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March 28, 2002

By Hand Delivery

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Commissioner J. Terry Deason
Commissioner Michael A. Palecki
Blanco Bayo', Director, Division of
Commission Clerk and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0862

Re: Proposed Codes of Conduct Rule, Rule 25-7.072, Florida Administrative Code, Docket No. 011368-GU

Dear Commissioners:

By Order dated February 28, 2002, the Florida Public Service Commission ("Commission") issued a Notice of Rulemaking in the above-captioned docket. In its Order, the Commission proposed to adopt new Rule 25-7.072, Florida Administrative Code (the "Proposed Rule"). The Commission's Notice was published on March 8, 2002, in the Florida Administrative Weekly. According to the Commission's Notice, the "Purpose and Effect" of the Proposed Rule is "to prevent cross subsidization by natural gas utilities of their unregulated marketing affiliates to avoid giving them unfair advantage over competitors." On behalf of NUI Energy, Inc., ("NUIE") we provide the following comments on the Proposed Rule.

I. <u>NUI Energy's Interest in the Proposed Rule</u>

NUIE is a corporation organized under the laws of the State of Delaware. NUIE has been selling natural gas to small and midsized retail customers in Florida on an unregulated basis for over seven (7) years and currently has nearly 1,000 customers in Florida. NUIE competes directly with other unregulated gas sellers including FPL Energy Services, Inc. ("FPLES"), a utility-affiliated gas marketer, in selling natural gas service in Florida. NUIE is affected by the

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Proposed Rule because (1) NUIE is an affiliate of NUI Utilities, Inc. d/b/a City Gas Company of Florida ("CGF"), a natural gas utility under the jurisdiction of the Commission, and (2) as discussed herein, the Proposed Rule does not prohibit or restrict the continued cross-subsidization of FPLES by its Commission-regulated parent utility company, Florida Power & Light Company ("FPL").

II. Specific Comments on Proposed Rule 25-7.072, F.A.C.

A. NUIE Supports the Objectives of the Proposed Rule

NUIE supports the Commission's stated objectives to prevent cross-subsidization by natural gas utilities of their unregulated marketing affiliates and ensure that the unregulated affiliates do not enjoy an unfair advantage over their non-affiliated competitors. NUIE believes that the Proposed Rule has been designed to protect and provide benefit to retail energy customers in Florida in two important ways: (1) by ensuring that utility customers are not subsidizing the activities of unregulated enterprises through the utility's rates, and (2) by creating and fostering a robust and fair competitive marketplace for the sale of unregulated natural gas, where consumers can reap the benefits that result from suppliers competing on a level playing field.

B. The Proposed Rule Does Not Go Far Enough to Prevent Cross-Subsidization

However, NUIE respectfully submits that the Proposed Rule, as currently drafted, falls somewhat short of the Commission's stated goals. Because the Proposed Rule only addresses the relationship between regulated natural gas utilities and their unregulated marketing affiliates, rather than addressing the broader issue of cross-subsidization practices by all regulated utilities -- including electric utilities that are affiliated with unregulated natural gas marketing companies -- over 3.9 million Florida utility ratepayers will not enjoy the benefits or protection afforded by the Proposed Rule and will continue to subsidize the activities of unregulated natural gas affiliates through the marketing and cost accounting practices of their regulated utilities. As a result, existing anti-competitive practices will continue to thrive in Florida's unregulated gas marketplace.

As published, the Proposed Rule reaches only the relationships between regulated gas utilities and their unregulated marketing affiliates. Therefore, FPL, a regulated electric utility in Florida, a major purchaser of gas and a substantial capacity holder on the Florida Gas Transmission ("FGT") system, and its unregulated gas marketing affiliate, FPLES, would entirely escape the application of the Proposed Rule. As a result, FPL's cross-subsidization of FPLES's unregulated natural gas business, and the attendant unfair competitive advantage FPLES enjoys over competing natural gas marketing entities, will continue unabated. It is troubling that the very activities the Commission is seeking to prevent through the Proposed Rule are already occurring in Florida. Moreover, these activities, seem to be considered "business as usual" at FPL and FPLES, and will continue even following the enactment of the Proposed Rule.

