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UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

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FEDERAL POWER
COMMISSION

Florida Power & Light Company

Docket No. E-9574
(Phase I and II)

INITIAL BRIEF OF CITIZEN INTERVENORS

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STATEMENT OF THE CASE

This proceeding considers the proposal of Florida Power and Light Company ("FPL") to acquire assets of the municipal electric system of the City of Vero Beach, Florida. The facts of the case are discussed in detail in the body of the brief. This statement shall briefly summarize the procedural setting and basic background.

Procedural History

The procedure was initiated on November 26, 1976 by an application filed by FPL, which sought an order from the Commission authorizing it to acquire the fixed assets of the Vero Beach electric system, pursuant to Section 203 of the Federal Power Act. The Application was noticed by the Commission on December 9, 1976. A timely protest, petition to intervene and motion to reject the application was filed by Messrs. John B. Dawson, Fred Gosset, and Eugene Lyon ("Citizens") on January 10, 1977. On that date, the Attorney for the City of Vero Beach filed a letter with the Commission in support of FPL.

By Order of February 7, 1977, the Commission granted intervention to Citizens 1/ and the City, denied Citizens' Motion to Reject and provided for a hearing.

The grant of intervention was followed by numerous pleadings relating to discovery and the scope of proceedings.

By Order of May 4, 1977, the Presiding Law Judge ruled on outstanding discovery matters, and established the scope of the proceedings. The Presiding Law Judge stated that the hearing would encompass three phases. The first phase, in essence, would consider the effect of the acquisition on FPL. The second would consider its effect on the Citizens of Vero Beach. The third would consider its effect on the public interest, including allegations of anticompetitive conduct by FPL and alternatives (to the transaction) that might be available to the City.

Hearings on Phases I-II began in Washington on June 27, 1977 and concluded on July 12, 1977. These proceedings include the case made by the Applicant, and its supporter Vero Beach, on behalf of the application. 2/

1/ Mr. Gosset was subsequently granted permission to withdraw from the intervention.

2/ See, e.g., Phase III Hearing, Tr. Vol. 5, page 430.
[Footnote continued on following page.]

Phase III of the hearing was scheduled to begin on August 22, 1977, and prepared testimony was filed on August 5, 1977 by Staff and Citizens. The onset of the hearing, however, was delayed by FPL's repeated requests for a limitation of the scope of the proceeding 1/ and an extension of time to prepare for trial.

Statements from Vero Beach citizens were taken in Florida on September 28, 1977.

Phase III began on November 1, 1977. On that date the Presiding Law Judge, essentially sua sponte, suggested that Phase III be deferred while the parties brief the record in Phases I-II. Citizens specifically requested that a consideration of alternatives available to the City be included in the Phase I-II record. The Judge, however, ruled that the presentation of evidence on alternatives and allegations of anticompetitive conduct shall be deferred until Phase III -- if that Phase is needed. 2/

The Background of the Transaction

FPL is the largest utility in Florida, and one of the largest in the country. It operates in 35 counties in Florida, providing service to over 1,800,000 customers in approximately 650 communities. Its 1976 operating revenues were approximately 1.189 billion dollars on sales of approximately 35 billion kilowatt hours. In January, 1977 it experienced an all-time high peak load of 8606 Mw. 3/

2/ [Footnote continued from preceding page.]

Prepared testimony on behalf of the Company's case was presented by officials involved in the negotiations of the transaction for FPL-Messrs. Ralph Mullholland, J.L. Howard and J.K. Daniel. Prepared testimony on behalf of the City was presented by Mr. John Little and Mr. Thomas Nason. Staff testimony was presented by Mr. Wilbur Early and James M. Brown. In addition to the testimony and examination of the above witnesses, Intervenors called on Mr. Floyd C. Wallace (a Vero Beach consultant), Mr. Marshall McDonald (FPL Chief Executive Officer), and Thomas Jones (of Ernst and Ernst), Mr. David Gregg, Jr. (City Councilman).

1/ FPL essentially sought to eliminate Citizens' participation in Phase III and to limit the consideration of FPL's anticompetitive conduct.

2/ The Judge made clear that his suggestion for briefing of Phase I-II was not intended to modify prior rulings on the scope of, and need for, Phase III. (See, e.g., Phase III Hearings, vol. 6 Tr. 490-491.)

3/ The above information is taken from Citizens' Exhibit 37. (FPL 1976 Form 10-K Report to the Securities and Exchange Commission.)

FPL has benefited from a generation mix that includes substantial access to relatively low cost nuclear power and natural gas. In 1976 it generated 53% of its power on residual oil, 22% on natural gas, and 23% on nuclear fuel. The average cost of generation, in mills per kwh, was 18.54 for residual oil, 7.15 for natural gas, and 2.05 for nuclear fuel. (Citizens Ex 37, p. 3)

FPL is interconnected with the Vero Beach electric system. FPL's service territory completely surrounds Vero Beach and FPL's transmission provides Vero Beach's only means of access to entities beyond FPL.

The Vero Beach electric system provides service in and around the City of Vero Beach. The City's system serves approximately 13,000 residential customers, 2200 commercial customers, and 2 industrial customers, with an installed capacity of approximately 118 Mw. In 1977, the City expected to produce approximately 300,000,000 kwhrs. 1/

The City's decision to sell the system originated sometime in 1974. 2/ The decision originated in a growing gap between rates charged by Vero Beach and FPL. Vero Beach's transmission and distribution costs have, on a mills per kwh basis, consistently been below FPL's. This gap related primarily to Vero Beach's higher cost of generation, and, specifically, to the differences in FPL's and Vero Beach's access to cheap fuel supply. 3/

Vero Beach, unlike FPL, has no access to nuclear generated power. In addition, while FPL's natural gas deliveries were proceeding without curtailment, 4/ Vero Beach encountered increasingly steep curtailments. By 1976, the City was receiving "virtually zero" gas, and expected to receive none in the future. 5/

1/ The above information appears in the testimony of John Little. (Tr. 365, et seq.)

2/ The precise time at which the City initially contemplate the sale is not clear. As discussed in Section IV, infra, this fact is of central relevance to an Internal Revenue Service Ruling related to the transaction.

3/ See Ernst and Ernst Report, FPL Application, Exhibit N, Schedule VI-1.

4/ FPL purchases its gas directly from producers in the field, and its contracts have not been subject to the operations of the Florida Gas Transmission curtailment plan. Vero Beach is a direct preferred interruptible customer of the Florida Gas pipeline.

5/ Tr. 375.

The City began negotiations with FPL for sale of the system in September, 1974. (No other potential buyers were solicited.) A proposal was presented to the City in early 1976. In September, 1976, the citizens voted, by a margin of over 2 to 1, to authorize the City council to proceed with the sale.

During the course of the negotiations, the City apparently did not rely on its long-term independent consulting firm (Black and Veatch) 1/ for assistance, and there was no formal study by an independent source of alternatives to the sale.

The Transaction

The proposed transaction would transfer essentially all the assets of the City system to FPL. 2/ The transaction was not based on any independent appraisal of the value of the assets to be transferred, as discussed more fully below.

1/ See, e.g., Tr. 593; 1096.

2/ The value of the proposal to the City (stated at approximately 42 million dollars) will differ from the price to be paid by the Company (approximately 36 million dollars). This difference relates, in part, to the retention by the city of certain cash assets and the discount FPL may achieve in securing the defeasance of electric system debt.

Summary of Argument

Section 203 of the Federal Power Act provides for the approval of the instant application upon showing that it is "consistent with the public interest." ^{1/} The Applicant bears the burden of showing that the public interest test can be met, and, as part of this burden, must provide a "full disclosure of all material facts." Pacific Power & Light Company v. FPC, 111 F.2d 1014, 1016 (9th Cir. 1940)

FP&L has failed to produce minimal evidence that benefits to its stockholders and ratepayers will outweigh the costs. The company acknowledges that there will be minimal, if any, gain in system-wide reliability, and that any economies to be obtained through the integration of the systems may be obtained by means other than sale. (Indeed, the Company was not able to provide specific plans for the use of the facilities to be acquired.) Moreover, the Company acknowledges that the acquisition will, at least in the short run, result in higher rates for its customers, and the dilution of earnings.

Against this backdrop, the Company offers only the opinion that in "the long run" the acquisition will make a "positive contribution." The opinion is not only unsupported by documentation, but, the Applicant failed to present minimally adequate data and analysis on its future rates and costs. Examination of Company witnesses revealed substantial contingencies which themselves are fatal and unexplored qualifications to the assertion of long-term benefits.

These contingencies, and the Company's testimony that there will be no detrimental effects on systemwide reliability from the sale, must be placed in the context of FP&L's October, 14, 1977 filing in Florida Power & Light Company, Docket No. ER 78-19. In that filing FP&L proposes to revoke its existing wholesale tariff, which makes wholesale power under the rate filed with this Commission generally available to municipal customers, such as Vero Beach. The Company states that it cannot generally undertake to serve new loads under its filed rates, and proposes to limit its filed wholesale service to customers presently receiving it. The assertion that FP&L cannot undertake to serve a large new load -- such as Vero Beach -- at wholesale, raises serious and unanswered questions about its ability to serve a large new load -- Vero Beach -- at retail.^{2/}

The record in Phase I-II shows that the measure of costs and benefits to Vero Beach's citizens and ratepayers remains speculative, and that, in any case, they would be obtained

^{1/} Section 203(a) reads, in part, "(A)fter notice and opportunity for hearing, if the Commission finds that the proposed disposition, consolidation, acquisition, or control will be consistent with the public interest, it shall approve the same."

^{2/} The Presiding Law Judge has stated that the record here takes notice of the filing. November 2, 1977 Hearing, Tr. 491.

at a price that does not represent a fair and objective appraisal of the public assets to be transferred. Moreover, there is no showing that alternatives to the proposal would not be more beneficial and less costly to the city.

The proposed sale is not merely not predicated on an independent appraisal of the worth of the assets to be transferred, but Company and city officials aver that the sale price cannot be related to any particular objective measure(s) of value. Instead, they claim that the price is reasonable because it represents a fair value arrived at through "arms' length" bargaining in the marketplace.

The record amply shows that the instant transaction is not an example of a free market bargain. In the City's view, the market was limited to one buyer, and perceived economic pressures created a strong desire to sell. These circumstances do not characterize the normal "market" transaction. Moreover, there is evidence that the City's freedom of negotiation was limited by the buyer's market dominance. First, the assumption that no wheeling was available apparently helped foreclose the entrance into the market of other potential buyers, whose mere presence could have stimulated FP&L to offer a more competitive price. Second, the buyer did not offer a separate price for the City's generation system. The record shows that the City's transmission and distribution system is more economic than FP&L's, and, at a minimum, it should have been able to pursue a bargain which retained these economies. Third, the City admittedly will not receive any consideration for substantial assets -- e.g., its natural gas entitlements and its grant of franchise rights. Fourth, the City did not even attempt to value its assets at reproduction cost -- the very measure of valuation insisted upon by the buyer in its most recent dealings in analogous circumstances. Citizens, in sum, cannot state what the fair price of the assets would be. The evidence, however, shows that it could not have been reasonably established solely by the bargaining between the City and FP&L.

The primary alleged benefit to the City relates to rate reductions that would be obtained if service were taken over by FP&L. The record shows that the analysis of this benefit was derived virtually totally with reference to cost and rate experience for the 1974-1976 period. City officials assumed that the experience of this period adequately anticipates the future. The record shows this assumption to be invalid. On the one hand, Vero Beach's access to cheap fuels may well improve without comparable improvement in FP&L's position. During the course of the hearing itself, Vero Beach experienced dramatic cost reductions without any comparable reductions in FP&L's costs. Indeed, the most recent rate comparison in the record shows that Vero Beach's

July 1977 bills should have been close to, and, in the case of industrial customers, below, comparable FP&L bills. On the other hand, the advantages that FP&L has reaped through nuclear power -- to which Vero Beach currently has no access -- may be diminished in the future. Examination of Company witnesses revealed substantial contingencies relating to FP&L's nuclear generation. In sum, the historical projections relied on and presented on behalf of the application are inadequate. The Company's failure to supplement the record with adequate projections requires the rejection of the application.

The record shows that the City failed to obtain the necessary analysis of alternatives available to it. While a full inquiry into alternatives has been deferred until Phase III, the record in Phases I-II shows that the City did not consider important alternatives and/or that they were precluded by the Company.

Finally, the City and the Company have failed to provide assurance that the transaction will not impair the City's credit. In a September 30, 1977 letter,^{1/} the Internal Revenue Service stated that the tax exempt status of the bonds will be subject to the provisos that (a) the sale of the system was not contemplated prior to June 1, 1974, and (b) that the City made a good faith effort to obtain fair value for the assets. As discussed in Sections IIA and IV, *infra*, the record shows that the burden of proof in regard to these provisos has not been met.

^{1/} Attached hereto as Appendix B. Citizens hereby move to lodge the letter into the Phase I-II record.

ARGUMENT

I. FP&L Has Failed to Show Benefits to it from the Proposal

Section 203(a) of the Federal Power Act places the burden of proof on an applicant proposing an acquisition. As stated in Pacific Power & Light Company v. Federal Power Commission, 111 F.2d 1014, 1017 (9th Cir. 1940), "(T)he Commission properly requires applicants to make a full disclosure of all material facts. The burden is on them of showing that the acquisition or merger is consistent with the public interest."

Here, FP&L has failed to show that the merger is even consistent with its own interest, much less the broader public interest. The record shows that the costs to FP&L outweigh the benefits. 1/

The Company simply did not present any documentation of benefits it might achieve through the acquisition. By the Company's admission, the acquisition will not significantly increase the reliability of the FP&L system. On the other hand, it will cause increased costs to ratepayers, at least in the short-run, and reduce the Company's level of earnings, at least in the short-term. Against clear near term detriments to ratepayers and stockholders, the Company holds out the prospect that in the "long term" the acquisition will make a "positive contribution." Not only did the Company fail to present support for this opinion, but, evidence developed on examination, revealed very substantial uncertainties in the Company's "long term" projections.

Finally, the Company's presentation here must be placed in the context of its recent wholesale rate and tariff filing in FP&L, Docket No. ER 78-19. In that filing, the Company states that it cannot take on new wholesale loads. The Company must be required to explain how it can take on a major new load at retail (Vero Beach), which, it states, could not reliably and economically be offered filed service at wholesale.

1/ In referring to "benefits" in the above discussion, Citizens do not include benefits that relate to the furtherance of monopoly power. The acquisition of a competitor might well be perceived as a benefit to FP&L. Indeed, the speculative nature of any other benefits to FP&L is so great, that the best explanation of the transaction -- from FP&L's vantage -- may lie in the motives of the monopolist.

I. A. The Company Made No Showing of Any Benefits Relating to the Acquisition

The Company made no showing -- other than sheer suggestion -- that benefits would accrue to it through the proposed acquisition. (It did not even attempt to show that the proposed purchase represented the most economical use of the funds available to it). Mr. Marshall McDonald, FP&L's President and Chief Executive Officer, was essentially unfamiliar with the terms of the agreement and their derivation. He relied, in recommending sale to the Directors, totally on Mr. Ralph Mulholland, the head of the FP&L negotiating team. Mr. Mulholland did not testify on benefits FP&L might receive. Only Mr. J.L. Howard, an FP&L financial officer and member of FP&L's negotiating team, testified on the prospective cost and benefits of the transaction to FP&L. Mr. Howard, however, acknowledged that, in the short-term, the transaction would be detrimental to FP&L's other customers and stockholders. He offered only a vague suggestion of a "positive contribution" in the "long run" without supporting evidence. As discussed in Section II B, infra, however, the Company not only declined to present (or did not have) evidence on future costs and rates, but declined to do so even when examination revealed contingencies that could undeniably have substantial effect on reliability and economy. Thus, Mr. Howard's speculation is wholly unacceptable.

Mr. Marshall McDonald, FPL chief Executive Officer, stated that he was not familiar with any "appraisals, evaluations," or "studies of benefits expected to be received by Florida Power & Light." (Tr. 854) Mr. McDonald stated that he did not know whether the acquisition would affect FPL's, credit rating, or whether it would decrease the rates to FPL's customers, and could not identify any financial benefits that would flow to customers as a result of the acquisition. (Tr. 873-874) 1/

Mr. McDonald stated that his recommendation to the Board of Directors (to proceed with the transaction) was based entirely on the recommendations made to him by Mr. Mulholland, the individual in charge of negotiations for the Company. Mr. McDonald stated that it is in the best interests of FPL to acquire the Vero Beach system because this was the conclusion arrived at by Mr. Mulholland. Mr. McDonald stated that he transmitted the substance of Mr. Mulholland's recommendations to the Board, but was not able, upon cross-examination, to "recall the specifics". (Tr. 891) It was stated that communications between the two were oral, and no documentation of Mr. Mulholland's recommendation was provided. (Tr.1283-1284)

1/ Mr. McDonald did suggest that, insofar as additional generation were added, reliability might be increased---since increased generation is related to increased reliability. (Tr. 872) As discussed in section IC, however, there are no claims to substantial reliability related benefits. Moreover, as discussed in section IE, FPL's recent filing in Docket ER78-19 calls into question testimony here that any reliability effects will be minimal.

