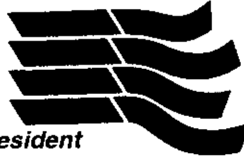
Florida  Air Conditioning Contractors Association

President	President-Elect	Vice President	Secretary	Treasurer	Past President
Larry Dennison	Joe Madden	Ed Boyd	Emilio Guzman	Warren Mohrfeld	Rudy Vivona
Melbourne, FL	Jacksonville, FL	Port Charlotte, FL	Miami, FL Miami, FL	Tallahassee, Fl	Winter Part, FL
(407) 259-0100	(904) 781-8060	(904) 627-8881	(305) 226-7542	(904) 575-9996	(407) 678-5410

August 17, 1999

The Honorable Joe Garcia
Chairman, Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

980643

Re: Workshop on Rules 25-6.105, 25-6.1351, 25-6.0436

Dear Chairman Garcia,

I am writing to you as President of the Florida Air Conditioning Contractors Association. Enclosed is a letter our association provided to you in January 1999 on the issue of deregulation and cross-subsidization.

We have reviewed the proposed rules and have several observations. These rules are limited to cost accounting procedures. As such, they are generally fine, but will there be other rules to cover other aspects of affiliate transactions? Obviously, we are concerned about cross-subsidization, cost shifting and discriminatory self-dealing, as well. In terms of the rules, will cross-subsidization be defined, and how are complaints going to be handled? What are the penalties for disregarding the rules?

As for the specific rules, a loophole is created under the exception in (3) (b), i.e. "Except, a utility may charge an affiliate less than fully allocated costs if the charge is above incremental cost and equivalent to market prices."

Another loophole is created in (4)(c)- "Except a utility may distribute indirect costs on an incremental or market basis if the utility can demonstrate that its ratepayers will benefit. Noted economists have found that ratepayers do benefit when they only charge incremental costs. Utilities can afford to charge incremental costs because the cross-subsidize their unregulated utilities. Contractors and small business in the market are undercut. After the market is captured, competition is decreased and prices are raised.

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"Serving The Air Conditioning Industry Since 1967"

EXECUTIVE DIRECTOR • Janice Ficarrotto • PO Box 180458 • Casselberry, FL 32718-0458
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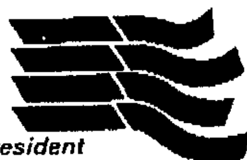
These rules appear to be part of a developing pattern that focuses on commodities, and sometimes excludes "non-tariffed" services. These services would be covered. The market price for services could be below the fully allocated costs. For example, if an affiliate develops a new product or software program, the utility pays the development costs but the affiliate receives the potential profit.

Thank you for the opportunity to share our concerns. We look forward to working with you on this important issue.

Sincerely,

Joe Madden
President

cc: FACCA
Richard Watson, Legislative Counsel
Hon. Tom Lee, Chairman, Senate Regulated Industries Committee
Hon. Luis Rojas, Chairman, House Utilities and Communications Committee



Florida Air Conditioning Contractors Association

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January 31, 1999

The Honorable Joe Garcia
Chairman, Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Dear Chairman Garcia

The purpose of this letter is to raise the visibility of our concerns about the ramifications of utility deregulation as it affects service contractors whose business is based on home appliance repair and warranty work. While utility deregulation in Florida will not occur this year, the issue of deregulation is being considered by Congress and several states have already deregulated their utilities. This letter is being sent to all Florida legislators, the Public Service Commission, and Governor Bush. We would appreciate your opening a file on this subject as we plan to communicate with you periodically.

The issue of deregulation cuts across the jurisdictions of several legislative committees as well as the Public Service Commission. The House Business Regulation & Consumer Affairs Committee conducted an interim study entitled "Electric Utility Entry into the Appliance Warranty and Repair Business". We have taken the liberty of enclosing a copy for your files.

Deregulation of utilities will have a ripple effect on consumers and small business we think you will want to consider. One law we think you need to keep in mind is the "law of unintended consequences". While public policy decisions have embraced deregulation of other industries, deregulation can have adverse effects on small businesses and consumers.

The deregulation of airlines, for example, has made air service to smaller communities more expensive. The deregulation of telephone service has resulted in lower long distance costs, but the threat of high local phone service is real.

Coupled with the trend toward deregulation is another trend of consolidation. We have witnessed first hand the effect of large funeral home conglomerates changing the funeral home industry. In retail and in auto sales, we are witnessing a restructuring of those industries into a few large corporations squeezing out small businesses. Small, personally oriented drug stores have been replaced by a very few large variety stores with almost no reduction in cost to the consumer.

Florida Air Conditioning Contractors Association

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The fear of service warranty contractors is unfair competition from large utilities. Competition is unfair when the entity seeking to compete enters a market with an improper advantage. In this case, it is our position that any utility company seeking to enter non regulated markets using money, customers (mailing lists and monthly mailings of utility bills), equipment, or offices obtained from being a regulated monopoly is unfair. This is known as "cross-subsidization" because it is the use of money from selling utilities that rightfully belongs to utility ratepayers for the development of business that does not provide any return to the consumer-only to the utilitycompany. Cross-subsidization by utilities is expensive to prove in court.

Many states have enacted "Codes of Conduct" which attempt to address these fears. The big question is how much can utilities use their customer base to promote a service warranty business. Can inserts be put in utility bills? As this issue ripens, we hope that you will keep small business in mind. Most employees in Florida are employed by small business. The engine that drives the Florida economy is the small business. We look forward to additional discussions with you on this topic.

