

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)

REPLY BRIEF OF CITIZEN INTERVENORS

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December 20, 1977

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December 20, 1977

Mr. Kenneth Plumb
Secretary
Federal Energy Regulatory
Commission
825 North Capitol Street
Washington, D.C. 20426

Re: Florida Power & Light
Company, Docket No.
E-9574 (Phases I-II)

Dear Mr. Plumb:

On behalf of Mr. John Dawson and Dr. Eugene Lyon, intervenors in the above-captioned proceeding, I hereby enclose the original and twenty-one copies of the Reply Brief in Phases I-II.

I would appreciate it if you would return two date-stamped copies to this office in the enclosed self-addressed, postage paid envelope.

Very truly yours,



Daniel Guttman

Attorney for Mr. John Dawson
and Dr. Eugene Lyon

DG:wah

Enclosure

cc: All parties to this proceeding

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Pursuant to the Presiding Law Judge's Ruling of November 2, 1977, Mr. John Dawson and Dr. Eugene Lyon, intervenors in the above-captioned proceeding, ("Citizens") hereby present their reply brief.

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SUMMARY OF ARGUMENT

The argument in the Initial Briefs of City and Company was essentially anticipated in the Initial Briefs of Citizens and Staff. As discussed in the latter, the claims of overall benefit to City and Company from the sale are simply not supported by the record. As detailed in Citizens' Initial Brief, and summarized further herein, the record shows that costs to FP&L outweigh the benefits, and that benefits to the City are speculative, and, in any case, would be obtained at a price that cannot be justified. 1/

The primary argument adduced by FP&L and the City on behalf of the sale does not refer to any benefits to be obtained, but to the existence of a Citizen vote that appears to strongly support the sale. As discussed in Section I herein, the record in this case indicates that the vote of the citizens cannot be a sufficient basis for approval of the application. That vote does not represent a decision to sell the system without regard to the costs and consequences -- but, a decision premised on the assumption that, the Citizens having been adequately apprised of the impact of the proposal and alternatives to it, the economic benefits would clearly exceed the costs.

1/ Citizens must note with amazement a refrain that appears in the FP&L Brief -- that Citizens and Staff failed to "present evidence." On page 13, for example, FP&L states that "(N)either Citizen Intervenors nor the Commission Staff presented any studies regarding the reasonableness of the purchase price." On page 28, FP&L states that, "no party challenging the proposed acquisition presented evidence that the procedures leading to the determination by the City Council of Vero Beach or the electorate to sell the system were deficient in any way."

First, the Applicant -- and not Staff and Citizens -- bear the burden of proof in this case. As detailed in Citizens' Initial Brief and herein, the Applicant (and the City) simply failed to present adequate "studies" of the reasonableness of the purchase price.

Second, Citizens and Staff, as the Company well knows, have filed and have continually been prepared to present testimony on the reasonableness of the transaction and the adequacy of the procedure surrounding it. (The prepared testimony of Citizens' expert Whitfield Russell, for example, details the apparent failure to present alternatives to the voters and the inadequacy of a purchase price that fails to provide consideration for the City's natural gas entitlements.) This testimony was scheduled for Phase III. However, Citizens, anticipating that FP&L might make statements such as those quoted above, urged that they be given a chance to at least present testimony on alternatives available to the City as part of the

The record shows, however, that neither the citizens nor the Commission (in this proceeding) have been presented with information necessary to safely permit such a conclusion. Citizens therefore suggest that the public interest would be best served if Vero Beach citizens are permitted to reconsider their decision in light of necessary information that was not made available to them prior to the vote; and a clear statement of the alternatives that are available. 2/

(footnote continued from previous page)

Phase I-II record. This request was vigorously resisted by Counsel for FP&L. (Phase III Tr. Vol. 6, pages 483-485) Ironically, in supporting the Company position, Counsel for the City explained that, "(W)e feel that the first thing that will arise is that there should be an alternative, but it is not available because of certain conduct of Florida Power & Light. I think it will be impossible -- we all know attempting to get alternatives in Phase I is an attempt to try Phase III before we brief the case." (Id., Tr. 485) In short, the absence of a direct presentation by Citizens and Staff as part of the record for the Phase I-II briefs reflects FP&L's resistance to the entry of such evidence into the record -- and not the absence of Citizen and Staff presentations.

Finally, and most importantly, the evidence of record does show that the purchase price is not reasonable and that the procedures leading to the determination to sell the system were deficient. As discussed in detail in Section IIA of Citizens' Initial Brief, and IIA herein, the purchase price simply cannot be deemed to represent fair value. In addition the record as discussed in Citizens' Briefs, (a) shows the failure to use minimally adequate procedures to assure the reasonableness of the purchase price, and (b) the failure to develop adequate data on the prospects for FP&L and the alternatives available to the City and (c) provides strong evidence that FP&L's monopoly power precluded the development of necessary information and alternatives.

2/ See Section IV of Citizen's Initial Brief.

ARGUMENT

I. As the Primary Support for FP&L's Application, Allegan is No Support At All

As discussed in Citizens and Staff's Initial Briefs, and as discussed in Section II below, the record fails to show sufficient evidence of benefit to justify the sale. The Initial Briefs of FP&L and Vero Beach, rely heavily on the Commission and Court decision in the Citizens of Allegan 1/ case, where substantial deference was given to the vote of citizens to sell their electric system.

Neither the Court nor the Commission in that case, however, held that the vote of the citizens was itself sufficient to carry the burden of proof in a Section 203(a) application. 2/ Thus, reference to the Allegan case alone cannot gain approval of an application that, as here, is otherwise unsupported.