Mr. Mulholland---the man who would know---did not offer testimony on the benefits (and/or costs) to FPL of the acquisition. Indeed, Mr. Mulholland's direct testimony (Tr. 38-49), is curiously devoid of reference to effects of the proposal on FPL itself. Thus, Mr. Mulholland speculated on the effect of the sale on the City and its employees (Tr. 44), on rates FPL would charge to Vero Beach's current customers (Tr. 45), and on jurisdictions surrounding Vero Beach. (Tr. 45) Nowhere did the man said to be most familiar with the benefits to FPL suggest what these benefits would be. 1/

Mr. Howard did provide a hint of what FPL viewed as a benefit of the transaction to its system. In his prepared testimony, Mr. Howard stated that, with regard to the effect on FPL stockholders:

"We expect that the initial earnings from this investment will be below the levels of FPL's other operation, which is common in the initial years of most investments. However, because of the size of the investment, the impact on FPL's total earnings will be negligible. Over the long run, we feel that the growth potential of this area should be sufficient to ultimately make a positive contribution to FPL's total earnings." (Tr. 56)

Thus, Mr. Howard's testimony forecasted near term costs to stockholders, while only suggesting the long term possibility of a "positive contribution" to earnings. No evidence was offered by FPL to support the claim of long term gain.

Under cross-examination, Mr. Howard did suggest that, in addition to the "long term" benefits cited in his direct testimony, primary benefits to FPL would be improvements in FPL's service to the FPL service territories contiguous to Vero Beach. 2/ (Tr. 1206-1207) As discussed at IC infra, however, not only was there general agreement that any reliability related benefits to the FPL system were marginal, but the record does not show that current service to the territory surrounding Vero Beach is unreliable. 3/ Finally, Mr. Howard explained that a primary benefit would be the acquisition of a well operating self-sustaining system":

1/ To be sure, Mr. Mulholland prefaced his testimony by the statement that "...I will describe the impact on Florida Power & Light Company's sales and revenues if Vero Beach's system were part of the Company's operations." (Tr. 38) The only question and answer set that remotely relates to this promised description appears at the top of Tr. 46. There Mr. Mulholland states that the size of the acquisition will not alter FPL's ranking (by size) in industry trade journals.

2/ As discussed infra, cross-examination also revealed near-term costs to current FPL ratepayers that were not identified in the direct presentation.

3/ Or, at least, significantly less reliable than service elsewhere on the FPL system.

"...the fact [that] Vero Beach is a self-sustaining system, it appears to be well built and capable of allowing growth without substantial additional investment." (Tr. 1207)

In short, FPL would benefit because it is purchasing a system whose operations and potential are already satisfactory.

I. B. There Is No Showing That Acquisition is Necessary to Produce the Most Efficient Use of the Assets to the Benefit of FPL and/or Vero Beach Customers.

In theory, the proposed acquisition might be of benefit to both FPL and Vero Beach because the FPL system could be able to operate the existing Vero Beach assets more efficiently than they could be operated by Vero Beach itself. This development could occur if either (or both) a) the municipal electric department were not capable of efficient management b) the acquisition could permit benefits through economies of scale that could not otherwise be obtained. The record shows that the sale is not based on the first consideration. The Vero Beach City management has received high marks for the daily operation of its electric system. There is suggestion that the Vero Beach units could be more efficiently used if they were "integrated" into the FPL system. FPL, however, has provided no specific plans for the use of these assets, much less specific measures of the benefits to be obtained. More importantly, there is no showing that any benefits of "integration" could not be obtained by means short of the sale of the system. On the contrary, there appears to be agreement that there are no technical obstacles to the achievement of efficiencies by means other than the sale of the system.

While Company officials generally stated that the Vero Beach system would be "integrated" into the FPL system, the details of "integration" were subjects of speculation, and the speculators neither foresaw substantial benefits to FPL, nor the development of economies that could not be otherwise obtained.

Company officials admitted that the management FPL would provide would not be inherently more capable than the management supplied by the City. As Mr. Mulholland stated, "I believe the Vero Beach system will not be operated any more efficiently than the Vero Beach City Manager and the employees have operated it prior to the Acquisition. I don't think there would be that much difference between who was operating it as a system." (Tr. 271) Mr. Mulholland further stated that FPL will not obtain any economies of scale from the acquisition (Tr. 269), and that he knew of no engineering benefits that FPL would realize. (Tr. 270)

FPL officials indicated that no major alterations of the Vero Beach system were contemplated, and indeed, the purchase is attractive because the system is a well functioning unit. ^{1/} As Mr. Daniel summarized, "[T]he Company intends to continue to operate the Vero Beach system in a manner similar to the City's present operations." (Tr. 62) As noted previously, Mr. Howard volunteered that the investment was attractive because, "Vero Beach is a self-sustaining system, it appears to be well-built and be capable of allowing growth without substantial additional investment." (Tr. 1207_)

Indeed, not only did Mr. Howard attest to the adequacy of the current Vero Beach system, but Mr. Mulholland suggested that prospects for its future usefulness---when integrated with FPL---appeared to be "rosy." Mr. Mulholland was asked whether current employees of the municipal electric system might be required to relocate. (After the expiration of the two-year guarantee of continued local employment.) He explained that relocation would be necessary only for employees involved in the operation of the Vero Beach generating system, and that, "two years from now I have no idea what the conditions will be, what the economy will be, or anything else." (Tr. 266) With this qualification, Mr. Mulholland volunteered that Vero Beach generation should not be closed down. "Those people have not had any problem. And it is my prediction that two years from now the economy is going to pick up, there will be new starts, new construction, new homes. And I think the crystal ball looks pretty rosy." (Tr. 268)

To the extent that economies result from the transaction, they would relate to the fact that the Vero Beach units would be subject to central dispatch, along with other FPL units and power purchase arrangements. While FPL officials testified that central dispatch was intended, no specific plans or measures of benefit were produced. More importantly, it was conceded that the proposed transaction is not necessary to obtain the benefits of central dispatch.

FPL witnesses provided only formulaic speculation on the implications of central dispatch. As Mr. Howard stated, for

^{1/} Mr. Daniel stated that some changes in distribution network might be required, to synchronize FPL and Vero Beach systems, (Tr. 63) In addition, the Company would replace certain 13 kv lines with 69 kv lines. (Tr. 62-63) As Mr. Daniel noted, however, the City itself has considered the conversion (Tr. 62) and it does not require the sale of the system.

example, the Vero Beach units "would be operated on the basis of economics. How they would operate under our system versus Vero would be difficult to tell until they were fully integrated." (Tr. 160) Mr. Mulholland, similarly, could not respond to the question, "[W]ill the units be run any differently under the ownership of FPL than they are now presently operated?" (Tr. 219) 1/

While FPL officials indicated that the Vero Beach units would be utilized in the near future, the length of their use, and the manner of use, are clearly not settled. Mr. Howard, for example, stated that his financial projections did not assume any particular date for the retirement of the Vero Beach plant, (Tr. 163-164), and that no decision had been reached regarding the retirement and salvage of the diesel units. (Tr. 136) Mr. Mulholland stated that no plan has been prepared by FPL for the use of Vero Beach generating equipment, "Nor is any program worked out as to when we will not use it." (Tr. 1310) As Mr. Daniel summarized, "I believe you will find the record reflects we do not have any definitive plans as to the generation, other than after the acquisition the generation in the Vero Beach system would be controlled as if it were integrated into the FP&L system."; (Tr. 1366) (See also Tr. 314)

Whatever benefits might--or might not---accrue from "integration" there is no evidence that these benefits could not, at least as a technical matter, be obtained without the sale. Mr. Daniel, the FPL engineering witness, responded that "it is probably technically feasible", when asked whether the "systems of FPL and Vero Beach could operate on the same integrated basis even if Vero Beach continued to own its own system." (Tr. 1367)

In conclusion, if there are any economic benefits to FPL from the acquisition of the Vero Beach system, the Company has not presented them to the Commission, in any supported fashion, and, apparently, has not undertaken to study or quantify them.

If the information and plans are minimal, why, it must be asked, does the Company appear so sanguine about its investment? There would appear to be two possible answers. First, the Company has undertaken the investment to eliminate a potential competitor. In this context, a transaction that on the surface, is devoid of compelling economic justification, may contain latent benefits to the acquiring party. Should Phase III be required, Citizens would seek to show that the transaction,

1/ Mr. Merriman indicated that Mr. Daniel could respond to this type of question. (Tr. 220) As discussed above, however, Mr. Daniel simply reiterated the general assertion made by Mr. Howard.

from FPL's perspective, is best explained by reference to its motives as a monopolist. Second, the record shows that, by FPL's admission, the Vero Beach system is a well run and "self-sustaining system" that can sustain growth without additional investment, (Tr. 1207) and, indeed, whose prospects might appear to be "rosy." (Tr. 268) If these assertions are correct they may prove too much. They indicate that considerable value must be attached to the future prospects for the system, and that the City is as well-equipped to realize these prospects as the Company.

I. C. There Is No Evidence that the Acquisition Will Significantly Increase the Reliability of the FPL System.

The record shows that the effect of the acquisition on the reliability of the FPL system is not quantifiable, and is likely to be marginal. There is no evidence that any necessary and significant improvements in reliability could not be obtained in the absence of the transaction. As discussed in Section I E, however, FPL's recent wholesale rate filing provides strong evidence that, the testimony here notwithstanding, the acquisition may raise substantial reliability problems.

Company witnesses said that the acquisition might--but would not necessarily---increase the reliability on the FPL system. Thus, Mr. Howard provided the following response to the question of whether or not the FPL system would be "a little bit more reliable" following the sale:

I think under the circumstances we would have to say 'not necessarily.' We are interconnected with them now, and through an interconnection exchange of dispatching level [sic] we have an opportunity to work with each other whether we own all of it or do not own all of it. So the same facilities are available. And that is what you mean by 'reliable,' I assume. (Tr. 256)

Similarly, Mr. Mulholland stated that the proposed acquisition would essentially have no effect on the reliability of FPL's system:

...you are talking of a small amount of generation. If you are trying to say that by that small amount of generation, mixed in with a truly large system you have increased reliability, I think you are stretching a point.

I said if there is more generating capability than they need, then I accept the fact that the system does have a little more generation. But it is too minute to have great bearing, I think. (Tr. 269)

The Company's position was affirmed by Staff Witness Brown, who testified that he knew of "no quantifiable benefits" to FPL's customers through the acquisition. (Tr. 1009)

Mr. Daniel, echoed by Mr. Howard (Tr. 63; Tr. 1376-77; Tr. 1205-1207) did suggest that the acquisition would increase the reliability of service to FPL customers on the "fringe" of the current Vero Beach service territory. Examination of Mr. Daniel, however, revealed that the potential benefits, if any, are wholly speculative. Mr. Daniel stated that a) the Company had hitherto not studied the need to increase reliability in the "fringe" area; b) that the Company had no studies of the costs involved; c) that he could not quantify the numbers of customers involved, or the specific geographic area at issue (Tr. 1376-77)

In short, Mr. Daniel did not state that the current degree of reliability in the "fringe" area is inadequate. "All I have said," Mr. Daniel summarized, "is that this [the proposed acquisition] would provide a chance to enhance that reliability." (Tr. 1376)

In sum, the Company does not show that the acquisition will bring any significant and measurable increase in reliability to the FPL system. As discussed in Section IE, *infra*, however, the Company's recent filing in Docket No. ER78-19 provides strong new evidence that the Company cannot take on new loads, and that the acquisition of the Vero Beach load might have significant detrimental effects on system reliability.

I. D. The Transaction Would Admittedly Work to the Short-Term Detriment of FPL's Customers and Stockholders, With Benefits Being Speculative in the Long Term.

The only reasonably quantifiable effects of the acquisition on FPL offered by FPL officials would be detrimental. Specifically, the acquisition of the Vero Beach load would a) increase average fuel costs, and thereby increase the fuel adjustment to all FPL customers, and b) reduce the average return to stockholders.

Mr. Howard stated that in the "long run" the investment would make a "positive contribution to total earnings." However, no analytical support for this assertion was provided. Moreover, as discussed elsewhere^{1/}, the Company did not volunteer studies or analyses of future operations.

Mr. Howard testified that FP&L expects "that initial earnings from this investment will be below the levels of FPL's other operations..." (Tr. 56) ^{2/} The acquisition will result in some increase in the fuel adjustment charge to FPL's customers, (Tr. 199). Mr. Howard characterized the magnitude of this additional charge as "negligible." (Tr. 200) The Company's recent filing in Docket ER78-19, however, places this additional cost at 5 million dollars annually.^{3/}

In addition, the acquisition of the Vero Beach load would ultimately contribute to a need for additional generation. (Tr. 199) In Mr. Howard's opinion the capital costs required would not, in the longer run, require an overall increase in FPL's base rates. (Tr. 201-202) This opinion, however, was heavily qualified (Tr. 202), and not based on "specific numbers." (Tr. 202) ^{4/}

In sum, according to Company witnesses, the most substantial benefit, if it can be called that, of the acquisition to FPL is the prospect that at some time in the future the Company will begin to earn a return on its investment commensurate with the return earned on other properties. This prospect,

^{1/} See, Section IIB.

^{2/} Citizens Exhibit 3 appears to be the only record evidence relating to FPL's future revenue projections. It is discussed at Tr. 131-136. It shows, at page 3 that FPL's actual investment in 1976 is significantly greater than the return of the investment to FPL in 1976. This study was not presented by FPL on its behalf. It was prepared by a member of Mr. Howard's staff in August, 1976, after FPL made its proposal to the City. The Company did not provide any data underlying the analysis assumptions on load growth and rate levels and structure. Indeed, as discussed in Section IIB, the Company continually declined to provide future projections and/or emphasized their speculative nature.

^{3/} FPL filing in Docket ER78-19, Volume V, Section 4-201

^{4/} At Tr. 201-202 Staff Counsel Rogers sought to ask Mr. Howard whether FPL's incremental cost of serving a new load (Vero Beach) would result in higher base rates for present customers. Mr. Howard stated it would not. He explained that additional capacity (built to serve new or growing loads) would be coal or nuclear---replacing high priced oil. Mr. Rogers then asked whether the high capacity load of new coal or nuclear units might offset any savings related to the replacement of oil. Mr. Howard replied that, "[I]t may or may not," and that he had not "quantified" the relationships.

however, is wholly speculative. As discussed at IIB the Company did not produce evidence (other than several expressions of opinion by witnesses) about FPL's future rates and rate structure. The speculative benefits must be weighed against the certainty of near term costs that are millions of dollars to customers alone, and that are the only clear consequences of the acquisition to FPL.

I. E. FPL's Recent Wholesale Rate Filing Presents New Evidence That the Transaction is Detrimental to FPL's Ability to Render Reliable Service and May be Contrary to the Interests of Both FPL and Vero Beach Customers.

On October 14, 1977 FPL filed new wholesale rates and tariffs with this Commission in Docket No. ER78-19. 1/ FPL's filing is a stark assertion that the acquisition of new loads will be detrimental to its operations. It raises the most serious questions about FPL's ability to acquire the new Vero Beach load. The testimony and evidence in this proceeding does not address the questions directly, but does appear to be severely inconsistent with the filing. In addition, the filing further shows that a) the proposed transaction is fatally deficient because it is not based on distinct consideration of the value of Vero Beach's generation b) both FPL and Vero Beach customers may be better off if the Vero Beach system retains its corporate identity.

1. The filing undercuts testimony and evidence that the acquisition will have no harmful effect on the efficiency and economy of FPL's operations.

FPL's existing wholesale tariff makes service generally available to municipal and cooperative electric systems-- including, presumably, Vero Beach.2/ FPL's proposed tariff, however, would revoke the general availability of wholesale service, and make such service available only to those customers now taking such service. 3/

1/ The Presiding Law Judge ruled that the record in this proceeding takes notice of the filing. November 2, 1977 hearing, Tr. 491.

2/ But see footnote 1, page 57, infra.

3/ Except that, in addition, FPL proposed to terminate wholesale service to the City of Homestead.

As stated in the prepared testimony of Mr. John J. Hudiburg, FPL Executive Vice President:

Due to the rapidly increasing demands of our present customers and the uncertainty that we will be able to construct sufficient capacity to supply all these demands, the Company is unable to make service under our Electric Tariff available to sales for resale customers other than those we presently serve. If there are other entities that request service from us, we will be happy to discuss the feasibility of our serving them at that time under specific contract rates and terms, if the conditions present on our system then made it possible for us to supply them without jeopardizing service to our other customers. Prepared testimony, at 8 (Docket No. ER78-19)

As discussed in Section I C, supra, the Company testified that the proposed acquisition will have no detrimental effect on FPL's system reliability. While, as discussed in Section IB, supra the Company's plans for use of generation were highly ambiguous, there was suggestion that the units would be placed on "cold standby" or used for peaking. (See, e.g. Tr. 161)^{1/} If the units are to be used on a standby or peaking basis then FPL would be relying heavily on its existing capacity to serve the Vero Beach load. The filing in Docket ER78-19, however states that FPL does not have adequate capacity to serve large new loads.

Can FPL reliably and economically serve a new load at retail---Vero Beach---that, it now says, it cannot serve at wholesale? The testimony and evidence presented by Company officials, provides, at best, no evidence that it can.

As discussed in Section IIB the analysis underlying the sale relates entirely to an historical test period. Cross examination revealed the existence of future developments, discussed at Section IIB, that might substantially impair the efficiency and economy of the Company's operations. The Company, as discussed in Section IIB, did not have or declined to produce adequate analysis on the contingencies and their

^{1/} The filing may belie this suggestion. As stated in Section I D, supra, the filing includes \$5 million in additional costs related to fuel for the Vero Beach system. This magnitude of additional costs suggests considerable reliance on Vero Beach generation.

implication, preferring to treat them as purely speculative. The filing in Docket No. ER 78-19 shows that the Company takes these contingencies quite seriously. As a predicate to approval of the application, the Commission must place the testimony in this proceeding in the context of the filing in Docket No. ER78-19.

