

STATE OF FLORIDA
DIVISION OF ADMINISTRATIVE HEARINGS

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| ALOHA UTILITIES, INC., and FLORIDA |) | |
| WATERWORKS ASSOCIATION, INC., |) | |
| |) | |
| Petitioners, |) | |
| |) | |
| vs. |) | Case No. 97-2485RU |
| |) | |
| PUBLIC SERVICE COMMISSION, |) | |
| |) | |
| Respondent, |) | |
| |) | |
| and |) | |
| |) | |
| CITIZENS OF THE STATE OF FLORIDA, |) | |
| OFFICE OF PUBLIC COUNSEL, |) | |
| |) | |
| Intervenors. |) | |
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FINAL ORDER

On January 5-6, 1998, a formal administrative hearing was held in this case in Tallahassee, Florida, before J. Lawrence Johnston, Administrative Law Judge, Division of Administrative Hearings.

APPEARANCES

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| For Intervenor: | Stephen C. Burgess, Esquire Deputy Public Counsel |

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STATEMENT OF THE ISSUES

The issues in this case are: (1) whether various statements regarding the Florida Public Service Commission's (PSC's) financial audit procedures and practices--including statements in the PSC Audit Manual, in various Standard Operating Procedures (SOP's), in the PSC's Audit Services Request (ASR) form, and the PSC's form letter notifying utilities of an impending audit--are invalid unpromulgated rules; and (2) whether Florida Administrative Code Rule 25-30.145 is an invalid rule.

PRELIMINARY STATEMENT

On May 23, 1997, Aloha Utilities, Inc. (Aloha) and the Florida Waterworks Association (FWA) filed a Petition for Administrative Determination of Invalidity of Agency Non-Rule Policies and Existing Rules. An Amended Petition for Administrative Determination of Invalidity of Agency Non-Rule Policies and Existing Rules was filed on May 30, 1997.

The case initially was scheduled for final hearing on June 24, 1997, but the parties stipulated to waive the 30-day statutory deadline for scheduling final hearing and jointly moved for a continuance. The motion was granted, and final hearing was continued until October 13, 1997.

On June 17, 1997, the PSC filed a Motion for Summary Final Order. Based on the written arguments, an Order Denying Summary Final Order was entered on August 12, 1997.

On September 29, 1997, the Petitioners filed an Unopposed Motion for Continuance. It was granted, and final hearing was rescheduled for January 5-6, 1998.

On October 6, 1997, the Citizens of the State of Florida, Office of Public Counsel, petitioned to intervene. An Order Granting Leave to Intervene was entered on October 8, 1997.

The PSC filed a Motion to Request Official Recognition on December 31, 1997.

The parties filed a Joint Prehearing Stipulation on January 2, 1998.

At final hearing, the PSC's Motion to Request Official Recognition was granted without objection. The Petitioners called two witnesses and had Petitioners' Exhibits 1 through 42 admitted in evidence. The PSC called two witnesses and had Respondent's Exhibits 1 through 9 admitted in evidence. The Intervenor cross-examined the witnesses, but called none of its own, and had Intervenor Exhibit 1 admitted in evidence.

After presentation of the evidence, the Petitioners ordered the preparation of a transcript of the final hearing and requested 30 days from the filing of the transcript for filing proposed final orders. The request was granted without objection. The transcript was filed on January 21, 1998.

FINDINGS OF FACT

The Petitioners

1. Aloha Utilities, Inc. (Aloha) is a privately-owned

utility company providing water and wastewater services to its customers. Aloha provides potable water, wastewater treatment and disposal services to approximately 12,000 customers in Pasco County, Florida.

2. Aloha operates two separate water systems and two separate wastewater systems. Aloha's four systems are separated geographically, and are separately treated for various regulatory purposes by the Florida Public Service Commission (PSC).

3. Aloha is a member of the Florida Waterworks Association, Inc. (FWA). The FWA is a voluntary trade association whose members are regulated water and wastewater utility companies. The FWA is the Florida Chapter of the National Association of Water Companies. The FWA's members are privately-owned water and wastewater utility companies, like Aloha, subject to environmental and economic regulation by the Florida Public Service Commission and other state and federal governmental agencies. The overall mission of the FWA is to act on behalf of its members in regulatory matters including policies, procedures, rules or proposed rules. The FWA has been actively involved in rulemaking and rule challenges on matters involving the PSC in the past.

4. A substantial number of the FWA's members are subject to PSC audits, including Aloha. The FWA's Board directed by unanimous vote that the FWA join Aloha in filing the petition in this case.

PSC Financial Audits

5. The Florida Public Service Commission (PSC) has jurisdiction over the rates and revenues that PSC-regulated utilities can collect from their customers. Revenues and rates charged and collected must be fair, reasonable, compensatory and not unfairly discriminatory. One important role of the PSC is to set revenues needed to operate the utility, including a fair rate of return.

