Commission declined to entirely deny EGS's request, the ALJs would have recommended the following forecast year, in order of suitability: (1) Phase I March 1997; or (2) Phase I July 1997.[52]

2. Nuclear Fuel Expense

Question: Was EGS's nuclear fuel expense projection a reasonable estimate?

Answer: Yes, for the interim fuel factor, and yes, as modified by General Counsel, for the final fuel factor.

a. EGS Position

For the interim fuel factor, EGS projected its nuclear fuel expense at $30,873,928 for the Phase I July 1997 forecast year[53] (or $31,814,684 for the Phase I March 1997 forecast year). EGS explained that its interim fuel factor nuclear fuel expense estimate was based on ambitious Reference Projection operating assumptions, such as 30-day outages every 18 months and a 95% capacity factor between refueling outages, along with dollar considerations such as the level and book value of existing inventories, financing costs, spent fuel disposal fees, decommissioning and

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[52] Another option is the Phase IV July 1997 forecast year; however, this PFD does not include a summary recommendation based on the Phase IV July 1997 forecast year.

[53] $30,873,928 = EGS's 70% share of River Bend fuel costs. $44,106,612 = 100% of River Bend fuel costs for the forecast year. EGS Ex. 13B (Rives Direct Test. workpaper); *see also* Cities Ex. 17 (Hubbard Direct Test.) at 83-86. For consistency with its total estimated fuel expenses, EGS should have referred to a projected nuclear expense of $30,874,211 (calculated from the expenses for the months July 1997-June 1998 on Schedule I-1.2 (March 1997 fuel factor)). *See* Response of EGS to ALJ's Request for Information at 4 n.1 (Dec. 2, 1997). Because EGS witness Monroe apparently used the Schedule I-1.2 figure ($30,874,211) rather than the EGS Ex. 13B figure ($30,873,928) to reach his final fuel factor calculations in EGS Ex. 23C (Errata to Monroe Supp. Direct Test.) at Ex. CAM-1 (rev. 2) (note Mr. Monroe's use of a total estimated EGS fuel and purchased power cost of $637,180,776, not $637,180,493, which would result from the use of the EGS Ex. 13B figure), however, the ALJs would have used the Schedule I-1.2 figure ($30,874,211), had it been appropriate to recommend an interim fuel factor.

decontamination fees, and anticipated contract and market prices associated with procurement of uranium concentrates, conversion, enrichment, and fabrication.[54]

For the final fuel factor, EGS initially proposed that nuclear fuel expense be excluded from eligible fuel expense, but ultimately agreed with General Counsel's modified performance-based treatment that nonetheless retained nuclear fuel expense in the fuel factor.[55]

b. General Counsel Position

General Counsel found EGS's 30-day refueling outage duration assumption for the interim fuel factor to be "very aggressive"[56] and, other than a minor adjustment related to choice of forecast year,[57] did not recommend any deviation from EGS's nuclear expense forecast.[58]

Indeed, though General Counsel rarely distinguished between the interim and final fuel factors, it appears General Counsel found EGS's interim fuel factor nuclear expense assumptions to be appropriate for the final fuel factor, too. As described in the forecast year controversy above and in footnote 53 above, General Counsel calculated a nuclear fuel expense level of $30,874,211, with a $11,217,949 reduction to forecasted natural gas expenses to reflect the use of a higher nuclear capacity factor than EGS had assumed for the nuclear fuel expense EGS had initially excluded from the final fuel factor eligible fuel expenses.

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[54] EGS Exs. 1 at Sched. I-1.1, I-1.2, and I-4 (with associated workpapers and fuel contracts), 13A (Rives Direct Test.) at 8-9, 13B (Rives Direct Test. workpaper).

[55] EGS Reply Brief (Phase IV) at 30, citing EGS Ex. 225 (Rives Rebuttal Test.) (Phase IV) at 27-29.

