BEFORE THE STATE OF CALIFORNIA

OFFICE OF TAX APPEALS

COUNTY OF SACRAMENTO

IN THE MATTER OF THE APPEAL OF: NEXTERA ENERGY CAPITAL HOLDINGS, INC., AND AFFILIATES, APPELLANT.	CASE NO. 20096580

CERTIFIED COPY

TRANSCRIPT OF PROCEEDINGS

Sacramento, California

Tuesday, February 21, 2023

Reported by:

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CSR No. 10621

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TRANSCRIPT OF PROCEEDINGS, taken at Office of Tax Appeals, 400 R Street, Sacramento, California, commencing at 1:04 p.m. and concluding at 4:16 p.m. on Tuesday, February 21, 2023, reported by Maria Esquivel-Parkinson, CSR No. 10621, RPR, a Certified Shorthand Reporter in and for the State of California.

APPEARANCES:

PANEL MEMBERS:

Asaf Kletter, Lead ALJ

Kenny Gast

Joshua Lambert

FOR THE APPELLANT:

Derick J. Brannan, Representative

Ronald A. Cox, Representative

FOR THE RESPONDENT:

STATE OF CALIFORNIA
FRANCHISE TAX BOARD
P.O. Box 1720, Legal Division
Rancho Cordova, California
By: Rafael Zaychenko, Tax Counsel

Delinda R. Tamagni, Tax Counsel

I N D E X

E X H I B I T S

(Appellant's Exhibit 1 through 20 were received at page 7)

(Respondent's Exhibits A through T and Exhibit U were received at page 7)

PRESENTATION

WITNESS TESTIMONY

CLOSING STATEMENT

SACRAMENTO, CALIFORNIA
TUESDAY, FEBRUARY 21, 2023
1:04 p.m.

ALJ KLETTER: This is the Appeal of NextEra Energy Capital Holdings, Inc., and Affiliates, OTA Case Number 20096580. Today is Tuesday, February 21st, 2023, and the time is approximately 1:04 p.m. We are holding this hearing today in Sacramento, California.

My name is Judge Kletter. I will be the lead administrative law judge for this appeal. With me are administrative law judges Kenny Gast and Josh Lambert. If the parties could please each identify yourself by stating your name for the record, beginning with Appellant. Thank you.

MR. BRANNAN: Derick Brannan with PricewaterhouseCoopers on behalf of Appellant NextEra Energy.

MR. COX: Ron Cox with PWC on behalf of Appellant.

MR. BORES: Scott Bores with NextEra Energy.

ALJ KLETTER: This is Judge Kletter. I just had a quick question, which I know -- and all of your party is at the table, so if you could please mention who else is with you.

MR. BRANNAN: Certainly. Also Ligia Machado with PWC on behalf of Appellant and Mr. Jay Beaupre.

I'm going to get your title wrong, Jay.

MR. BEAUPRE: Senior director of state tax.

MR. BRANNAN: Senior director of state tax with the Appellant.

ALJ KLETTER: Thank you. This is Judge Kletter. And just a confirmation, Mr. Bores said that he was with NextEra. Is he with Florida Power & Light Company or also with --

MR. BORES: Oh, I will clarify. I'm the vice president of finance for Florida Power & Light, which is a subsidiary of NextEra Energy.

ALJ KLETTER: This is Judge Kletter. Thank you.

And then if the Franchise Tax Board could please mention who will be appearing for them as well.

MR. ZAYCHENKO: Certainly. This is Rafael Zaychenko for Respondent Franchise Tax Board. And with me is Delinda Tamagni as co-counsel for Franchise Tax Board.

ALJ KLETTER: This is Judge Kletter. Thank you. So for today, the issues are whether Florida Power & Light Company and Appellant were engaged in a unitary business for the 2009 through 2015 tax years;

and a second issue is if it, Florida Power & Light Company and Appellant were engaged in a unitary business, whether the allocation and apportionment provisions of Revenue and Taxation Code Section 25120 through 25141 do not fairly represent the extent of Appellant's business activity in California.

With respect to the evidentiary issue -- sorry, the evidentiary record, Franchise Tax Board has provided Exhibits A through S during briefing and additional Exhibits T and U. Appellant does not have any -- does not object to the admissibility of these exhibits; therefore, these exhibits are entered into the record.

(Respondent's Exhibits A through T and Exhibit U received into evidence.)

ALJ KLETTER: Appellant has provided Exhibits 1 through 17 and following the prehearing conference provided additional Exhibits 18 through 20. There were no -- FTB did not object to the admissibility of these exhibits; therefore, these exhibits are entered into the record.

(Appellant's Exhibits 1 through 20 were received into evidence.)

ALJ KLETTER: And no additional exhibits were presented today.

So, Mr. Brannan, are you ready to begin your presentation?

MR. BRANNAN: Yes. As a point of clarification, Judge Kletter, during the prehearing conference, there was a question about the propriety or the timeliness of the 2009 and '10 refund claims. And I don't know if it's appropriate or not, but I think my question is are those concerns resolved at this point or should I address them.

ALJ KLETTER: This is Judge Kletter. Those concerns are resolved. Thank you.

MR. BRANNAN: Thank you. And I'm ready to proceed when necessary.

ALJ KLETTER: Please begin.

PRESENTATION

BY MR. BRANNAN, Attorney on behalf of the Appellant:

Thank you very much, Judge Lambert, Judge Kletter and Judge Gast for your time this afternoon.

On a fundamental basis, you know, as described by the issue statements, this case is about fairness. And fairness is not a concept that we see very often in the tax world, quite frankly, because it is generally driven by the statutes.

This case is driven by the facts, and all of the facts make the difference here. And the question really is whether it is fair for the State of California to impose tax on income earned by a Florida-based, rate-regulated public utility zealously regulated by the Florida Public Service Commission -- we'll call them "FPSC" or "the Commission" throughout -- and the activities of FPL, Florida Power & Light, which really have no rational relationship to the State of California.

Appellant is engaged in two distinct businesses. One is a Florida-based, rate-regulated public utility, and the other is a wholesale power business which sells power to commercial buyers outside of Florida. The two businesses have no material operational ties and should not be part of the same unitary business.

To compound matters in this case, Appellant loses money on its wholesale operations in California through its wholesale business but makes money on its rate-regulated utility in Florida. As a result, and regardless of whether or not the businesses are part of the same unitary group, the standard formula brings in taxable gain from Florida that has no reasonable connection to Appellant's business activities in California.

The FTB's approach to the instant matter reveals honestly a startling lack of depth. The FTB ignores the facts and relies on labels, unsupported factual statements, and conclusory legal statements to make its case. Empty assertions are insufficient to sustain the Respondent's determination. It's not true simply because the FTB says it's true.

And we embrace our burden on appeal, and we do ask and encourage the panel members to ask questions about the facts and to look at whether those facts, as articulated on both sides, are material to the overall operation into a unitary determination in this case.

The facts and law in this case overwhelmingly support Appellant's position on appeal. I'm not sure how or why, but Respondent seems to have lost perspective over the years on what it means to be a unitary business and what distortion is all about. And with that in mind, I'm going to start the presentation with some historical references here to make sure that we're all starting on the same page.

So Slide 2 has the issues. I'll move to Slide 4. "The Unitary Method: Why do we have it and what does it do?" And these are the things that generally we assume that we understand, but sometimes we don't.

The unitary method evolved from a series of property tax cases that involve railroads and the challenges associated with valuing in-state property which was part of a larger interstate railway system. When considered on a state-by-state basis, the tangible property in any given state -- could be the track in one state, the track and switches in another state, ticket offices in another state -- and are a very limited value on their own without reference to the entire interstate railroad.

The unit rule of assessment was born to remedy that problem. So the first quote there on the page of Slide 4 is, "Where interstate operations are carried on and that portion of the corporation's business done within the state cannot clearly be segregated from that done outside the state, the unit rule of assessment employed is employed as a device for allocating to the state for taxation its fair share of the taxable values of the taxpayer." And that's from the Butler Brothers case and actually goes back to the Adams Express case from 1897. So there's history here as to what this rule is supposed to mean and how it's supposed to work.

California and other states expanded this unit rule of assessment to multi-state franchise tax matters in response to the increased complexity of a multi-jurisdictional business and developed the unitary method in order to better reference those activities creating taxable value in a specific state. The goal of both the unit rule of assessment and the unitary method is to achieve fair apportionment of the income or the property values fair to the state and, in this case, fair to the taxpayer.

Case authorities are rife with examples of the businesses traditionally targeted by this unitary method, and it's where the profits of the corporation are largely earned by a series of transactions across state boundaries such as acquire raw materials in one state, manufacture in another state, sell in a third state. And we appreciate that when transactions occur across state boundaries that the unitary method is, in fact, an ideal way theoretically and legally to come up with an answer for that dilemma.

The soundness of the method though is demonstrated by reference to how the taxpayer conducts its business, and that's what matters here. We need to look at the taxpayers and the two different trades or businesses that they are conducting. And they are not unitary.

Continuing with the material in front of you on Slide 4, once determined that a certain set of activities constitute a unitary business, the State must then apply a formula apportioning the income or loss of that business within and without the state. Such an apportionment formula must under both the due process and commerce clauses be fair.

Moving to Slide 5, there's a couple of case authorities that also help us understand what the goal of a standard apportionment formula should be. The apportionment formula should strive to give weight to the various factors which are responsible for earning the income subject to tax. The formula must actually reflect a reasonable sense of how income is generated in the state.

While California has a right to fairly apportion income from an interstate business, that's not what's at issue here in spite of the some of the briefing that's taken place. California is still prohibited from taxing value earned outside of its borders. And that's what's going on in this case.

Revenue and Taxation Code Section 25137 echos these considerations by requiring that the apportionment formula fairly represent the extent of the taxpayer's business activity in the state.

Slide 6. What happens when the apportionment formula isn't fair? We can run it through the ringer.

We can reach our determination. What do we do then if there's still something that's not right? And that's the second part of the presentation that has to do with distortion.

The unitary determination is about how the pieces of the business do or do not work together to earn income subject to tax. By comparison, the apportionment factors are intended to reflect those activities giving rise to the income in a particular tax jurisdiction. Distortion assumes the existence of a unitary business, which, as you well know, is at issue in this case. But it assumes that there is a unitary business when you get to that inquiry and asks the further question as to whether the factors or the apportionment formula accomplish a fair result.

Fair apportionment requires both some minimal connection between California and the out-of-state activities which California seeks to tax and a rational relationship between the income attributed to the State and the intrastate values of the enterprise.

Similarly, a state may not tax a unitary business unless some part of it is conducted in the state and the out-of-state activities are related in some concrete way to the in-state activities. All of these describe situations that we're going to talk about factually in just a moment.

Lastly, consistent with these authorities, if the business within the state is truly separate and distinct from the business without the state so that the segregation of income may be made clearly and accurately, separate accounting method may be properly used or may properly be used. That's a statement from Butler Brothers reiterated in California Edison Stores, repeated yet again in the Container Corp. decision at the appellate court level. That's nothing new. It's just something that very rarely does the FTB want to acknowledge or accept.

Slide 7. I'd like to take you to an example that's in the materials. It's an article by Keesling and Warren. And hopefully those gentlemen do not need any introduction. They are considered kind of deans in this area. They're cited routinely by the California and U.S. Supreme Courts. Mr. Warren at least was one of the coauthors of UDITPA.

And we'd like to turn to what's in one of their articles. And they set up a hypothetical, and the hypothetical starts with a profitable cotton farm operating exclusively in California who then acquires a copper mine in Arizona that operates at a loss. The cotton farm furnishes capital, closely manages, supervises and controls the copper mining operations.

The cotton farm and copper mine have many shared functions, such as accounting, handling of insurance, and purchasing of supplies. And all of those are performed in California. The authors acknowledge that the cotton farm and the copper mine are unitary due to common ownership and shared administrative functions, but then they raise the question, and it's the very question we deal with here today.

And the question is whether it is right to apportion income from the cotton business in California to Arizona and apportion loss from the copper business in California by application of the standard three-factor formula, and three-factor was obviously the standard at that time. The authors conclude that such a result is not only wrong but absurdly wrong.

In continuing, we go on to Slide 8. Notwithstanding the features of common ownership, common management, and common use of property and personnel, there are two separate series of income-producing activities. The income from the sale of cotton can clearly be identified as being attributable to the activities carried on wholly within the state of California. The mining operations in Arizona in no way contributed to the production and sale of cotton and should not be credited with any of the net income derived therefrom.

That's the situation we have today. And to the extent there's any question about the similarity or differences of the businesses in Arizona and California, the authors actually go further in the article and they say even if the taxpayer conducted a cotton farm in Arizona instead of a copper mine, the authors would reach the same conclusion.

So there's a key consideration here. The example is presented by the authors as an obvious example of when distortion ought to apply, even with a unitary business. This example is not just a little wrong, it's absurdly wrong. And these are the people that put the system together that we're here to apply today.

Unfortunately, for purposes of briefing and for purposes of this proceeding, the FTB has yet to even address the example. It was in our opening brief. It was in our reply brief. And we invited the FTB to respond to it, and they have yet to do that. This in spite of the fact that the FTB cited another article by Keesling and Warren in their own materials.

So we're acknowledging them as an authority, and yet we don't want to talk about it. Unfortunately, that's part of a continuing trend here in this matter before the panel. And we ask you again, please look at the cases, please look at the facts.

So next moving to Slide 10. There's a very, very simple organization chart. And we offer this for a few reasons. One, it provides a very high level overview of Appellant's corporate structure.

Two, throughout this presentation, we'll generally refer to the rate-regulated retail business as Florida Power & Light, or FPL. The business is generally conducted by FPL. So for purposes of this discussion, factually they are the same. Similarly, we'll refer to NextEra Energy Resources, or NEER, as the business that conducts the wholesale business outside of the state of Florida.

But third, and this is important, when we refer to those boxes as I like to call them on the org chart, we don't mean to limit the discussion to the corporate entity. As we know historically from the Edison California Stores, boxes don't matter to the unitary analysis. What matters is the trade or business.

If boxes mattered, and this is the point of Edison, then I could routinely adjust the content of my unitary business simply by creating a new entity, and that's not the goal. So the chart is there. The references are there. It's generally how the business works. But the boxes themselves are not critical or not really remotely relevant to the unitary determination for us today.

So at this point what I'd like to do is ask Mr. Scott Bores -- to put him under oath and ask him some questions. I'm sure you'd rather hear from him on the facts of this case than listen to me continue. So I'm not quite sure what the process is for that. I'm not sure, Judge Kletter, if it's you or if it's the court reporter.

ALJ KLETTER: Yeah. So this is Judge Kletter. Just want to ask Mr. Bores to be sworn in for his testimony so we can accept his statements as evidence. If you could please raise your right hand, I'll swear you in.

Do you solemnly swear or affirm that the testimony you are about to give is the truth, the whole truth and nothing but the truth?

THE WITNESS: I do.

THE COURT: You may please begin whenever you're ready then. Thank you.

MR. BRANNAN: So I will kind of frame the structure for Mr. Bores through some, you know, open questions here and would encourage, certainly, the panel at any point in time if they want to follow up. But I also understand that the panel and Respondent will be given an opportunity to question Mr. Bores when we're done.

SCOTT BORES,

having been called as a witness on behalf of the Appellant and previously sworn by the Administrative Law Judge, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. BRANNAN, Attorney on behalf of the Appellant:

Q. But, Mr. Bores, for the record, would you just state your name. You just did that, I guess, but tell the panel a little bit about yourself and your background.

A. Sure. My name is Scott Bores. I'm the vice president of finance for Florida Power & Light. I've been employed by Florida Power & Light for approximately 12 years, all of my career in finance. Today I'm responsible for the profit and loss of Florida Power & Light, which includes all the accounting, budgeting, forecasting, economic projections, and generation resource planning or essentially the new generation we need to add at the utility to serve our customers.

Q. Mr. Bores, would you please tell the panel a little bit about NextEra Energy, keeping in mind that the focus of the appeal is on the 2009 through 2015 tax years.
A. Yeah. NextEra Energy today is the largest rate regulator or largest electric utility in terms of market cap. For the years under appeal, roughly 20- to $35 billion of revenue a year. Approximately 15,000 employees.
As Mr. Brannan talked about, comprised of two separate businesses. There's NextEra Energy Resources, the wholesale business that sells power or essentially helps other utilities, municipalities across 27 other states at the time to ultimately decarbonize through selling them low-cost renewable power.
Florida Power & Light is a separate rate-regulated utility heavily regulated by the Florida Public Service Commission that ultimately at the end of the day serves the retail consumer, at that time probably about $20 billion of revenue a year, roughly 9,000 employees, serving today about 5.8 million customers or 12,000 residents across the state of Florida.
Q. So, Mr. Bores, if you would, kind of describe for the panel a little bit more about NextEra Energy Resources, you know, what it is that they are, if you will, selling throughout the country and where

they sell.
A. Yeah. So for the years under appeal, NextEra Energy Resources I believe was roughly 27 states, and a lot of those states were states that had what we call renewable portfolio standards, or a requirement that a certain amount of power be consumed or procured from renewable assets, I would say. Back at that time, a renewable asset -- wind, solar -- would not be the most economical choice and, hence, why you probably wouldn't see any of that at Florida Power & Light under the years under appeal.
But given certain state mandates and tax credits that were available, that was the strategy of NextEra Energy Resources, to go build wind and solar for other utilities and municipalities to help them meet their renewable portfolio standards and ensure that adequate amounts of power were being delivered in these states from renewable assets.
Q. Who are the NEER customers, you know, generally speaking?
A. They are going to be your large municipalities. I mean, here in California, I know PG&E is a customer. Southern Cal. Edison is a customer. Up in Oregon where I was this last weekend, Portland General Electric is a customer. So a lot of those big other utilities are

municipalities across the United States.