While Company officials in this Docket were hesitant to speculate on costs and changes in the Company's fuel mix, the filing in Docket No. ER78-19 shows that problems are substantial and that the historical data presented on behalf of the application is not adequate. Mr. Hudiburg, for example, not only reaffirmed the Company's continued difficulties with nuclear power, but suggested a fundamental shift in its planning strategy:

In 1977, FPL initiated steps to cancel two proposed nuclear units originally planned for the South Dade site. The units were cancelled because of the uncertainties associated with the licensing and fuel cycle of nuclear units. FPL's plans now call for coal burning units to meet generation needs in the mid-1980's. Hudiburg, prepared testimony at 4. (Docket No. ER78-19)

The filing in Docket No. ER78-19 not merely shows that the acquisition of a major new load by FPL must be questioned. It also a) provides further evidence that the proposed terms do not adequately consider the value of the generation to be transferred and b) actively supports the proposition that both FPL and Vero Beach's customers may in fact be best served if the Vero Beach system is preserved as a distinct corporate entity.

I.2. The filing shows that Vero Beach's generation is of substantial value to FPL.

Mr. Mulholland testified that the Company did not offer, and the City apparently did not ask for a separate price (or proposal) relating to Vero Beach's generation.^{1/} As discussed in Section IIB, the recent disparity in costs between FPL and Vero Beach is caused by the City's higher costs of generation, and primarily by the City's higher fuel costs. At minimum, therefore, the City should have considered a bargain by which the generating units were sold, but the City retained the economies of its transmission and distribution system. In refusing to even consider such a deal, the negotiators implied that the generation was of no significant

^{1/} Tr. 1308.

value to FPL. The filing in Docket No. ER78-19, however, shows that the Vero Beach generation should be of substantial value to FPL. Indeed, Company witnesses in this proceeding suggested that, in the near-term, the units were to be placed on "cold standby" (Tr. 161) The filing includes \$5 million for additional fuel costs related to the operation of the Vero Beach units.

In sum, the filing shows that FPL will rely substantially on the Vero Beach generation. The citizens of Vero Beach are entitled to a clear statement of the value of this generation to FPL.

- I. 3. The filing in ER 78-19 suggests that customers of Vero Beach and FPL may be better off if the City system retains its corporate identity.

The filing in Docket ER78-19 appears to be an assertion that FPL is facing serious difficulties relating to capacity. The integration of Vero Beach's generation into the FPL system should alleviate this problem. However, the record here shows that such integration does not require the transaction proposed here (Tr. 1367), and indeed, that central dispatching of FPL and Vero Beach units would not require significant additional costs. (Tr. 316)

Thus, the benefits of Vero Beach's additional capacity could be achieved without the transaction." 1/

If the transaction does occur, however, FPL's customers (including those now served by Vero Beach) will lose a source of lower-cost capital that FPL could employ to finance needed additional construction.

As Mr. Hudinburg's prepared testimony in Docket No. ER78-19 states, the Company's future is clouded by the problem of raising the large sums of capital needed to finance additions to capacity. "Florida Power & Light Company must meet these higher costs of capital at a time when our operations are subject to severe economic pressure and rapid inflation." (Hudinburg, prepared testimony, at 6)

1/ These benefits, of course, would flow to both FPL and Vero Beach customers, since FPL would recompense Vero Beach for the use of excess capacity.

As Mr. Howard acknowledged, Vero Beach, as a municipal system, could provide capital at a lower cost than such capital would be available to FPL (Tr. 127). If Vero Beach were acquired, the opportunity for FPL's customers to benefit from Vero Beach's lower costs (eg., through joint ventures) will be lost. 1/ The acquisition of Vero Beach would deprive FPL's customers of a potential aid in achieving their best overall interest.

CONCLUSION

The Applicant here has failed to meet its burden of proof. It has no more than hinted at proposed benefits to it of the transaction. These benefits are not only "long term" and speculative, but not even supported by minimally credible speculation. By contrast, the record shows admitted and measurable short-term detriments to the Company's customers.

The record further shows that any gains in economy, or reliability to FPC may be achieved independently of the proposed transaction. Moreover, FPL's filing in Docket No. ER78-19 implies that the record here seriously understates the detriments to FPL's customers that might result from the acquisition, and suggests that the customers of both FPL and Vero Beach could be better off from the retention of Vero Beach as an independent electric system.

1/ In testimony, before the Florida Public Service Commission in Docket No. 760727-EU (CR), on behalf of a proposed rate increase, FPL Vice President Robert Gardner stated that FPL's recent decision to cancel its South Dade nuclear unit was based, inter alia, on the potential financing costs and difficulties. Mr. Gardner stated that the decision to cancel was not "in the best overall interests of the customers because we think that it is going to result in higher generation costs in the long run, while it may be some savings to customers immediately..." (Tr. 2790)

II. There Has Been No Showing that the Potential Benefits to the Citizens Outweigh the Potential Costs

As the citizens hearing in Vero Beach made plain, the primary concern of the Vero Beach citizenry, in approving the sale of the system, is economics. ^{1/} The record shows that the basic information and analysis necessary to a fair evaluation of the worth of the City's assets and the savings that might accrue from the sale were not developed. The record does contain significant evidence that the City undervalued its assets and overestimated the benefits of service by FPL. (Moreover, as discussed in Section I-B, *supra*, the record indicates that any economies to be obtained through the integration of the Vero System with FPL's do not, at least from the technical standpoint, require the Vero Beach system to be acquired by FPL.)

The record shows that the City officials did not call upon independent expert advice to advise on central questions of cost and benefit to the city. No engineering and/or economic expertise was called upon to study the alternatives available to the city. No independent source was called upon to appraise the worth of the system, assuming it were to be sold.

An appraisal of the system's worth is essential. Company and City officials continually averred that the sale price is not based on any quantifiable measures or any set of assumptions, but rather on the "business judgment" of Company and City officials. The record, however, shows that this is not an arm's length transaction. Indeed, the alternative that is clearly most attractive to the city -- sale of the generation plant -- was not even offered by FPL. Moreover, the proposal admittedly does not include consideration for valuable assets which the city is transferring. In sum, the call for an independent appraisal is not an assertion of abstract right, but based on the evidence that there is high questionability to a transaction which, admittedly, cannot be explained by objective criteria.

There is little dispute that the primary concern of those citizens who favor the sale is economics. The most obvious measure of this concern is any disparity between the rates (and underlying costs) on the Vero Beach system and FPL. This disparity depends upon two variable factors -- namely (1) the costs of operating the FPL system (and related rates) and (2) the costs of operating the

^{1/} See generally, testimony of Vero Beach Citizens, at September 28, 1977 hearing in Vero Beach.

Vero Beach system (and related rates).

Phases I and II show that, in regard to both variables, the decision to sell was based on inadequate analysis and data, and erroneous assumptions.

First, the record shows that the City did not adequately analyze the prospective costs and rates of service under FPL. The City officials did not ask for and the Company did not volunteer minimally adequate information on the future costs of service on the FPL system. Examination at the hearing revealed contingencies that may substantially effect the reliability and economy of FPL's service.

Second, the City erroneously assumed that, in the future, any cost changes in its system would be paralleled by changes in the FPL system. The record shows (1) that Vero Beach's costs have decreased substantially without alteration in FPL's costs; and (2) that FPL's costs may increase substantially without change in Vero Beach's.

Third, the City did not consider alternative means (to a sale) of reducing the rate differential between the FPL system and the Vero Beach system. As Citizens would show in Phase III, the City did not present to the voters and/or did not consider, several important alternative means of reducing its costs. Even in the absence of Phase III testimony, however, the record in Phase I-II shows that (1) the vote of the Citizens was based on an admitted failure to consider certain alternatives and (2) the preclusion of other alternatives because, apparently, the Company would not make them available.

II. A. The Public Interest Requires an Independent Appraisal of the Assets to be Sold

The proposed sale of the Vero Beach municipal electric system would take place without any independent appraisal of the value of the assets to be sold. Moreover, both buyer and seller insist that there is no objective formula or method which would produce the sale terms arrived, nor is there any relationship between these terms and the value of any particular assets to be transferred.

Buyer and seller would claim that no independent measure of the system's value is necessary because the final terms represent the best judgement, however undefineable the criteria, of the willing buyer and the willing seller. Thus, it is contended, the transaction embodies the classic determination of fair market price. No further measure of this

price is necessary or possible.

The efforts to shield the transaction from independent scrutiny -- to cloak all judgment, or lack thereof -- behind the willing buyer/willing seller rationale is both strange and unacceptable.

The record in this proceeding shows that the claim that an appraisal is necessary is not mere sound and fury without substance. The record shows that this was not a typical "arm's length" transaction. The City itself asserts that there was no "market" for the system -- except for FPL. The proposed price admittedly is not related to any traditional methods of valuation, and some traditional methods were not even considered. The City's key asset -- its generating plant -- was not even separately valued. Other basic items to be transferred -- the City's grant of franchise and its natural gas contract -- are to be given away for no value.

II. 1. The Right of Appraisal is a Recognized Adjunct of Merger/Acquisition Transactions

If, as City officials contend, the transaction is a classic businessman's bargain -- to meet the classic business end of greater economy -- than the public interest requires that citizens be afforded the minimal rights that are accorded in business settings. If the assets to be transferred were corporate, the law would require an appraisal at the request of individual stockholders.

The right of appraisal is commonly accorded to stockholders who question transactions entered into by corporations. ^{1/} While this right may well be exercised to the ultimate benefit of the majority -- where, as here, the transaction terms are clearly questionable -- it is explicitly accorded as a right that may be exercised by those in the minority.

Florida law expressly provides dissenting stockholders with appraisal rights. Section 607.247 Florida Statutes ^{2/} provides that dissenting shareholders may request payment of "fair value" for their shares. The corporation shall respond to this request by submitting its determination of "fair value", including supporting

^{1/} See, e.g., Valuation of Dissenters' Stock Under Appraisal Statutes, 79 Harv. L. Rev. 1453.

^{2/} Attached hereto as Appendix A.

information. Should the shareholder disagree with this determination, a court determination of "fair value" -- including, if the court elects, the appointment of appraisers -- may be had.

There is no reason in public policy why the right to an independent determination of fair value should not exist where the assets being sold are proprietary assets owned by the public. The public interest in such a right is especially strong where, as here, the sale is cloaked as a businessman's market transaction -- in the absence of a freely functioning market.

II. 2. The Proposed Transaction Is Not an Arms' Length Determination that Itself Embodies Fair Market Value

Company and City officials continually resisted any effort to pin the terms of the transaction to any specific formula or criteria. While some valuation methods were employed, the final price -- by Company and City testimony -- does not relate to any of these analyses. (See, e.g., Tr. 56; 166; 402-404). ^{1/} Instead, the assertion was made that the transaction was simply the end result of an "arms' length" negotiation process. (See, e.g., Tr. 56). Indeed, Mr. Little appears to have stated that the "value" of the Vero Beach system is unknown:

Q. Mr. Little, who eventually determined the value of the system of Vero Beach, and the price Vero Beach would accept for the sale of that system?

A. The \$42.6 million represented as the value of the transaction to the people of Vero Beach was arrived at through the process of negotiation, Mr. Spiegel, and mutually agreed to.

Q. It being the highest price you could obtain from Florida Power and Light, you decided therefore that was the value of the system?

A. As in any negotiation you make a judgment of whether you have gotten, to use a colloquialism, all the blood of the turnip or not. And it was our judgment we had done exactly that.

^{1/} See, e.g., Mr. Howard's statements that none of the analyses performed "tied" to the \$42 million value of the City (Tr. 199), and that there was no intentional relation between FP&L's purchase payment and the calculation of depreciated original cost value (Tr. 100), to which it appears to equate.

Q. Who determined whether that price was equal to the value of the system?

A. I don't know that a determination of that nature was made. 1/

It is well-established, as Company and City officials strenuously contend, that a market transaction may itself be a satisfactory measure of the value of the item being transferred. It should be equally clear, however, that where market value is relied on, there must be a freely functioning market. See, e.g., Sporborg, et al. v. City Specialty Stores, Inc., 123 A. 2d 121, (Court of Chancery of Delaware, 1956).

It would be hard to imagine a transaction more remote from the "free market" than the instant transaction. In the view of the seller itself, there was only one potential buyer -- FPL. As the seller explains, its decision to sell was based on dramatically rising costs with, the seller says, no prospect for improvement.

The story here is not merely that of the combination of a "lone buyer, seller in distress." Here, the buyer was capable of applying monopoly pressure to limit the alternatives available to the buyer, and there is evidence that other potential buyers were excluded from the market. Here, the seller would receive substantial assets for which, admittedly, no consideration is to depend. Here, the seller knew it lacked a ready yardstick to measure its transaction, but failed to avail itself of traditional alternatives.

2.a. The transaction was not a Market Transaction Because the Market was Artificially Limited

Phase III, if it takes place, should permit a full assessment of the effects of FPL's monopoly power and practices on Vero Beach's actions. The record in Phases I-II, however, provides evidence that, at least, precludes reliance on the claim that the transaction here was a free market transaction.

The record in Phase I-II establishes that the City assumed that wheeling was unavailable. Phase III will determine whether this assumption reflected anticompetitive behavior by FPL, or, indeed, simply the City's own blindness

1/ Tr. 688, emphasis supplied.

to alternatives. ^{1/} The very existence of this assumption, (even if it were not founded in reality) demonstrates that the transaction could not have been a free market transaction. The assumption itself limited Vero Beach's perception of the number of potential extrants into the market, and, by consequence, enhanced FPL's bargaining power.

The Ernst and Ernst report assumed that, "(N)o current wheeling options are available." (Exhibit N, Schedule VI-2, Condition B). Mr. Jones stated that this assumption was provided by the City. (Tr. 517).

There can be no question that wheeling is a necessary component of a wide range of alternatives that might be available to Vero Beach -- essentially, all alternatives relating to dealings with entities beyond the bottleneck of the FPL transmission system. The record shows no reason why wheeling should not have available to Vero Beach. If, contrary to Ernst and Ernst's assumption, it was available, then the sale is based on a gross misperception of the alternatives available to the City. If, for whatever reason, it was not available in fact, or, even not perceived to be available, than the transaction could not have been an arm's length transaction.

Mr. Little testified that, in his opinion, FPL represented the only possible purchaser of the system. (See, e.g., 597). He acknowledged that, technically and legally, other utilities might be potential buyers. (See, e.g. Tr. 598) It would, however, have been "impractical" for another utility to purchase the system. (Tr. 600). The "impracticality," Mr. Little acknowledged, relates, in part, to FPL's transmission bottleneck:

Q. When you used the word "impractical" to obtain outside buyers, did you have in mind the fact Florida Power & Light controlled the transmission lines to the outside world?

A. I was aware that their transmission system surrounded Vero Beach and that wheeling arrangements would have to be made, and that in a sense is part of the impracticality of the whole situation. (Tr. 605).

Thus, to the extent that wheeling did not appear to be available, the seller's perception of the market was unduly limited. If the assumption were correct, moreover, the market itself was unduly limited.

^{1/} Mr. Mulholland, for example, testifies that the City never "formally" requested wheeling. Tr. 47-48. Of course, it may not have done so because of knowledge of FPL's recalcitrance. The circumstances will be explored in Phase III.

Mr. Little testified that at least one other utility (Citizens Utilities Company), "would have been interested" (Tr. 599). Mr. Little, apparently, did not even recommend that Citizens be approached (Tr. 601-602). Mr. Little implied that the failure to seek alternatives could not hurt the City because FPL met all of the City's objectives (Tr. 600). Mr. Little failed to recognize, however, that the mere presence of Citizens as a potential buyer would have enhanced the likelihood that FPL would offer a real "market price." See, e.g., United States v. Penn-Olin Chemical Corporation, 378 U.S. 158 (1964), where the Supreme Court recognized the role of potential entrants as stimuli to competitive behavior. Thus, to the extent that FPL precluded wheeling options -- and made Citizens entrance into the market less likely -- it reduced the likelihood that the City could obtain a market price.

Moreover, any constraints on wheeling service would not merely deter potential buyers of the entire system, but also, entities that might be interested in buying parts of the system -- e.g., generation, capacity and/or energy. While the number of entities that would buy the entire system may be small, any of the Florida electric systems might be interested in a lesser purchase. The mere existence of such potential purchasers would, again, serve to keep FPL "honest" in its bargaining with the City. FPL's knowledge that the potential does not exist -- because the City did not believe wheeling to be possible -- enhanced FPL's upper hand in the negotiations.

2.b. The Failure of the City to Obtain Any Consideration for Valuable Assets is Compelling Evidence that the Proposal is Not an Arms' Length Transaction

The record shows that no consideration will be provided to Vero Beach for the transfer of some assets that are of undeniable and substantial value. The most substantial of these assets are the City's natural gas entitlements 1/ and its grant of a franchise. The transfer of such assets without consideration is incompatible with an "arms length" market transaction.

As part of the transaction, FPL will receive a thirty-year franchise from the City. 2/ The franchise includes an assurance that the City will not compete with FPL during the

1/ Vero Beach is a direct preferred interruptible customer of the Florida Gas Transmission Company.

