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September 22, 1999

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By Hand Delivery

Blanca S. Bayó, Director
Records and Reporting
Florida Public Service Commission
4075 Esplanade Way, Room 110
Tallahassee, Florida 32399-0850

RE: Comments of Florida Power & Light Company in Docket No. 980643-EI

Dear Ms. Bayó:

Enclosed for filing on behalf of Florida Power & Light Company (FPL) are the original and fifteen (15) copies of FPL's Comments in Docket No. 980643-EI.

If you or your Staff have any questions regarding this filing, please contact me.

Very truly yours,

Charles A. Guyton

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cc: Mary Anne Helton, Esq.
Parties of Record

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Florida Power & Light Company

Comments on the August 24, 1999 Draft of Proposed Rule
Docket No. 980643-EI

General Comments

Florida Power & Light Company ("FPL") continues to believe that the proposed rule amendments are unnecessary and that a rulemaking should not proceed. There is no compelling need for the proposed rules. The Commission may safely make case by case determinations based on an evidentiary record without promulgating a rule. There has been no documented abuse that needs to be corrected. The Uniform System of Accounts, an extensive set of regulations, is already in place. Rulemaking to enforce uniformity when there are valid reasons for differences serves no rational purpose. Absent a demonstrated need for a rule, the cost and expenditure of resources necessary for a rulemaking docket should be avoided.

While FPL continues to believe that the concerns stated above have not been addressed by the Staff, the Staff is proceeding with proposed rule development, and FPL offers the following comments on Staff's draft proposed rule dated August 24, 1999. These do not reflect all of FPL's differences with Staff's draft, and the absence of a comment should not be perceived as an endorsement of the proposed language. Also, some of the comments are related to each other. For instance, if some provisions are not dropped as suggested by FPL, then some of FPL's proposed language changes may not be appropriate or FPL may suggest different language at a later stage of the proceeding, if it progresses.

Specific Comments

25-6.1351 Cost Allocation and Affiliate Transactions

(1) Purpose. The purpose of this rule is to establish cost allocation guidelines and reporting requirements to ensure proper accounting for affiliate transactions and utility nonregulated activities so that these transactions and activities are not subsidized by utility ratepayers. This rule is not applicable to affiliate transactions for purchase of fuel and related transportation services which are subject to Commission review and approval in cost recovery proceedings.

(2) Definitions
(a) Affiliate – Any entity that directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with a utility. As used herein, "control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a company, whether such power is exercised through one or more intermediary companies, or alone, or in

conjunction with, or pursuant to an agreement, and whether such power is established through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, associated companies, contracts or any other direct or indirect means.

(b) Affiliated Transaction – Any transaction in which both a utility and an affiliate are each participants, except transactions related solely to the filing of consolidated tax returns.

(c) Cost Allocation Manual (CAM) – The manual that sets out a utility's cost allocation policies and related procedures.

(d) Direct Costs – Costs that can be specifically identified with a particular service or product.

(e) Fully Allocated Costs – The sum of direct costs plus a fair and reasonable share of indirect costs.

(f) Indirect Costs – Costs, including all overheads, that cannot be identified with a particular service or product.

(g) Nonregulated – ~~The components of a utility's financial statements that are not taken into account in determining fair, just, and reasonable rates for utility service.~~ Activities or entities that are not subject to price regulation by the Florida Public Service Commission.

(h) Regulated – The components of a utility's financial statements that are taken into account in determining fair, just, and reasonable rates for utility service. Activities or entities that are subject to price regulation by the Florida Public Service Commission.

The proposed definitions of "regulated" and "nonregulated" will not work. When used later in the draft rules, the terms refer to activities or entities that are either subject to commission regulation or are not subject to Commission regulation. However, the definitions do not refer to activities or entities, it refers to components of financial statements. For instance, subsection 3(d) of the rule speaks of a "nonregulated affiliate." As meant in the rule, this is an affiliate that is not subject to Commission price regulation, but your definition would mean an affiliate that is not reflected in a utility's financial statements in setting rates.