6. The PSC sets revenues in one of two situations. One is a "file-and-suspend" rate case initiated by a utility to raise its rates. The other situation can arise when the PSC initiates an earnings investigation and decides that a utility's revenues are too high.

7. In order to assist the PSC in determining whether a utility's rates are fair, the PSC's staff performs financial audits. (Other kinds of audits are performed for other purposes, as well.)

8. Sometimes, the PSC requests that its staff conduct an audit; sometimes, the PSC's staff decides on its own that an audit is appropriate; sometimes, the staff's decision to audit is influenced by expressions of interest by the PSC or its members.

Burden Imposed on Utility by a PSC Financial Audit

9. PSC financial audits require that utilities present financial information using the Uniform System of Accounts developed by the National Association of Regulatory Utility

Commissioners (NARUC). Original documentation supporting the accounts--including canceled checks, invoices, contracts, cash receipt journals, and tax returns--also would have to be made available to the PSC's auditors.

10. In addition to making the required financial information available to the PSC's auditors, a PSC audit often requires that the utility create schedules, calculations and reconciliations not kept in the normal course of a utility's business in order to establish that the test year is representative.

11. A utility can incur substantial costs in responding to a financial audit by PSC staff. While not required by the PSC, it is typical for utility accountants with regulatory experience to be present at the PSC audit of their utility clients. Lawyers and engineers sometimes are also paid for services related to a PSC audit.

Burden of the Aloha Audit

12. By letter dated March 5, 1997, the PSC informed Aloha that it would "compile and audit [Aloha's] rate base, capital structure and net operating for the test year ended December 31, 1996 in accordance with Commission audit procedures."

13. As of March 5, 1997, Aloha's 1996 financial books had not been closed, and Aloha's 1996 Annual Report had not been prepared. It is unusual for the PSC to initiate an overearnings audit before reviewing the Annual Report for the test year to be reviewed.

Aloha informally requested that the audit be delayed until after the closing of Aloha's financial books for 1996 and the filing of the Aloha's 1996 Annual Report. The PSC granted the request.

14. Since Aloha had not been audited in 19 years, the audit letter would require that Aloha present 19 years of financial information using the NARUC Uniform System of Accounts and make the original supporting documentation available to the PSC's auditors.

15. To comply with the audit letter, Aloha also would be required to spend a substantial amount of time preparing and providing support for a great many proforma adjustments which would be necessary to attempt to make the 1996 test year representative. Aloha was involved in a complex reuse case in 1996. This reuse case was one of the first such cases filed in the State of Florida. During 1996, Aloha had more than \$500,000 in interim rates in escrow which it could not use. Because of the escrowed funds, Aloha's cash flow for 1996 was very tight, and normal operating and maintenance expenses were held to a minimum. In 1996, Aloha had high capital costs related to the reuse system, and it had more than \$4 million of construction work in progress, relating primarily to the reuse facility construction and to the relocation of water and wastewater lines necessitated by order of the Department of Transportation.

16. Each of Aloha's four systems has its own rate base. Several of these systems have their own authorized rates of return. The existence of four separate systems complicates the proposed

Aloha audit, and increases the cost to be incurred by Aloha for this audit.

17. The proposed audit of Aloha would involve a minimum of two or three PSC auditors being present on site at Aloha's offices for a period of six to eight weeks or longer.

18. The total estimated direct cost to Aloha of the proposed audit is \$132,580. These estimated costs are relatively high, owing in part to the characteristics of the Aloha audit. In particular, the engineering and legal fees appear to be unusually high.

Recovery of Costs of a PSC Financial Audit

19. Utilities generally can recover the costs of an audit. If the audit results in a determination that the utility is over-earning, these costs are taken into consideration, as appropriate, when the utilities new rates are established in a separate PSC proceeding for this purpose. (The Petitioners characterize the results of such a proceeding as "indirect costs" of an audit.) If the audit results in a determination that the utility's rates are reasonable, or that the utility is under-earning, the utility can initiate a limited proceeding to recover the costs of the audit. For various reasons, a utility may choose not to initiate such a proceeding. Likewise, if the audit results in a determination that the utility is under-earning, the utility may initiate a rate case to establish higher, reasonable rates, but the utility may or may

not choose to do so.

PSC Audit Manual and DAFA SOP's

20. The PSC has an Audit Manual to guide its auditors in conducting financial audits of regulated companies. The Audit Manual has been in existence since at least 1983. The August 1996 version was introduced into evidence in this case. The Audit Manual contains the "Commission audit procedures" referred to in the audit letters sent out by the PSC to inform utilities that an audit will be conducted.

