



and \$2.7 million in premiums paid for calls under a collar arrangement. In sum, PEF netted a gain of \$45.3 million in option premiums.

For fuel oil, PEF's hedging of No. 6 fuel oil primarily consisted of financial swaps over the past four years, with a combination of swaps and a limited number of options in 2007. Prior to the use of financial swaps in 2004, PEF used physical hedge contracts for its No. 6 oil.

For No. 2 fuel oil, PEF did not initiate any form of financial hedging until 2006. In 2006, the company used swaps for its No. 2 oil, while in 2007 the company used a majority of swaps with a limited number of options. Similar to the uncertainty in the natural gas market, PEF chose the use of financial swaps as a means of further reducing price volatility in the fuel oil market.

**What are the company's targets and threshold limits for its financial hedging program?**

PEF's *Risk Management Guidelines—Risk Limit Structure* establishes the company's tenure and volume of the fuel hedging commitments. More specifically, the reporting limits are the established hedging percentage targets for both natural gas and fuel oil. The hedging percentage targets represent the maximum tolerance level that PEF's hedging portfolio is not expected to exceed. It is PEF's policy not to hedge more fuel than forecasted to meet customer demand.

Exhibit 27 depicts the monthly hedging percentage targets for PEF's forecasted fuel burns for natural gas, No. 6 fuel oil, and No. 2 fuel oil. As shown in the exhibit, PEF hedges are layered over time, with a greater percentage of hedges being transacted in the short-term. For example, if the "current" year is 2008, the accumulated volumes of natural gas hedged against 2008 and 2009 forecasted burns cannot exceed 80 percent and 60 percent, respectively. The accumulated volume includes hedges entered into during the "current" year and prior years. The hedging contracts also must settle within the year they were used to offset the forecasted burn. In other words, a hedging contract entered into during 2008 to offset 2009 forecasted burn would have to settle in 2009.

**Approved Hedging Strategy**  
**Progress Energy Florida**  
(percent of forecast)

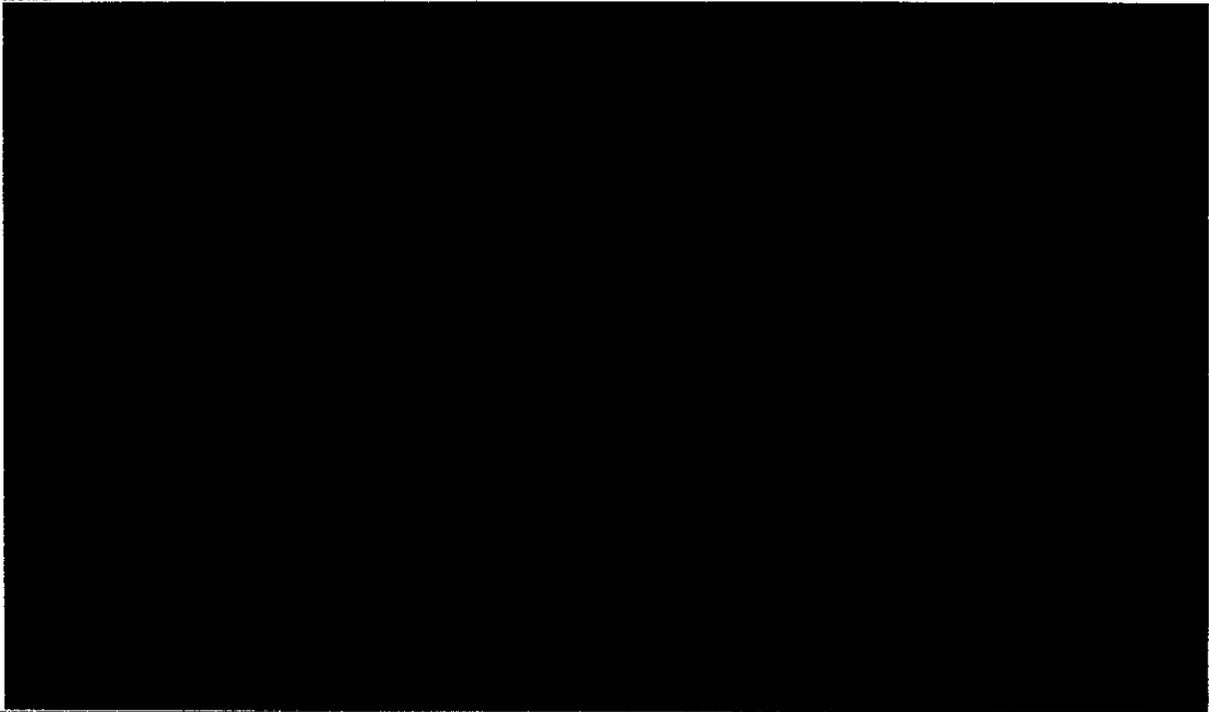
	2008	2009	2010	2011	2012	2013	2014	2015
Natural Gas								
No. 6 Fuel Oil								
No. 2 Fuel Oil								