The equally important point, however, is that FP&L and the City would ignore the basis for deference in Allegan, and its terms. A review of the decisions, especially in the context of the Commonwealth Edison case 3/ which FP&L and Vero Beach also heavily rely on, indicates that the bases for accord- ing significant weight to the vote in Allegan do not exist here. When the facts here are compared with the findings and reasoning in Allegan, it would appear that Allegan suggests that the public interest would be served by the rejection of the application here.

The decisionmakers in Allegan hardly provided an abstract and absolute deference to the role of a citizens' vote. To the contrary, the Court emphasized that the ruling "is narrowly confined to the facts and circumstances before us . . ." 414 F.2d, at 1127. The deference was specifically based on findings that cannot be made here.

1/ Consumers Power Co., 39 FPC 390 (1968), aff'd Citizens for Allegan County, Inc. v. FPC, 414 F.2d 1125 (D.C. Cir. 1969)

2/ As the court stated, "(T)he City's determination was not made decisive [by the Commission], nor could it be." 414 F.2d at 1130.

3/ Commonwealth Edison Co., 36 FPC 927 (1966) aff'd sub. nom. Utility League v. FPC, 394 F.2d 16 (7th Cir.) cert denied, 393 U.S. 953 (1968)

First, the record showed that the substantial benefits sought by the citizens through acquisition would actually flow to them from the acquisition.

The Allegan electric system, unlike the Vero Beach system, was electrically isolated, and faced related problems of reliability and growth. 39 FPC 104. The Commission decision was based on the finding that the acquisition would provide a significant and needed means of achieving reliability. 1/ Of special importance, for the purposes of this case, the Allegan decisions took notice of evidence that the buyer offered the seller an alternative to the sale.

In Allegan, as here, citizen intervenors contended that the sale reflected coercion. In Allegan, however, the Commission was presented with specific and unambiguous showing that the buyer was itself willing to make available what the Commission and Court apparently deemed to be a reasonable alternative. As the court summarized, at 1132,

"Citizens originally claimed that coercion existed in that Consumers offered the City 'no reasonable choice other than to sell,' and that Consumers did not offer to supply Allegan with electric energy in reasonable terms. The answering pleading attached as an exhibit a letter to the City Council from Consumers offering to sell power at the Company's standard wholesale power rate."

Thus, while the Court expressly recognized, at 1132, that "the significance of the political determination would be effectively undercut by any showing of coercion or undue influence," it did not find undercutting evidence and cited evidence to

1/ Thus the Court cited, at 1132 the Commission's finding that "(L)ooking at the bases alleged by the intervenor and the benefits to the city resulting through increased tax revenue, interest on investment of the purchase price [undisputed facts], enhanced electric system reliability; and considering the entire record before us, we find that on balance the transaction is consistent with the public interest." (emphasis supplied)

the contrary. Here, as summarized infra, there is ample evidence that FP&L refused to provide alternatives and exercised its market power to achieve an unconscionable bargain. Moreover, in starkest contrast to the Court's depiction of Consumer's behavior in Allegan--FP&L doggedly tries to postpone its answer to the evidence. 1/

Thus, the Allegan Court and Commission scrutinized the transaction to ascertain the primary consideration the citizens sought to receive. They assured themselves that this consideration was, indeed, of value, that it was, in fact, being obtained, and that there was affirmative evidence that the sale did not reflect duress. Finally, the Commission assured itself that the further public interests were met. 2/

1/ Most significantly, when Citizens urged that the question of alternatives be considered in Phase I-II, Counsel for FP&L insisted that such consideration be delayed. See Phase III, Vol. 6 Tr. 485-490. Thus, FP&L, by insisting that the record in Phase I-II is complete without any affirmative showing that it has made alternatives available has chosen to fail the Allegan test.

2/ As the Allegan Court stated, at 1130:

"The FPC was aware that its role was not a mere 'ministerial one' even though the City had made its choice. As it stated in denying rehearing:

" . . . it is clear that we would be concerned if the proposed acquisition by a public utility would impair reliability of service or would inherently diminish the potentiality for increased service at the lower reasonable rates, or was at so low a price as to indicate coercion by the buyer or at so high a price as to impair the financial status of the purchaser.

[W]e would also be concerned if there were indications that significant competition between the acquired system and the purchasing utility was being eliminated by the merger, without compensating public benefits which otherwise were not likely of achievement."

As discussed in Citizen's Initial Brief and in Section II above, the application here does not satisfy the concerns expressed by the Commission in Allegan.

The facts in this case are starkly at odds with those relied on in the decisions in Allegan. Here, the record does not show that the city will achieve the primary end sought by the acquisition. It does provide evidence of duress, which is not rebutted by evidence that the buyer offered substantial alternatives to the seller.

The record makes abundantly clear that the primary end sought by the voters here is economic -- they wish to pay lower electric bills. 1/

There is no claim, as in Allegan and Commonwealth, 2/ that Vero Beach is an electrically isolated system, which seeks a sale in order to achieve reliability and growth. Nor -- contrary to the implication of the FP&L brief -- is there evidence that the City seeks to get out of the electric business because of the philosophical preference of the voters -- e.g., citizens prefer private power to public power. 3/

Here, in contrast to Allegan, the record does not show that the end sought by the citizens will clearly be achieved by sale. On the contrary, it shows that the seller failed to provide essential data on this possibility and that it failed to call attention to the existence of, much less adequately illuminate, the substantial risks involved.

In Allegan, the public system was isolated prior to the sale, and would become part of an integrated system after it. There, the benefits related to the undeniable contrast between "before" and "after," and the certainty of the

1/ See generally transcript of Citizen hearing, September 28, 1977.

2/ Commonwealth, like Allegan, also involved the integration of a previously isolated system, by consequence of which substantial and undeniable benefits could be realized. In that case, as in Allegan -- but in contrast to this proceeding -- the Commission found that the seller had offered a reasonable alternative (bulk power) to the sale. 36 FPC, at 940.