2/ Application, Exhibit L, Exhibit D.

life of the franchise. 1/ While Citizens do not suggest the value of the franchise and agreement not to compete, the presumption must be that it is of substantial value. At the least, the value must be identified and assessed. As Mr. Howard testified, however, none of the purchase price is attributable to the franchise value. (Tr. 187-188).

Similarly, the proposal does not assign any value to natural gas entitlements which, contrary to the express assumption of City negotiators, are obviously of substantial value.

The City apparently assumed that it would receive "virtually zero" gas in the future. (Tr. 375). This assumption was presumably based on the fact that Vero Beach received only 120 MMcf in all of 1976. (Florida Gas Transmission Company, FERC Form 1, for the year ended December 31, 1976, pages 520 B-C). The deliverability prospects for Vero Beach's supplier (Florida Gas Transmission) have increased dramatically, however, and Mr. Little's assumption of "virtually zero" gas is clearly in error. In May, 1977, for example, Vero Beach received 134 MMcf of gas -- or more than in all of 1976. Moreover, for the period April 1, 1976 - March 31, 1977, FGT projects deliverability to Vero Beach of 939.1 MMcf. (FGT Form 16 report to FERC, April 30, 1977, Schedule 1A).

There can be no question that Vero Beach's gas contract represents a current asset of considerable value -- assuming the validity of the FGT projections stated above, well over one million dollars in 1977-78 alone. 2/ Citizens do not suggest the precise measure of consideration to be provided on the gas contract. Citizens do state that it must be valued and that consideration must be provided. The terms of acquisition proposed were, as Mr. Little stated, based on the assumption that "virtually zero" gas would be available, and the asset was obviously not considered.

1/ Id.

2/ The measure of value would, in essence, be the savings attained from generating with gas instead of oil. Mr. Whitfield Russell, in testimony filed on behalf of Citizens in Phase III, calculated the savings to be over 1.5 million dollars annually. Mr. Russell's calculation, appearing at page 16 of his prepared testimony, is based on the data filed by FGT with the Commission cited above, and data in the Phase I-II record on Vero Beach's oil generation costs.

2.c. The Failure to Seek or Obtain A Separate Price for the Generating System is Further Evidence of the Absence of an Arms' Length Bargain

As Mr. Mulholland stated, FPL did not offer, and the City apparently did not seek, a separate price for the transfer of the generating system alone (See, e.g., Tr. 1308). The record provides strong evidence that this alternative would be the most economic alternative for the City and of interest to FPL. The failure of the negotiators to seriously consider this apparently economic alternative strongly suggests that the City was not engaged in a classic free market transaction. As the Ernst and Ernst report shows,^{1/} the recent disparity in costs and rates between FPL and Vero Beach related to relative fuel and generation costs. Even in 1974 and 1975, Vero Beach's transmission, distribution, and customer costs were significantly below those of FPL.

Assuming assets had to be sold to help the system, the record provides no reason why Vero Beach would have to sell assets that were more efficient than FPL's. At minimum, Vero Beach should have obtained a price for the least economic assets. Hypothetically, it might be argued that the generation plant is of no value to FPL. The record shows that this is not the case. First, FPL will continue to operate the generation into the indefinite future, and, indeed, there is the suggestion that the future may be "rosy" for the generation. (See, Section I, B supra). It must be presumed that they will be used and useful to FPL. Finally, FPL's filing in Docket ER 78-19, especially when placed in context of the uncertainty regarding FPL's nuclear plants ^{2/} implies that FPL would find the generating plants to be of substantial value.

2.d. The Negotiators Conspicuously Failed to Employ the Valuation Method Insisted on By FPL in Similar Circumstances

Witnesses noted that the price to be paid by FPL, corresponded most closely to the original cost

^{1/} Schedule VI-1.

^{2/} See Section IIB, infra.

depreciated value of FPL's assets. It was stated that this reflected happenstance, not design (Tr. 100). Neither the City nor the Company sought to value the system at reproduction cost. (See, e.g., Tr. 95; 913). Incredibly, this method of valuation has been insisted upon by the Company in regard to the most recent valuation of its own assets in the context of a proposed acquisition. In the past year Daytona Beach's citizens debated a proposal to acquire FPL's assets upon the expiration of the FPL franchise. Mr. McDonald told the Daytona citizens that the depreciated original cost proposed -- 25 million dollars -- was an unacceptable measure of compensation and that the Company would insist upon reproduction cost --

Ladies and Gentlemen, I'm here to tell you that no way are we going to sell the part of our system that serves Daytona Beach for anything like \$25 million.

Then they made this assumption, these people just blithely overlooked the fact that they are not proposing to take over a stretch of wire and some substations. They are propositing to take over a healthy, efficient, going business in which we have invested enormous capital, time, skill, experience and effort.

They'd like to assume they can buy the system for the original cost of the physical facilities minus the accumulated depreciation. Now that's just plain ridiculous Tr. 880 (emphasis supplied)

While Citizens do not suggest the precise measure of reproduction cost, it would certainly appear to be higher than the depreciated original cost to which the FPL offer equates. 1/ While Citizens do not suggest that reproduction cost should be the prime measure of value, it must at least be considered, where, as here, no objective measures of valuation were relied on.

1/ In the face of inflation and dramatically rising capital costs, the original cost depreciated value is undeniably less than the reproduction.

Mr. Wallace, for example, stated that the current cost of the City's newest unit would be at least 10-15% higher than the purchase price. (Tr.1022-3).

Conclusion

As Ernst and Ernst told the City "...we attempted to obtain information concerning the purchase of other municipal systems by investor-owned systems. Unfortunately, there was no information available on any current transactions similar to the one discussed in this report." (Application, Exhibit N, page one.)

As the Supreme Court has stated, Kimball Laundry Co. v. United States, 338 US 1, 6 (1949) (fn. omitted), in the context of an eminent domain proceeding:

If exchanges of similar property have been frequent, the inference is strong that the equivalent arrived at by the haggling of the market would probably have been offered and accepted, and it is thus that the "market price" becomes so important a standard of reference. But when the property is of a kind seldom exchanged, it has no "market price," and then recourse must be had to other means of ascertaining value, including even value to the owner as indicative of value to other potential owners enjoying the same rights.

In the absence of both a market place to establish value and any yardstick transaction, common sense would dictate that the city provide its citizens with objective yardstick measure(s) of the fair value of their assets. As the above discussion shows, the need for these measures is more than academic. The record simply does not show the value of the assets. It does show that any identity between the transaction proposed and fair value is highly unlikely and would be purely coincidental.

II. B. FPL has failed to come forth With the Necessary Information on Future Cost and Rate Prospects

The decision to sell the system was based on the rate disparity that existed in the period immediately prior to the decision to sell the system--i.e., the 1974-1976 period following the Arab Oil Embargo. During this period a rate disparity arose because FPL had access to power generated from cheap fuel and Vero Beach did not.

The record shows that Vero Beach officials did not request, and FPL officials did not volunteer (and may not possess) future FPL projections which might indicate whether the rate disparity is to continue. The record shows that negotiations assumed that historical data would be sufficient guide to future. Specifically, it was assumed that any

changes in FPL's costs (and rates) would be paralleled by changes in Vero Beach's costs. 1/ The record shows that this assumption is fatally in error. In fact, the 1974-76 period appears to be a "worst case" for the City and a "best case" for FPL.

First, during the course of the hearing itself Vero Beach's costs dropped dramatically without parallel change in FPL's. Indeed, the most recent rate comparisons in the record show rates should be close to FPL's for residential customers and actually below FPL's for industrial service. Second, the record shows that FPL's future costs are subject to substantial contingencies relating to its nuclear units. The City does not have nuclear power and therefore simply does not have these contingencies. The very nuclear units which helped give FPL a substantial cost advantage in 1974-76 may be off line for substantial periods in the near future, may require substantial repair costs, and the Company may have difficulties in maintaining the economic fuel supply it has hitherto had access to.

While examination of witnesses revealed the inadequacy of historical data, the Company did not, or could not, come forth with needed information on future contingencies. Indeed examination revealed that during the negotiation process itself the City and Company negotiators operated with little or no knowledge about the existence and impact of the contingencies. The failure of FPL to produce the needed information is a failure to provide the essential disclosure needed to protect the public interest and meet the test of Section 203(a) of the Federal Power Act. See, e.g., Pacific Power & Light Co., supra.

II.1. FPL did not offer, and the city did not seek, basic data on FPL's future costs.

As Mr. Little explained:

We made no assumptions beyond 1976, Mr. Spiegel, because I felt, and the staff agreed that anything that was apt to happen to them, speculating into the future was also likely to happen to us. (Tr. 638)

In commissioning Ernst and Ernst to analyze the "impact" of the sale, the City apparently did not ask Ernst and Ernst to examine future rates to be charged by FPL, and Ernst & Ernst did not undertake to do so.

Indeed, Ernst and Ernst did not even undertake to gather or analyze data relating to the near term future. The accounting firm, for example, did not attempt to obtain information on FPL's rate projections within the two year period of

1/ With the qualification that things could get better for FPL without improving for Vero Beach.

the Ernst and Ernst study. (Tr. 502-503) Nor was Ernst and Ernst asked to revise its July, 1976 study in recognition of FPL's September 3, 1976 announcement that a substantial retail rate increase would be sought. (Tr. 545)

As FPL's Mr. Howard explained, the City did not request any data regarding FPL's future fuel cost and fuel mix projections. Moreover, as the examination of Mr. Howard revealed, the Company itself did not prepare or consider such information in connection with the transaction:

- Q. Will you undertake to obtain for me information concerning the projected costs of your fuel mix, Florida Power & Light's fuel mix?
- A. There were no numbers of fuel mix prepared in connection with the numbers we did for Vero Beach. Any numbers that might be available to me along those lines would not have been prepared in connection with Vero Beach.
- Q. All right. So in connection with Vero Beach you did not project and consider relative fuel costs beyond those available at the time the studies were made in 1976?
- A. Not beyond that point in time.
- Q. Did the City of Vero Beach officials request any such information from you in the course of these negotiations, or from Florida Power & Light?
- A. He asked for some fuel comparisons under specific assumptions they wanted, at a point in time, if you wibl, which we provided. That point in time was 1976.
- Q. They requested no data for the future?
- A. As I recall, any we provided dealt with 1976.
- Q. But did they request any projected data?
- A. I do not recall any such requests. Tr. 151-152.

Not only were the negotiations conducted in the absence of any information about future fuel costs and mixes, and related rate projections---but members of the FPL negotiating team were, themselves, not familiar with FPL rate projections,

if they existed. Mr. Howard, for example, stated that the Company had not studied the potential future relationship between FPL's rates and Vero Beach's rates. (Assuming the system were not sold) (Tr. 126) Ironically, Mr. Howard's testimony that the sale would significantly reduce the electric bills of Vero Beach current customers was based on the Ernst and Ernst study (Tr. 127)---which, as stated above, did not encompass projected rate data. Mr. Mulholland, the individual in charge of negotiations for FPL, did not know whether studies concerning FPL's projected retail rates exist. (Tr. 1303) Neither, for his part, did Mr. Daniel. (Tr. 1351)

II.2. The assumption that FPL and Vero Beach would experience parallel cost behavior in the future is demonstrably invalid.

If, as Mr. Little assumed, 1/ the relative future costs of FPL and Vero Beach were certain to follow the pattern of 1974-1976, then the rate disparity of that period could reasonably be expected to continue to exist into the future.

A priori there is reason to believe that the assumption is invalid. In fact, as the record shows, it is not.

The 1974-76 "test period" actually represented a "worst case" for Vero Beach and, by comparison, a "best case" for FPL. During this period Vero Beach access to (relatively low cost) natural gas was heavily curtailed. It has no access to nuclear fuel, and therefore, relied increasingly on oil--the highest priced fuel. (See, eg. Tr. 372-73)

FPL, by contrast, has, in the recent past, been able to rely on natural gas for over 20% of its generation and nuclear fuel for approximately 25%. 2/

1/ Tr. 638. Mr. Little effectively conceded the invalidity of his assumption at Tr. 638-647.

2/ See Citizens Exhibit 37, page 3. In 1976 FPL used natural gas for 22% of its generation and uranium for 22%. The natural gas generation averaged 7.15 mills/kwh, nuclear averaged 2.05 mills/kwh, and, by contrast, residual oil averaged 18.54. FPL's nuclear generation in 1976 came primarily from Turkey Point Units 3 and 4. St. Lucie I did not come on line until the end of the period. Thus, the volume of FPL's nuclear generation could be more favorable in the future, except, as discussed above, for the substantial contingencies that relate to it. St. Lucie II, the only other FPL nuclear unit on which FPL is proceeding, will not be on line until the 1980's.

Thus, Vero Beach, in the 1974-76 period, was already nearly completely reliant on the highest priced fuel. Any change in its access would likely be for the better, and would not necessarily be paralleled by a change in FPL's costs.

Such a development actually took place during the course of the hearing when Vero Beach began to receive substantial deliveries of natural gas. Moreover, as the most recent rate data in the record shows, it came close to closing the gap between FPL and Vero Beach's rates.

The rate differentials evidenced in the Ernst and Ernst report, and the April 1977 rate comparisons produced in the Daniel and Little testimony were undeniably substantial. The Little testimony, for example, reveals a \$34.85 per 1000 kwh residential rate for FPL, compared to a \$52.69 per kwh rate for Vero Beach, or a municipal rate that is 1.51 times FPL rate. 1/ Since the time the comparison was made the FPL base rates have increased. 2/

The volatility of fuel mix and the impact of changes of mixes was dramatically illustrated by the rate comparisons sponsored by Staff Witness Early. 3/ As the comparison of hypothetical July, 1977 bills show the differential had been reduced to 5.4% for a 1000 kwh residential bill. Moreover, FPL's rate for all industrial consumption levels would be higher than those charged by Vero Beach. (Tr. 1571). Thus, while Ernst and Ernst concluded that there were no alternatives which might bring Vero Beach's rates within 5% of FPL's within two years, the narrowing of the gap was achieved without any action by Vero Beach---simply because of differential changes in access to fuel.

Moreover, as Staff Exhibit 47 showed, FPL's own rates were clearly higher than those charged by New Smyrna Beach's municipal system. New Smyrna Beach is a neighbor of FPL and Vero Beach.

1/ Vero Beach Exhibit 3.

2/ In re: Petition of Florida Power and Light Co. for an Increase in Rates and Charges. Fla. P.S.C. Docket No. 760727-EU (CR), "Order Authorizing Certain Increases", Order No. 7843 (June 16, 1977). These rates are reflected in Staff Exhibit 47.

3/ Staff Exhibit 47. As shown at page 5, the per 1000 kw residential rates should have been \$44.91 for Vero Beach and \$43.21 for FPL.

The point, of course, is not that the Staff rate comparison must be preferred to the comparison sponsored by Messrs. Little or Daniel. 1/ Rather, it is that costs--- and especially fuel costs---are highly volatile, and that historical data alone is inadequate. Adequate data about the future is vital.

The increase in Vero Beach gas deliveries demonstrates both the invalidity of the City's assumption that "virtually no gas" would be available in the future, and the assumption that changes in costs to Vero Beach will not necessarily

1/ It should be made clear that while Vero Beach has received substantially more gas than it assumed possible, this gas will largely be delivered in spring and summer months. On the other hand, it now appears possible that Vero Beach will continue to receive gas over a number of years. As discussed in the text above, Florida Gas' deliverability projections to Vero Beach have increased immensely, and by its July 12, 1977 filing in Florida Gas Transmission Docket No. CP 74-192, FGT indicated that it may be able to attach substantial additional quantities of gas (200 bcf). In any case, as stated in the Phase III prepared testimony of Whitfield Russell, the point is not that Vero Beach should build its future on natural gas, but rather that near-term gas availability provides breathing space to take advantage of longer-term alternatives.

parallel changes in cost to FPL. During the 1974-76 "test period", upon which the decision to sell was based, FPL had uncurtailed access to tremendous quantities of natural gas. 1/ Vero Beach, by contrast was sustaining increasingly severe curtailments under its contract. In the future, the deliveries to FPL can only decline by contrast with the 1974-76 period. 2/ Deliveries to Vero Beach, by contrast, only can increase. Not only have they increased dramatically, but it is possible that they will remain at a significant level for at least the near term future. 3/

1/ FPL's gas supply is purchased directly from producers in the field. To date it has not been subject to the Florida gas curtailment plan. The primary FPL contracts are a 200,000 Mcf/day warranty contract with Amoco, which should expire in the mid-1980's, and a 90,000 Mcf/day contract with Sun Oil, which is set to expire in Mid 1979. If the Sun contract is not renewed or replaced, FPL will lose a significant gas supply.

2/ Id.

3/ See projections discussed in Section II-A2b. Pursuant to a July 12, 1977 pleading in Docket No. CP 74-192, Florida Gas Transmission Company stated that it may be able to add 200 Bcf to the pipeline. This possibility is under consideration by the parties to that proceeding.

In the case of nuclear fuel, FPL's prospects may be significantly worse than in the 1974-76 period, while Vero Beach's can only improve. Vero Beach has no nuclear generated power and cannot be worse off. During the 1974-76 period FPL was the sole beneficiary of nuclear power in Florida, and reaped enormous economic benefits from this ownership.^{1/} To the extent that the economics may become less favorable in future years, FPL's advantages will diminish.