Q. Did NEER during these years do any business in Florida?

A. No, they did not.

Q. So let's talk a little bit more about your current employer, Florida Power & Light. Tell us a little bit more about FPL, what they do, how they do it. And I'll let you just take it from there.

A. So as I eluded to earlier, Florida Power & Light is a rate-regulated utility. We are governed by the Florida Public Service Commission. I like to view them as a -- another set of board of directors who essentially oversees our business and makes sure that we are providing low-cost, reliable electricity to our consumers and having happy consumers at the end of they day.

And we'll talk a little bit about the regulation. But, ultimately, we build generation to serve the end consumer. More than 50 percent of our business or assets are poles and wires, transmission and distribution assets. Roughly 50 percent is just on the distribution side to ultimately deliver the electrons to the end consumer. We bill them, collect the revenues from them, and ultimately service them through all their electrical needs.

Q. So talk about the geographic limitations on where FPL operates.
A. So we are -- we are limited in our service territory, and that is regulated by the Florida Public Service Commission, who ultimately sets up I'll call it service territory boundary limits for utilities.
In the state of Florida, there are three big I'll say regulated utilities: Florida Power & Light, Duke Energy Florida, and Tampa Electric Co., who each have over, you know, half a million customers. And so we have service territories where we are allowed to practice, and ultimately the Commission determines that.
Q. Does FPL ever buy power from NEER?
A. No, we do not. Never have.
Q. Why not?
A. There's no need to. We have done a very good job of putting up a wall to ensure that NEER is not in Florida. There is no need for them to be in Florida during the years under appeal. Florida Power & Light ultimately serves the end consumer, as do the other utilities and municipalities in Florida serve their end consumers. So there's just really no need for them to be there.
Q. Does FPL sell power to NEER?
A. It does not.
Q. So you've spoken a little bit about the commission

and its regulatory oversight, but also in the materials is reference to the Federal Energy Regulatory Commission. Does FERC regulate in any way the FPL retail operations?

A. No. I will say all electric and gas utilities across the United States are to file a, quote/unquote, annual report, a FERC Form 1 with FERC. That essentially lays out income statement, balance sheet at a very detailed level and then has some of the SEC footnotes from their 10-K, 10-Q, whatever SEC requirement.

The commissions -- or I should say all commissions that I am aware of across the United States adopt what we call the "FERC Chart of Accounts" or the set of detailed accounting, very much more detailed than what the SEC would require in an SEC document, to put all of your assets and liabilities on your balance sheet as well as accounts to put all your revenues and expenses on your income statement.

I think they do that for comparability and benchmarking purposes. This way all utilities can benchmark across each other across the United States. Commissions like to see that data. That is really where the FERC regulation stops. It's just a simple annual report that every other utility.

Everything else is heavily regulated by the Florida Public Service Commission. And there is a lot of annual reporting, monthly reporting, in-depth rate case reviews that we have to go through to ultimately set our rates and have our rates approved as just and reasonable.

Q. So you've seen -- I mean, we call them FERC reports I guess affectionately that are submitted to the state. It's -- the state is who is kind of requiring the global report that we're referring to as the FERC report. Let's talk about the, you know, the multiple reports that are required by the Commission at this point. You started to address them, and maybe we could break them out in a little bit of detail.

A. Sure. So I'll say the first one that we file is every month we are required to file an "Earning Surveillance Report." And it is exactly as it is. It's a way for them to surveil our business and making sure we are operating within the parameters of the last rate agreement that they have approved or ultimately a settlement agreement that we may have entered into.

Rates are set through a litigated process, a very detailed litigated process that ultimately allows the Commission as well as many intervening parties -- our big intervenor is the Office of Public Counsel, a legislative group that is established to protect the consumer.

That is a monthly report where they are allowed to -- we provide our income statement, balance sheet, cost of capital, and ultimately what is our return, allowed return on equity and how do we perform compared to that so they can monitor our business.

On an annual basis, we do file what we call an "Annual Status Report" with the Commission. It is their own way of them wanting to look at our income statement, balance sheet, and results. And attached to that is the FERC Form 1 for a more detailed review. But our commission has their own oversight.

In addition, we have an annual clause or rider process for things such as our fuel expense, which is a passthrough, any environmental costs that we can incur. In Florida we now have something called a "storm protection plan clause" as a result of all the hurricanes and us hardening our system. We're starting to bring power lines underground, so we have to file a projection of cost and an actual cost and they come in and do detailed audits on all of that stuff each year.

Q. Just to back up for a moment, I got a little ahead, but, you know, you observe these reports, but can you give a little more background about your personal interaction with the Commission.

A. Yeah. So I am usually in front of the Commission a couple times a year testifying, whether it be through a rate case docket. I was up there a few months ago talking about fuel, fuel costs, and ultimately what has happened with fuel costs given all the volatility we saw in the natural gas market.

I spent time testifying before the Commission on hurricane costs and restoration. Any investments we want to make or retirement of an asset early to provide a benefit to customers we have to bring forth to the Commission to get their approval to retire it and establish what we call a "regulatory asset" so we can continue to recover that investment after it's retired.

So numerous avenues that we're in front of the Commission, as I talked about. There's also all the rider or clause proceedings that happen throughout the year. So there are lots of touch points for the Commission to oversee our business and ensuring that we are protecting the -- or they are protecting the end consumer at the end of the day.

Q. So you just referenced what it is that the Commission does. I mean, what would you describe their role in the state of Florida?

A. I think that they have an oversight function of our business. Right? I alluded to a third board of directors or a second set of board of directors for Florida Power & Light. Anything we want to do ultimately has to be approved by them at the end of the day. They have final prudence review on any dollar we spend. And that's a very important thing to us that we take very seriously at Florida Power & Light is ensuring that we spend our dollars prudently. We have an obligation to our customers and to our shareholders to make sure that any dollar we spend we can recover.

And I think probably the best example I can give is a rate proceeding at FPL. If we want to change base rates, it is a nine-month, in-depth process that starts usually in January with us filing a letter that we're going to indicate we are going to come in for a rate case.

Usually in March we will file thousands of pages of documents. In Florida we use a projected test year. So if I want to set rates for '24, I would file in '23 with a projection of: Here's my income statement and balance sheet for 2024.

But the commission lays out certain minimum filing requirements or schedules that they make you file, and at the end of the day, those are thousands of pages of documents going through. Revenues on one document. Operating expenses on another document. Cost of capital, debt, interest rates, economic conditions, return on equity, et cetera, et cetera.

Along with that, we will usually file the testimony of 15-plus expert the witnesses who support their different areas, whether it be cost of capital, budgeting and forecasting, rates, tariffs, et cetera. Once we file that case in March, you have a four-month discovery process.

So you've got the Commission staff who do their own audit as well as start to pull apart the case and ask questions. You have all the intervenors. So I talked about the Office of Public Counsel. We'll usually have some environmental groups. We'll have the industrial power users. We'll have the Retail Federation intervene in the case. So ten-plus intervenors that are asking us questions over a four-month period to build their own testimony to support what they view side of the case. We will then go through usually a two-week hearing process where all the witnesses come up, direct and then rebuttal.

And ultimately, that will culminate in a staff recommendation and finally a Commission vote so we can implement rates for the 1st of the following year. So very in-depth process that touches every aspect of our business when we go to reset rates.

Q. So is this just a formality from year to year, or has the Commission ever pushed back on some of these proposals?
A. No, the Commission constantly pushes back. There has -- there has yet to be a rate case where we've gotten everything we asked for. And probably the best example would be our 2009/2010 rate case. We asked for just under a billion dollars of rate increases to allows us to earn a fair return and they essentially blanked us out and gave us zero.
And so we had to quickly come and file a rate case again the next year, but it was a bad day at Florida Power & Light. We were downgraded by all the credit rating agencies in New York. Our stock I think lost over 15 percent of its value in that one day. And so it just shows you how important kind of that regulatory relationship is and ensuring that you do good by the customer and are prudent in what you do so you can have a fair regulatory outcome.
Q. So quick question for the panel. I mean, can you maybe draw a comparison between the financial accounting records and the regulatory recordkeeping requirements that you have to deal with?
A. So I think they're vastly different. I would view the regulatory accounting records as much, much more

detailed and a lot more reporting than anything we need to do from a SEC or FERC standpoint. It is a much more in-depth process and a much more regular touchpoint than what we do with the SEC or FERC.

MR. BRANNAN: I think that's all I have. I don't know, members of the panel, if you have questions. Obviously, Mr. Bores will be available and can certainly invite the FTB -- excuse me -- Respondent to ask questions of Mr. Bores at this time as well.

ALJ KLETTER: This is Judge Kletter. I'm not sure if some of the questions, you know, might be best suited for following the remainder of the presentation. But -- so forgive if this question -- feel free to indicate. You know, that's afterwards. But I just had a question in general about the relationship between, you know, the Florida Power & Light business and the NextEra, you know, that energy -- competitive energy business.

Does the relationship between those businesses affect the rate-setting process with the FPSC?

MR. BORES: So I'm going to say no. In general, no. They're two vastly different businesses. And so what we do at FPL has no bearing on NextEra Energy Resources and vice versa. It is fully -- FPL has its own CEO, has its own management team. All of that is included in the rates that ultimately get charged to the Florida consumer and are part of that rate process. There's nothing of the wholesale business that comes into that rate case whatsoever as part of that process.

ALJ KLETTER: Thank you. This is Judge Kletter. And just one other question. You mentioned that, you know, there were some efforts made to put up a wall between the FPL business and the NextEra competitive energy business. Could you explain a little bit more what you meant by that, you know, that a good effort was made to put up a wall between those businesses.

MR. BORES: Yes. And a lot of that I'll say started with the Florida Public Service Commission when they saw this NextEra Energy Resources business or the wholesale business start to grow. It was quickly determined that we needed to put protections in to ensure that the retail consumer was ultimately protected at the end of the day. So one of the reports we file with the Commission every year is something that's called the "Diversification Report." It essentially lists out all of the affiliates of NextEra, FPL, NextEra Energy Resources and shows any intercompany transactions between those affiliates.

And the rule that was established was quickly put in place that if FPL is buying something from one of those affiliates, it needs to either get it at the lower of cost or market to ensure it's getting the lowest possible price and ultimately protecting the retail consumer.

Likewise, if we're selling something, it's got to be at the higher of cost or market. Right? So it's got this protection put in to ensure that the retail consumer is always getting the deal at the end of the day and protecting them. And so that's always lasted and kind of been put in place, and an agreement was made that NextEra Energy Resources, or the wholesale business at that time, would not compete in Florida as a result.

ALJ KLETTER: This is Judge Kletter. Thank you for those explanations. I want to turn it over to the FTB and ask.

FTB, do you have any questions for the witness?

MR. ZAYCHENKO: I'd like to confer with co-counsel first, if I may.

ALJ KLETTER: Sure. Thank you.

This is Judge Kletter. I just wanted to ask the FTB. Do you want a five-minute break to confer with your co-counsel?

MR. ZAYCHENKO: I think we're fine. We're almost done, Judge.

ALJ KLETTER: Okay. Thank you.

MR. ZAYCHENKO: I'm sorry. I'm trying to find the specific quote that I'd like to read out.

CROSS-EXAMINATION

BY MR. ZAYCHENKO, Attorney for the Respondent:

Q. So this is -- this comes from the 2009 NextEra annual report. Actually, sorry, FPL's annual report before it rebranded to NextEra. So its chairman and CEO stated that the group would change its name in order to underscore the evolution that the company had been undergoing for over the past decade. So I guess my first question is, is this an accurate statement contained in NextEra's annual report?

MR. BRANNAN: For accurate -- I guess -- well, go ahead, Mr. Bores.

A. So I'm going to preface the answer with I wasn't there in 2009, but from what I understand, yes, we had started to grow the wholesale business starting I think in 2000/2001 is when we really launched that NEER business. And so I think as it started to grow, they wanted to distinguish and rebrand.

Q. (By Ms. Zaychenko) Thank you. So I think my follow-up question would be was that name change the product of a decade of evolution. I believe that's what

the annual report says.
A. Subject to check, I'm going to say I would think what's in the SEC document is factual.
Q. Okay. Thank you.
MR. ZAYCHENKO: So that's all for my questions. And I'd like to begin my opening statement.
ALJ KLETTER: This is Judge Kletter. I just want to check with my panel if they have any questions of Mr. Bores before we move on to FTB, beginning with Judge Gast.
ALJ GAST: Thank you. This is Judge Gast. I have a few questions, but I'll probably reserve most of them for the end. One question I have is can you kind of explain a little bit of the history of FPL, NextEra, and, you know, I know the -- it sounds like the group started in Florida and then branched out into other states. So this isn't like an acquisition of another entity type -- type thing. Can you kind of discuss what happened briefly during that history. I know you weren't there, but that would be pretty helpful for kind of the history of the company.
MS. BORES: Yeah. So I'll give you my best understanding. So Florida Power & Light has been around from -- since sometime I'm going to say the 1920s. We started off with selling ice and then owned donkeys and

orange citrus groves at one time and ultimately started serving electricity to the end consumer. And so that has always been the core of the business, the Florida rate-regulated utility.

In the 2000 time frame I will say, what is now the wholesale business NextEra Energy Resources started to grow in other states or look for how can this business grow or what can we do outside of the state of Florida, completely different business from what's in the state of Florida. And so I think it started with buying a few discrete assets. But then as we saw renewables start to take off, it started developing renewables for other utilities. It found that market and that strategy that it wanted to capitalize on.

And so it was just a -- I'm going to say this evolution that we've been talking about is that business or wholesale business grew from almost nothing and started getting a little bigger each year that really wanted to rebrand and give it its new name such that it was no way, shape, or form affiliated to Florida Power & Light is probably the best way to say that.

ALJ GAST: Okay. And who made that decision to rebrand? Was that the Florida company? Was it a wholly separate kind of, you know -- the wholesale business now?

MR. BORES: I think it was probably I'm going to call it the executive team who sits at the top at NextEra Energy. It was probably just to avoid any confusion that this new business that was being created and they saw a path to growth would any way, shape, or form be associated with Florida Power & Light. Just didn't want to confuse the Florida consumer, politicians, you name it of this is a whole separate business that now has nothing to do with FPL because it's getting big enough where people are going to start noticing it in annual reports and other things as it's starting to generate revenue.

ALJ GAST: Okay. Thank you. I'll probably have more questions later, so I'll let FTB go.

MR. BRANNAN: Judge --

ALJ KLETTER: Sorry. This is Judge Kletter, but, Mr. Brannan, did you have a question?

MR. BRANNAN: I had not really begun any of the legal presentation. Mr. Bores was intended as a fact witness to set up kind of the rest of my presentation. So however -- I mean, obviously, it's your hearing, but however you want to present it. I'm not sure it would be tradition for them to automatically go to the FTB for their presentation, but, obviously, up to you.

ALJ KLETTER: Yeah. So this is Judge Kletter.

I believe you were 12 minutes into your presentation. You presented the witness. FTB asked questions of the witness. I just want to allow my other panel member the opportunity to ask any questions.

MR. BRANNAN: Of course.

THE COURT: And then we'll proceed with the remainder of your presentation, Mr. Brannan. Thank you.

MR. BRANNAN: Thank you.

ALJ KLETTER: Judge Lambert, do you have any questions?

ALJ LAMBERT: Not at this time. Thanks.

ALJ KLETTER: Okay. Great.

So, Mr. Brannan, you can please continue your presentation.

MR. BRANNAN: Sure. And if I may, a couple of follow-up questions for Mr. Bores.

REDIRECT EXAMINATION

BY MR. BRANNAN, Attorney on behalf of Appellant:

Q. You know, one of the questions was asked about the -- you know, I call it the lower of cost or market rule, which he described, and how there's a built-in protection, if you will, for the Florida consumers.

My question is, you know, Mr. Bores, how does that rule in other protections of the Commission, I mean, how does that impact performance or the relationship, if you will, between the wholesale business and the retail rate-regulated business.

A. I would say it discourages us to do business. Ultimately, you know, if FPL is always getting a deal, they're not going to want to buy anything from us. It kind of helps keep us separate. Right? Ultimately, if we have to do something at higher cost or market, it's the shareholder who's going to take the hit because it's not the customer. And so it kind of helps divide and ensure that we do minimal transactions between each other.

Q. So also a question from the FTB about, you know, a bold new frontier -- and I apologize, I'm not really deliberately misstating, but the idea of moving into the renewable business. Could you clarify I think, one, the difference between clean energy and renewable energy; and then, two, how there may be differences as between the energy sold by the wholesale side versus the retail side.

