OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **NEXTERA ENERGY CAPITAL HOLDINGS, INC., AND AFFILIATES**	OTA Case No.: 20096580

OPINION

Representing the Parties:

For Appellant:	Derick J. Brannan, Representative Ronald A. Cox, Representative Ligia L. Machado, Representative
For Respondent:	Rafael Zaychenko, Tax Counsel III Delinda Tamagni, Tax Counsel IV
For the Office of Tax Appeals:	William J. Stafford, Tax Counsel III

A. KLETTER, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19331, NextEra Energy Capital Holdings, Inc. (NEECH) and affiliates (collectively, appellant) appeals respondent Franchise Tax Board's (FTB's) deemed denials of appellant's claims for refund of $966,950, $924,326, $1,520,896,[1] $0,[2] $890,969, $1,877,585, and $2,416,183, plus applicable interest, for the respective 2009 through 2015 tax years (collectively, Years at Issue).

Office of Tax Appeals (OTA) Administrative Law Judges Asaf Kletter, Kenneth Gast, and Josh Lambert held an oral hearing for this matter in Sacramento, California, on February 21, 2023. At the conclusion of the hearing, the record was closed, and this matter was submitted for decision.

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[1] Appellant and FTB dispute the amount of appellant's refund if it prevailed for the 2011 tax year. However, Office of Tax Appeals need not decide this issue because this Opinion concludes that appellant is not due a refund for the 2011 tax year.

[2] The parties agree that no refund was due to appellant for the 2012 tax year.

ISSUES

1. Whether appellant was engaged in two separate businesses, a rate-regulated electric utility business[3] and a wholesale energy business,[4] or in one unitary business for the Years at Issue.
2. If appellant was engaged in a unitary business for the Years at Issue, whether appellant has demonstrated that the standard allocation and apportionment provisions found in California's Uniform Division of Income for Tax Purposes Act (UDITPA) (R&TC sections 25120 et seq.) do not fairly reflect the extent of its California business activity.

FACTUAL FINDINGS[5]

General Background

1. NextEra Energy, Inc. (NEE) was appellant's parent company.[6] Appellant was one of the largest electric power companies in North America. NEE directly wholly owned NEECH, which in turn directly wholly owned NextEra Energy Resources, LLC (NEER).[7] NEE also directly wholly owned Florida Power & Light Company (FPL).
2. Appellant conducted its business through two wholly owned operating subsidiaries: (1) FPL, a rate-regulated electric utility that primarily supplied retail electric service wholly within Florida (rate-regulated electric utility business); and (2) NEER, a wholesale energy business that primarily generated and sold clean and renewable electricity on the wholesale market solely outside of Florida (wholesale energy business).
3. Through its affiliates, appellant collectively operated one of the largest U.S. nuclear power generation fleets. Appellant, including NEER and FPL, was headquartered in Juno Beach, Florida.

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[3] Florida Power & Light Company (FPL) and its subsidiaries conducted the rate-regulated electric utility business. It is undisputed that FPL and its subsidiaries were unitary.

[4] NextEra Energy Resources, LLC (NEER) and its affiliates, excluding those in the rate-regulated electric utility business, conducted the wholesale energy business. It is undisputed that NEER and its affiliates were unitary.

[5] Unless otherwise specified, all facts are applicable to each of the Years at Issue.

[6] All "NEE" references include its former name, FPL Group, Inc.

[7] The record does not indicate whether NEER was a disregarded LLC or a corporation for tax purposes, though it does not affect the unitary analysis below. All "NEECH" references include its former name, FPL Group Capital Inc., and all "NEER" references include its former name, FPL Energy, LLC.

Appellant's Business Conducted Through FPL

4. FPL was incorporated in 1925 in Florida.

5. From 2010 through 2015, FPL was the largest electric utility in Florida. FPL provided retail electric service to customers through its integrated transmission and distribution system that linked its generation facilities to its customers. FPL's electric service to customers was provided primarily under franchise agreements that FPL negotiated with Florida municipalities or counties.

6. All of FPL's customers were located within Florida. FPL earned over 90 percent of its revenues from retail customers—specifically, residential and commercial retail customers. NEE's 2011 through 2015 SEC annual reports state that FPL's business strategy focused on customer satisfaction by ensuring FPL delivered superior value through high reliability, low bills, and excellent customer service.

7. FPL also operated several nuclear plants in Florida. Nuclear sources provided 21 and 22 percent of FPL's power generating capacity for the respective 2009 and 2015 tax years.

8. FPL had no assets or plants in California. It also had no power generation, transfer, or distribution facilities in California. FPL had no employees, customers, or sales in California.

The Florida Public Service Commission's (FPSC's) Regulation of Appellant's Business

9. The FPSC regulated FPL and appellant's rate-regulated electric utility business. The FPSC had jurisdiction over public utilities' retail rates, service territory, issuance of securities, planning, siting, construction of facilities, and other matters within Florida.

10. Rate regulation was one of the FPSC's most significant powers. The FPSC conducted extensive investigation and approved increases to the "base rates" that FPL charged customers to recover the basic costs of constructing, operating, and maintaining the utility system. An expense that the FPSC determined was improper, imprudent, or unnecessary was disallowed and excluded from the amount FPL could collect from customers.[8]

[8] The FPSC also set "cost recovery clause" rules which permitted FPL full recovery of certain activity costs, such as fuel, purchased power, or energy conservation, and provided a return on certain allowed assets. Activities engaged in pursuant to a cost recovery clause were subject to the FPSC's approval, its review for compliance, and its adjustment of the charges during the year. An expense that the FPSC considered excessive or imprudently incurred could be disallowed.

11. The FPSC adopted administrative rules establishing cost allocation requirements for affiliated transactions and utility non-regulated activities.[9] Generally, when FPL sold products or services to appellant's non-regulated affiliates, those items were charged at the higher of fully allocated costs or market price. Generally, when FPL purchased products or services from appellant's non-regulated affiliates, the items were charged at the lower of fully allocated costs or market price. Generally, when FPL transferred an asset to appellant's non-regulated affiliates, the asset was transferred at the greater of market price or net book value.[10]

12. The FPSC administrative rules contained an exception for charges for services between FPL and NEE, between FPL and its regulated utility affiliates, or to FPL from an affiliate that existed solely to provide services to members of FPL's corporate family.[11]

13. To comply with FPSC administrative rules and Federal Energy Regulatory Commission (FERC) rules,[12] appellant used an integrated structure of billings and allocations codified in its Cost Allocation Manual (CAM). The CAM provided guidelines to employees regarding the company's cost allocation policies and practices for affiliate transactions.

14. In addition to rate regulation, the FPSC required corporate disclosures. Pursuant to so-called "Diversification Reports," a public utility was required to annually disclose to the FPSC its corporate structure and any changes to the structure, shared services or intercompany transactions in excess of $300, and new or amended contracts with affiliates. Pursuant to so-called "Rate of Return Surveillance Reports," a public utility was required to disclose to the FPSC its earnings and profits each month so that the FPSC could ensure the utility's earnings and profits remained within the approved range.

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[9] Fla. Admin. Code, § 25-6.1351 (Cost Allocation and Affiliate Transactions). The rule ensured that affiliated transactions and non-regulated utility activities were not subsidized by utility ratepayers. (*Ibid.*)

[10] Exceptions to the above affiliate sale rule allowed FPL to charge amounts other than fully allocated costs. (Fla. Admin. Code, § 25-6.1351.) An exception to the affiliate transfer rule did not require the "greater of" the asset values where the transaction benefitted regulated operations. (*Id.* at § (3)(c).) Where FPL transferred an asset to an affiliate and charged less than market price, it had to notify the Commission Clerk within 30 days. (*Id.* at § (3)(d).)

[11] Fla. Admin. Code, § 25-6.1351, § (3)(a). Despite the exception, the code states that "[a]ll affiliate transactions, however, are subject to regulatory review and approval." (*Ibid.*)

[12] 18 C.F.R., ch. 1, subch. C, Part 101[providing Uniform System of Accounts rules (accounting rules)] and Order 707 [requiring FPL to use "at cost" pricing rules.]

Appellant's Business Conducted Through NEER

15. NEER was formed in 1998 to aggregate appellant's existing wholesale energy business.

16. NEER was one of the largest wholesale generators of electric power in the United States. Wholesale power generation was a capital-intensive business. NEER produced the majority of its electricity from clean and renewable sources and was the largest owner of wind and utility-scale solar energy projects in North America. NEER owned electric generating facilities located in 27 states in the United States and four provinces in Canada. NEER's generation facilities were wholly outside of Florida.[13]

17. The majority of NEER's revenue was derived from the output of its generation facilities, and more than 90 percent of its revenues were derived from the wholesale electricity market. NEER utilized several nuclear plants for power generation throughout the United States, all of which were outside of Florida. Nuclear sources provided 14 and 13 percent of FPL's power generating capacity for the respective 2009 and 2015 tax years.

18. NEER's business activities included wholesale energy-related commodity marketing and trading, development of natural gas reserves, oil production, and pipeline development. NEER also owned a retail electricity provider.

19. As stated in NEE's 2012 through 2015 SEC annual reports, NEER primarily competed based on price but believed the green (i.e., clean environmental) attributes of its generating assets, its creditworthiness, and its ability to offer and manage reliable customized risk solutions to wholesale customers were competitive advantages.

Centralized Corporate Divisions, Groups, and Departments

20. Appellant maintained a centralized Nuclear Division, headed by NEE's EVP of the Nuclear Division and Chief Nuclear Officer. The Nuclear Division supported NEER and FPL nuclear plants located throughout the United States. The Nuclear Division performed a number of services for FPL and NEER, including operations support, licensing support, and training support. Support services also included nuclear regulatory compliance, risk management, and government relations. NEE's nuclear fleet support

[13] NEER's California facilities in 2009 included ten wind farms, one solar field, one gas field, and one coal/petroleum coke asset. In 2015, NEER's California facilities included ten wind farms and seven solar fields.

operations provided other corporate shared services to both FPL and NEER nuclear plants.

21. Appellant maintained a centralized Integrated Supply Chain (ISC) group. The ISC group served two main functions. First, the group provided purchasing for projects as they were being developed and constructed. ISC group employees for this function were either NEER or FPL employees. Purchases related to a specific project were charged to that project. Purchases related to generic projects were charged to generic categories that included generic wind, generic solar, or FPL. Second, the ISC group housed a central maintenance team that worked on scheduled repairs for wind farms. Items required for the repair and time incurred related to the repair were charged to the specific project.

22. Appellant maintained a centralized Engineering and Construction (E&C) group, which was comprised of engineers and construction personnel. The ISC group supported the E&C group with its purchasing needs. FPL or NEER employed E&C group personnel depending on the group that the personnel supported. Shared E&C services were related to oversight and planning functions as an owner's representative. Third-party E&C companies performed the actual engineering and construction services.

23. Appellant maintained a centralized Power Generation Division.[14]

24. Appellant centralized senior corporate management at the highest level, but FPL and NEER often had parallel corporate structures and maintained autonomous departments for their own corporate general management and administrative services. FPL's legal, finance, and human resources departments either included NEE executives or had reporting lines to NEE's corporate department heads.