21. The audit procedures in the Audit Manual set out a format for PSC financial audit reports. They also cover audit topics, including: compliance with the NARUC Uniform System of Accounts; rate base; utility plant; accumulated depreciation expense; contributions in aid of construction (CIAC); CIAC and amortization; working capital (formula method and balance sheet method); revenue and expense; capital structure and cost; related party transactions; review of tax returns; review of proforma adjustments; review of officers' compensation. Not all of these audit topics are applicable to each audit; their applicability depends on the requirements of the audit, which vary from audit to audit.

22. By its own terms, the Audit Manual "supplements the [Division of Auditing and Financial Analysis] DAFA Standard Operating Procedures Manual (SOP)." Staff is expected to follow them or "be prepared to justify deviations." The Petitioners did

not put the DAFA SOP Manual in evidence, but the PSC did.

(Respondent's Exhibit 9)

23. Neither the Audit Manual nor the DAFA SOP Manual has been adopted as a rule by the PSC, appears in the Florida Administrative Code, or has been incorporated by reference as a rule by the PSC in the Florida Administrative Code.

24. The PSC has not officially notified utilities that the Audit Manual and DAFA SOP Manual exist and has not notified utilities when changes have been made. It is not clear from the evidence whether utilities commonly know of their existence. The documents are not confidential, and the PSC would willingly furnish copies to any utilities that ask for them.

25. PSC auditors are expected to reference the Audit Manual and the DAFA SOP Manual and to use them in guiding their decisions in the field. These Manuals instruct the auditors in how to conduct an audit for the PSC and how to produce an audit report in the form desired by the PSC. As such, they do not implement, interpret, or prescribe law or policy or describe the procedure or practice requirements of the PSC. Rather, they are the equivalent of a compendium of "[i]nternal management memoranda which do not affect either the private interests of any person or any plan or procedure important to the public and which have no application outside the agency issuing the memorandum."

The Decision to Audit

26. The Audit Manual specifically incorporates Chapter 1630 of the PSC Generic Standard Operating Procedure ("SOP") regarding the process for requesting the initiation of an audit. This SOP is part of the Commission's 1600 Series Standard Operating Procedures, which have not been adopted as rules.

27. Under Generic SOP 1630, the Division of Water and Wastewater completes and sends to the Division of Auditing and Financial Analysis a form known as an Audit Service Request ("ASR"). When an ASR is issued, an audit will occur in most cases.

28. Although not presented by the Petitioners, the PSC put in evidence its Division of Water and Wastewater SOP's relating to auditing utilities. (Respondent's Exhibit 1) SOP No. 2101, on File-and-Suspend Rate Case Procedures, would suggest that some kind of audit is done in response to all utility filings for rate increases; nonetheless, the evidence indicates that it is sometimes decided, for various reasons, that no audit is necessary. SOP No. 2102, on Overearnings Procedures, suggests that audits follow overearnings investigations and states simply that a formal investigations are initiated when overearnings are "clearly evident," while informal investigations are initiated when overearnings are not "clearly evident," but only "suspected." Again, the evidence indicates that it is sometimes decided, for various reasons, that no audit is necessary for an overearnings investigation.

29. A review of the evidence reveals that neither the Audit Manual, the SOP's, nor the ASR address the manner in which it should be decided whether to initiate an audit. Rather, they describe the internal procedures within the PSC for initiating an audit once the decision to audit has been made. As such, they do not implement, interpret, or prescribe law or policy or describe the procedure or practice requirements of the PSC. Rather, they are the equivalent of "[i]nternal management memoranda which do not affect either the private interests of any person or any plan or procedure important to the public and which have no application outside the agency issuing the memorandum."

30. The decision whether to initiate an audit is made on a case-by-case basis which does not lend itself to statements of general applicability. The PSC usually performs an audit in "file-and-suspend" rate cases, but not always. Likewise, the PSC usually performs an audit in earnings investigations, but not always. The decision to initiate an audit depends on the facts of the particular case and the application of professional judgment to those facts. The PSC has made no statements of general applicability on the subject; nor should it or could it do so.

31. Usually, the decision whether to initiate an overearnings audit is made after review of a utility's annual report, but not always. In the case of Aloha, the decision to audit the 1996 test year was made before Aloha filed its 1996

annual report. The decision to audit Aloha was made for several reasons: (1) a separate, unaudited PSC reuse docket involving Aloha was pending; (2) the PSC received sworn testimony in a quality of service investigation docket that was consolidated with the reuse docket asserting that Aloha was overearning (together with conflicting testimony that Aloha was not overearning), and the PSC expressed interest in the issue; (3) the PSC's staff was aware that Aloha was involved in approximately \$280,000 of related-party transactions that created numerous possibilities for Aloha to subsidize operations of the related parties; and (4) Aloha (and, in particular, its rate base) had not been audited in 19 years.