A. Yes. So at Florida Power & Light, we pride ourselves on having clean generation. But that generation today is approximately 70 percent natural gas, 25 percent-ish nuclear, and today less than 4 percent solar, so very small. Back in the years under appeal here, we were less than 1 percent solar at Florida Power & Light. And so we call it clean, but it's clean natural gas because we were burning more oil in America than anybody else in 2001.

NextEra Energy Resources, or the wholesale business, is focused on renewables: Purely wind, solar, battery. And as I talked about, for the years under appeals it wasn't economics. It was renewable portfolio standards and other things that were helping drive that demand, and nobody had the expertise to do it because it was so new. And that's where NEER found and capitalized on this strategy.

As far as how we sell it to the end consumer, I think I talked about it at FPL earlier. We generate, put it through our own poles and wires, and ultimately get it to the end consumer that we bill.

For the wholesale business, they will build the wind farm, they will build their solar site and then sell that electricity to the utility or the municipality who then ultimately transmit that through their own poles and wires to their own consumer who then bills their own consumer. So the wholesale business vastly, vastly different than how we do things at Florida Power & Light.

Q. One last question. The rebranding that's been discussed and is referenced from the 2009 annual report, I mean, when you talk about avoiding confusion with the end users, does that impact on the Commission side as well? I mean, is it just another way to make sure the businesses stay separate?

A. Absolutely. I think it was to make sure all stakeholders clearly understood that there were two separate businesses and this new business that was starting to grow was in no way, shape, or form affiliated with Florida Power & Light or going to impact the end consumer of Florida Power & Light.

MR. BRANNAN: And that's all I have for Mr. Bores.

ALJ KLETTER: This is Judge Kletter. So, Mr. Brannan, if you could now move to the remainder of your presentation.

MR. BRANNAN: Great.

ALJ KLETTER: Thank you.

MR. BRANNAN: Thank you very much.

PRESENTATION (Resumed)

BY MR. BRANNAN, Attorney on behalf of Appellant:

There are a few slides, basically through Slide 14, that cover some factual points. I believe they've been covered by Mr. Bores' testimony so we don't need to walk through those. Certainly, if there are any questions about what's in them we're happy to respond.

Beginning more with, you know, if you will, the traditional legal argument at this point, as I indicated at the beginning, this is a question about fairness and whether the State of California can fairly tax revenue or taxable income that's generated from Florida activities.

So we start with, as we must I guess, with the various tests for a unitary business, specifically the three unities, the contribution and dependency test, and then also the constitutional standard. All of them are essentially blessed by the U.S. Supreme Court in the Barclays decision and, notably, all require some form of operational interdependence across state lines, be it the unity of use, contribution and dependency, or the functional integration.

The focus in this case is really about the lack of operational integration. And we'll talk a bit about strong, centralized management. I appreciate that the FTB is pushing that. It just doesn't exist, and we'll explain why when we get to that point. But again, it's the unitary method and what it is intended to accomplish.

To demonstrate the existence of a single unitary business -- this is on Slide 17 -- it is necessary to do more than simply list circumstances which are labeled unitary factors. So when the FTB suggests things like intercompany finance, transfer of personnel, again and again, there are these references to these unitary buzz words.

It's like playing bingo. And you hear them come out and you're like, oh, we got another point. But what I'm asking the panel to do is to look at the details. When those labels come out, they are not material to the operations of these two very separate businesses. So it's necessary to do more than simply list the circumstances. Such factors are distinguishing features of a unitary business only when they establish functional integration between the activities involved.

So Slide 18, you'll see a brief summary of the Woolworth case. And Woolworth is intriguing. The court considered whether the U.S. retail operations and Canadian retail operations were part of the same unitary business. And in the end, despite almost complete overlap of officers in control, officers and directors, the court concluded that the two nearly identical retail operations were not part of the same unitary business.

And the rational is helpful here. Because the businesses had separate operational functions, there were no centralized purchasing, manufacturing or warehousing or intercompany sales of merchandise. Woolworth is a very, very important case here today. We don't even think that our businesses are separate. We focus on Woolworth, but I want to point out that I think our facts are far better than what's in Woolworth.

The businesses are different. Not just from a customer standpoint but because we're selling at wholesale, generating and dumping it onto the grid, if you will, versus what happens in Florida when the primary concern because of the regulatory oversight are the individual retail consumers in Florida. Very, very different businesses.

Another point. I mentioned earlier that Respondent has ignored authority that we have tried to put together and tried to get them to consider. We've mentioned Woolworth in both our opening and reply briefs, and the FTB has ignored it. They've failed to respond. Please ask the FTB to explain why Woolworth doesn't apply to the instant case.

Also referenced Tenneco West at Slide 19. In that case the taxpayer sought to combine oil and gas -- its oil and gas business with other lines of business: Packaging, shipbuilding, automotive parts manufacturing, and heavy equipment businesses.

All of the businesses had centralized activity such as intercompany transactions, intercompany financing, corporate approval of large expenditures, human resources, accounting, on and on. Nonetheless, the court concluded that the businesses were not unitary because such ties, meaning the administrative ties that we just referenced, represented corporate level activities that exist in most parent-subsidiary relationships.

Again, disturbing trend. We mentioned Tenneco. They don't address it. Please ask the FTB to address these very, very critical case authorities for this case. They make a difference here.

Slide 20, additional unitary authorities from the Board of Equalization including Quaker State Oil. Quaker State gets to the similar line of business. And our position is that they're very different lines of businesses between the retail and the wholesale businesses.

In Quaker State, in spite of the fact that both a coal mining business and an oil refining business were engaged in fossil fuel energy and had centralized administrative services, the board found that the businesses were not unitary based on lack of intercompany transactions and the different manner in which the businesses acquired their raw materials. Those same factors apply here.

Another case that's not referenced is A. M. Castle and they talk about the distinction between or how to distinguish between two businesses and whether they are in the same line of business or not. On page 1808 and 1809 of the A. M. Castle case they talk about, look, it's not enough that businesses be similar. There's a second requirement, and that requirement is that after the businesses are combined that the management can make better use of the resources in the combined business.

Again, looking to the oversight provided by or demanded by the Florida Public Service Commission, that can't happen in this business. That's what we just talked about. That's why the businesses are separate, so that the Commission can protect the individual consumers.

So Slide 21, there's a list of factors that we'd ask you to consider. First, why FPL and NEER are not unitary from our perspective. Very simply, as we've already described, there's different regulatory oversight and constraints. The wholesale business is primarily going to be regulated by FERC, the Federal Energy Regulatory Commission, because they do stuff across state lines.

The retail rate-regulated business is primarily, if not almost exclusively, regulated by the Florida Public Service Commission. And it's important because the FTB throughout its brief says, Hey, they're all regulated so it's all the same. And the fact is, it's not all the same. The Florida Public Service Commission is the single most important player in this case and in the state of Florida when it comes to the provision of power to its residents.

What's not addressed in the FTB's brief or not recognized is the impact of the regulatory agency on the business. It's not enough to just say the FPSC regulates the business and we're done here. As you heard from Mr. Bores, the FPSC acts as a second board of directors reviewing nearly every aspect of the business as it goes forward and provides power to the residents of the state of Florida.

I'm listening and I have a list here of things that I'm hoping he covers in his testimony, and I didn't see anything that he missed. But I think the better question for him is, "Is there anything that they don't regulate and that they don't look at with their comprehensive financial reports?" And the answer has to be, "No, they look at everything." That's what he said.

That's his testimony. And that is, in fact, what happens.

The Commission has significant oversight and regulatory control, retail rates, profit margin, service territory, debt, any sort of financing. They cover everything and they monitor it. They have motive to protect the residents of the state. They have their own Florida state council that gets involved in the rate hearings, these intervenors actively pursuing their own agendas.

Then you have this, the Florida Public Service Commission. They have access. They have access to all of the information, be it financial or logistics when it comes to how we're going to provide power. And they have the authority. So as a third-party nonshareholders in this business, they can make the right decisions for their people who, by the way, aren't necessarily going to be shareholders in this business.

So there is vastly different regulatory oversight. And more important, the impact of that oversight is -- it basically reaches to every aspect of the business. Similarly, they have different business models. You have a retail model versus a wholesale model. We've talked about that.

Pricing. FPSC sets the pricing. They set the parameters for the pricing for the individual consumers. The wholesale market is very different. They have to negotiate each contract that they have. Their pricing is subject to traditional market forces. This is a government-sanctioned monopoly that is granted to FPL in Florida, and with that comes the obligation to basically answer to that Commission as to how they do business and how they provide power to the individuals in the state.

Different customers. We just talked about that. Individual small businesses in Florida versus wholesale other utilities outside the state. And again, there's a very clear boundary here. This isn't a case about internal accounting records showing we make this money here, we make this money there. This isn't a -- this description is not separate accounting. This description is separate business operations that happen to coincide with geographic boundaries, boundaries that are preserved by both sides of the business in order to keep the regulators happy.

They have different trading operations, different generation facilities and energy sources. You just heard from Mr. Bores about the difference between the renewable focus on the wholesale side and the focus on the retail side within Florida about what the cost benefit is. Can they provide energy at a fair price?

Historically, we didn't do renewables in Florida under FPL because it wasn't economical. It's getting there today. The business is changing, not necessarily through any integrated strategy adopted by management. The business is changing because economics allow it to change. And that, again, is out of deference to the regulatory authorities.

You heard Mr. Bores mention that 50 percent of the assets of FPL are dedicated to the distribution side of the business. The wholesale business doesn't have any of that. They don't need to worry about getting it to individuals. That's half of the assets of a business that are dedicated to something that the wholesale business doesn't even touch on.

So we have different infrastructure, different networks. And also at the end of the day, we have different employees and management teams. FPL has its own CEO. NEER has its own CEO. And they have very different functions because they run very different businesses.

We'll talk in a little bit about overlapping executives or management that the FTB has spent a little bit of time on in their briefs, but at the end of the day, what you have is you have separate businesses with their own infrastructure, and at the end of the day there are some shared services that are allocated out at cost pursuant to regulatory requirements.

But they're different employees, different management teams. They run their own businesses. And the biggest difference of all is that the FPL business is answerable to the Florida Public Service Commission and the NEER business, the wholesale business, is not.

Last thing, geography. It's very easy in a unitary discussion to look at the taxpayer and say, Hey, the whole reason for the unitary method is to avoid geographic boundaries and to find a different way to identify the income-earning activities that take place in a different state. That's how the unitary method works. I get that. That's why I started this presentation when and where I started the presentation. But what's important about the geography in this case is that it does, in fact, draw a line around the two businesses.

On one hand you have FPL, which is limited to Florida. We have a convenient geographic boundary. There are a couple plants across the border in Florida that generate electricity. 100 percent of their customers are in the state of Florida. On the flip side, the wholesale business NEER, they don't do business in Florida. And that's important. This isn't an accounting exercise. This is the way they do business because of the regulatory oversight.

So let's talk about what Respondent objects to here. And I think the first and the obvious one is Respondent says, Hey, they're both in the same line of business. They both sell energy and they both are subject to regulatory oversight. Hopefully, I've beat that one to death. I don't have anything more to say. They're not in the same line of business. Electricity is the end result, but that's not enough. It's why the cases that I referenced earlier include Mohasco, Woolworth, Skoal. I mean, what you're looking at here is even if you think they're the same, they're really not. And the support for that is in everything that Mr. Bores just said.

The other key point here that we need to realize is we're dealing with a very unique creature under the law, and that unique creature is a government-regulated public utility. So we need to think about and recognize that there is a reason that it's different. It's okay that it's different.

We need to understand how it operates, which is what Mr. Bores tried to do, and we need to understand that it operates that way in order to keep it separate from the rest of the business. And for my purposes here today, it just happens to coincide with the case I want to make that says that they're not unitary. You know, that's a happy coincidence on my side, but it doesn't change the facts that we're dealing with that Mr. Bores has talked about.

The FTB talks a lot in their briefs about overlapping management. In support of their case, they offer a 79-page list and they say, Hey, look at my papers. They don't tell us where the information is in those 79 pages. So we went through it. And it's in the briefs. It's in our -- I think it's our second reply brief.

In the 79-page list, there are 44 possible overlapping positions between executive and upper management for FPL. Of those positions, there are at best 18 overlapping positions. Of the 18 overlapping positions, if you read the titles, 12 of those positions are basically administrative or financial in nature, such as treasurer, vice president of tax -- no disrespect to Jay -- executive vice president in human resources, in corporate services, vice president of compliance, and the corporate secretary.

Now, I don't really mean to diminish the importance of those roles in the business, but those roles are administrative. Those roles are not operational. So what you're left with at this point is six potentially operational roles out of 44 seats that could become and as between FPL and the other businesses. The short answer, that's not material. The short answer is when you have six operational overlaps at the executive or at the management level in a 15,000-person business, those people are not going to drive that car. That's not what happens.

And the last thing, I think most important, the whole purpose of the overlapping personnel discussion is that there is going to be some transfer of value that takes place during the breaks or when they have their board meetings and we share expertise between the businesses to help one another.

So one, I don't think that's a realistic problem given that we're talking about six operational possible overlaps here. But I think the part that's left out entirely of the FTB's analysis and the Respondent's analysis the role of the Public Service Commission in Florida. Very candidly, it doesn't matter much what those people talk about because everything's got to be run through the Commission.

So all of the rationals and all of the analysis for why overlapping management, overlapping directors are important, candidly, they get thrown out of the window in this case. The Commission tells them what they can do and what they cannot do. They may not like it. They are given parameters for rates. They've got to hit their number. If they do, they get to do it again next year. But there's not a lot of strategy business planning that goes on that helps change the direction of the business when you have this independent third party, this Commission, telling them how they need to run their business.

Asserted intercompany transactions. So the FTB in Table 3 of their opening brief, they put up a big number. Billions. Those are big numbers. I saw those numbers. I'm like, "Oh, my gosh. What is that?" And if you look at that, you say, "Well, that's kind of material." Well, once again, instead of putting a label out there with no real legal or factual support, let's talk about what those numbers represent.

Over the seven years, 84 percent of those numbers represent dividends or transfers of cash between the businesses. That is not a unitary tie. That's an investment. That is how they -- parents are recouping the investment in the support of the subsidiary businesses. Lakeside Village makes it very clear. Just the transfer, the payment of a dividend is not a unitary tie. So just like that, 84 percent of that money is irrelevant for the discussion.

Second, 13 percent of it has to do with back office or administrative functions. Three percent has to do with basically operational functions. That 3 percent, that dollar value of intercompany transactions for nonpower services, that 3 percent represents less than a quarter of one percent of the receipts for this business.

Second, we can look at the 13 percent. We can look at those shared services. And the FTB spends a lot of time on that. Shared services are allocated amongst the businesses' purely back office administrative functions and they're allocated at cost. There is no profit. And that 13 percent, even if we were to give the benefit of the doubt on the value that's transferred back and forth, total along with the 3 percent of the operational, we're still talking about 1 percent of the gross receipts of this business. And this is the point, materiality matters.

The other point here is that all of this evidence that's being provided by the FTB to show substantial intercompany transactions, all of it is generated for the sole purpose of convincing the Florida Public Service Commission that we are not sharing value between the two businesses. That's why the data is here. That's why they follow this chart of accounts. That's why they submit the diversity report. Shared services, the dollar value is immaterial. The dollar value -- or excuse me -- the services themselves are administrative in nature. I mean, we cover that in our brief, our reply brief at page 17.

The other thing that happens here, and it's a little more subtle point and it's what Mr. Bores mentioned earlier, which is, you know, when you are -- when you have to deal with a financial transaction in a certain way, this lower cost or market thing, when you have to do that, it creates a disincentive to do business together.

You've got this -- what they actually call it, and it's my words but -- well, actually, it's their words, I'll just say them, but it's a push-pull. There's a healthy tension as between the two sides of the business where on one side you've got the Commission saying we've got to take care of the individual users in the state of Florida, and on the other side you have the shareholders that are saying, "I just want you to make money."

But the same thing happens with these shared services. There may or may not be a better way for them to allocate the costs out, but the regulators require them to do it at cost. It's in the -- it's done on a methodology that's approved by the IRS. It is not subject to question how they do that. It is, nonetheless, something they look at to make sure that we're not leaking value from the Florida state business to the wholesale business.

I talked a bit about the sales of tangible property. Mr. Bores again referenced this lower cost or market -- lower of cost or market idea. The value is set forth in the FTB's brief. And it's not so much to recognize. We're talking at most like $8 million in any given year of total of the property that transferred. And again, we are talking about businesses that have 8, 10, $15 billion worth of assets, I think 50 billion currently. But it's a huge number. Eight million a year? It's not material.

And you can't look at something and say, Well, it happened and, therefore, it is important. Because when you're in a business's side and the goal of the reporting is to make sure that you're not sharing value, when you look at these numbers, you have to say, yeah, that's no big deal. We're talking about a total benefit, if you will. Because this is one of those rare areas where you can actually quantify the benefit that goes from one side of the business to the other. It's

$2 and a half million a year. Those are the numbers in the FTB's brief. That's not material.