Examination at the hearing showed that the economic advantages of nuclear power to FPL may be significantly eroded in the near future. The possibilities include a) increased fuel costs, and b) further capital expenditures to repair equipment, and c) high cost of replacing nuclear generated power if nuclear units are taken off line.

First, FPL has informed regulatory agencies of uncertainties regarding its future supply of uranium, and the costs of this supply. Turkey Point Nos. 3 and 4, which comprised approximately 21% of FPL's generation in 1976, are fueled by uranium supplied by Westinghouse. (Citizens Ex. 37, page 4) According to FPL, "Westinghouse has taken the position that its obligations to supply uranium under the contract have terminated, that the contract expires in 1980, and that it has no plans for removing spent fuel from the Turkey Plant site." (Id.)

Moreover, the FPL 1976 Form 10-K report to the Securities and Exchange Commission (Citizens Exhibit 37) further states that the price to be paid by FPL to Westinghouse may be subject to future adjustment. The Company concludes that, "(T)here is no assurance that the uranium to meet the Company's future requirements will be available, or, if available, what price the Company may have to pay. Increased costs or reduced availability of fuels to the Company could have a material adverse effect on the Company's cash flow." (Cit. Ex. 37, at page 5)

When Counsel for intervenors sought to inquire into the potential increased costs raised by the Westinghouse litigation, Counsel for FPL objected to the inquiry, ^{2/} and the objection was sustained.

^{1/} Citizens Exhibit 37, page 4, for example, shows FPL's average nuclear fuel costs to be 2.05 mills/kwh, in comparison with 18.54 mills/kwh oil costs.

^{2/} Tr. 148.

FPL has the burden of proof in the proceeding. It cannot expect to have the application approved if it declines to produce information on facts that are highly material.

Not only did Company officials decline to testify about the potential implications of the Westinghouse litigation, but, of equal importance, Mr. Little said he did not ask FPL about the possible impact of a Westinghouse default on FPL's rates. (Tr. 1436-1437), nor did he examine the 10-K report from which the above statements are taken. (Tr. 1437) 1/

In addition to difficulties relating to costs and acquisition of fuel, the Company may, in the near future, be forced to shut two of its three operating nuclear units (Turkey Point 3 and 4) down for repairs. The shutdown would not only imply the need for substantial additional capital expenditures, but also, require FPL to replace low-cost nuclear generation with high cost oil generation.

FPL's 1976 10-K (Citizens Exhibit 37, at p. 2) states that Turkey Point Units 3 and 4 may require "new tube generator bundles." The replacement cost is assessed at \$30-50 million per unit. If replacement is necessary, each unit could be out of service for up to two years. (Id.) "Power resources," the Company has told this Commission, "could be inadequate during any period that both units were simultaneously out of service." (FPL, Form 1 for year ended December 31, 1976, page 125)

Finally, FPL's formal reports indicate that the Company may experience difficulties in refueling its nuclear units. The Company states that, in regard to Turkey Point Units 3 and 4, "present storage facilities are full and future refuelings of either unit cannot be accomplished unless the modification of the facilities are compared and approved by the NRC or other storage arrangements are made." (Form 1, Id.)

As discussed above, City officials based their recommendation to sell on historical performance--- and considered a period in which FPL was receiving substantial benefits from the operation of the Turkey Point units. Since the risks discussed above represent future contingencies, the sale was not based on any studies or analyses in which their potential implications were considered.

1/ Mr. Little stated that he did read the FPL annual reports to shareholders.

Indeed, not only was the sale not based on such analysis, but under examination, Company officials were unable to shed necessary light.

Company officials acknowledged that the Turkey Point outages, if they occurred, would increase the fuel adjustment costs and, to the extent that the repair costs were capitalized and approved as rate base items, base rates would increase as well. (See, eg. Tr. 325-326; 1169; 1250; 1255) Mr. Howard provided a "rough estimate" that the fuel adjustment could be \$2.50 per 1000 kwh per unit, for each month a unit is out. (Tr. 1169)

The Company did not provide any support for Mr. Howard's "rough estimate", and Company officials could provide little to amplify on statements in the 10-K and the Form 1. Mr. McDonald, for example, stated that a shut-down, if it occurred, would occur in the 1978-81 period (Tr. 786), but that no determination has been made on whether or not the repairs must be undertaken. (See, eg. TR. 783; 792) Mr. McDonald did not know of any study of the potential impact of a shut-down on the rates (Tr. 792), and indicated that no study would be undertaken until a final determination on repair was made. (Tr. 792-798) In the face of this lack of information counsel for FPL refused to supply even the names of person(s) "principally responsible for translating the possible contingencies into impacts on rates." (Tr. 798)

II. 3. The applicant failed to meet its burden of providing necessary information about future costs and rates.

If the Company could provide little information on the likelihood and impact of a Turkey Point shutdown, it also provided little meaningful information on projections of overall fuel costs and mixes, and the rates that would result from them.

The Company did not present a witness capable of testifying on fuel projections. Mr. McDonald is FPL's Chief Executive Officer. He stated that his responsibilities include FPL's fuel costs and projected fuel costs. (Tr. 766-767) Nonetheless, he did not know the current projections of FPL for fuel cost in the next five years (Tr. 767), and did not know of any studies made by FPL containing "written projections or estimates or judgments as to what these costs will be in the future, perhaps under varying assumptions." (Tr. 770) Mr. McDonald generally stated that he assumed that the Company's Fuel and Rate departments were considering such matters. (See, generally Tr. 764-790) The Company did not present a

witness from either of these departments. 1/

Continued cross-examination over objection from Company Counsel, did produce some opinion about FPL's future costs. This opinion, however, was not supported by any documentation, much less expression of underlying assumptions. Indeed, there is no clear relationship between the opinions expressed and other evidence testified to by FPL.

1/ Delegation of responsibility may be a virtue, but the Company seems to delegate its intelligence function with a vengeance. While fuel costs represent the single largest item in FPL's generating costs, Mr. McDonald was not familiar with even the most superficial aspects of fuel costing in general, and FPL's costs, in particular. For example, Mr. McDonald a) did not know, within an order of magnitude, the relation of fuel costs to cost of service. (Tr. 773); b) did not know the approximate cost of nuclear fuel to FPL, including a ballpark estimate (Tr. 777) c) had "no frame of reference" to respond to a question concerning the approximate cost of FPL's natural gas; d) did not know how to convert a natural gas cost, in Mcf, into an average cost per kilowatt hour of fuel generated (Tr. 778); e) did not know whether FPL's purchased gas cost was more or less than \$2.00/McF; f) did not know the name(s) of FPL's nuclear fuel supplier(s), other than Westinghouse; g) could not provide information on negotiations for additional nuclear fuel (Tr. 783). Interestingly, Mr. McDonald testified that he came to FPL after years as an oil industry executive. (Tr. 765)

Mr. Mulholland, for example, volunteered that "[O]ur projections indicated the cost per kilowatt-hour, including fuel adjustments, is expected to be less than 5 cents per kilowatt hour...." (Tr. 1305) Mr. Mulholland, however, stated that this assumption was not used "as far as negotiations go" (Tr. 1306). Moreover he could not provide the assumptions or analysis underlying the figure. (Tr. 1305-1306; 1339) Indeed, it is not even clear whether the figure cited is FPL's costs, or the related rate.

Mr. Mulholland stated that the 1980 projection was obtained orally from "people like Mr. Howard and Mr. Daniel." (Tr. 1305) There is, however, no evidence that these individuals were any more familiar with the projections. As the following exchange makes clear, Mr. Daniel -- to whom Mr. Mulholland referred specifically in response to the line of inquiry (Tr. 1305) -- was as much in the dark as Mr. Mulholland:

Q. Have you had occasion to refer to any projections or study, formal or informal, of the future level of fuel costs of Florida Power & Light?

A. No, sir.

Q. Do you know whether any such exist in the Company?

A. No, I don't know for certain that they do or do not. (Tr. 1351)

Similarly, Mr. Daniel was aware of the existence of an "informal" study done by Mr. Howard, but could not comment on its substance. (Tr. 1349-1350) 1/

1/ While the Mulholland opinion can have no probative value, it does raise further questions. It must be presumed that the opinion does not contemplate difficulties with the nuclear units. If the Turkey Point Units were, as discussed above, not operating, the costs could be considerably higher than the \$50.00/kwh costs projected by Mr. Mulholland.

In sum, FPL did not have, or refused to produce, essential information on future fuel mix and cost, and related rates. It did not produce minimal information despite repeated requests, and has clearly chosen to leave a less than adequate record. 1/ It has done so in a case where it has the statutory burden of producing information to show the reasonableness of its proposal, and it alone has the needed information. Moreover, it has done so where evidence, as discussed above, reveals that future fuel costs, and related rates, are highly problematical. Under these circumstances, the "adverse inference" must be drawn, and the Company's application must be rejected. 2/

1/ Citizens must note that Mr. Howard did state, at Tr. 1217 that, in 1980, the company would rely on natural gas for 13% of its generation and 31% of its generation. No supporting assumptions or data were provided. There is, for example, no suggestion as to how these figures would relate to nuclear contingencies discussed above. Nor is there a translation of these figures into rates. In addition, the Company declined to supplement the 1980 figures with comparable figures for the years 1977-79. See November 4, 1977 letter of Matthew Childs to Robert Bear, item 4.

2/ The "adverse inference" rule is summarized in International Union (UAW) v. NLRB, 159 F.2d 1329 (CADC, 1973), at 1336.

Simply stated, the rule provides that when a party has relevant evidence within his control which he fails to produce; that failure gives rise to an inference that the evidence is unfavorable to him. As Professor Wigmore has said:

"* * * The failure to bring before the tribunal some circumstance, document, or witness, when either the party himself or his opponent claims that the facts would thereby be elucidated, serves to indicate, as the most natural inference, that the party fears to do so, and this fear is some evidence that the circumstances or document or witness, if brought, would have exposed facts unfavorable to the party. These inferences, to be sure, cannot fairly be made except upon certain conditions; and they are also always open to explanation by circumstances which make some other hypothesis a more natural one than the party's fear of exposure. But the propriety of such inference in general is not doubted."

Although this rule can be traced as far back as 1722 when it was applied in the famous case of the shimney sweep's jewel, it has been utilized in scores of modern cases as well.

II.C. The Supporters of the Application Failed to Present Adequate Analysis of Alternatives Available to the City

Citizens understand that Phase III of this proceeding, if necessary, will permit Staff and Citizens to present evidence that a) Vero Beach has failed to consider alternatives (to sale) available to it, and b) that FPL's anticompetitive conduct has precluded Vero Beach from considering and/or attaining essential alternatives. The record in Phases I-II, in its own right, demonstrates that Vero Beach failed to obtain the necessary independent analysis of alternatives available to it, and provides strong evidence that alternatives may have been precluded by FPL. Absent necessary analysis of alternatives, it is impossible to state that the benefits of the sale to Vero Beach outweigh the costs.

The City did not seek an independent analysis of alternatives to the sale. In fact, it apparently did not even consult Black & Veatch, its long-time engineering consultants, until the end of the two year negotiations (see, e.g., Tr. 593; 1096). Rather, in support of its application, FPL presented the Ernst and Ernst evaluation of the "impact" of the FPL proposal on Vero Beach.^{1/} The deficiencies of that study are profound. The inadequacy of Ernst & Ernst's analysis of the rate differential between FPL and Vero Beach is discussed at section II-B. Of equal importance, Ernst and Ernst was essentially not asked to consider alternatives available to Vero Beach.

As Mr. Jones, testifying on behalf of Ernst & Ernst, made clear, the firm's report was primarily intended to analyze the impact of the proposal before the city--and not alternatives to it. (See, e.g., Tr. 479) The firm did not intend to do "detailed evaluations of alternatives" (Tr. 508). The Ernst & Ernst team did not have the engineering and technical capacity needed to perform the type of planning alternatives study that utilities may typically commission. (See, e.g., 512-513).

The final section of the Ernst & Ernst report did note some possible alternatives and concluded that Vero Beach's rates could not be brought to within 5% of FPL's rates within two years from the date of the study. While Mr. Jones was careful to explain, as noted above, that the final section was not integral to the essence of the report (see, e.g., Tr. 513), it is important to emphasize that it cannot be said to be an adequate presentation of alternatives.

^{1/} Application, Exhibit N.

First, of course, Ernst & Ernst's conclusion that no alternatives existed which would permit near-term reduction of the rate disparity has been belied by events. As Staff Witness Early's testimony, the most current rate comparisons in the record, shows, the Vero Beach rates are close to and/or below the 5% target.^{1/}

Second, the Ernst & Ernst report assumed that "[N]o current wheeling options are available." (Exhibit N, Schedule VI-2, Condition B) (Mr. Jones stated that this assumption was provided by the City. Tr. 517). There can be no question that wheeling is a necessary component of a wide range of alternatives that might be available to Vero Beach--essentially, all alternatives relating to dealings with entities beyond the bottleneck of the FPL transmission system. The failure to consider wheeling alternatives is fundamental.

Cross-examination revealed further basic gaps in the Ernst & Ernst discussion of alternatives. Ernst & Ernst, for example, a) did not consider the potential sale of Vero Beach's excess generating capacity (Tr. 536-536), even though the City admittedly suffers from excess capacity (See, e.g., Tr. 551), and, as discussed at Section I-E, FPL may be in serious need of such capacity; b) did not consider possible access to nuclear units that are already on line (Tr. 549); c) did not explore the alternative of economy energy exchanges with FPL. (Tr. 556); d) did not consider whether the perceived rate gap could be narrowed to +5% over any time period greater than two years (Tr. 484); and e) did not consider that, as discussed previously, the gap might narrow because of increase in FPL's fuel costs and rates. (See, e.g., Tr. 503-505).

In sum, in Phase III, if it takes place, Citizens would show that the City failed to consider specific alternatives that could be more beneficial than the present proposal, and that this failure was related to FPL's foreclosure of basic alternatives. The Phase I-II record shows in its own right that the City did not adequately consider the alternatives available to it.

^{1/} Ernst & Ernst apparently shared the City's erroneous assumptions discussed supra, that future fuel cost changes could not reduce the rate gap. See e.g., Tr. 503-504.

II.D. There Is No Showing that the Acquisition
Is Needed to Increase the Reliability And
Economy of Service to Vero Beach Customers.

As discussed supra, the disparity in fuel costs is the primary basis for the sale. In fact, as the Ernst & Ernst report documents,^{1/} the City's transmission, distribution, and customer service costs are actually lower than the Company's. This pattern suggests, as discussed, that the City would benefit most if it preserved its transmission, distribution, and customer service economies, while acting to rectify diseconomies related to generation. In fact, as Mr. Daniel acknowledged, the integration of the City's generating units could be technically attained without the sale. (Tr. 1367).

As discussed in Section I, supra, there was no showing that the acquisition would significantly improve reliability to FPL. Nor does the record show that acquisition will provide any significant increases in reliability to Vero Beach's customers. (See, e.g., Tr. 434).

It is, however, open to question whether the FPL system is as reliable as the Vero Beach system. Mr. Little testified that the City negotiators did not undertake to examine FPL's outage record. (Tr. 445). As the Chairman of the Florida Public Service Commission observed in her opinion in the Company's most recent retail rate filing, ^{2/} "Southeast Florida has been called the blackout capital of the world, a problem which Florida Power & Light (FP&L) seems to be dragging its feet in solving." As the majority in that case summarized, ^{3/}

"On May 16, 1977, Florida Power & Light Company experienced an extensive 'blackout' in southeast Florida, generally from West Palm Beach southward. This outage, which affected some 2 1/2 million customers, was preceded by several other similar occurrences in recent years."

^{1/} Application, Exhibit N, Schedule VI-1.

^{2/} In Re: Petition of FPL for an Increase in Rates and Charges: Docket No. 760727-EU (CR), Order No. 7843, June 16, 1977, at page 39, slip opinion. Chairman J.K. Hawkins concurred in part, and dissented in part.

^{3/} Id., at 24.

Finally, FPL's filing in Docket No. ER78-19, 1/ and its potential difficulties with its nuclear units 2/ suggest that the Vero Beach load might prove an excessive burden to FPL.

1/ See Section IE.

2/ See Section IIB.

III. The Record Does Not Show That
The City Electric Revenue Bondholders
Are Adequately Protected

FPL and the City of Vero Beach have failed to meet their burden of showing that the proposed transaction will not adversely affect the credit of Vero Beach. While Citizen Intervenor discuss this issue because of their concern about the financial credit of their community, there is also a larger public interest which could be adversely affected if potential investors in municipal securities come to believe that there is a risk that the tax-exempt status of the interest could be jeopardized by the use of bond proceeds for non-municipal purposes. The City requested the Internal Revenue Service ("IRS") to rule on whether the defeasance of the City's bonds under the proposed transaction would jeopardize the tax status of income received from the bonds. (Tr. 79) Approval by the IRS is necessary because, as discussed below, the transaction might be deemed to be a transaction which would preclude tax exempt status for the municipal bonds to be defeased. The IRS approval is a condition of closing this transaction (Tr. 82). On September 30, 1977 (following the close of Phase I-II hearings) the IRS issued a letter statement regarding the transaction. The IRS letter is attached hereto as Appendix B, and Citizens request that it be lodged into evidence in the Phase I-II record.^{1/} That letter, as discussed below, provides the tax exempt status may be continued. This conclusion, however, is qualified by the provisos that a) the city did not contemplate sale prior to June 1, 1974 and b) that the "City's representatives made a good faith effort in bargaining for the sale of the electric system to receive full value for it." As discussed in Section IIA, supra, the record shows that an adequate determination of fair value has not been made. Therefore, this casts serious doubt on whether the city has met the standard stated by the IRS. As discussed below, the record contains evidence that the sale was contemplated prior to June 1, 1974.