Sincerely,

Rick Watson

Richard Watson
Legislative Counsel

cc: FACCA

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(407) 260-2212 • Fax (407) 260-5732 • E-Mail: facca@iag.net or janice@iag.net

Electric Utility Entry into the Appliance Warranty and Repair Business

FOR YOUR INFORMATION
FROM CAM FENTRISS

The Honorable Mark Ogles, Chairman
By the Staff of
Committee on Business Regulation and Consumer Affairs
Becky Everhart, Staff Director
December 1998

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A. Description of the Electric Power Industry in Florida

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I. Introduction and Executive Summary

During the 1998 Regular Session of the Florida Legislature, representatives of several air-conditioning contractor associations requested and received a hearing before the Committee on Business Regulation and Consumer Affairs. At that hearing, they expressed their concern that electric power utilities, spurred by the prospect of deregulation at some point in the next several years, would likely enter the field of major electrical appliance warranty and repair, and would furthermore be in a position to engage in unfair competition.

At the heart of the contractor's concern regarding unfair competition is the specter of cross-subsidization. Cross-subsidization is an "internal subsidy." In the instance of a regulated utility, its most direct form would occur if revenues collected by a utility from its electric power rate-payers were used to pay some of the costs of developing and sustaining a warranty and appliance repair business. More indirect forms of cross-subsidization would consist of: logo and name recognition; marketing and promotion; and purchasing power and credit lines.

According to the contractors, this cross-subsidization would allow the utilities to charge warranty and repair rates that would undercut the fair market price that businesses without such subsidization would need to charge. The result, according to the contractors, would be that utilities would be enabled to rapidly acquire market share, and would eventually -- having eliminated its small business competitors -- be in a position to charge consumers higher rates than before.

This is known as "predatory pricing." Predatory pricing occurs when a business entity sets its prices for goods or services at a level which actually loses money initially. This is a viable strategy when a business has a large revenue base in a separate – though often closely related – area. Therefore, such a strategy is generally only available to very large businesses with sufficient revenue to lose money in a small segment of its business, over the short term. The purpose of such a strategy is to seize control over (monopolize) a market.

Predatory pricing is illegal under federal and state antitrust laws. However, *proving* predatory pricing is a very "fact specific" exercise. This means that the laws against predatory pricing (antitrust laws) are not -- and possibly *cannot be* -- written in such a fashion that it is immediately and indubitably clear whether any particular activity actually constitutes a violation in each specific context. In order to make a determination, it is necessary to examination a multitude of facts that are specific to the case in question. Consequently, in any instance of business practice, it is easily and legitimately a matter of differing opinion as to whether such specific practice amounts to predatory pricing -- up until the point a court or regulatory agency makes its ruling.[1]

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[1] A current case-in-point to illustrate this is the ongoing dispute between the Federal Justice Department and Microsoft Corporation. Microsoft produces the "Windows 95" operating systems for personal computers. This operating system is used in almost 90% of personal computers.

Up until a couple of years ago, Netscape Communications possessed a similar near-monopoly with its Internet "browser" product. Netscape currently alleges that Microsoft is violating Federal Antitrust laws by engaging in predatory pricing by *giving away free* its own Internet browser (Internet Explorer). Netscape essentially contends that Microsoft is doing this with the intent of absorbing its loses up to the point that it drives Netscape out of business, at which point Microsoft would be free to raise its prices.

Naturally, Microsoft disputes this, and maintains that it is competing -- legitimately -- in the competitive business environment. So, what you have here is a situation in which the facts are not in dispute, yet it may take years of legal process to determine whether the specific facts of the case constitute an antitrust violation.

In the case of electric power utilities, there is -- in addition to the general laws against predatory pricing -- the fact that the funds that would be used for any cross-subsidization would be coming from utility rate-payers. Power utilities currently derive their revenue in a monopoly environment. That is, they are granted a geographical jurisdiction within which they face no competition. All consumers within that area have no choice regarding from whom they will purchase electrical power or the price they will be charged.

The Florida Public Service Commission (PSC) approves these jurisdictional monopolies, as well as the prices which consumers are charged. With regard to the investor-owned utilities, the PSC is charged with assuring that rates charged by utilities are set *at the lowest reasonable rate that is fair to both the ratepayer and the utility.* Pursuant to this responsibility, the PSC is called upon to assess the utilities' legitimate costs of doing business and then factor in a reasonable rate of profit in determining the rates the utility may charge the consumer. Consequently, as a question quite separate from the predatory pricing issue, there is the issue of the propriety of a regulated utility diverting revenues gained pursuant to the argument that these rates are only so high as are found to be *necessary* to conduct that regulated activity (plus a small profit).

The contractors contend that the potential of such an internal subsidy, with some of the overall costs of doing business as an appliance warranty/repair business being paid by electric utility rate-payers, would amount to granting the utility an unfair competitive advantage. And, depending on the degree of market share this subsidy allowed the utility to gain, could even amount to an antitrust violation.

Staff queried the PSC regarding the electric power utility industry in Florida, and then surveyed each of the regulated electric utilities. There are five investor-owned electric utilities, 33 municipally-operated electric utilities, and 17 electric cooperatives. According to the responses received, <u>none</u> of the 33 municipally-operated electric utilities or 17 electric cooperatives engage in any appliance warranty or repair business. Of the four investor-owned utilities which responded to our survey, <u>three</u> (Tampa Electric Company [TECO], Florida Power, and Florida Power and Light [FPL]) also do <u>not</u> engage in any appliance warranty or repair business.

The only electric utility which <u>does</u> engage in appliance warranty or repair in Florida is Gulf Power. Gulf Power uses General Electric for the appliance repair service. General Electric uses local contractors to do the actual repairs. Their warranty program has approximately 5,000 clients.

