

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for rate increase by)
Florida Power & Light Company) Docket No. 120015-EI
) FILED: July 2, 2012
_____)

DIRECT TESTIMONY

OF

DAVID P. VONDLE, CMC

On Behalf of the Citizens of the State of Florida

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DIRECT TESTIMONY

Of

DAVID P. VONDLE, CMC

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket No. 120015-EI

I. BACKGROUND

A. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is David P. Vondle. My business address is 4926 Calle de Tierra, NE, Albuquerque, NM 87111.

Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

A. I am President of Vondle & Associates, Inc.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. I received a Bachelor of Science degree in Industrial Management from the University of Akron and a Masters of Business Administration degree from Southern Methodist University. I have been a management consultant for over thirty years, working mostly in the public utility industry. I have been designated a Certified

1 Management Consultant (CMC) by the Institute of Management Consultants (IMC)
2 USA. IMC USA is the certifying body for the Certified Management Consultant™
3 (CMC®) designation. The CMC certification process confirms the CMC's education,
4 continuing professional development and commitment to the highest ethical
5 standards, and the IMC USA examiners rigorously assess the CMC's consulting
6 engagements and competence to apply the knowledge and skills defined in IMC
7 USA's Competency Framework and Certification Scheme for Certified Management
8 Consultants.

9 I started working in affiliate relationships and transactions in 1981 when I led
10 the Cross-Sectional Purchasing Study of Four Florida Telephone Companies for the
11 Florida Public Service Commission (FPSC or Commission). That study led to my
12 testifying in the AT&T anti-trust trial. I have continued to work on affiliate
13 relationships and transactions through management audits of affiliate relationships for
14 state regulatory commissions, assistance to utilities in complying with affiliate rules,
15 and litigation support and expert witness services for law firms, attorneys general and
16 public advocates in court and regulatory cases.

17
18 **Q. HAVE YOU EVER PROVIDED EXPERT TESTIMONY BEFORE A**
19 **REGULATORY AGENCY OR BODY?**

20 A. Yes. I have testified on affiliate relationship and transaction topics several times in
21 U.S. and state district courts and before several state public utility commissions in
22 Alaska, California, Connecticut, Massachusetts, Maine, and New Mexico. I have also
23 testified on capital programs, staffing and costs. I have attached my résumé as
24 Exhibit DPV-1, which includes a list of my expert testimonies.

25 In 1981, I testified before the FPSC about a management consulting study I

1 led for the Commission regarding contributions-in-aid-of-construction for water and
2 wastewater utilities.

3

4 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS DOCKET?**

5 A. The purpose of my testimony in this docket is to review Florida Power & Light's
6 (FPL's) affiliate relationships and transactions in relation to the FPSC's rules and
7 precedents. I raise several concerns regarding FPL's current affiliate relationships
8 and transactions and propose alternative structures and methodologies. Lastly, based
9 on my findings, I make recommendations on adjustments to FPL's affiliate charges.

10

11 **B. REGULATORY STANDARD**

12 **Q. WHAT IS THE REGULATORY STANDARD FOR AFFILIATE**
13 **RELATIONSHIPS AND TRANSACTIONS IN FLORIDA?**

14 A. The foundation for Florida's regulatory standard for affiliate relationships and
15 transactions is Section 366.05(9), Florida Statutes, which stands for the
16 proposition that FPL's Florida ratepayers should not be used to subsidize
17 nonutility affiliate activities. Specifically, Section 366.05(9) states, in part, that
18 "[t]he commission may also require such reports or other data necessary to
19 **ensure that a utility's ratepayers do not subsidize nonutility activities.**"
20 (Emphasis added).

21 The Commission established the standard for evaluating affiliate
22 relationships and transactions in Rule 25-6.1351, F.A.C., Cost Allocation and
23 Affiliate Transactions, (affiliate transaction rule or Rule) which I have attached
24 as Exhibit DPV-2.

1 Q. CAN YOU SUMMARIZE THIS RULE?

2 A. Yes. The rule applies to transactions between a utility and its affiliates, and
3 also a utility's unregulated activities, with the intent that these affiliate and
4 nonregulated transactions and activities not be subsidized by utility ratepayers.
5 (Rule section 1) Some of the key points regarding the rule's applicability to
6 FPL in this case are:

- 7 • Substantially all entities under the NextEra Energy, Inc. (NEE) corporate
8 umbrella are, by rule definition, FPL affiliates. Rule section 2(a)
- 9 • FPL must charge affiliates the higher of fully allocated cost or market price,
10 and affiliates must charge FPL the lower of fully allocated cost or market
11 price for non-tariffed products and services under most circumstances
12 (asymmetrical cost allocation). Rule sections 3(b) and 3(c)
- 13 • FPL accounting records must show whether each transaction involves a
14 product or service that is regulated or nonregulated. Rule section 4(a)
- 15 • Direct costs shall be assigned to each non-tariffed service and product
16 provided by FPL. Rule section 4(b)

17 Q. IS THERE A RELEVANT COMMISSION ORDER AS WELL?

18 A. Yes. In Order No. PSC-01-1374-PAA-WS, issued June 27, 2001, in Dockets
19 Nos. 000737-WS and 010518-WS, the Commission stated:

20
21 By their very nature, related party transactions require closer scrutiny.
22 Although a transaction between related parties is not per se unreasonable, it is
23 the utility's burden to prove that its costs are reasonable. Florida Power Corp.
24 v. Cresse, 413 So. 2d 1187, 1191 (Fla. 1982). This burden is even greater when
25 the transaction is between related parties. In GTE Florida, Inc. v. Deason, 642
26 So. 2d 545 (Fla. 1994) (GTE), the Court established that the standard to use in
27 evaluating affiliate transactions is whether those transactions exceed the going
28 market rate or are otherwise inherently unfair.

1 Order No. PSC-01-1374-PAA-WS at p. 15.

2

3 **Q. HOW SHOULD THE REGULATORY STANDARD BE APPLIED FOR**
4 **AFFILIATE TRANSACTIONS?**

5 A. The utility bears the burden of proof to ensure that its transactions with
6 affiliates are fair, that they are priced appropriately at market price or fully
7 allocated cost, and that they do not disadvantage the ratepayer. In addition, the
8 utility must account for affiliate transactions in a detailed, prescribed manner
9 and allocate costs according to the rule. If the utility does not meet its burden
10 of proof or does not comply with the affiliate accounting and allocation rules,
11 the affiliate charge should not be allowed.

12

13 **C. IMPORTANCE OF AFFILIATE RELATIONSHIPS AND CHARGES**

14 **Q. CAN YOU EXPLAIN WHY AFFILIATE RELATIONSHIPS AND**
15 **CHARGES ARE IMPORTANT IN REGULATING PUBLIC**
16 **UTILITIES?**

17 A. Yes. Under traditional utility ratemaking, such as in this case, the utility's rates
18 are set based upon a determination of its revenue requirement. The higher the
19 allowed costs are, the higher its overall revenue requirement; and, hence, its
20 rates and future revenue. With affiliate relationships, there is an opportunity
21 for a company to allocate common or shared costs between a regulated utility,
22 which recovers its allowed costs in regulated rates, and unregulated affiliates
23 that have no limit on revenues and profits. Therefore, there is a strong financial

1 incentive for companies to allocate more costs to a regulated utility to increase
2 its revenue requirement and rates and to allocate fewer costs to unregulated
3 affiliates to increase their profits. Essentially, every extra dollar of common
4 cost that is allowed to be charged to a utility results in another dollar of revenue
5 to the utility; and, every dollar not charged to an unregulated affiliate results in
6 an additional dollar of profit to that affiliate.

7
8 **Q. WHAT ARE THE TOTAL COSTS THAT ARE SUBJECT TO**
9 **AFFILIATE TRANSACTIONS BETWEEN FPL AND ITS AFFILIATES,**
10 **AND WHAT IS THE POTENTIAL IMPACT OF SUBSIDIZATION BY**
11 **FPL'S CUSTOMERS?**

12 A. I have summarized FPL's projected 2013 affiliate transactions in Exhibit DPV-
13 3. Charges from FPL to affiliates are projected to be \$150.6 million and
14 charges from affiliates to FPL are projected to be \$22.2 million. In my
15 testimony, I will describe how FPL fails to ensure the reasonableness of these
16 amounts and actually uses methods that skew the costs in the direction of FPL
17 and its customers. For the reasons I will detail in my testimony, in light of the
18 lack of adequate support for the charges, I will recommend the Commission
19 disallow 20% of the total for ratemaking purposes. In addition, I will
20 recommend that the Commission open a separate docket for the purpose of
21 establishing procedures and mechanisms that will more closely govern FPL's
22 affiliate relationships and transactions in the future.