It is confusing to define for purposes of the rule commonly applied terms differently than they are commonly used. For instance, if an affiliate is not subject to Commission price regulation (does not have its rates set by the Commission because it is not providing a public utility service), it is confusing to refer to such an entity as "regulated" because the Commission has or may recognize the expenses and revenues of such an entity when setting a utility's rates. Even if the Commission takes that unusual step of recognizing nonutility affiliate revenues and expenses in setting rates, the entity in question is not "regulated." The definitions proposed by the Staff will be a source of endless confusion about Commission jurisdiction. They will also invite the Commission to recognize matters in setting rates that are beyond their jurisdiction. FPL respectfully submits that

everyone is better served by definitions that comport with common understandings of the terms "regulated" and "nonregulated."

Additionally, the definitions included in the draft can be very difficult to apply in practice. For example, how will the determination be made of whether an activity is taken into account when determining fair, just and reasonable rates for utility services? Would that be the utility's last rate case? Would that be how a matter is treated on Surveillance Reports? If so, how is that determined? The rule regarding Surveillance reports does not address a number of matters. At present the treatment of matters under Surveillance reports not specifically addressed by rule is handled on an ad hoc basis by informal agreements with Staff or by utility discretion. That hardly provides the specificity that is intended by a rule. Would this even be utility specific or would this be a generic determination? Would a disallowance of an expense be considered to be a matter "taken into account?" If a type of activity were included for some but not all utilities when setting rates, how would that activity be treated? If the utility's last rate case were used, then how would new activities that emerge subsequent to the rate case be treated under this rule provision?

(i) Subsidize – ~~The act of utility ratepayers paying more than their share of costs associated with affiliate transactions and utility nonregulated activities.~~ Accounting for costs by allocating more or less cost from one entity to another than the underlying economic transaction supports.

FPL proposes the language suggested by TECO at the workshop. It is even handed, in that it addresses subsidies that may run in either direction. This is in accord with the NARUC approach. The rule should not suggest by implication that it is appropriate for customers or any other entity to pay less than their fair share of costs. Moreover, the prior definition failed to define subsidy because it failed to define the operative phrase "their share of costs."

(3) Non-Tariffed Affiliate—Transactions ~~with Non-~~ Involving Regulated Activities

(a) The purpose of subsection (3) is to establish requirements for non-tariffed affiliate transactions involving regulated activities.

FPL's proposed changes make the purpose of this subsection consistent with the Commission's authority. The Commission has clear authority to protect utility customers from cross subsidization or from paying too much to an affiliate for a product, service or asset related to the provision of utility service (provision of electricity). The Commission does not have authority to protect competitors of the utility when the utility is providing unregulated (nonutility) service. Similarly, the Commission does not have authority to police a utility's offerings of competitive, unregulated services. The Commission's authority stops at assuring that utility customers are not subsidizing the utility's offerings of competitive, unregulated services.

As drafted, the rule goes too far. It addresses transactions with affiliates that are totally unrelated to the provision of electric service. FPL agrees that costing utility services to an affiliate as proposed in subsection (b) is necessary to prevent cross-subsidies. However, subsection (c) goes too far and is not necessary to prevent cross-subsidies. The way to protect against subsidies when utilities are purchasing from affiliates products or services to be used in the provision of unregulated (nonutility) services is not to apportion these costs to ratepayers. The way to protect against cross-subsidies arising from affiliated transactions related to nonregulated activities is to separate the costs and revenues for the nonregulated activities from the costs and revenues for regulated activities and only apportion to ratepayers the costs for regulated activities. The Commission attempting to address all purchases from affiliates, including those purchases totally unrelated to the provision of electric service, goes too far. It cannot be justified as an effort to prevent cross subsidies. That is properly protected against by separating regulated from nonregulated activities. Imposing transfer-pricing standards for the purchase from affiliates of products and services totally unrelated to the provision of electricity cannot be justified as falling within the Commission's authority.

(b) A utility must charge an affiliate fully allocated costs for all non-tariffed services and products purchased by the affiliate from the utility. Except, a utility may charge an affiliate less than fully allocated costs if the charge is above incremental cost and equivalent to market prices. If a utility charges less than fully allocated costs, the utility must maintain documentation to support doing so in accordance with the record retention requirements in Rule 25-6.014(3), F.A.C.