Transfer of personnel, it's the same thing. The FTB labels it as significant transfers of employees. On average, we're talking 171 employees. I think it's 181 employees by year. Again, roughly 1 percent of the total employees of the business. It's not material.

Interesting point. These folks are not located in a big city. And so if you want a new job where you live, it's one of the only or major employers in the area in Juno, Florida. What's going on here is that people are just looking for another job. This is not a deliberate plan of the business, to move people around to share expertise. One percent. That 1 percent number seems to show up an awful lot. And I will tell you, there is no metric in the world where 1 percent is a material number. It's just not. And it doesn't impact their operations.

Intercompany financing. The FTB suggests -- I want to make sure I get the words right -- significant and numerous instances of intercompany financing. That's great. It's another label. So I'm going to keep going. I'm going to keep talking about this stuff because it's important that we focus on the facts.

If you look at actual instances of intercompany financing, at the end of the day the FTB refers to 164 pages of board of directors' minutes. It's one of their exhibits. And it says, hey, the evidence is in here. The evidence is in that 164 pages. Well, if you really look at it, there are exactly two viable instances of intercompany financing.

One instance is a line of credit that started at $36 million in 2008, and it was subsequently increased to $63 million in 2009. And then the investment was transferred out of the FPL business in 2010. So we have a two-year open letter of credit, and it was moved out of the business. It's not in the materials. The reason it was moved out is because they wanted to keep the business separate.

So you can look at that and you can say, Well there is an example of intercompany financing. Or you can look at it and say, Well, they didn't do that right so they fixed it to keep the businesses separate. And the other example is a separate guarantee of up to -- it's $28 million and it happened in 2012. It's no longer active. Two examples of intercompany financing. Those are not numerous instances, nor are the amounts material to a business of this scope on either side.

Mr. Bores talked about the idea of this commitment to clean energy that is referenced in the

2009 annual report. What's important is to understand that that commitment on a global level to clean energy, that's great. All politics aside, that's what we all ought to be doing right now.

And at the time, what you had is you have a company who's leading the league. This is a wholesale business on renewables. That's solar and wind. And at the time, what you had was a -- FPL sitting in Florida that may or may not have been interested in this, but their portfolio didn't recognize that at all. Less than 1 percent solar, zero wind power.

And the reason they couldn't is because it didn't make economic sense to do that, and the Commission knew that. They're worried about what am I -- what's that bill? When that bill shows up in your mailbox every month, what's that bill going to say? Is it going to be a big number or is it going to be a small number? And what they want, they want that number to be small for their consumers, for their voters. And so you didn't have this activity. You didn't have the solar or wind emphasis on that side of the business. It was for economics.

So the last point I think is fascinating because the FTB also at the end of its discussion in the briefs on the unitary business talks about how the businesses are, in fact, different. And that's an odd approach to take at the end of the briefs. And they label it it's diversified business where they complement each other.

Well, it's an interesting point, but it's a stark departure from what they've been arguing throughout the entire briefs about how similar the businesses are. So we look at it and we say diversified business. Well, that's great. They are, in fact, different businesses. We'll agree with that.

As far as it being a unitary tie, again, Lakeside Village. When you have complementary businesses that generate different cash flows, that's not a unitary tie. That's just good investment strategy. So we have a position that's inconsistent with everything else in the briefs, and then second we have a position that doesn't have any legal support.

So the unitary argument, you have two separate businesses, you have dramatically different regulatory climates, you have case authority by way of Woolworth and Tenneco, and so you have examples of where these businesses are conducting separate businesses. We can talk for a long time about, "Well, yeah, they all sell energy," but that ignores the fundamentals of how they do business, of their geographic limitations, of who their customers are, of what energy it is that they are generating, of who they answer to when it comes to price-setting or any other economic measure within the business.

Again, the Florida Public Service Commission is the single most important actor in this whole story because they are not answerable to anybody in this room and they control every meaningful aspect of how that business goes. And for those reasons, the wholesale business conducted outside of Florida, the rate-regulated retail business conducted inside of Florida, are separate businesses. They cannot and should not be a unitary business.

So there's a natural stop. I do have a meaningful presentation on the distortion issue. I'm happy to respond to any questions on the legal issue or any other comments that the panel may want to raise at this point.

ALJ KLETTER: This is Judge Kletter. Thank you for that opportunity. I just want to turn it over to my panel members first to see if they have any additional questions at this time.

Judge Gast, do you have any questions?

ALJ GAST: I have one question for Mr. Brannan. You make much of the fact of the Florida business, you know, is highly regulated and then the other side of the business, NextEra, is not as regulated. What are your thoughts on, you know, other industries like the banking and financial industry, how they can be combined with nonfinancial and banking entities? I think it's safe to say the banking industry is heavily regulated as well. So how is that any different from this?

MR. BRANNAN: I think that the difference is -- may be multi-fold, but the one that immediately jumps to my mind is the impact of the regulatory commission. What you've heard from Mr. Bores is that the Florida Public Service Commission operates much like a second board of directors. It's not just a piece of it, it's every aspect of the business.

FERC regulates interstate commerce, interstate transfer of utilities. There's a case that is referenced in the materials. It's General Motors vs. Tracy. I have the citation here someplace. But at the end of the day, what the U.S. Supreme Court does in that case is it says there is a difference between a local distribution company, which is basically a retail company that historically had been regulated by the states, and a wholesale business. And then they conclude, they -- (a), they are not the same business; and (b), therefore, they will be subject to different regulatory constraints.

So what I would say is that, one, there are different regulators, not the same regulators across, you know, different banks in different states. So different regulators, different regulatory authority, different regulatory interest.

FERC, for example, when they regulate across state lines, they're looking to preserve markets. They're looking to make sure that there's no holdups in the markets, that everybody has equal access. What the Florida Public Service Commission is doing is they are regulating to make sure that their constituents are taken care of. And so they're very different.

And really what's missing from the discussion is there can be situations where different regulatory bodies -- I mean, let's take a public utility here in California. I have no doubt that they are heavily regulated as well. And if you were to put a business regulator by the State of California or the State of Georgia or the State of Florida together, all of the sudden the impacts would probably be quite similar. But when you put a business that is national in nature and doesn't work inside the state of Florida and you have one that is exclusively inside the state of Florida, you're going to have different regulatory impacts, and

that's what's important here.
ALJ GAST: Thank you. Sorry. One other question here. The parent company NEE, NextEra Energy, Inc. --
MR. BRANNAN: Um-hum.
ALJ GAST: -- you know, we're talking about Florida Power & Light and then NEER on the other side, but the parent at the top, what is the parent's relationship to both of those entities and how does that -- how does the parent -- what does the parent do basically?
MR. BRANNAN: Great question. I think there's two aspects, and the first aspect of it is factually what do they do. And if it's acceptable, I'll certainly ask Mr. Bores to address that question.
ALJ KLETTER: This is Judge Kletter. That's fine.
MR. BRANNAN: Thank you.
MR. BORES: Certainly. So the way I would characterize NextEra Energy, Inc., the parent company, is it is simply your traditional Delaware limited liability holding company, and it is the SEC equity-issuer, or stock-issuer. That is really the sole purpose of NextEra Energy, Inc., is to serve as kind of the limited liability company that ultimately issues the

equity on the stock exchange that is used to fund the business of FPL and NEER, hence some of the dividend payments and intercompany funding that Mr. Brannan was talking about.

MR. BRANNAN: So I think that's the first --

Any questions in response to what Mr. Bores said, Judge Gast?

ALJ GAST: Just a follow-up, just so I understand it a little bit more. Why hold -- maybe this is, you know, you don't know the answer, but why hold these entities as brother-sister entities and not, you know -- what's the word -- you know, siphon off the assets of the wholesale business or the highly regulated business such that they're not under common ownership? Why common ownership in this instance?

MR. BORES: So I'm going to honestly say I don't know the answer. I would assume it has to do something legal-wise or tax-wise, but I'm not the expert on that.

ALJ GAST: Okay. No problem. Thank you.

MR. BRANNAN: I won't pretend to know the answer to that one either.

I think the second part of the question is more the legal question. And what you have is you have a common parent which is kind of the evidence, the common ownership and the unitary discussion. But I think what you also have in that parent, the box, you know, again, we need -- what I'm focusing on in the presentation is the trade or business and what I would say the separate trades or businesses that represent the wholesale and the retail businesses.

Based on the description from Mr. Bores, what you have is you have the investor. You have somebody who's just providing oversight as to the finances. The economics. They're doing -- it's the standard oversight provided, and I'm going to get the words from the case wrong, but it's the oversight provided that any investor would do under similar circumstances.

So why have a holding company? I don't know. What they do? They're looking after the money. And I don't mean to diminish that as importance for the overall financial success of the business, but I will say it doesn't have anything to do with the operations of the business.

You know, I'm aware of, you know, the legal authority that's out there. And it's like, well, when you have a holding company, they don't do anything but watch the money, then that has to be really important. And you can sense a little cynical tone here coming from me. Because that's important if there's really nothing else going on. And in this case when we look at the trade or businesses that we have, there's a lot going on.

There's a lot going on outside the state, and there's a lot going on inside the state, meaning the state of Florida in this case. And the fact that somebody's sitting on the top looking over it, that can't be a factor of unitary significance when all of the cases say, Hey, if it's just an investment function, if they're just monitoring the dividends that flow up, that's not a unitary tie that really ought to have any merit -- merit any consideration in this case.

ALJ GAST: Thank you. That's all the questions I have for now.

ALJ KLETTER: This is Judge Kletter. I just want to turn it over to Judge Lambert. Do you have any questions?

ALJ LAMBERT: I have no questions. Thanks.

ALJ KLETTER: This is Judge Kletter. I have just a couple hopefully short clarifying questions. My first question is, is NEER treated in California as a public utility?

MR. BRANNAN: No. I can have Mr. Bores confirm that, but it's not a public utility that I'm aware of.

MR. BORES: My shrug says I have no idea, sorry.

ALJ KLETTER: Thank you. And then just a follow-up question. If you happen to know it, do you know if the Florida Power & Light and NEER use the same Industry Classification Code, like the Department of Commerce NAICS code?

MR. BRANNAN: I do not know. We can certainly get an answer to that. Maybe at the break.

ALJ KLETTER: And then just a couple questions about the general overview on the corporate structure and oversight. So was there a particular point in time at which the FPSC started regulating Florida Power & Light that its operations became basically inter-Florida, solely inter-Florida? Was there a discrete point in time in which, you know, those regulations made it -- you know, for example, context for this question. In 2009 they divested the Seabrook Nuclear Plant in New Hampshire, but Florida Power & Light owned that.

So, you know, was there a point in time at which, you know, like the -- I think in the briefing it says that the FPSC regulation is why they divested it. But is there a discrete point in time in which the FPSC regulation started or became more intense?

MR. BRANNAN: I -- I might speculate that they have been subject to regulatory control since as early as 1925 when they were formed and provided services to the residents of the state of Florida, but I --

Mr. Bores, I don't know if you have anything further on that.

MR. BORES: No. That was going to be my same answer. I can note from dealing with some of the consultants who we deal with who are former commissioners, they were commissioners in the 1970s and oversaw rate regulation on Florida Power & Light at that point in time. So it's existed for quite some time.

ALJ KLETTER: Thank you for that. This is Judge Kletter. Just one other question. So the briefing mentions that the -- that New Hampshire Seabrook property was divested out of Florida Power & Light. I just want to confirm that the ownership was transferred to NEER.

MR. BRANNAN: That is correct. That is no longer a Florida Power & Light asset. When it was, it was I'm going to call it walled off such that no Florida Power & Light customer was paying anything associated with Seabrook or any of those operating costs. That was all pushed to I'll say whatever other affiliate existed at that point in time.

ALJ KLETTER: Thank you. This is Judge

Kletter. And then just, sorry, one last question is that -- it's maybe obvious -- but where is NEER headquarters? Like where are their headquarters?

MR. BORES: NEER is headquartered in Juno Beach, Florida, as well. But again, many locations throughout the United States now.

ALJ KLETTER: This is Judge Kletter. Thank you for answering those questions. It looks like the time is almost 2:30, so just a suggestion that we take a five-minute break and then we'll resume with the FTB's presentation.

Unless, Mr. Brannan, did you --

MR. BRANNAN: No, I do have some discussion on the distortion matter.

ALJ KLETTER: Oh, I'm so sorry. I didn't mean to preempt that.

MR. BRANNAN: No, I've -- if --

ALJ KLETTER: So please feel free to use your time. Yeah.

MR. BRANNAN: Again -- great. Thank you very much.

ALJ KLETTER: If you want to do that, and then we'll --

MR. BRANNAN: I'll do that before we take the break? Okay. It's going to take about 15 minutes.

ALJ KLETTER: That's fine. I just want to make sure that we get a break before two hours have gone by, so...

MR. BRANNAN: Understood.

ALJ KLETTER: Thank you.

MR. BRANNAN: Thank you very much.

So we will move on to the distortion side of the position. You know, as you can see, we feel very strongly as to the position that the businesses are not unitary. However, if the panel determines that the businesses are unitary, then we would assert that the standard apportionment formula does not fairly reflect the business in the state and, therefore, there ought to be some alternative remedy available for apportionment purposes. And the remedy we propose is separate accounting. It's specifically allowed under 25137(a).

So it's -- this I think is a really important time to mention that in 1966 when the state adopted UDITPA, their -- the true form UDITPA, obviously the Uniform Distribution of Income for Tax Purposes Act as enacted in California, but the original form of UDITPA specifically excluded utilities from the combined reporting group. Oddly, they also excluded banks and financial corporations, maybe going back to Judge Gast's question. But the -- California decided not to exclude utilities.

And at the time, there was some discussion about why they would do that and there was the suggestion that there may be some constitutional issues if we arbitrarily exclude them from this unitary concept and the combined reporting idea. But there were questions about it because it was part of the original version of UDITPA to keep utilities out. And maybe -- you know, I don't know. Honestly, I tried to chase it down. I couldn't. But maybe a lot of the discussion topics here are why UDITPA said we're going to exclude that.

For example, Florida, the FPL is not subject to franchise tax in Florida. They're subject to a gross receipts tax. It's a different animal. I think Oregon and Kansas are a couple of the states that adopted UDITPA as written so utilities are not part of a unitary group in those states.

So why does it matter here? Why does it matter as I introduce the distortion discussion? Well, it matters because in Exhibit 19 that was submitted, you know, roughly 15 days ago, you have a letter from Crawford Thomas, at the time the chief counsel of the FTB. And in 1966 he writes to the Chief Counsel, Special Subcommittee on State Taxation in the U.S. House of Representatives.

And the question is asked. You know, essentially what he's responding to is a series of questions. And it's in the materials, but I'll read it because it's extremely helpful here. "We really," referring to the State of California, "did not exclude utilities in financial corporations from the operation of the Act. Our Attorney General felt that if we exclude these corporations, some constitutional objections might be raised." And then he says what's really important for this case. "Any adjustments in the formula for these businesses can be handled through Section 25137."

So what's the point? Well, the point is I'm fine if the legislature can do whatever they want to do when it comes to adopting all or some portion or pieces of UDITPA. That's fine. That's certainly their prerogative. But when you have the chief counsel for the FTB at the time say, Hey, don't worry about it. If a problem comes up, we have distortion. We can deal with this.

And so I think that's going to be tested here in this case. Because what does that letter mean? Is this just a huge bait and switch for taxpayers or for policymakers or for congress, representatives from congress? We didn't really mean what we said? Or are we going to say, "Hey, they might be unitary. But if they are and we don't think it's fairly apportioned, then we are going to look to distortion. And we're not going to give taxpayers an absolute no, distortion will never lie in this situation. We acknowledge it." That's from the chief counsel. And so that really is my question.

So let's talk a little bit about distortion. And, you know, we start on Slide 24 with some distortion slides. What happens when the unitary method isn't fair? I guess one last point. So really what's going on when we talk about utilities, we are also talking about, again, a very unique creature in the corporate framework. We're talking about somebody with different considerations than your typical C corporation, than the typical corporate taxpayer in the state. And that is also part of the reason why they merit separate consideration.

And again, I have outlined the impacts and why these people are different, why FPL is different. And they all go hand-in-hand with the idea that they are a separate legal entity with additional kind of regulatory authority. So they're different.

Slide 24. Even if a business is part of a unitary group, the apportionment formula still cannot attribute to California an unfair amount of income in relation to the value transferred in state. We know based on the net income numbers that are required by the state for us to prepare that when we have this business in Florida that they make a lot of money. What we also know is that the business represented by the wholesale power business, the renewable business primarily, they do not make any taxable income. They operate at a loss. And those numbers are generally presented in Exhibit 1 to Appellant's brief.

And so you have this situation where everybody looks at and they say, Well, you know, you have a loss here and you have a gain there, and all of a sudden we see what's happening. And we appreciate that traditionally the case authority is like, Yeah, well, we don't care about that. But what I'm telling you and what our case is about is that you should care in this case because the facts prove something different.