1 **D. OVERVIEW OF FPL'S AFFILIATE RELATIONSHIPS**

2 **Q. WHAT ARE FPL'S AFFILIATE RELATIONSHIPS?**

3 A. The FPL MFR Schedule C-30 projects eight FPL affiliate relationships in 2013
4 with:

- 5 • NextEra Energy, Inc. (its parent)
- 6 • NextEra Energy Resources, LLC (the principal unregulated NEE subsidiary)
- 7 • FPL Energy Services, Inc.
- 8 • FPL FiberNet, LLC (one of the other major nonregulated NEE subsidiaries)
- 9 • Palms Insurance Company
- 10 • Lone Star Transmission, LLC (the second other major nonregulated NEE
11 subsidiary)
- 12 • New Hampshire Transmission, LLC
- 13 • NextEra Energy Transmission, LLC

14 However, the FPL MFR Schedule C-30 is somewhat misleading in that,
15 according to the response to OPC Interrogatory No. 165, Attachment 1, there
16 are approximately 238 actual separate affiliate relationships that FPL has
17 chosen to roll-up into the eight reported in Schedule C-30. My reading of the
18 affiliate transaction rule is that FPL must comply with the rule for each
19 individual affiliate relationship -- all 238 that exist.

20
21 **Q. PLEASE DESCRIBE FPL'S CORPORATE STRUCTURE.**

22 A. According to NextEra Energy, Inc.'s (NEE's) and Florida Power & Light's
23 (FPL's) 2011 United States Securities and Exchange Commission Form 10-K,
24 FPL is a wholly owned subsidiary of NEE. NEE is one of the largest electric
25 power companies in North America with over 41,000 megawatts of generating

1 capacity in 24 states in the U.S. and three provinces in Canada, NEE employs
2 approximately 14,800 people. NEE's nonregulated operations are organized
3 under NextEra Energy Capital Holdings, Inc. (NEECH).

4 The principal nonregulated subsidiary under NEECH is NextEra Energy
5 Resources, LLC (NEER). NEER is one of the largest wholesale generators of
6 power in the U.S., with approximately 16,600 megawatts of generating
7 capacity. NEER also provides full energy and capacity requirements services,
8 owns a retail electricity provider serving customers in 13 states and the District
9 of Columbia, and engages in power and gas marketing and trading activities.

10 In addition to NEER, other subsidiaries are organized under NEECH,
11 including FPL FiberNet and Lone Star. FPL FiberNet delivers wholesale and
12 enterprise telecommunications services in Florida and certain parts of the South
13 Central U. S. Lone Star is a rate-regulated transmission provider in Texas. The
14 SEC requires large corporations like NEE to subdivide their operations into
15 "reportable segments." NEE's SEC reportable segments are FPL, NEER and
16 Corporate and Other. The Corporate and Other reportable segment is primarily
17 comprised of interest expense, the operating results of FPL FiberNet, Lone Star
18 and other business activities, as well as corporate interest income and expenses.

19
20 **Q. WHAT IS THE FINANCIAL SCALE OF NEE'S AND FPL'S**
21 **OPERATIONS?**

22 A. In 2011, NEE's operating revenues (including those of subsidiaries) were \$15.3
23 billion, its net income was \$1.9 billion and it had total assets of \$57.2 billion.
24 Of the totals, FPL was responsible for \$10.6 billion in operating revenue
25 (69%), \$1.1 billion in net income (56%), and \$31.8 billion in assets (56%).

1 FPL's \$654 million of 2011 income tax expense accounted for 124% of NEE's
2 2011 income tax expense of \$529 million, as the other two reportable segments,
3 NEER and Corporate and Other, had credits of \$24 million and \$101 million,
4 respectively. FPL's 2011 capital expenditures of \$3.5 billion were 53% of
5 NEE's \$6.6 billion total.

6
7 **Q. DOES FPL HAVE A TYPICAL AFFILIATE STRUCTURE?**

8 A. No. In my experience, utility companies of the scale of NEE and FPL typically
9 have utility operating companies in more than one state and are structured with
10 a separate service company that provides common and shared services to
11 multiple utility operating companies and unregulated companies. By having
12 only one utility operating company (FPL) serving only one state (Florida), NEE
13 has not had to form a service company. Instead, NEE uses FPL, in Witness
14 Ousdahl's term, as its "primary operating entity." That is, FPL combines the
15 functions of a utility operating company and a service company serving
16 unregulated affiliates. FPL provides common and shared services to itself, to
17 its parent and to unregulated affiliates that would typically be provided by a
18 service company in other companies of this scale.

19
20 **Q: PLEASE DESCRIBE HOW FPL ACCOUNTS FOR ITS AFFILIATE**
21 **CHARGES TO AND FROM ITS AFFILIATES.**

22 A. Witness Ousdahl, beginning on page 28 of her direct testimony, describes three
23 methods of charges to affiliates:

- 24 • Direct Charges – Costs of resources used exclusively to provide service for
25 the benefit of one company are directly charged to that company. Direct

1 charges are projected to be \$60.1 million or 40% of the \$150.6 million total
2 charges to affiliates in 2013.

- 3 • Service Fees – Service fees are charged monthly for many of the fleet
4 support operations. There are three current service fees: Nuclear (allocated
5 on number of generating units); Energy, Marketing and Trading (allocated
6 on time studies or specific analyses by function); and, Nuclear Information
7 Management (allocated on number of generating units). Service fees are
8 projected to be \$13.8 million or 9% of affiliate charges in 2013.
- 9 • Affiliate Management Fee (AMF) – for governance costs and general
10 corporate support services. AMF allocations for 2013 are projected to be
11 \$75.6 million, or 50% of affiliate charges.
 - 12 ○ Some are collected in cost pools and allocated on cost drivers, such
13 as number of employees, square feet, and work stations. These
14 charges are estimated by FPL to be 40% of the AMF charges, or
15 \$30.2 million in 2013.
 - 16 ○ Cost pools which do not have identified cost drivers are allocated
17 using FPL's general allocator, the Massachusetts Formula. These
18 charges are estimated by FPL to be 60% of the AMF charges, or
19 \$45.4 million in 2013.

20 In addition, MFR Schedule C-30 lists FPL charges to FPL FiberNet of \$1.2
21 million for pole attachments in 2013.

22 Based on my review, I have inferred that FPL's service fees allocation
23 are a general allocation methodology using the single factor general allocation
24 formula of the relative number of nuclear units. I further surmised that the

1 AMF allocations based on cost drivers and the pole attachment charges are
2 “rate” based allocation methodologies. I construed that the AMF allocations
3 using the Massachusetts Formula are a general allocation methodology.

4 MFR Schedule C-30 lists all charges to FPL from affiliates as direct
5 charges.

6 **II. CONCERNS WITH FPL’S CURRENT AFFILIATE TRANSACTION**

7 **METHODOLOGIES**

8 **A. AFFILIATE STRUCTURE**

9 **Q. DOES THE UNUSUAL NEE/FPL AFFILIATE STRUCTURE YOU**
10 **MENTIONED EARLIER CAUSE CHALLENGES IN DETERMINING**
11 **APPROPRIATE AFFILIATE CHARGES?**

12 **A.** Yes. Service companies have the benefit of being separate legal entities with
13 accounting structures designed to facilitate cost allocation from a central pool
14 to all of the benefitting entities. Common and shared costs are accumulated in
15 cost pools in the service company and then allocated based upon a preferred
16 allocation methodology hierarchy which will be discussed later in my
17 testimony. All service company costs are allocated among the family of
18 benefitting affiliates each year.

19
20 Typically, any employee who regularly serves more than one company
21 on a regular, material basis is a service company employee. As examples, the
22 generation or transmission expert who advises regulated and unregulated
23 operations would be a service company employee and the accountants who do

1 financial accounting for several affiliates would be service company
2 employees.

3 However, in FPL's case, because there is no service company, there is
4 an extra step which complicates accounting for and allocating common and
5 shared costs among the corporate family. In a service company, all costs are
6 allocated to the entities served by the service company. For FPL, costs must
7 first be segregated between its pure utility operating company costs and the
8 common or shared costs that should be allocated among FPL and its affiliates.
9 As mentioned above, NEE/FPL has a strong incentive to classify costs as
10 purely FPL utility operating costs that are not allocated to unregulated
11 affiliates.