(c) When a utility purchases services and products from an affiliate and applies the cost to regulated operations, a ~~A~~ utility shall apportion to regulated operations the lesser of fully allocated costs or market price ~~when purchasing services and products from an affiliate~~. Except, a utility may apportion to regulated operations more than fully allocated costs if the charge is less than or equal to the market price. If a utility apportions to regulated operations more than fully allocated costs, the utility must maintain documentation to support doing so in accordance with the record retention requirements in Rule 25-6.014(3), F.A.C. This section does not apply to parent company or affiliated service company transactions with the utility. ~~Competitive bidding must be used when the utility projects to spend more than $500,000 in a calendar year for a particular product or service.~~

As drafted subsection (c) is too broad. It encompasses all purchases from affiliates, regardless whether the transaction relates to the regulated operations of the utility. It requires the utility to apportion to regulated operations (ratepayers) costs related to nonregulated activities. Why should ratepayers be apportioned costs related to nonregulated activities? Clearly, they should not. Nonregulated activities by the utility

should be separately accounted for and not charged to ratepayers. If a utility engages in nonregulated activities, the utility customers and the Commission should be indifferent to those activities, as long as they are separated and not charged to ratepayers. It is the separation of regulated and nonregulated activities that protects ratepayers. The Commission charging affiliated transactions for the delivery of unregulated services to ratepayers hardly protects ratepayers. There is no need for this rule to reach so far as to capture and charge to ratepayers costs associated with affiliate transactions entered into to deliver unregulated services.

FPL believes that the draft rule is too restrictive and could be detrimental to ratepayers. The rule would discourage transactions with an affiliate if the affiliate could not charge the utility a market price. The transaction could be the most advantageous alternative to the ratepayers. Adding the exception would allow the flexibility for these transactions to take place and the burden would still be on the utility to show that the transaction did not harm the ratepayers.

Transactions with the parent or holding company should be excluded from the scope of this rule. The parent company typically performs various administrative functions for the utility and its other subsidiaries. This would also be the case for transactions with an affiliated service company.

In addition, FPL believes that the requirement for competitive bidding in this section may not be in the best interest of the ratepayers. The requirement for competitive bidding seems to imply that the lowest bid should be awarded the project. FPL believes that factors other than price (e.g. quality of the product or service, financial stability of the company providing the product or service, etc.) should also be considered. Would there be a violation of this rule if the lowest bidder were not selected? Applicable transactions with affiliates related to regulated should face the same standards of prudence as any other transactions with non-affiliated companies.

(d) When ~~an~~ assets used or to be used in regulated operations are ~~is~~ transferred between ~~from~~ a utility and ~~to~~ a ~~nonregulated~~ affiliate, the transfer is to be recorded at the utility ~~must charge the affiliate the greater of~~ at market ~~or net book~~ value. ~~When an asset is transferred from a nonregulated affiliate to a utility, the utility must record the asset at the lower of market or net book value.~~ An independent appraiser must verify the market value of a transferred asset with a net book value greater than $1,000,000.

The rule should be limited in scope to assets that are related to the provision of regulated service. If the utility buys an asset to provide an unregulated service, then the Commission has never included it in rate base, utility customers have never paid a return on it, and it is a private asset for which the utility retains discretion as to how to price when selling. Similarly, if an affiliate transfers an asset to a utility unrelated to regulated operations (to provide an unregulated service), then the asset would not be included in rate base and customers will not be asked to pay a return on it. In these circumstances,

which are clearly unrelated to the Commission's authority to establish rates for the provision of electricity, there is no need for the Commission to attempt to regulate.

The pricing policy for the transfer of any asset related to the provision of regulated service should be the same for affiliates as it is for non-affiliates. The draft rule as written could discourage certain transfers of assets from an affiliate to a utility if the market price is greater than the net book value. This could result in a detriment to the ratepayers if the transaction is not consummated. The requirement for an independent appraisal for large transfers should provide adequate protection for the ratepayers without unduly punishing the affiliate.

~~(e) If an affiliate's accounts and records do not conform to the Uniform System of Accounts as prescribed by Rule 25-6.014, the utility must maintain a mapping system that reconciles the affiliate's accounts to the respective USOA accounts.~~

FPL does not see the need for this section. The utility should maintain the necessary support for all of the charges that it incurs. This section in very vague and could potentially be expensive to implement since it could require significant changes to existing computer systems in addition to the cost to keep the information current.

~~(f) Each affiliate involved in affiliate transactions must maintain all underlying data concerning the affiliate transaction for at least three years after the affiliate transaction is complete. This paragraph does not relieve a regulated affiliate from maintaining records under otherwise applicable record retention requirements.~~

The utility should be responsible for maintaining details associated with affiliate transactions. Nonregulated affiliates should only keep the details required for their operations and not be bound by regulatory record keeping requirements.