Florida utility companies queried by staff dispute the contention that their entry into the warranty/repair field does -- or will -- involve unfair competition. Response from the electric power utilities may generally be summarized as asserting that:

1) <u>Many of the potential activities the contractors object to may legitimately be seen as an "advantage," *but cannot be fairly characterized as amounting to "unfair" competition*</u>. Advantages utility companies might possess, such as name recognition, use of logo, or benefits derived from purchasing power and credit lines, amount to advantages <u>any</u> established business legitimately possesses when considering expanding their operations. The utilities point out that such advantages are also possessed by businesses such as Sears or K-Mart.

2) Other activities, such as using the employees, infrastructure, buildings, furnishings, equipment, vehicles, or any other physical assets of the regulated activity <u>do</u> amount to

unfair competition (in the form of cross-subsidization), but the utilities deny they would attempt to act in such a manner, and point out that the Florida Public Service Commission -- under current law -- is already charged with preventing such cross-subsidization.

Other states have wrestled with this problem. This report sets forth those states' experiences in some detail. Several of those states have chosen to enact "Codes of Conduct" (either statutorily or through administrative action) to prevent unfair competition.

******

This report makes the following conclusions:

- Currently, the utilities in Florida are not entering the fields of appliance service warranty and repair to any *significant* extent. Only Gulf Power actually engages in this business. However, Florida Power is conducting an "inside wiring *pilot project*" to determine whether they will enter this field.[2]

- Utility entry into the fields of appliance service warranty and repair has occurred in other states, and several states have set forth (either statutorily or by administrative action) "Codes of Conduct" and other cross-subsidization controls which must be observed by utilities entering these fields.

- Contractor arguments that deregulation -- should it occur -- will provide impetus for utility entry into the fields of appliance service warranty and repair appear to make sense. Competition can logically be expected to spur a search for more ways to service and expand a customer base. However, there is actually no *bar* to utilities proceeding prior to any deregulation. Therefore, it would not be correct to see this issue as either *contingent* upon deregulation or *necessarily linked* to deregulation.

- The appropriate executive agency to consider a Code of Conduct or other controls on utility entry into the fields of appliance service warranty and repair would be the Public Service Commission.

- What the contractor representatives appear to be seeking (besides the general goal of "raising the consciousness" of the Legislature on this issue) is to have the Legislature *place in statute* guidelines for such controls. Such guidelines would clearly designate which activities would be considered to be cross-subsidization or some other type of "unfair" competition. Without such a Code of Conduct, it is left to administrative hearings and litigation to determine permissible and impermissible virtually activities on a *case-by-case basis*.

- The ultimate issue is whether the existing laws -- as adjudicated through PSC hearings and litigation -- are sufficient to fairly and efficiently assure the utilities will not unfairly compete, or whether these laws should be supplemented with a Code of Conduct (developed either statutorily or through administrative agency action) in order to clearly delineate what activities and actions constitute unfair competition.

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[2] "Inside wiring" refers to the electrical wiring that runs from the outside meter to each of the outlets within the house. Such work would compete with electrical contractors, but does not involve *electrical appliance* work, which is the focus of this report.

The policy options available to the Legislature are:

1) The Legislature could conclude that no action is needed as far as statutory changes are concerned, that existing state and federal laws are adequate to address the situation. Disputes between contractors and utility companies engaged in appliance service and repair would be resolved administratively though hearings before the PSC or through litigation.

   Under this option the Legislature could hold hearings to be certain that existing laws are indeed adequate.

2) The Legislature could conclude that no action is needed as far as statutory changes are concerned, but could direct the PSC to hold hearings with the goal of determining if it needs to adopt a Code of Conduct to set forth allowable and prohibited activities with regard to electric utilities engaging in appliance warranty and repair work. Such a Code of Conduct could, for instance, settle such questions as whether the use of the logo by repair affiliates should be prohibited, and under what circumstances and controls advertisements urging consumers to use these affiliates for their repair work would be allowed to be included in the electric utility's monthly billings.

3) The Legislature could hold hearings and enact a Code of Conduct, statutorily.

II. Regulation of Power Utilities in Florida

As in other states, an executive agency in Florida -- the Public Service Commission (PSC) -- is empowered to regulate electric utilities. The five-member PSC is created in s. 350.031, F.S. Its members are appointed by the Governor to 4-year terms, subject to confirmation by the Senate. Chapter 366, F.S., sets forth the regulation of public utilities, including electric power utilities.

In Florida, three types of utilities provide electricity: investor-owned utilities; rural electric cooperatives; and municipally-owned systems. In certain circumstances, these utilities are treated in varying fashions under Florida law. The PSC exercises a greater degree of control over investor-owned utilities, with such control extending to holding "rate cases," in which the actual dollar figure they may charge for a unit of electricity (a kilowatt hour) is set. The rates charged by the municipal electric companies and electric cooperatives are not set by the PSC. Instead -- for those types of entities -- the PSC exercises authority regarding such things as resolving territorial disputes, and requiring electric power and conservation and reliability within a coordinated grid.

The area in which an electric utility may provide service is defined through territorial agreements between utilities and approved by the PSC. Additionally, the agency has authority to resolve territorial disputes where they arise. These agreements are negotiated as growth occurs and utilities seek to serve the newly-developed areas. Thus, the exclusive service area of a particular utility, be it an investor-owned, municipal or rural cooperative utility system, develops over time, in response to the growth patterns of the area. It is defined by territorial agreements or dispute resolutions between the utility and adjacent utilities over a number of years.

The three "core' functions of an electric utility are generation, transmission[3], and distribution.[4] However, not all utilities perform each of the three functions. Each of the five investor-owned utilities generates electricity, as do 16 of the 33 municipal systems and two of the 17 electric cooperatives. In 1998, investor-owned utilities owned 78% of the generating capacity in the state, a reduction from a level of 85.8% in 1984 (with municipals, rural electric cooperatives, and federally-owned generation accounting for the remaining portion). In 1998, Florida's utilities generated 176,286 gigawatts of electricity and served 7,435,789 customers.