12 An example of the complexity of FPL cost allocation is that several
13 executives have dual regulated and unregulated roles. According to the NEE
14 2011 10-K report, page 23, six of the 14 NEE executive officers also have a
15 second role as FPL officers. For example, the Executive Vice President of the
16 NEE Power Generation Division is also the Executive Vice President of the
17 FPL Power Generation Division. In addition, FPL's 2011 Diversification
18 Report lists non-regulated affiliate responsibilities for several of FPL's officers.
19

20 **Q. ARE THERE OTHER STRUCTURAL COMPLICATIONS?**

21 A. Yes. According to OPC Interrogatory No. 3, NEE, NEER and other affiliates
22 are now providing shared common services back to FPL that are typically in a
23 shared services company or, at least, were previously centralized in FPL.

1 These include aviation operations, nuclear, information management, legal, and
2 human resources services. Other affiliates that may be providing what are
3 normally shared common services to FPL include NextEra Energy
4 Infrastructure (transmission, finance, and regulatory affairs), FPL Energy
5 Services (customer service and energy marketing and trading), and Lone Star
6 Transmission (transmission and general counsel). These affiliates have an
7 incentive to charge a disproportionate amount of their costs to FPL.
8

9 **Q. IS THERE AN ALTERNATIVE TO THE FORMATION OF A SEPARATE**
10 **SERVICE COMPANY?**

11 A. Yes. With sophisticated accounting software systems, it is possible for a
12 regulated utility to create a “virtual service company” capable of accomplishing
13 many of the functions of a separate corporate entity. However, just doing this
14 within FPL would not address the common support services provided to FPL
15 by affiliates.
16

17 **Q. DOES FPL HAVE THE ABILITY TO IMPLEMENT VIRTUAL SERVICE**
18 **COMPANIES?**

19 A. Yes. According to FPL witness Ousdahl, FPL recently underwent a conversion
20 to a new accounting software program called SAP. It is my understanding that
21 the SAP system has the capability to allow FPL and the affiliates who charge
22 FPL to assign employees who work for multiple affiliates to a “virtual” service
23 company established as a division or department within the entity. While not

1 as attractive as establishing a real legal entity service company for all of NEE,
2 establishing virtual service companies within FPL and each affiliate charging
3 FPL would improve the transparency of affiliate transactions.
4

5 **B. COST ALLOCATION METHODOLOGIES – FPL TO AFFILIATES**

6 **Q. HOW ARE FPL'S COSTS ALLOCATED TO AFFILIATES?**

7 A. MFR Schedule C-30, as summarized in my Exhibit DPV-3, shows that the fully
8 allocated cost of affiliate charges of \$150.6 million in 2013 will be allocated to
9 affiliates by the following methods: 40% by direct charges; 9% by service fees;
10 1% by pole attachment charges to FPL FiberNet; and 50% by Affiliate
11 Management Fee (AMF). Direct charges include simple convenience payments
12 made on behalf of affiliates by FPL. FPL does not follow the normal practice
13 of reporting which charges are convenience payments and the portion of the
14 costs that is allocated by direct charges of FPL employee time.

15 FPL also has an unusual practice of combining charges made by rates
16 (per employee, per square foot, etc.) and by the Massachusetts Formula general
17 allocator under the AMF category. This disguises the amount allocated using
18 the general allocator. However, FPL estimates that 60% of the AMF, or about
19 \$45.4 million, is allocated with the Massachusetts Formula in 2013.

20

21 **Q. HOW ARE FULLY ALLOCATED COSTS DETERMINED?**

22 A. The cost accounting to determine the total cost for a cost pool for a product or
23 service is fairly straightforward. The direct costs are collected in each cost pool

1 and appropriate overheads are then applied to determine the total fully loaded
2 cost for a cost pool or direct charge for a particular product or service. The
3 challenge is to allocate those costs among FPL and the affiliates in an equitable
4 manner.

5
6 **Q. ARE THERE PREFERRED METHODS TO ALLOCATE COSTS?**

7 A. Yes. The basic principle is to attach cost to the cause of the cost as precisely as
8 possible. For utility and affiliate cost allocations, there is a generally accepted
9 hierarchy of preferred cost allocation methodologies. The hierarchy, from most
10 preferred to least preferred, is:

11 **Direct charges whenever possible.** That is, the cost, in the finest granularity
12 practical, is charged directly to the entity causing the cost. For example, if an
13 invoice from a third party vendor is paid by FPL on behalf of an affiliate (a
14 “convenience payment”), that full cost should be charged to the affiliate.
15 Likewise, if an FPL engineer works on a project for an affiliate, the fully
16 allocated cost of each hour spent on that project should be charged directly to
17 that affiliate.

18 **Charge rates linked to cost drivers applied to all allocation recipients**
19 **equally.** This technique is appropriate when the costs cannot be directly
20 assigned to a benefitting entity, but a pool of costs can be allocated on a simple
21 cost driver. This is appropriate for things like shared office space in which all
22 the fully allocated costs associated with having the office are accumulated in a
23 cost pool and then are allocated to the office tenants on an occupied square
24 footage basis.

1 **General allocator.** This is the least preferred allocation method and should be
2 used sparingly. This method only applies when neither direct charges nor
3 acceptable cost drivers can be identified. Costs that fall in this category are
4 allocated based upon one or more general allocation factors like sales, assets or
5 growth rates determined to be fair to all recipients. Because of the incentive to
6 overcharge regulated utilities and undercharge unregulated affiliates, great care
7 must be taken to select a general allocation formula that is clearly fair to the
8 utility.

9
10 **Q. DOES FPL USE THE PREFERRED HIERARCHY OF COST**
11 **ALLOCATION METHODOLOGIES?**

12 A. No. FPL under-utilizes positive time reporting for direct charges and cost
13 pools, and over-utilizes the general allocator. Also, the general allocator FPL
14 has chosen, the Massachusetts Formula, is inappropriate for a steady, regulated
15 utility with growing unregulated affiliates. Each of these deficiencies is
16 discussed below.

17
18 **C. POSITIVE TIME REPORTING**

19 **Q. WHAT IS POSITIVE TIME REPORTING?**

20 A. Positive time reporting charges each employee work hour to a specific client,
21 work order or activity. It is the standard way for private attorneys, public
22 accountants, consulting engineers, management consultants and other
23 professionals to charge their clients for hourly services. It is also the most
24 accurate way for FPL employees providing services to FPL and affiliates to
25 account for their time and allocate their costs.

1 **Q. WHAT IS THE ALTERNATIVE TO POSITIVE TIME REPORTING?**

2 A. Fixed time allocations with exception reporting is the principal alternative to
3 positive time reporting. With fixed time allocations, employees' time is
4 allocated among work orders or activities the same way each reporting period,
5 usually based on estimates or time studies of how time would be spent.

6 Exception reporting requires a fixed time allocation employee first to
7 identify that he or she is spending time differently than the fixed allocation and
8 then to take the initiative to report an exception in the time reporting system.
9 Fixed allocations are less accurate than real-time positive time reporting of how
10 time is actually spent. Exception reporting is highly suspect in its ability to
11 identify differences from the fixed allocation and to actually report the
12 exception in the time keeping system.

13

14 **Q. DOES FPL USE POSITIVE TIME REPORTING APPROPRIATELY?**

15 A. No. The response to OPC Interrogatory No. 8 says, “[f]ixed employees use
16 exception reporting and variable employees use positive time reporting.” The
17 response to OPC Interrogatory No. 157 says, “[p]ositive time reporting is used
18 by either non-exempt or bargaining unit employees. Exception reporting is
19 used only by exempt employees.” All of the professional services employees –
20 engineers, accountants, IT specialists, and so on – who are typically exempt
21 employees do not use the more accurate positive time reporting methodology.

22

23 **D. MASSACHUSETTS FORMULA**

24 **Q. WHAT IS THE MASSACHUSETTS FORMULA AND HOW IS IT**
25 **APPLIED?**

1 A. The Massachusetts Formula is a size driven allocation methodology. The
2 Massachusetts Formula is based on the relative amounts of the simple average
3 of property, plant, and equipment (assets); revenue; and, payroll among FPL
4 and its affiliates. Electric utilities are asset and employee intensive enterprises
5 with high revenues. The response to OPC production of documents (POD) No.
6 11 shows the calculations for the 2012 Massachusetts Formula allocations.
7 According to Exhibit KO-13, the Massachusetts Formula allocations of
8 approximately \$45.6 million for 2013 are 64% to FPL, 33.82% to NEER, and
9 only 2.18% to all other affiliates.