C. Facts Revealing Cross-Subsidization of FPLES by FPL

The Commission's Bureau of Auditing Services ("Bureau") prepared an audit report entitled Florida Power and Light Natural Gas Audit, Twelve Months Ended December 31, 2000, Audit Control No. 00-353-4-1, (hereafter "Audit Report," attached as Exhibit A to this letter), which documents the audit by the Bureau of the purchasing and selling practices of natural gas by FPL and FPLES during the year 2000. As documented in the Audit Report, the Bureau has uncovered facts that show that FPL and FPLES are engaged in a course of conduct that violates the fundamental tenets supporting the Proposed Rule. Specifically, the Audit Report reveals the following:

1. FPL electric service ratepayers are cross-subsidizing the business of FPLES.

Audit Report Disclosure No. 4 states:

> Florida Power and Light Energy Services (FPLES), the non-regulated gas marketing affiliate of Florida Power and Light, only records revenues and cost of gas, and sales and administrative costs related to customers that are outside of Florida Power and Light's utility territory. If customers of FPLES are in Florida Power and Light's utility territory, the revenue, cost of gas and other sales and administrative costs related to those customers are recorded as utility revenue and expenses. FPLES customers that are out of territory are approximately 30% of all of its customers. Therefore, approximately 70% of the business of FPLES is recorded in the utility.

Audit Report, Disclosure No. 4, p.10 (emphasis added).

Audit Report Disclosure No. 4 concludes: "[I]n addition, because gas sales operated at a loss in the year 2000, the loss related to in-territory customers was passed through utility operations." Audit Report , Disclosure No. 4, p. 10.

2. FPLES management costs in FPL's electric utility service territory are absorbed and subsidized by FPL.

Audit Report Disclosure No. 5 describes FPL's practice of recording FPLES's in-territory revenues and payroll in the regulated FPL utility and not in FPLES books. Because of this practice, FPLES revenues and payroll are not included in the percentage allocation used to allocate common management related costs. Audit Report Disclosure No. 5 recognizes that "[s]ince total management fee allocation costs are $123,133,181, if in-territory gas operations were recorded in FPLES instead of the utility, an additional $123,133.81 would have been removed from FPL utility operations and charged to FPL Group Capital." Audit Report Disclosure No. 5, p. 12.

3. FPL is subsidizing FPLES's marketing efforts.

Audit Report Disclosure No. 6, which describes charges to FPLES, states: "The cost of some brochures and mailings used to promote the sale of gas was paid by Florida Power & Light, charged to in-territory (ER 94)." Audit Report, Disclosure No. 5, p. 14. The Audit Report opines that "[t]he time the utility employees charge to ER 94, as mentioned above, represents amounts that are charged directly to the utility for in-territory business. Therefore, these utility employees are working for the non-regulated gas business." Audit Report, Disclosure No. 5, p. 15. Audit Report Disclosure No. 5 further states:

> Using the company's methodology of charging in-territory revenues and expenses to the utility and out-of-territory revenues and expenses to FPLES, costs of items used for both in-territory and out-of-territory should have been allocated. They were not. If the Commission determines that non-regulated operations should not be included in utility books, the entire amount of revenue and expense related to in-territory gas should be removed and transferred to FPLES.

Audit Report, Disclosure No. 5, p. 15 (emphasis added).

4. The relationship between FPL and FPLES may be creating an environment that lessens retail competition within the state of Florida to the detriment of gas consumers.

In Audit Report Disclosure No. 3, Commission Auditors opined that "[t]he ability of FPL Group to be able to support FPLES so that it can stay in the market in spite of a loss condition may contribute to an anti-competitive environment since many small companies could not sustain a similar loss." Audit Report, Disclosure No. 3, p. 9.

5. FPL and FPLES are sharing employees, which would be in violation of Section 2(c)(5) of the Proposed Rule.

Specifically, Audit Report Disclosure No. 4 expressly describes the natural gas marketing "sales blitz" and regular marketing practices in which FPL employees engaged on behalf of FPLES. Audit Report Disclosure No. 4 recognizes that: "FPL employees are selling the services which is being billed by FPLES but recorded by FPL. They represent themselves as FPL employees and not as FPLES employees." Moreover, per Audit Report Disclosure No. 6, "[t]he number of customers of FPLES increased 135% (from 91 to 214) in July of 1999 because FPL utility employees participated in the sales blitz that occurred from February to April 1999." Audit Report, Disclosure No. 6, p. 14.

These provisions and others in the Audit Report make abundantly clear that the great majority of FPLES's business in Florida is subsidized by FPL electric utility ratepayers, in clear contravention of Chapters 350 and 266, Florida Statutes, which prohibit such cross-subsidization by the utility ratepayers of Florida. NUIE submits that to comply with Chapters 350 and 366, Florida Statutes, and the prohibition on cross-subsidization therein, <u>all</u> of FPLES's gas business expenses and revenues -- not just out-of-territory expenses and revenues -- must be separated from FPL's utility operations. As FPL currently operates, its electric utility ratepayers are subsidizing FPLES's marketing and other business expenses.