^{1/} Citizens did not receive a copy of the letter from the City until November 21, 1977 in response to a request of November 15, 1977.

III. A. The Proposed Transaction Could
Be Precluded By Law

The end result of this transaction would appear to accomplish what tax law sets out to prohibit. The City of Vero Beach will be engaging in what could be considered to be an indirect arbitrage transaction -- namely, the use of the municipal bond proceeds to construct a power system which is now being exchanged for higher-yield taxable securities. Alternatively, from another vantage point, the company is paying less cash to acquire this power system than the "value" of its offer would dictate and it will now receive the benefit of the city's low-cost financing. Both results could result in the loss of tax exemption to the bond holders if the Vero Beach bonds are considered arbitrage bonds under I.R.C. §103(d) or industrial development bonds under I.R.C. §103(c). (The statute is attached as Appendix C).

The testimony of J. C. Howard documents the fact that the proposed transaction would be subsidized by the use of the low cost tax-free municipal financing. He thus explains the proposed plan of defeasance as part of FPL's offer:

"The concept is to substitute U.S. government securities guaranteed by the full faith and credit of the United States for the present bond security which is revenue to be generated by the electric system. The government securities would be placed with a trustee. The government securities will be selected so as to assure that the interest income and principal from the government securities will provide the cash required to pay the principal and interest on the electric system's Bonds as it becomes due." (Tr. 58)

As he testified, this procedure will save FPL at least \$2.4 million ^{1/} because of the extrayield of the taxable securities over the tax free electric revenue bonds used to construct the city's electric system. (Tr. 58)

^{1/} Citizens Exhibit 2 shows a company estimate of the cost to FPL of defeasing \$30.4 million of the municipal revenue bonds at \$25 million -- a savings of \$5.4 million.

Under the arbitrage and insustrial bond provisions of the Internal Revenue Code the reasonable expectations of the City at the time of issuance of the bonds will determine whether the bond interest will remain tax-exempt. 1/

III. B. The IRS Letter

Citizens have obtained from the City of Vero Beach a copy of the Internal Revenue Service Ruling which they move to lodge in the record. A copy is attached hereto. This Ruling, which is expressly based upon documents and information submitted to IRS by the City of Vero Beach, states that the holders of the bonds in question will not be required to include the interest received thereon in gross income. However, the Ruling was made dependent upon two factual questions involving the intentions of the City as follows:

1/ Proposed Treasury Regulations §1.103-13(b)(2)(iii)(c) proposed May 3, 1973 and December 3, 1975 (1976 CCH Standard Tax Reports ¶992, p. 14,193) contain the following example of unreasonable accumulation of indirect proceeds which could render the interest on municipal securities taxable where the proceeds are utilized to acquire securities of a higher yield than the municipal issue. Depending upon the resolution of the issue of intent, the example could be strkingly similar to the Vero Beach situation:

Example - On January, 1974, City A issues \$1 million of 20-year serial non-callable governmental obligations with level debt service. City A plans to expend all the original proceeds of the issue to finance the construction of a municipal parking lot at a cost of \$1 million. At the time the bonds are issued, City A plans to sell the parking lot on July 1, 1985, for \$600,000 cash. As a result of the sale, City A will have on hand on July 1, 1985, indirect proceeds that are sufficient to pay substantially all of the principal with interest to such date, of the outstanding governmental obligations. Since on the date of issue City A could reasonably have foreseen that substantially all of the governmental obligations could be retired on July 1, 1985, there is an unreasonable accumulation of indirect proceeds. Accordingly, the indirect proceeds of the issue must be taken into account as proceeds for purposes of section 103(d)."

This ruling is issued with the proviso that the City did not plan, foresee or contemplate the proposed sale of the Electric System to Florida Power and Light Company at any time prior to June 1, 1974, the date of issue of the final series of Electric Bonds to be defeased. This ruling is also issued on the condition that the City's representatives made a good faith effort in bargaining for the sale of the Electric System to receive full value for it.

Revenue Rulings do not operate as a final determination of the fact questions involved. Treas. Reg. §601.201(1)(2). In effect, the IRS has determined that under the facts submitted to it by the City, the bondholders could lose their tax exemption if the Service later determines that the City planned, foresaw or contemplated the sale prior to June 1, 1974 or that the City's representatives failed to make a good faith effort to receive full value for the power system.

The Record in Phases I and II of this proceeding raise very substantial concerns with regard to these criteria which the Service has indicated could be viewed as controlling. The failure of the City to obtain an appraisal ^{1/} might be argued to be an indication of a failure to make a good faith effort to obtain full value. In addition there is evidence that responsible city officials contemplated the sale of the System before the June 1, 1974 date established by the IRS.

City Finance Director Thomas Nason testified that he prepared an evaluation study of the value of the Vero Beach Municipal power system dated May 17, 1974. He testified that this question of value "naturally arose" as a result of customer complaints. The study was conducted pursuant to the City Manager's instructions resulting from letters of complaint regarding high electric bills:

Q. Could you explain for the record what prompted this May 17, 1974 study?

A. To the best of my recollection we had been having many customer complaints. They were concerned with the rapidly escalating fuel costs, and in general the price of electricity.

^{1/} See Section II-A, supra. See, in particular, Mr. Little's testimony quoted therein, that he did not know whether a determination of the system's value was ever made. (Tr. 688)

Any time that you are working in a, I quote, 'fishbowl', or whatever you will call it, a government, you look to see what you can do, that is obvious. We cannot negotiate with the Arabs, not easily; that is at the Federal level. You have a fully costed system that has tight budget review, with very limited alternatives to reduce the manpower costs, within that. So the question naturally arose of what is the system worth, approximately, give us a ball park guess. That is how this document was generated.

Q. Did Mr. Little ask you to prepare this for him?

A. This came about through a discussion in his office about some of the letters and a couple of them as I recall were from luminaries in the area who were concerned about the rapidly escalating price of energy. It is just one of these things, would it not be a good idea just to find out. (Tr. 743-744).

A link between the May study and subsequent developments appears to be indicated by the official minutes of the Vero Beach City Council of July 9, 1974. On that date, the City directed the City Manager to negotiate the sale of the power plant. The minutes refer to this action as a continuing investigation, implying that prior activities had been conducted with reference to the sale. (Citizens' Exh. 12, p. 7).

Further corroboration of the probability that City officials were considering the sale before June 1, 1974 would appear to be the letter of May 3, 1974 from F. C. Wallace, detailing the history of all prior negotiations to sell the Vero Beach system. (Citizens Exh. 25). Mr. Nason stated that he asked for the information because Mr. Fred Gossett had stated that there had been previous consideration of selling the system. (Tr. 1458-59). However, Mr. Nason did not clearly explain the need for the information. (Tr. 1461).

John Little testified that the sale had not been contemplated by him prior to July, 1974. However, Mr. Little's testimony is not readily reconciled with Mr. Nason's testimony. For example, Mr. Little testified that he had "no thought" of the sale of the system in his mind until the whole matter of selling the system hit him "cold right then and there" at the July 9, 1974 City Council Meeting.¹ However, Mr. Nason testified that the

¹/ Tr. 589.

May, 1974 study was precipitated by a discussion with Mr. Little of letters from "luminaries in the area" complaining about the high cost of energy. (Tr. 743-44). Customer bill complaints were cited as the stimulus to the sale negotiations, although Mr. Little cites these complaints to the July, 1974 meeting (tr. 589).

In addition to suggesting that the sale may have been contemplated before June 1, 1974 the record also suggests that in substance, the bonds were not authorized until after June 1, 1974. Although the IRS Ruling lists June 1, 1974 as the issue date of the last electric bonds, the record shows that the bonds were authorized by the Vero Beach City Council on July 9, 1974 at the same meeting where a committee was appointed to continue the investigation of the possible sale of the system. (Citizens Exh. 12, p. 4).

Conclusion

The burden upon the City and the Company is that of showing that the proposed defeasance plan will not injure bondholders. The IRS states that the continued availability of a tax exempt status will depend upon the adequacy of the City's bargaining effort and the provision that the sale was not contemplated at any time prior to June 1, 1974. The record in Phases I-II does not provide assurance that the IRS proviso has been met. In the absence of necessary assurance, the proposal cannot be approved.

IV. The Public Interest Requires That Alternatives and Information Be Made Available to the Citizens of Vero Beach

The record in Phases I-II shows that the Applicant has not met its burden of showing benefits from the proposed transaction to its stockholders and ratepayers, and, therefore, the application must be rejected. While Citizens are concerned about the interests of FPL's customers and ratepayers, they are, of course, primarily concerned with the interests of Vero Beach's citizens and ratepayers. The record in Phases I-II shows that the measure of costs and benefits to Vero Beach remains speculative, and that there is inadequate showing that the City's credit would not be impaired. In any case, any benefits would be obtained at a price that simply does not represent the fair and objective appraisal of public assets that is required. Finally, there is no showing that alternatives to the proposal would not be more beneficial and less costly to the City.

If, because of FPL's failure to meet its burden, the application is denied, the City, and its Citizens, would, in effect, be cut adrift without the information necessary to determine the best course of action. The public interest would not be served by such a development.

Citizens have urged that this Commission provide the Citizens with an expedited consideration of the alternatives available to the City.^{1/} The City and FPL have objected to this course, ^{2/} and the consideration of alternatives has been deferred until Phase III. ^{3/}

^{1/} See Citizens "Response to Motion to Establish Procedures and Motion for Expedited Hearing on Possible Interim Savings to Vero Beach," October 3, 1977. (Citizens request for an expedited determination of savings to be obtained by the purchase of wholesale power from FPL). See also Phase II transcript, Vol. 6, pages 476-478. (Citizens' request for the consideration of alternatives as part of the Phase I-II records).

^{2/} Phase III hearings, Vol. 6, Tr. 483-485.

^{3/} See, e.g., Phase III hearings, Vol. 6, Tr. 486; 490-491.

If the Presiding Law Judge finds that the Applicant has not met its burden of proof--and that the Phase III hearing is not necessary--the public interest requires that the Commission take action to ensure that the City and its citizens have the information needed to take further informed action. 1/

If, therefore, the Presiding Law Judge should find that the burden of proof has not been met, Citizens respectfully request that the Presiding Law Judge, in his decision, request FPL to a) state whether certain alternatives are available, and, if not, why not; and b) provide information which, lacking in the hearing record, is needed by Vero Beach Citizens to determine the attractiveness of a sale of all, or part, of the system. 2/ The request should include the following:

- 1) Wheeling. FPL's transmission system is the bottleneck that Vero Beach must be able to pass through if it is to obtain access to any alternatives that might be available from systems other than FPL. The Ernst & Ernst report, as discussed, states that wheeling was not available to the City. FPL should state whether wheeling is available, and on what terms. 3/

1/ It has been Citizens' contention that Citizens have not been adequately apprised of alternatives available to them, in significant part because of FPL's anticompetitive behavior. Citizens' Phase III presentation is outlined in the pre-trial brief, filed pursuant to the request of the Presiding Law Judge, on November 1, 1977. In addition, as discussed herein, the evidence in Phase I-II itself establishes that the City did not adequately consider alternatives, and that FPL's behavior appears to have limited these alternatives.

2/ Citizens note that related questions may be before the Commission in Florida Power & Light Company, Docket No. ER87-19, (discussed in Section I, supra); and Florida Power & Light Company, Docket No. ER77-175.

3/ Citizens understand that FPL may offer limited wheeling arrangements to Vero Beach in regard to particular transactions. However, as Dr. Gordon Taylor's prepared testimony in Phase III here and in Florida Power & Light Company, Docket No. ER77-175 explains, this service is an unacceptable substitute for a generally available wheeling tariff and rate.

- 2) Wholesale power under the Company's current rates and tariff on file with the Commission. The current FPL wholesale rate tariff (SR-1) makes the rate generally available to municipalities. The record does not show, however, whether FPL would provide service under the tariff. 1/ The Company should state whether service under the SR-1 tariff is available to Vero Beach.
- 3) Wholesale power under FPL's proposed rates and tariff in Docket No. ER78-19. As discussed in Section I, the Company proposes to limit the availability of wholesale power under its filed rates and tariffs to entities now purchasing such power. The proposed tariff would therefore preclude Vero Beach from obtaining service under the filed rates. The Company states that the tariff revision is necessary because it cannot, presumably for reasons of reliability and economy, take on new loads. The Company, through the acquisition, however, states a desire to take on the Vero Beach load. The Company should explain why service to Vero Beach cannot be available under the proposed tariff.
- 4) Schedule D Interchange power. Schedule D of the Vero Beach/FPL interchange arrangement provides for the negotiation of firm power sales. According to Mr. Little, the City has not sought Schedule D power. (See, Tr. 1391-1393). The Company should state whether such power is available, and on what terms.

1/ Citizens had proposed to consider service under the SR-1 tariff in expedited proceedings. See "Citizens' Response to Motion to Establish Procedures and Motion for Expedited on Possible Interim Savings to Vero Beach," October 3, 1977.

The Phase I-II record does not reveal whether FPL would have made service available. However, Citizens note Citizens' Exhibit 34 K, which was offered into evidence but not examined upon. That document, which appears to be background material prepared by City officials for a public presentation to the Citizens, contains, at page 6, a consideration of wholesale power purchase. The page bears the heading "FP&L would not sell unless forced by court order."

- 5) The unbundling of the terms of sale. The Company did not provide a separate price for the purchase of the City's generating system. As the Ernst & Ernst report shows, the City obtains substantial economies (by comparison with FPL) in its transmission and distribution operations. There is no reason, a priori, why the transfer of the generation assets alone would not be more beneficial than the transfer of the entire system. As FPL testimony here and the filing in ER78-19 show, the generation units will clearly be of value to FPL. FPL should be requested to provide a separate price for the generating plant.
- 6) Centralized dispatching and related economic benefit. As discussed in Section I, economies to be gained relate to the integration of the Vero Beach facilities into the FPL system. Testimony shows that this integration can technically be obtained without the sale (Tr. 1362) and that the costs (to FPL) of centralized dispatching do not appear to be substantial. (Tr. 316). FPL should be requested to state why the mutual benefits of systems integration cannot be obtained in the absence of the sale.
- 7) FPL's future costs. FPL should be requested to provide information on future rates and costs, especially information relating to the implications of nuclear power contingencies revealed in the record, and the reliability and economy difficulties implied by the filing in Docket No. ER78-19.

In sum, Citizens are not opposed to any course of action that can be reasonably shown to be in the best interests of the City. The City cannot afford to make a decision until it has adequate information.

CONCLUSION

WHEREFORE, in view of the foregoing, it is respectfully requested that the Application in this proceeding be denied, that the Presiding Law Judge take further action as requested in Section IV herein, and that such further relief as may be appropriate be provided.

Respectfully submitted,



Daniel Guttman



Robert Harley Bear

December 5, 1977

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Appendix A

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When a sale of corporate property or assets is accomplished there is a presumption that the directors acted honestly and in the best interests of the stockholders. Id.

An injunction would lie against sale of stock of a bus company to a county which would result in de-

stroying the identity of the bus company, where it would violate a provision in the contract for sale of stock of the company, against disposition of the bus company franchise and certificate. *Coast Cities Coaches, Inc. v. Whyte*, App., 130 So.2d (1961).

607.244 Right of shareholders to dissent

(1) Any shareholder of a corporation shall have the right to dissent from any of the following corporate actions:

(a) Any plan of merger or consolidation to which the corporation is a party; or

(b) Any sale or exchange of all or substantially all of the property and assets of the corporation, including a sale in dissolution.

(2) A shareholder may dissent as to less than all the shares registered in his name. In that event, his rights shall be determined as if the shares as to which he has dissented and his other shares were registered in the names of different shareholders.

(3) Unless the articles of incorporation otherwise provide, this section shall not apply:

(a) To the shareholders of the surviving corporation in a merger if a vote of the shareholders of such corporation is not necessary to authorize such merger.

(b) To the holders of shares of any class or series which, on the date fixed to determine the shareholders entitled to vote at the meeting of shareholders at which a plan of merger or consolidation or a proposed sale or exchange of property and assets is to be acted upon, were either registered on a national securities exchange or held of record by not less than 2,000 shareholders.

(c) To a sale or exchange pursuant to an order of a court having jurisdiction in the premises.

(d) To a sale for cash on terms requiring that all or substantially all of the net proceeds of sale be distributed to the shareholders in accordance with their respective interests within 1 year after the date of sale.

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Historical Note

Derivation:

Laws 1975, c. 75-250, § 81.

Laws 1953, c. 28170, § 1.

Fla.St.1951, § 612.40.

Prior Laws:

Fla.St.1975, § 608.23.

Comp.Gen.Laws 1927, § 6504.

Laws 1960, c. 60-23, § 4.

Laws 1925, c. 10096, § 38.

Library References

Corporations § 182.4(4), 584.

C.J.S. Corporations §§ 515, 516,
1612 et seq.