3/ Citizens acknowledge that Mr. Kramer, whose testimony is referred to in the FP&L Brief, at 20-21, did come close to stating that he wished the system sold without regard to the alternatives. The record of the hearing at Vero Beach, however, shows that the vast majority of speakers were for the sale because they believe it would reduce costs -- and not because they had any immutable predisposition to sell.

"after" being achieved was not at issue. Here, by contrast, the benefits relate to the assertion that "after" will be the same as "before," in terms of the continued ability of FP&L to provide cheaper service. As discussed in detail in Citizens Initial Brief 1/, however, the Applicant simply did not present any case relating to the "after" part of the story, but examination of Company and City witnesses demonstrated the invalidity of the assumption that it would be simply an extension of the "before".

Moreover, again in sharp contrast to the finding in Allegan, the record provides ample evidence that the seller did not make available alternative means by which the City might seek the primary end -- economic savings -- it sought. First, the seller admittedly did not offer a separate price for the City's generation system. As discussed in Citizens Initial Brief, the record shows that this alternative, by permitting the City to retain the benefits of its greater economics in transmission and distribution, would seem to maximize the end (economic savings) sought by the City. The failure of FP&L to "unbundle" its offer not only is a failure to meet the Allegan test, but is itself evidence of anticompetitive conduct. 2/ Second, the record contains evidence that FP&L did not make wheeling available to Vero Beach, and thereby several limited alternatives to the City. 3/ Third, the record contains evidence that FP&L did not offer access to nuclear power to the City, nor is there evidence that it offered a price for any of the City's excess capacity -- even though, as FP&L's filing in Docket No. ER78-19 shows 4/, it would seem to have need for it.

Finally, there is no statement -- as in Allegan -- that FP&L would make wholesale power available to Vero Beach. While such power would appear to have been available under the terms of the Company's tariff on file with the Commission, the Company objected to inquiry on the availability of this alternative, and, unlike Consumers' Power Company in Allegan, failed to take the simple step of publicly affirming its availability. Indeed, as noted in Citizens Initial Brief, a document made available by the City indicates that wholesale power was not readily available. 5/

1/ And Staff's, as well.

2/ See, e.g., IBM v. United States, 298 U.S. 131 (1936)

3/ See Citizens' Initial Brief, Section IIA.

4/ See Citizens Initial Brief, Section IE.

5/ See Initial Brief, page 57, footnote 1

In sum, in contrast to Allegan, the record in this case simply does not permit the Commission to find that the primary end sought by the voters -- here, economic savings -- will clearly be achieved, and that the means to achieving it were not artificially limited by the seller. Unless such findings can be made, the public interest would seem to lie in offering Citizens the opportunity to reconsider their alternatives in view of the record in this proceeding, in view of the Commission's evaluation of that record, and with the benefit of Commission action to produce further needed information on alternatives. 1/

In urging approval based on Allegan, FP&L and the City state that the Commission must not substitute its judgment for the nonquantifiable elements embodied in the vote of Citizens. This line of argument is a red herring. Citizens do not urge the Commission to substitute its judgment for the "nonquantifiable" voter judgment of "political philosophy, management capability, governmental priority, etc." 3/ The issue in this proceeding is not whether or not the Commission should impose its own judgement in place of that of the citizens, but whether the Commission has a duty to inform the citizens of the failure of FP&L and City to provide adequate evidence that the quantifiable benefits sought will be obtained.

1/ As explained in Section IV of Citizens Initial Brief, because the record here shows that the Citizens lack information on alternatives, a rejection of the application should be accompanied by that information and alternatives are forthcoming.

2/ FP&L Brief at 19, quoting Little testimony.

3/ Allegan, 414 F.2d at 1130, cited at page 17 of the City brief and page 28 of the Company brief.

To emphasize, the voters, and not the experts, should be able to determine the fate of their electric system. The vote was clearly based on the assumption that economics would be achieved, that fair value was being obtained, and of course, that reliability was not being sacrificed. There is hardly serious suggestion that the voters would prefer to sell the system if the economic or reliability costs outweigh the benefits and/or on terms that are onerous and do not reflect fair value.

In urging rejection of the instant application, therefore, Citizen-Intervenors do not seek to deny the right of the voters to decide. Rather, Citizens ask the Commission to provide the voters with the benefit of its expert examination of the certainty and adequacy with which the proposed transaction meets the end sought by voters.

The Initial Briefs of FP&L and the City place strong and repeated emphasis on the assertion that the City "is under no compulsion, fiscal, operational, political or otherwise to dispose of the electric system." 1/ If this is the case, there should be no compelling objection to a decision by this Commission that does not deny the ultimate authority of the voters, but a) advises the voters that their ends may not be met by the proposed transaction, b) that takes action to provide such further information and alternatives as may be required to permit further and full deliberation.

1/ See, e.g., FP&L Brief, at 19. (quoting Mr. Little)

II. The Applicant and the City failed to Meet the Burden of Proof Required by Section 203(a) of the Federal Power Act

The Briefs of FP&L and the City rest their case on the assertion that the record shows that the benefits of the sale outweigh the costs. The record, as detailed in Citizen and Staff Initial Briefs, simply does not permit such findings to be made.

FP&L summarizes its position by stating that, "the record in Phases I and II demonstrates that the proposed acquisition of the Vero Beach would, on balance, produce significant benefits to FP&L, the City, the present customers of the City's system and various tax supported agencies in Indian River Country, Florida." (FP&L Brief, at 18)

Vero Beach concludes its brief by summarizing that, "the record in Phases I and II shows:

1. The City's employees are adequately protected.
2. The condition and reliability of the assets to be acquired are excellent.
3. FP&L's ability to render service will be improved by the acquisition.
4. FP&L's cost of service may increase minimally in the short-run, but should improve . . .
5. The acquisition should not effect FP&L's rate structure.
6. The weight of evidence indicates in all likelihood that the rates of FP&L will continue to be below those that would be charged by the City.
7. The purchase price is reasonable. (City Brief, at 18)

The record does not show, as FP&L contends, that the proposed acquisition would, "on balance, produce significant benefits" to FP&L, the City, and present customers of the City's system.