[56] General Counsel Ex. 3A (Dishong Direct Test.) at 26.

[57] *See* PFD § II(C)(1) at p. 19 *supra.*

[58] *See* General Counsel Ex. 3A (Dishong Direct Test.) at 25-27.

c. **Cities Position**

Cities proposed to reduce EGS's $30,873,928 interim fuel factor estimate by $3,298,257 to $27,575,671 based on the assumption that, for the forecast year, EGS should be able to lower its nuclear fuel costs to the industry median for 1994 and 1995.[59] Cities found it unreasonable and illogical that EGS's projection of $6.17/MWh[60] should be so much higher than the industry median of $5.51/MWh,[61] given that EGS's projection is based on industry top quartile performance for capacity factor and production costs.[62] Cities argued that EGS has not demonstrated any special circumstances to justify exceeding industry median cost, and that, in this era of emerging competition, industry median cost is an appropriate cap for nuclear fuel expense in the fuel factor.[63]

Though Cities never expressly said so, the same reasoning would presumably apply to the final fuel factor, too.[64]

Cities also initially recommended exclusion from EGS's fuel factor of the decontamination and decommissioning (D&D) fee paid by EGS (and all other U.S. utilities buying federal uranium enrichment services) to the U.S. Department of Energy,[65] because, on June 22, 1995, the U.S. Court of Federal Claims held that this annual assessment was unlawful.[66] On May 6, 1997, however, after

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[59] Cities Ex. 17/48 (Hubbard Direct Test.) at 85.

[60] *Id.* at 85; EGS Ex. 13B (Rives Direct Test. workpaper).

[61] Cities Ex. 17/48 (Hubbard Direct Test.) at 85.

[62] Cities Initial Brief at 1.

[63] *Id.* at 85-86.

[64] Cities' position on this point is confusing, given that Cities used EGS's interim fuel factor nuclear expense forecast but then later maintained that EGS had waived any right to an interim fuel factor.

[65] Cities Ex. 17/48 (Hubbard Direct Test.) at 41-43 and 86-87.

[66] *Yankee Atomic Electric Company v. United States*, 33 Fed. Cl. 580 (1995).

the prefiling of Cities' testimony, the U.S. Federal Circuit Court of Appeals reversed the lower court's decision.[67] At the hearing on the merits, EGS witness Mr. Rives revised his supplemental direct testimony[68] to reflect the reversal.[69] Based on EGS's agreement to (1) continue to make the D&D payments under protest and (2) refund such payments to ratepayers if the courts ultimately find the fees unlawful,[70] Cities witness Mr. Hubbard withdrew his recommendation that D&D fees be excluded from eligible fuel expenses.[71] The testimony of Mr. Rives and the background portions of Mr. Hubbard's testimony on this point, however, remain in the record in order to respond to the Commission's request in its order on rehearing in EGS's last fuel reconciliation.[72]

d. EGS Response

EGS responded that it had met its burden to prove that its proposed nuclear fuel expenses were reasonable while Cities' proposal was simply an arbitrary reduction with no basis in fact or law.[73] Under cross-examination, Cities witness Mr. Hubbard stated that he based his recommendation on considerations such as (a) EGS's current fuel reconciliation filing, which shows EGS's nuclear fuel costs declining over time and approaching the industry median, while Entergy's other nuclear plants' fuel costs have already been lower than the industry median, and (b) the need for consistency of Phase I fuel factor assumptions with Phase IV (competitive issues) fuel factor

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[67] *Yankee Atomic Electric Company v. United States*, 112 F.3d 1569 (Fed. Cir. 1997).

[68] EGS Ex. 13D (Rives Supp. Direct Test.) at 3.

[69] Tr. (Rives) at 900-03.

[70] Tr. (Rives) at 910-11; *see also* EGS Reply Brief at 7 n.7.

[71] Tr. (Hubbard) at 1619-25.