Exhibit 27

Source: Data Request 1.10

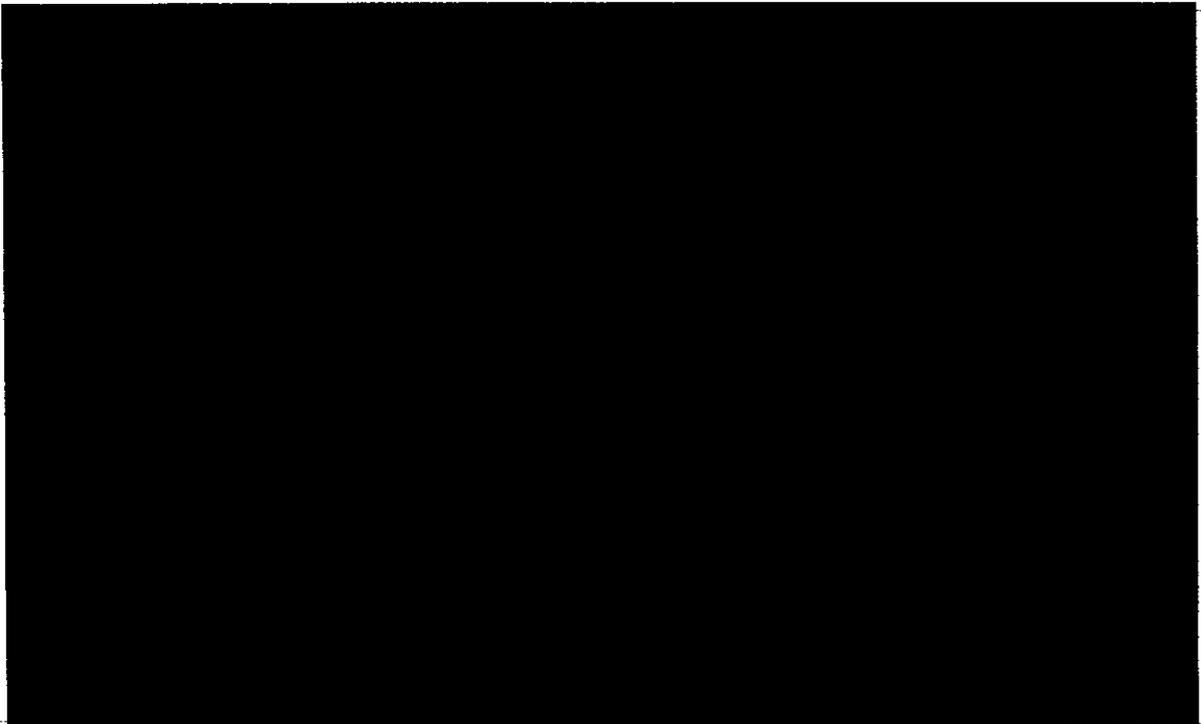
Using another example, if the "current" year is 2008, PEF traders may enter into natural gas hedges to offset forecasted fuel requirements for 2010; however, the accumulated volume of

that No. 2 oil is primarily used for PEF's peaker units. As a result, the actual burn could vary greatly from forecasted conditions due to unforeseen conditions to meet customer demand.