And what they do is that, you know, looking at the next quote, If application of the standard formula results in an arbitrary or unreasonable tax levy in relation to local business activity, the taxpayer may obtain relief. The Uniform Act expressly recognized that this possibility may occur in some instances by providing alternative methods of allocation and apportionment. And then you see the Restatement of Section 25137 and how it allows for separate accountings and alternative remedy.

You know, I don't know when this happened. It happened over history. And I don't know how it happened. But it seems that the tax agency in this state has erased that from the lexicon and kind of ignored the fact that separate accounting is out there. It's an allowed remedy, and it's allowed and appropriate in cases like this one.

So let's talk about Microsoft and General Mills. Microsoft is the leading, if not the only, California Supreme Court case that really cares much about distortion, and they get into the nitty gritty. The Microsoft Corp concluded that alternative remedies recognized by UDITPA are designed to ameliorate situations where businesses have operations with significantly different margins. The standard apportionment operates under this assumption that profit margins, which the apportionment factors represent, do not vary significantly from states to state. That's why the apportionment formula works is because there's -- they expect, because of the way the business transactions are supposed to be related, they expect --

across state lines, they expect the profit margins to be relatively constant.

NextEra's apportionment -- or NextEra's operations, they upset that fundamental preference -- or premise, excuse me. Its Florida-based operations make money. And they are actually -- it's kind of interesting because they are subject to external constraints as to how much money they make and how they determine the rate and how much they're supposed to charge. But in this situation, the tax numbers that are required to be prepared by the FTB's own rules show no taxable income for the wholesale business.

So continuing. From Microsoft, when there are variations in state-to-state margins, negative versus positive in this case, rote application of the standard formula does not fairly represent the extent of a taxpayer's activity in the state and cannot properly estimate the amount of income attributable to every state in which the taxpayer has a presence.

More from Microsoft. The court concluded that rote application of the standard formula to high-volume, low-profit treasury activities would result in severely underestimating the amount of income attributable to every state except the state hosting the treasury department. In other words, it's going to under-attribute income in every state except the one that's hosting the low-margin activities. We have a little bit of the flip side here, and we'll get into the numbers in a second.

Again, the details matter here. Looking at Microsoft, as further evidence of their concern with rote application of the standard formula, the court cited to an example from Keesling and Warren wherein a taxpayer earned $1 million of income from two states but sold a $1 million building in one state at no gain.

And the court recognized that receipts from the sale of the building resulting in no gain and acknowledged that the standard formula would distort the proper attribution of income to the location of the office building. What you have is the California Supreme Court recognizing that, Hey, we can recognize through distortion when unprofitable activities are being inappropriately mixed with profitable activities. Now, I'm reading a lot into that example, and I know it, but if you go back and you read it again, that's exactly what they're doing. They're just reducing the scale.

In order to determine whether or not the standard formula resulted in distortion so as to justify an alternative method of apportionment, the Microsoft court considered both the qualitative and quantitative factors. And so now we're going to walk through some of those considerations, starting with General Mills. And we're on Slide 27.

General Mills was supplying the qualitative analysis articulated by Microsoft and found that the hedging receipts were qualitatively different from the General Mills business because the activity was not conducted for its own profit but as a risk management tool to support General Mills' main line of business.

I think we're familiar with that general holding, but there's some application here. Because what you have is you have a business that is driven by different profit considerations. Again, it's the oversight of the Florida Public Service Commission. They're telling you how to do it. They are not driven by profit concerns to go maximize profit. They are driven by different consideration than those that apply to the normal trade or business, much like the hedging activities. Because the hedging, the perfect answer at the end of year is zero. That means we have hedged perfectly.

It's the same thing. The right answer for Florida Power & Light is to come up with a number, plus or minus a hundred basis point and hit the target that's set for them by the regulatory authorities. That's not what happens in the wholesale business. They're out there trying to make money, unencumbered, unhindered if you will, by the rate-setting process. And so there's some similarity there between what these businesses do and the comparison of the hedging business versus General Mills' primary trade or business.

So the qualitative considerations we have talked about at length, but I need to bring them up again because it's a separate discussion now. It's the factors that we're talking about. And when the -- we try and decide whether the factors work, we look at these qualitative comparisons of the asserted two different lines of businesses.

Different profit motives? Different business models? You betcha. We've got that here. Rate regulated is different from wholesale. Different customers? Yep. Different geographic locations? Yep. Different capital requirements? Yep, we got that too. Different equipment? Yes. Again, half of the Florida Power & Light assets, distribution networks. Whole business? Got none of that. Different employees? Yes. We have any -- a tremendous number of those qualitative differentiators that the General Mills court talked about. And I would just recycle and repeat the same discussion that we've been having here today and the testimony from Mr. Bores. The businesses are different.

So let's talk about the quantitative analysis from Microsoft and General Mills. There's a number of charts beginning on Slide 29, and I'll try to move through them briskly. But what General Mills and Microsoft were concerned about, or Microsoft in particular, with these quantitative metrics was trying to determine whether the standard apportionment formula attributed an unreasonable amount of activity inside or outside the state.

And it's important because, I get it, it's not just about income at this point. It's about how the factors are working. So the question is what's happening with the activity that's taking place inside or outside the state. In Microsoft, the court found that it was distortive because 24 percent of Microsoft's unitary business activities were attributed to Washington because that's where the treasury operations were. That's where the low-margin operations were.

In General Mills, it was an average of 9 percent of the business activity was assigned to Minnesota. Again, its headquarters. It's where the hedging activities took place. So the math, what they're looking at is: Okay. When we do this apportionment formula, how are the numbers moving? How are the business activities being reflected?

So we look at the chart on Slide 29. And the comparable number is the portion of wholesale nonregulated activity that's attributable to Florida. And that's an odd number to think of, but if you want to draw the apples-to-apples comparison as to what's going on at General Mills and Microsoft, that's the number that we're looking at.

And the comparable percentage, it moves on average, actively attributed to Florida by operation of the formula on average 45 percent of the wholesale business. The wholesale activities end up being attributable to Florida because of the presence and the impact actually of what's going on with FPL. And this is even though the wholesale business has no meaningful operations or profit-generating activities in Florida. There's something wrong with the way the formula is working here.

Similarly, on the flip side, if you focus -- if you focus on what happens to the Florida-based rate-regulated business, the standard formula operates to attribute on average 55 percent of its activities outside of Florida. And that result just can't be. And the reason it can't be is because we know that every nickel of retail business is from the state of Florida.

This is not -- again, this is not an accounting trick. This is how the business works.

And when you compare the results of the standard apportionment formula to how the business works, there's a disconnect and it doesn't work. By focusing on the formula and the factors, we can see that the formula does not fairly reflect the business activities in California, or in Florida for that matter. And it really is supposed to be a two-way street. Just because the General Mills and Microsoft cases only deal with situations where income is being moved outside the state, we have to look at it the other way too. We have to be fair. There has to be consistency in the manner in which we look at these quantitative measures.

Again, by reference to the same ratios discussed in Microsoft and General Mills, Microsoft's short-term investment produced less than 2 percent of the company's income but 73 percent of the gross receipts. General Mills' hedging activities produced at most 2 percent of the company's income but between 8 and 30 percent of the company's gross receipts.

So let me make a couple of points here real quick. First, the FTB has suggested that Appellant should not focus on income for purposes of the quantitative analysis, says that's not the purpose of a distortion analysis. In the abstract I agree, but the factors move the income and so the courts, not just us, the courts consider the impact of the factors on income when they do the quantitative analysis. We're just repeating the numbers that are in the cases. The fact that they happen to consider what happens to the income is just part of the quantitative analysis.

Second, the courts compare taxable income. Because, at the end of the day, that's how the apportionment formula works. You use the factors to apportion taxable income. The factors reflect activities. It's supposed to be a surrogate for how that income is earned. But when you have that apportionment formula, you're moving the income. So that's the other reason why we get to look at the income when we're doing the proper quantitative analysis.

So Slide 31, NEER, or the wholesale business, is responsible for none of the combined report's group income, but it generates on average 59 percent of the gross receipts. Okay. That's the Microsoft comparison. That's the General Mills comparison, when they talk about income and the, you know, apportionment factors and the receipts. It's exactly the same numbers. And you can see how the numbers are presented there on the chart.

The wholesale business generated losses for state tax purposes in each of the years, so it had zero percent of the group income. And while the Florida-based, rate-regulated retail business generated substantial income, on average 143 percent of the group income. That's the difference between the negative number and the positive number that they end up at.

The problem with the negative numbers is that you really can't do the math with a negative number. But, in part, this exercise about how you can never divide by a negative, it really proves the point. It proves that the ratios don't work. It proves that the apportionment formula is unfair.

Slide 32. Compare the profit margins. Again, it's a similar exercise. You look at the profit margins attributable to the rate-regulated retail business and you compare them to what's going on. You have a meaningful profit margin and you have a negative profit margin.

So what the Microsoft court did is they recognize, again, that distortion should be used to moderate disparate profit margins. So the Court considered the relative difference between the profit margins of treasury and the nontreasury operations. And on Microsoft, it revealed the nontreasury margin was some 170 times that of the treasury activities.

Applying the same math to the instant case, there's an even higher degree of relative difference between the negative profit margin and -- of the wholesale activity. In fact, it's infinite distortion. Because again, you can't do the math when there's no profit on the other side to measure against.

Slide 33. The inclusion of FPL's receipts and the standard apportionment factor reduces the combined groups' apportionment factor by an average of 90 percent. Microsoft and General Mills also compared the relative change in the standard apportionment formula when excluding the treasury or hedging activities. In both cases the numbers were sufficient to show distortion.

The numbers compel the same result in this case. Inclusion of the distortive activity reduced apportionment at Microsoft by roughly 100 percent, while General Mills reduced it by 8 percent. When you apply that same math, it's a reduction of 90 percent in this case, much closer to the more dramatic case at Microsoft, but all three of these situations identify a distortive situation. And again, you can see the math there as part of Slide 33.

If there is distortion, then the question is what is it the remedy. And the remedy in this case that we propose is separate accounting. And the reason for separate accounting is because you look at the way the businesses are conducted. For purposes of this discussion, I'll say, sure, they're part of the same unitary business. And that's okay. Don't agree with it, but if that's where we are when we're talking about distortion, then that's okay. But the thing I know, even if they are part of the same unitary business for these years is you know that all of the revenue for Florida Power & Light came out of Florida and you know that all of the revenue or non-revenue for the wholesale business came out of basically anyplace other than the state of Florida.

And that, again, is not me sitting in the back room coming up with the accounting numbers. That is a simple, practical recognition of how these companies do business and where they make their money or where they spend their time or where their activities are, which is the goal of the apportionment formula.

And to combine them when they're so different and to combine them when they have such different oversight and to combine them when they have such disparate goals, to combine them when they have such different sources for their power be it renewable versus nonrenewable, at the end of the day, even if they are unitary, we go back to the Keesling and Warren example, that obvious example that says even if they're unitary it would be wrong to combine them for apportionment purposes. And not just wrong, it would be absurdly wrong given the circumstances of this case.

So that's my presentation on distortion. If there are any questions, certainly happy to respond.

ALJ KLETTER: This is Judge Kletter. Thank you for your presentation. I just want to turn it over to my panel.

Judge Gast, do you have any follow-up questions?

ALJ GAST: No follow-up questions. Thank you.

ALJ KLETTER: And I just want to turn it over to Judge Lambert.

Do you have any follow-up questions?

ALJ LAMBERT: No, thanks.

THE COURT: Okay. This is Judge Kletter. I don't have any follow-up questions, so let's go ahead and -- the time now is 2:50. We'll take a short recess of ten minutes to, you know, take a break. And we'll return at 3:00 p.m. And just make sure that, you know, you mute your microphones when you're on the break, that it's not working or anything like that.

But, Mr. Brannan, did you have a question?

MR. BRANNAN: No. I was about to say thank you very much.

ALJ KLETTER: Okay. Thank you.

Sorry. This is Judge Kletter. Just wanted to let you know also that the stream continues so they can visually see you.

(Recess)

ALJ KLETTER: Hello, everyone. This is Judge Kletter. The time is 3:01, and we're on the record. We've returned from a ten-minute recess. I just want to turn it over to FTB. You have 45 minutes to make your presentation. And, Mr. Zaychenko, are you ready to begin?

MR. ZAYCHENKO: Yes, I am. Thank you.

ALJ KLETTER: Uh-huh. Please begin. Thank you.

MR. ZAYCHENKO: Thank you.

PRESENTATION

BY RAFAEL ZAYCHENKO, Attorney for Respondent:

So Rafael Zaychenko for Respondent Franchise Tax Board. Recent events have made it clear that FPL -- sorry. Recent events have made it clear that FPL has substantially benefited from NEER's expertise in

Florida. Hurricane Ian left a trail of destruction in its wake with many homes in Florida losing power; however, the community of Babcock Ranch remained unscathed and didn't lose power as other communities were left devastated and without basic necessities like electricity and running water.

Babcock Ranch remained unscathed because it was designed to weather hurricanes. Part of its hurricane-resistant design was a solar electrical generation system operated by Florida Power & Light, notably not NEER.

Babcock Ranch is emblematic of the benefits of green energy in our modern world and indicative of FPL's recent dependency on NEER as well as during the appeal years before you today. The NextEra group is an integrated economic enterprise which is characterized by contribution and dependency between its various affiliates and purportedly separate businesses. NEER's operations in California unquestionably benefited FPL's operations in Florida. As Appellant's name suggests, Appellant's activities in California helped shepherd FPL's operations in Florida into the next era of the group's public utility business. Appellant's request for separate accounting is therefore properly rejected.

This appeal involves two issues: First, whether NextEra and its affiliates comprised a unitary group during the taxable years at issue. And second, whether Appellant is entitled to relief under Rev and Tax Code Section 25137.

And now to the first issue in this appeal. FPL and NEER were unitary because both substantially contributed to and benefitted from each other. Appellant's arguments are erroneous for four reasons. First, as NEER and FPL were engaged in the same line of business, unity between them is presumed. Second, the group's very business model highlights contribution and dependency between FPL and NEER. Third, extensive overlap between FPL and NEER's officers, directors, and employees further establishes that the two were unitary. And fourth, intercompany transactions between FPL and NEER are a substantial indicator of unity.

In terms of burden of proof, a taxpayer has the burden of proof in an action for a tax refund and must affirmatively establish the right to a refund by a preponderance of the evidence. Each appeal must be decided on its own facts, and no one factor's controlling.

Respondent's unitary determination is presumed correct. Whereas here the FTB has determined that a unitary relationship exists, a taxpayer contesting

Respondent's determination of unity must prove by a preponderance of the evidence that in the aggregate the unitary connections relied on by Respondent are so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist.

Appellant has not met its burden to show by a preponderance of the evidence that the unitary connections relied on by Respondent are so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist. Respondent's unitary determination, therefore, is properly sustained.

So unity between FPL and NEER -- or NextEra --

ALJ KLETTER: This is Judge Kletter. I'm sorry. I just want to ask you to maybe move your mic a little closer because you're --

MR. ZAYCHENKO: Okay.

THE COURT: -- cutting in and out. Thanks.

MR. ZAYCHENKO: There we go.

The existence of a unitary business may be established under either of two alternative tests. The three unities or the contribution or dependency test. When either test is met, unitary combination is required. The goal of both tests is to ascertain whether there was a unitary flow of value between the various group members.

This discussion focuses primarily on the contribution or dependency test consistent with the opinion of influential commentators that the contribution or dependency test is the vast improvement upon the three unities test. Here both NEER and FPL contributed to and depended on each other in numerous ways satisfying the contribution or dependency test which only requires contribution or dependency for a unitary determination.

And first, as FPL and NEER were engaged in the same line of business, unity between them is presumed. A presumption of unity arises when businesses are in the same line of business. FPL and NEER were engaged in the same line of business as both were energy companies. California Regulation Section 25120(b) provides in part that the activities of a taxpayer will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon, or contribute to each other and the operation of a taxpayer as a whole.

A taxpayer is generally engaged in a single trade or business when all of its activities are in the same general line. In such circumstances, a strong presumption of unity is created. The presumption is entirely reasonable because when companies are in the same line of business it becomes more much likely that their existing business-related resources are better put to use, either through economies of scale or operational integration or a sharing of expertise.

It's important to know that businesses need not be identical. Instead, it's sufficient that they be in the same general line. FPL and NEER were both in the same energy line of business. Their slight operational differences, that is fuel type, customers, or regulatory authorities, do not change the fact that their lines of business were the same. Both FPL and NEER generated and transmitted electricity for profit. Appellant must, therefore, overcome the strong regulatory presumption that NEER and FPL were non-unitary, and Appellant is unable to carry this burden.

Appellant cites the appeal of Quaker State where taxpayer argued that its oil refining and coal mining companies were in the same line of business because both were engaged in the fossil fuel industry. Clearly, oil refining and coal mining are completely distinct businesses. Unsurprisingly, the State Board of Equalization did not find that coal mining and oil refining were in the same line of business.

By contrast, in this instance both NEER and FPL are in the same electricity generation and distribution business. Appellant's attempt to analogize oil refining and coal mining to FPL's rate-regulated and NEER's rate-unregulated operations highlights the weakness of its position.