25. NEE's EVP and general counsel was the head of the corporate legal department, and NEE maintained some high-level management employees in legal. NEER and FPL had separate legal departments with their own employees and general counsel reporting to NEE's general counsel. NEER and FPL had their own VP of Finance reporting to NEE's EVP of Finance and CFO. NEE had a centralized treasury function. However, NEER and FPL had separate finance and accounting structures, and separate sales tax teams.

[14] The parties have not addressed—and the record does not clearly state—this Division's function in briefing. The Power Generation Division's services included power generation support services. FPL and NEER also utilized the Power Generation Division's work management system in their operations.

NEE's EVP of Human Resources and Corporate Services oversaw human resources, but FPL provided most of the human resources services for appellant, including NEER.

26. There was no common trading (hedging) group. Trading groups within NEE and FPL operated separately and independently.

27. Appellant sponsored a qualified noncontributory defined benefit pension plan for substantially all its employees, including FPL employees.

Shared Services and Intercompany Transactions

28. There were three major categories of shared services between FPL and appellant's affiliates, including NEER. First, strategic and governance-related support services were generally performed by NEE's corporate center executive team, but sometimes, NEE's subsidiaries performed the services. Shared services included board of director-related activity, legal compliance, investor relations, internal audit, and office of general counsel.

29. Second, certain divisions within FPL provided fleet construction and operations support for appellant, including NEER. FPL leveraged its commercial and technical practices and knowledge regarding fleet construction, compliance, and operating capabilities to optimize results for its customers and appellant's broader enterprise, including NEER.

30. Third, FPL provided most of the information technology (IT) and management services,[15] and corporate communications services[16] for appellant, including NEER. FPL also provided the following corporate support services for appellant, including NEER: (1) auditing; (2) environmental services; (3) risk management; and (4) federal government affairs services. NEER maintained its own separate divisions for many of these corporate support services. Shared services that benefited non-regulated affiliates, including NEER, were generally tracked and allocated among all affiliates in accordance with appellant's CAM and billed pursuant to a corporate services charge formula.

31. Shared services included services for certain centralized corporate functions, including legal, human resources, finance and accounting. Shared services also included services

[15] FPL's IT services for appellant included: (1) maintenance of corporate applications; (2) support for telecommunications and network operating centers; (3) maintenance of mainframe operations; and (4) support for help desk and workstations.

[16] FPL's corporate communications services for appellant included: (1) internal communications; (2) external media communications; and (3) annual report services.

for certain centralized divisions and groups that benefited FPL and NEER, namely the: (1) Nuclear Division; (2) E&C group; (3) ISC group; and (4) Power Generation Division. The Nuclear Division was supported by NEE's nuclear fleet support operations that provided services to FPL and NEER's fleet of nuclear power generation assets.[17] The E&C Division shared services included oversight and planning, administration of corporate travel, and accounts payable. The Power Generation Division shared services included power generation support services.

32. In 2010, ownership of the Seabrook substation, adjacent to the Seabrook nuclear plant in New Hampshire, was transferred from FPL to NEER's wholesale energy business.

<u>Executive Force and Employee Transfers</u>

Executive and Officer Overlap Between NEE and FPL

33. NEE's Director and CEO, and (except for 2012) Chairman was FPL's Chairman for all Years at Issue. The CFO and EVP of Finance, and (except for 2009 and 2010) Vice Chair served with NEE and FPL for all Years at Issue.[18]

34. NEE's 2009 SEC annual report lists 16 executive officers (e.g., President, CEO, CFO). The officers were annually elected by, and served, the electing entity's board of directors. Officers could serve multiple boards. NEE and FPL shared nine executive officers, including the EVPs of three of the four centralized divisions. NEE's Chairman and CEO was also the Chair of the Executive committee of NEE's board of directors.

35. For the 2010 tax year, four FPL directors, and its Chairman of the Board and CEO served overlapping roles with NEE. NEE's 2010 SEC annual report lists 15 executive officers.

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[17] FPL allocated nuclear fleet operations support provided by NEE to FPL and NEER's nuclear plants as follows: (1) a nuclear service fee for nuclear operations and security, fuels support, nuclear business management, engineering, and assurance support; and (2) a nuclear information management service fee for nuclear procurement, work management system application support, information management business unit management team support, data services, and infrastructure support to NEER's nuclear plants. It is unclear whether nuclear fleet support operations also included training support, regulatory support, and licensing, or whether those services were performed solely by the Nuclear Division employees under the second category of shared services. FPL allocated nuclear support service costs based on the percentage of generating units across appellant's enterprise.

[18] NEE's Director, CEO and Chairman was succeeded between 2012-2013 by another board member. NEE's CFO and EVP of Finance was succeeded in 2011 by another board member.

NEE and FPL shared eight executive officers, including the EVPs of three of the four centralized divisions. FPL shared 14 other officers with NEE.[19]

36. For the 2015 tax year, FPL's Chairman of the Board was shared with NEE. NEE's 2015 annual report lists 12 executive officers. NEE and FPL shared eight executive officers, including the EVPs of all four centralized divisions. All NEE's executive officers shared with FPL had been officer or employee of appellant for five continuous years or more.[20] FPL shared 15 other officers with NEE.[21]

Executive and Officer Overlap Between FPL and NEER, and FPL and NEECH

37. FPL's and NEE's Chairman was NEER's Chairman for the 2009 through 2011 tax years. FPL's and NEE's CFO and EVP of Finance in 2009 became NEER's president and CEO from 2011 through 2015.

38. For the 2010 year, NEER shared six officers with FPL, inclusive of NEER entities that held nuclear plants. Four NEECH directors served director or officer roles with FPL and eight other NEECH officers served with FPL.

39. For the 2015 tax year, NEER shared nine officers with FPL, inclusive of NEER entities that held nuclear plants. Three NEECH directors served director or officer roles with FPL and four other NEECH officers served with FPL.

40. As mentioned above, NEE's EVP for Finance, Legal, and Human Resources were the heads of appellant's corporate departments, including NEER and FPL. The EVP of the Nuclear Division and Chief Nuclear Officer of NEE, NEER, and FPL was a VP of two NEER nuclear plants.

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[19] FTB relied on and utilized FPL's 2010 Diversification Report and FERC Form 1, *Annual Report of Major Electric Utilities, Licensees, and Others*, as representative of the Years at Issue.

[20] NEE and FPL former or concurrent executive roles included: (1) NEE and FPL's EVP of Power Generation, formerly president of a NEE subsidiary; (2) NEE and FPL's EVP of Human Resources & Corporate Services, formerly VP and chief operating officer (COO) of FPL, and prior to that, VP of ISC of NEE and FPL; (3) NEE and FPL's CFO and EVP of Finance, and formerly NEE's vice chairman and chief of staff; (4) NEE and FPL's president of the Nuclear Division, formerly NEE and FPL's EVP of the Nuclear Division; (5) NEE's president & CEO and FPL's Chairman of the Board, formerly FPL's CEO, and prior to that, NEE's president and COO; (6) FPL and NEE's EVP and NEE's general counsel, formerly, also NEE's assistant secretary; and (7) NEE and FPL's EVP of E&C and ISC, formerly NEE and FPL's VP of E&C and ISC, and prior to that NEE's and FPL's VP of ISC, and before that FPL's VP of E&C.

[21] Appellant provided a list of shared officers from FPL's 2015 Diversification Report and FERC Form 1.

41. Approximately 180 employees were annually transferred to or from FPL and appellant's affiliates, a figure representing approximately 1 percent of appellant's total workforce.[22]

Loans and Guarantees

42. NEECH provided funding for NEER and affiliates other than FPL.

43. NEE provided FPL with a $36 million line of credit in the 2008 tax year, which was increased to $63 million for the 2009 tax year, to finance the acquisition by FPL of additional substation-related assets related to its existing assets adjacent to the Seabrook nuclear power plant. As noted above, the Seabrook assets were transferred to NEER in the 2010 tax year.

44. For the 2012 tax year, NEECH provided the Florida Department of Corrections (FDOC) with a guarantee of up to $26.2 million, when FPL's subsidiary partially assigned its contract obligation to the FDOC to undertake certain energy efficiency measures.

Original Tax Filing and Claims for Refund

45. Appellant filed worldwide California unitary combined reports, including NEE, NEER, and FPL, and elected to file a group return.[23] NEE and FPL were not listed as California taxpayers but as appellant's unitary affiliates. NEECH was listed as a California taxpayer.[24]

46. Appellant submitted timely claims for refund for the Years at Issue, asserting that it conducted two separate trades or businesses. Appellant alleged that its wholesale energy business was entirely conducted through NEER primarily outside of Florida, and FPL operated a separate and distinct rate-regulated electric utility business wholly within Florida. Thus, appellant requested that FPL and its subsidiaries be removed from its California combined reports. The exclusion of FPL's substantial taxable income from the California combined report generated the alleged refunds appellant asserted it was due.

[22] This figure only includes employees earning over $30,000.

[23] Appellant computed its California apportionment percentage using a three-factor formula (property, payroll, and double-weighted sales) for the 2009 and 2010 tax years, and a single-sales factor for the 2011 through 2015 tax years.

[24] NEER is not listed on appellant's Schedules R-7, the group return elections. Complete copies of appellant's returns are not in the record.

47. In the alternative, appellant requested that if FTB determined that NEER was in fact engaged in a unitary business with FPL, FTB should grant equitable relief pursuant to R&TC section 25137.

48. FTB did not respond to appellant's claims for refund. Appellant deemed its claims denied under R&TC section 19331 and filed this timely appeal.

DISCUSSION

Issue 1: Whether appellant was engaged in two separate businesses, a rate-regulated electric utility business and a wholesale energy business, or in one unitary business for the Years at Issue.

I. Burden of Proof

Appellant bears the burden of proving entitlement to its refund claim. (*Appeal of Jali, LLC*, 2019-OTA-204P.) Except as otherwise provided by law, the burden of proof requires proof by a preponderance of the evidence. (Cal. Code Regs., tit. 18 (Regulation), § 30219(c).) To meet this evidentiary standard, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Appeal of Belcher*, 2021-OTA-284P.) In an action for refund, a taxpayer cannot assert error and thus shift to the state the burden to justify the tax. (*Appeal of Carr, Jr.*, 2022-OTA-157P.) FTB's determinations cannot be successfully rebutted when the taxpayer fails to provide credible, competent, and relevant evidence as to the issues in dispute. (*Appeal of Wright Capital Holdings LLC*, 2019-OTA-219P (*Wright Capital*).) Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Bindley*, 2019-OTA-179P.)

FTB's determination that a taxpayer was engaged in a single unitary business with affiliated corporations is presumptively correct, and the taxpayer bears the burden of proving that the determination is erroneous. (*Appeal of Trails End, Inc*. (85-SBE-106) 1985 WL 47214 (*Trails End*).) Where FTB has determined that a unitary relationship exists, a taxpayer "contesting [FTB's] determination of unity . . . must prove by a preponderance of the evidence that, in the aggregate, the unitary connections relied upon by [FTB] are so lacking in substance as to compel the conclusion that a single integrated economic enterprise did not exist." (*Appeal of Smith*, 2023-OTA-069P; see also *Appeal of Saga Corp*. (82-SBE-102) 1982 WL 11779 (*Saga*); *Appeal of Kikkoman International, Inc*. (82-SBE-098) 1982 WL 11776 (*Kikkoman*).)