III. <u>Conclusion</u>

NUIE submits that in order for the Commission to achieve its stated objectives to prevent cross-subsidization of unregulated natural gas marketing affiliates by regulated utilities and to prevent unfair competitive practices involving unregulated natural gas marketing affiliates, the Proposed Rule should be expanded to apply to the operations of <u>all</u> utility-affiliated gas marketing companies -- not just regulated <u>gas</u> utilities -- with respect to the operation of the affiliate within the regulated utility's service territory.

In order to achieve its objectives, NUIE would propose that the Commission either (1) modify the proposed definition of "Marketing Affiliate" in Rule 25-7.072(1) to read as follows (underline language is added): (1) Marketing Affiliate means an unregulated business entity that is a subsidiary of a gas utility <u>or electric utility</u> or is owned by or subject to control by the gas utility's <u>or electric utility's</u> parent company, and sells gas at the retail level to a transportation customer within the gas utility's <u>or electric utility's</u> service territory, and make other conforming changes within the Proposed Rule; or (2) initiate a separate rulemaking to impose similar requirements on electric utilities and their unregulated marketing affiliate; or (3) consider amending the existing Cost Allocation and Affiliate Transactions Rule, Rule 25-6.1351, F.A.C., to address these issues; or (4) initiate a proceeding to specifically address the cross-subsidization issues addressed in the <u>Florida Power and Light Natural Gas Audit, Twelve Months Ended December 31, 2000, Audit Control No. 00-353-4-1.</u>

Therefore, NUIE's support of the Proposed Rule must be qualified because, in NUIE's opinion, the Proposed Rule does not fully achieve the Commission's stated objectives. Only when FPL's cross-subsidization of FPLES and the resulting unfair competitive advantage it enjoys in the natural gas marketing area are adequately addressed by the Commission's rules can the

Commission fully achieve its objectives of preventing ratepayers' subsidization of unregulated affiliates and fostering competition that will benefit Florida utility ratepayers.

Sincerely,

Jon C. Moyle, Jr.
Cathy M. Sellers
Attorneys for NUI Energy, Inc.

cc: Paul J. Chymiy, Esquire, NUI Corporation
PSC Staff and Interested Parties

Exhibit A: Florida Power and Light Natural Gas Audit, Twelve Months Ended December 31, 2000, Audit Control No. 00-353-4-1

FLORIDA PUBLIC SERVICE COMMISSION

DIVISION OF REGULATORY OVERSIGHT
BUREAU OF AUDITING SERVICES

Miami District Office

FLORIDA POWER AND LIGHT

NATURAL GAS AUDIT

TWELVE MONTHS ENDED DECEMBER 31, 2000

AUDIT CONTROL NO. 00-353-4-1

Iliana H. Piedra, Audit Manager

Raymond Grant, Audit Staff

Gabriela Leon, Audit Staff

Yen Ngo, Audit Staff

Ruth Young, Audit Staff

Kathy L. Welch
Miami District Office Audit Supervisor

Exhibit A

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DIVISION OF REGULATORY OVERSIGHT
AUDITOR'S REPORT

MARCH 26, 2001

TO: FLORIDA PUBLIC SERVICE COMMISSION AND OTHER INTERESTED PARTIES

We have applied the procedures described in this report to audit the purchasing and selling practices of natural gas by Florida Power and Light and FPL Energy Services, Inc., a subsidiary of FPL Group, Inc. during the year 2000.

This is an internal accounting report prepared after performing a limited scope audit. Accordingly, this report should not be relied upon for any purpose except to assist the Commission staff in the performance of their duties. Substantial additional work would have to be performed to satisfy generally accepted auditing standards and produce audited financial statements for public use.

SUMMARY OF SIGNIFICANT PROCEDURES

Our audit was performed by examining, on a test basis, certain transactions and account balances which we believe are sufficient to base our opinion. Our examination did not entail a complete review of all financial transactions of the company. Our more important audit procedures are summarized below. The following definitions apply when used in this report:

Scanned- The documents or accounts were read quickly looking for obvious errors.

Compiled- The exhibit amounts were reconciled with the general ledger, and accounts were scanned for error or inconsistency.

Reviewed- The exhibit amounts were reconciled with the general ledger. The general ledger account balances were traced to subsidiary ledgers, and selective analytical review procedures were applied.