The record shows, contrary to the City's contention, that the purchase price is not reasonable. The record lacks information that could "show" the effect on FP&L's ability to render service, FP&L's cost of service, FP&L's rate structure, and the future relationship between FP&L's rates and those

that would have been charged by the City. On the other hand, examination of FP&L's witnesses and the Company's filing in Docket No. ER78-19 raise substantial and unanswered concern that the Company's direct presentation here may have seriously understated the economic costs and reliability related dangers of the sale. If any of the City's proposed findings have been shown, it is that the City's assets are in excellent working condition. This, however, simply calls into question the sale's terms and necessity. 1/

Citizens respectfully suggest that most of the FP&L and City argument in support of the conclusions proposed by them, quoted above, were anticipated and adequately dealt with in their Initial Brief. 2/ Here, Citizens summarize the deficiencies in the FP&L and City presentations and respond to some additional matters raised in the Initial Briefs of Company and City.

A. The Adequacy of the Sale Price

As discussed in detail in Citizens' Initial Brief, there is ample evidence that the proposed transfer price cannot be accepted as the embodiment of fair value which City and Company urge. City and Company briefs simply rely on the assertion that the transaction was an arms' length transaction which is itself independent measure of fair value. The briefs provide further evidence that the Company and the City officials simply do not understand, or prefer to blind themselves, to the meaning of market value and the evidence that shows that neither market value nor fair value is present here.

- 1. There is No Precedent for the Contention that the Negotiations Here Represent a Determination of Fair Value.

The City states that "(T)he FP&L-City negotiations appear to be remarkably similar to those conducted in Commonwealth Edison, 36 FPC at 937, 66 PUR 3d at 428, where a price agreed to by the parties "after hard bargaining by both parties . . . based on many factors, including market value, earnings, book value, sales and growth prospects considering

1/ Assuming, arguendo, that City employees are adequately protected, this finding would not itself support a sale. In addition, FP&L's assertion that benefits may flow to neighboring tax jurisdictions, if accurate, would hardly compel a sale in the absence of benefits to FP&L and Vero Beach themselves. (and in the presence of detriments to FP&L stockholders and ratepayers and an inadequate sale price for the City)

2/ And Staff's Initial Brief, as well.

the economics expected to be achieved . . . "was approved by the Commission." (City Brief, at 15)

In Commonwealth Edison, however, the seller was a private corporation with stock that was traded on a market. Here, as detailed in Citizens' Initial Brief, the City itself perceived no market for its assets (other than FP&L). The record is devoid of any evidence of how third parties would state market value.

Mr. Little himself effectively acknowledged that the City does not know the fair value of the system. (Tr. 688)

Moreover, in Commonwealth Edison, the purchase price was "approximately \$24 million more than the then market value [based on stock prices] for the acquisition." 1/ If in Commonwealth the sellers received a price substantially in excess of the market measure, here the seller received a price that does not include any consideration for substantial assets to be transferred. Moreover, as discussed infra, the City will not even receive an assured annual income stream to replace the current annual increase in stockholder (citizen) equity.

FP&L's reliance, at page 22, on the recent Commission decision in the El Paso Natural Gas Co. abandonment case 2/ reflects a similar myopia. As the Commission's opinion in that case discussed at great length, that proceeding contained substantial presentations by the Applicant and its supporters that sought to support, by independent expertise and quantified and examinable methodology, the proposed transfer price. 3/ The Applicant itself produced an "independent engineer" to testify on the fair value. 4/ Moreover, before the transaction is completed "an independent engineer engaged by El Paso will determine the fair market value of the line." 5/

In short, the record in El Paso contains evidence of independent and critical analysis of value that are simply lacking in this case. Once again, the Company mistakes the truism (affirmed in El Paso) that "arms' length bargaining in the market" can be a valid measure of value, with the circumstances here -- i.e., the absence of a market, the absence of independent and alternative valuations, and positive evidence that the price does not reflect a fair valuation.

1/ Commonwealth, 36 FPC, at 937. (fn. omitted)

2/ FERC Opinion No. 4, November 10, 1977

3/ See pages 28-38 of the opinion.

4/ Id., page 32

5/ Id., page 6

FP&L's and Citizens' respective views are two ships passing in the night, and Citizens respectfully suggest the record shows that FP&L has chosen to sail the Titanic.

The Company simply declines to recognize the evidence. It states, at page 21 of its brief:

"The principal support for the reasonableness of the purchase price is the fact that the price was the result of extended arms-length negotiations by informed agents of the two parties. The evidence is uncontroverted on this point."

FP&L would simply ignore the evidence, detailed in Citizens' Initial Brief, at Section IIA, that -- FP&L and City assertions notwithstanding -- the transaction was not an arm's length transaction. This evidence includes (a) the absence of a free market; (b) the artificial limitation of the market; (c) the failure of the buyer to unbundle the sale, and provide an offer (for the City generating system) that might have permitted the City to maximize its savings (d) the failure of the seller to provide consideration for valuable assets; and (e) the failure of buyer or seller to even consider the valuation method -- reproduction cost -- recently insisted upon by the seller in similar circumstances. FP&L simply would ignore the record. It would argue, for example, that the proposed transaction would fulfill the City's goal of obtaining a purchase price "reflecting a reasonable value for the system to be sold." (FP&L Brief, fn. 8, page 10) But, as Mr. Little himself appeared to admit, a determination of value was never made. (Tr. 688, quoted at pages 25-26 of Citizens' Initial Brief)

FP&L's assertion that the "evidence is uncontroverted" that negotiations were conducted by "informed agents of the two parties" is especially neglectful of the record. As detailed in the Citizen and Staff Initial Briefs, both Company and City officials lacked information that is essential if the transaction is to be judged reasonable. 1/

1/ See Citizens Brief, Section IIB (lack of information on benefits to FP&L); IB (lack of information on the use of the City system by FP&L); IC (lack of information on reliability-related benefits); IB (lack of information on future effects of acquisition on stockholders and ratepayers.)