Each appeal must be decided on its own particular facts and no one element is controlling. (*Appeal of Hollywood Film Enterprises, Inc.* (82-SBE-052) 1982 WL 11730; *Container Corp. v. Franchise Tax Bd*. (1981) 117 Cal.App.3d 988, 995, affd. (1983) *Container Corp. v. Franchise Tax Bd*. 463 U.S. 159 (*Container*).)

II. Tests to Determine Unity

When a taxpayer derives income from sources both within and without California, its franchise tax is measured by its net income derived from or attributable to sources within this state. (R&TC, § 25101.) If the taxpayer is engaged in a single unitary business with affiliated corporations, the income attributable to California must be determined by applying an apportionment formula to the total income derived from the combined unitary operations of the affiliated companies. (*Edison Cal. Stores, Inc. v. McColgan* (1947) 30 Cal.2d 472, 480-482 (*Edison*).)

The California Supreme Court has set forth two alternative tests for determining whether a business is unitary. (*A.M. Castle & Co. v. Franchise Tax Bd.* (1995) 36 Cal.App.4th 1794, 1804-1806 (*A.M. Castle*).) In *Butler Bros. v. McColgan* (1941) 17 Cal.2d 664, 678 (*Butler Bros I*), affd. (1942) 315 U.S. 501 (*Butler Bros II*), the court held that the existence of a unitary business was "definitely established" by the presence of (1) unity of ownership; (2) unity of operation, as evidenced by central accounting, purchasing, advertising, and management divisions; and (3) unity of use, as evidenced by a centralized executive force and general system of operation (a.k.a., the "three unities" test). All three unities must be found to exist. (*Dental Ins. Consultants, Inc. v. Franchise Tax Bd.* (1991) 1 Cal.App.4th 343, 348 (*Dental Ins.*).) Later, in *Edison*, *supra*, the court stated that a business is unitary if the operation of the business done within California is dependent upon or contributes to the operation of the business outside California (a.k.a., the "dependency or contribution" test). (*Edison*, *supra*, 30 Cal.2d at p. 481.) Both unitary tests require common ownership, directly or indirectly, of more than 50 percent of an affiliated corporation's voting stock. (R&TC, § 25105 [defining a commonly controlled group].) If either the three unities test or the dependency or contribution test is satisfied, the businesses are deemed unitary. (*A.M. Castle*, *supra*, 36 Cal.App.4th at p. 1805.)

The United States Supreme Court has stated that the prerequisite to a constitutionally acceptable finding of a unitary business is a flow of value, not necessarily a flow of goods. (*Container*, *supra*, 463 U.S. at p. 178.) A question relevant in the unitary business inquiry is whether contributions to income of the affiliates resulted from functional integration, centralization of management, and economies of scale. (*Id*. at p. 179.) To show that income is not subject to apportionment, the Court has stated that the taxpayer must show that the income was earned in the course of business activities unrelated to its in-state business activity. (*Mobil Oil Corp. v. Commissioner of Taxes of Vermont* (1990) 445 U.S. 425, 439, 442 (*Mobil*).[25]) For California purposes, any test may be applied to determine unity so long as there is a flow of value between the segments which make up a unitary business. (*A.M. Castle*, *supra*, 36 Cal.App.4th at p. 1806.)

A California regulation also provides that "[t]he determination of whether the activities of the taxpayer constitute a single trade or business or more than one trade or business will turn on the facts in each case. In general, the activities of the taxpayer will be considered a single [i.e., unitary[26]] business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer was a whole." (Cal. Code Regs., tit. 18, § 25120(b).) Labels are not helpful in justifying either combination or decombination, regardless of who uses them. (*Appeal of Sierra Production Service* (90-SBE-010) 1990 WL 176060 (*Sierra Production*).) Unitary combination cases are decided on the basis of specific, concrete evidence, when it is available. (*Ibid*.; *Saga*, *supra*.)

III. <u>Analysis</u>

A. <u>The Parties' Assertions</u>

FTB argues that there is extensive overlap in management between NEER and FPL, and substantial intercompany transactions and services between FPL and appellant's affiliates, including NEER. FTB asserts that NEER and FPL were engaged in the same line of business because they transmitted and generated electricity for profit, and therefore, unity between them is presumed. FTB claims that dependency or contribution was inherent in appellant's business model. FTB contends that there are "ample" indicia of unity and appellant has not met its burden

[25] In *Mobil*, the Court reasoned that no underlying unitary business would exist where business activities generating dividend income have nothing to do with the activities of the recipient in the taxing state. (*Mobil*, *supra*, 445 U.S. at 439.) However, it did not need to address that situation because unrelated business activity was not shown. (*Ibid*.) The Court reasoned that a taxpayer undertaking this argument would need to show that the operations of the unrelated activity are "distinct in [a] business or economic sense" from its in-state activity. (*Ibid*.)

[26] *A.M. Castle*, *supra*, 36 Cal.App.4th at p. 1805, fn. 11. This parenthetical helps explain that Regulation section 25120(b)'s determination of a single trade or business is equivalent to a unitary business finding for that activity.

to prove that these connections are so insubstantial as to compel the conclusion that a single integrated economic enterprise did not exist.

Appellant disagrees, contending that FPL conducted the rate-regulated electric utility business, which was unrelated to, and not unitary with, NEER's wholesale energy business. Appellant also identifies several potential unitary factors which were present, but which it asserts do not show flows of value indicative of a unitary relationship. Appellant asserts that any common management of the purportedly separate businesses was limited in impact due to the FPSC's regulatory oversight. Next, appellant characterizes shared services between the alleged separate businesses as limited, generally administrative in nature, and typical for any parent-subsidiary relationship. Further, appellant characterizes intercompany transactions between NEER and FPL as small and immaterial. Thus, appellant urges that FPL's rate-regulated electric utility business is separate and distinct from NEER's wholesale energy business under the applicable unitary business authorities.

B. <u>Controlling Ownership</u>

A prerequisite to application of the unitary tests is common ownership, directly or indirectly, of more than 50 percent of an affiliated corporation's voting stock. (R&TC, § 25105.) Here, the parties agree that common ownership is present, as NEE directly wholly owned FPL and indirectly wholly owned NEER.

C. <u>Strong Central Management and Centralized Departments</u>

Unity of use in a business's centralized executive force and general system of operation is a factor in determining whether a business is unitary under the three unities test. (*Butler Bros I*, *supra*, 17 Cal.2d at p. 678; *Butler Bros II*, *supra*, 315 U.S. at p. 508.) In addition, a California regulation establishes a "strong presumption" that the activities of the taxpayer constitute a single trade or business where "there is strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, or purchasing." (Cal. Code Regs., tit. 18, § 25120(b)(3).)[27] Both the unity of use and the California regulations are relevant standards pursuant to which unity is determined. (*Mole-Richardson Co. v. Franchise Tax Bd.* (1990) 220 Cal.App.3d 889, 895, 899 (*Mole-Richardson*);

[27] On appeal, FTB does not assert that the presumption under Regulation section 25120(b)(3) applies here. FTB only alleges that common management and an integrated executive force are present unitary factors. Where no presumption applies, the taxpayer bears the burden of proof. (*Sierra Production*, *supra*, at p. *5; *Saga*, *supra*, at p. *6, fn. 3.)

Tenneco West, Inc. v. Franchise Tax Bd. (1991) 234 Cal. App.3d 1510, 1525 (*Tenneco*).)

i. Authorities Discussing Strong Central Management Generally

Under the three unities test, unity of use refers primarily to integration and control of executive forces. (*A.M. Castle*, *supra*, 36 Cal.App. 4th at p. 1806.) An integrated executive force is "an element of exceeding importance" in determining unity. (*Chase Brass and Copper Co. v. Franchise Tax Bd.* (1970) 10 Cal.App.3d 496, 504 (*Chase*).) For a subsidiary corporation to have the assistance and direction of high executive authority of such a corporation as [its parent] is an invaluable resource. (*Ibid.*) The "major policy matters" should be the focus in determining whether various entities have an integrated executive force. (*Ibid.*) Unitary authorities contemplate that the central executive force will "play a regular operational role in the business." (*Sierra Production*, *supra*, at p. *5, fn. 5; Cal. Code Regs., tit. 18, § 25120(b)(3) [conglomerates are one business when "the central executive officers are normally involved in the operations of the various divisions . . ."]; *Container*, *supra*, 463 U.S. at p. 180, fn. 19.) Thus, a showing of strong central management requires more than the mere existence of common officers or directors or an allegation that the various business segments were under the ultimate control of the same person or group of people. (*Sierra Production*, *supra*, at p. *5, fn. 5.)[28] What constitutes "strong central management" will depend, to a considerable extent, on the facts of each case. (*Ibid.*)

ii. Strong Central Management Through Implicit Control

In *Trails End*, *supra*, on which FTB relies, the Board of Equalization (BOE) analyzed implicit control in determining whether a commonly controlled group was unitary.[29] There, the taxpayer's board of directors, responsible for company policy and finances, was composed entirely of current or former officers of directors of its parent, who served similar managerial roles with the taxpayer, its parent. Even though the parent's officers were not involved in the taxpayer's day-to-day operations, BOE held that their presence on the taxpayer's executive staff

[28] FTB claims that a substantial number of shared officers and directors implies "significant operational oversight and involvement at all levels." However, *Sierra Production, supra*, at p. *5, holds to the contrary.

[29] In *Trails End*, the taxpayer was a molding and manufacturer of custom-designed plastic parts and products that functioned as an autonomous business enterprise in its day-to-day operations. Nutrilite, a supplement manufacturer, owned 80 percent of the taxpayer and was its parent. Of the asserted unitary group members, BOE analyzed strong central management only with respect to Nutrilite. (*Trails End*, *supra*, at pp. *4-5.)

and board "is relevant to show that [the taxpayer] was subject to at least the implicit control of [the parent] so as to render the two corporations an integrated enterprise." (*Trails End*, *supra*, at p. *4, citing *Container*, *supra*, 463 U.S. at p. 177, fn. 16.)

Here, there was an overlap of executives at the highest level that cannot be disputed, and which shows NEE's implicit control of FPL and NEER. NEE's Director, CEO and Chairman was FPL's and NEER's Chairman for the 2009 through 2011 tax years, NEE's Chairman was FPL's Chairman for the 2012 through 2015 tax years, and NEE's CEO (also its president in July 2012) was FPL's CEO from May 2012 through May 2014. NEE's Chairman and CEO was also the Chair of the NEE board of director's Executive committee. Four out of five FPL directors who served for the full 2010 tax year also served with NEE, and two out of three FPL directors were shared with NEE in the 2015 tax year. NEE's and FPL's CFO and EVP of Finance served concurrently for all Years at Issue. A majority of NEE's executive officers were shared with FPL: nine out of 16 officers in the 2009 tax year and eight out of 12 in the 2015 tax year. NEE's executive officers served in three of the four centralized divisions in the 2009 tax year, and all four centralized divisions in the 2015 tax year. NEE and FPL shared 14 to 15 officers in the 2010 and 2015 tax years, respectively. All NEE's executive officers shared with FPL had been an officer or employee of appellant for five continuous years or more, and many served former or concurrent roles within FPL and NEE.