10

11 **Q. IS FPL'S MULTIFACTOR GENERAL ALLOCATION**
12 **METHODOLOGY APPROPRIATE?**

13 A. No, for two important reasons. First, as mentioned above, the preferred
14 methodologies of direct charges and rates are underutilized, making the
15 strongly less-preferred multi-factor allocation methodology over-used. This
16 over-use compounds the second problem, which is that the Massachusetts
17 Formula selected by FPL as its general allocator is biased in the direction of
18 overcharging FPL and undercharging unregulated affiliates.

19

20 **Q. WHAT IS WRONG ABOUT FPL'S USE OF THE MASSACHUSETTS**
21 **FORMULA FOR ITS GENERAL ALLOCATOR?**

22 A. A major failing of the Massachusetts Formula is that it gives no weight to
23 growth and change. In reality, the growth and change of developing
24 unregulated affiliates command proportionately more management attention
25 and services than a stable, steady regulated utility. FPL notes that its

1 percentage share of the Massachusetts Formula allocation decreases over time,
2 but only because of the faster growth rate of the unregulated affiliates. The
3 Massachusetts Formula does not account for the effort required to drive that
4 growth in the unregulated affiliates operating in the challenging competitive
5 arenas.

6 Newness and growth are important cost drivers and can be better
7 indicators of the level of management attention and staff services than absolute
8 size alone.

9

10 **Q. IS THERE AN ALTERNATIVE TO THE MASSACHUSETTS FORMULA**
11 **THAT, IN YOUR OPINION, WOULD MORE FAIRLY ALLOCATE**
12 **THE COSTS THAT ARE THE SUBJECT OF THE FORMULA?**

13 A. Yes. First, FPL should increase its use of direct charges and rates for cost
14 allocation, thereby reducing its reliance on the less preferred general allocator.
15 Second, after appropriate inquiry and investigation, the Commission should
16 require FPL to develop a new general allocation formula that gives proper
17 weight to the growth and change aspects of unregulated affiliates that consume
18 management attention and staff resources. The general allocation formula
19 should also deemphasize payroll as a factor as contract labor is a ready
20 substitute for employee payroll. The different mixes of employees and
21 contractors can distort the payroll factor among FPL and its affiliates.

22

23 **E. COST ALLOCATION METHODOLOGIES – AFFILIATES TO FPL**

24 **Q. ARE FPL'S AFFILIATES' PRICING AND COST ALLOCATION**
25 **METHODOLOGIES ADEQUATE?**

1 A. No. All of the affiliate charges to FPL are listed as direct charges in MFR
2 Schedule C-30. (The response to OPC Interrogatory No. 161 clarifies that
3 some affiliate charges to FPL are allocated, and are not direct charges.)
4 However, other than a line item cost comparison for FiberNet and AT&T, FPL
5 provided no support for being charged the lower of cost or market price by
6 affiliates. For charges based upon direct or allocated cost, none of the FPL
7 affiliates have cost allocation manuals that are designed to enable FPL to
8 comply with the Commission's affiliate transaction rule. FPL, as the regulated
9 entity, is responsible to assure that charges to it from affiliates comply with the
10 Florida Rule. Therefore, FPL should assure the methodologies employed by its
11 affiliates comply with the Rule. Further, FPL should audit the transactions to
12 assure that the affiliate methodologies are being applied properly.

13 FPL does not perform the accounting for the affiliates who charge FPL.
14 It has no oversight responsibility or authority to assure that the fully allocated
15 cost based charges to FPL are correctly calculated and are accurate. Further,
16 there have been no internal audits of affiliate charges to FPL in Witness
17 Ousdahl's memory according to an informal telephone interview. FPL has
18 provided no assurance that the 2013 affiliate charges to FPL of \$22.2 million
19 are correct and proper, other than that the affiliates comply with federal
20 financial accounting rules. However, it is possible to comply with federal
21 financial accounting rules and still overcharge FPL.

1 for proving that FPL is paying the lower of cost or market when affiliate
2 products or services are an option.

3 It is more difficult to determine the market price for shared common
4 support services that do not easily lend themselves to competitive bidding. In
5 some cases, market studies may be able to determine comparable professional
6 fee rates for engineering, legal, accounting and similar professional services.
7 Then, FPL could compare its or its affiliates' fully allocated cost hourly rates to
8 the going market rates determined by the study. A similar approach could be
9 used for those costs charged by rates, such as, per square foot, per full-time
10 equivalent employee (FTE) or per workstation.

11

12 **Q. DID FPL AVAIL ITSELF OF EITHER OF THESE METHODS FOR**
13 **ADDRESSING MARKET PRICES FOR AFFILIATE COSTS?**

14 A. No. Interrogatories and requests for PODs on this topic produced only three
15 examples of any effort remotely related to addressing market prices for the
16 hundreds of affiliate transactions other than asset transfers. One was only a
17 sole source justification for a purchase by FPL from an affiliate for an
18 emergency generator installation that did not include any competitive pricing
19 information. The second was a simple line item comparison of FiberNet prices
20 to AT&T prices that included no explanation or analysis and no indication that
21 AT&T was bidding on an equal footing for FPL's business. The third is a
22 periodic (five-year interval) market study of office space rental costs that FPL
23 uses as a basis for the rent that FPL charges its affiliates for office space.

1 FPL offered no market price information for any of the other hundreds
2 of affiliate transactions for tens of millions of dollars of related costs that are
3 incurred each year. It is clear that FPL rarely makes any attempt to determine
4 the higher of market or cost for pricing services to affiliates and the lower of
5 market or cost for purchases from affiliates, other than for transfers of assets.
6

7 **Q. DOES FPL MEET ITS BURDEN FOR ASYMMETRICAL PRICING?**

8 A. No. FPL appears to make good faith efforts to do asymmetrical pricing for
9 asset transfers. However, it makes little or no effort to do asymmetrical pricing
10 for affiliate transactions for goods and services. As an example, the FPL Cost
11 Allocation Manual, Exhibit KO-9 page 3, discusses cost or market pricing for
12 transfers of assets, but does not require it for purchasing or selling goods and
13 services from and to affiliates.

14 Witness Ousdahl states in her testimony, page 27, lines 13-15, “[t] he
15 CAM largely follows the published guidelines recommended by the National
16 Association of Regulatory Utility Commissioners (“NARUC”).” However, the
17 NARUC Guidelines included in the FPL CAM state in Section D: “1.
18 Generally, the price for services, products and the use of assets provided by a
19 regulated entity to its non-regulated affiliates should be at the higher of fully
20 allocated costs or prevailing market prices.” And, “2. Generally, the price for
21 services, products and the use of assets provided by a non-regulated affiliate to
22 a regulated affiliate should be at the lower of fully allocated cost or prevailing
23 market prices.” (See, KO-9, p. 13 of 16) FPL adopts the NARUC Guidelines
24 for asymmetric pricing, and then fails to implement them for goods and
25 services transactions with affiliates.

1 Q. CAN YOU PROVIDE AN EXAMPLE OF A RELATIONSHIP IN
2 WHICH THE MARKET PRICE OF FPL SERVICES MIGHT BE
3 HIGHER THAN THE FULLY ALLOCATED COST?

4 A. Yes. The response to OPC Interrogatory No. 12, Attachment 1, lists extensive
5 services provided by FPL to FPL Energy Services (FPLES). These include call
6 center customer assistance, transferring new customer calls to FPLES, financial
7 hedge transactions, mark to market adjustments, and many others. This is a
8 prime example of NEE/FPL “leveraging” the FPL organization developed to
9 serve ratepayers in order to facilitate the development of an affiliated
10 enterprise. FPL’s “leveraging” of its resources, and good will paid for by its
11 Florida ratepayers violates the intent of Section 366.05(9), Florida Statutes, and
12 the affiliate transaction rule that Florida ratepayers not subsidize FPL affiliate
13 nonutility activities. It is highly likely that the market value of these important
14 services is higher than the cost allocations assigned to FPLES. FPL does not
15 meet its burden to prove that the amounts it is charging FPLES are the higher
16 of cost or market price.