[72] Official Notice Ex. 4, Docket No. 15102, Order on Rehearing, Finding of Fact (FoF) No. 166 (p. 55) (not yet published). That finding stated the Commission's desire to see this issue addressed in EGS's next fuel reconciliation case.

[73] EGS Initial Brief at 4.

assumptions.[74] EGS interpreted this response, along with Mr. Hubbard's admission that he had not yet studied "all the [presumably Phase-IV-related] projections about where GSU thinks they will be in 1997, '98, and '99," to mean that Mr. Hubbard's methodology omitted analysis of EGS's Phase I fuel expense projections;[75] Cities did not specifically refute this charge.[76]

EGS also pointed out that Cities witness Mr. Hubbard apparently disregarded a number of considerations that could cause EGS's nuclear fuel expense to be justifiably higher than the industry median: (a) EGS's leasing rather than purchasing nuclear fuel;[77] and (b) EGS's entering into contracts for uranium acquisition, uranium financing, conversion, enrichment, and fabrication, which, while perhaps on terms reasonable and prudent[78] at contracting time, later proved to be above the industry median.[79]

Furthermore, EGS noted that Mr. Hubbard found that EGS's nuclear fuel cost projection was optimistic and, if unmet, would lead to under-recovery,[80] but that he did not perform any calculations to assess whether his proposed fuel factor would recover too much, not enough, or just the right

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[74] Tr. (Hubbard) at 1846-47.

[75] *Id.*; EGS's Initial Brief at 6-7.

[76] *See* Cities Initial Brief at 1-5; Cities Reply Brief at 1-3.

[77] Financing expenses for *leasing* are "eligible fuel expenses" included in the fuel factor, while financing expenses for *buying* are included in rate base, so if nuclear fuel is leased rather than purchased, the fuel factor will be higher, even if leasing ultimately results in overall lower costs (as EGS asserts). EGS Ex. 13A (Rives Direct Test.) at 22-23; Tr. (Hubbard) at 1818-19; *see also* EGS Exs. 79 and 75B (Rives Rebuttal Test.) at FBR-26.

[78] EGS argued that prudence review is inappropriate in a fuel factor proceeding. EGS Initial Brief at 8.

[79] *Id.* at 8-9; Tr. (Hubbard) at 1844-1845.

[80] EGS Ex. 17/48 (Hubbard Direct Test.) at 84; Tr. (Hubbard) at 1841-43.

amount.[81] Instead he offered his judgment that Cities' proposed fuel factor would recover, on balance, around the right amount.[82]

EGS also pointed out that Cities witness Mr. Hubbard had never before testified in a fuel factor proceeding and that he has little or no experience with nuclear fuel forecasting or pricing, while EGS witness Rives has considerable experience in the nuclear fuel industry.[83]

Finally, EGS posited that, under the fuel rule, a revised fuel factor should incorporate reasonable estimates, not aspirational goals or industry benchmarks.[84] In making that point, EGS noted that Mr. Hubbard said he was not aware of any PUC decision using an industry median to set expenses in a fuel factor proceeding.[85]

e. ALJs Analysis

The ALJs find EGS's position persuasive for the reasons cited by EGS and General Counsel, and, in particular, because only EGS's and General Counsel's expense estimate was based on EGS's (not other utilities') projected fuel expenses, as contemplated by the fuel rule, as currently written and historically interpreted.[86] The ALJs therefore would have found EGS's interim fuel factor

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[81] *Id.* at 1848.

[82] *Ibid.*

[83] EGS Initial Brief at 4, citing Tr. (Hubbard) at 1777-78, 1849, EGS Ex. 12A (Rives Direct Test.) at 1-2.

[84] EGS Reply Brief at 6.

[85] Tr. (Hubbard) at 1844. EGS also argued that Mr. Hubbard's approach is based on the premise that 50% of the country's nuclear plants have some unrecoverable nuclear fuel expenses. EGS Initial Brief at 9. The ALJs observe that this is not necessarily true if expenses decline industrywide over time, given that Mr. Hubbard proposed use of a historical ('94-'95) benchmark to evaluate EGS's future ('97-'98) expenses.