607.247 Rights of dissenting shareholders

(1) Any shareholder electing to exercise a right of dissent shall file with the corporation, prior to the taking of the vote of shareholders on the proposed corporate action, a written objection to such proposed corporate action. If such proposed corporate action be approved by the required vote and such shareholder shall not have voted in favor thereof, such shareholder may, within 10 days after the date on which the vote was taken, make written demand on the corporation or, in the case of a merger or consolidation, on the surviving or new corporation, domestic or foreign, for payment of the fair value of such shareholder's shares.

(2) Notwithstanding subsection (1), when a merger, consolidation, or sale or exchange of assets has been approved by written consent of shareholders pursuant to [s. 607.394,]¹ any shareholder failing to give consent or, when a corporation is to be merged without a vote of its shareholders into another corporation, any of its shareholders, may, within 15 days after the plan of such merger, consolidation, or sale [or exchange]² of assets shall have been mailed to such shareholders, make written demand on the corporation or, in the case of a merger or consolidation, the surviving or new corporation, domestic or foreign, for payment of the fair value of such shareholder's shares.

(3) If such proposed corporate action is effected, such corporation shall pay to such shareholder, upon surrender of the certificate or certificates representing such shares, the fair value thereof as of the day prior to the date on which the vote was effected approving the proposed corporate action by the shareholders of the corporation in which the dissenting shareholder owns shares or, in the case of a merger pursuant to s. 607.227, as of the day prior to the date on which a copy of the plan of merger was mailed to each shareholder of record of the

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subsidiary corporation. In any case, the fair value of shares shall be computed by excluding any appreciation or depreciation in anticipation of such corporation action. Any shareholder failing to make demand within the applicable 10-day or 15-day period shall be bound by the terms of the proposed corporation action. Any shareholder making such demand shall thereafter be entitled only to payment as provided in this section and shall not be entitled to vote or to exercise any other rights of a shareholder.

(4)³ No such demand may be withdrawn unless the corporation shall consent thereto. However, the right of such shareholder to be paid the fair market value of his shares shall cease, and his status as a shareholder shall be restored without prejudice to any corporate proceedings which may have been taken in the interim, if:

(a) Such demand shall be withdrawn upon consent.

(b) The proposed corporate action shall be abandoned or rescinded or the shareholders shall revoke the authority to effect such action.

(c) In the case of a merger, on the date of the filing of the articles of merger the surviving corporation is the owner of all the outstanding shares of the other corporations, domestic and foreign, that are parties to the merger.

(d) No demand or petition for the determination of fair value by a court shall have been made or filed within the time provided in this section.

(e) A court of competent jurisdiction shall determine that such shareholder is not entitled to the relief provided by this section.

(5) Within 10 days after such corporate action is effected, the corporation or, in the case of a merger or consolidation, the surviving or new corporation, domestic or foreign, shall give written notice thereof to each dissenting shareholder who has made demand as herein provided, and shall make a written offer to each such shareholder to pay for such shares at a specified price deemed by such corporation to be the fair value thereof. Such notice and offer shall be accompanied by:

(a) A balance sheet of the corporation, the shares of which the dissenting shareholder holds, as of the latest available date and not more than 12 months prior to the making of such offer; and

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(b) A profit and loss statement of such corporation for the 12-month period ended on the date of such balance sheet.

(6) If within 30 days after the date on which such corporate action was effected the fair value of such shares is agreed upon between any such dissenting shareholders and the corporation, payment therefor shall be made within 90 days after the date on which such corporate action was effected, upon surrender of the certificate or certificates representing such shares. Upon payment of the agreed value, the dissenting shareholder shall cease to have any interest in such shares.

(7) If within such period of 30 days a dissenting shareholder and the corporation do not so agree, then the corporation, within 30 days after receipt of written demand from any dissenting shareholder given within 60 days after the date on which such corporate action was effected, shall, or at its election at any time within such period of 60 days may, file an action in any court of competent jurisdiction in the county in this state where the registered office of the corporation is located requesting that the fair value of such shares be found and determined. If, in the case of a merger or consolidation, the surviving or new corporation is a foreign corporation without a registered office in this state, such petition shall be filed in the county where the registered office of the domestic corporation was last located. If the corporation shall fail to institute the proceeding as herein provided, any dissenting shareholder may do so in the name of the corporation. All dissenting shareholders, wherever residing, shall be made parties to the proceeding as an action against their shares quasi in rem. A copy of the initial pleading shall be served on each dissenting shareholder who is a resident of this state and shall be served on each dissenting shareholder who is a nonresident. The jurisdiction of the court shall be plenary and exclusive. All shareholders who are parties to the proceeding shall be entitled to judgment against the corporation for the amount of the fair value of their shares. The court may, if it so elects, appoint one or more persons as appraisers to receive evidence and recommend a decision on the question of fair value. The appraisers shall have such power and authority as shall be specified in the order of their appointment or an amendment thereof. The judgment shall be payable only upon and concurrently with the surrender to the corporation of the certificate or certificates representing such shares. Upon payment of the judgment, the dissenting shareholder shall cease to have any interest in such shares.

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(8) The judgment shall include an allowance for interest at such rate as the court may find to be fair and equitable in all the circumstances, from the date on which the vote was taken on the proposed corporate action to the date of payment.

(9) The costs and expenses of any such proceeding shall be determined by the court and shall be assessed against the corporation, but all or any part of such costs and expenses may be apportioned and assessed as the court may deem equitable against any or all of the dissenting shareholders who are parties to the proceeding, to whom the corporation shall have made an offer to pay for the shares, if the court shall find that the action of such shareholders in failing to accept such offer was arbitrary or vexatious or not in good faith. Such expenses shall include reasonable compensation for, and reasonable expenses of, the appraisers, but shall exclude the fees and expenses of counsel for, and experts employed by, any party. If the fair value of the shares, as determined, materially exceeds the amount which the corporation offered to pay therefor or if no offer was made, the court in its discretion may award to any shareholder who is a party to the proceeding such sum as the court may determine to be reasonable compensation to any expert or experts employed by the shareholder in the proceeding.

(10) Within 20 days after demanding payment for his shares, each shareholder demanding payment shall submit the certificate or certificates representing his shares to the corporation for notation thereon that such demand has been made. His failure to do so shall, at the option of the corporation, terminate his rights under this section unless a court of competent jurisdiction, for good and sufficient cause shown, shall otherwise direct. If shares represented by a certificate on which notation has been so made shall be transferred, each new certificate issued therefor shall bear similar notation, together with the name of the original dissenting holder of such shares, and a transferee of such shares shall acquire by such transfer no rights in the corporation other than those which the original dissenting shareholder had after making demand for payment of the fair value thereof.

(11) Shares acquired by a corporation pursuant to payment of the agreed value thereof or to payment of the judgment entered therefor, as provided in this section, may be held and disposed of by such corporation as in the case of other treasury shares, except that, in the case of a merger or consolidation, they may be held and disposed of as the plan of merger or consolidation may otherwise provide. The shares of the surviving or resulting

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corporation into which the shares of such dissenting shareholders would have been converted had they assented to the merger or consolidation shall have the status of authorized but unissued shares of the surviving or resulting corporation.

- ¹ Cross reference corrected by the division of statutory revision.
- ² Bracketed language inserted by the division of statutory revision.
- ³ Subsection (4) was substantially edited by the division of statutory revision in the interest of clarity.

Historical Note

Derivation:

Laws 1975, c. 75-250, § 82.

Laws 1953, c. 28170, § 1.

Fla.St.1951, § 612.40.

Prior Laws:

Fla.St.1975, § 608.23.

Comp.Gen.Laws 1927, § 6564.

Laws 1969, c. 69-23, § 4.

Laws 1925, c. 10096, § 38.

Law Review Commentaries

Florida deadlock statute. Marvin E. Barkin, 13 U.Miami L.Rev. 395 (1959).

Pre-emptive rights of shareholders. Ronald D. McCall, 13 U.Fla.L.R. 221 (1960).

Library References

Corporations § 182.4(4), 584.

C.J.S. Corporations §§ 515, 516, 1612 et seq.

Notes of Decisions

I. Construction and application

Where fruit grower refused to accept interest in new packing association in substitution for interest in old association assets of which had been taken over by new association, under refund certificate, in settling account with fruit grower, new pack-

ing association was required to credit fruit grower's account with refund due her under certificate. Merker v. Lake Region Packing Ass'n, 126 Fla. 589, 172 So. 702 (1937), rehearing denied and modified as to allowance of interest 128 Fla. 208, 174 So. 229.

607.251 Voluntary dissolution by incorporators or directors

A corporation which has not commenced business and which has not issued any shares may be voluntarily dissolved:

(1) Before the organizational meeting of the directors named in the articles of incorporation by the incorporator or incorporators.

(2) At or after the organizational meeting of said directors by the director or directors in the following manner:

(a) Articles of dissolution shall be executed by the incorporator or by the director or a majority of the directors, as the case may be, and acknowledged by him or them, and shall set forth:

1. The name of the corporation.

Appendix B

Internal Revenue Service

OCT 3 1977

Anderson	Jantac	Slack
Bentley	Kernp	Vetter
Cook	Kopel	Walsh
Department of the Treasury		Weeks
Ellis	Fearck-fox	Accts Pay
Fritz	Rivas	Gen Books
Washington DC 20224	Sheehan	
Howard	Skinner	File FNG

Mr. John C. Richardson
 Brown, Wood, Ivey, Mitchell
 & Petty
 One Liberty Plaza
 New York, New York 10006

Person to Contact: Mitchell J. Bragin

Telephone Number: (202) 566-3434

Refer Reply to: T:I:I:2:3

Date: SEP 30 1977

Dear Mr. Richardson:

This is in response to the letter of June 15, 1976, and subsequent correspondence, submitted by Mr. I.W. Cordisco, City Attorney for Vero Beach, Florida (the "City"), in which we have been requested to rule regarding the Federal income tax status of several issues of the City's electric revenue bonds and the City's water and sewer bonds which are to be defeased as more fully described below.

The City presently owns and operates an electric generation, transmission and distribution system (the "Electric System"), which serves the City, the town of Indian River Shores and the county in which the City and Indian River Shores are located. The City has owned and operated the Electric System, which was constructed at a cost in excess of \$46,000,000, for many years. Several issues of revenue bonds (the "Electric Bonds") were sold by the City to finance the construction of the Electric System. Seven issues of these Electric Bonds remain outstanding having an unpaid principal of \$30,435,000. These bonds were issued on the following dates and in the following principal amounts:

<u>Date of Issue</u>	<u>Principal Amount</u>
December 1, 1955	\$ 1,300,000
June 1, 1960	4,200,000
June 1, 1962	3,600,000
December 1, 1968	6,100,000
June 1, 1971	1,000,000
June 1, 1972	5,000,000
June 1, 1974	12,000,000
Total	\$33,200,000

Mr. John C. Richardson

Due to the increase in oil prices and the increasing cost of operating the Electric System, the City desires to sell the Electric System. On May 27, 1976, Florida Power and Light Company ("FPL") submitted a Formal Proposal to the City, setting forth the terms of FPL's offer to purchase the Electric System and a description of the formula used for determining the purchase price to be paid. The Formal Proposal set forth the assets of the Electric System to be acquired. On July 23, 1976, the City Council of the City accepted the Formal Proposal, with amendments, and adopted a resolution to place the question of the City's sale to FPL on a referendum to be submitted to the voters on September 7, 1976. On that day, the voters approved an amendment to the City's Charter to permit the sale of the Electric System to FPL.

The Formal Proposal, as accepted by the City, provided that FPL would: (1) pay the City \$7,232,000, (2) defease the outstanding Electric Bonds, (3) buy the inventory relating to the Electric System, and (4) assume the risk of variations in the cost of defeasance prior to closing. The City also would retain assets of the Electric System, having a value of \$3,549,000. Under the Formal Proposal the anticipated purchase price to FPL was approximately \$34,622,000; however, this price could go higher because of FPL's assumption of the risk of any variations in the cost of defeasance. Upon sale of the Electric System, the outstanding Electric Bonds will remain outstanding and will not be redeemed until maturity.

It is presently estimated that the \$30,435,000 principal amount of outstanding Electric Bonds may be defeased for approximately \$26,000,000. Under the proposed plan of defeasance, the City will deposit with its Escrow Agent a portion of the money or United States Government Securities, if FPL elects to deliver such securities, received from the sale of the Electric System. All monies received by the Escrow Agent will be invested in United States Government Securities. These securities, together with interest paid thereon, will serve as substituted security for the Electric System revenues which were previously pledged to secure the Electric Bonds. The amount and maturities of these securities will be so scheduled as to provide sufficient funds from the principal and interest

Mr. John C. Richardson

payable thereon to make all required interest payments on the Electric Bonds when due and to retire them at maturity. The establishment of the Escrow Fund with United States Government Securities will act to release the City from all covenants contained in the ordinances authorizing the Electric Bonds, other than the covenant to pay the interest when due and to retire the Electric Bonds at maturity.

The escrow account will terminate after all payments of principal and interest due with respect to the Electric Bonds have been transmitted to the paying agents for the Electric Bonds. It is represented that upon the termination of the escrow account, any funds remaining in the account will be distributed to the City since FPL will relinquish all right, title and interest to such funds prior to closing the proposed purchase of the Electric System.

In addition to the outstanding Electric Bonds, the City also issued \$6,600,000 principal amount of Water and Sewer Bonds on August 8, 1972, of which the principal amount outstanding is \$6,500,000. The ordinance authorizing the Water and Sewer Bonds contains a covenant that these Bonds will be paid from water and sewer revenues and "from the City's 60 percent share of surplus revenue arising from the operating of the Electric System of said City." Accordingly, the City's authority to sell the Electric System is restricted; therefore, the City proposes to defease the outstanding Water and Sewer Bonds thereby releasing it from the covenant and permitting the proposed sale of the Electric System.

The defeasance of the Water and Sewer Bonds will be accomplished as follows: The City will deposit with its Escrow Agent a portion of the consideration received from the sale of the Electric System. The Escrow Agent will invest any monies deposited with it in United States Government Securities. These securities, together with the interest payable thereon, will serve as substituted security for the City's 60 percent share of the surplus revenue arising from the operation of the Electric System, previously pledged to secure the Water and Sewer Bonds. The amount and maturities of these securities will be so scheduled as to provide sufficient funds from the principal and interest payable thereon to make all required payments on the Water and Sewer Bonds when due and to retire

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the Water and Sewer Bonds at maturity. Upon the sale of the Electric System, the outstanding Water and Sewer Bonds will remain outstanding and will not be redeemed until maturity.

The Escrow Account will terminate after all payments of principal and interest due with respect to the Water and Sewer Bonds have been transmitted to the paying agents for the Bonds. Any remaining balance in the Escrow Account will be paid to the City.

Section 103(a)(1) of the Internal Revenue Code of 1954 provides the general rule that gross income does not include interest on the obligations of a State, a Territory, or a possession of the United States, or a political subdivision thereof.

The Electric Bonds and the Water and Sewer Bonds were both direct issues of the City, a political subdivision of the State of Florida. Although the Electric System is to be sold and the outstanding Bonds defeased to permit the sale, the City continues to be the obligor to which the bondholders look for payments on the Bonds. The proposed sale of the Electric System does not convert the City's Bonds into obligations of FPL nor does it remove the City's obligation to pay the principal and interest on the Bonds.

Accordingly, based upon the documents and information submitted, we conclude that:

(1) After the sale of the Electric System pursuant to the terms of the Formal Proposal, the holders of the outstanding Electric Bonds and the holders of the outstanding Water and Sewer Bonds will not be required to include the interest received thereon in their gross incomes.

(2) Regardless of whether the Electric Bonds and the Water and Sewer Bonds are ultimately held to be defeased as proposed, income earned by the City's escrow account will not be included in the gross income of Florida Power and Light Company, but will be attributed to the City.

Mr. John C. Richardson

This ruling is issued with the proviso that the City did not plan, foresee or contemplate the proposed sale of the Electric System to Florida Power and Light Company at any time prior to June 1, 1974, the date of issue of the final series of Electric Bonds to be defeased. This ruling is also issued on the condition that the City's representatives made a good faith effort in bargaining for the sale of the Electric System to receive full value for it.

Sincerely yours,

Mario E. Lombardo

Chief, Individual Income
Tax Branch

Appendix C

§ 103. Interest on certain governmental obligations

(a) **General rule.**—Gross income does not include interest on—

(1) the obligations of a State, a Territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia;

(2) the obligations of the United States; or

(3) the obligations of a corporation organized under Act of Congress, if such corporation is an instrumentality of the United States and if under the respective Acts authorizing the issue of the obligations the interest is wholly exempt from the taxes imposed by this subtitle.

(b) **Exception.**—Subsection (a) (2) shall not apply to interest on obligations of the United States issued after September 1, 1917 (other than postal savings certificates of deposit, to the extent they represent deposits made before March 1, 1941), unless under the respective Acts authorizing the issuance thereof such interest is wholly exempt from the taxes imposed by this subtitle.

(c) **Industrial development bonds.**—

(1) **Subsection (a) (1) not to apply.**—Except as otherwise provided in this subsection, any industrial development bond shall be treated as an obligation not described in subsection (a) (1).

(2) **Industrial development bond.**—For purposes of this subsection, the term “industrial development bond” means any obligation—

(A) which is issued as part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person who is not an exempt person (within the meaning of paragraph (3)), and

(B) the payment of the principal or interest on which (under the terms of such obligation or any underlying arrangement) is, in whole or in major part—

(i) secured by any interest in property used or to be used in a trade or business or in payments in respect of such property, or

(ii) to be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business.