17

18 Q. CAN YOU PROVIDE AN EXAMPLE OF A PROBLEM WITH
19 AFFILIATES UNDER-COMPENSATING FPL FOR SERVICES?

20 A. Yes. The response to OPC Interrogatory No. 18, asking how affiliates pay for
21 the value of using FPL established contracts or relationships, says that, “[t]here
22 is no separate compensation provided to FPL by affiliates for having FPL
23 establish vendor contracts or relationships.” In other words, FPL does the work
24 paid for by ratepayers to establish vendor relationships and contracts, and
25 affiliates can utilize those relationships and contracts for free, thereby causing

1 Florida ratepayers to subsidize the affiliates' nonutility activities. This is
2 another example of NEE "leveraging" the value of FPL for the benefit of its
3 unregulated subsidiaries. FPL should be compensated for the value of the
4 relationships and contracts utilized by affiliates.

5
6 **Q. WHAT IS FPL'S POSITION ON "LEVERAGING" THE FPL**
7 **ORGANIZATION FOR THE BENEFIT OF ITS UNREGULATED**
8 **AFFILIATES?**

9 A. Witness Ousdahl, in response to OPC Interrogatory No. 4, said, "[a]s affiliate
10 operations began, FPL leveraged its fleet and support organizations to serve the
11 enterprise . . ." My interpretation of this statement, based on the information
12 provided by FPL, is that FPL and NEE consciously decided to utilize the FPL
13 organizational assets paid for by Florida ratepayers to assist in the development
14 of its now substantial unregulated operations. NEE uses the resources and
15 capabilities assembled in FPL to serve Florida customers under regulated
16 tariffed rates to facilitate diversification into unregulated operations.

17 In my experience, new and growing unregulated enterprises normally
18 take more time and energy than a well-established, "going concern" regulated
19 utility. It is likely that a disproportionate share of FPL's time and energy has
20 been applied to these diversification efforts. As I will explain below, this raises
21 the concern that the developing enterprises do not pay their fair share of FPL's
22 costs. As explained above, NEE and FPL have a large incentive to undercharge
23 the diversified businesses that are being leveraged from the organizational
24 resources of FPL paid for by the Florida ratepayers. An example of this is
25 NEE's leveraging of the FPL Nuclear Division and the FPL Power Generation

1 Division to develop NEE's large scale unregulated generation portfolio in
2 NEER, as described in the response to OPC Interrogatory No. 5.

3

4 **Q. IS FPL'S "LEVERAGING" APPROPRIATE?**

5 A. Only if FPL's customers are properly compensated for the utilization of its
6 organizational resources paid for by Florida ratepayers at every step and in
7 every instance.

8

9 **Q. HAS FPL (AND HAVE THE FLORIDA RATEPAYERS) BEEN**
10 **PROPERLY COMPENSATED FOR THE UTILIZATION OF FPL**
11 **ORGANIZATIONAL RESOURCES IN THE DEVELOPMENT OF THE**
12 **UNREGULATED AFFILIATES?**

13 A. No. In my testimony, I will point out several instances of FPL (and the Florida
14 ratepayers) being inadequately compensated for the use of the FPL
15 organizational resources in developing and operating the unregulated affiliates.

16

17 **B. ECONOMIES OF SCALE**

18 **Q. WHAT IS FPL'S POSITION ON THE POSSIBLE BENEFIT OF**
19 **LEVERAGING FPL'S ORGANIZATIONAL RESOURCES TO**
20 **DEVELOP ITS UNREGULATED AFFILIATES?**

21 A. Witness Ousdahl discusses the leveraging of FPL's organizational resources for
22 the benefit of its unregulated affiliates. She states on pages 26 and 27 of her
23 direct testimony that, "[w]hile the activities embedded in FPL today continue to
24 be necessary to support the provision of electric service to FPL's Florida retail
25 customers; charging a portion of these support services to its affiliates has

1 allowed FPL to reduce its share of these necessary fixed costs for the benefit of
2 its retail customers and shareholders.” She adds, “Furthermore, by spreading
3 the fixed cost of the support activities over a broader base, the retail utility
4 customers’ cost responsibility is reduced below what they would otherwise
5 incur.” In other words, FPL should benefit from economies of scale of serving
6 the unregulated affiliates from the regulated utility.

7
8 **Q. DID YOU FIND EVIDENCE OF THESE ECONOMIES OF SCALE?**

9 A. No. On the contrary, I found evidence that the costs of the kind of support and
10 shared services normally provided by a service company to a utility like FPL
11 and the unregulated affiliates are projected to increase faster than inflation.
12 According to MFR Schedule C-33, over the 2009 to 2013 period,
13 Administration and General (A&G) Expenses increase from \$74.51 per
14 customer to \$93.84 per customer, an increase of 25.9%; and, Operations and
15 Maintenance (O&M) Expenses Less Fuel per KWH sold increases from
16 \$0.01422 to \$0.01829, an increase of 25.7%. However, over the same period,
17 the Consumer Price Index is only projected to increase from 214.5 to 233.8, an
18 increase of 9%.

19 A&G expenses per customer and non-fuel cost per KWH sold are the
20 type of expense rates that should benefit from the economies of scale Witness
21 Ousdahl is touting. Both FPL and its unregulated affiliates are expected to
22 grow over this period and should provide ever greater economies of scale. For
23 example, according to the NEE/FPL 2011 Form 10-K, FPL has estimated
24 planned capital expenditures of \$10.7 billion from 2012 through 2016 and
25 NEER and Corporate and Other has estimated planned capital expenditures of

1 \$6.6 billion. However, the FPL filing does not reflect corresponding
2 economies of scale happening.

3

4 **Q. WHY DO YOU THINK THE ECONOMIES OF SCALE ARE NOT**
5 **PROJECTED TO APPEAR?**

6 A. As I discuss throughout my testimony, FPL has several deficiencies in the way
7 it implements and oversees its affiliate relationships and transactions, such as
8 the lack of a service company as mentioned above. In my opinion, these
9 deficiencies are contributing to FPL and Florida ratepayers failing to benefit
10 from actual economies of scale that are and will be occurring.

11

12 **C. SOLE SOURCE AFFILIATE CONTRACTS**

13 **Q. HAS FPL AWARDED SOLE SOURCE CONTRACTS TO**
14 **AFFILIATES?**

15 A. Yes, almost all of FPL's contracts with affiliates are sole source contracts,
16 meaning it has not given the chance to win the business to unaffiliated
17 competitors. The response to OPC Interrogatory No. 25 says, "[s]chedule C-
18 31, Contracts with Affiliates, is apparently referencing page 455 of FPL's 2010
19 FERC Form 1. The majority of the contracts included on page 455 are
20 considered sole source arrangements." Also, in response to OPC POD No. 5,
21 FPL only provided partial documentation of two of nine new affiliate
22 contractual relationships. FPL did not adequately justify any of the nine
23 relationships.

24 The new or amended sole source contracts listed in Schedule C-31 are

1 for things like accounts receivable financing (\$900 million at one percent per
2 year), purchase of emergency generators (\$28 thousand), switchyard upgrades
3 (\$50 million), Future Enterprise Network Architecture (\$1.5 million), and
4 insurance (over \$9 million) that are easily and normally bid to unaffiliated
5 suppliers by other electric utilities.

6 **Q. IN YOUR OPINION, DOES FPL'S USE OF SOLE SOURCE**
7 **CONTRACTS COMPLY WITH THE COMMISSION'S AFFILIATE**
8 **TRANSACTION RULE?**

9 A. No, on two counts. First, Florida's asymmetrical pricing affiliate transaction
10 rule requires that FPL determine market prices so it can price goods or services
11 from affiliates at the lower of market price or fully allocated cost. A
12 competitive bidding process with full participation by non-affiliated suppliers is
13 the ideal way to establish market prices.

14 Second, a non-affiliated supplier may be able to offer FPL a more
15 advantageous relationship. FPL may be overpaying its affiliates or it may be
16 receiving less advantageous terms and conditions.

17
18 **D. SERVICE AGREEMENTS**

19 **Q. WHAT ARE SERVICE AGREEMENTS?**

20 A. Service agreements are contracts between a service provider and an affiliate. This is
21 a good management practice that spells out commitments and expectations on both
22 sides. For holding companies with service companies, there is typically a service
23 agreement between the service company and each affiliate served. Further, there is

1 typically a service agreement between a regulated utility and each affiliate that
2 provides it goods or services. Service agreements specify such things as the goods
3 and services to be provided, the service levels to be achieved, how the transactions
4 will be priced, standard terms and conditions, audit rights, and so on. It is best if the
5 agreements are signed by accountable executives on each side who are
6 organizationally unrelated, making the agreements as arms-length as possible.

