ORIGINAL

Progress Energy

JAMES A. MCGEE
ASSOCIATE GENERAL COUNSEL
PROGRESS ENERGY SERVICE COMPANY, LLC

April 1, 2004

HAND DELIVERY

Ms. Blanca S. Bayó, Director
Division of the Commission Clerk
and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Docket No. 040001-EI

Dear Ms. Bayó:

Enclosed for filing in the subject docket on behalf of Progress Energy Florida, Inc., are an original and fifteen copies each of the direct testimony of Donna M. 04203-04 Davis, Michael F. Jacob, and Pamela R. Murphy.

04204-04 04205-04

Please acknowledge your receipt of the above filing on the enclosed copy of this letter and return to the undersigned. Also enclosed is a 3½ inch diskette containing the above-referenced documents in Word format and related exhibits in Word, Excel and PDF format. Thank you for your assistance in this matter.

Very truly yours,

James A. McGee

JAM/scc
Enclosures

cc: Parties of record

AUS 1
CAF
CMP
COM 5+org
CTR
ECR
GCL 1
OPC
MMS
SEC 1
OTH

100 Central Avenue (33701) • Post Office Box 14042 (33733) • St. Petersburg, Florida
Phone: 727.820.5184 • Fax: 727.820.5519 • Email: james.mcgee@pgnmail.com

PROGRESS ENERGY FLORIDA

DOCKET NO. 040001-EI

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of the direct testimony of Donna M. Davis, Michael F. Jacob, and Pamela R. Murphy on behalf of Progress Energy Florida has been furnished to the following individuals by regular U.S. Mail the 1st day of April, 2004.

Wm. Cochran Keating, IV, Esquire
Office of the General Counsel
Economic Regulation Section
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Vicki Gordon Kaufman, Esquire
117 S. Gadsden Street
Tallahassee, FL 32301

John T. Butler, Esquire
Steel, Hector & Davis
200 S. Biscayne Blvd., Suite 4000
Miami, Florida 33131

Norman Horton, Jr., Esquire
Messer, Caparello & Self
P. O. Box 1876
Tallahassee, FL 32302

Robert Scheffel Wright, Esquire
John T. LaVia, III, Esquire
Landers & Parsons, P.A.
P. O. Box 271
Tallahassee, Florida 32302

Lee L. Willis, Esquire
James D. Beasley, Esquire
Ausley & McMullen
P.O. Box 391
Tallahassee, FL 32302

Jeffrey A. Stone, Esquire
Russell A. Badders, Esquire
Beggs & Lane
P. O. Box 12950
Pensacola, FL 32576-2950

Robert Vandiver, Esquire
Office of the Public Counsel
c/o The Florida Legislature
111 West Madison St., Room 812
Tallahassee, FL 32399-1400

Ronald C. LaFace, Esquire
Seann M. Frazier, Esquire
Greenberg Traurig
101 East College Avenue
Tallahassee, FL 32301

Michael B. Twomey
P. O. Box 5256
Tallahassee, FL 32314-5256

James A. McGee

Attorney

PROGRESS ENERGY FLORIDA

DOCKET NO. 040001-EI

DIRECT TESTIMONY OF DONNA M. DAVIS

Q. Please state your name and business address.

A. My name is Donna M. Davis. My business address is P.O. Box 1551, Raleigh, North Carolina 27602.

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

A. I am employed by Progress Fuels Corporation (PFC) in the capacity of Controller, Coal Accounting and Regulatory Services.

Q. What are the duties and responsibilities of your position with PFC?

A. As Controller of Coal Accounting and Regulatory Services, my duties include responsibility for the books and records of PFC's "regulated" business, *i.e.*, the procurement and delivery of coal to the Crystal River plant site of Progress Energy Florida (Progress Energy or the Company) to supply the requirements of its four coal-fired generating units located at the site. This responsibility includes managing the accounting functions related to the costs of waterborne coal transportation services provided to Progress Energy and the Commission's market proxy pricing mechanism for these services, which I participated in developing for presentation to the Commission in 1993. My duties also include supervising the preparation of the Commission's monthly Form 423-2 regarding coal purchases and transportation for Progress Energy.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address the issue raised by Staff and deferred by the Commission at the November 2003 fuel hearing regarding whether additional adjustments are required by the Commission's 1993 order approving the Company's market proxy pricing mechanism to remove upriver mine-to-terminal transportation costs from FOB Barge coal purchases charge to Progress Energy by PFC in 2002.