Examined- The exhibit amounts were reconciled with the general ledger. The general legder account balances were traced to subsidiary ledgers. Selective analytical review procedures were applied, and account balances were tested to the extent further described.

Confirmed- Evidential matter supporting an account balance, transaction, or other information was obtained directly from an independent third party.

Verify- The item was tested for accuracy and compared to the substantiating documentation.

FPL ENERGY SERVICES (FPLES) : In order to determine if sales to affiliates were following affiliate transaction rules, verified selected purchases of gas from FPL's Energy Management and Trading invoices. Compared spot trades for Florida Power and Light, FPL Energy Services and FPL Energy.

In order to determine if FPLES was charging its customers reduced rates subsidized by FPL, verified gas revenues to monthly billing records. Read contracts with selected customers and recalculated bills.

In order to determine whether there was cross-subsidy, compiled the calculations of the Management Fee to determine the accuracy of all the components included in the fee and allocation basis to the companies and reviewed types of charges included in the Risk Management Fee.

Read company procedures for the purchase of gas and the code of conduct policy.

Read PSC Order No. 00-2235-FOF-EI - Cost Allocation and Affiliate Transactions. Read applicable FERC orders. Read NARUC White Paper on Affiliate Transactions.

FLORIDA POWER AND LIGHT (FPL):

In order to determine if a cross-subsidy existed because of common use of employees and whether employees selling gas represented themselves as FPL employees, scanned a payroll listing of all utility employees who worked for FPL Energy Services during various months in 2000. Selected employees for interviews. Verified information provided by interviewees. Verified that the related payroll charged to FPL Energy Servicesincludes overhead costs; also, verified that charges for rent expense and furniture and computer charges were also charged to FPL Energy Services.

To determine cost of gas sold, scanned selected months of the utility's Monthly Gas Closing Reports and the Natural Gas Price Computations worksheets. Verified any selected adjustments.

Determined from the Natural Gas Receiving Reports and Natural Gas Requisitions how the sales to FPL Energy Services are recorded.

Compared the unit prices from various sales, including FPL Energy Services, for 2000, from the Miscellaneous Bills for Natural Gas Sales to determine if market rate was charged.

Compared the gas usage from the Natural Gas Price Computations worksheets to actual meter readings.

Read company procedures for the purchase of gas and the code of conduct policy.

Read any related Internal Audits.

Recalculated various electric utility bills for Florida Power and Light customers who are also FPL Energy Services, Inc. customers to determine if FPL customers using FPLES were getting discounts on electric service.

SCOPE LIMITATION:

We were not able to perform a test of the actual Utility purchases of gas because the answer to Document/Record Request 34 (dated 2/22/01) was not complete. The answer to the request (dated 3/7/01) provided a list of gas vendors for the utility for requested months, however, no invoice amounts were included. On 3/8/01 we notified our FPL coordinator that additional information was needed. As of the end of the audit, this was not provided. Initially, Document/Record Request 9 (1/23/01) asked for documentation related to various gas purchases, the answer provided (dated 2/9/01) was copies of the Monthly Gas Closing Reports, which detail the gas purchases by vendor. However, these amounts represent various invoices and our sample could not be selected from these reports. Request 34 was written as a follow up to Request 9, in order to receive more detail for the amounts included in the Monthly Gas Closing Reports and to be able to select a sample. We will follow up this work in the upcoming Fuel Clause Audit.

AUDIT DISCLOSURE NO. 1

Subject: Fuel Clause And Transportation

Statement of Fact: One of the objectives of this audit was to determine if the sales of gas to FPL Services and other gas companies were removed from the cost of fuel that flowed through the fuel clause and whether transportation was included in the amounts charged to the affiliate.

Schedule A-2 from the Fuel Recovery Clause was reviewed to determine the gas accounts that flow through the fuel clause. It was determined that accounts 501.120-Recoverable Fuel Gas Steam Generation and account 547.120-Recoverable Fuel Gas Other Power Generation relate to gas. Accounts 547.121 and 547.122 also relate to gas in that they are the depreciation of the Fort Lauderdale and Martin Gas pipelines. These relate to the actual utility plant projects and not to the transportation related to sales of gas on the Florida Gas Transmission pipeline.

A few charges to account 501.120 and 547.120 were traced to source documentation to determine how the items were charged (ie. from inventory or directly), and whether sales to other companies were removed from the accounts that went to the fuel clause.