**Exhibit 28**

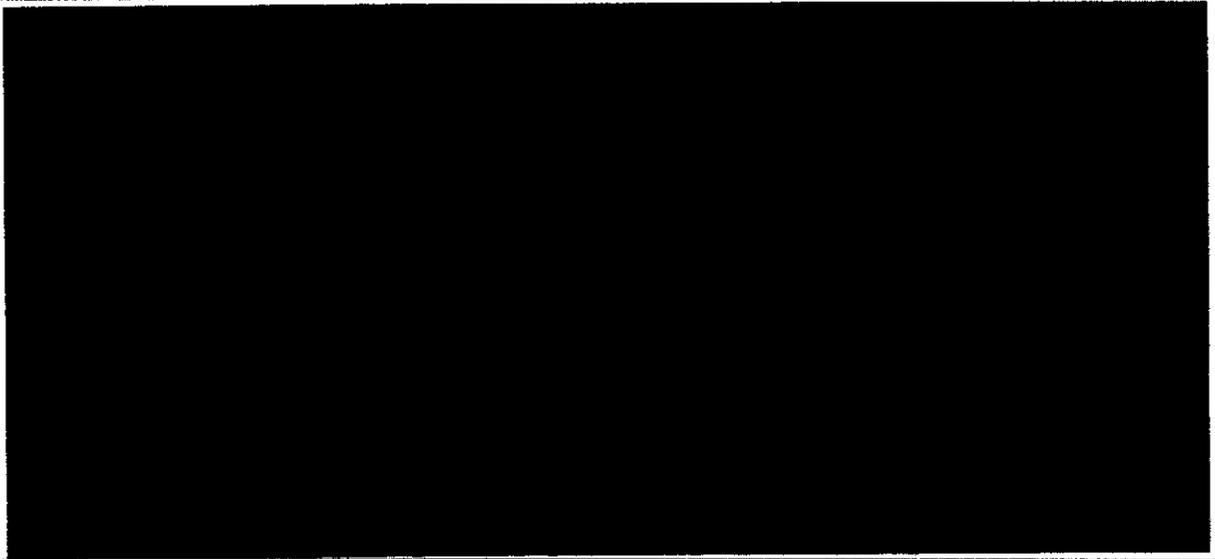
*Source: Data Request 2.7*



**Exhibit 29**

*Source: Data Request 2.7*

**Exhibit 31** shows the trend in the monthly average market price of natural gas per MMBtu against the monthly average of PEF's financial hedging settlement costs for the same fuel. From 2003 to 2005, PEF's primary method of hedging natural gas was through the use of fixed price physical contracts. As a result, there were no financial hedging settlements over this period.



**Exhibit 31**

*Source: Data Request 3.1*

From March 2006 (the first month PEF reported financial settlement costs) to December 2007, PEF's natural gas hedges settled at an average of \$8.24 per MMBtu. In comparison, the average market price for natural gas over the same period was \$7.64 per MMBtu. In sum for this period, PEF's natural gas hedges settled, on average, 60¢ more per MMBtu than the market price. Within calendar year 2007, PEF's natural gas hedges settled, on average, at 70¢ more per MMBtu than the market price.