Second, their group's very business model highlights contribution and dependency between FPL and NEER. The NextEra group has emphasized the benefits inherent in the relationship between NEER and FPL. According to Appellant, the diversification and balance represented by FPL and NEER was a valuable characteristic of the business. This valuable characteristic of the business highlights the flows of value between NEER and FPL as NEER contributed to the NextEra group's evolution to clean and renewable energy.

The NextEra group has consistently placed great emphasis on transitioning to clean energy. In 2009, its chairman and CEO emphasized that the group would change its name in order to underscore the evolution that the company had been undergoing over the past decade. Important to the overall strategy and success of Appellant's overall business, NEER was extensively involved in clean energy production.

The fact that the FPL group had been undergoing an evolution to clean energy for a decade highlights the importance of NEER and clean energy to NextEra for a substantial period of time. The importance of NEER to the NextEra group's increased reliance on clean energy highlights the contribution of NEER to NextEra's business as well as the NextEra group's dependency on NEER for it expertise in clean energy.

Although Appellant goes to great lengths to emphasize that NEER operated at a tax loss, Appellant's arguments are irrelevant. NEER had substantial net income during the years at issue. In 2009, for example, despite having half the employees of FPL, NEER generated almost as much in net income as FPL. NEER's tax losses are indicative of Appellant's tax strategy, not of its profitability.

In addition, the NextEra group's net income was substantially reduced by tax credits claimed primarily by NEER. The fact that NEER generated tax credits reduced the overall taxable income for the group, including FPL's taxable income, further supports Respondent's argument that there was contribution and dependency between FPL and NEER.

Appellant emphasizes that NEER generated electricity from clean energy with the implication being that FPL does not generate electricity from clean energy. However, during the years at issue, FPL, with approximately 95 percent of its power generation coming from natural gas, nuclear, and solar, was also one of the environmentally cleanest utilities in the nation. And Appellant states three times in its opening brief that NEER also generated clean energy. Thus it's apparent that both FPL and NEER generated electricity from clean energy.

Appellant's attempts at trivializing the connections between FPL and NEER carry little substance and don't support a lack of unity. Rather, Appellant's business model and efficiencies directly substantiate that NEER and FPL were part of Appellant's unitary group.

Appellant's attempt to distinguish power sources used by FPL and NEER in order to prove the two were non-unitary also lacks substance. Both NEER and FPL relied on the same power sources -- natural gas and nuclear energy -- to a similar extent. The fact that FPL and NEER utilized slightly different types of fuels for generating electricity does not demonstrate that they were not unitary.

Appellant places considerable emphasis on the fact that NEER and FPL operated in different geographic areas. However, Appellant emphasizes a distinction that does not reflect any real difference between NEER and

FPL. In appeal of Kikkoman, the California State Board of Equalization held that foreign and U.S. affiliates were unitary despite that they operated in different countries.

The SBE rejected Appellant's attempts to denigrate the unitary connections between the foreign and U.S. affiliates holding that the experience of foreign executives was indicative of unity even if the executives were unfamiliar with U.S. marketing. As such, operating in distinct regions or serving distinct customers does not refute a finding of unity. And here, FPL and NEER both operated in the same line of business within the same country, in contrast with the Appellant Kikkoman. Therefore, the unitary connections between FPL and NEER are more pronounced here than in Kikkoman. And Appellant's reliance on geography, therefore, does not disprove the existence of a unitary relationship between FPL and NEER.

Lastly, Appellant places substantial emphasis on the fact that FPL was a highly regulated utility while NEER was presumably less regulated. However, according to Appellant's annual report, NEER and FPL's business, financial condition, results of operations and prospects may be adversely affected by the extensive regulation of their business.

Both FPL and NEER were highly regulated. The fact that different sets of regulations apply does not refute their unitary relationship. Though FPL is regulated by FPSC, both FPL and NEER were highly regulated energy companies. In addition, the SBE has held the two corporations were unitary despite that they were subject to different banking regulatory schemes. And this is Appeal of Bank of Tokyo and Union Bank. Therefore, FPL being a publicly related utility has no bearing on the lack of unity between the FPL and NEER, and Appellant's attempt to separate the unitary business is futile.

Third, extensive overlap between FPL and NEER's officers, directors, and employees further establishes that the two were unitary. NEER and FPL shared numerous officers and directors, though Appellant attempts to discount the importance of shared officers and directors. In particular, their shared officers is evidenced on pages 23 of NextEra's annual reports contained in Appellant's Exhibit 13.

Shared officers and directors are dominant indicators of unity. Here as in Appeal of Coachmen Industries, although Appellant minimizes the importance of common officers and directors, it seems inevitable that this situation would lead to a mutually beneficial exchange of information and know-how. Similarly in Kikkoman, the SBE stated that, "We cannot imagine that Appellant did not benefit from the expertise and experience of these executives. The Japanese executives may not have been experts in U.S. marketing, but they certainly knew about the product Appellant sold."

None of the claims Appellants makes -- sorry, Appellant makes in order to discount the presence of a flow of value between NEER and FPL refutes a strong indication of the unitary relationship between the two. As the Appellant Kikkoman, Appellant attempts to minimize the flow of value between FPL and NEER by asserting that one was highly regulated, a monopoly utility company, while the other operated on the open market. However, both FPL and NEER were energy companies in the same line of business. The fact that both were energy companies in the same line of business with similar operations and with overlapping officers and directors highlights the flow of value between FPL and NEER as a result of the shared expertise of the shared officers and directors.

In Kikkoman Japanese executives might not have been familiar with the U.S. market, but the SBE looked past that difference. Similarly in this case, despite the differences between the FPL and NEER, the overlap of officers and directors is highly indicative of a unitary relationship.

One should presume -- sorry -- that NEER and FPL shared executives for a reason. The expertise of highly paid high-level executives who served in both FPL and NEER undoubtedly benefited both and demonstrates contribution and dependency between NEER and FPL.

Appellant attempts to downplay the significance of officer overlap by asserting the shared officer positions were administrative, oversight in nature. However, the U.S. Supreme Court in Container Corporation found unity, though subsidiaries themselves were relatively autonomous and fully integrated. Moreover, according to Chase Brass, major policy matters are what count in our estimation of integration.

In addition, the fact that Mr. Bores, who was not the VP of operations but instead a VP of finance, his testimony shows that administrative positions offer value to FPL and NextEra. Moreover, Mr. Bores introducing himself as being from NextEra is -- instead of FPL is evidence of the close ties between FPL and NextEra.

And lastly, testimony about operations -- or, sorry, Appellant's lack of testimony about operations is also telling. It should be presumed that the testimony when -- would be unfavorable to the Appellant, which is why they haven't had this sort of testimony before the Office of Tax Appeals. Thus, though Appellant labels executive positions as performing NEER oversight, this does not diminish the overlap of officers and directors as a substantial indicator of unity. And lastly, significant transfers of employees here is also indicative of unity.

And then intercompany transactions between FPL and NEER are a substantial indicator of unity. The Appellant emphasizes that NEER and FPL had a disincentive to have intercompany transactions between them. But then the question is: Despite the disincentive, why did they have millions of dollars of intercompany transactions? Clearly they were providing some sort of value. Though intercompany sales are not required in order to find unity, substantial intercompany transactions between the FPL and NEER further support the existence of contribution and dependency between the two businesses.

The U.S. Supreme Court in Container Corporation found a unitary enterprise to exist even though sales of materials from Appellant to its subsidiaries accounted for only about 1 percent of the subsidiary's total purchases and the subsidiaries themselves were relatively autonomous and fully integrated. The court explained that a prerequisite to a constitutionally acceptable finding of a unitary business is a flow of value, not a flow of goods.

ALJ KLETTER: Mr. Zaychenko, this is Judge Kletter. Just when you're reading, if you could slow down a little --

MR. ZAYCHENKO: Okay.

ALJ KLETTER: -- so it can be transcribed. Just pace yourself. Thank you.

MR. ZAYCHENKO: Nevertheless, presence of intercompany flows of goods and services between NEER and FPL further supports that the two were unitary during the years at issue. In Appeal of Cotrin (phonetic), the SBE has held this to be the case, even when intercompany transactions were made on arm's length terms. The SBE in the Appeal of Saga Corporation has also recognized that an intercompany flow of services is just as significant a unitary indicator.

Here FPL provided millions of dollars of services to NEER, FPL and NEER were in the same line of business, and there were numerous and substantial intercompany transactions, including intercompany financing, nuclear support, common pension plan, information technology and management, corporate communication systems, engineering and construction, finance and accounting, legal, human resources, auditing, environmental risk services, and risk management services. The level of intercompany transactions in Appellant's case is highly indicative of considerable flows of value and evidence of contribution and dependency.

In addition, the intercompany transactions between FPL and NEER here are more indicative of unity than arm's length intercompany transactions. Though Appellant asserts that the transactions between the FPL and NEER were at arm's length, this is not accurate. An arm's length price is determined by arm's length bargaining in the open market. Arm's length transactions thus relate to the market price of a good or service, not on cost. However, in this instance, transactions and prices were based on cost and cost drivers. Transactions between FPL and NEER, in many instances priced either below or above fair market value, were, therefore, not an arm's length. And non-arm's length transactions are especially indicative of a unitary relationship.

In addition, even if NEER and FPL's transactions were at arm's length, the transactions would have resulted in economies of scale. These economies of scale and cost savings are evidence of contribution and dependency between FPL and NEER and significant evidence of unity.

Moreover, transactions between FPL and NEER actually benefited FPL at the expense of NEER. According to Appellant, to protect customers there existed a tremendous bias in favor of FPL. For example, when the FPL sold products or services to NEER or its subsidiaries, those items were charged at the higher of cost or market price. However, when FPL purchased products or services from its subsidiaries, it was charged a lesser of cost or market price. The fact that FPL was benefited to the detriment of NEER not only demonstrates that the two did not deal at arm's length but also illustrates that NEER transferred its profit potential to FPL making FPL's operations significantly cheaper and profits higher.

So given the same line of business presumption, NextEra's business model, the overlap of officers and directors, and substantial intercompany transactions, ample evidence supports the conclusion that FPL and NEER's operations contributed to and supported each other as separate components of a unitary business. Appellant, therefore, has not sustained its burden of demonstrating that the unitary connections relied on by

Respondent are so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist.

Now, we'll discuss the second principle issue in this appeal. Appellant's request for Section 25137 relief is properly denied because Appellant has not established that proper grounds for Rev and Tax Code Section 25137 relief exists. Appellant's request is properly denied for two reasons. First, Appellant is not entitled to Rev and Tax Code Section 25137 relief because it has not demonstrated the unitary combination unfairly reflects its business activities in California. And second, Appellant is not entitled to Rev and Tax Code Section 25137 relief because its proposed alternative is unreasonable.

Under Rev and Tax Code Section 25137, if the standard allocation and apportionment provisions do not fairly represent the extent of a taxpayer's business activity in this state, taxpayer may petition for or Franchise Tax Board may require if reasonable the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

The party attempting to employ another method of apportionment has the burden to prove by clear and convincing evidence that, first, the approximation provided by the standard formula is not a fair representation of the taxpayer's business activity in California; and second, that its proposed alternative is reasonable.

Rev and Tax Code Section 25137 applies when California's standard apportionment provisions produce an equitable result. A comparison of the very levels of taxation from differing apportionment methods by itself, however, does not demonstrate that the standard apportionment formula unfairly reflects the extent of a taxpayer's activity in this state.

The central question under Rev and Tax Code Section 25137 is not whether some quantitative comparison has produced a large enough distortive figure. Rather, the question is whether there's an unfair reflection of business activity under the standard apportionment formula. Rev and Tax Code Section 25137 does not authorize deviation merely because a purportedly better approach exists.

Allegations that the normal apportionment formula is not precise also do not justify proposed deviations. Rough approximation is sufficient in the form apportionment of income from a unitary business. As long as the normal apportionment methods fairly represent the extent of a taxpayer's business activity in this state their use will be upheld. In addition, an Appellant's mere allegations of distortion based on separate accounting principles is insufficient.

So first, Appellant is not entitled to Rev and Tax Code Section 25137 relief because it has not demonstrated that unitary combination unfairly reflects its business activities in California. Appellant has asserted that California's standard apportionment formula unfairly reflects its activities in California. Appellant has the burden in showing then by clear and convincing evidence that California's apportionment methodology unfairly reflects NEER's activities in California. Appellant, however, has not sustained this burden.

Appellant asserts that there is no rational relationship between California's apportionment methodology and Appellant's activities in California. However, Appellant is erroneous on numerous counts. First, Appellant had substantial presence in California. Appellant had numerous power plants located in California, millions of dollars of payroll, and hundreds of millions of dollars of property and sales within the state.

California has provided a significant market and opportunities for Appellant to generate and sell electricity. Appellant fails to note its significant physical market presence in California. However, Appellant's substantial presence in California supports the conclusion that Appellant's activities in California are substantial. Given those rather substantial activities, California may fairly impose a tax on Appellant.

Moreover, contrary to Appellant's assertions, FPL and NEER contributed to and depended on each other in a myriad of ways, as discussed in my statement earlier. The extensive indicia of unity demonstrates that the businesses were not substantially qualitatively different despite Appellant's allegations to the contrary. NEER's activities in California both contributed to and depended upon FPL's activities as well as income in Florida. Therefore, Appellant's assertions to the contrary are demonstrably false.

In addition, Appellant's repeated portrayal of NEER as unprofitable is erroneous. As discussed earlier, NEER generated nearly as much in net income as FPL, despite having significantly less employees. Though NEER appeared to operate at a tax loss, this loss was largely a function of Appellant's tax strategies, which also substantially lowered FPL's tax liability.

Appellant's description of NEER and its unprofitable business activities is, therefore, false.

Lastly, the fact that FPL's benefited at the expense of NEER in transactions that exhibited a tremendous bias in favor of FPL unquestionably demonstrates a flow of value to FPL from NEER. Appellant's assertion there was no flow of value is, therefore, clearly and demonstrably erroneous.

Given this flow of value between FPL and NEER, California can rationally and reasonably apportion NextEra group's income on the basis of a combined report, which includes both NEER and FPL. Therefore, California's standard apportionment methodology does not unfairly reflect Appellant's activities within the state.

And second, Appellant is not entitled to Rev and Tax Code Section 25137 relief because its proposed alternative is unreasonable. To be granted its requested relief, Appellant's proposed alternative must be reasonable. Here Appellant's proposed alternative, which is separate accounting, is founded on unsupported allegations, is unreasonable, and is properly denied.

Courts have roundly criticized Appellant's requested relief, which is geographic-based separate accounting, as flawed. A state does not tax extra territorial income when it levies a tax on a business that, under separate accounting, is attributed no net income. Separate accounting though useful may not fit the different requirements of a state which seeks to tax values created by a business within its borders.

While it purports to isolate portions of income received in various states, separate accounting often fails to consider contributions to income resulting from functional integration, centralization of management, and economies of scale. Therefore, it is misleading to characterize the income of a business as having a single identifiable source because these factors of profitability arise from the operation of a business as a whole.

In addition, separate accounting is problematic because it is subject to manipulation and imprecision and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise.

In the present case and as discussed earlier, Appellant makes numerous unfounded allegations and it further suggests that separate accounting is the proper alternative to the standard unitary apportionment methodology. However, Appellant's alternative of separate accounting is problematic for the same reason the courts have soundly rejected separate accounting.

According to Appellant under its version of separate accounting, FPL's quite profitable while NEER is unprofitable. Even if NEER were, indeed, unprofitable -- and it is not -- FPL and NEER are still unitary. In Butler Brothers, the court held that a state may properly impose an income tax even when separate accounting would have a taxpayer show losses. This is because, as has been noted earlier, separate accounting does not consider the contributions to income resulting from functional integration, centralization of management, and economies of scale inherent in the unitary relationship which unquestionably is present between NEER and FPL.

As discussed in Mobile Oil, Appellant's attempts at characterizing Florida as the sole identifiable source of FPL's income are misleading because of the factors of profitability which arise from the operation of the NextEra group as a whole.

As discussed in Container Corporation, Appellant's request for separate accounting is problematic because it results in manipulation and imprecision and ignores and captures inadequately the many subtle and largely unquantifiable transfers of value that took place among the components of the NextEra group, a single unitary enterprise. For these reasons, Appellant's request for separate accounting is unreasonable and should be rejected.

In conclusion, NEER and FPL are unitary under the contribution or dependency test, and Appellant has not met its burden of showing otherwise. Unity is evidenced by factors such as NEER and FPL's same line of business, Appellant's business model, shared officers and directors, and substantial intercompany transactions.

In addition, Rev and Tax Code Section 25137 relief is not appropriate because Appellant has not shown that unitary combination unfairly reflects Appellant's business activities in California. And Appellant's proposed alternative is unreasonable. Respondent, therefore, respectfully requests that its actions be sustained. Thank you.

ALJ KLETTER: This is Judge Kletter. Thank you for your presentation, Mr. Zaychenko. I want to just turn it over to my panel members.

Judge Gast, do you have any questions for FTB?