32. The decision to audit includes the decision what to audit. As with the decision to audit, the decision what to audit depends on the facts of the particular case and the application of professional judgment to those facts. As such, this decision also must be made on a case-by-case basis, which does not lend itself to statements of general applicability. The PSC has made no statements of general applicability on the subject; nor should it or could it do so.

Notice of Audit

33. When it decides to audit a utility, the PSC sends a letter notifying the utility of the impending audit. The letters are basic form letters which are adapted to show the name of the utility and the type of audit.

34. The PSC expects utilities to comply with requests to initiate an audit. If a utility does not comply with an audit request, it can be subject to fine or face other administrative actions. Compliance with PSC audit requests is mandatory.

35. The form of the letter notifying utilities of an impending audit does not implement, interpret, or prescribe law or policy or describe the procedure or practice requirements of the PSC. Rather, it merely gives a utility notice of the PSC's decision to conduct an audit.

Materiality Standards

36. A review of the evidence reveals that neither the Audit Manual, the SOP nor the ASR includes any statement of general applicability that implements, interprets, or prescribes law or policy on the subject of quantitative materiality standards. The Petitioners contend that there should be rules establishing quantitative materiality standards so that the costs of unnecessary audits can be avoided. But the evidence is that, while materiality is considered in PSC financial audits, quantitative standards of materiality are not applied. The evidence is that materiality is a question of judgment determined on a case-by-case basis in the context of the particular audit being conducted.

37. A statement of general applicability that implements, interprets, or prescribes law or policy on the subject of quantitative materiality standards would not be appropriate. After first explaining the related concepts of materiality and

relevance, the Financial Accounting Standards Board states:

Magnitude by itself, without regard to the nature of the item and the circumstances in which the judgment has to be made, will not generally be a sufficient basis for a materiality judgment. The Board's present position is that no general standards of materiality can be formulated to take into account all of the considerations that enter into an experienced human judgment.

Quantitative materiality standards for PSC audits, as suggested by the Petitioners, would not be appropriate.

38. It also is not clear that quantitative materiality standards would avoid the costs of an audit. It would seem that an audit of some kind would have to be conducted in order to determine the magnitude of an audit finding before it could be determined whether the finding is material, even using a quantitative standard.

Audit Exit Conference Procedures

39. The PSC Audit Manual sets out procedures for audit exit conferences that afford utilities an opportunity for input into the audit process. (Policy 2200, Audit Planning, p. 2202) However, these procedures are not promulgated as rules.

40. Until recently, as part of the audit exit conference, utilities were given an opportunity to review and discuss preliminary draft audit findings and exceptions. In the current version of the Audit Manual, this is not permitted, and no opportunity for input is afforded until after the audit report is prepared. (Id.)

41. The current version of the PSC Audit Manual provides that, after the audit report is prepared, the audited utility will "have a 10-15 day time period to respond with comments." (Id.) The PSC decides whether to accept the audit report after considering the utility's response.

42. Unlike the other alleged unpromulgated rules, the audit exit conference procedures allowing for utility input into the audit process implement, interpret, or prescribe law or policy or describe the procedure or practice requirements of the PSC. As such, they affect the private interests of the utilities and are procedures important to the public.

43. It is both feasible and practicable to promulgate the audit exit conference procedures as a rule, including the statement that the audited utility will "have a 10-15 day time period to respond with comments."

Use Made of Audits

44. It is up to the PSC to decide what to do with an audit report and the utility's response. The PSC could accept the audit report or reject it, or it could accept the audit report with modifications.

45. Next, the PSC decides what do with the report it has accepted. If the report was generated in the context of a "file-and-suspend" rate case, the case proceeds. If the report was generated in the context of an earnings investigation, it could

lead to PSC action to reduce the utility's rates; if so, the utility's due process rights will be defined in the context of that proceeding. In either case, findings will be made based on the evidence adduced in the new proceeding, not on the basis of the audit report itself. The subsequent proceeding, which would be governed by Florida Administrative Code Rules Chapter 25-22, affords the utility a full opportunity to defend against the audit findings. The defense can include presentation of a case that the test year adjustments were incorrect, or that another test year is more appropriate. It can also include presentation of a case that certain audit findings are irrelevant or immaterial.

Questionable Pre-Challenge Inquiry

46. The PSC contends that sanctions should be imposed on the Petitioners because, as the evidence makes clear, the Petitioners challenged the PSC Audit Manual as being an unpromulgated rule without ever having taken any action to obtain a copy of it and read it.

CONCLUSIONS OF LAW

Audit Exit Conference Procedures

47. The law is clear that: "Each agency statement defined as a rule by s. 120.52 shall be adopted by the rulemaking procedure provided by this section [120.54, Florida Statutes] as soon as feasible and practicable." Section 120.54(1)(a), Florida Statutes (1997). "Any person substantially affected by an agency

statement may seek an administrative determination that the statement violates s. 120.541(1)(a)." Section 120.56(2), Florida Statutes (1997).