7

8 **Q. DOES FPL UTILIZE SERVICE AGREEMENTS WITH ITS**
9 **AFFILIATES?**

10 A. Of the hundreds of affiliate relationships identified by FPL (rolled up into eight
11 categories) in its MFRs, FPL provided only two affiliate agreement-like documents.
12 The first is a Corporate Support Services Agreement between FPL and Lone Star
13 Transmission required by the Public Utility Commission of Texas (PUCT). The
14 second is a Master Service Agreement between FPL and FPL FiberNet. There are no
15 other service agreements.

16

17 **Q. IS IT GOOD PRACTICE TO REQUIRE SERVICE AGREEMENTS**
18 **BETWEEN AFFILIATES AS DOES THE PUBLIC UTILITY**
19 **COMMISSION OF TEXAS?**

20 A. Yes. In addition to being a good management practice, some states require
21 service agreements to be filed and approved by the regulatory commission. In
22 addition to Texas, I am also aware that Maine requires Commission approved
23 service agreements between regulated operating companies and their affiliates.
24 This is a good regulatory practice as well and assures the affiliate relationships
25 are structured to comply with affiliate rules and regulations. Service

1 agreements also provide a starting point for audits of affiliate relationships and
2 transactions. In addition to making sure the affiliate relationship is structured
3 correctly, it is also important to assure that it is being operated as designed. I
4 recommend that the Commission investigate the desirability of requiring
5 service agreements between FPL and its affiliates.

6
7 **E. USE OF THE FPL NAME**

8 **Q. IS FPL COMPENSATED FOR THE USE OF ITS NAME BY**
9 **UNREGULATED AFFILIATES?**

10 A. No. The FPL response to OPC Interrogatory No. 14 says, “[t]here is no
11 separate compensation provided to FPL by affiliates for the use of the Florida
12 Power & Light name.” This is contrary to the Florida requirement for FPL to
13 charge affiliates the higher of market price or fully allocated cost for value
14 received. In the case of using the FPL name, FPL charges affiliates nothing at
15 all. However, the ratepayers have supported FPL in building its brand over
16 many years. In my opinion, NEE likely chose to include FPL in the names of
17 unregulated subsidiaries operating in Florida because of the positive
18 connotation it would bring. FPL should be charging them the market value for
19 the benefits provided by use of the FPL name.

20 This is another good example of NEE and FPL “leveraging” the value
21 of FPL built by ratepayers, and FPL being inadequately compensated for the
22 use of FPL assets, resources and intellectual property.

23
24 **IV. FINDINGS, RECOMMENDATIONS, AND ADJUSTMENTS**

25 **Q. IN YOUR EXPERT OPINION, DID FPL MEET ITS BURDEN OF**

1 **PROOF REGARDING THE REASONABLENESS OF ITS PROPOSED**
2 **AFFILIATE CHARGES AND PAYMENTS?**

3 A. No. FPL did not adequately support the charges, either in its direct case or in
4 responses to interrogatories and POD requests. In my opinion, FPL's direct
5 case makes assertions without proof and its responses to the interrogatories and
6 POD requests that ask for specific support of its affiliate charges and payments
7 were inadequate. FPL did not comply with important aspects of the Florida
8 affiliate transaction rule nor the precedents emphasizing its burden to prove that
9 affiliate charges and costs are reasonable.

10 It is clear that NEE's strategy is to leverage the FPL ratepayer funded
11 resources to build its unregulated affiliates. It is also clear that FPL is not
12 adequately compensated for the use of its ratepayer funded resources by
13 affiliates. The claim that FPL somehow benefits from economies of scale by
14 serving unregulated affiliates from FPL funded resources is not supported by
15 the evidence.

16 FPL has organized its affiliate relationships and transactions in a
17 manner that makes the true nature of the relationships and transactions less than
18 transparent. However, it is clear that FPL does not meet the full letter or spirit
19 of the Florida affiliate transaction rule or the precedents which place the burden
20 of proof on FPL to establish the reasonableness of its affiliate transactions.
21 FPL has multiple deficiencies in its affiliate relationships and transactions.

1 **Q. CAN YOU SUMMARIZE THE DEFICIENCIES YOU FOUND IN FPL'S**
2 **AFFILIATE RELATIONSHIPS AND TRANSACTIONS?**

3 A. Yes, they are as follows:

- 4 1. There is no service company legal entity encompassing the common and
5 support services provided by both FPL and NEER. This makes determining the
6 appropriateness of affiliate transactions difficult.
- 7 2. Of its hundreds of affiliate relationships (which FPL rolls up into eight
8 categories), FPL has service agreement-like contracts for only two of them.
- 9 3. Asymmetric pricing is not used by FPL for all affiliate transactions for goods
10 and services as required by the affiliate transaction rule. Asymmetric pricing is
11 only adhered to for asset transfers.
- 12 4. The preferred allocation methodologies of direct charges and rates for affiliate
13 cost allocations are used too little, and the use of the less preferred general
14 allocator is used too much.
- 15 5. Positive time reporting for all service company type functions is underutilized,
16 making cost accounting less accurate.
- 17 6. The Massachusetts Formula general allocator overemphasizes size, specifically
18 the things that characterize electric utilities (assets, employees and revenue)
19 and underemphasizes growth and change, which typify the unregulated
20 affiliates. It also over-emphasizes payroll as a factor, which can be misleading
21 when an entity uses contractors instead of employees. The Massachusetts
22 Formula over-allocates costs to FPL and under-allocates costs to unregulated
23 affiliates.

- 1 7. FPL does not document the benefit of purchases of goods and services to FPL
2 ratepayers from affiliates and does not assure that affiliates' fully allocated cost
3 calculations are accurate.
- 4 8. The use of sole source contracts with affiliates is inappropriate, particularly
5 when the goods or services involved are readily available in the marketplace.
- 6 9. Affiliates do not pay for the value of using the FPL name.

7

8 **Q. WHAT SHOULD BE DONE IN THIS CASE ABOUT THE FPL**
9 **DEFICIENCIES IN AFFILIATE RELATIONSHIPS AND**
10 **TRANSACTIONS?**

11 A. Because of the manner in which FPL reports its affiliate relationships and
12 transactions, it is impossible to calculate the cost to ratepayers for each of the
13 nine deficiencies identified. However, it is substantial. The Commission
14 should require remedies of the deficiencies before the next rate case so that the
15 reasonable affiliate transactions can be clearly identified. This will allow the
16 Commission to assess FPL performance against the affiliate transaction rule
17 and precedents much more precisely going forward.

18 For this case, as a proxy for the substantial cost to ratepayers of the nine
19 identified deficiencies in FPL's affiliate relationships and transactions, I
20 recommend that the Commission increase the 2013 projected FPL affiliate
21 charges to affiliates by 20% and reduce the 2013 charges from affiliates to FPL
22 by 20%. Based upon my experience, 20% is an appropriate representation of
23 the order of magnitude of the ratepayer subsidization caused by the deficiencies

1 identified. This would increase the FPL charges to affiliates by \$30.1 million
2 from \$150.6 million to \$180.7 million, and would reduce the charges by
3 affiliates to FPL by \$4.4 million from \$22.2 million to \$17.8 million.
4 Therefore, I recommend that FPL test year operating and maintenance expenses
5 be decreased by \$34.5 million to reflect the impact of my adjustment.

6
7 **Q. DO YOU HAVE ANY ADDITIONAL RECOMMENDATIONS?**

8 A. Yes. Due to the large negative impact of the existing situation to Florida
9 ratepayers, the Commission should also open an investigation into FPL's
10 affiliate relationships and transactions to address the deficiencies I have
11 identified in my testimony.

12
13 **Q. WHAT WOULD THE INVESTIGATORY DOCKET THAT YOU**
14 **RECOMMEND ENCOMPASS?**

15 A. I would recommend that an investigatory docket encompass the following
16 areas, at a minimum:

17 *Virtual and/or Service Company* -- Ideally, NEE/FPL should establish a
18 service company legal entity encompassing FPL, NEER and other subsidiary
19 provided common and support services. Alternatively, the Commission could
20 require FPL to form virtual service companies within FPL and its affiliates
21 providing services to FPL utilizing available features in the SAP accounting
22 system. All employees who materially serve more than one company (at least
23 ten percent of their time to a second company) should be assigned to a service

1 company, real or virtual.