C

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2. The Reliance on the Nason "Valuations" is
Further Evidence of the Inadequacy of the Sale Price.

Company and City briefs invoke Mr. Nason's May, 1974 "valuations" of the City system (Vero Beach Exhibit 8) as indication that the "arm's length" negotiations did indeed, achieve a reasonable result. 1/ This reliance hardly can bolster the Company's cause. If Citizens did not refer to the Nason work in their Initial Brief, it was because of testimony by City officials that the Nason Valuations were not relied on by the City, or the Company. In addition, as Staff's Initial Brief notes, they cannot be accorded weight as competent valuation. The fact that the City and Company would now rely on them is itself further evidence of the absence of needed support for the sale price. In fact, as discussed below, minimal scrutiny of the Nason valuations shows that they may underestimate value by millions of dollars.

Both Mr. Little and Mr. Nason specifically disclaimed any reliance. Thus, the following exchange between Staff Counsel and Mr. Little. 2/

Q: During the negotiations did you rely on Mr. Nason's valuation of the system?

A: No. I said previously that I did not, if by his "valuation" you mean methods of arriving at "value". I was aware of these calculations, asked for some of them. I did not rely on them, nor were they really a factor in the negotiations, in my opinion. (Tr. 1439, emphasis supplied)

Thus, the following exchange with Mr. Nason, for his part:

Q: Did the City rely on your valuations in the study?

A: Not to my knowledge. (Tr. 745)

1/ City Brief at 14-15 ; Company Brief at 12-13. The Company also refers to Mr. Gregg's work, although the City, revealingly, does not. The record bears only vague references to Mr. Gregg's work, which was not produced by the City despite the requests of Counsel for Citizens. (See, e.g., Tr. 1545;1555;1560; 1562; 1565.)

2/ Citizens must note that the above quotation may be contrary to Mr. Little's testimony, at Tr. 402-404, that the Nason work was relied on. However, at Tr. 402-404 Mr. Little does not indicate that it played any significant role.

In the context of the above testimony, it is, at least, surprising that City and Company Briefs would resurrect the Nason work. It does not look any better on its second coming.

As Staff's Initial Brief explains, there is no reason to accord weight to the Nason work. 1/ Mr. Nason had never performed a valuation of a utility (Tr. 745); had no comparable valuations to guide him (Tr. 747) and, by his own admission, only sought to produce "some rough estimates" (Tr. 740)

Minimal scrutiny of the Nason "valuations" readily demonstrates why an independent appraisal is absolutely necessary here. First, while the price to be paid by FP&L roughly corresponds -- by coincidence -- to the lowest measure arrived at by Mr. Nason. (depreciated original cost 2/), Mr. Nason did not even consider the valuation method -- reproduction cost -- insisted upon by the Company in similar circumstances. 3/ There can be little question that a reproduction cost valuation should be in excess not only of the sale price, but of the other values arrived at. Second, Mr. Nason's valuation clearly did not account for substantial assets, e.g., the value of the franchise to FP&L. Third, the valuations actually performed are in error on their own terms.

1/ Staff Brief, at 20.

2/ Mr. Nason produced valuations of \$38,000,000, \$44, 260,000, and \$41,097,000. The price to be paid by the Company (approximately \$36.6 million), would, at the most, fall below the lowest measure found by Mr. Nason.

Apparently, however, the City set \$40,000,000+ as its minimum price. In a startlingly revealing passage of its Brief, the Company explains how the terms of the sale were manipulated to convince citizens that they were getting the bottom line (\$40 million) value sought:

"Because the City's negotiators had publicly stated that the value of the Vero Beach system exceed [sic] \$40 million, FP&L's offer was presented on the basis of the "value to the City . . . The present estimated purchase price would be approximately \$36.6 million." FP&L Brief, at 11.

3/ See Citizens Initial Brief, Section IIA2d.

In addition, to a valuation at depreciated original cost, Mr. Nason performed two further valuations using the capitalized earning technique. These two valuations produced values of \$44,260,000 and \$41,097,000. The keys to a valuation employing capitalization of earnings are, of course, the definition of "earnings" and the capitalization rate chosen. The record shows that Mr. Nason, without justification, used assumptions that are, at the least, highly questionable. The substitution of assumptions that are, at least, equally valid, would substantially increase valuation, by millions of dollars.

Mr. Nason's valuations defined "earnings" as the annual contribution provided by the Electric System to the City General Fund. In fact, the City's annual "earnings" are far greater than that sum. The contribution to the General Fund might be roughly analogized to the dividends paid by a corporation. In addition to dividends, however, a corporation's earnings also include those retained by the corporation for the further conduct of the business. The Nason valuation simply ignores retained earnings.

In the case of the City, the earnings retained by the business must equal at least two-thirds of the amount paid to the general fund, and, in practice, have been about equal to the amount contributed to the General Fund.

As explained by Black and Veatch, the City's consultants:

"The City's revenue bond ordinances stipulate that at least 40 percent of the excess revenues of the Electric Department must be retained for capital improvements and that the remainder may be used "in any lawful manner."