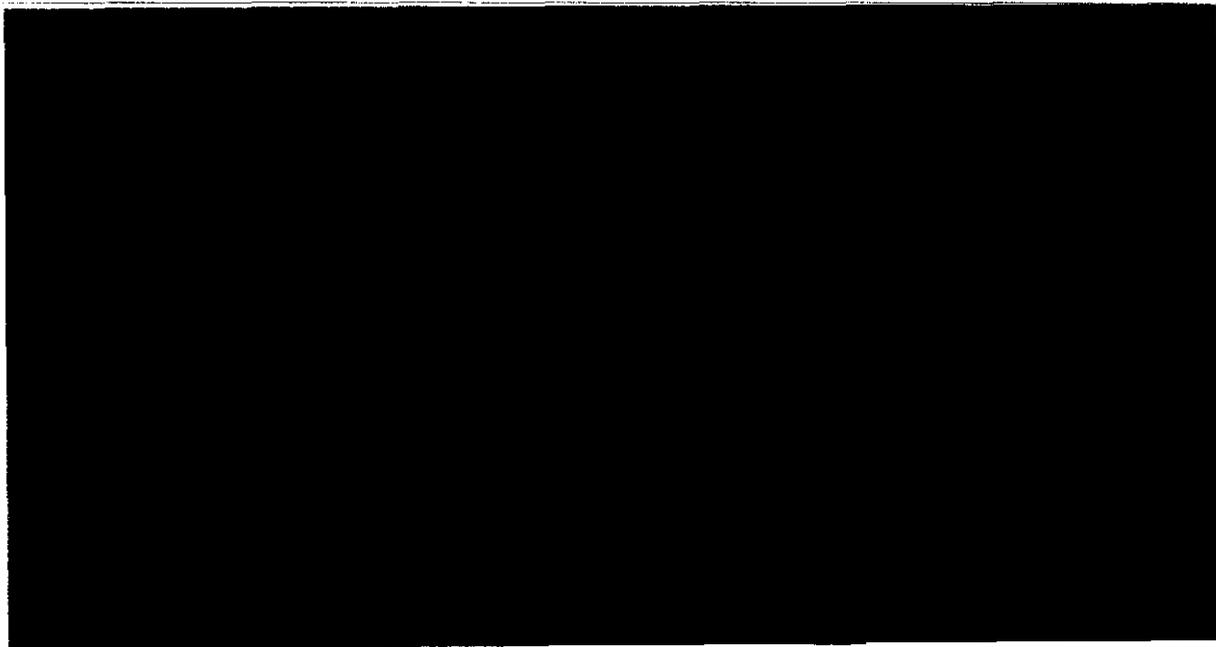
As shown on Exhibit 31 natural gas prices peaked at \$12.31 per MMBtu in October 2005, and dropped the very next month to \$8.23 per MMBtu, and dropped even further two months later in December 2005 to \$5.60 per MMBtu.

**Exhibit 32** trends the market price of No. 6 fuel oil against hedging settlement costs of both fuels over the same five-year period. The first financial hedging settlements for No. 6 oil were reported in June 2004. Prior to June 2004, hedging for No. 6 fuel oil was done primarily through the use of fixed-price physical contracts. From June 2004 to December 2007, PEF's hedging settlement costs for No. 6 oil averaged \$36.94 per barrel. In comparison, the market average was \$40.77 per barrel. The difference represents a gain of \$3.83 per barrel. For the most recent year, 2007, PEF also showed an average gain of 87¢ per barrel. For the year, PEF's No.6 fuel oil settled, on average, at \$50.76 per barrel, whereas the average market price was \$51.63.