Electric utilities in Florida are subject to what is known as "economic regulation." Economic regulation is essentially a reasoned, "Faustian" bargain between government (concerned for providing essential services to citizens) and the business entity (concerned for its own legitimate profits in an environment free from competition). In this bargain, the regulated entity agrees to offer its service to every applicable citizen or business, and also agrees to accept government intervention in setting its prices. What the *regulated entity* receives in return for its concessions is freedom from open competition. This freedom comes in the form of a geographic monopoly in which to operate. What *the state* receives in return for its concessions is an assurance that those citizens within that monopoly will all be offered service, and at the lowest (as determined by the government body) reasonable price.

Other examples of instances in which the government establishes economic regulation (the business entity agreeing to service all applicants at a regulated price in return for freedom from competition within a geographical monopoly) include: harbor pilots;[5] emergency medical services (ambulances); nursing homes; and hospitals.[6]

The table that follows outlines a number of the regulatory objectives established in the Florida Statutes.

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[3] "Transmission" is the "wheeling" of large amounts of electricity from one part of the state to another.

[4] "Distribution" is the actual *retail sale* of electricity to consumers.

[5] Only a limited number of harbor pilot licenses are available, no matter the number of qualified applicants. Also, licensed pilots are obligated to offer their service to all ships which need them, and the rates they may charge are set by the Pilotage Rate Review Board, under the Department of Business and Professional Regulation.

[6] Regulation of some health fields (hospitals, hospices, nursing homes, and emergency medical services) has limited licensure and provisions which serve to minimize or eliminate competition. A person or group may not build or operate a hospital, hospice, or nursing home within a given health care market simply by virtue of being capable of doing so. A hospital, hospice, or nursing home may not be built, or go into operation, without applying for, and receiving from the Agency for Health Care Administration (AHCA) a "certificate of need." Requiring a certificate of need before issuing a license amounts to a regulatory effort to prevent costly duplication or harmful competition. Similarly, emergency medical services are granted jurisdictional monopolies, within which other ambulance services will not be allowed to operate.

HOW STATUTORY PROVISIONS ESTABLISH BASIC REGULATORY OBJECTIVES

Basic Regulatory Objectives	Florida Statutes
A utility shall serve all who apply for service.	Chapter 366.03 provides that each public utility shall furnish to each person reasonably sufficient, adequate, and efficient service upon terms as required by the commission.
A utility shall provide service without discrimination.	Chapter 366.03 provides that no public utility shall make or give any undue or unreasonable preference or advantage to any person or locality, or subject the same to any undue or unreasonable prejudice or disadvantage in any respect.
A utility shall provide adequate and reliable service at just and reasonable prices.	Chapter 366.041(2) provides that adequate service be rendered by the public utilities in the state in consideration for rates, charges, tolls, and rentals fixed by said commission and observed by said utilities under its jurisdiction.
A utility is allowed to receive reasonable rates for its services.	Chapter 366.041(1) provides that no public utility shall be denied a reasonable rate of return upon its base in any order entered pursuant to PSC proceedings.
A utility is subject to being assigned duties assisting other public interest objectives.	Chapter 366.04(6) provides that the Commission shall...prescribe and enforce safety standards. Chapter 366.04(5) provides that there be an adequate and reliable source of energy for operational and emergency purposes in Florida. Chapter 366.81 provides that public utilities utilize the most efficient and cost-effective energy conservation systems.

III. The Contractors' Concerns

According to a report prepared by Spectrum Electronics of California for the Air Conditioning Contractors of America, the U.S. heating, ventilation, air conditioning and refrigeration (HVACR) industry has revenues of over $67 billion per year and employs over 530,000 people. About 70% of the employees work for small contractors who employ less than 50 people, and almost half work for employers with less than 10 employees. The industry pays "high" wages to its employees, who average about $17 per hour and provides independent livelihood to over 53,000 small business owners and their families. The report states:

> Increasingly, the future of these independent contractors is threatened by anticompetitive practices associated with the entry of large electric and gas *utilities into the HVACR industry through unregulated affiliates.* About 42% of utilities are now active in the HVACR business, but most of their activity is recent. In the early 1990's only two major utilities, Consumer's Power of Michigan and Public Service of Colorado, had major HVACR businesses. By 1997, the number of utilities in the HVACR market had grown to over 50.

At the heart of the contractors' concerns regarding unfair competition is the specter of cross-subsidization. Cross-subsidization is an "internal subsidy." In the instance of a regulated utility, its most direct form would occur if revenues collected by a utility from its electric power rate-payers were used to pay some of the costs of developing and sustaining a warranty and appliance repair business. More indirect forms of cross-subsidization would consist of: logo and name recognition; marketing and promotion; and purchasing power and credit lines.

According to the contractors, this cross-subsidization would allow the utilities to charge warranty and repair rates that would undercut the fair market price that businesses without such subsidization would need to charge. The result, according to the contractors, would be that utilities would be enabled to rapidly acquire market share, and would eventually -- having eliminated its small business competitors -- be in a position to charge consumers higher rates than before.

This is known as "predatory pricing." Predatory pricing occurs when a business entity sets its prices for goods or services at a level which actually loses money initially. This is a viable strategy when a business has a large revenue base in a separate -- though often closely related -- area. Therefore, such a strategy is available only to very large businesses with sufficient revenue to lose money in a small segment of its business, over the short term. The purpose of such a strategy is to seize control over (monopolize) a market.