As in *Trails End*, *supra*, OTA finds that FPL's staff and board was shared with many NEE directors, executive officers, and officers at the highest level. Appellant has not presented evidence establishing that the NEE directors, executives, and officers were not responsible for company policy and finances. FTB's determinations cannot be successfully rebutted when the taxpayer fails to provide credible, competent, and relevant evidence as to the issues in dispute. (*Wright Capital*, *supra*.) Thus, FPL was under NEE's implicit control based on the presence of NEE directors, executives and officers on FPL's staff and board.

Concerning NEER, there were six direct concurrent overlaps with FPL for the 2010 tax year and nine for the 2015 tax year. These individuals were the EVPs or VPs of appellant's four centralized groups. Additionally, FPL's EVP of the Nuclear Division and Chief Nuclear Officer, and other FPL officers served VP or other roles at two NEER nuclear plants.[30] As previously noted, NEE's Director, CEO and Chairman was the Chairman for FPL and NEER for the 2009 through 2011 tax years. Also, as noted below under transfer of key executives, FPL's and NEE's CFO and EVP of Finance in 2009 became NEER's president and CEO from 2011 through 2015. FPL, NEE, and NEER shared significant managerial links through NEE's implicit control of FPL, and NEE executives and FPL officers shared with NEER in the four centralized divisions and three centralized groups. Therefore, NEE implicitly controlled NEER based on the presence of NEE and FPL executives and officers on NEER's staff and board.

Appellant attempts to minimize the roles of the shared board of directors, executives, and officers, asserting that common management positions at NEE were "clearly distinct from operations and would not create the synergies required for a unitary determination."[31] However, appellant provides no evidence to show that NEE's high level management was not involved in appellant's rate-regulated electric utility business conducted by FPL and its wholesale energy business conducted through NEER. Without elaborating, appellant dismisses seven FPL officers who overlapped only with NEE (and not NEER) because "corporate-level" roles are "non-operational." Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Bindley*, *supra*.) However, corporate executive overlap is relevant to a unitary determination, and can help establish functional integration. (*Trails End*, *supra*, at pp. *4-*5; *Chase*, *supra*, 10 Cal.App.3d at p. 504; *Container*, *supra*, 463 U.S. at p. 180, fn. 19; *Mole-Richardson*, *supra*, 220 Cal.App.3d at pp. 897-899.)

Next, appellant diminishes 12 individuals as holding only "administrative and oversight" positions. However, the individuals were high ranking directors, executives, and officers overseeing corporate departments, financing, and nuclear operations at FPL and NEER.[32] What

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[30] The parties do not address NEECH in detail, but three to four NEECH directors were also FPL directors, and NEECH and FPL shared between four and eight officer roles during the Years at Issue. Appellant has stated that NEECH did not fund FPL but has not otherwise explained the overlap.

[31] Appellant responds to the shared executive officers and directors identified by FTB and a list of 44 FPL directors and officers, whose overlapping roles were reported to the FPSC in FPL's 2015 Diversification Report and FERC Form 1. Appellant asserts that 19 FPL officers and directors were solely within FPL's rate-regulated electric utility business. However, OTA cannot discern based on the lack of shared corporate names whether these officers solely engaged in activities unrelated to the wholesale energy business. (See *Mobil*, *supra*, 445 U.S. at p. 439, fn. 16.) Above, OTA addresses appellant's assertions regarding the remaining 25 shared FPL directors and officers.

[32] The 12 individuals included: (1) three NEE executives and high-level management employees who were the heads of the legal, human resources, and finance departments for appellant's business, including NEER; (2) NEE's and FPL's shared director, and NEE's and NEECH's CEO; (3) NEECH's and FPL's shared director, and

matters is whether executive control at the highest level was within NEE. (*Chase*, *supra*, 10 Cal.App.3d at p. 504.) In *Chase*, *supra*, executive control was evidenced by the executives of the subsidiaries reporting to the president of their parent with respect to major policy matters. (*Ibid*.) Here, appellant provides no evidence and cites no authority that the reporting lines did not concern major policy matters. In the absence of credible and relevant evidence, FTB's determinations must be upheld. (*Wright Capital*, *supra*.)

Appellant then turns to six of FPL's officers and directors who could "impact the nonregulated operations," i.e., the EVPs and VPs in charge of the four centralized divisions, namely: the (1) Nuclear Division; (2) ISC group; (3) E&C group; and (4) Power Generation Division. Each of these individuals generally served with NEE, NEER (and its nuclear plants), and FPL concurrently.[33] Appellant argues that the "employees and management reporting to [these Divisions' officers] were generally employed directly either by FPL or NEER with job responsibilities focused on their employer."[34] Appellant concludes that "these roles are indicative of oversight and reporting lines," and not an integrated executive force. However, in *Chase*, the Court of Appeal rejected the taxpayer's argument that "the president of Chase had a complete staff and line organization under his direction" because "executive control at the highest level was in [the parent]." (*Chase*, *supra*, 10 Cal.App.3d at p. 504.) Here, appellant has provided no evidence to rebut the conclusion that executive control at the highest level was within NEE. Further, appellant has not addressed or provided evidence to show that NEE executives, or FPL's and NEER's shared officers in the centralized divisions, were not normally involved in FPL's or NEER's operations. FTB's determinations cannot be successfully rebutted when the taxpayer fails to provide credible, competent, and relevant evidence as to the issues in dispute. (*Wright Capital*, *supra*.)

Appellant argues that overlapping officers (in its estimation, 18) are insignificant compared to appellant's combined workforce, inclusive of FPL. But strong central management

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NEE's, NEECH's, and FPL's CFO and EVP or SVP of Finance; (4) NEE's, NEECH's and FPL's treasurer, who was also a NEECH Director and VP; (5) and FPL's VP of Finance and Nuclear Fleet, who was a VP at two NEER nuclear plants; and (6) NEE and FPL's SVP of Corporate Development and Strategic Initiatives, who served a similar role with NEER's as VP.

[33] There is only one exception, the VP of Power Generation Technical Services for FPL. The record does not show how that FPL officer overlapped with NEER's wholesale energy business.

[34] Appellant states that for the Nuclear Division "each FPL and NEER nuclear plant [] had its own dedicated operations and management teams."

is not determined by the number of shared employees, or the ratio of its shared workforce to total workforce; rather, it is determined by the presence of an integrated executive force. (See *Chase*, *supra*, 10 Cal.App.3d at p. 504.)

Thus, OTA concludes that appellant has not rebutted NEE's implicit control of FPL and NEER. As in *Trails End*, *supra*, a majority of NEE directors and executives served on FPL's staff and board, and often in similar capacities. (*Trails End*, *supra,* at p. *4.) OTA also concludes that appellant has not rebutted NEE's implicit control of NEER, through implicit control of FPL and the presence of NEE and FPL executives and officers on NEER's board and staff. (*Appeal of Smith*, *supra*.)

iii. Whether NEE Had Actual Control of FPL and NEER

Actual control may be found where there is a link between management and operations. (*Trails End*, *supra*, at p. *5; *Container*, *supra*, 463 U.S. at p. 177 [finding requisite control where parent provides direction to subsidiaries for compliance with its standard of professionalism, profitability, and ethical practices].) In *Trails End*, actual control was evidenced where the taxpayer's chairman and CEO, and high ranking official of its parent, formed an integrated executive committee prior to the appeal year to develop, coordinate, and direct all of the taxpayer's administrative, manufacturing, and sales functions. (*Trails End*, *supra*.) Through the appeal year, the CEO and another official of the parent served on the executive committee and on the taxpayer's board of directors, and the parent monitored the taxpayer's financial condition in various ways.[35] (*Ibid*.)

Here, NEE implemented management policies that provided FPL with financial, accounting, and professional and ethical guidelines.[36] NEE also established various board of

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[35] The parent required the taxpayer to submit monthly reports and its agreement to combined reporting tax preparation. The taxpayer also consulted with its parent before replacing an obsolete equipment model.

[36] At audit, appellant provided policies addressing various authorities and limits around commitment of company resources, entitled *Policy and Procedure # NEER-ACQ-012, Commitment Authority (Rev Date 4/6/17)*. FTB reviewed this document and noted that the same upper-level officers were responsible for approvals across all entities, regardless of whether the project was part of FPL, NEER, or another of appellant's affiliates.

Appellant also provided evidence that NEE established accounting controls and written policies including a Code of Business Conduct & Ethics (Code) that states management's policy on conflicts of interest and ethical conduct. NEE required key personnel to annually confirm compliance with its Code.

The relevant documents are not in the record. However, appellant bears the burden to show that NEE's approval policy was typical of a corporate parent's oversight over its subsidiaries. (*Appeal of Smith*, *supra*.)

director committees, including an Executive committee.[37] NEE's Chairman and CEO served on the Executive committee and on FPL's board of directors for the 2015 tax year. Appellant has not addressed NEE's management policies or executive committees, and it has the burden of proof. (*Appeal of Smith*, *supra*.) Here, as in *Trails End*, *supra*, and *Container*, *supra*, OTA finds that appellant has not rebutted the evidence of actual executive control. (*Trails End*, *supra*, at p. *5; *Container*, *supra*, 463 U.S. at p. 177.)

The parties did not address two cases where the California Court of Appeal held that close control by management was sufficient to uphold a unitary finding. In *Dental Ins.*, *supra*, the California Court of Appeal found a California corporation in the business of dental insurance claim review and advice was unitary with its subsidiary that operated small agricultural farms in the state. The court held that the "close control by the parent and the shared administrative functions, coupled with the undisputed unity of ownership, establish the requisite economic, operational and managerial interdependence to establish the unitary nature of these businesses." (*Dental Ins., supra,* 1 Cal.App.4th at p. 352.)[38] In *Mole-Richardson*, *supra*, the Court of Appeal held that a California lighting business was unitary with a Colorado farm business due to strong central management. (*Mole-Richardson, supra,* 220 Cal.App.3d at p. 899.)[39] The court dismissed the taxpayer's argument that "functional integration" is a new and different concept with which a business enterprise must be evaluated to justify unitary treatment under *F.W. Woolworth Co. v. Tax and Rev. Dept. of N.M.* (1982) 458 U.S. 354 (*Woolworth I*) *and F.W. Woolworth Co. v. Franchise Tax Bd.* (1984) 160 Cal.App.3d. 1154 (*Woolworth v. FTB*). (*Mole-Richardson*, *supra*, 220 Cal.App.3d at pp. 897-99.)

[37] NEE's board of directors had an Executive committee, Governance & Nominating committee, a Guarantee Approval committee, a Finance and Investment committee, a Nuclear committee, and an Exposure Management committee. The parties provided some committee board minutes, which do not clearly indicate whether the committees were or were not involved in FPL's or NEER's activities. The parties did not directly address the committees in briefing.

