power Plans for 2008

1. Coal
PEF forecasted coal requirements for 2008 will be purchased under term coal supply agreements. The coal supply will be delivered to PEF's plants via railroad and barge transportation agreements. Spot purchases will be made as needed.

2. Oil
PEF's forecasted heavy and light fuel oil requirements for 2008 will be purchased under term supply agreements with flexible volume provisions at indexed market prices. Spot market purchases will be utilized as needed.

3. Natural Gas
PEF's forecasted natural gas requirements for 2008 will be purchased primarily under term supply agreements that are primarily based on market index pricing. Spot purchases of natural gas will be utilized as needed.

4. Economy Power and Purchased Power
PEF actively seeks opportunities to make economy and term purchases based on market prices versus dispatch costs, available power and transmission, and overall needs.