Predatory pricing is illegal under federal and state antitrust laws. However, in the case of electric power utilities, there is -- in addition to the general laws against predatory pricing -- the fact that the funds used for any cross-subsidization would be coming from utility rate-payers. The contractors contend that the potential of such an internal subsidy, with some of the overall costs of doing business as an appliance warranty/repair business being paid by electric utility rate-payers, would amount to granting the utility an unfair competitive advantage. And, depending on the degree of market share this subsidy allowed the utility to gain, could even amount to an antitrust violation.

This service directly competes with private industry. Even though private contractors are invited to participate by supplying the repair service itself, the utility becomes the "broker"

or third party agent. In many instances, the warranty agreement may end up supplanting the contractors' agreements. Initially, contractors are asked to bid for the opportunity to be on the utility's list of "authorized service providers." However, contractors worry that eventually the utility will set the price they will charge the consumer -- and pay to the contractors -- at a lower level than an open market would produce. The concern, as stated above, is that the consumer's price will be artificially low because the utility will subsidize part of the cost through its rate-payer base.

In addition to concerns regarding *direct* cross-subsidization, the contractors maintain that a pervasive *indirect* subsidization exists. In any instance in which the utility has done preliminary work to determine whether (and how) to enter a market like appliance repair, the contractors contend that such utilities:

> ... have invested at least one and perhaps a couple of years in researching the ideas behind these programs. They have contributed the time of senior management, public relations and marketing staff employed by the utility. They have paid untold dollars to outside consultants and to corporate attorneys. They have conducted consumer research and focus groups. They have developed campaigns to sell the contracting industry on their ideas. All of this activity in research and development has surely cost significant dollars. Marketing and program implementation as well as program administration will cost a lot more.

The contractors contend that legislation to address their concerns regarding both direct and indirect cross-subsidization should consider the following points:

1. Logo and Name Recognition - Any utility wishing to operate a for-profit business should not be able to rely on the name, logo or corporate identity that was established under a regulated business.

2. Human Resources - Utility employees whose wages and benefits are paid by ratepayers should not allowed to work for the for-profit business.

3. Utility Assets - Infrastructure, buildings, furnishings, equipment, vehicles and all other physical assets were gained through the revenue generated by a captive ratepayer base. These assets should not be available on the for-profit side.

4. Marketing and Promotion - Everyone who uses electricity or gas is known to the utility and is communicated to once a month through the billing process. Already a utility includes promotional and marketing materials with their bill. This should not be allowed with regard to promoting an appliance repair and warranty business, since the ratepayer revenue funds the costs of the mail-out.

5. Purchasing Power and Credit Lines - Some utilities in other parts of the country are already developing programs that would allow rate-payers to finance new equipment (on their utility bill) through ten-year leasing programs. These long-term leasing programs are designed to lock-in consumers to that utility for a period of time, regardless of rates, and would be unfair.

IV. The National Experience

A. Overall

A report titled Impacts of Utility Entry into Air Conditioning Installation and Maintenance, prepared for the national association of HVACR contractors states that cross-subsidization is one of the key problems created by a mixed market environment. It states that concern about the potential for cross-subsidization has prompted restrictions on utilities in other states and has "posed a persistent problem for regulators." According to the report:

> Cross-subsidization occurs when an affiliate in an unregulated market is able to price its product or services below cost due to its relationship with a regulated entity. Whether this cross-subsidy takes the form of covering the affiliate's losses with revenues from the regulated utility or arises from the use of assets of the regulated entity to reduce the cost of providing service, the unregulated affiliate enjoys a competitive advantage due to its relationship with the regulated monopoly. This internal subsidy is borne, directly or indirectly, by the consumers of the regulated entity.

According to the report, the result of this cross-subsidy, "...is both inefficiency in the regulated market and a skewing of competition in the unregulated market as the affiliate is able to drive out otherwise efficient rivals through below cost pricing." The cross-subsidy enjoyed by the affiliate may allow the affiliate to offer prices far enough below its cost to allow it not only to drive out competitors, but to prevent new entrants into the market. The report further states:

> Once competition is eliminated, prices in the unregulated market will rise and the threat of predatory pricing will be sufficient to dissuade potential new entrants. Obviously, cross-subsidies pose adverse consequences for consumers and competitors alike.

Nationally, utility participation in the HVACR market has taken a variety of forms, including:

- contractor certification programs;
- sales of referrals for customers seeking HVACR service;
- sales of HVACR maintenance plans (either directly or through an affiliate); and
- general HVACR maintenance and contracting.

B. Status In Specific States

In response to the entry of utilities into the fields of appliance repair and warranty, some state regulatory commissions have begun crafting standards of conduct to govern utility affiliate transactions, particularly those states moving towards a deregulated market.

Among these states, many are moving towards stricter requirements of physical and financial separation for electric utilities and their non-regulated affiliates. Impacts of Utility Entry into Air Conditioning Installation and Maintenance, noted that **New Hampshire** and **California** have required that the utilities and their affiliates be separate corporate entities. **Iowa**, while not requiring complete separation, has prohibited the sharing of vehicles, service tools and other assets between the utility and its unregulated affiliates. **Minnesota** probably enacted the strictest rules. It required that unregulated affiliates pay a 1% of revenues franchise fee to the regulated utility. (This was later overturned by state courts.) Other states are currently considering similar rules including: charges for shared data processing and administrative support; permitting sharing of marketing and other data only if it is available to all competitors on a nondiscriminatory basis; and other rules to prevent abuse of utility market power.

The report made the following findings:

Maryland -- Baltimore Gas and Electric (BG&E) is moving aggressively into the HVACR business. Through their Home Products and Services division , formed in 1994, BG&E sells HVACR and appliance service contracts, repairs and installs HVACR systems, and sells appliances. BG&E's Commercial Building Systems division designs, finances and supervises the installation of commercial HVACR systems. BG&E cross-subsidizes its affiliates, which pay nothing for such vital services as advertising, data or customer referrals from the regulated utility.