ALJ GAST: Yeah. I have one question for Mr. Zaychenko. I thought I saw in the FTB's brief that a taxpayer cannot request 25137 relief for separate

accounting, or is that not your position at this point?
MR. ZAYCHENKO: I think each appeal stands on its own. And in this instance, separate accounting would be inappropriate just because of how similar the businesses are and the flows of value inherent between the two as opposed -- you know, in -- when considering other appeals, I might do it in a different case, but in this appeal, that's our current position.
ALJ GAST: Okay. Thank you. And sorry, I said one question, but I actually have one more.
MR. ZAYCHENKO: That's fine.
ALJ GAST: In terms of your position on the same trade or business, A. M. Castle, you know, kind of almost expands that, even though it says it doesn't. What are your thoughts on how that applies here with whether these two businesses were using, you know, existing resources to help their business?
MR. ZAYCHENKO: So I think that's, you know, that's an excellent point. I think the -- Mr. Bores kind of emphasizes how the parent company kind of set up investment in both these entities, and so I'm not exactly sure as to the, you know, the details of this investment, but he appeared to say that, you know, this investment benefited both businesses and the parent company is holding these kind of allowed funds for both

these entities.

So I think in this case these funds would definitely benefit both entities. And that was kind of this better existing use of resources, the parent company that allows financing for the lower-tier operating entities. And another thing that he touched upon was how, you know, NextEra kind of came to be and how FPL wanted to leverage -- what he appeared to be saying was leverage -- kind of leverage its kind of knowledge base operating in Florida and expand it elsewhere.

So I think that's an excellent point is that, you know, you could potentially have an expansion of, you know, what it means to be in the same line of business potentially and the fact that in this instance you clearly are leveraging the business to benefit both these two operating subsidiaries, FPL and NextEra.

ALJ GAST: Thank you.

ALJ KLETTER: This is Judge Kletter. I just want to turn it over to Judge Lambert. Do you have any questions for FTB?

ALJ LAMBERT: Yeah. I was wondering, FTB, Appellant was talking about the admin costs being, you know, immaterial and they were saying it's just admin and then also it's like a low percentage overall of, you know, these transactions. And I was wondering if you could respond to that and, you know, provide some information as to why it would be significant in your eyes.

MR. ZAYCHENKO: So I think in my eyes what kind of colors this case is the fact that this is the same line of business. So if you have, you know, completely different businesses, different lines of business with no real possibility of sharing expertise, when you have administrative services, there's not really a flow of value.

In this instance, when they're in the same line of business -- and that's kind of the issue first, with kind of separate accounting considering just the numbers, you have to look also the quality of what's being provided. Here, for example, like nuclear support, both these entities essentially had the same nuclear department.

So there's definitely -- it's hard to qualify and quantify. It's like slicing at shadows, as the Supreme Court said. But there's definitely flows of value -- sorry. There's flows of value when you -- when you operate in the same line of business and when you provide administrative services from one entity to the other. So like I said, two points. It's hard to quantify. And two, given the same line of business presumption, there's added value in these transactions that seem kind of in the aggregate a little minor.

And also, you know, Appellant points out, you know, it's so difficult to have intercompany transactions. It was such a pain. And then the question, the follow-up question is, you know, why have these transactions if it's such a bear to kind of, you know, account for all of this and keep them separate, et cetera? Obviously, there's unquantifiable flows of value. Like I said, it's like slicing a shadow. It's why FTB has this presumption that's inherent in these administrative functions.

And I think Mr. Bores's testimony also kind of reflects the fact that, you know, the fact that, you know, his title isn't VP of Operations. The fact that he's able to testify for Appellant about both these businesses shows that there's flows of value even though the position is merely administrative. And as Appellant's representative himself has discounted kind of, you know, in a way Mr. Bores's experience in testimony, I think still it's a pretty significant indicator of unity in this case.

ALJ LAMBERT: Okay. Thanks. So FTB agrees that there is, like, separation because of FERC, but some of the value is inherent you're saying?

MR. ZAYCHENKO: Correct. So there is a separation, but that's the point of, you know, having the unitary business concept is you're separating something that inherently you can't quantify, you can't separate. So that's why you have this concept you combine, and that's just the presumption that, you know, the FTB, when you're in the same line of business, is allowed to utilize. And that's what we're doing here.

Just because -- you know, if you look at it from our perspective, you know, we don't really know how the business works. That's why we're allowed this presumption. And taxpayer has the opportunity to rebut it, and they haven't rebutted it in this instance.

ALJ LAMBERT: Okay. Thank you.

MR. ZAYCHENKO: You're welcome.

ALJ KLETTER: And this is Judge Kletter. I just have two confirming questions, one about intercompany transactions and one about intercompany financing.

During Appellant's opening presentation, they mentioned just that there were those two evidences of loans or guarantee. One was the 36 million letter of credit increased to 63 million in 2008, and then also a $28 million loan. I just want to confirm. Were there any other intercompany transactions that were not included in those?

MR. ZAYCHENKO: I -- it's my understanding that there was. The trouble with -- and, you know, Mr. Bores is kind of mixed up, you know, with what entity he works, but basically the point is that it's hard to know which entity because the -- the board minutes list entities. It's hard to know which entity actually belongs to the FPL and which belongs to NEER.

So some of the other two, I think Respondent found a couple more, but the Appellant has said, Well, these entities, even though they had FPL in the name or something, belonged to NextEra or vice versa. So basically it might be otherwise. You would just need an org chart and you would need to compare all the entities and see, you know, which side they fall. And the names might be mixed up so, you know, I did a search as best that I could, but, you know, we only have limited access to information. And I was able to, you know, glean as much as I could.

And then I think my brief also touched on another guarantee. I don't recall exactly what it was. There was another instance of intercompany transactions that was discussed in the annual reports that wasn't necessarily reflected in the -- in the board minutes.

And that was in the -- I believe in the response brief, the supplemental brief in response to the OTA's questioning.

ALJ KLETTER: This is Judge Kletter. Thank you. And then just one more question about the intercompany transactions. Again, in Appellant's opening presentation, they mentioned that there were virtually no intercompany product sales, e.g., you know, maybe similar or the same, that there were no electricity sales between FPL and NEER. And I just am wondering like does FTB dispute that or not?

MR. ZAYCHENKO: I don't think we've seen evidence to the contrary in that regard.

ALJ KLETTER: Thank you. So I'd like to turn it over now to -- oh, I'm sorry. I wanted to turn it over to Judge Gast for another question. Oh, I'm sorry, to Judge Lambert.

ALJ LAMBERT: Oh, yeah. I just had a follow-up question for Appellant. I was wondering, in terms of these nuclear operations that FTB was talking about, so NextEra and FPL both have nuclear plants and, you know, were using these nuclear operation supports. So what would you say is the difference between those operations? Is it the retail/wholesale regulated/nonregulated thing?

MR. BRANNAN: I think there are a number of differences, and I think first is the one you went to, which is the difference between retail operations in Florida and wholesale operations outside the state.

I think second, you know, all nuclear plants, they're operated on their own. And what you have is you have a complete set of kind of operators and managers that operate at the plant level. And then they do -- there is, you know, at the top of that pyramid, certainly, for these companies. There is a single representative who reports to the Nuclear Regulatory Commission.

I think what's missed in that description is the two nuclear plants that are in Florida are also regulated by the Florida Public Service Commission. And so all of their activities, all of their transactions fall under the auspices of the FPSC. And that is -- and I'll ask Mr. Bores about it here in just a minute, but, I mean, it's -- it's kind of the same deal. The nuclear plants that are not in Florida are not subject to those restraints. So all nuclear plants subject to Nuclear Regulatory Commission, so everybody's regulated somehow some way. But what you have -- you know, they're going to look to safety of those -- of the operation of those plants. But when you get into Florida and they're talking about the pricing of the power that goes to the residents of the state, once again, you're under the auspices of the FPSC and, if you will, kind of that invasive authority where they're looking to protect their constituents.

And so similar? There are some similarities. There are some same regulatory constraints as between all the nuclear plants. But then the ones in Florida, they are subject to a different level on top of that when it comes to the regulatory oversight.

So I hope that responds to your question.

ALJ LAMBERT: Yeah. Thanks. That's helpful.

ALJ KLETTER: This is Judge Kletter. You know, Mr. Brannan, would you like to make a final statement rebuttal to what Mr. Zaychenko said?

MR. BRANNAN: Very much so.

ALJ KLETTER: So I believe you have 15 minutes, and you may begin.

CLOSING STATEMENT

BY MR. BRANNAN, Attorney for Appellant:

So I guess if I may, I'd like to take a couple of minutes and ask Mr. Bores a couple more questions. And I really kind of resent the idea that he's mixed up as to who he works for. The question was, you know, who do you represent. Well, he's representing the Appellant, and that's NextEra Energy. And there's no dispute over that.

There's also no dispute over to what his title is. And so that sort of personal commentary is not appropriate here, and I don't like it and it shouldn't happen. I'll refer to Respondent for what's happened in some of the briefs, but don't take on my witness. That's crummy.

So, Mr. Bores, if you will, can I ask you a couple of questions? So you've heard about the history of the agency and kind of what prompted, if you will, the creation of NextEra Energy. Do you have a little further background on that that might be helpful to respond to some of the comments that were made during the FTB's presentation?

MR. BORES: Yes. I think FTB's a little misconstrued with maybe how the businesses are vastly different. FPL has always been I call it the mother ship or the bread and butter. Right? We started in 1925 as the rate-regulated utility and have grown over that.

As the business continued to grow at FPL, there was an opportunity to say should we create a side business or something else that is vastly, vastly different from FPL, and that is where the wholesale business, or NextEra Energy Resources, was born in the early 2000s. That business model is going out and working with other utilities who have, as we talked about, renewable portfolio standards to help them bring renewables. That is not FPL's business model at all. FPL's business model is do what's the best and most economic for the retail customer.

And yes, it was quote/unquote clean energy, but again, that's because we burn more foreign oil than anybody and we made a business decision to move to natural gas, which turned out to be clean, affordable, and led us to a great emissions profile. That is the vastly different strategy than the wholesale business, which is again, building wind, solar, for other utilities to help them achieve renewable portfolio standards.

And so I think we're trying to say that they have a similar business, they operate similarly, but the exact opposite couldn't be true. At FPL -- and I don't want to belittle my job, but we are given a guaranteed return or an allowed return on equity, which means we, quote/unquote, have a guaranteed profit unless we screw things up. Right? We have our rate base, the return we're allowed on that. And unless we really screw things up or don't do well by the customer, we have a guaranteed profit.

That is not the business model of NextEra Energy Resources or the wholesale business. They have to go out, fight and scrap against other developers, compete on price. And ultimately their profit margin is variable, depending on the contracts they enter and the customers they win with. And so I think trying to say we operate as one, it can't be further from the truth.

MR. BRANNAN: Mr. Bores, I believe you're also familiar with the Babcock Ranch story. As an aside, taken from a 2022 article. Again, by reference to the years that we're considering here, '09 to '15, why don't you talk a little bit about Babcock Ranch and how FPL came to be cited in the article provided by the Respondent.

MR. BORES: Yeah. So I'm chuckling a little bit because I can tell FTB watched 60 minutes and read the article. So Babcock Ranch, great community. Built by Syd Kitson, who's a wonderful man doing great things. And the article kind of highlights that the solar was available to power Babcock Ranch.

Unfortunately, when Hurricane Ian hit, if you've ever gone through a hurricane, there was a lot of cloud cover that comes in with that hurricane. And so at the time Hurricane Ian hit, 3:00 p.m. in the afternoon, there was significant cloud cover and less than 1 percent of that solar was producing power.

By the time Hurricane Ian rolled over Babcock Ranch, it was nighttime where the sun does not shine and there was zero solar power being produced for Babcock Ranch. What kept Babcock Ranch's lights on was the transmission infrastructure as well as two natural gas power plants -- one in Fort Myers, one up in Manatee above Tampa -- that supplied power that ultimately flowed across our transmission lines to keep the lights on for Babcock Ranch.

So it had nothing to do with renewable or solar energy or anything that the wholesale business is doing. It is all part of Florida Power & Light's core strategy of producing and delivering reliable electricity and really hardening our transmission and distribution infrastructure to protect and make sure customers can get power as quickly as possible following a hurricane.

MR. BRANNAN: So I think that's the segue into that's the problem with presumptions and assumptions and implicits and, you know, global statements about flows of value where really none has been demonstrated. Because if you know the background for the story, what you realize is that the example of how FPL is taking advantage of fill-in-the-blank NEER in their solar expertise for purposes of this article, it's just not true. And you can't just make up stuff and continue making up stuff in order to prove a case. And that's why we have focused the best we can on the details underlying.

Let's talk about intercompany financing. So the question is asked, "Are there additional examples?" And the answer is, "No, there's not. There are two, and we described them." And the FTB's saying, "Oh, well, we tried as hard as we could." That's not a good answer here. There are two.

And as far as the example in the briefs, it was talked about the FTB pulled an agency by label which had been part of FPL but then it was rolled into the other part of the business, it was put on the other side of the fence, and that's when the financing happened. So that's not intercompany financing. The financing that was talked about in the briefs is between entities that are on the wholesale side of the business.

The other two examples that are cited in the brief simply weren't intercompany. They were entirely on the side -- on one side of the fence or the other. So there are two examples, one of which was lasted three years, the other one which I don't know how long it lasted but I know that it's gone.

So, Mr. Bores, one quick question for you. Who's responsible for the financing for the rate-regulated retail activities?

MR. BORES: Ultimately, that resides with the treasurer who does the overall financing of the business, but any of those decisions need to kind of be worked through me as well as the president and CEO of Florida Power & Light, who ultimately have profit and loss responsibility for the business.

MR. BRANNAN: Do the regulators -- do the regulators allow Florida Power & Light to go to NEER for financing?

MR. BORES: No. Again, as part of our oversight process every year, we are required to file a financing application with our regulator letting them know here's how much debt and capital we plan to raise in the markets in order to fund the business for the upcoming year. And they need to approve that before we move forward with our financing plan for the year.

MR. BRANNAN: So let me address a couple of questions on intercompany transactions. And I'm just going to say 1 percent under any conceivable measure is not numerous, substantial, material or helpful to just -- to concluding that there might be a unitary business. They're just not. Personnel, 1 percent; intercompany sales of assets, 1 percent; zero intercompany product sales. One percent, 1 percent, 1 percent.

I'm not making up those numbers. The data is in the briefs. So we need to recognize that there is some things that are out there and they just happen. And the question is: Are they deliberately working together? No. In fact, the opposite is true. They are deliberately working apart from each other.

Let me make a couple more points. There's a reference again, you know, to somehow we're creating a loss company where one doesn't exist. I didn't make the rules for how to determine taxable income or loss that goes into the combined report. The FTB did. And you follow those rules, and the wholesale business has a loss. It's pretty much that simple.

Now, we can talk about what's reflected in the financial reports, but I can't tell you how many times I've heard -- I mean, we look at Thor Power Tools, it's a U.S. Supreme Court case. I think there's a Board of Equalization appeal by the same name. And what they talk about is why those reports are different.

Financial reports for -- financial reports for SEC purposes, they focus on different things. We talk about conservatism where they always want to understate for purposes of informing the investor. They are different. It's the reason they're not used for tax purposes.

Instead of bringing out financial reports in this context when the numbers that we're talking about apportioning are the ones that the FTB tells us to compute, and by the way that have never been questioned at audit, is really mixing apples and oranges and bringing that whole discussion to, you know, a whole different level. Because we don't get to use book numbers for pretty much anything. We have to go by the FTB's rules for tax purposes.

So to suggest that we're -- there's a tax strategy -- the government says you get to take depreciation on assets. You take depreciation. It's an expense. It reduces your income. And in this case, it makes the income into a loss for the wholesale business. And that's the number that's subject to apportionment. There are no games here. There are no tricks. We are not trying to fool anybody.

Let's talk about tax credits. Tax credits are federal credits after tax. The idea that there's some sort of unitary connection here, no. That's the equivalent of pushing money around based on dividends.

We know that such activities or cases cited it in the briefs where when you move money from one entity to another, that's an investment decision. That's a money decision. Federal tax credits after the fact are not indicators of unity.

There's a couple of cases cited by the FTB, and I have to say, okay, one of them is Hugo Neu-Proler, and they talk about the reason that the entities were set up. And thereafter, they never talk about tax benefits again. It's not part of the decision.

Let's move to PBS. PBS is a decision, I think you all are very familiar with it. There is a statement in there that talks about, hey, you know, these are things that may be indicators of unity, and they mention tax benefits. Okay. One, there's not a single case authority underlying that. The author kind of made it up.

Two, there was some discussion of flows of value coming from its net operating loss carried forwards. It was not part of the decision in the case. That's just irrelevant to the decision in that case.

And last, and I always think this is kind of fun, the entire decision in PBS was offered as an advisory opinion. The parties had already stipulated to the outcome in that case. So if we were looking at that as a judicial opinion, there would be no merit to it at all. It would never have been published. So why it was published I don't know. But if you look at the decision, it's a point that was never contested by the parties, it didn't matter to the decision, and the parties agreed to a different result. I'm not sure what authority there is in that case that says tax benefits are somehow helpful to the parties.