[38] There, the evidence showed that there was nearly total overlap between the two company's directors and officers, the parent made capital and financial contributions, and the parent's directors and officers made ultimate policy decisions. The court distinguished *F.W. Woolworth Co. v. Franchise Tax Bd.* (1984) 160 Cal.App.3d. 1154, noting that "unlike the detached operations and management control" of that case, in its case, "executive guidance and financial contributions . . . went beyond the routine interest of the parent company in the performance and profitability of a wholly owned subsidiary." (*Dental Ins.*, *supra*, 1 Cal.App.4th at p. 353.)

[39] There, the evidence showed that: (1) all major business decisions were made by the taxpayer's president and CEO; (2) many business functions were performed at a central location, realizing cost savings from economies of scale; (3) property of the California business was mortgaged to fund improvements of the farm business; and (4) a single attorney was general counsel for all businesses. (*Mole-Richardson*, *supra*, 220 Cal.App.3d at pp. 893, 900.)

Here, appellant relies on *Woolworth v. FTB*, *supra*, and *Tenneco*, *supra*, for the proposition that common management is insufficient where FPL and NEER's operations are operated separately and independently. In *Woolworth v. FTB*, on a record barren of nearly any evidence of connection between two business, the court held that "the degree of centralization of management between [the two businesses] was no more than could be expected between any parent company and a wholly owned subsidiary." (*Woolworth v. FTB*, *supra*, 160 Cal.App.3d at p. 1161.) While the California Court of Appeal found "obvious managerial links," including interlocking boards of directors and frequent communication between upper management, those ties were insufficient to overcome the substantial evidence indicating that the two companies were fundamentally not unitary in operation. (*Ibid*.)

In *Tenneco*, the taxpayer was a unitary business engaged in oil and oil related businesses. (*Tenneco*, *supra*, 234 Cal. App.3d at p. 1517.) The California Court of Appeal held that certain Tenneco subsidiaries engaged in shipbuilding, packaging, automotive parts manufacturing, and manufacturing and selling construction and farm equipment were not so integrated with Tenneco's business as to constitute a unitary business. (*Id*. at p. 1533.) In concluding that Tenneco's degree of central management was not strong, the court determined that management involvement did not extend significantly beyond the normal review and oversight of a parent over its subsidiaries. (*Id*. at pp. 1528-1531.) Corporate activity such as the annual planning process, weekly meetings between the CEO and executive committee, internal audit, corporate-wide procedures manual, and so forth,[40] may constitute typical parent-subsidiary behavior. (*Id*. at p. 1528.)

When asked at the hearing about NEE's relationship to NEER and FPL, appellant stated that NEE served only as the kind of limited liability company that issues stock, and characterized NEE as an investor overseeing the finances. However, during the 2013 through 2015 tax years, NEE commenced an enterprise-wide initiative throughout appellant to improve productivity and reduce operations and maintenance (O&M) expenses (cost savings initiative), including NEER and FPL. As stated in NEE's 2013 through 2015 SEC annual reports, FPL implemented ideas

[40] The full list of executive activities in *Tenneco* includes "financial strategy with debt targets and dividend payout ratios, approval of major capital expenditures, external financing, cash management, real property disposition, guarantees, loans, advances to and from divisions, insurance, and 'overruling subsidiaries ideas." (*Tenneco*, *supra*, 234 Cal. App.3d at p. 1528.)

generated from the cost savings initiative to lower its O&M expenses. The cost savings initiative used an early retirement program, which leveraged appellant's sponsored pension for all employees, including FPL's.[41] In 2014, FPL's operating expenses decreased $79 million due to an absence of the implementation costs as well as realized costs savings from the initiative. FPL was a vertically-integrated business that depended on customer satisfaction through "low bills."

Here, the cost savings initiative is further evidence as in *Trails End*, *supra*, and *Dental Ins.*, *supra*, that NEE monitored FPL's financial condition and contributed to FPL's business beyond the routine interest of a parent company. Involvement in day-to-day operations is not required. (*Trails End*, *supra*, at p. *4.) Appellant has not shown that NEE's oversight was limited to the detached management control typical of a parent-subsidiary relationship.[42] Appellant has not shown that this evidence of executive control was insignificant. (*Appeal of Smith*, *supra*.)

iv. Transfer of Key Executives

Significant transfers of key executives among FPL and appellant's affiliates is a unitary factor. (*Trails End*, *supra*; *Appeals of Monsanto Co.* (70-SBE-038) 1970 WL 2471 (*Monsanto*).) While a separate unitary factor, it is relevant to strong central management. Here, FPL's and NEE's CFO and EVP of Finance in 2009 became NEER's president and CEO from 2011 through 2015. Effective May 2012, NEE's CEO (also its president in July 2012) served as FPL's CEO, until May 2014. Other transfers included: (1) a NEE subsidiary's president became EVP of NEER's and FPL's Power Generation Division; (2) the VP and Chief Operating Officer of FPL became NEE's and FPL's EVP of Human Resources and Corporate Services; (3) NEE's vice chairman and chief of staff became FPL's EVP of Finance and CFO; (4) NEE's assistant secretary became FPL's EVP and general counsel; and (5) NEE's VP of E&C became NEE and FPL's EVP of E&C and ISC. (See fn. 20, above.) This factor supports a unitary finding.

[41] NEE's 2015 SEC annual reports state that while management expected that the ideas generated from the cost savings initiative would keep FPL's O&M costs recovered through base rates flat through 2016, operating expenses increased in 2015 because of higher O&M expenses "associated with the growth in the NEER business," among other items.

[42] In addition to NEE's management policies, its board of director executive committees, and the cost savings initiative, NEE, NEER and FPL were linked as previously mentioned under implicit control, which is relevant to the degree of actual control: NEE's Director, CEO and Chairman was also FPL's and NEER's Chairman for the 2009 through 2011 tax years; NEER's president and CEO from 2011 through the 2015 tax year was formerly FPL's and NEE's CFO and EVP of Finance; NEE executives were the department heads of three centralized corporate groups overseeing FPL and NEER; and FPL and NEER shared six and nine officers in the four centralized divisions for the 2010 and 2015 tax years, respectively.

v. Whether FPL was Operated Autonomously

Appellant argues that common management is insufficient where, as in its case, FPL's rate-regulated electric utility business was separate and independent from its wholesale energy business conducted through NEER. Appellant relies on *Tenneco*, *supra*, for the proposition that FPL was operated autonomously. However, *Tenneco* is distinguishable. In *Tenneco*, the court based its conclusion that Tenneco's degree of central management was not strong on a determination that Tenneco's subsidiaries had a high degree of operating autonomy as reflected in public documents, policy manuals and speeches. (*Tenneco*, *supra*, 234 Cal. App.3d at pp. 1526-1528.) However, appellant has not established that FPL had a high degree of operating autonomy.

Here, the record of the degree of FPL's operating autonomy as reflected publicly is not well-developed. During the hearing, Mr. Bores, VP of Finance of FPL, provided testimony that FPL was a longstanding utility, and that NEER was formed as an investment out of FPL assets. Mr. Bores testified that the rebrand (i.e., name change) arose out of the growth of NEER's wholesale energy business. He claimed that NEE executive team wanted to avoid confusion by its investors, FPL's customers, and others who reviewed NEE's annual reports. Specifically, he testified that the rebrand sought "to make sure all stakeholders clearly understood that there were two separate businesses, and that this new business that was starting to grow was in no way, shape, or form affiliated with [FPL] or going to impact the end consumer of [FPL]."

However, Mr. Bores was not part of the NEE executive team or NEE at the time, nor was he with FPL then. His testimony regarding the rebrand addresses NEER's operating autonomy, not FPL's, and does not directly address strong central management. Appellant has the burden of proof and has not provided credible and relevant evidence as to the issue in dispute. (*Wright Capital*, *supra*.) Appellant has not shown that its rate-regulated electric utility business was operated autonomously from its wholesale energy business. (*Appeal of Smith*, *supra*.)

vi. Whether FPSC's Regulation of FPL's Business Precludes Unity

Appellant argues in the alternative that, to the extent common management may exist between the two purported businesses, the FPSC's regulatory restrictions required that FPL autonomously operate its rate-regulated electric utility business. The FPSC held jurisdiction over public utilities' retail rates, service territory, issuance of securities, planning, siting, construction of facilities, and other matters. OTA examined the FPSC administrative rules, which primarily concern regulation of FPL's electric service rates, intercompany pricing, monthly and annual disclosures, and approvals of regulated transactions. However, the FPSC's administrative rules did not require FPL to operate its business separately and independently.

In briefing, appellant focused on the FPSC's significant power to regulate FPL's electric service charges to retail customers, the FPSC's cost allocation rules, which were incorporated into appellant's CAM, and the annual and monthly disclosures required by the FPSC pursuant to Diversification Reports and Rate of Return Surveillance Reports. However, appellant has not shown that the FPSC prevented NEE's board of directors from playing a regular operational role in FPL's business. Appellant has also not shown that the FPSC prevented the centralized divisions shared with NEER from achieving economies of scale, operational integration, or sharing of expertise. Further, OTA notes that FPSC oversight contains exceptions, for example, transactions engaged in by a non-regulated affiliate that did not involve a utility were not subject to FPSC oversight, and the FPSC ratemaking rules did not apply to an affiliate that existed solely to provide services to members of FPL's corporate family. OTA notes that NEE's SEC annual reports refer to FPL's business only as a "rate-regulated" business. Appellant has not shown that complete separation of operations from all other affiliates was required such that unitary flows of value could not be achieved.

The fact that the FPSC regulated FPL's business but did not regulate NEER's wholesale energy business does not establish a discrete enterprise. There is not a separate unitary test or heavier burden of proof for a taxpayer engaged in a diverse business, i.e., activities with two or more different income producing activities. (*See Sierra Production*, *supra*, at p. *3 and fn. 2.) Similarly, there is not a separate unitary test or heavier burden of proof for a taxpayer with regulated activities and unregulated activities, or activities regulated in a different or heavier manner. The traditional unitary tests must be employed. (*A.M. Castle*, *supra*, 36. Cal.App. 4th at pp. 1805-1807.)

Appellant's reference to FPL's "autonomous" operation appears to assert that FPL did not depend upon or contribute to appellant's unitary business (specifically, NEER's wholesale energy business) conducted in California.[43] However, appellant has not shown that its rate-regulated electric utility business through FPL was separate and distinct from its wholesale

[43] Mr. Bores' testimony at the hearing, which concerned "putting up a wall" between the two asserted businesses, focused on the FPSC intercompany affiliate transaction rules pursuant to Fla. Admin. Code, § 25-6.1351.

energy business wherever conducted. In the absence of credible and relevant evidence, FTB's determinations must be upheld. (*Wright Capital*, *supra*.)

Further, each part of the unitary business does not need to be directly connected. In *Monsanto*, the taxpayer claimed that the purported unitary subsidiary "has no dealings of any kind with [the taxpayer's] California facilities" and that none of its products sold to the subsidiary "had any direct or indirect connection with any of [the taxpayer's] California locations." (*Monsanto*, *supra*, at p. *4.) BOE disagreed, stating that "the argument misconceives the unitary business concept. All that need be shown is that during the critical period [the subsidiary] formed an inseparable part of [the taxpayer's] unitary business wherever conducted. By attempting to establish a dichotomy between [the taxpayer's] California operations and [the subsidiary], [the taxpayer] would have us ignore other parts of [the taxpayer's] business which cannot justifiably be separated . . ." (*Ibid.*; *see also Appeal of Aimor Corp.* (83-SBE-221) 1983 WL 15592 [unnecessary for each part of a unitary business to be directly related to each other part].)