Delmarva Power (recently renamed Connectiv), which supplies electricity to Delaware and Eastern Maryland, has been even more aggressive in the HVACR area. Delmarva/Connectiv has purchased several electrical contracting businesses and now sells, finances and installs residential and commercial central air conditioning systems. Connectiv recently announced that its HVACR business tripled to $95 million in 1997. This amounts to a market share of over 20% in Connectiv's territory.

The Washington, D.C., area gas utility, Washington Gas, is also aggressively selling HVACR services. Its HVACR service programs go back at least to the early 1980's. They sell appliance and HVACR service contracts and finance purchases through a "Thrift Purchase Plan". The actual service work is done by a combination of Washington Gas staff and "trade associate" contractors. Washington Gas also operates a contractor referral program.

Several Maryland area utilities are considering entering the HVACR warranty and repair business. Maryland regulators and the Maryland Legislature are currently debating how to regulate these utility programs. The staff of the Maryland PSC has recommended strict separation between BG&E and its affiliates, including competitive bidding for all utility contracts and open purchase of all utility services such as customer data. The Legislature passed tight cost allocation rules for utility subsidiaries.

Delaware -- In Delaware, the state Legislature passed a Joint Resolution establishing Fair Conduct rules for utility subsidiaries. Delmarva Power had bought several HVACR contracting businesses and the utility was referring customers to these unregulated subsidiaries without informing the customers of the corporate relationship. The Delaware Public Service Commission examiner found Delmarva Power's actions to be in clear violation of the Code Of Conduct.

Virginia -- Virginia Power (VEPCO) had an aggressive HVACR program but was pulling back from this business as of late 1997. VEPCO designs, builds and manages commercial HVACR systems. It created a "Comfort Assured" Preferred Dealer Network to install and service residential heat pump systems and provide low interest loans through these contractors. VEPCO also bought an appliance and HVACR service contract and warranty business. Under significant legal and political pressure, VEPCO is now selling the warranty business and is reducing its other HVACR service business. VEPCO also signed an agreement with the Virginia Coalition for Fair Competition to follow strict standards of conduct.

Colorado -- Public Service of Colorado (PSC) services air conditioning systems and appliances and is also constructing a large chilled water plant to provide cooling to downtown Denver. The plant will use off-peak power in the evening to chill water for day time use. PSC has reduced its once aggressive appliance service business to cover the Denver area only.

The most aggressive utility provider of HVACR services in Colorado and several nearby states is KN Energy, once mainly a gas transmission and distribution company. KN Energy provides appliance service (including HVACR), and appliance warranties along with a wide variety of gas and telecommunications services.

A nearby utility, NorAmEnergy, now part of Houston Industries, is aggressively expanding its appliance and air conditioning service business in **Texas**, **Oklahoma**, **Arkansas**, **Louisiana** and **Minnesota** and may soon enter the **Colorado** market.

Colorado's Public Utilities Commission is finalizing a modestly strict code of conduct rules for unregulated affiliates which require full payment to the utility for all data and other services.

New York -- New York utilities are discussing providing a variety of HVACR services but relatively few programs are being implemented as of late 1997. The most active program is that of Brooklyn Union Gas and their merger partner Long Island Lighting (LILCO) -- now Keyspan Energy. Brooklyn Union sells and installs gas air conditioning and sells gas appliance maintenance contracts. Any further Keyspan entry into the HVACR business is being held up by negotiations surrounding the merger.

The other major New York utilities, Niagra Mohawk, Consolidated Edison, Rochester Gas and Electric and New York State Electric and Gas are not aggressively pursuing the HVACR business.

The New York Public Utilities Commission (PUC) has ordered all state utilities, including Brooklyn Union/Keyspan, out of the HVACR business by 2000, unless the utilities can prove they are not cross-subsidizing. The April 4, 1997, PUC order requires that all utility HVACR services be provided by separate subsidiaries, that past expenditures be refunded to customers, and that HVACR service prices be immediately raised to unsubsidized levels.

Michigan -- Consumers Power has been aggressively trying to enter the HVACR business for 15 years, but they have been held up by litigation and the Michigan Coalition for Fair Competition has continued to fight these utility HVACR programs. Consumers Power sells appliance and HVACR service contracts for residences and

is discussing broader HVACR services. Consumers Power also has a referral program which includes a 10% kickback from the contractor.

Detroit Edison sells appliance and HVACR service contracts. Detroit Edison is also installing its Liquid Pressure Amplification Pump as part of commercial refrigeration and air conditioning systems.

Michigan Consolidated Gas (part of MCN Energy) has expanded from servicing gas appliances to selling service contracts for central air conditioning systems in the Detroit and Grand Rapids areas. Michigan Consolidated advertises its "100 years of gas appliance service experience."

These utility programs and potential cross-subsidy problems would be severely limited, if not killed, by pending Michigan legislation enacting utility standards of conduct. The proposed Michigan standards would prohibit unregulated subsidiaries from using the utility's name, staff or data bases. The Michigan Alliance for Fair Competition has repeatedly sued successfully to limit regulated utility provision of HVACR services.

Ohio -- Ohio utilities entered many the HVACR business, in 1997. When Ohio Edison (now part of First Energy which includes Toledo Edison and Cleveland Electric Illuminating) bought two of the nation's largest mechanical contractors, Roth Brothers and RPC Mechanical, with combined revenues of over $90 million. Ohio Edison has announced that through these contractors it will supply the full spectrum of HVACR, roofing, and building services primarily to commercial and industrial customers. They are also starting a "one call" appliance service program. This dramatic move makes Ohio Edison/First Energy a major HVACR player.