The City has always anticipated the General Funds' share of excess revenues at the time of the preparation of the City's annual budget. Since it is not possible to make an accurate estimate in advance, and since the transfer is limited to no more than 60 percent of the coming years' excess revenues, the budgeted amounts have been necessarily conservative and the transfers now approximate 50 percent of the actual excess revenues. 1/

Thus, the Nason valuation only capitalized approximately one-half of the "excess revenues" achieved by the system each year. It capitalized the amount transferred to the General Fund, but not that retained by the electric system.

1/ Citizens' Exhibit 6, pages 25-26.

As Mr. Wallace, of Black and Veatch, acknowledged, the amount kept by the system would be similar to "retained earnings." (Tr. 1020) As Mr. Nason acknowledged, retained earnings, "net worth," "proprietorship" and "stockholders equity" are essentially synonymous. In brief, if earnings are to be considered in valuation, there is no justification for a failure to consider retained earnings. 1/

The omission of retained earnings in Mr. Nason's "valuation" is readily seen to be substantial error. To correct the error it is necessary to adjust Mr. Nason's capitalization of earnings and his additional capitalization of "going concern" value.

In capitalizing earnings, Mr. Nason defined earnings to equal the \$621,000 contribution to the General Fund for fiscal year 1973. Capitalizing this at 8%, Mr. Nason obtained a sum of \$7,762,000. The \$621,000 however, represents only approximately half of fiscal year 1973 earnings. That is, it does not include that sum retained by the business. When retained earnings are added, the amount capitalized would clearly be far greater, and of course, the resulting value would be substantially increased. Assuming the contribution to the General Fund were equal to retained earnings, the value would increase by another \$7,762,000 2/

A similar adjustment, to include retained earnings, must also be made to Mr. Nason's calculation of the "going concern value" of the system. 3/

Depending upon the precise measure of retained earnings, these two adjustments to the Nason calculation would likely bring the maximum Nason valuation to well over \$50,000,000 -- a sharp contrast with the \$36.6 million purchase price paid by FP&L.

1/ Citizens would readily acknowledge that the concept of earnings can be elusive. The intent of the above discussion is not to define all that might be counted as earnings by the City, but rather to state that a very large category of equity has been neglected. An adequate valuation of the system -- e.g., by an independent source -- could find that other components of gross revenues might also be deemed to be additions to stockholders equity.

2/ Citizens cannot locate actual data for fiscal 1973, but it would appear that retained earnings were somewhat less than the General Fund contribution, and, therefore, the \$7,762,000 is somewhat overstated.

3/ As stated at page 1 of Vero Beach Exhibit 8, "In addition a present valuation estimate was made as to the going concern value of the power system; this estimate was predicated on the rate of increase of the contribution to the General Fund for the past 6 years. This increase amounted to approximately \$84,000 per year. The present value of the incremental increase at this rate for the next 5 years was calculated and then capitalized at 8%."

In addition to the inexplicable failure to provide for retained earnings, Mr. Nason also employed a questionable capitalization rate. Mr. Nason chose an 8% rate. As he admitted, however, a low risk operation -- such as a utility -- might merit a 6% rate. ^{1/} (Tr. 917) Since all parties agree on the excellent condition of the City's assets and the record is replete with attestations to the very "rosy" growth prospects of the City's "self-contained" system, there is ample reason to assume that the City merits the higher rate. At the least, this should have been an assumption employed by City officials in a "conservative" approach to the sale of their assets. (Tr. 917) If the higher rate were employed the valuation would, again, be millions of dollars above that arrived at. For example, when \$621,000 is capitalized at 6% instead of 8%, the result is \$10,352,070 instead of \$7,762,500. An additional adjustment would be made to the capitalization of going concern value. The capitalization of \$333,000 at 6% instead of 8% would produce a value of \$5,551,110 instead of \$4,162,500. Thus, a slight change in the capitalization rate -- a change supported by the evidence -- would increase the valuation by close to \$4,000,000. When the 6% capitalization adjustment is combined with an adjustment to capitalize retained earnings, the result is a valuation that is well over \$10 million dollars above the result set forth by Mr. Nason.

The point, of course, is not that the above rough calculations are themselves an adequate determination of value. Rather, they show that the Nason valuations -- even if they had been relied on -- are more than questionable, and cannot be pulled out of the hat to justify a transaction that cries out for an independent and expert determination of fair value.

^{1/} Citizens note that Mr. Nason apparently used a 6% rate in his own early valuations of the system. See Appendix B to Citizens' Motion to Supplement Record, December 20, 1977

B. The Economic Effect on Citizens,
Stockholders, and Ratepayers

As detailed in the Initial Briefs of Citizens and Staff, (a) the record shows that the only clear economic effects on FP&L will be short-term costs to ratepayers and stockholders; (b) the record does not contain adequate evidence about future rate-related savings to the City, but does show potential costs that City negotiators did not anticipate, and regarding which Company officials cannot now produce adequate information. Moreover, for reasons discussed, supra, the purchase price contemplates substantial economic losses to the City from the sale. 1/

The Company and City Briefs assert that overall economic benefits will flow from the sale. In doing so, however, they broadly ignore the record evidence discussed in detail in Citizen and Staff Briefs. Citizens do not seek to repeat that evidence here, 2/ but must note some of the more glaring assertions made in neglect of the record.

1/ Claimed future savings to the City depend not only on the assurance of rate-related savings, but on the assurance that the purchase price would provide an income stream to the City to replace the income that would have come from the system's operations.

As discussed supra, and in Citizens' Initial Brief, the purchase price is clearly inadequate. As discussed supra, the City, operating under the logic of the Nason valuations, ~~has not sought to replace the income from current electric operations that is retained by the electric system.~~ The purchase price would provide a sum that could generate (through annual interest) an equivalent to the annual General Fund contribution-but fail to include a sum that would generate the retained earnings potential lost through the sale. Thus, any rate-related savings should be balanced against losses relating to the cessation of annual payments to replace those presently attained as retained earnings.