Q. Have you prepared an exhibit to your testimony?

A. Yes, I have prepared and attached to my prepared testimony Exhibit No. ___ (DMD-1), which is a table showing a breakdown of total upriver waterborne coal purchases between FOB Barge and FOB Mine purchases from 1992 through 2002.

Q. How were the costs of upriver mine-to-terminal transportation dealt with in the market price proxy for PFC's waterborne transportation costs approved by the Commission in 1993?

A. The market proxy approved by the Commission in 1993 was based on PFC's actual waterborne transportation costs for upriver coal purchases in 1992. PFC purchased 1,698,183 tons of coal that year for waterborne delivery to FPC, of which 471,920 tons, or 27.8 percent, were purchased on an FOB Barge basis. For these purchases, and for FOB Barge purchases in general, the upriver mine-to-terminal, or short-haul, transportation costs are included as a part of the commodity cost of coal when purchases by PFC at the river terminal, rather than being incurred by PFC as a separate transportation cost. For this reason, these 1992 short-haul costs were not included in the market proxy's base year, meaning that PFC's waterborne transportation costs of $23.00 per ton for 1992 included only 72.2 percent of the short-haul costs associated with its total waterborne tonnage. If the initial market proxy had been adjusted to include all short-haul costs, the price for 1993 would have risen to about $24.30 per ton, and this higher amount would then have been escalated each year through 2003. Had the initial market proxy price been calculated in this manner, it would have been necessary for PFC to remove the upriver short-haul costs from <u>all</u> FOB Barge purchases in subsequent years in order to ensure that customers did not pay for these costs twice.

However, this was not the case -- the initial market proxy price was based on PFC's actual, unadjusted 1992 waterborne transportation costs. Since these costs included only 78.2 percent of its total short-haul costs, with the remaining 27.8 percent of these costs included in the commodity price of FOB Barge coal purchases, PFC has attempted to maintain approximately the same ratio for coal charged to Progress Energy at an FOB Barge price since the market proxy began in 1993.

Q. Is it feasible for PFC to procure and schedule its actual FOB Barge purchases in a manner that maintains this 1992 ratio?

A. No, it is not feasible, nor would it be desirable, to control actual FOB Barge purchases in such a precise manner, particularly on a consistent year-in, year-out basis. A substantial portion of PFC's FOB Barge coal is procured through spot purchases. The precise quantity of spot purchases is dictated by factors such as the amount of coal secured by contract purchases and the flexibility to adjust these amounts provided by the contract terms, variations in the requirements of the Crystal River coal units due to changes in system requirements, system generation mix, unplanned outages, etc., and the availability and price of spot coal. Because of these variables, expected annual quantities of spot purchases can vary significantly from year to year, and variations from expected quantities for any given year frequently occur during the year. As a result, it would be unrealistic to expect that spot purchases, most of which are purchased FOB Barge, could be scheduled with this level of precision, nor would it be cost-effective to limit favorably priced spot purchases that might exceed this level.

Given the swings in the quantities of FOB Barge purchases caused by these conditions, PFC has not attempted to achieve a 28 percent ratio for these purchases each and every year, particularly since annual variations are often offsetting, or self-correcting, from year to year. Instead, PFC keeps track of the cumulative level of FOB Barge purchases and makes adjustments to remove the short-haul component from the price of these purchases if the level becomes appreciably higher than the 28 percent ratio.

Q. What result has PFC achieved from this practice for adjusting FOB Barge purchases since the inception of the market proxy in 1993?

A. My Exhibit No. ___ (DMD-1) shows the annual and cumulative quantities of coal purchases charged to Progress Energy on an FOB Barge basis from 1993 through 2002, the year to which the issue raised by Staff applies. To be clear, these quantities do not include FOB Barge purchases which have been adjusted to remove short-haul costs from the purchase price, since the prices charged to Progress Energy for these adjusted purchases were effectively FOB Mine prices.