[86] While reconciling fuel expenses involves assessment of prudence, thus allowing and perhaps sometimes requiring comparisons to other utilities' expenses, EGS's fuel factor must be based on EGS's likely **actual** expenses, where consideration of other utilities' past expenses may not be of as much value, especially where long-term contracts

nuclear fuel expense estimate reasonable. As for the final fuel factor, the benchmark chosen by General Counsel and EGS better indicates EGS's likely expenses than Cities' benchmark does.[87] The ALJs therefore find EGS's and General Counsel's final fuel factor nuclear fuel expense estimate of $30,874,211 reasonable and do not recommend adoption of Cities' proposed adjustment.

3. EGS Request for Good Cause Exception for Wheeling Revenues and Account 565 Expenses

Question: Should EGS's request be granted for good cause exceptions from the fuel rule requirements to include wheeling revenues and Account 565 expenses?

Answer: Yes (therefore, EGS's wheeling revenues and Account 565 expenses are ***not*** *reconcilable/eligible fuel expenses), to avoid a misallocation and a double dip, for the interim fuel factor (and, as will be seen below, for the fuel reconciliation). No, for the final fuel factor, because EGS failed to show good cause and instead only provided reasons why the fuel rule should be changed.*

a. Background

In its Application and in prefiled testimony, EGS asked to be excused from the fuel rule's requirement that "eligible fuel expenses" include expenses recorded in Account 565[88] of the Federal

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and long-lasting inventories are involved, such as with nuclear fuel.

[87] The ALJs observe that the approximately 87 percent capacity factor associated with the recommended nuclear expense projection is far higher than the 81 percent target capacity factor recommended in the competitive issues portion of the March 25 PFD. However, given that no party recommended a better basis for projecting nuclear fuel expense, the ALJs have recommended what appears to be the most appropriate estimate available in the evidentiary record.

[88] P.U.C. SUBST. R. 23.23(b)(2)(B). No party argued that EGS misclassified the expenses it recorded in Account 565, or that expenses categorized elsewhere should be placed in Account 565.

Energy Regulatory Commission (FERC) Uniform System of Accounts and revenues from wheeling transactions[89] (comprising revenues from Access Service and Company Service).[90] EGS did not provide any estimates of these expenses/revenues for the forecast year,[91] but it did provide figures for the fuel reconciliation period in this case (July 1995-June 1996).[92]

In this fuel reconciliation period for EGS, the only items recorded in Account 565[93] are $12.1 million of "transmission equalization" expenses[94] paid pursuant to Service Schedule MSS-2 of the Entergy System Agreement (ESA). (See Attachment C for a discussion of the ESA. See Appendix F for a copy of MSS-2.) Under the MSS-2 expense/revenue formula, EGS and other "short" (*i.e.*, relatively transmission-deficient) Entergy operating companies (EOCs) effectively pay into a pool from which the "long" (*i.e.*, relatively transmission-plentiful) EOCs draw; this formula is intended to equitably distribute the ownership costs of certain transmission facilities (mostly high-voltage (≥230 kV)) in the Entergy System.[95]

"Access service" is transmission service provided by the Entergy System (not EGS) to wholesale customers under an open access transmission tariff filed with the FERC. Access service

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[89] P.U.C. SUBST. R. 23.23(b)(2)(B)(vi)(II).

[90] EGS Ex. 1 at Application (Vol. 1), pp. 1, 6-7, 29-30; *see* EGS Ex. 24A (Peters Direct Test.) at 5.

[91] General Counsel Ex. 6 (Panjavan Direct Test.) at 11.

[92] EGS Ex. 24A (Peters Direct Test.) at 6, 8.