2/ See, generally, Sections ID and IIB of Citizens' Initial Brief.

FP&L's assertion that there will be no adverse impact on the rates paid by its customers is not merely incorrect, but positively perverse. As the FP&L brief states, at page 21:

"The record also shows that, if the acquisition is approved, there will be no adverse rate impact on FP&L's customers In short, Mr. Howard's testimony stands unrebuted and clearly would support the finding that there will be no adverse rate impact on FP&L's customers as a result of the acquisition."

As Mr. Howard admitted, however, the acquisition will result in some increase in fuel adjustment charges to FP&L's customers. (Tr. 199) 1/ Thus, at the outset, the Company would define rates to exclude fuel adjustment charges. Of course, ratepayers would hardly make such a distinction. If they could, there would be no claim that the sale is needed to reduce rates. It was the increased fuel charges that stimulated the citizen desire to sell the Vero Beach system. 2/ Vero Beach's citizens will certainly be shocked to learn that the promise of low rates under FP&L carries the qualification that the Company does not consider fuel cost increases to be rates.

Even if FP&L were permitted to define away fuel cost increases, FP&L's assertion would still be without support. At best, the record simply permits only speculation on the effects of the acquisition on FP&L's base rates. Mr. Howard himself effectively acknowledged as much. In an exchange between Staff Counsel Rogers and Mr. Howard, at Tr. 201-202, Mr. Howard was asked whether the additional

1/ Mr. Howard characterized the increase as "negligible," (Tr. 200), but no precise measure of the increase was provided. As noted in Citizens Brief, at page 16, the Company's filing in FP&L Docket No. ER 78-19 shows that the sum involved will be in the millions of dollars. Volume V, Section H-201 shows over \$5 million in fuel expenses for the Vero Beach plant alone in calendar year 1978. Further information would be necessary, however, to relate this sum precisely to the total increased fuel costs to be shared by FP&L customers.

2/ As the FP&L Brief, at page 4, itself explains:

"In late 1973, the City's system began to face two serious problems: rapidly escalating oil prices and a decline in the availability of natural gas as boiler fuel. As a result, customers of the City's system experienced higher than normal electric bills in the early winter of 1974. In February, 1974, the City began to show the fuel adjustment component of the electric bill as a separate bill entry, in order to indicate to the customer the marked effect of fuel patterns and costs."

capacity needed to serve Vero Beach would require an increase in base rates. He stated that it would not, explaining that new capacity would replace oil, and that "coal generation may well be cheaper than the present generation." (Tr. 202). Mr. Rogers then asked if higher incremental costs of the new capacity might offset any reduction in fuel costs (relating to the displacement of oil). Mr. Howard, as the following quotation shows, effectively acknowledged that he did not know the rate effect of the additional capacity ultimately needed to serve the Vero Beach load:

- Q. When you talked about the resulting mix of using nuclear and coal, is there not associated with those additional generating units a higher incremental capital cost that must be factored in?
- A. There probably will be.
- Q. And that probably will offset any impact that will have in lowering rates?
- A. It may or may not.
- Q. You have not quantified that, though?
- A. No. I have given you my judgment, not specific numbers (Tr. 202) (Emphasis supplied).

Of course, as detailed in Citizens' Initial Brief, 1/ Mr. Howard's judgment was not supported by minimum documentation of FP&L's future costs and rates. Moreover, as further discussed in the Initial Brief, 2/ the FP&L system may experience, and according to the filing in Docket No. ER 78-19 is already faced with, serious capacity problems. If such problems exist, then the cost to FP&L of serving Vero Beach could be far more substantial than the Company's presentation suggests. Indeed, the Company Brief 3/ explains that expected growth in the Vero Beach area would have a downward pressure on rate increases. If this growth occurs in the absence of adequate capacity, however, the effect would likely be the opposite.

1/ Section IIB.

2/ Section IE.

3/ Page 25.

The Company's reliance on the Ernst and Ernst report (commissioned by the City)1/ simply underscores its own failure to present necessary data on its future rates. As explained in Citizens' Initial Brief, Ernst & Ernst relied on historical rate data, and did not consider possible future changes. 2/ The FP&L Brief, at page 24 however, would cite Ernst & Ernst's Mr. Jones for the proposition that, in the future, FP&L's rates should remain below those the municipal system would be capable of.

But FP&L completely misses the point. As discussed in detail in Citizens' Initial Brief, 3/ the record shows that the City and Company assumption about future behavior is invalid. The Company fails to acknowledge that Mr. Jones' assumption --- admittedly not based on data on FP&L's future rates and costs -- must be qualified by the evidence in this case. 4/

The City, for its part, similarly prefers to forward Ernst & Ernst's statements in the face of admissions that they were based on limited data, and evidence that they are, in fact, incorrect. Thus, the City states:

"There is no evidence in this record and no reason to believe that Vero Beach's will get within 5% of FP&L's rates in the foreseeable future." (City Brief, at 14).

In fact, the most current rate comparison in the record shows that this end should have been effectively achieved in July, 1977. 5/

1/ FP&L Brief, pages 24-25.

2/ Citizens' Initial Brief, pages 33-34; 45-46.

3/ Section IIB.

4/ Moreover, the Ernst & Ernst evaluation of the chances of the City to reduce the rate gap with FP&L did not take into consideration the rate increase application announced by FP&L on the eve of the election. FP&L know of the magnitude of the increase months before this announcement. Ernst & Ernst was not asked to reevaluate their conclusions in light of this information.