Over the ten-year period from 1993 through 2002, waterborne coal purchases charged to Progress Energy and its customers on an FOB Barge basis have averaged 24.5 percent, or 3.3 percentage points less than the level of FOB Barge purchases reflected in the market proxy. This difference represents approximately $2.4 million in additional costs that Progress Energy and its customers would have paid to PFC if FOB Barge purchases through 2002 had been adjusted more precisely to the market proxy ratio of 27.8 percent. Overall, the exhibit demonstrates that PFC has, in fact, maintained the approximate ratio of FOB Barge purchases that existed in the market proxy's base year, and that any imprecision in the method employed by PFC for that purpose has been to the benefit of Progress Energy and ultimately its customers.

Q. Staff contends that PFC's waterborne coal purchases for 2002 included FOB Barge synfuel purchases from Massey Coal Company that should have been adjusted to remove short-haul transportation costs. How do you reconcile this with your explanation of PFC's adjustment practice for FOB Barge purchases?

A. As I understand it from the position of Staff stated on page 7 of the Commission's order from the November 2003 hearing (Order No. PSC-03-1461-FOF-EI), the problem concerns PFC's coal purchases under a "must take" contract with Massey Coal Company that were converted to synfuel and then delivered to Crystal River. Normally, PFC purchases Massey coal at the mine and has it trucked to an upriver terminal for waterborne delivery to Crystal River. In that case, the short-haul trucking costs are absorbed by PFC since these costs are covered by the market proxy. However, over a period from 2001 to 2003, PFC had the opportunity to sell coal purchased from Massey for conversion to synfuel at several facilities located near the terminal and then re-purchase the converted coal at $2.00 per ton less than the price paid to Massey, at which time the coal continued on the waterborne transportation route for delivery to Crystal River.

Although the converted coal was re-purchased by PFC on an FOB Barge basis, with its previously incurred short-haul costs added to the commodity price, PFC established an accounting practice to ensure that the short-haul costs associated with the Massey-to-synfuel re-purchase would be treated no different than in a normal Massey purchase. In preparing the paperwork to account for these purchases, PFC's buyers add the short-haul costs to the discounted re-purchase price so that the total price of the purchase can be properly recorded on PFC's books when the paperwork is forwarded to the Accounting Department. After the purchase transaction has been recorded, the accounting personnel assign the short-haul costs to PFC's unregulated business and the discounted commodity costs are then booked to its regulated business for billing to Progress Energy. In this way, the difference between a normal FOB Mine Massey purchase and the sale and FOB Barge re-purchase would be transparent to Progress Energy's customers, except for the $2.00 per ton discount. However, the problem underlying the issue raised by Staff occurred when an error was made in preparing the paperwork for the Massey purchases in question.

Q. What was the nature of this paperwork error?

A. In preparing the accounting paperwork for a particular Massey purchase that began in May 2002, an error was made by omitting the related short-haul costs from the FOB Barge purchase price that was not discovered until December 2002. During this period, the erroneous commodity-only price was processed by accounting personnel in accordance with the practice described above. As a result, the short-haul costs were removed from the purchase price recorded on PFC's regulated books for billing to Progress Energy, even though no short-haul costs had been included in the FOB Barge price in the first place. The erroneous purchase price for these transactions was also reported on the Company's Form 423s for the months of May through December, 2002.

When the error was discovered in December 2002, an adjustment was made in January 2003 on PFC's regulated books which added back the mistakenly removed short-haul costs. A similar adjustment was also submitted in January 2003 on Form 423-2c, the sheet in the 423 forms used to report adjustments to previously reported purchases.

Q. Can you provide a numeric illustration of the way this error affected the accounting practice you've described?

A. Yes, although I will use hypothetical figures since the actual prices are confidential. For purposes of this illustration, assume that the Massey FOB

Mine price was $35.00 per ton, that the discounted synfuel price was $33.00 per ton, and that the short-haul costs was $6.00 per ton. Using these figures, the paperwork sent to Accounting for the Massey-to-synfuel purchases should have added $6.00 to the synfuel price of $33.00, for a total FOB Barge price of $39.00. Had this been done, Accounting would have recorded $39.00 as total price of the purchase, assigned the short-haul costs of $6.00 to PFC's unregulated business, and charged $33.00 to its regulated business for billing to Progress Energy. The $33.00 price also would have been reported on the Company's Form 423s submitted to the Commission.