**Exhibit 32**

*Source: Data Request 3.1*

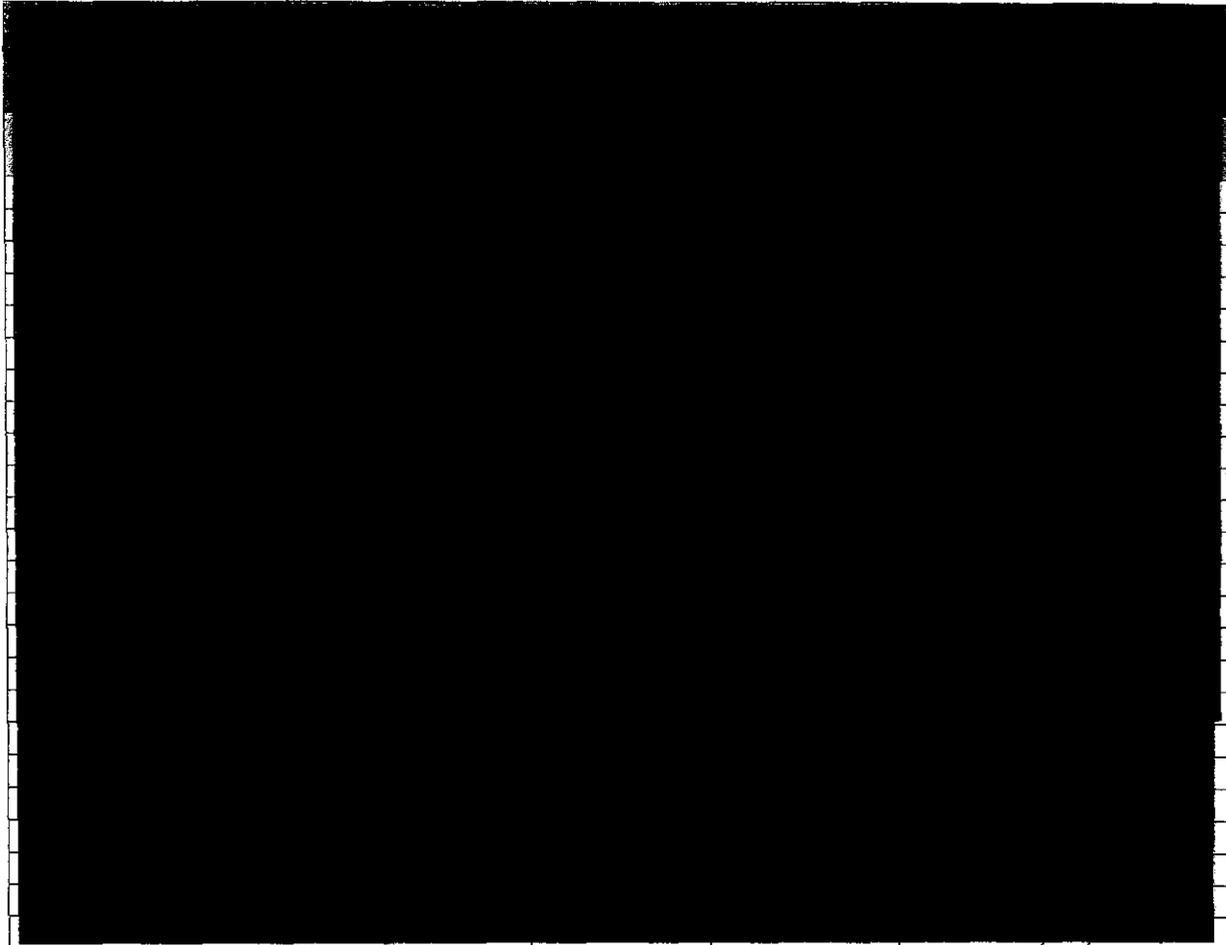


**Exhibit 33**

*Source: Data Request 3.1*

The hedging trend for No. 2 fuel oil is shown in **Exhibit 33**. The Exhibit points out the volatility of No. 2 fuel oil market prices. Price spikes of \$296 and \$325 per barrel in April 2004 and March 2005 were followed by even greater spikes of \$1,906 and \$413 per barrel in December 2006 and April 2007. These extreme spikes make obvious the need for hedging of No. 2 fuel oil purchases. Prior to 2005, PEF procured No. 2 fuel oil via short and long-term market price contracts and spot purchases. Since inception of a financial hedging program for No. 2 fuel oil, PEF has recorded an average gain of \$136 per barrel. For the year 2007, the average reported hedging settlement costs were \$80.28 per barrel and the average market price

financial transactions between the company and counterparty. Exhibit 35 lists each current counterparty, their credit ratings, and Progress Energy's established credit limit for each party.



**Exhibit 35**

*Source: Data Request 2.13*

Progress Energy has a dual relationship with several counterparties; allowing these counterparties to initiate financial hedging transactions and also contract for physical supply of natural gas and fuel oil. For natural gas, in 2006, PEF initiated both financial and physical transactions with three counterparties: BP Corporation North America, Macquarie Bank Limited, and Morgan Stanley Capital Group. In 2007, PEF initiated dual transaction with four counterparties: BP Corporation North America, Macquarie Bank Limited, Morgan Stanley Capital Group, and Shell Energy North America.

For oil transactions, PEF has a dual relationship with BP Products North America, Inc. Progress conducted both financial and physical transactions for fuel oil in each year 2004 through 2007.

**Does the company conduct audits of its fuel procurement program and hedging instruments?**

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