Source documentation consisted of the Natural Gas Requisition. The requisition shows the gas used at each location for each unit times an average unit price that is determined as follows:

Total Cost of Commodity for the Month +
Total Transportation Cost for the Month +
FGT Gas Lateral Payments -
Less Sales of Gas +
Plus or Minus Imbalance Adjustments +
Gas Adjustments To True-Up Accruals=
Total Cost / (Divided by)
Gas Used from CFIS (Plant Metering) =
Unit Price to Cost to Expense

Opinion: The sales of gas to affiliates and other gas companies are removed from the inventory cost at the sales price which is based on the daily market. This cost is sometimes higher than the purchase price and sometimes lower. Prices lower than the FPL purchase price usually occur because the company buying the fuel ordered it at a fixed price the prior month.

The attached schedule summarizes the monthly transactions. The schedule shows that for the year, Florida Power and Light made a profit on the gas sales based on the commodity price alone. However, we cannot determine from the sales schedules provided, which sales are bundled (with transportation) and which are unbundled (without transportation). A review of the daily sales tickets to Florida Power and Light Energy Services (FPLES) shows that there were occasions where FPLES bought bundled gas from FPL and this is probably true for other sales. When FPL sells gas to other companies, including the affiliate, it is usually sold unbundled (without transportation). The tickets do show, however, that when a bundled sale is made, the charge is high enough to include a charge for transportation.

The schedule also shows that FPLES paid more than the average price of gas sold in each month and that there were sales at lower prices and higher prices. Review of the daily tickets show that the sales were made to Florida Power and Light Energy Services at an amount over the daily market rate.

FLORIDA POWER AND LIGHT
ANALYSIS OF GAS SALES
TEST YEAR 2000

MONTH	SALES TOTAL MMBTU	SALES TOTAL DOLLARS	AVERAGE PRICE	FPL COMM. PURCHASES MMBTU	FPL COMM. PURCHASES DOLLARS	NOTE A AVERAGE PURCHASE PRICE FPL	AVERAGE FPL PRICE BUNDLED	MMBTU SOLD TO SERVICES	DOLLARS SOLD TO SERVICES	UNIT PRICE TO SERVICES	HIGHEST UNIT PRICE ALL SALES	LOWEST UNIT PRICE ALL SALES
JANUARY	1,563,096	3,890,782.25	2.49	21,660,528	51,436,026.25	2.38	2.87	382,183	906,168.51	2.37	4.86	2.23
FEBRUARY	1,081,773	2,869,749.91	2.65	18,433,739	50,074,156.40	2.72	3.26	398,671	1,051,119.74	2.64	4.50	2.63
MARCH	602,008	1,646,475.51	2.73	21,954,439	60,242,748.34	2.74	3.23	406,111	1,072,301.01	2.64	4.25	2.64
APRIL	1,846,204	5,513,405.55	2.99	23,107,067	68,239,068.33	2.96	3.51	416,560	1,231,978.18	2.08	3.08	2.96
MAY	885,508	3,107,747.37	3.51	22,776,227	72,092,775.43	3.17	3.77	505,842	1,782,065.87	3.52	5.00	3.12
JUNE	3,119,914	13,852,224.78	4.44	20,908,318	91,607,663.60	4.38	5.08	459,090	2,141,899.10	4.67	4.90	4.29
JULY	987,007	4,516,161.63	4.58	21,509,918	93,624,798.00	4.35	5.07	479,357	2,204,540.63	4.60	5.10	4.18
AUGUST	1,445,314	6,388,801.94	4.42	21,937,131	85,666,436.32	3.91	4.56	494,684	2,263,087.09	4.57	5.04	4.10
SEPTEMBER	1,245,119	6,406,966.01	5.15	19,368,253	91,419,972.18	4.72	5.45	500,112	2,624,863.51	5.25	5.81	4.62
OCTOBER	772,081	4,082,765.38	5.29	17,214,633	91,069,146.70	5.29	6.06	563,128	3,030,043.60	5.38	5.43	4.68
NOVEMBER	1,646,973	8,229,332.57	5.00	14,976,561	69,657,263.06	4.65	5.40	580,060	2,924,193.40	5.04	6.18	4.52
DECEMBER	3,965,330	34,032,807.34	8.58	13,963,370	86,979,508.60	6.23	6.25	638,640	4,680,340.49	7.33	10.26	7.22
TOTAL	19,159,327	94,536,310.24	4.93	237,820,174	913,108,552.30	3.84		5,824,428	25,912,619.22	4.45		

NOTE A: BEFORE IMBALANCE AND ACCRUAL ADJUSTMENTS AND FGT LATERAL PAYMENTS

Exhibit

AUDIT DISCLOSURE NO. 2

Subject: Cost Allocation Order

Statement of Fact: According to the Cost Allocation and Affiliate Transaction Order PSC-00-2235-FOF-EI, dated November 27, 2000, an affiliate must be charged the higher of fully allocated costs or market, however, the rule is not applicable to "fuel and related transportation services that are subject to Commission review and approval in a cost recovery proceeding".