[93] Account 565 is entitled "Transmission of Electricity by Others." 18 Tex. Reg. 836, 838 (Feb. 9, 1993) (adoption of fuel rule revisions).

[94] These expenses should not be confused with transmission service facilities charges (access fees and impact fees) paid pursuant to P.U.C. SUBST. R. 23.67. Also, see footnote 116 *infra*, wherein the ALJs observe that MSS-2 transmission equalization payments bear little if any relationship to expenses actually incurred for any wheeling services.

[95] EGS Ex. 24A (Peters Direct Test.) at 5-6; EGS Ex. 9 (Turner Direct Test.) at Ex. KMT-1 (Entergy System Agreement), §§ 4.06 (p. 21 of 75), 20.01 (p. 44 of 75).

revenues are received at the Entergy System level and are allocated to the various Entergy operating companies in proportion to each company's load. In the fuel reconciliation period, EGS received about $2.6 million in access service revenues on a total company basis.[96]

"Company service" is transmission service provided by EGS (not the Entergy System) to several wholesale customers which have been directly connected to EGS's transmission system for many years; current customers include Cajun Electric Power Cooperative, Inc., Sam Rayburn G&T, Inc., Sam Rayburn Municipal Power Agency, Lafayette Utility System, and Louisiana Energy and Power Authority. In the fuel reconciliation period, EGS received about $33.5 million in adjusted company service revenues.[97]

Before proceeding with consideration of the parties' arguments, the reader should perhaps be aware of the confusion at the threshold of this issue. EGS witness Mr. Peters said he was puzzled that General Counsel and Cities objected to a good cause exception for the fuel factor but not for the fuel reconciliation.[98] The ALJs believe that Mr. Peters was puzzled because General Counsel and Cities did not distinguish between the Phase I and the Phase IV fuel factor[99] -- *i.e.*, the ALJs believe that General Counsel and Cities intended to oppose EGS's request for good cause exception in Phase IV but not in Phase I, yet they neglected to mention that they did not oppose a good cause exception for the Phase I interim fuel factor.[100] If such is the case, then the position of General Counsel and Cities is in fact consistent with EGS's alternative position that, to avoid a double dip,

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[96] EGS Ex. 24A (Peters Direct Test.) at 9.

[97] *Id.* at 14-15.

[98] EGS Ex. 97 (Peters Rebuttal Test.) at 6-7.

[99] *See also* PFD § II(C)(1) (at p. 19 *supra*) regarding choice of forecast year.

[100] Indeed, the next question-and-answer in Mr. Peters's rebuttal testimony suggests that Mr. Peters did in fact understand the reason for General Counsel's and Cities' positions; thus Mr. Peters had no reason to be puzzled. The ALJs are puzzled that the parties did not communicate more thoroughly and frankly on this important issue. (Note that EGS claimed it remained puzzled even after the hearing. EGS Initial Brief at 14.)

Account 565 expenses and wheeling revenues should not be treated as reconcilable until implementation of the Phase IV fuel factor along with new base rates.[101] Furthermore, opposing a good cause exception for the Phase IV fuel factor is not necessarily inconsistent with declining to oppose a good cause exception for both the Phase I fuel factor and the fuel reconciliation. If, however, the ALJs have incorrectly assessed General Counsel's and Cities' positions, the ALJs humbly apologize to EGS (as well as General Counsel and Cities) and pronounce themselves not merely puzzled but completely befuddled.[102] In any event, the ALJs will proceed with consideration of EGS's request, even if no other parties intended to object regarding the interim fuel factor, because EGS bears the burden of proof to establish good cause for an exception, and because other parties objected regarding the final fuel factor.

b. EGS Position

EGS argued that these transmission-related expenses and revenues should be in base rates, not reconcilable fuel factor charges, because: (1) they are demand-related, not energy-related;[103] (2) they are relatively fixed, not variable; and (3) they are effectively already in base rates (for wheeling customers), and inclusion in the (retail) fuel factor would misallocate expenses as between wheeling customers and retail customers and would also create a "double dip" depriving EGS of the

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[101] *See* PFD § II(C)(3)(b)(iii) (at p. 36 *infra*) regarding EGS's "double dip" argument.