Thus, appellant has failed to show that the degree of central management was not strong.[44] (*Appeal of Smith*, *supra*.)

vii. Centralized Departments

The existence of centralized departments for such functions as financing, advertising, research, or purchasing is a unitary factor. (Cal. Code Regs., tit. 18, § 25120(b)(3).) A business is unitary when, in addition to strong central management, "there are centralized offices which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing." (*Ibid.*) The unity of operation element includes "staff" functions, such as purchasing, personnel, advertising, accounting, legal services, and financing. (*A.M. Castle*, *supra*, 36 Cal.App. 4th at p. 1807.)

OTA finds that there were centralized departments which performed substantial functions for appellant's affiliates, including NEER and FPL. NEE, NEER, and FPL shared a headquarters location in Juno Beach, Florida. NEER and FPL's employees reported to common NEE

[44] Appellant also asserts that appellant's shareholders had an interest in avoiding subsidizing FPL because "FPL's regulatory rate structure would not generate shareholder earnings to offset NEER's reduction in earnings." Appellant has not provided evidence that shareholder interests prevented flows of value between NEER and FPL. Unsupported assertions are insufficient to satisfy a taxpayer's burden of proof. (*Appeal of Bindley*, *supra*.)

executives and officers in four centralized divisions, namely the: (1) Nuclear Division; (2) ISC group; (3) E&C group; and (4) Power Generation Division. FPL's legal, finance, and human resources departments either included NEE executives or reported to NEE's corporate department heads. NEE's general counsel also provided certain enterprise-wide legal services for appellant's affiliates, included NEER and FPL. Appellant sponsored a qualified noncontributory defined benefit pension plan for substantially all employees of appellant, including NEER and FPL. NEE maintained a centralized treasury function. FPL provided most of the human resources, fleet construction and operations support, IT and management, and corporate communications services for appellant, including NEER, in addition to the various other services which benefitted the entire enterprise, including NEER.[45]

Appellant asserts that NEER and FPL generally maintained parallel corporate structures with autonomous departments for each of its own corporate general management and administrative services.[46] In *Tenneco*, the Court of Appeal concluded that the taxpayer's degree of central management was not strong in part, because of the lack of substantial centralized departments. (*Tenneco*, *supra*, 234 Cal. App.3d at pp. 1528-1529.) The court found that corporate departments were minimal, and despite the existence of Tenneco's legal department, its subsidiaries maintained autonomous legal activities. (*Ibid*.)[47] *Tenneco* is distinguishable. Here, NEER and FPL had four centralized divisions and three centralized groups, and FPL housed and provided a broad range of services to appellant's affiliates, including NEE and NEER.

Appellant asserts that that NEER and FPL maintained their own employees and management teams. In *Chase*, *supra*, the court acknowledged that the taxpayer's president "had a complete staff and line organization under his direction," but ultimately the taxpayer's executive reported to its parent. (*Chase*, *supra*, 10 Cal.App.3d at p. 504.) Thus, the court found that "executive control at the highest level was [with the parent]." (*Ibid*.) Here, even though NEER and FPL employed employees and management teams, they were reported to, and were subject to, NEE's control.

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[45] The findings of fact describe these services in more detail, generally at Shared Services and Intercompany Transactions.

[46] Appellant asserts that this was due to the FPSC regulatory requirements imposed on FPL's business. However, the only authority cited was 18 C.F.R. § 35.39 which it asserted required separate trading groups.

[47] The court dismissed the fact that subsidiaries' accounting and financial activities were subject to parental review because centralized accounting without more is not a unitary factor. (*Tenneco*, *supra*, 234 Cal. App.3d at p. 1529.)

Finally, appellant claims that NEER and FPL had entirely separate employees performing day-to-day operations. However, unitary authorities show that strong central management, such as here, coupled with centralized departments, can establish functional integration. (*Mole-Richardson*, *supra*, 220 Cal.App.3d at pp. 897-99.) Management involvement in day-to-day operations is not required. (*Trails End*, *supra*, at p. *4.) Mere decentralization of day-to-day management responsibility and accountability cannot defeat a unitary business finding. (*Container*, *supra*, 463 U.S. p. 180, fn. 19, citing *Exxon Corp. v. Wisconsin Dept. of Rev.* (1980) 447 U.S. 207, 224 (*Exxon*).)

Appellant has not shown that its rate-regulated electric utility business and wholesale energy business lacked substantial centralized departments. (*Appeal of Smith*, *supra*.)

viii. Conclusion: Strong Central Management and Centralized Departments

Appellant has not rebutted the evidence of strong central management, nor of centralized departments. (*Wright Capital*, *supra*.) Thus, strong central management, coupled with the existence of centralized departments, supports a unitary finding. (*Appeal of Smith*, *supra*.)

D. Shared Services and Intercompany Transactions

i. Shared Services

Appellant makes three arguments with respect to shared services. First, appellant claims that because intercompany transactions do not involve "the sale or transfer of raw materials and/or electricity" between NEER and FPL, "as such [they] are of limited value." Appellant provides no support or legal authority for these assertions. (See *Container*, *supra*, 463 U.S. at pp. 178-179 [flow of value, not necessarily a flow of goods is prerequisite for a unitary business finding]; *Saga*, *supra*, at p. *5 [food services were taxpayer's product and evidenced intercompany transactions on which a unitary finding was based]; *Appeal of Bindley*, *supra*.)

Second, appellant contends that the mere sharing of some administrative functions is typical for any parent-subsidiary relationship and insufficient to establish unity, citing *Tenneco*, *Woolworth I*, and *Woolworth v. FTB*. OTA reviewed the typical parent-subsidiary relationships described in the cited cases and finds them distinguishable. As described previously, in those cases, the parent's interest in the subsidiary was limited to routine annual planning, communications, and corporate procedures manual activity, and similar activities. Here, appellant fails to address the shared services' breadth and scope, which were striking.[48]

OTA finds the four centralized groups analogous to *Exxon*'s Coordination and Services Management segment. In *Exxon,* the taxpayer was a vertically integrated petroleum company. Its three segments included: (1) Corporate Management; (2) Coordination and Services Management that provided many essential corporate services and coordinated some operational functions; and (3) Operations Management, including marketing operations. (*Exxon*, *supra*, 447 U.S. at pp. 211-212.) The Supreme Court's determination that the marketing department was part of the taxpayer's unitary business was based in part on the Coordination and Services Management activities because those centralized activities reduced the risk of business disruptions. (*Id*. at p. 226.) As in *Exxon*, FPL was a vertically integrated business, and NEER's business was highly capital-intensive. Both FPL and NEER were sensitive to cost. An assured supply of raw materials, and a stable outlet for products was important to both FPL and NEER. As in *Exxon*, the shared services, which were often provided primarily by FPL, or within the four centralized divisions, reduced the risk of operational disruptions. FTB's determinations cannot be successfully rebutted when the taxpayer fails to provide credible and relevant evidence as to the issues in dispute. (*Wright Capital*, *supra*.)

Here, taken together, appellant has not shown that the shared services between FPL and the rate-regulated electric utility business, on one hand, and the wholesale energy business, through NEER, are typical of any parent-subsidiary relationship. (*Appeal of Smith*, *supra*.)

ii. Intercompany Transactions

Appellant asserts that 97 percent of the intercompany transactions are "purely administrative and do not prove a contribution and dependency." Of the 97 percent, appellant asserts that 84 percent were "dividend payments or movement of cash to pay taxes and regulatory fund obligations remitted at the parent company level," and 13 percent were "allocation of costs for shared services."

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[48] There were five broad categories of shared services between NEE, FPL, and appellant's other affiliates: (1) strategic and governance-related support services; (2) fleet construction and operations support; (3) corporate support services; (4) corporate shared services of the four centralized divisions; (5) corporate shared services for three centralized corporate groups: namely legal; human resources; and finance and accounting. See the Shared Services and Intercompany Transactions described in the findings of fact, and related footnotes.

Concerning the 84 percent, appellant asserts that "it is well-settled that such payments have no unitary relevance and do not prove a contribution and dependency between FPL and NEER." Appellant cites to *Container*, *supra*, *Appeal of Lakeside Village Apartments, Inc.* (92-SBE-022) 1992 WL 202573, and *Appeal of Simco*, *Inc.* (64-SBE-067) 1964 WL 1472. However, appellant has not provided sufficient proof of its assertion. As discussed above, *Container* distinguished between operational and investment functions in funding. (*Container*, *supra*, 463 U.S. at p. 166.) In *Appeal of Lakeside Village Apartments*, *supra*, payment of dividends was the only intercompany financing, and the BOE held that factor alone was insufficient to support a unitary finding because it served an investment function. (*Id*. at p. *4.) In *Appeal of Simco*, *Inc.*, *supra*, BOE determined that, under the facts presented to it, the sale of properties of one business to finance another business's expansion did not alone constitute a unitary business.[49] Here, OTA lacks sufficient facts to determine what appellant did with the dividend or other payments.

The other 13 percent are shared administrative services, some or all of which overlap with the shared services described above. Concerning the second category of intercompany services, fleet construction and operations support, certain divisions within FPL leveraged their commercial and technical practices and knowledge regarding fleet construction, compliance, and operating capabilities to optimize results for appellant's broader enterprise. Those services therefore appear to provide flows of value, such as economies of scale and sharing of expertise. Further, the centralized divisions appear to have provided operational support and sharing of expertise. For example, FPL was a vertically-integrated business, and NEER's business was highly capital-intensive. Both FPL and NEER relied on nuclear sources for 13 to 22 percent of their generating capacity. The Nuclear division provided nuclear operations support (including technical nuclear services) and infrastructure support to avoid outages. The Nuclear Division's single point of contact for federal regulatory authorities avoided redundancies.

Appellant argues that the administrative services were routine, and that IRS transfer pricing rules allow administrative services to be charged at cost, and thus, such services cannot create considerable flows of value to justify a unitary determination. First, to the extent any

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[49] BOE considered whether the sale of oil properties, orange and walnut groves were unitary with a cattle operation. It found that while the properties were sold to finance the business' expansion, they were not used in furthering it, and without more, lacked sufficient unitary ties. OTA notes that *Appeal of Simco*, *Inc.*, *supra*, is a 1964 appeal predating the distinction between operational and investment functions.

integrated transactions and services were subject to FPSC administrative rules whose pricing favored FPL, OTA finds that such transactions and services demonstrate transfers of value from NEER to FPL due to lack of arm's length pricing. (Fla. Admin. Code, § 25-6.1351.) Second, for transactions priced at arm's-length, OTA notes that geographical accounting (and the corresponding use of transfer pricing) often "ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise." (*Container*, *supra*, 463 U.S. at pp. 164-165.) Also, it is well established that if a unitary business is present, arm's length pricing of transactions between segments of a business does not negate unity. (*Exxon*, *supra*, 447 U.S. at p. 226.)