2 As discussed earlier, FPL recently underwent a transition to new
3 financial account software that would, in my opinion, make virtual service
4 companies a realistic possibility.

5 ***Service Agreements*** -- The investigatory proceeding should consider requiring
6 the use of service agreements between FPL and each of its affiliates.

7 ***Asymmetric Pricing*** -- The investigatory proceeding should include the manner
8 in which the Commission will require proof of asymmetric pricing for all FPL
9 affiliate transactions.

10 ***Allocation Methodologies*** -- The investigatory proceeding should include
11 methods by which the Commission may require FPL to substantially increase
12 the use of direct charges and rates for affiliate cost allocations and decrease the
13 use of a general allocator.

14 ***Positive Time Reporting*** -- The investigatory proceeding should consider
15 requiring FPL to develop and implement positive time reporting for all service
16 company professional services type functions.

17 ***General Allocator*** -- The Commission should include in its investigatory
18 docket a consideration of the deficiencies in using the Massachusetts Formula,
19 and require FPL to develop a general allocator that better reflects the
20 consumption of management attention and staff services by growing
21 unregulated affiliates. The general allocation formula should also deemphasize
22 payroll as a factor as contract labor is a ready substitute for employee payroll.
23 The mix of employees and contractors can distort the payroll factor among FPL

1 and its affiliates.

2 ***Benefits of Purchases from FPL Affiliates to Ratepayers*** -- The investigatory
3 proceeding should consider requiring FPL to document the benefit of purchases
4 of goods and services from affiliates to FPL ratepayers and assure that the
5 affiliates' fully allocated cost calculations are accurate.

6 ***Extent of FPL's Use of Sole Source Contracts in Lieu of Competitive Bidding***
7 -- The investigatory proceeding should investigate FPL's overuse of sole source
8 contracts with affiliates and consider requiring FPL to bid all existing affiliate
9 contracts to all qualified potential providers.

10 ***Compensation for Use of FPL Name*** -- As part of the investigatory proceeding
11 that I recommend, the Commission should require FPL to charter an
12 independent appraisal of the value of using the FPL name and require FPL to
13 charge all FPL named affiliates the appropriate royalty fees.

14

15 **Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

16 **A. Yes.**

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Direct Testimony of David P.Vondle has been furnished by electronic mail and/or U.S. Mail on this 2nd day of July, 2012, to the following:

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SUMMARY OF QUALIFICATIONS

Mr. Vondle has over twenty-five years of management consulting experience, primarily in the public utilities industry. He is an expert in affiliate interests and transactions, corporate/subsidiary relationships, transfer pricing, shared services and inter-company services contracting and contractor management. Mr. Vondle has provided expert witness testimony on affiliate interest topics in ten jurisdictions, including state regulatory commissions and US and state district courts. Mr. Vondle has conducted management audits of investor owned utilities for 15 state regulatory commissions and one US territory. He has assisted the public advocates in Maine, Massachusetts and New Mexico.

Mr. Vondle has relevant experience with domestic holding company/operating company/service company entities including: Exelon/Commonwealth Energy, CenterPoint/Texas Generation Company; Xcel Energy/Southwestern Public Service Company; FirstEnergy/its three Pennsylvania Operating Companies and Jersey Central Power & Light; SCE/Southern California Edison; Allegheny Power System/Potomac Edison Company and West Penn Power; Verizon/New York Telephone; and, Sempra/Southern California Gas Company.

Mr. Vondle also has extensive experience with US state regulation of international holding companies with US operating companies, including: National Grid/Niagara Mohawk; Iberdrola/Energy East/The Energy Network/Southern Connecticut Gas and Central Maine Power; Eon/Louisville Gas & Electric and Kentucky Utilities; and, Emera/Bangor Hydro and Maine Public Service Company.

Mr. Vondle has performed affiliated interest reviews of United Illuminating, Pacific Gas & Electric, Utilicorp United, United Cities Gas, SBC/SNET, SBC/Ameritech, NYNEX, Bell Atlantic, US West, GTE/Contel, and Alltel. He has designed or reviewed the contractual relationships between energy companies and strategic partners for energy supply, operations and maintenance services, capital project design and construction, and customer services for multiple investor owned and public power entities.

Mr. Vondle is a co-author of the Public Utilities Fortnightly article, "The Regulation of Affiliated Interests" and is the author of Service Management Systems published by McGraw-Hill.

EXPERT WITNESS AND REGULATORY SUPPORT EXPERIENCE

Mr. Vondle has appeared as an expert witness in the following jurisdictions:

- Alaska Public Utility Commission - Contel rate case (affiliate relationships), 1982.*
- California Public Utility Commission – PGE Corporate/subsidiary relationships (affiliate relationships), 2001.*
- California Senate Energy Committee – PGE Corporate/subsidiary relationships (affiliate relationships), 2001.*
- Connecticut Public Utility Commission – Southern Connecticut Gas affiliated interest proceeding (affiliate relationships). Docket No. 00-12-08, 2002.
- Connecticut District Court – Litigation support and expert witness for the State of Connecticut in a lawsuit against a district energy supplier owned by an investor owned utility (affiliate relationships), 2008.*
- U.S. District Court for the District of Columbia - AT&T anti-trust trial (affiliate relationships) Case No. 74-1698 (D.D.C.), 1981.
- Florida Public Service Commission - setting of contributions-in-aid-of-construction, 1981.*
- Guam Public Utilities Commission - Guam Power Authority rate case. Docket No. 94-001, 1995.
- Maine Public Utilities Commission – Emera/Maine Public Service merger and Emera/Algonquin Public Utilities/First Wind (both on affiliate relationships) Docket No. 2010-89, 2010.
- Massachusetts Department of Public Utilities – NiSource/Bay State Gas Company rate case. Docket No. 09-30, 2009.
- New Mexico Public Service Commission - Public Service Company of New Mexico's acquisition of the Gas Company of New Mexico (affiliate relationships) NMPSC Case No. 1891/2, 1984.
- Texas Public Utility Commission – Southwestern Public Service Company rate case beginning May 31, 2006 (affiliate relationships and benchmarking) SOAH Docket No. 473-06-2536, PUC Docket No. 32766, 2005.

*Docket Number is unknown.

RELATED CONSULTING EXPERIENCE

- Lead consultant in the areas of affiliate interests and customer service in a management audit of the three FirstEnergy Pennsylvania operating companies for the Pennsylvania Public Utility Commission. (2006)
- Lead consultant in the areas of affiliate interests, transmission and distribution, and shared and support services in a management audit of FirstEnergy/Jersey Central Power

& Light Company for the New Jersey Board of Public Utilities. (2010)

- Lead consultant in an analysis of the relationship between Energy East and its subsidiaries The Energy Network and Connecticut Natural Gas for a law firm in connection with litigation. (2008)
- Lead consultant in an affiliated interest audit of SBC/Southern New England Telephone Company for the Connecticut Department of Public Utility Control. (2005)
- Lead consultant in the areas of affiliate relationships and incentive compensation in an analysis of Louisville Gas & Electric's and Kentucky Utilities' earnings sharing mechanism for the Kentucky Public Service Commission. (2004)
- Lead consultant for the areas of corporate payments/affiliated interests, income taxes and gas supply in the review of Pacific Gas and Electric's financial condition in connection with the California energy crisis for the California Public Utility Commission. (2001)
- Lead consultant in the management audit of affiliate relations of Southern Connecticut Gas for the Connecticut Department of Public Utility Control. (2000)
- Lead consultant for a management audit of United Illuminating on behalf of the Connecticut Department of Public Utility Control. Areas of responsibility were affiliate relations and customer service. (2002)
- Engagement director for a study of affiliated interests in the Glacier State Telephone's, a subsidiary of Continental Telephone Company, rate case for the Alaska PUC. The study produced several precedent-setting recommendations for reduced rate requirements and improved regulation of affiliated interests. (1982)
- Assisted a multi-state utility in developing a fair and acceptable affiliated interest policy and cost allocation methodology.
- Provided strategic planning for the consolidation of all corporate support services of a large telecommunications company. The consolidation reduced costs, improved service, increased competitiveness, and sharpened customer focus. Also developed the transfer pricing chargeback system.
- Lead consultant in the areas of best practices, merger costs and savings, merger integration team analysis, and cost and savings quantification in the analysis of the SBC/Ameritech merger for the Illinois Commerce Commission. (2001)
- Directed a project to assist a regional Bell holding company in its development of a new transfer pricing policy for corporate, regulated, and unregulated entities. The policy was designed to motivate rational economic behavior, and to comply with all affiliated interest regulatory requirements.
- Lead Consultant in the areas of Shared Services, Employee Costs and Natural Gas Procurement for a Revenue Requirements Study for the Los Angeles Department of Water and Power. (2004)
- Lead Consultant in the area of Shared Services in a Strategic Assessment of the City of Los Angeles Department of Water and Power.(2002)