FP&L shamelessly outdoes the City in its reliance on a proposition that is belied by the record. Thus, FP&L offers Mr. Jones' opinion that 5% target could not likely be met "within four or five years." (FP&L Brief, at 25). The goal was not only met in the course of the hearing, but Ernst & Ernst did not attempt to study a period beyond two years (Tr. 584) -- and of course, its analysis of the alternatives is totally inadequate. 1/

Finally, FP&L and the City cannot make their case by use of rate comparisons in the record. First, as discussed in detail in Cities' Initial Brief, these historical comparisons are of little value in the absence of necessary information about possible future changes. Second, the most current comparison, 2/ presented by Staff witness Earley, shows a relatively small rate gap -- if any. 3/

Although FP&L and the City assert that the analysis by Staff Witness Wilbur C. Earley may be unrepresentative, they make no effort to show how the April bill comparison sponsored by FP&L witness Daniel is any more representative. Mr. Earley's analysis is the only comparison in the record which includes the effect of an FP&L rate increase which became effective July 8, 1977. (Tr. 1576).

Apparently realizing that the rate comparison made by Mr. Daniel is subject to the same criticism it attempts to make of Mr. Earley's comparison, FP&L adopts the comparison of Mr. Frank Howard, the operator of two Holiday Inns in Vero Beach. In presenting his analysis, Mr. Howard went to great lengths to leave the impression that the Holiday Inn West, served by FP&L, paid less for more electricity in comparison to the Holiday Inn served by the Vero Beach municipal system. He cited the greater number of rooms (Tr. 320), the larger size of the meeting room and commercial building that houses the restaurant, lounge, kitchen and offices (Tr. 321), the electrical sewer and water treatment plant (Id.) and the tremendous lighted parking lot (Id.). He then based his analysis upon average per-room consumption (Id.). It was not until cross-examination that Mr. Howard revealed that the Holiday Inn served by the Vero Beach municipal system actually used significantly more electricity (Tr. 322). (This is hardly surprising, considering that the Holiday Inn served by the City is located on the beach in a tourist area and thus subject to higher usage.) Further cross-examination revealed that the Holiday Inn Oceanside did not have a demand meter although the Holiday Inn served by FP&L did. (Tr. 324-325). The consumption patterns for the Holiday Inn Beach and City operations are obviously different, as demonstrated by the greater consumption of electricity in the Beach operation, and there is no record evidence of how Mr. Howard could have compared demand charges other than through guesswork.

1/ See Citizens Initial Brief, Section IIC.

2/ Staff Exhibit 47.

3/ See further discussion at pages 36-37 of Citizens Initial Brief.

C. Reliability

As detailed in Citizens' Initial Brief, the record shows that the proposed transaction is not needed to provide any significant increase in reliability to the FP&L and/or Vero Beach systems. 1/ On the other hand, evidence of contingencies on the FP&L system 2/ and the Company's recent filing in FP&L Docket NO. ER78-19, 3/ suggest that the acquisition of the Vero Beach load may pose problems that are inadequately examined in the record. (These contingencies and the filing in ER78-19 are not considered in the FP&L and Company Briefs)

FP&L states that 4/ the "benefits in terms of reliability and service described on the record are unchallenged." They are also nonexistent. As quoted in Citizens' Initial Brief 5/ Company officials declined to suggest, upon invitation, that the acquisition would have any significant positive effect on reliability. City and Company Briefs, however, put forth the following positive effects:

(1) An increase in reliability to the "fringe" areas around Vero Beach now served by FP&L;

(2) An increase in reliability to the beach area (in Vero Beach) relating to an upgrading of distribution lines;

(3) The creation of a district office by FP&L to service customers.

The record shows that the above factors are make-weights that evince a strong desire to find benefits where they do not evidently exist.

The Company effectively acknowledged that service to "fringe" areas (which it could not define) (Tr. 1376-7)

1/ See Sections IB-IC and IID.

2/ Citizens' Brief, Section IIB.

3/ Citizen's Brief, Section IE.

4/ Brief at 26.

5/ Brief at 14-15.

is presently adequately reliable. Indeed, until this hearing, there is no indication the Company had given thought to any reliability problem in the area. (Tr. 1376-77)

In sum, as Mr. Daniels summarized the claim of greater fringe area reliability, "(A)ll I have said, "is that this [the acquisition] would provide a chance to enhance that reliability." (Tr. 1336)

While the upgrading of the Vero Beach distribution system should improve reliability, the acquisition is hardly necessary to achieve this end. The City itself continually contemplated this improvement, and is as capable of achieving it as FP&L.

Finally, Citizens assume that the promise of a new district office is not seriously offered as a significant justification for the sale. However, it does raise interesting questions. Is the Company acknowledging that its current customer services in the Vero Beach area are inadequate?

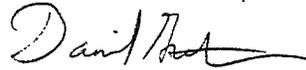
On the other hand, where is the assurance that the Company's services can equal those currently provided to Vero Beach citizens by a utility system that, as the Ernst & Ernst report shows, has been providing customer services more economically than FP&L? 1/

1/ As the Ernst & Ernst report shows, at Schedule VI-1, Vero Beach's customer service costs (in dollars per customer) have been consistently below FP&L's -- and FP&L's are increasing at a rate nearly 75% greater than the City's.

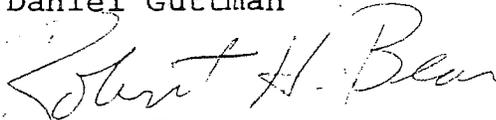
CONCLUSION

WHEREFORE, in view of the foregoing, and as further stated in Citizens' Initial Brief, Citizens respectfully request that the application be denied and that such further action as requested in Citizens' Initial Brief be taken.

Respectfully submitted,



Daniel Guttman



Robert H. Bear

December 20, 1977

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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 §1.17 of the Rules of Practice and Procedure.

Dated at Washington, D.C. this 20th day of
December, 1977.



Daniel Guttman

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