Deal tickets for several days in the year were obtained and compared for prices charged to all companies FPL sold gas to and to what FPL paid for the gas.

Opinion: The utility sells gas to the non-regulated subsidiary, Florida Power and Light Energy Services (FPLES) and prices it at market price plus a profit margin.

Fully allocated costs would include an allocation of costs of the Energy Marketing and Trading Group since it is making the purchases for FPLES, in addition to bundled or unbundled commodity costs. FPLES has its own buyer, but is not allowed to purchase commodity from anyone but FPL Energy Marketing and Trading (a division of the utility). This requirement was made because of risk management.

Since gas purchases are recovered through the fuel clause, and fuel transactions recovered through the clause are exempt from the affiliate rule requiring the company to transfer costs at the higher of fully allocated costs or market, it appears that FPL is exempt from the affiliate transaction rule.

Not charging costs Associated with Energy Marketing + Trading Group

AUDIT DISCLOSURE NO. 3

Subject: Competitive Pricing

Statement of Fact: Allegations were made that FPLES is charging lower prices than the rest of the industry because it is being subsidized by FPL. Subsidization is being discussed in another disclosure. FPLES did have a higher cost of gas than sales revenue for the year 2000. Review of FPLES sales contracts revealed another reason for the loss that may relate to the low pricing.

[redacted]

Opinion: The pricing model used by FPLES may contribute to the low prices that caused the complaint. The ability of FPL Group to be able to support FPLES so that it can stay in the market in spite of a loss condition may contribute to an anti-competitive environment since many small companies could not sustain a similar loss. However, there are other marketers that also have parent companies that are in a position similar to FPLES.

If FPLES changes the billing methodology for its customers from one that is [redacted] FPLES and FPL may never recover the loss incurred this year.

AUDIT DISCLOSURE NO. 4

Subject: Utility V.S. FPLES

Statement of Fact: Florida Power and Light Energy Services (FPLES), the non-regulated gas marketing affiliate of Florida Power and Light, only records revenues and cost of gas, and sales and administrative costs related to customers that are outside of Florida Power and Light's utility territory. If customers of FPLES are in Florida Power and Light's utility territory, the revenue, cost of gas and other sales and administrative costs related to those customers are recorded as utility revenue and expenses. FPLES customers that are out of territory are approximately 30% of all of its customers. Therefore, approximately 70% of the business of FPLES is recorded in the utility. The percent varies based on the usage of the in-territory customers and direct payroll which is charged based on work orders to in-territory, or out-of-territory time.

FPL employees are selling the service which is being billed by FPLES but recorded by FPL. They represent themselves as FPL employees and not as FPLES employees. The number of customers of FPLES increased 57% (from 91 to 214) in July of 1999 because FPL utility employees participated in a sales blitz that occurred from February to April of 1999.

Opinion: Although the customers receive bills from FPLES, the non-regulated subsidiary, the revenues, cost of gas and transportation, and the sales and administrative costs related to customers in FPL utility territory are recorded in the regulated utility books. FPL representatives believe that in-territory business is base revenue enhancement and should be recorded in the utility business. Whether non-regulated revenues and expenses should be included in regulatory operations needs to be determined.

FPL Filed same [illegible] *

In addition, because gas sales operated at a loss in the year 2000, the loss related to in-territory customers was passed through utility operations. The company provided an income statement of in-territory revenues and expenses charged to utility operations. It follows this disclosure. It shows a loss of $216,363 for in-territory unregulated gas sales that is recorded in utility books. However, the loss does not include an allocation of corporate overhead costs ($123,133.18 see management fee disclosure) or overhead on payroll charged ($192,622.78 see payroll disclosure). In addition, the income statement was provided the last week of the audit and could not be verified.