American Electric Power (AEP) is indirectly entering the HVACR business through its proposed 10 year guaranteed savings programs. For large customers willing to contract for buying electricity for 10 years, AEP guarantees cost savings and installs energy saving equipment, including HVACR equipment, for free. It is unclear how extensive these new power contracts will be and what their impacts will be on existing HVACR contractors.

Columbia Gas has an appliance warranty program in Ohio. Consolidated Natural Gas is experimenting with an appliance warranty program in nearby Pennsylvania, which may be extended to the territory of CNG's East Ohio Gas.

Neither of Ohio's other major electric utilities, Cincinnati Gas and Electric (now Cinergy) and Dayton Power and Light, are actively pushing air conditioning installation and maintenance programs.

The Ohio Legislature is considering utility standards of conduct which would control these programs, but passage is uncertain.

Nevada -- Nevada Power proposed a preferred dealer network where it would sell referrals to selected contractors, but this program was effectively killed by PSC action. They are also planning a central chilled water cooling system for the Las Vegas "Strip." Having lost the dealer referral battle, Nevada Power is now entering the home and appliance warranty business (including HVACR) through an insurance

affiliate, First Choice Insurance. This program is running into problems with the contractor's licensing board, as is a similar insurance program run by Old Republic.

V. The Electric Power Industry in Florida

A. Description of the Electric Power Industry in Florida

1. Overall

Staff surveyed the Florida Public Service Commission, as well as each of the 55 regulated electric utilities in Florida. There are five investor-owned electric utilities, 33 municipally-operated electric utilities, and 17 electric cooperatives. The electric power industry consists of: (1) Generation; (2) Transmission (the "wheeling" of large amounts of electricity from one part of the state to another); and (3) Distribution (the actual *retail sale* of electricity to consumers).

However, not all utilities perform each of the three functions. Each of the five investor-owned utilities generates electricity, as do 16 of the 33 municipal systems and two of the 17 electric cooperatives. The others buy electricity from those who produce it.

In 1998, investor-owned utilities owned 78% of the generating capacity in the state, a reduction from a level of 85.8% in 1984 (with municipals, rural electric cooperatives, and federally-owned generation accounting for the remaining portion). In 1998, Florida's utilities generated 176,286 gigawatts of electricity, served 7,435,789 customers, with the investor-owned utilities serving 79% of that customer base.

2. Geographical Scope of Service for the Investor-owned Utilities

Of the five investor-owned utilities:

Florida Power and Light (FPL) serves an area of approximately 27,650 square miles in 35 counties located along Florida's east coast from the Keys to Jacksonville and the southwestern coast as far north as Bradenton. FPL served an average of 3.6 million customers during 1997.

Florida Power provides electric service to all or part of 32 counties in west central and north Florida, serving approximately 1.3 million customers.

Tampa Electric Company (TECO) serves over 525,000 residential, commercial and industrial retail customers in west central Florida. Its retail regulated service area consists of about 2,000 square miles, including almost all of Hillsborough County and parts of Pasco, Pinellas and Polk Counties.

Gulf Power serves approximately 350,000 customers in the 10 most western counties in Florida (sometimes referred to as the "Panhandle").

Florida Public Utilities Company is the smallest of the investor-owned utilities. It serves basically Marianna and Femidina Beach, Florida. It has approximately 24,000 retail customers. It did not respond to our request for information.

3. **Do electric power utilities in Florida currently engage in -- or have any plans to engage in -- the business of home appliance warranty or repair?**

   According to the responses received, none of the 33 municipally-operated electric utilities or 17 electric cooperatives engage in any appliance warranty or repair business. Three of the four responding investor-owned electric utilities (Tampa Electric Company, Florida Power, and Florida Power and Light) also do NOT engage in any appliance warranty or repair business. Florida Power is, however, engaged in an "inside wiring pilot project" to conclude at the end of 1998. This pilot project does not include appliance or air-conditioning system repair. It involves warranty and repair of *inside electrical wiring* (i.e., the electrical wiring contractors install between the electric meter and the electrical outlets inside the home). This pilot project will determine whether Florida Power will engage in electrical wiring warranty and repair work on a widespread basis.

   Gulf Power indicated that it has for several years engaged in marketing of extended service warranties on appliances and servicing of appliances under warranties (via third parties). Gulf Power uses General Electric for the appliance repair service. General Electric uses local contractors to do the actual repairs. Their warranty program has approximately 5,000 clients.

B. Power Utilities' Viewpoint on the Contractors' Concerns

The electric power utilities' responses to this committee's questionnaire may be summarized as follows:

1. Many of the potential activities the contractors object to may legitimately be seen as an "advantage," *but cannot be fairly characterized as amounting to "unfair" competition*. Advantages utility companies might possess such as name recognition, use of logo, or benefits derived from purchasing power and credit lines amount to advantages any established business legitimately possesses when considering expanding their operations. The utilities point out that such advantages are also possessed by businesses such as Sears or K-Mart.

2. Other activities, such as using the employees, infrastructure, buildings, furnishings, equipment, vehicles, or any other physical assets of the regulated activity do amount to unfair competition (in the form of cross-subsidization), but the utilities deny they would attempt to act in such a manner, and point out that the Florida Public Service Commission -- under current law -- is already charged with preventing such cross-subsidization.