(3) **Exempt person.**—For purposes of paragraph (2) (A), the term “exempt person” means—

(A) a governmental unit, or

(B) an organization described in section 501(c) (3) and exempt from tax under section 501(a) (but only with respect to a trade or business carried on by such organization which is not an unrelated trade or business, determined by applying section 513(a) to such organization).

(4) **Certain exempt activities.**—Paragraph (1) shall not apply to any obligation which is issued as part of an issue substantially all of the proceeds of which are to be used to provide—

(A) residential real property for family units,

obligations interest on— of a possession of the of the foregoing, or of

under Act of Congress, United States and if of the obligations the used by this subtitle. to interest on obliga- 1917 (other than postal present deposits made Acts authorizing the the ves imposed by

otherwise provided in shall be treated as an

of this subsection, any obligation—

or a major portion of ly or indirectly in any who is not an exempt (3)), and

on which (under the ng arrangement) is, in

ly used or to be used in of such property,

respect of property, or in a trade or business.

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501(c) (3) and exempt with respect to a trade or which is not an unrelated g section 513(a) to such

shall not apply to any substantially all of the

units,

- (B) sports facilities,
- (C) convention or trade show facilities,
- (D) airports, docks, wharves, mass commuting facilities, parking facilities, or storage or training facilities directly related to any of the foregoing,
- (E) sewage or solid waste disposal facilities or facilities for the local furnishing of electric energy or gas,
- (F) air or water pollution control facilities, or
- (G) facilities for the furnishing of water, if available on reasonable demand to members of the general public.

(5) Industrial parks.—Paragraph (1) shall not apply to any obligation issued as part of an issue substantially all of the proceeds of which are to be used for the acquisition or development of land as the site for an industrial park. For purposes of the preceding sentence, the term "development of land" includes the provision of water, sewage, drainage, or similar facilities, or of transportation, power, or communication facilities, which are incidental to use of the site as an industrial park, but, except with respect to such facilities, does not include the provision of structures or buildings.

(6) Exemption for certain small issues.—

(A) In general.—Paragraph (1) shall not apply to any obligation issued as part of an issue the aggregate authorized face amount of which is \$1,000,000 or less and substantially all of the proceeds of which are to be used (i) for the acquisition, construction, reconstruction, or improvement of land or property of a character subject to the allowance for depreciation, or (ii) to redeem part or all of a prior issue which was issued for purposes described in clause (i) or this clause.

(B) Certain prior issues taken into account.—If—

- (i) the proceeds of two or more issues of obligations (whether or not the issuer of each such issue is the same) are or will be used primarily with respect to facilities located in the same incorporated municipality or located in the same county (but not in any incorporated municipality),
- (ii) the principal user of such facilities is or will be the same person or two or more related persons, and
- (iii) but for this subparagraph, subparagraph (A) would apply to each such issue,

then, for purposes of subparagraph (A), in determining the aggregate face amount of any later issue there shall be taken into account the face amount of obligations issued under all prior such issues and outstanding at the time of such later issue (not including as outstanding any obligation which is to be redeemed from the proceeds of the later issue).

(C) Related persons.—For purposes of this paragraph and paragraph (7), a person is a related person to another person if—

- (i) the relationship between such persons would result in a disallowance of losses under section 267 or 707(b), or

(ii) such persons are members of the same controlled group of corporations (as defined in section 1563(a), except that "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears therein).

(D) \$5,000,000 limit in certain cases.—At the election of the issuer, made at such time and in such manner as the Secretary or his delegate shall by regulations prescribe, with respect to any issue this paragraph shall be applied—

(i) by substituting "\$5,000,000" for "\$1,000,000" in subparagraph (A), and

(ii) in determining the aggregate face amount of such issue, by taking into account not only the amount described in subparagraph (B), but also the aggregate amount of capital expenditures with respect to facilities described in subparagraph (E) paid or incurred during the 6-year period beginning 3 years before the date of such issue and ending 3 years after such date (and financed otherwise than out of the proceeds of outstanding issues to which subparagraph (A) applied), as if the aggregate amount of such capital expenditures constituted the face amount of a prior outstanding issue described in subparagraph (B).

(E) Facilities taken into account.—For purposes of subparagraph (D) (ii), the facilities described in this subparagraph are facilities—

(i) located in the same incorporated municipality or located in the same county (but not in any incorporated municipality), and

(ii) the principal user of which is or will be the same person or two or more related persons.

For purposes of clause (i), the determination of whether or not facilities are located in the same governmental unit shall be made as of the date of issue of the issue in question.

(F) Certain capital expenditures not taken into account.—For purposes of subparagraph (D) (ii), any capital expenditure—

(i) to replace property destroyed or damaged by fire, storm, or other casualty, to the extent of the fair market value of the property replaced,

(ii) required by a change made after the date of issue of the issue in question in a Federal or State law or local ordinance of general application or required by a change made after such date in rules and regulations of general application issued under such a law or ordinance, or

(iii) required by circumstances which could not be reasonably foreseen on such date of issue or arising out of a mistake of law or fact (but the aggregate amount of expenditures not taken into account under this clause with respect to any issue shall not exceed \$1,000,000),

shall not be taken into account.

(G) **Limitation on loss of tax exemption.**—In applying subparagraph (D) (ii) with respect to capital expenditures made after the date of any issue, no obligation issued as a part of such issue shall be treated as an obligation not described in subsection (a) (1) by reason of any such expenditure for any period before the date on which such expenditure is paid or incurred.

(H) **Certain refinancing issues.**—In the case of any issue described in subparagraph (A) (ii), an election may be made under subparagraph (D) only if all of the prior issues being redeemed are issues to which subparagraph (A) applies. In applying subparagraph (D) (ii) with respect to such a refinancing issue, capital expenditures shall be taken into account only for purposes of determining whether the prior issues being redeemed qualified (and would have continued to qualify) under subparagraph (A).

(7) **Exception.**—Paragraphs (4), (5), and (6) shall not apply with respect to any obligation for any period during which it is held by a person who is a substantial user of the facilities or a related person.

(d) **Arbitrage bonds.**—

(1) **Subsection (a) (1) not to apply.**—Except as provided in this subsection, any arbitrage bond shall be treated as an obligation not described in subsection (a) (1).

(2) **Arbitrage bond.**—For purposes of this subsection, the term “arbitrage bond” means any obligation which is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly—

(A) to acquire securities (within the meaning of section 165(g) (2) (A) or (B)) or obligations (other than obligations described in subsection (a) (1)) which may be reasonably expected at the time of issuance of such issue, to produce a yield over the term of the issue which is materially higher (taking into account any discount or premium) than the yield on obligations of such issue, or

(B) to replace funds which were used directly or indirectly to acquire securities or obligations described in subparagraph (A).

(3) **Exception.**—Paragraph (1) shall not apply to any obligation—

(A) which is issued as part of an issue substantially all of the proceeds of which are reasonably expected to be used to provide permanent financing for real property used or to be used for residential purposes for the personnel of an educational institution (within the meaning of section 151(e) (4)) which grants baccalaureate or higher degrees, or to replace funds which were so used, and

(B) the yield on which over the term of the issue is not reasonably expected, at the time of issuance of such issue, to be substantially lower than the yield on obligations acquired or to be acquired in providing such financing.

This paragraph shall not apply with respect to any obligation for any period during which it is held by a person who is a substantial user of property financed by the proceeds of the issue of which such obligation

is a part, or by a member of the family (within the meaning of section 318(a) (1)) of any such person.

(4) **Special rules.**—For purposes of paragraph (1), an obligation shall not be treated as an arbitrage bond solely by reason of the fact that—

(A) the proceeds of the issue of which such obligation is a part may be invested for a temporary period in securities or other obligations until such proceeds are needed for the purpose for which such issue was issued, or

(B) an amount of the proceeds of the issue of which such obligation is a part may be invested in securities or other obligations which are part of a reasonably required reserve or replacement fund.

The amount referred to in subparagraph (B) shall not exceed 15 percent of the proceeds of the issue of which such obligation is a part unless the issuer establishes that a higher amount is necessary.

(5) **Regulations.**—The Secretary or his delegate shall prescribe such regulations as may be necessary to carry out the purposes of this subsection.

(e) **Certain irrigation dams.**—A dam for the furnishing of water for irrigation purposes which has a subordinate use in connection with the generation of electric energy by water shall be treated as meeting the requirements of subsection (c) (4) (G) if—

(1) substantially all of the stored water is contractually available for release from such dam for irrigation purposes, and

(2) the water so released is available on reasonable demand to members of the general public.

(f) **Cross references.**—

For provisions relating to the taxable status of—

(1) Bonds and certificates of indebtedness authorized by the First Liberty Bond Act, see sections 1 and 6 of that Act (40 Stat. 35, 36; 31 U.S.C. 746, 755);

(2) Bonds issued to restore or maintain the gold reserve, see section 2 of the Act of March 14, 1900 (31 Stat. 46; 31 U.S.C. 408);

(3) Bonds, notes, certificates of indebtedness, and Treasury bills authorized by the Second Liberty Bond Act, see sections 4, 5(b) and (d), 7, 18(b), and 22(d) of that Act, as amended (40 Stat. 290; 46 Stat. 20, 775; 40 Stat. 291, 1310; 55 Stat. 8; 31 U.S.C. 752a, 754, 747, 753, 757c);

(4) Bonds, notes, and certificates of indebtedness of the United States and bonds of the War Finance Corporation owned by certain nonresidents, see section 3 of the Fourth Liberty Bond Act, as amended (40 Stat. 1311, § 4; 31 U.S.C. 750);

(5) Certificates of indebtedness issued after February 4, 1910, see section 2 of the Act of that date (36 Stat. 192; 31 U.S.C. 769);

(6) Consols of 1930, see section 11 of the Act of March 14, 1900 (31 Stat. 48; 31 U.S.C. 751);

(7) Obligations and evidences of ownership issued by the United States or any of its agencies or instrumentalities on or after March 28, 1942, see section 4 of the Public Debt Act of 1941, as amended (C. 147, 61 Stat. 180; 31 U.S.C. 742a);

(8) Commodity Credit Corporation obligations, see section 5 of the Act of March 8, 1938 (52 Stat. 108; 15 U.S.C. 713a-5);

(9) Debentures issued by Federal Housing Administrator, see sections 204(d) and 207(i) of the National Housing Act, as amended (52 Stat. 14, 20; 12 U.S.C. 1710, 1713);

(10) Debentures issued to mortgagees by United States Maritime Commission, see section 1105(c) of the Merchant Marine Act, 1936, as amended (52 Stat. 972; 46 U.S.C. 1275);

(11) Federal Deposit Insurance Corporation obligations, see section 15 of the Federal Deposit Insurance Act (64 Stat. 890; 12 U.S.C. 1825);

(12) Federal Home Loan Bank obligations, see section 13 of the Federal Home Loan Bank Act, as amended (49 Stat. 295, § 8; 12 U.S.C. 1433);

(13) Federal savings and loan association loans, see section 5(h) of the Home Owners' Loan Act of 1933, as amended (48 Stat. 133; 12 U.S.C. 1464);

(14) Federal Savings and Loan Insurance Corporation obligations, see section 402(e) of the National Housing Act (48 Stat. 1257; 12 U.S.C. 1725);

(15) Home Owners' Loan Corporation bonds, see section 4(c) of the Home Owners' Loan Act of 1933, as amended (48 Stat. 644, c. 168; 12 U.S.C. 1463);

(16) Obligations of Central Bank for Cooperatives, production credit corporations, production credit associations, and banks for cooperatives, see section 63 of the Farm Credit Act of 1933 (48 Stat. 267; 12 U.S.C. 1138c);

(17) Panama Canal bonds, see section 1 of the Act of December 21, 1904 (34 Stat. 5; 31 U.S.C. 743), section 8 of the Act of June 28, 1902 (32 Stat. 484; 31 U.S.C. 744), and section 39 of the Tariff Act of 1909 (36 Stat. 117; 31 U.S.C. 745);

(18) Philippine bonds, etc., issued before the independence of the Philippines, see section 9 of the Philippine Independence Act (48 Stat. 463; 48 U.S.C. 1239);

(19) Postal savings bonds, see section 10 of the Act of June 25, 1910 (36 Stat. 817; 39 U.S.C. 760);

(20) Puerto Rican bonds, see section 3 of the Act of March 2, 1917, as amended (50 Stat. 844; 48 U.S.C. 745);

(21) Treasury notes issued to retire national bank notes, see section 18 of the Federal Reserve Act (38 Stat. 268; 12 U.S.C. 447);

(22) United States Housing Authority obligations, see sections 5(e) and 20(b) of the United States Housing Act of 1937 (50 Stat. 890, 898; 42 U.S.C. 1405, 1420);

(23) Virgin Islands insular and municipal bonds, see section 1 of the Act of October 27, 1949 (63 Stat. 940; 48 U.S.C. 1403).

Aug. 16, 1954, c. 736, 68A Stat. 29; June 28, 1968, Pub.L. 90-364, Title I, § 107(a), 82 Stat. 266; Oct. 24, 1968, Pub.L. 90-634, Title IV, § 401(a), 82 Stat. 1349; Dec. 30, 1969, Pub.L. 91-172, Title VI, § 601(a), 83 Stat. 656; Dec. 10, 1971, Pub.L. 92-178, Title III, § 315(a), (b), 85 Stat. 529; Dec. 23, 1975, Pub.L. 94-164, § 7(a), 89 Stat. 976; Dec. 31, 1975, Pub.L. 94-182, § 301(a), 89 Stat. 1056.

Editorial Notes

Pub.L. 94-164, § 7(a), and Pub.L. 94-182, § 301(a), both redesignated subsec. (e) as subsec. (f) and inserted an identical subsec. (e), relating to certain irrigation dams, applicable to obligations issued after the date of enactment of the Acts (Pub.L. 94-164 enacted Dec. 23, 1975 and Pub.L. 94-182 enacted Dec. 31, 1975).

Section 7 of the Second Liberty Bond Act (31 U.S.C. 747), referred to in par. (3) of subsec. (e), was repealed by Pub.L. 86-346, title I, § 105(b) (2), Sept. 22, 1959, 73 Stat. 622. See 31 U.S.C.A. § 742, Money and Finance.

Section 4(c) of the Home Owners' Loan Act of 1933, as amended (12 U.S.C. 1463), referred to in par. (15) of subsec. (e), was omitted from the code. See notes under former section 1463 of U.S.C.A., Title 12, Banks and Banking.

Section 9 of the Philippine Independence Act (48 U.S.C. 1239), referred to in par. (18) of subsec. (e), was omitted from the code. See notes under former sections 1010-1276e of U.S.C.A., Title 48, Territories and Insular Possessions.

Section 10 of the act of June 25, 1910 (39 U.S.C. 760), referred to in par. (19) of subsec. (e), was repealed by Pub.L. 86-682, § 12(c), Sept. 2, 1960, 74 Stat. 708.

§ 104. Compensation for injuries or sickness

(a) **In general.**—Except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include—

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

(2) the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness;

(3) amounts received through accident or health insurance for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (B) are paid by the employer); and

(4) amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country or in the Coast and Geodetic Survey or the Public Health Service, or as a disability annuity payable under the provisions of section 831 of the Foreign Service Act of 1946, as amended (22 U.S.C. 1081; 60 Stat. 1021).

For purposes of paragraph (3), in the case of an individual who is, or has been, an employee within the meaning of section 401(c) (1) (relating to self-employed individuals), contributions made on behalf of such individual while he was such an employee to a trust described in section 401(a) which is exempt from tax under section 501(a), or under a plan described in section 403(a), shall, to the extent allowed as deductions under section 404, be treated as contributions by the employer which were not includible in the gross income of the employee.

(b) **Cross references.**—

(1) For exclusion from employee's gross income of employer contributions to accident and health plans, see section 106.

(2) For exclusion of part of disability retirement pay from the application of subsection (a) (4) of this section, see section 402(h) of the Career Compensation Act of 1949 (37 U.S.C. 272(h)).

Aug. 16, 1954, c. 736, 68A Stat. 30; Sept. 8, 1960, Pub.L. 86-723, § 51, 74 Stat. 847; Oct. 10, 1962, Pub.L. 87-792, § 7(d), 76 Stat. 829.

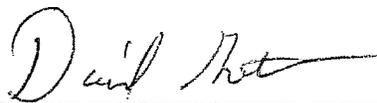
Editorial Notes

The Foreign Service Act of 1946, referred to in subsec. (a) (4), is classified to 22 U.S.C.A. § 1081, Foreign Relations and Intercourse.

VERIFICATION

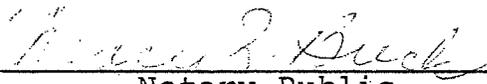
DISTRICT OF COLUMBIA, SS:

Daniel Guttman, being first duly sworn, deposes and says that he is an attorney for Messrs. John Dawson and Eugene Lyon and that as such he has signed the foregoing "Initial Brief of Messrs. John Dawson and Eugene Lyon" for and on behalf of said parties; that he is authorized by the parties so to do; that he has read said Initial Brief and is familiar with the contents thereof; and that the matters and things therein set forth are true and correct to the best of his knowledge, information and belief.



Daniel Guttman

Subscribed and sworn to before me
this 5th day of December, 1977



Notary Public

My Commission Expires September 30, 1978

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused to be served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding in accordance with the requirements of Section 1.17 of the Rules of Practice and Procedure.

Dated at Washington, D.C. this 5th day of December,
1977.



Daniel Guttman