AUDIT DISCLOSURE NO. 5

SUBJECT: MANAGEMENT FEE

STATEMENT OF FACTS: Costs that relate to all divisions are accumulated and allocated to non-regulated operations using a three-part formula consisting of revenues, plant, and payroll. Overall, 7.22% of these costs were allocated to non-regulated and 92.78% to regulated. The 7.22%, or $8,886,285 was charged to FPL Group Capital, Inc. The company does not charge this amount down to the individual divisions that make up Group Capital. Therefore, the amount related to FPLES is not on the FPLES income statement. However, the affiliate allocation basis for 2000 shows .25% of the 7.22% relates to FPLES.

The types of costs allocated include information management, human resources, finance, corporate communications, auditing, and resource analysis and planning. These amounted to $87,521,399.

In addition, in the year 2000, a category called change in control was charged. Several of the officers contracts contained performance incentive provisions relating to bonuses and stock options that would be received over the life of the contract if certain performance goals were met. The contracts also stated that 100% of the incentives would be paid when the stockholders approved a merger. Therefore, on December 15, the incentives that relate to future performance were required to be paid. An amount of $35,611,782 was recorded for this change of control provision. Of this amount, $33,041,748 was recorded in utility operations (Account 930.299) and $2,570,034 was allocated to non-regulated operations and charged to FPL Group Capital, Inc. It is included in the $8,886,285 above.

Total of the affiliated costs for common business units of $87,521,399 and the change of control of $35,611,782 is $123,133,181.

Because FPLES's in-territory revenues and payroll are recorded in the utility and not in the FPLES books, these revenues and payroll are not included in the percentage allocation used to allocate common management fee related costs.

OPINION: Common overhead costs that relate to the operation of in-territory gas are not separated and not charged on the FPLES in-territory gas income statement.

A revised allocation schedule was prepared that included the revenues shown in the income statement in disclosure four and in-territory payroll provided in another request. Inclusion of these items increases the management fee allocation to FPLES from .25% to .35% or an increase of .10%. Since total management fee allocation costs are $123,133,181, if in-territory gas operations were recorded in FPLES instead of the utility, an additional $123,133.18 would have been removed from FPL utility operations and charged to FPL Group Capital.

2000 FPL Affiliate Allocation Basis

	Revenues 2000 Actual	%	Gross PP&E 2000 Average	%	Total Payroll 2000 Act/Fcst	%	Avg %
FPL UTILITY	$6,360,801,290	89.62%	$18,460,940,678	91.66%	$654,350,722	95.52%	92.27%
FPL ENERGY	$631,610,301	8.90%	$1,557,241,274	7.73%	$21,462,913	3.13%	6.59%
PALM INSURANCE	$30,935,445	0.44%	$0	0.00%	$0	0.00%	0.15%
FPLES	$33,442,352	0.47%	$14,298,811	0.07%	$3,503,087	0.51%	0.35%
FIBERNET	$40,635,859	0.57%	$108,480,893	0.54%	$5,700,000	0.83%	0.65%
TOTAL	$7,097,425,247	100.00%	$20,140,961,656	100.00%	685,016,722	100.00%	100.00%

AUDIT DISCLOSURE NO. 6.

Subject: Charges to FPLES

Statement of Fact: A list of all payroll charged by the utility to FPLES for May and June 1999 and May, June and November 2000 was obtained. This list provided includes payroll charged to FPLES for Expense Requisition (ER) 99 - affiliate charges, which represents affiliate charges for Energy Services for out-of-territory business and charged to FPL utility business for ER 94 - revenue enhancement charges which represents charges for the in-territory business. This is explained further in Disclosure No. 4.

Approximately 15 employees from this list were selected for interviews based on the different locations charged and on whether they charged time to specific months and not others. An additional 10 employees were selected from organizational charts for specific business units which includes sales representatives and account managers. These employees were interviewed to determine the duties they performed, if it appeared they charged enough time, if they knew of any other individuals in their business unit who worked in the gas business and to obtain any other information which could be relevant to the audit. Some of the interviewees mentioned other employees in their business unit who may have charged to the gas business. These employee names were verified to time records to determine that they charged some of their time. The auditors also verified that the payroll charged to FPLES is inclusive of overheads. These overheads (79.22%) are not recorded on in-territory gas payroll. They, therefore, are not included in the Income Statement for in-territory operations shown in Disclosure 4. Therefore, a larger loss would be shown in this statement if these overheads were included. (Payroll in-territory $243,199.67 times 79.22% = $192,662.78 additional expense, additional loss)

Various employees mentioned training given to them and a sales blitz they attended. The number of customers of FPLES increased 135% (from 91 to 214) in July of 1999 because the FPL utility employees participated in the sales blitz that occurred from February to April 1999.