48. Section 120.52(15), Florida Statutes (1997), provides in pertinent part:

(15) "Rule" means each agency statement of general applicability that implements, interprets, or prescribes law or policy or describes the procedure or practice requirements of an agency and includes any form which imposes any requirement or solicits any information not specifically required by statute or by an existing rule.
. . . The term does not include:

(a) Internal management memoranda which do not affect either the private interests of any person or any plan or procedure important to the public and which have no application outside the agency issuing the memorandum.

49. The statement in the Audit Manual setting out audit exit conference procedures and affording utilities an opportunity to respond to audit findings is a "statement of general applicability that . . . describes the procedure . . . of" the PSC. This procedure is not contained in existing statute or rule. As such, it is a rule under Section 120.52(15), Florida Statutes (1997).

50. The PSC argues that none of the statements in the PSC Audit Manual, the SOP's or the ASR have to be promulgated as rules because no utility is substantially affected by any audit, in that agency action affecting the utility's substantial interests is not taken until subsequent PSC proceedings take

place under Florida Administrative Code Rules Chapter 25-22. But nothing in Section 120.52(15) supports this argument. To the contrary, under Section 120.52(15), any "agency statement of general applicability that . . . describes the procedure or practice requirements of an agency" is a rule, whether or not the statement affects substantial interests. (On the other hand, the effect on the Petitioners' interests is pertinent to the standing issue under Section 120.56(2), Florida Statutes (1997). See Conclusion 71, infra.)

51. As found, it is both feasible and practicable to promulgate a rule setting out audit exit conference procedures, including the statement affording utilities an opportunity to respond to an audit report. See Section 120.54(1)(a), Florida Statutes (1997).

Other Statements in PSC Audit Manual, SOP's and ASR

52. It is concluded that the other statements in the PSC Audit Manual, SOP's and the ASR are not rules under the Section 120.52(15) definition.

53. The ASR is nothing more than a form used internally to notify the DAFA that audit services are being requested.

54. The form letter notifying utilities of an impending audit does not implement, interpret, or prescribe law or policy or describe the procedure or practice requirements of the PSC. Rather, it merely gives a utility notice of the PSC's decision to conduct an audit.

55. Statements in the Audit Manual and SOP's relating to the decision to initiate an audit make it clear that those decisions are made on a case-by-case basis. The PSC has made no statements of general applicability on the subject; nor should it or could it do so. The decision to initiate an audit depends on the facts of the particular case and the application of professional judgment to those facts. For that reason, the PSC's decision to audit Aloha for the 1996 test year before Aloha filed its 1996 annual report (like other similar audit decisions) was not a departure from procedure, as the Petitioners assert; rather, there is no rule for deciding whether and when to initiate an audit.

56. The other statements in the Audit Manual and SOP's also neither implement, interpret, or prescribe law or policy, nor describe the "procedure or practice requirements" of the PSC, since they only apply internally to the manner in which the PSC staff conducts audits.

57. As to the latter part of the statutory definition, to the extent that some statements in the Audit Manual might impose requirements on utilities or solicit information from them, those requirements are "specifically required by statute or by an existing rule." See also Section 120.74(1)(d), Florida Statutes (1997)(requiring agencies to "[d]elete rules redundant of statutes").

58. Section 367.121(2), Florida Statutes (1997), already

authorizes the PSC to, "during all reasonable hours, enter upon any premises occupied by any utility and set up and use thereon any necessary apparatus and appliance for the purpose of making investigations, inspections, examinations, and tests and exercising any power conferred by this chapter." This is statutory authorization to conduct an audit. "Such utility shall have the right to be notified of and be represented at the making of such investigations, inspections, examinations, and tests."

Id. No other statutory rights are conferred upon the utility with respect to the conduct of an audit. Section 367.121(1)(c), Florida Statutes (1997), already authorizes the PSC to "require such regular or emergency reports from a utility, including, but not limited to, financial reports, as the commission deems necessary" Section 367.156(1), Florida Statutes (1997), already gives the PSC "reasonable access to all utility records and records of affiliated companies, including its parent company" Contrary to the arguments of the Petitioners, Section 367.156(1) is not limited to records reflecting transactions among the utility and affiliated companies (although those records clearly also are covered by the statute.) Florida Administrative Code Rule 25-30.110(2) already requires utilities to maintain all information requested in any of the statements under challenge. Florida Administrative Code Rule 25-30.115 already requires utilities to maintain their accounts and records in conformity with the 1966 NARUC Uniform Systems of Accounts.

Florida Administrative Code Rule 25-30.145, which also is under challenge, already defines "the reasonable access to utility and affiliate records provided for in § 367.156(1) for the purposes of management and financial audits." Section (1)(b) of the rule provides:

Reasonable access means that company responses to audit requests for access to records shall be fully provided within the time frame established by the auditor. In establishing a due date, the auditor shall consider the location of the records, the volume of information requested, the number of pending requests, the amount of independent analysis required, and reasonable time for the utility to review its response for possible claims of confidentiality or privilege.