As stated by one utility company respondent:

> The general thrust [of the contractor assertions is that] utilities have unlimited resources, in the form of captive ratepayers, from which to finance their diversification into the appliance repair/warranty business. There appear to be two derivative concerns resulting from this basic proposition: that utilities' activities will be subsidized by regulated operations; and to a somewhat lesser degree, independent contractors can't compete against large utilities. We should regard the second concern as a subset of the first, since inability to compete against a larger corporate entity that can achieve economies of scale and greater operating efficiencies, both of which serve

to give lower cost and better service to customers, should be recognized as a favorable outcome, not one that should elicit prohibitive legislation. In other words, if utilities can produce goods and services at lower cost and with greater customer satisfaction than other competitors, without "subsidizing" those goods and services from regulated operations, then consumers benefit and the market is working appropriately. After all, large chain grocery stores meet the mass market need more efficiently and at lower cost than the corner market, and while some may yearn for the more nostalgic small store up the street, no one would suggest that legislation should be passed prohibiting the larger chain stores from entering the market. This would only result in economic damages to consumers by restricting competition, quite the opposite effect the contractor associations would suggest. The real purpose of this argument is to create a legislative shelter by prohibiting or handicapping potential new entrants.

Another respondent states:

> There is no evidence in Florida to support the claim that electric or gas utilities would subsidize all services provided by the utilities. Accounting rules and continuing audit oversight by the Florida Public Service Commission ensure that no such subsidies are allowed. The Securities and Exchange Commission also has rules which each public corporation must follow, including rules which prohibit subsidization of one business unit by another. The Federal Trade Commission and the United States Department of Justice actively enforce national statutes which prohibit unfair competition. The document makes broad assertions that cross-subsidy has and continues to occur using examples from other utilities in other states as a basis for that assertion. In fact, such violations are the exception, not the rule, and those few who break the rules are subject to penalties.

On the issues of logo usage and credit lines, that respondent goes on to assert:

> Good names and logos were not bought and paid for by (utility) ratepayers. Logos were paid for by shareholders. Good names and good reputation were earned by good performance, not provided by ratepayers. No utility should be forced to neuter its identity (good or bad) because another business or group wants to use its own branded name(s) while prohibiting the utilities from using their own branded names. Likewise, a utility owned by shareholders should not be prohibited from utilizing the <u>shareholders</u>' purchasing power or credit line to do business in any area which is legal and as long as it does not unfairly use its efficient resources.

Another respondent states:

> The concerns raised by the contractor associations appear to be oriented more toward establishing artificial protection for themselves from competition rather than the preservation of fair competition... Cross-subsidization of competitive initiatives at the expense of the regulated business enterprise must be avoided, but the contractors' concerns that customers of public utilities would cross-subsidize new, competitive business ventures by public utilities are without merit. Electric utilities in Florida have been in the household appliances business for decades.

On the issue of the adequacy of existing laws, a respondent states:

> The Florida Public Service Commission and other regulatory bodies have generations of experience in ensuring that the costs of appliance business enterprises be recorded "below the line" and therefore excluded from the

costs used in establishing electric rates. Rate regulation assures that customers are only charged the legitimate cost of electric service and avoids any cross-subsidy of non-utility service. In addition, federal regulations require a public utility to make any sales of goods and services to its affiliates at cost, and affiliates must sell any goods or services to the public utility company or other affiliates at cost (17 CFR 250.90). The regulations also control the determination of cost (17 CFR 250.91). Accordingly, there is no basis to presume the existence of any cross-subsidy.

VI. Conclusions

This report makes the following conclusions:

- Currently, the utilities in Florida are not entering the fields of appliance service warranty and repair to any *significant* extent. Only Gulf Power actually engages in this business.

- Utility entry into the fields of appliance service warranty and repair has occurred in other states, and several states have set forth (either statutorily or by administrative action) "Codes of Conduct" and other cross-subsidization controls on utilities entering these fields.

- Contractor arguments that deregulation -- should it occur -- will provide impetus for utility entry into the fields of appliance service warranty and repair appear to make sense. Competition (deregulation) can logically be expected to spur a search for more ways to service and expand a customer base. However, there is actually no *bar* to utilities proceeding prior to any deregulation (Gulf Power is doing it now). Therefore, it would not be correct to see this issue as either *contingent* upon deregulation or *necessarily linked* to deregulation.

- The appropriate executive agency to consider Codes of Conduct or other controls on utility entry into the fields of appliance service warranty and repair would be the Public Service Commission.

- What the contractor representatives appear to be seeking (besides the general goal of "raising the consciousness" of the Legislature on this issue) is to have the legislature *place in statute* guidelines for such controls. Such guidelines would clearly designate which activities would be considered to be "cross-subsidization" or some other type of "unfair" competition. Without such Codes of Conduct, it is left to administrative hearings and litigation to determine permissible and impermissible activities on a case-by-case basis.

- The ultimate issue is whether the existing laws -- as adjudicated through PSC hearings and litigation -- are sufficient to fairly and efficiently assure the utilities will not unfairly compete, or whether these laws should be supplemented with Codes of Conduct (developed either statutorily or through administrative agency action) in order to clearly delineate what activities and actions constitute unfair competition.

VII. Policy Options

The policy options available to the legislature are:

1. The legislature could conclude that no action is needed as far as statutory changes are concerned, that existing state and federal laws are adequate to address the situation. Disputes between contractors and utility companies engaged in appliance service and repair would be resolved administratively though hearings before the PSC or through litigation.

   Under this option the Legislature could hold hearings to be certain that existing laws are indeed adequate.

2. The Legislature could conclude that no action is needed as far as statutory changes are concerned, but could direct the PSC to hold hearings with the goal of determining if it needs to adopt a "Code of Conduct" to set forth allowable and prohibited activities with regard to electric utilities engaging in appliance warranty and repair work. Such a Code of Conduct could, for instance, settle such questions as whether the use of the logo by repair affiliates should be prohibited, and under what circumstances and controls advertisements urging consumers to use these affiliates for their repair work would be allowed to be included in the electric utility's monthly billings.

3. The legislature could hold hearings and enact the Code of Conduct in the statutes.