(4) Cost Allocation Principles
- (a) Utility accounting records must show whether each transaction involves a product or service that is regulated or nonregulated.
- (b) Direct costs shall be assigned to each service and product provided by the utility.
- (c) Indirect costs shall be distributed on a fully allocated cost basis. Except, a utility may distribute indirect costs on an incremental or market basis if the utility can demonstrate that its ratepayers will benefit. If a utility distributes indirect costs on less than a fully allocated basis, the utility must maintain documentation to support doing so in accordance with the record retention requirements in Rule 25-6.014(3), F.A.C.
- (d) Each utility must maintain a listing of revenues and expenses for all non-tariffed products and services.

(5) Reporting Requirements. Each utility shall file information concerning its affiliates, affiliate transactions, and nonregulated activities on Form PSC/AFA 19 (xx/xx) which is incorporated by reference into this rule. Form PSC/AFA 19, entitled, "Annual Report of Major Electric Utilities," may be obtained from the Commission's Division of Auditing and Financial Analysis.

(6) Audit Requirements

(a) Each utility involved in affiliate transactions or in nonregulated activities must maintain a Cost Allocation Manual (CAM). The CAM must be organized and indexed so that the information contained therein can be easily accessed.

(b) Each utility shall file with the Commission an audit covering a one-year period issued by an independent auditor commenting on the utility's compliance with its CAM. Beginning January 1, 2001, the compliance audit shall be performed no less than once every three years. The first report would be for a year ending no later than December 31, 2003. The audit report shall be filed with the annual report or within 30 days of filing the annual report required by Rule 25-6.135.

(c) Each utility shall file, along with the audit report, a list of all errors, irregularities, and incidents of non-compliance with the CAM detected by the independent auditor during the audit, regardless of materiality.

~~(d) All costs associated with the audit must be separately identified and shall not be chargeable to expense for ratemaking purposes.~~

FPL is concerned about the increased costs that will result from an independent audit of compliance with the CAM. The FPSC should utilize its existing staff to conduct these audits as they do for any other utility transactions. Therefore, FPL believes that paragraphs (b), (c) and (d) should be eliminated completely. If there are to be audit requirements in the proposed rule, FPL's additional language helps clarify the timing of the initial audit and the term covered by each audit.

There is no justification for imposing regulatory costs on a utility and then prohibiting the utility from recovering such costs as is proposed in the draft rule. Previous FPSC policy has been to allow government imposed costs in rates. The purpose of the rule is to ensure that ratepayers do not subsidize nonregulated operations. Since the rule is intended to protect the ratepayers, utilities should be allowed to recover the total costs of any required audits. Therefore, section (d) should be eliminated.

Staff has suggested that the cost of the audit is the price the utility pays for entering into affiliated transactions or engaging in nonregulated activities. The same "logic" could be used to disallow any audit costs incurred in regulating utilities. (The cost of an independent financial audit is the price a utility pays for entering into business, but the Commission allows those costs to be recovered through rates.) The Legislature, which empowers the Commission to regulate the provision of utility services, has not stated that utilities may not enter into affiliate transactions or engage in unregulated business, and it

has not labeled such transactions to be inherently imprudent or suspect. In fact, it envisioned that such transactions and business activities would happen. All the Legislature has done is empower the Commission to prevent cross-subsidies arising from such transactions. It has empowered the Commission to protect ratepayers, just as it empowers the Commission to protect ratepayers in establishing just and reasonable rates. The Commission and the Supreme Court have properly recognized for many years that the regulatory costs associated with protecting customers in setting rates are properly recovered by utilities. These audit costs are no different. They exist solely because of Commission mandate and are justified as necessary to protect ratepayers. Even the Staff has previously recognized that, "[i]t would appear, however, to be in society's best interest to have utilities diversify into areas where they enjoy economies of scale or scope or where they could reduce diseconomies of scale or scope." Until the Legislature sees fit to prohibit affiliated transactions or utilities offering unregulated service, the Commission should not engage in conduct designed to prohibit or deter such activity, such as imposing large costs without a prospect of recovery of those costs. The Commission denying recovery for costs it imposes is arbitrary, unsound rate making, inconsistent with the Legislature's directive, and probably unconstitutionally confiscatory.