59. In reaching these conclusions, the decision in Dept. of Revenue vs. Vanjaria Enterprises, 675 So. 2d 252 (Fla. 5th DCA 1996), must be addressed. In Vanjaria, the Department of Revenue (DOR) assessed taxes, and the taxpayer brought a proceeding to challenge the assessment in circuit court. The trial court made a "finding that DOR's procedure for assessing taxes on multiple-use properties, as set forth in the Training Manual, was an unpromulgated rule." Id. at 254. On appeal, the DOR contended "that the audit method contained in the Training Manual is not an unpromulgated rule, in that it merely represents a direct application of the statute." Id. at 255. The Fifth District Court of Appeal disagreed. The court held:

A review of the effect of the tax assessment procedure in the instant case reveals that the procedure is a rule in that it is a

"statement of general applicability that implements, interprets, or prescribes law or policy." § 120.52(16), Fla. Stat. Furthermore, the tax assessment procedure creates DOR's entitlement to taxes while adversely affecting property owners. The Training Manual was created to be used as the sole guide for auditors in their assessment of multiple-use properties. In determining exempt versus nonexempt uses of multiple-use properties, DOR's auditors strictly comply with the procedure set forth in the Training Manual for all audits performed. Moreover, DOR auditors are not afforded any discretion to take action outside the scope of the Training Manual.

Id. To the contrary, the PSC Audit Manual and SOP's are merely guides to auditors in the effective conduct of audits and preparation of audit reports. The Audit Manual and SOP's do not contain statements of general applicability; to the contrary, they permit the PSC's auditors to exercise professional judgment. In addition, and more importantly, the Audit Manual and SOP's do not in themselves implement, interpret, or prescribe law or policy; they only serve to guide the auditors. If law or policy is to be implemented, interpreted, or prescribed, this would occur in subsequent PSC proceedings governed by Florida Administrative Code Rules Chapter 25-22.

60. In these respects, the statements in the Audit Manual and SOP's are more akin to the statements held not to be rules in Dept. of Highway Safety and Motor Vehicles vs. Schluter, et al., 23 Fla. L. Weekly D192 (Fla. 1st DCA Dec. 31, 1997). In that case, six policies were challenged as being unpromulgated rules.

Three of the policies were applicable only "in certain circumstances." The Schluter court held those three policies were not rules:

We agree with appellant that the first three of the six policies do not constitute rules. They cannot be considered statements of general applicability because the record establishes that each was to apply only under "certain circumstances." Consequently, as in *Department of Highway Safety & Motor Vehicles v. Florida Police Benevolent Ass'n*, 400 So.2d 1302 (Fla. 1st DCA 1981), these statements should be considered effective merely as guidelines, in that their application was subject to the discretion of the employee's supervisor. The Department's first three declarations cannot be said to have been "intended by their own effect to create rights, or to require compliance, or otherwise to have the direct and consistent effect of law." *McDonald v. Department of Banking & Fin.*, 346 So.2d 569, 581 (Fla. 1st DCA 1977) (emphasis added). We therefore reverse the ALJ's determination that they constituted rules under section 120.52(15).

Except for statements that simply reiterate statutory or rule requirements (such as the maintenance of records or production of records for inspection during an audit), rather than being rules, the statements are more like internal management memoranda under Section 120.52(15)(a). Statements simply reiterating statutory or rule requirements also are not rules under Sections 120.52(15) and 120.74(1)(d), Florida Statutes (1997).

Notice of Audit

61. The letters the PSC sends to utilities to notify them of impending audits do not implement, interpret, or prescribe law or policy; nor do they describe the "procedure or practice

requirements" of the PSC. Rather, they merely give utilities notice of the PSC's decision to conduct an audit. To the extent that they are forms that impose requirements on utilities or solicit information from them, those requirements are "specifically required by statute or by an existing rule." See Conclusions 57-58, supra. They are not rules under Section 120.52(15), Florida Statutes (1997).

Rules of Other Agencies

62. The Petitioners cite the rules of other agencies setting out audit standards as supporting the conclusion not only that rulemaking in the area is feasible and practicable under Section 120.54(1)(a), Florida Statutes (1997), but also that the statements in the PSC Audit Manual, SOP's, and ASR form should be promulgated as rules. But, as to the latter, the mere promulgation of statements by other agencies does not make the statements rules under the Section 120.52(15) definition. In addition, all of the rules of the other agencies were promulgated to impose audit responsibility on regulated entities, not to govern the agency's own internal audit functions.

Validity of Rule 25-30.145

63. Florida Administrative Code Rule 25-30.145 provides:

(1) This rule addresses the reasonable access to utility and affiliate records provided for in § 367.156(1) for the purposes of management and financial audits.