However, because of the error in omitting the short-haul costs from the total FOB Barge purchase price, $33.00 was sent to Accounting as the total purchase price. Following the standard practice, Accounting assigned $6.00 to unregulated business, and charged $27.00 to regulated business for billing to Progress Energy, which was also reported on the Form 423s for Many through December, 2002. When the error was discovered, an adjustment was booked to PFC's regulated business that added back $6.00 to the purchase price for billing to Progress Energy. This resulted in a total adjusted price of $33.00, the same price that would have been billed to the Company if the error had not occurred. In addition, this $6.00 adjustment and $33.00 total price was submitted to the Commission in January 2003 on Form 423-2c.

Q. How did Staff response to your January 2003 adjustment to the price of these Massey-to-synfuel purchases previously reported on the Form 423s?

A. When this adjustment was reviewed by Staff, it understandably thought PFC was improperly charging Progress Energy for the short-haul costs associated with these Massey purchases, when in fact the adjustment only corrected the erroneous commodity costs previously reported for these purchases. As a result, Staff disputed PFC's contention that FOB Barge purchases charged to Progress Energy in 2002 had been adjusted to the 28 percent level reflected in the market proxy.

Q. How did PFC and Progress Energy respond to the conclusions reached by Staff about these FOB Barge purchases?

A. We responded by attempting to explain and document the somewhat complicated facts of the Massey-to-synfuel sale and re-purchase, and how these facts were further complicated by the reporting error that I described in my previous answer. The documentation included the Massey contract and its FOB Mine price, the synfuel conversion contracts and their FOB Barge prices that were tied to the Massey price less a $2.00 discount, and the short-haul trucking invoices paid by PFC for transporting the Massey coal to the synfuel facilities on the river. The documentation provided to Staff was followed by several phone conversations and face-to-face meetings to explain and discuss the documentation and respond to Staff questions.

I was personally convinced that a careful explanation of the facts surrounding these transactions and the reporting error would readily resolve the misunderstanding. To this day I remain at a loss as to why this did not prove to be the case.

Q. Would you please recap the treatment of FOB Barge purchases charge to Progress Energy in 2002?

For 2002, PFC's books show that 1,774,617 tons of coal were purchased upriver for waterborne delivery to Crystal River, of which 1,096,884 tons were purchased FOB Barge. Of these actual FOB Barge purchases, 592,596 tons were adjusted to remove short-haul costs, leaving 504,288 tons billed to Progress Energy on an FOB Barge basis, or 28.4 percent of the total upriver coal purchases. As noted earlier, including these tons, all FOB Barge purchases billed to Progress Energy from 1993 through 2002 represent 24.5 percent of total upriver purchases over the same period, compared to 27.8 percent reflected in the market proxy price.

Q. Does this conclude your direct testimony?

A. Yes, it does.

PROGRESS FUELS CORPORATION

Exhibit No. ____ (DMD-1)
Witness: Donna M. Davis

UPRIVER WATERBORNE COAL PURCHASES

	Base Year											1993 - 2002	
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	Total	Average
Tons Purchased:													
FOB Barge	471,920	308,399	485,840	388,355	400,821	430,659	492,529	450,697	501,297	381,858	504,288	4,036,344	465,732
FOB Mine	1,226,263	861,242	861,931	894,489	1,568,230	1,580,365	1,510,061	1,429,964	1,669,253	1,626,913	1,270,329	12,411,535	1,432,100
Total	1,698,183	1,169,641	1,347,771	1,282,844	1,969,051	2,011,024	2,002,590	1,880,661	2,170,550	2,008,771	1,774,617	16,447,879	1,897,832
Percent of Total:													
FOB Barge	27.79%	26.37%	36.05%	30.27%	20.36%	21.41%	24.59%	23.96%	23.10%	19.01%	28.42%	24.54%	24.54%
FOB Mine	72.21%	73.63%	63.95%	69.73%	79.64%	78.59%	75.41%	76.04%	76.90%	80.99%	71.58%	75.46%	75.46%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%