- Lead Consultant in the areas of inter-company contracting and contract services management with former affiliates for a major energy company. The project included contracts for power procurement, administrative and general services, and energy management services.
- Lead Consultant on a strategic examination of the status and results to date of deregulation and restructuring in the electric industry for a multi-state electric utility. The emphasis was on the Northeast and Midwest and included the effect of PJM, bilateral, auction and RFP power procurement and electric price trends under the various restructuring methods.
- Directed the overhaul and modernization of the services contracting process for a large energy utility. The effort included the company's contracting philosophy, contracting economics, contractor qualifications, labor relations issues, bid packaging, bidding and selection procedures, contract pricing, contract documents, internal controls, and audit requirements.
- Provided strategic planning for the consolidation of all corporate administrative support services of a large telecommunications company. The consolidation reduced costs, improved service, increased competitiveness, and sharpened customer focus. Also developed the transfer pricing policy (charge-back system to the subsidiaries and affiliates).
- Led a team for a large Western combination utility that examined all of its shared support services and recommended a new management process that will improve internal client satisfaction and reduce costs. The new management process includes clear definition of roles, defined quality and service requirements, accurate costing, clear pricing and billing, and integrated business planning and performance appraisal.
- Lead consultant in the areas of affiliate interests and jurisdictional cost allocations in the Missouri PSC's management audit of Utilicorp United. (1998)
- Lead consultant for affiliated interests, cost allocations, finance, revenue requirements, and accounting in the audit of Alltel for the Pennsylvania PUC. (1989)
- Lead consultant for affiliated interests, cost allocations, finance, revenue requirements, and accounting in the audit of Contel for the Pennsylvania PUC. (1987)
- Lead consultant for affiliated interests, cost allocations, and cross-subsidization in the management audit of GTE for the Pennsylvania PUC. (1987)

EDUCATION

- BS, Industrial Management, the University of Akron
- MBA, Southern Methodist University

MEMBERSHIPS AND CERTIFICATION

- Institute of Management Consultants
- Certified Management Consultant (CMC)

New Mexico Angels (private equity), Member

25-6.1351 Cost Allocation and Affiliate Transactions.

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

(2) Definitions.

(a) Affiliate – Any entity that directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with a utility. As used herein, “control” means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a company, whether such power is exercised through one or more intermediary companies, or alone, or in conjunction with, or pursuant to an agreement, and whether such power is established through a majority or minority ownership or voting of securities, common directors, officers or stockholders, voting trusts, holding trusts, associated companies, contracts or any other direct or indirect means.

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

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

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

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

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

(g) Nonregulated – Refers to services or products that are not subject to price regulation by the Commission or not included for ratemaking purposes and not reported in surveillance.

(h) Prevailing Price Valuation – Refers to the price an affiliate charges a regulated utility for products and services, which equates to that charged by the affiliate to third parties. To qualify for this treatment, sales of a particular asset or service to third parties must encompass more than 50 percent of the total quantity of the product or service sold by the entity. The 50 percent threshold is applied on an asset-by-asset and service-by-service basis, rather than on a product line or service line basis.

(i) Regulated. – Refers to services or products that are subject to price regulation by the Commission or included for ratemaking purposes and reported in surveillance.

(3) Non-Tariffed Affiliate Transactions.

(a) The purpose of subsection (3) is to establish requirements for non-tariffed affiliate transactions impacting regulated activities. This subsection does not apply to the allocation of costs for services between a utility and its parent company or between a utility and its regulated utility affiliates or to services received by a utility from an affiliate that exists solely to provide services to members of the utility’s corporate family. All affiliate transactions, however, are subject to regulatory review and approval.

(b) A utility must charge an affiliate the higher of fully allocated costs or market price for all non-tariffed services and products purchased by the affiliate from the utility. Except, a utility may charge an affiliate less than fully allocated costs or market price if the charge is above incremental cost. If a utility charges less than fully allocated costs or market price, the utility must maintain documentation to support and justify how doing so benefits regulated

operations. If a utility charges less than market price, the utility must notify the Division of Economic Regulation in writing within 30 days of the utility initiating, or changing any of the terms or conditions, for the provision of a product or service. In the case of products or services currently being provided, a utility must notify the Division within 30 days of the rule's effective date.

(c) When a utility purchases services and products from an affiliate and applies the cost to regulated operations, the utility shall apportion to regulated operations the lesser of fully allocated costs or market price. Except, a utility may apportion to regulated operations more than fully allocated costs if the charge is less than or equal to the market price. If a utility apportions to regulated operations more than fully allocated costs, the utility must maintain documentation to support and justify how doing so benefits regulated operations and would be based on prevailing price valuation.

(d) When an asset used in regulated operations is transferred from a utility to a nonregulated affiliate, the utility must charge the affiliate the greater of market price or net book value. Except, a utility may charge the affiliate either the market price or net book value if the utility maintains documentation to support and justify that such a transaction benefits regulated operations. When an asset to be used in regulated operations is transferred from a nonregulated affiliate to a utility, the utility must record the asset at the lower of market price or net book value. Except, a utility may record the asset at either market price or net book value if the utility maintains documentation to support and justify that such a transaction benefits regulated operations. An independent appraiser must verify the market value of a transferred asset with a net book value greater than \$1,000,000. If a utility charges less than market price, the utility must notify the Division of Economic Regulation in writing within 30 days of the transfer.

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

(4) Cost Allocation Principles.

(a) Utility accounting records must show whether each transaction involves a product or service that is regulated or nonregulated. A utility that identifies these transactions by the use of subaccounts meets the requirements of this paragraph.

(b) Direct costs shall be assigned to each non-tariffed service and product provided by the utility.

(c) Indirect costs shall be distributed to each non-tariffed service and product provided by the utility on a fully allocated cost basis. Except, a utility may distribute indirect costs on an incremental or market basis if the utility can demonstrate that its ratepayers will benefit. If a utility distributes indirect costs on less than a fully allocated basis, the utility must maintain documentation to support doing so.

(d) Each utility must maintain a listing of revenues and expenses for all non-tariffed products and services.

(5) Reporting Requirements. Each utility shall file information concerning its affiliates, affiliate transactions, and nonregulated activities on Form PSC/ECR/101 (3/04) which is incorporated by reference into Rule 25-6.135, F.A.C. Form PSC/ECR/101, entitled "Annual Report of Major Electric Utilities," may be obtained from the Commission's Division of Economic Regulation.

(6) Cost Allocation Manual. Each utility involved in affiliate transactions or in

nonregulated activities must maintain a Cost Allocation Manual (CAM). The CAM must be organized and indexed so that the information contained therein can be easily accessed.

Specific Authority 350.127(2), 366.05(1) FS. Law Implemented 350.115, 366.04(2)(a), (f), 366.041(1), 366.05(1), (2), (9), 366.06(1), 366.093(1) FS. History—New 12-27-94, Amended 12-11-00, 3-30-04.

FPL Transactions with Affiliated Companies - 2013
MFR Schedule C-30 (\$000)

Affiliate	Charges from FPL to Affiliate					Charges from Affiliate to FPL
	Direct Charges	Service Fees	Pole Attachments	AMF	Total	Direct Charges
NextEra Energy Resources, LLC	43,862	13,785		69,990	127,637	4,973
FPL Energy Services, Inc.	686			1,475	2,161	751
FPL FiberNet, LLC	1,856		1,179	2,790	5,825	6,304
NextEra Energy, Inc.	6,710			268	6,978	
Palms Insurance Company	6,232				6,232	10,161
Lone Star Transmission, LLC	362			814	1,176	
New Hampshire Transmission, LLC	343			91	434	
NextEra Energy Transmission, LLC				133	133	
Totals	60,051	13,785	1,179	75,561	150,576	22,189