Appellant concedes that the remaining 3 percent of the transactions were "operations-related transactions," but asserts that they are "miniscule in relation to [appellant's] total sales."[50] In *Saga*, *supra*, BOE rejected the taxpayer's contention that its subsidiary purchased extremely small percentages of its total sales for the relevant period, and thus intercompany sales were immaterial. (*Saga*, *supra*, at p. *5.) BOE looked instead to the percentage of the subsidiary's total expenses incurred in providing the services, and percentage of food service provided by the taxpayer to the subsidiary (there, 100 percent), among other factors. (*Ibid*.) Thus, the circumstances matter in determining whether intercompany sales are material. Here, appellant has not provided such percentages for FPL or NEER.[51] Thus, OTA cannot discern the materiality of the sales.

Concerning intercompany asset sales, appellant focuses on the difference between the fair market value of the assets and their purchase price. However, in *Saga*, BOE held that FTB is not required to prove a discrete and measurable earnings increase to support a unitary finding. (*Saga*, *supra*, at p. *6.) Appellant has not shown that the shared services and intercompany transactions were superficial or trivial. (*Appeal of Smith*, *supra*.)

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[50] Appellant does not identify the intercompany transactions or services which constitute the 3 percent.

[51] For example, the percentage of FPL's total sales that the operations-related transactions with the wholesale energy business represented, or the percentage of NEER's total operations-related transaction sales with FPL and its subsidiaries. Appellant also has not provided the percentage of expenses the operations-related transactions represented of NEER's and of FPL's total expenses.

iii. Conclusion: Shared Services and Intercompany Transactions

Appellant has not shown that the shared services and intercompany transactions between its rate-regulated electric utility business through FPL and its wholesale energy business through NEER are typical of a parent-subsidiary relationship. Appellant bears the burden of proving that these services are lacking in substance, which it has not shown. (*Appeal of Smith*, *supra*.) Thus, OTA finds that the shared services and intercompany transactions support a unitary finding.

E. Intercompany Loans and Guarantees

Substantial intercompany loans are significant evidence of unity. (*Dental Ins.*, *supra*, 1 Cal.App.4th at p. 349.) However, the flow of capital resources from a parent to its subsidiaries can serve either an investment function or an operational function. (*Tenneco*, *supra*, 234 Cal.App.3d at p. 1531, citing *Container*, *supra*, 463 U.S. at p. 180, fn. 19.) Where the flow of funds arises "out of a passive investment or distinct business operation," it serves an investment function and is not a unitary factor. (*Container*, *supra*, 463 U.S. at p. 166.)

Here, the evidence shows a limited number of intercompany loans and guarantees between NEER, NEECH, and FPL. The parties agree that there was a 2008-2009 loan and a 2012 guarantee from NEECH to FPL.[52] In briefing, FTB identified other instances of potential intercompany financing; however, appellant contests those instances, stating that those cases involve financing between NEECH and non-regulated affiliates of appellant (i.e., not between NEER and affiliates and FPL).[53] Appellant provided evidence showing that the 2008-2009 loan and the 2012 guarantee were immaterial in value compared to its average capital expenditures for the Years at Issue. Appellant did not address whether the loan and guarantee were operational to appellant's business. (*Appeal of Smith*, *supra*.) Based on the record, OTA cannot determine whether the intercompany financing served an investment or operational function.

F. Ultimate Unitary Conclusion

OTA finds that appellant has not met its burden to show that unitary connections between the rate-regulated electric utility business through FPL and the wholesale energy business

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[52] The findings of fact, Intercompany Loans and Guarantees, describe the loan and the guarantee.

[53] At the hearing, OTA questioned FTB regarding other instances of intercompany financing. FTB asserted that there were other intercompany instances in its briefing, and appellant asserted that these examples were not applicable.

through NEER are so insubstantial as to compel the conclusion that appellant did not conduct one unitary business.[54, 55] OTA applies the dependency or contribution test,[56] and finds that the following unitary factors are present and have not been shown to be immaterial: (1) controlling ownership; (2) strong central management and centralized departments; (3) transfers of key executives; and (4) shared services and intercompany transactions.

Issue 2: If appellant was engaged in a unitary business for the Years at Issue, whether appellant has demonstrated that the standard allocation and apportionment provisions found in California's UDITPA do not fairly reflect the extent of its California business activity.

I. Applicable Law and Burden of Proof

R&TC section 25137 provides that, if the standard allocation and apportionment provisions do not fairly represent the extent of the taxpayer's business activity in California, the taxpayer may petition for, or FTB may require, with respect to all or any part of the taxpayer's business activity, if reasonable: (a) separate accounting; (b) the exclusion of any one or more of the factors; (c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or (d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income. The party invoking R&TC section 25137—in this case, appellant—has the burden of proving by clear and convincing evidence that: (1) the approximation provided by the standard apportionment formula is not a fair representation of the taxpayer's business activity in California; and (2) its proposed

[54] In this appeal, FTB has not elaborated on the basis for its assertion that NEER and FPL are in the same line of business such that the presumption of Regulation section 25120(b) applies. In *A.M. Castle*, *supra*, the Court of Appeal construed the "same general line" presumption to apply where: (1) the two businesses are similar (but not necessarily identical); and (2) after the two corporations are combined, it permits the parent corporation to make better use of its existing business-related resources. (*A.M. Castle*, *supra*, 36 Cal.App. 4th at pp. 1808-1809.) Here, FTB has provided no concrete evidence for its conclusion that both NEER and FPL were in the same business of "transmitting and generating electricity for profit." Thus, FTB is not entitled to apply the "same line of business" presumption. Where there is no presumption applicable, the taxpayer will, as in the usual tax case, bear the ultimate burden of persuasion by a preponderance of the evidence. (*Sierra Production*, *supra*, at p. *5; *Saga*, *supra*, at p. *6, fn. 3.)

[55] To the extent appellant raises arguments that OTA has not addressed, it has considered them and found the resolution of these arguments to be immaterial to the outcome.

[56] As a practical matter, OTA is mindful that the dependency or contribution test "overlaps with the three unities test in many areas and many of the same facts and factors are used in reaching a determination under either test." (*A.M. Castle*, *supra*, 36 Cal.App. 4th at p. 1807.)

alternative is reasonable. (*Microsoft Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 750, 765 (*Microsoft*).)

In *Microsoft*, the California Supreme Court examined the following two effects to determine whether to apply an alternative method in place of the standard apportionment formula where treasury function receipts were included in the taxpayer's gross receipts: (1) whether the treasury functions were qualitatively different from the taxpayer's principal business; and (2) whether the quantitative distortion that arose from the inclusion of the treasury function receipts was substantial. (*Microsoft*, *supra*, 39 Cal.4th at p. 766; *General Mills, Inc. v. Franchise Tax Bd.* (2012) 208 Cal.App.4th 1290, 1299, 1301 (*General Mills*); *Appeals of Amarr Company, et al.*, 2022-OTA-041P (*Appeals of Amarr*).[57]) In *General Mills*, the Court of Appeal clarified that qualitative difference may arise not only from operations unrelated to a taxpayer's main business, but also from activity related to a taxpayer's main business that only serves a supportive function and has no direct profit-making purpose. (*General Mills*, *supra*, 208 Cal.App.4th at pp. 1301, 1305.) Quantitative distortion refers to whether the challenged activity distorts the standard apportionment formula by a substantial amount. (*Id.* at pp. 1299, 1307-1313; *Microsoft*, *supra*, 39 Cal.4th at pp. 757, 766.) Both qualitative difference and quantitative distortion are examined together in "assessing whether the standard [apportionment] formula fairly represents the [taxpayer's] business activity in California," but are not independent and separate requirements. [58] (*General Mills*, *supra*, 208 Cal.App.4th at p. 1301; *Appeals of Amarr*, *supra*.)

II. Analysis

a. Appellant's Assertions

Appellant's primary assertion is that there is no flow of value or rational relationship between FPL's Florida rate-regulated electric utility business and NEER's wholesale energy business activities in California, sufficient to justify the result obtained by application of the

[57] Other considerations have been examined when evaluating distortion under R&TC section 25137. (See, e.g., *Appeal of Crisa Corporation* (2002-SBE-004) 2002 WL 1400003 [providing five examples of fact situations that may result in using an alternative apportionment method].) In this case, we address the factors as applicable to appellant's arguments and the facts of this case.

[58] *General Mills* identifies the qualitative and quantitative effects as simply two factors to apply to factual findings. (*General Mills*, *supra*, 208 Cal.App.4th at p. 1301, fn. 9.) OTA applies the two factors to the facts before us because, even though this case does not involve treasury functions, the qualitative and quantitative factors may be examined in determining whether the standard formula fairly reflects appellant's California business activity.

standard apportionment formula,[59] i.e., substantial California taxable income for the Years at Issue. Appellant asserts that FPL was profitable, but that NEER earned no taxable income from its California operations. The parties agree that all of appellant's California business activities and assets were in furtherance of NEER's wholesale energy business, and that FPL had none of the following in California for the Years at Issue: assets; plants; power generation, transfer, or distribution facilities; employees; customers, or sales. Thus, appellant asserts that its substantial California taxable income, which is entirely attributable to FPL's Florida-based operation, is a clear indication that the standard apportionment formula taxed extraterritorial values.

i. Qualitative Difference

Appellant argues that the combination of the rate-regulated electric utility business wholly in Florida and the wholesale energy business solely outside of Florida is inherently distortive. First, appellant contends that differences between FPL's rate-regulated electric utility business and NEER's wholesale energy business are analogous to *Microsoft* and *General Mills* and invoke distortion. Concerning *Microsoft*, appellant argues that its operations upset the fundamental premise of UDITPA because the profit margins were inconsistent between states: FPL's operations assertedly had a "regulated and authorized" 10 to 10.5 percent profit margin, while NEER's wholesale energy business purportedly reported zero taxable profit. Concerning *General Mills*, appellant argues that NEER and FPL operated in different geographies, with different clients and business models, and vastly different regulatory oversight and constraints.[60]

However, OTA finds that appellant's situation does not fit the treasury function paradigm of *Microsoft* because appellant's main business was its rate-regulated electric utility business conducted through FPL and its wholesale energy business conducted through NEER; thus, appellant had no activity unrelated to its main business. In *Microsoft*, the taxpayer operated in multiple states and had a treasury department that invested the company's excess operating cash in short-term securities. Its investment activity, however, occurred in only one state, Washington, where the treasury department was located. Microsoft's investment activity

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[59] Appellant's standard apportionment was different for the 2009 and 2010 tax years, where it utilized a three-factor formula (property, payroll, and double-weighted sales), and the 2011 through 2015 tax years, where it used a single-sales factor.

[60] During the hearing, appellant also identified differences in trading operations, generation facilities and energy sources, infrastructure and distribution networks, different pricing, and different employees and management teams between FPL and NEER.

generated minimal income (less than 2 percent of its business income) but generated significant gross receipts (approximately 73 percent of gross receipts). (*Microsoft*, *supra*, 39 Cal.4th at pp. 770-771.) Microsoft's investment activity was also unrelated to its principal business. (*Id*. at p. 766; *General Mills*, *supra*, 208 Cal.App.4th at p. 1306.)

