BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY OF

JOSEPH MCCALISTER

ON BEHALF OF

PROGRESS ENERGY FLORIDA

DOCKET NO. 080007-EI

AUGUST 4, 2008

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 (PEC) in the capacity of Director, Gas & Oil Trading.

Q. What are your responsibilities in that position?

A. I am responsible for the procurement of natural gas, fuel oil and emission allowances on behalf of PEC and Progress Energy Florida (PEF).

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Q. Have you previously provided testimony before this Commission in connection with PEF's Environmental Cost Recovery Clause?

A. Yes. In last year's docket (No. 070007-EI), I presented testimony outlining PEF's overall approach to procuring emission allowances as part of its

Integrated Clean Air Compliance Plan and preparation for the compliance requirements of the Clean Air Interstate Rule (CAIR).

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to summarize PEF's actions to date related to its emission allowance procurement strategy as part of its Integrated Clean Air Compliance Strategy in preparation for the requirements under the CAIR.

Q. How does PEF determine how many emission allowances it needs to purchase?

A. As part of the fuel and generation forecasts, emission projections are generated. The forecasts are generated periodically and are based on input assumptions such as generation availability and capacity, planned generation outage schedules, purchased power contracts, fuel and emission price forecasts, planned environmental equipment installations and load projections. To determine if the Company needs to purchase emission allowances for compliance requirements in the current or in future time periods, PEF compares the forecasts of the emissions that will be generated to the number of emission allowances that PEF owns through allocations, purchases and accumulated inventory. In aggregate, the tons of emissions that PEF expected to generate based on the forecasts is greater than the number of allowances that PEF owns for the respective periods. As such, PEF projected the need to purchase allowances from the market in order to comply with the regulations.

Q. How did CAIR impact PEF's procurement activities for emission allowances?

A. The CAIR established an updated cap-and-trade system for sulfur dioxide (SO_2) and nitrogen oxides (NOx) and covered 28 eastern states and the District of Columbia. CAIR established modified SO_2 annual compliance requirements under Title IV of the Clean Air Act by requiring two (2.0) SO_2 allowances to be submitted per ton of SO_2 emissions beginning with 2010 annual compliance filings and 2.86 SO_2 allowances to be submitted per ton of SO_2 emissions starting with 2015 annual compliance filings. In addition, CAIR established new seasonal and annual emission compliance requirements for NOx. Beginning in 2009, CAIR required affected sources to complete a seasonal NOx emission allowance compliance submittal for the May 1 through September 30 time period and an annual NOx emission allowance compliance submittal for the January 1 through December 31 time period each year.

Q. What strategy has PEF pursued for procuring emission allowances to ensure compliance with CAIR?

A. PEF's overall procurement strategy for meeting emission allowance requirements is to buy allowances over time based on forecasted needs to comply with existing and future compliance requirements. PEF believes a procurement strategy of buying emission allowances over time is a reasonable and prudent approach to ensure compliance requirements are met and reduce price risk and volatility for customers. With the adoption of CAIR, this procurement approach was particularly prudent given PEF's forecasted needs,

market liquidity and the market price volatility associated with the new annual NOx allowances.

As part of its Integrated Clean Air Compliance Plan, PEF forecasted the need to purchase both seasonal and annual NOx emission allowances in order to comply with CAIR beginning with 2009 operations. For that reason, and consistent with its strategy, PEF has been purchasing seasonal and annual NOx allowances over time to gradually increase inventories to the levels necessary to achieve compliance. As of June 30, 2008 PEF had approximately $59.2 million in annual NOx emission allowance purchases in inventory, approximately $6.3 million in seasonal NOx emission allowance purchases in inventory and approximately $18 million in SO_2 emission allowance inventory.

Q. How do the Estimated/Actual purchases of emission allowances for the period January 2008 through December 2008 compare with PEF's original projections?

A. The revenue requirements on the inventory of SO_2 and NOx emission allowances are estimated to be $4,454,498 or 86% higher than originally projected. At the time of the last year's projection filing, prices for NOx allowances were highly volatile and unpredictable because the market for these allowances was for a new compliance obligation, trading was just beginning, and the allowance allocations to the applicable states and company accounts had not been made. As a result, there was a high degree of uncertainty related to the exact timing of NOx allowance purchases in the future. PEF applied an

approach for NOx allowance purchases, whereby inventory and rates included only purchases that had already been agreed to at the time of filing. NOx allowance purchases were projected in inventory balances only if there was an executed contract with a transaction that was expected to settle during the year. Subsequent to the filing, market activity increased and the EPA began making allocations of emission allowances. As PEF forecasted significant needs for annual NOx allowances and consistent with its strategy, PEF began making additional purchases of annual NOx allowances. As such, the variance is primarily attributable to the subsequent NOx allowances purchases that did not have executed contracts at the time of the previous projection filing.

Q. How does the average price that PEF paid for NOx allowances compare to market indicators?

A. The average price PEF paid for vintage 2009 NOx allowances that are included in inventory was approximately [redacted], which was lower than market indications at the time of my testimony last year, as well as recent market prices as of July 10, 2008. As I testified last year, as of July 27, 2007, vintage 2009 NOx emission allowances were being bid around $5,200/ton (what buyers were willing to pay) and offered at $6,200/ton (the price sellers wished to receive). At that same time, actual, observed published market trades ranged between $4,750/ton and $5,100/ton. As of June 30, 2008, vintage 2009 NOx allowances were trading at approximately $5,000/ton.

Q. Have there been any recent developments concerning CAIR?

A. Yes. As discussed in the pre-filed testimony of Patricia Q. West, the U.S. Circuit Court of Appeals for the District of Columbia recently issued a decision vacating CAIR. Although the decision is not final, PEF has stopped purchasing CAIR emission allowances in light of the market uncertainty created by the Court's decision.

Q. Does this conclude your testimony?

A. Yes it does.