So now we've dealt with created losses in accordance with the OTA's -- or excuse me, the FTB's own methodology. We've dealt with tax credits that are a matter of federal law. And there's no real meaningful authority that suggests that they're a unitary indicator.

Let's talk a little bit about a couple of other things. Same line of business. You've heard our piece and you've heard my reference to the legal standard as to what is a same line of business or what is not. We say they're different. Okay. For purposes of this discussion, let's say they're in the same line of business. That doesn't automatically make 1 percent numbers and intercompany transactions meaningful from a unitary standpoint. It just doesn't.

We can raise all of the assumptions we want about, Hey, if they're in the same line of business, then they should be sharing this or they could be sharing that or we're going to assume that when they have a board meeting that the board members are going to sit and talk to each other about all this other stuff. Well, our witness tells you that they don't do that because they're different businesses.

And as far as Mr. Bores' qualifications, he's not an operational guy. What he's here to tell you in quite a credible fashion is that the impact that the Florida Public Service -- excuse me, the FPSC has on his business. And he knows that because he goes over there and he deals with those folks. He deals with the regulators. He testifies before those panels. He understands what they're asking for. He's responsible for the regulatory reports. That's why he's here.

Does he have a general understanding of the business? Of course he does. That's his job. But to belittle his qualifications as somebody who's not an operational guy, that's not why he's here, for one. And two, it doesn't have anything to do with his testimony.

Let's talk about the unitary test when we talk about contribution or dependency. And because this -- this is of critical importance. And I hate lawyers that sit down and they get into parsing of the words, but sometimes it's just what you've got to do.

The contribution or dependency test talks about whether the activities in the state -- and those activities we know and we don't dispute. They are substantial with regard to wind and solar power, something that during these years, the activities in Florida, they had no wind power and they had a miniscule amount of solar power at their disposal during those years.

So if the test is how does the in-state activities in California contribute or depend on the activities that are sitting in Florida, I still don't know the answer to that from the FTB's position. What they want to do is they want to assume, Hey, we have a presumption. I don't care about the presumption right now. I don't think it applies. That should be clear from everything I've said, everything my witness has said. But if you look at that presumption, it's like, Wait a minute. Okay. I can presume away a lot of questions, a lot of factual inquiries. We can have a little digression here about the how the rules of evidence work. A presumption does a couple of things. It gets you over the hill. It means that we, the Appellants in this case, have the burden of proof.

Now, what does that mean? It means we have a burden of coming forward with evidence and a burden of persuasion. What I would sit here and tell you is that we have come forward with evidence piled up to the roof in this building right now. And I would also suggest to you that we met that initial burden of coming forward, and I will tell you that we should have met the burden of persuasion because the FTB hasn't responded in 90 percent of the information that we're putting out here. All they're offering is global references and global labels about how these things exist.

The 1 percent question from Judge Lambert, "How are those things material?" They're just not. And they don't impact -- most important point, they don't impact their operations. They're just separate, and they're separate because they have to be. So look at the verbiage of the contribution or dependency.

The functional integration, if you read background around on that label as set forth in the Mobile Oil case and the constitutional cases, what they're talking about there is operational integration: How are they working together to earn money? How does this company make money? Well, they make money in two ways. They have a wholesale market outside of Florida and they have a retail market inside of Florida.

Let's talk about Container Corp. and the idea that a flow of value is all that's required. Well, of course, we can't disagree with that. It's a flow of value. That's fine. I know what Container says. But go read Container again, and what it does say at the end of it, toward the end of the unitary discussion, it says: Yeah, you don't need flow of product.

And in this case, by the way, there's two really important things that the appellate court called out. One, intercompany financing. Substantial intercompany financing. And we can throw that label around in our case, and I'll tell you it doesn't exist. But I'm not going to disagree with the U.S. Supreme Court as to how much substantial intercompany financing was worth.

The second point that they call out from the appellate court decision is how much the overlapping board of directors really matters and how active they were when it came to creating strategy on a go-forward basis and how much they were involved in the decisions to expand on the international market. That didn't happen here. It doesn't happen here. And even if it did, with the six people or the 13 people that were remaining on the overlapping executives in management, we still have not accounted for the influence and the ultimate decisionmaking authority of the Florida Public Service Commission.

We can't have that conversation about overlapping management without acknowledging that there's an 800-pound gorilla in the room and they get to make the rules. And they do make the rules. You heard, they push back when we suggest things to them. They don't rubber stamp. They protect their constituents. Which, by gosh, that's what they're supposed to do. But when they do it, we can't sit there and say it doesn't have any impact at all on Florida -- on FPL.

A couple more things.

ALJ KLETTER: I just -- sorry to --

MR. BRANNAN: Yes.

THE COURT: -- interrupt you, Mr. Brannan. I just want to let you know, five minutes left in your rebuttal.

MR. BRANNAN: Thank you. So let's talk about a couple more things quickly. The cases that are referenced on intercompany transactions and whether they matter or they don't -- I've got to find the right one. I don't have it. Never mind. Let's talk about the different regulatory oversight and the -- specifically the case of the Bank of Tokyo and Union Bank. There's, indeed, a sentence in the case that says, "Appellant claims that they are subject to different regulatory constraints, one from the Japanese regulators and one from the U.S. regulators," and that's it.

There's no discussion at all in that case about the impact that the regulators have on the case. There's nothing like what you've just heard about FPSC. So to take a single sentence in a case and make it an absolute dead stop on that regulatory discussion is not reflective of really what the case is talking about.

What the case really talks about at the end of the day is we don't think that's an important factor in this case. What they really care about was the transfer of personnel, transfer of management, transfer of expertise. That's what that case is about.

As far as the intercompany transactions, intercompany -- Respondent cites to three cases: Coachmen Industries, Nippondenso and also Saga Corporation. What's fascinating is that the flow of product, while not required under the Container decision, it is still a very, very meaningful consideration, and there is none in this case.

In Coachmen there was -- between 23 and 38 percent of the taxpayer total purchases were intercompany. In the Nippondenso case the SBE -- they looked at it, and between 77 and 89 percent of the products were intercompany. In the Saga Corporation, 100 percent of certain services were billed intercompany.

Those situations, we can talk all we want about shared services, we can talk all we want about back-office functions, administrative functions is 1 percent, but the one that matters most is these economies of scale on the product. What is it that they sell? How do they make money? Not how do they manage it. Not how do they watch over it. It's how they make money.

So let me get to one last point on the distortion side. So we talk about whether separate accounting is appropriate or not. It's in the statute. And the fact that the FTB doesn't like it or the fact that it was a reason that we have the unitary method, it doesn't matter. It's in the statute. And so we can look at it and we can say, "Okay. Have we proven distortion?" And I submit that we have using the qualitative and quantitative considerations that are in the brief, none of which were specifically addressed by Respondent by the way.

We're making a case here. We're putting facts and details and law in front of this panel. We're not just giving you labels. Please read those charts. Please read the detail before you decide to render a decision in this case. It's important.

So the last thing that just gets lost in this presentation -- really two things. But we talk about separate accounting and all of the ills and woes of separate accounting that are identified by every court that looks at this. And they say, "We don't like separate accounting. It's subject to manipulation. We're going to lose track of the factors of profitability. This functional integration economies of scale, centralized management, separate accounting can't do that. It's subject to manipulation."

Okay. So again, what's missing in this discussion? It's the uniqueness of the public utility. It's the role, it's the rigor of the review of the Florida Public Service Commission. They go to sub-account levels. They go to details in review that the SEC never even dreams about. And if their review's not enough, when they go in for a rate regulatory process, they get intervenors that come in and testify. Not just the Commission, but the public counsel for the State of Florida and any third party that wants to show up and do that.

And they all get to look at the numbers. They all get to ask questions about the numbers. These numbers easily survive whatever concerns there might be as to the imprecision. We can't lose track of the fact that there's a third-party regulator that crawls all over these things. It's important. Because all of the ills that people suggest in connection with separate accounting, they're just off the table here.

I think one last point, and it's really on the last slide of the distortion presentation -- if I can find it. Apologies. It's the problem with paper. So there's a couple of comments, and I think this one is Container. And this really is my last comment. It continually makes the point when they talk about distortion, and it says, "Even if the records are skewed to resolve all doubts in favor of the State so as to attribute imputed profit from intercompany asset sales," et cetera, "then there would still be a problem with the apportionment formula."

And in this case, if you skew everything to resolve all doubts in favor of the State, NEER's operations would still show taxable loss. And the example that they use in their -- in the case is they talk about imputed profit on intercompany sales. Well, in this case, we actually have that number because we have to track it for regulatory purpose. And that number for intercompany asset sales -- okay, so we know intercompany product sales is zero. And that number for intercompany asset sales is an average of $2.5 million a year. This is a billion-dollar business. You find that money in the couches in the offices at the staff. There's just -- you know, I'm sorry. I don't mean to minimize the role of people in this, but $2 and a half million? That's just dust. That's why it's not material.

They are so concerned about separating the two businesses that they track down to that level. They track transfers of employees that make more than $30,000 a year. They track transactions that are worth more than $300 per transaction. That is the level of detail that's available. And the reason they do it is to keep the businesses separate.

And the last point. You know, if we take a step back, what are we talking about? And it's based on the separate taxable income or loss of FPL and NEER as reflected in Exhibit 1 to Appellant's brief, the transfer of value from FPL to NEER. We can't quantify it. We understand that. I understand that's part of the purpose of the -- of the unitary business concept is: We don't see it, we're pretty sure it's there, and so we're going to assume it's there until the taxpayer comes and tells that it's not.

But just to get to the break-even point for NEER, the transfer of value from FPL to NEER for NEER to show a single dollar of taxable income in the State of California would have to be more than $431 million per year, or roughly 37 percent of the average net income that's attribute able to FPL.

So the tax number that we're -- has been suggested that we're somehow contriving or creating into a net tax loss, in order to get to zero, we have to take 37 percent of the income of FPL and we have to give it or transfer it through imputed income or through these shared transactions, $431 million per year just to get the wholesale business or just to get California to a neutral number, not an income and not a loss. That is the scale of the disparity between the two businesses.

And I'm going to start here with something I started with. This case is about fairness. And fairness is an odd concept in the tax world, but it is a very real one. It's one that's referenced by all of the cases. It's one that's referenced by the statute. And beyond all of the material that we've provided, beyond all of the qualitative and quantitative discussion and analysis that we're talking about, at the end of the day it just ain't fair.

It's not fair when you have a business that clearly by any stretch of accounting or operational considerations has earned all of its money in Florida, and it's not fair for California to reach out and grab a piece of that for tax purposes. And that's what this is about. It's about fairness.

And this is a situation that's unique because you have a public utility, because of the aggressive nature of the regulatory oversight of the FPSC, because they are making money in Florida and they are not making tax money anywhere else in the country. This is a unique situation, and it is exactly -- if they're not unitary. If they are unitary, it's exactly the sort of situation that distortion is intended to cover, and we go back again to the example cited by Keesling and Warren. Thank you very much.

ALJ KLETTER: This is Judge Kletter. Thank you for your rebuttal. I just want to turn it over to my panel members.

Judge Gast, do you have any final questions for either of the parties?

ALJ GAST: Yeah. I have a few final questions for Appellant.

So just so I understand, there is no common management on both sides of the work structure, the FPL and the NextEra? Even though it flows up to an ultimate parent, they're run autonomously like in the Woolworth case at the U.S. Supreme Court and California.

MR. BRANNAN: I hear a couple of questions in there, and if I may?

ALJ GAST: Yes.

MR. BRANNAN: If I don't respond, please get me again. One, in Woolworth they had near perfect overlap of all upper management, and in spite of that they determined that they were not unitary.

In our case, and we've detailed it and I'm going to -- I've got so many numbers kicking in my head right now, but I think there are, if you look at FPL alone and we draw the line as reflected in the diversification reports, there are 44 possibilities of people that are sitting in executive management -- executive or management roles at FPL.

Of those 44, we're down to 17 that are, in fact, common. Maybe it's a little lower than that. I apologize. That's the range. Of that number, six of them are in operational roles, such as the nuclear or the site building, you know, in those titles. And again, they're in the briefs. So there is some overlap.

I -- we would say it's not material on its own because we are still talking at that point of six people, and it is on its own -- FPL I think is 8700 employees. And on top of that, if you go to the purpose of that overlapping management, the idea is just some horde of grand strategy discussions that can take place. That whole discussion can't be had unless we acknowledge the role that the Public Service Commission has in connection with that business.

ALJ GAST: Okay. Thank you. And in terms of savings from shared services, were there any significant savings? I understand that it was 1 percent of transactions involved, but what were the savings?

MR. BRANNAN: The problem, honestly, is that you have to assume that there are savings based on economies of scale, which is a point that Respondent makes. And so the problem we have is that all of the services are booked at cost. And so to the extent that there are benefits from these economies of scale, you can't really put a number on it the way that they're accounted for. But when you look at the big number, that's your 13 percent of intercompany non-power, non-dividend transactions. And that number is still -- it's right at -- it's like 1.01. It's just over 1 percent of the total receipts of the business.

So when I look at that, fine, we can add a 20 percent profit figure on that, add a 30 percent number that moves the value to one side or the other of the equation. And it's still not material to the overall operations of the business. So I can't say none. I want to be honest and practical here. I can't say none. I can say that we don't know, and I can come up with a number that says, okay, but it's still not material to the operations.

ALJ GAST: Okay. And then a final question. Just a big picture for me because I'm a big picture guy. Why 2009 are they not unitary and not in prior years? What changed, other than maybe a statute of limitations, you know, for asserting a refund claim in prior years?

MR. BRANNAN: I think there's -- I think the -- the most direct answer is statute of limitations. I think that's the easiest answer. I mean, there's a comment that came up on Seabrook, and it was interesting because there's a couple things about it. Just to clarify for the record, Seabrook is a substation. It's not a nuclear power plant. It's worth about $10 million.

So admittedly, it was on the wrong side of the line when it came to the regulatory side. So they moved it. It's an imperfect world that we live in. But that happened in 2008 or 2009 I believe is the -- is the correct time frame. The it's not like Seabrook drove it. But you always have these little -- you know, the fluff that's out there that we need to diligently watch. And then if it's on the wrong side of the line, we need to move it to keep the businesses separate.

So that's a longwinded explanation or response to your question, but I think there's no -- there's no magic. I think as the businesses are constructed, they're still not unitary.

ALJ GAST: Okay. Thank you.

ALJ KLETTER: This is Judge Kletter. I want to turn it over to Judge Lambert.

Do you have any follow-up questions for either of the parties?

ALJ LAMBERT: No, thanks.

ALJ KLETTER: Thank you. And this is Judge Kletter. I just have one -- a couple questions for Appellant.

So there was some discussion about, you know, which entities were -- or which employees were shared, and there was the 17 and the 44.

MR. BRANNAN: Um-hum.

ALJ KLETTER: I just want to confirm. So like a lot of the discussion we've been talking about the FPSC. And with respect to the board of directors, were the board of directors interlocking and, you know, what -- what operational role did the board of directors of NextEra Energy play between the two operating businesses?

MR. BRANNAN: I think the best answer that I could provide to that is the answer that Mr. Bores gave when we asked what the holding company did. Because I think that's where that -- where that activity -- and I have to be cautious. I mean no disrespect to those folks. But what drives the unitary discussion is really operations. And what the board of directors does at that level is monitor the activities. They look at rates of return. They look at -- they follow the money. And they want to do what's right for their shareholders on that side.

But again, you know, I'm a broken record here, and I'm not going to apologize for it. That's -- they're up there, but they still have to answer at some day at some -- you know, in some way they have to answer to the FPSC.

ALJ KLETTER: This is Judge Kletter. Thank you. I have no further questions.

So this concludes our hearing. I'd like to thank the parties for their presentations. The judges will meet and decide the case based on the documentations and the testimony presented here today. We will issue our written decision no later than 100 days from today. This case is submitted, and the record is now closed. This concludes this hearing session.

Thank you.

MR. BRANNAN: Thank you all for your time.

MR. ZAYCHENKO: Thank you.

(Conclusion of the proceedings at 4:16 p.m.)

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REPORTER'S CERTIFICATE

STATE OF CALIFORNIA)
COUNTY OF SACRAMENTO) ss.

I, MARIA ESQUIVEL-PARKINSON, do hereby certify that I am a Certified Shorthand Reporter, and that at the times and places shown I recorded verbatim in shorthand writing all the proceedings in the following described action completely and correctly to the best of my ability:

LOCATION: OFFICE OF TAX APPEALS
400 R Street
CASE: In the Matter of the Appeal of
NextEra Energy Capital Holdings, Inc.
DATE: Tuesday, February 21, 2023

I further certify that my said shorthand notes have been transcribed into typewriting, and that the foregoing pages 1 through 153 constitute an accurate and complete transcript of all my shorthand writing for the dates and matter specified.

I further certify that I have complied with CCP 237(a)(2) in that all personal juror identifying information has been redacted if applicable.

IN WITNESS WHEREOF, I have subscribed this certificate at Sacramento, California, on this 15th day of March, 2023.

Maria Esquivel-Parkinson
CSR No. 10621, RPR

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