The cost of some brochures and mailings used to promote the sale of gas was paid by Florida Power and Light, charged to in-territory (charged to ER 94). The invoices related to these costs provided by the company total approximately $25,303 and are dated March, April, June and July 2000. FPLES gas operations is charged rent expense along with furniture and computer charges for its two employees which work exclusively for gas.

In addition, it was determined that the salary of the managers that supervise some of the people interviewed were not charged to the in-territory gas operations. The portion of salary related to revenue producing products for these people and the other administrative staff are charged to a utility work order number 2830. Total charges for this work order are $338,933.87 for the year 2000. These people did also charge a percentage of their time to an out-of-territory work order.

Audit Opinion: For the employees that were interviewed, it appears the time spent on the Gas business correlates with the information given to us in the interviews.

However, the time the utility employees charge to ER 94, as mentioned above, represents amounts that are charged directly to the utility for in-territory business. Therefore, these utility employees are working for the non-regulated gas business.

Payroll overheads, of $192,662.78 for in-territory employees, are never charged to FPLES and are not on the In-Territory Income Statement. It is therefore, included in FPL Utility costs.

It could not be determined if one of the risk managment employees was properly allocated to FPLES. We requested information March 20 which was still not received at the conclussion of the audit.

The costs for some sales brochures and mailings mentioned in the interviews, which totaled approximately $25,303, were charged to in-territory only. The costs are, therefore, included in utility expenses. Because of the timing of receiving the answers to these audit requests, we were unable to do further testing on charges made to FPL utility costs related to in-territory gas to determine if other charges such as this were also charged 100% to the utility. Using the company's methodology of charging in-territory revenues and expenses to the utility and out-of-territory revenues and expenses to FPLES, costs of items used for both in-territory and out-of-territory should have been allocated. They were not. If the Commission determines that non-regulated operations should not be included in utility books, the entire amount of revenue and expense related to in-territory gas should be removed and transferred to FPLES.

Some of the payroll for the managers that was charged to work order 2830 of $338,933.87 also relates to in-territory gas and is not included in the income statement attached to disclosure four. If the Commission determines that non-regulated operations should not be included in utility books, the amount that relates to FPLES products should be charged to FPLES. We were unable to determine the portion of this amount that relates strictly to gas since there are other revenue enhancing products. Because we received the response the last week of the audit, we were unable to obtain information necessary to determine an allocation methodology.

AUDIT DISCLOSURE NO. 7

SUBJECT: RISK MANAGEMENT EXPENSES

STATEMENT OF FACTS: FPLES purchases gas through FPL Energy Marketing and Trading (utility) exclusively. A company representative explained that this is because FPL Energy Marketing and Trading is responsible for risk management.

The risk management system is called the "nucleus" system. Traders input all trades into the system, and the system matches the deal tickets with the confirmations. The system reports are reviewed by FPL Utility personnel. Before July 2000, risk management for FPLES was being performed by FPLES which had its own version of "nucleus."

By FPLES using the utility's risk management system and personnel, two objectives are met. One, a separation of duties and; two, there is no duplication of the system which monitors the trades (nucleus).

Three different situations occurred with regard to FPLES payments for the use of the "nucleus" system.

1. FPLES incurred expenses in 1998 and 1999 for the installation and implementation of the "nucleus" system. The amounts follow:

Total 1998	$612,000
Total 1999	$611,434

None of these expenses were allocated back to FPL Utility for the costs associated with the "in-territory sales." "In-territory sales and costs are " are discussed in Audit Disclosure 4.

2. The expense for the use of "nucleus" for FPLES for the year 2000 is $15,000. This was paid in November 2000 and charged to FPLES. None of this is allocated to FPL utility operations for "in-territory cost of sales."

3. The expense for utility personnel to review the "nucleus" reports for July through December 2000 was $3,282.48 and charged to FPL utility "in-territory" account. The only personnel charge to FPLES for "out-of-territory cost of sales" was $343 in the month of July 2000.

OPINION: It appears that the treatment of risk management expenses is inconsistent from year to year. For the years ended 12/31/98 and 12/31/99, FPLES appears to be paying for both the "in-territory" and "out-of-territory" risk management costs.

For the year ended 12/31/00, FPLES is paying for nucleus but not for any of the payroll associated with risk management except for a minor amount of $343.

Using the company methodology of charging in-territory to the utility and out-of-territory to FPLES, the charges should have all been allocated. If the "in-territory sales and expenses" should be included on FPLES books only and not separated as noted in Disclosure 4, then the entire risk management expense should be on FPL Energy Services books.