(a) The audit scope, audit program and objectives, and audit requests are not constrained by relevancy standards narrower than those provided by § 367.156(1).

(b) Reasonable access means that company responses to audit requests for access to records shall be fully provided within the time frame established by the auditor. In establishing a due date, the auditor shall consider the location of the records, the volume of information requested, the number of pending requests, the amount of independent analysis required, and reasonable time for the utility to review its response for possible claims of confidentiality or privilege.

(c) In those instances where the utility disagrees with the auditor's assessment of a reasonable response time to the request, the utility shall first attempt to discuss the disagreement with the auditor and reach an acceptable revised date. If agreement cannot be reached, the utility shall discuss the issue with successive levels of supervisors at the Commission until an agreement is reached. If necessary, a final decision shall be made by the Prehearing Officer. If the audit is related to an undocketed case, the Chairman shall make the decision.

(d) The utility and its affiliates shall have the opportunity to safeguard their records by copying them or logging them out, provided, however, that safeguard measures shall not be used to prevent reasonable access by Commission auditors to utility or affiliate records.

(e) Reasonable access to records includes reasonable access to personnel to obtain testimonial evidence in response to inquiries or through interviews.

(f) Nothing in this rule shall preclude Commission auditors from making copies or taking notes. In the event these notes relate to documents for which the company has asserted confidential status, such notes shall also be given confidential status.

(g) Form PSC/AFA 6 (2/95), entitled "Audit Document and Record Request/Notice of Intent" is incorporated by reference into this rule. This form is used by auditors when requests are formalized. This form documents audit requests, the due dates for responses, and all Notices of Intent to Seek Confidential Classification.

64. The Petitioners contend that Rule 25-30.145 is invalid because Section (1)(a) of the rule provides: "The audit scope, audit program and objectives, and audit requests are not constrained by relevancy standards narrower than those provided by § 367.156(1)." It is not at all clear why this should make the rule invalid. Section (1)(a) of the rule actually does nothing more than reference Section 367.156(1). This does not make the rule invalid. In addition, Rule 25-30.145(1)(a) essentially codifies part of the decision in Southern Bell vs. Deason, 632 So. 2d 1377, 1388-1389 (Fla. 1994)(rules of discovery do not limit PSC access to documents during audits conducted as part of the PSC's exercise of its regulatory function).

65. The Petitioners also contend that Rule 25-30.145 is invalid because it does not include standards to govern the PSC's decision making in the initiation, conduct or use of financial audits. But, as found, rulemaking is not appropriate to the initiation or conduct of audits, and the use of audits is determined in subsequent proceedings governed by Florida Administrative Code Rules Chapter 25-22.

66. The Petitioners also contend that Rule 25-30.145(b) is invalid because it enlarges, modifies, and contravenes the law implemented by the rule. See Section 120.52(8)(c), Florida Statutes (1997). Specifically, the Petitioners contend that the rule enlarges the scope of audits authorized by statute in that

it requires the preparation of schedules, calculations, and reconciliations not kept in the ordinary course of a utility's business. But that rule itself only requires that utilities provide "access to records"; it does not require the utilities to prepare schedules, calculations, or reconciliations not kept in the ordinary course of a utility's business.

67. Even if Rule 25-30.145 did require the preparation of schedules, calculations, and reconciliations not kept in the ordinary course of a utility's business, the rule implements Section 350.117(1), Florida Statutes (1997), which provides:

The commission may require such regular or emergency reports, including, but not limited to, financial reports, as the commission deems necessary to fulfill its obligations under the law.

A rule authorizing the PSC to require the preparation of schedules, calculations, and reconciliations in connection with a financial audit would not enlarge, modify, or contravene Section 350.117.

68. The Petitioners contend that subsection (2) of Section 350.117 places due process limitations on the authority conferred by subsection (1). But, by its terms, subsection (2) only applies to "management and operation audits," not financial audits. Besides, subsection (2) only requires that, if the PSC considers the results of management and operation audits in establishing rates, "the company shall not be denied due process as a result of the use of any such management or operation

audit." The company's due process rights are protected in the subsequent proceeding, governed by Florida Administrative Code Rules Chapter 25-22, in which rates would be established.

69. In addition, it is noted that Florida Administrative Code Rule 25-30.110(2) already requires:

Each utility shall furnish to the Commission at such time and in such forms as the Commission may require, the results of any required tests and summaries of any required records.

This rule has not been challenged.