The sales factor is designed to reflect the markets for the taxpayer's goods or services under the implicit assumption that a corporation's profit margins generated under the sales factor will not vary inordinately from state to state. (*Microsoft*, *supra*, 39 Cal.4th at p. 768.) However, under such peculiar conditions, rote application of the sales factor would have severely underestimated the amount of income attributable to every state except the state in which the treasury department was located, for which the income would be severely overestimated. (*Id*. at pp. 768-769.) The Court found that the taxpayer's inclusion in the sales factor of gross receipts from its short-term investment activity with gross receipts from its other business activities distorted the standard apportionments formula's attribution of income to each state. (*Id*. at p. 770.) The sales factor problem in *Microsoft* was that its treasury operations and non-treasury operations had significantly different corporate margins, which the Court defined as differences between cost and sales price. Microsoft's non-treasury margin of more than 31 percent was roughly 170 times greater than its treasury margin of 0.2 percent. (*Id*. at p. 769, fn. 19.)

The treasury paradigm concerns activities unrelated to a taxpayer's main business. In contrast, appellant's main business was conducting FPL and NEER's business activities. The assignment of wholesale energy business activities to Florida, and rate-regulated electric utility business activities to California, is not a failure of the standard apportionment formula; rather, it is a result of conducting a unitary business. Here, appellant asserts NEER and FPL had extremely different margins inside and outside of Florida, and the standard apportionment thus unreasonably attributes NEER's wholesale energy business to Florida, and FPL's rate-regulated electric utility business to California. However, appellant has not shown that its activities conducted through NEER or FPL were incidental to appellant's main business, like the treasury department in *Microsoft*.

Appellant asserts that the unitary combination of NEER and FPL caused income to be assigned to a location unrepresentative of the businesses' respective markets. However, NEER and FPL were in a unitary business, and while FPL generated receipts and income assigned to California, appellant also received factor representation in the apportionment formula for values assigned to Florida, but not California. Furthermore, in *Microsoft*, the short-term security margins, as defined by the differences between cost and sales price, were several orders of magnitude different than for other receipts. (*Microsoft*, *supra*, 39 Cal.4th at p. 767.) Here, appellant provides no evidence to demonstrate that NEER's margins were such that mixing its sales with FPL's sales created a sales factor problem. (*Id*. at p. 768.) Thus, appellant has not shown that the unitary combination of NEER's and FPL's receipts caused an issue with the sales factor.

NEER and FPL were in a unitary business, and isolating NEER's activities and characterizing it as having an identifiable source ignores the factors of profitability that arise from the operation of the business as a whole. (*Mobil*, *supra*, 445 U.S. at p. 438.) Appellant disagrees with the combination of FPL's asserted income with NEER's purported loss. However, variations in profitability among different jurisdictions do not preclude formulary apportionment of a unitary business. (*Kikkoman*, *supra*.) Appellant's disagreement with combination does not show distortion warranting application of an alternative apportionment formula.

Appellant's situation also does not fit the hedging paradigm of *General Mills* involving support activities that have no direct profit-making purpose because FPL's and NEER's gross receipts arose from activities conducted for profit in appellant's main line of business. Appellant's assertions regarding significant or inherent differences regarding clients and business models,[61] geography,[62] and regulatory oversight,[63] among others, between its rate-regulated electric utility business conducted through FPL and the wholesale energy business through NEER do not establish qualitative differences. In *General Mills*, the cited qualitative differences demonstrated that the hedging activities served only a supportive function and were not sales for profit. Here, appellant has not shown that NEER's activities were only supportive and not sales

[61] Appellant asserts that NEER's wholesale energy business focused on power generation and wholesale markets while FPL's rate-regulated electric utility business focused on retail sales, customer service, and "placating" the FPSC. Appellant claims that NEER's business did not involve transmission and distribution functions, while FPL's business involved the entire supply chain including power transmission and distribution. Appellant also asserts that NEER's business was focused on cost, while FPL's business was focused on customer satisfaction.

[62] Appellant asserts geographic location is a relevant factor and that absent common geography, there can be no meaningful overlap in operations. Appellant asserts that FPL's customer base and power generation facilities were nearly entirely in Florida, while NEER generated power and sold it to customer entirely outside of Florida.

[63] Appellant argues that FPSC oversight created a disincentive to pursue traditional economies of scale or operational synergies between two businesses within the same corporate group.

for profit. While appellant asserts that FPL's activities are assigned to California under standard apportionment, and that NEER's activity are assigned to Florida, it fails to identify why that shows distortion and not mere application of the unitary business principle. (*Kikkoman*, *supra*.)

Second, appellant claims that UDITPA section 2 recognized the geographically restricted nature of public utilities and excluded them from UDITPA's purview. Although California's UDITPA did not exclude public utilities when it was enacted, appellant provides a copy of a 1966 letter from FTB's Chief Counsel to the Chief Counsel of Special Subcommittee on State Taxation of Interstate Commerce which states that "[a]ny adjustments in the formula for these businesses can be handled through [R&TC] Section 25137." Appellant asserts that the statement supports its entitlement to relief under R&TC section 25137.

Appellant's argument is essentially an observation that R&TC section 25137 was intended to address distortive effects of the standard apportionment formula for public utilities. Appellant also emphasizes that a public utility has geographic limitations and is heavily regulated. However, that does not entitle appellant to relief. OTA finds the Supreme Court of Illinois' reasoning persuasive in *Citizens Utilities Co. of Illinois v. Dept. of Rev.* (1986) 111 Ill.2d 32, 43 (*Citizens Utilities*). There, the taxpayer, who was a public utility, argued that formulary apportionment should not apply to it. In rejecting the taxpayer's argument, the court looked at Illinois' adoption of apportionment formula and found that no exemption or specific apportionment formula was established for public utilities in their formulary apportionment statute. The court stated that "while the official comments to the [the enactment of Illinois' UDITPA] refer to adopting the 'principles of the Multistate Tax Compact,' they do not include among those principles the one urged by the taxpayer, namely, the income of highly regulated enterprises should be apportioned by means of separate accounting." (*Citizens Utilities*, *supra*, 111 Ill.2d at p. 43.) Appellant concedes that California's UDITPA did not adopt section 2 to exclude public utilities from its application. Thus, as in *Citizens Utilities*, OTA finds "no compelling reason to depart from the clear language of [California's UDITPA] requiring formula apportionment for all unitary businesses, including public utilities." (*Ibid*.)

ii. Quantitative Distortion

Appellant argues that taxing the rate-regulated electric utility business violates the constitutional principle of external consistency, i.e., that the standard apportionment formula's factors reasonably reflect how income is generated. (*Container*, *supra*, 463 U.S. at p. 169;

Colgate-Palmolive Co v. Franchise Tax Bd. (1992) 10 Cal.App.4th 1768, 1784 (*Colgate-Palmolive*).)[64] Appellant asserts that "[e]vidence may always be received which tends to show that a state has applied [an apportionment formula] which, albeit fair on its face, operates so as to reach profits which are in no just sense attributable to transactions within its jurisdiction." (*Hans Rees' Sons v. State of N.C ex rel. Maxwell* (1931) 283 U.S. 123, 138 (*Hans Rees*).)

Appellant provides two quantitative distortion figures. First, for the Years at Issue, the inclusion of FPL's receipts in the standard apportionment formula reduces the apportionment factor by 90 percent on average (rounded), to 1.7 percent on average from 3.2 percent on average (rounded). Second, appellant compares FPL's average net income and NEER's average net loss of $1.15 billion (rounded) and $432 million (rounded), respectively to appellant's combined total California net income of $722 million (rounded) for the Years at Issue.

Here, appellant focuses on the results of the apportionment formula and not on the elements which make up the distortion to be measured. For example, appellant focuses on profit margins, but does not identify, as in *Hans Rees*, what activities generated appellant's profit margins, the profit margins for those activities, and where income from those activities was assigned. (*Hans Rees*, *supra*, 283 U.S. 123 at pp. 127, 134-135 [discussing the "buying profit," "manufacturing profit," and "selling profit" which generated the income at issue].) Appellant's measurement of the distortion does not account for the flow of value in its business and is not comparable to *Hans Rees*. (*Colgate-Palmolive*, *supra*, 10 Cal.App.4th at p. 1786; *Mobil*, *supra*, 445 U.S. at p. 439.)

In *Citizens Utilities,* the taxpayer, a public utility, claimed to establish the unconstitutionality of formulary apportionment by showing that under combined reporting, its tax liability increased by 213 percent over the amount determined by separate accounting, which the taxpayer argued, fairly and accurately represents the extent of its Illinois business activity. (*Citizens Utilities*, *supra*, 111 Ill.2d at p. 52.) The court rejected the taxpayer's arguments in two steps.

[64] The constitutional standard to strike down apportionment formula's application is "if the taxpayer can prove by clear and cogent evidence that the income attributed to the State is in fact out of all appropriate proportions to the business transacted in the State, or has led to a grossly distorted result." (*Container*, *supra*, 463 U.S. at p. 170 [internal citations omitted].) The party showing distortion under R&TC section 25137 need only meet the statutory terms, not the constitutional standard. (*Microsoft*, *supra*, 39 Cal.4th at p. 765, fn. 16.) Here, appellant seeks only statutory relief.

First, whether separate accounting fairly represents Illinois business activity is not the relevant question, the pertinent inquiry is whether the taxpayer's business activity in the state contributed to the income reported by its parent or affiliates. That question is answered where the taxpayer constituted a unitary business, and in that case, formulary apportionment is applicable. (*Id*. at pp. 52-53.) Under California's unitary authorities, appellant has not shown that it did not constitute a unitary business. Thus, as in *Citizens Utilities*, the standard apportionment formula of UDITPA applies to appellant.

Second, the court contrasted the specific evidence introduced in *Hans Rees* with the facts before it, and in concluding that the taxpayer did not show distortion, stated that "it proves nothing to say that a 213% increase of tax liability results by application of unitary taxation rather than separate accounting. . . percentages without explanation are not helpful." (*Citizens Utilities*, *supra*, 111 Ill.2d at p. 53.) Here, without identifying or providing specific evidence of distortion, appellant provides two figures, one, a comparison of the California taxable income under separate accounting, and two, a comparison of the standard apportionment under separate accounting. But appellant has not shown that standard apportionment formula arbitrarily taxed income earned outside of California.

iii. Conclusion: Unfair Reflection

Appellant failed to demonstrate by clear and convincing evidence that the standard apportionment formula does not fairly represent the extent of its California business activities for the Years at Issue. Thus, appellant is not entitled to relief under R&TC section 25137.[65]

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[65] Because appellant has not shown that California's apportionment formula unfairly represented the extent of its California business activity, OTA does not address appellant's proposed alternative apportionment formula.

HOLDINGS

1. Appellant was engaged in a unitary business for the Years at Issue.
2. Appellant has failed to demonstrate that the standard allocation and apportionment provisions found in California's UDITPA do not fairly represent the extent of its California business activity.

DISPOSITION

FTB's deemed denials of appellant's claims for refund for the Years at Issue are sustained.

DocuSigned by:
Asaf Kletter
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Asaf Kletter
Administrative Law Judge

We concur:

DocuSigned by:
Kenneth Gast
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Kenneth Gast
Administrative Law Judge

DocuSigned by:
Josh Lambert
CB1F7DA37831416
Josh Lambert
Administrative Law Judge

Dated: 5/30/2023