70. The Petitioners also contend that the PSC's Rule 25-30.145 and the alleged rules regarding the PSC's auditing practices and procedures are invalid because they do not include quantitative materiality standards. In support of this contention, they cite Section 120.52(8)(g), Florida Statutes (1997)(a rule is invalid if it "imposes regulatory costs on the regulated person . . . which could be reduced by the adoption of less costly alternatives that substantially accomplish the statutory objective"). But, as found, quantitative materiality standards would not be appropriate for PSC audits. It also is not clear that such standards would avoid the costs of an audit. Finally, Section 120.52(8)(g) only is a ground for invalidating a rule under certain circumstances that are not present in this case. See Section 120.541(1)(c), Florida Statutes (1997).

Standing

71. The PSC and the Public Counsel argue that the Petitioners have no standing because they are not substantially affected by the agency statements being challenged. Their points are well-taken as to the statements that are not rules but rather are essentially internal management memoranda. As for the statements regarding Audit Exit Conferences, they argue instead that the Petitioners' interests are not implicated until subsequent PSC proceedings take place under Florida Administrative Code Rules Chapter 25-22 and that the costs of an audit can be recovered in those or other subsequent PSC proceedings (such as limited proceedings to recover the direct costs of an audit that does not establish overearnings.) But, notwithstanding those arguments, it is concluded that an audited utility is substantially affected by PSC statements regarding Audit Exit Conferences.

Attorney Fees

72. Section 120.595(4)(a), Florida Statutes (1997), provides:

Upon entry of a final order that all or part of an agency statement violates s. 120.54(1)(a), the administrative law judge shall award reasonable costs and reasonable attorney's fees to the petitioner, unless the agency demonstrates that the statement is required by the Federal Government to implement or retain a delegated or approved program or to meet a condition to receipt of federal funds.

Since the PSC did not make the latter showing with respect to the audit exit conference statements in its Audit Manual, the Petitioners are entitled to reasonable costs and reasonable attorney's fees. However, the reasonable costs and reasonable attorney's fees for challenging just the audit exit conference statements in the Audit Manual may well not be the same as (but, rather, significantly less than) the reasonable costs and reasonable attorney's fees for unsuccessfully challenging the validity of other statements and Rule 25-30.145.

73. Reasonable expenses, including a reasonable attorney's fee, also are available under Section 120.569(2)(c), Florida Statutes (1997), which provides:

All pleadings, motions, or other papers filed in the proceeding must be signed by the party, the party's attorney, or the party's qualified representative. The signature constitutes a certificate that the person has read the pleading, motion, or other paper and that, based upon reasonable inquiry, it is not interposed for any improper purposes, such as to harass or to cause unnecessary delay, or for frivolous purpose or needless increase in the cost of litigation. If a pleading, motion, or other paper is signed in violation of these requirements, the presiding officer shall impose upon the person who signed it, the represented party, or both, an appropriate sanction, which may include an order to pay the other party or parties the amount of reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee.

The evidence in this case is that the Petitioners challenged the PSC Audit Manual as being an unpromulgated rule without ever

having taken any action to obtain a copy of it and read it. This may not have been a reasonable inquiry. But the evidence did not prove that the challenge was filed for an improper purpose, or for frivolous purpose or needless increase in the cost of litigation. (Inconsistent and weak positions are not necessarily improper or frivolous.) Absent such proof, no sanction may be imposed under Section 120.569(2)(c). See Final Order, E.S. vs. Dept. of Health, etc., DOAH Case No. 89-6262F, entered July 10, 1990 ("in addition to demonstrating that the Department did not conduct a reasonable inquiry, Petitioner must show that the Department's claim of abuse was both factually and legally without merit" under Section 120.57(1)(b)5, as it then was worded)(at Conclusion 70).

DISPOSITION

Based on the foregoing Findings of Fact and Conclusions of Law, the Amended Petition is granted to the extent that the audit exit conference procedures set out in Policy 2200, Audit Planning, on page 2202 of the PSC Audit Manual are held to be invalid unpromulgated rules under Section 120.54(1)(a), Florida Statutes (1997), but otherwise the Amended Petition is denied. Jurisdiction is reserved for purposes of determining the Petitioners' reasonable costs and reasonable attorney's fees under Section 120.595(4)(a), Florida Statutes (1997), for challenging just the audit exit conference procedure statements

in the PSC Audit Manual.

DONE AND ORDERED this 9th day of March, 1998, in
Tallahassee, Leon County, Florida.

J. LAWRENCE JOHNSTON
Administrative Law Judge
Division of Administrative Hearings
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NOTICE OF RIGHT TO JUDICIAL REVIEW

A party who is adversely affected by this Final Order is entitled to judicial review pursuant to Section 120.68, Florida Statutes. Review proceedings are governed by the Florida Rules of Appellate Procedure. Such proceedings are commenced by filing one copy of a notice of appeal with the Clerk of the Division of Administrative Hearings and a second copy, accompanied by filing fees prescribed by law, with the District Court of Appeal, First District, or with the District Court of Appeal in the Appellate District where the party resides. The notice of appeal must be filed within 30 days of rendition of the order to be reviewed.