[102] The ALJs have also considered that General Counsel and Cities may have decided the Phase I fuel factor was not sufficiently important to warrant separate discussion. (*See* footnote 2 at p. 4 *supra*.) Before the ALJs issued Order No. 148 denying EGS's request for an interim fuel factor, Cities filed a document indicating a belief that EGS's request for an interim fuel factor was moot. Cities Objection to Additional Evidence, Request Not to Rule on EGS's Request for Interim Fuel Factors or Alternative Motion to Deny EGS's Request for Interim Fuel Factors (Phase I) at 1-2 (Dec. 8, 1997).

[103] EGS equated "demand-related" to "kW-related" and "energy-related" to "kWh-related." *See, e.g.*, Tr. at 2567 (June 25, 1997).

opportunity to recover about $12 million in costs, while attempts to avoid a misallocation and a double dip would result in an onerous, time-consuming recalculation of base rates.[104]

i. That These Expenses/Revenues Are Demand-Related

EGS's first argument against reconcilability was essentially a conceptual challenge to the fuel rule. In urging that these transmission-related expenses and revenues should not be reconcilable because they are demand-related, not energy-related, EGS never argued that its wheeling revenues, for example, are somehow uniquely demand-related or otherwise different in nature from those of other Texas utilities, thus possibly showing good cause and justifying an exception to the general rule.

At the hearing, General Counsel agreed with EGS that transmission-related expenses and revenues are demand-related, at least for cost-of-service-study purposes.[105] On the other hand, General Counsel contended that the Commission, after considering the demand-related nature of wheeling during the rulemaking process,[106] nonetheless decided these types of expenses and revenues should be reconcilable. General Counsel did not point to any evidence of such consideration, and the ALJs were unable to find any such reference in the Texas Register,[107] but EGS did not refute this claim. The ALJs consider it a point likely to have been made, however, given its apparent obviousness.

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[104] EGS Exs. 24A and 24B (Peters Direct Test.) *passim*.

[105] Tr. (Panjavan) at 3404; Tr. (McGill) at 3536-38 (June 30, 1997).

[106] General Counsel Ex. 6 (Panjavan Direct Test.) at 10.

[107] *See* 18 Tex. Reg. 836-45 (Feb. 9, 1993) (adoption of rule), 17 Tex. Reg. 7145 (Oct. 6, 1992) (proposal of rule). Nor did the ALJs find any such reference in the transcripts for the January 26, 1993 open meeting at which the Commission adopted the fuel rule revision making wheeling revenues reconcilable.

The ALJs conclude that EGS here argued for a change of the rule, not an exception to the rule. The ALJs therefore find that EGS's "demand-related" argument does not support a good cause exception.

ii. That These Expenses/Revenues Are Not Variable

EGS also posited that these expenses and revenues are "not variable in the sense that fuel cost is variable and should be excluded from Reconcilable Costs on that basis alone."[108]

General Counsel, however, disagreed and stated that "the main reason that wheeling revenues/expenses were considered reconcilable expenses was that they are potentially volatile because of uncertainty in wheeling transactions."[109]

Disagreeing with both EGS and General Counsel, the ALJs observe that, in adopting the fuel rule revision that, *inter alia*, categorized wheeling revenues as reconcilable, the Commission "reject[ed] the use of a distinction between volatile versus non-volatile costs as a basis for determining which costs should be included in eligible fuel costs."[110] Indeed, the Commission expressly stated that it was "not concerned about ... volatility" when rejecting a comment that firm wheeling costs should be base-rated because they are not subject to wide and sudden fluctuations.[111] The reason for the Commission's rejection of the variability criterion is not clear to the ALJs, but the ALJs note that: (a) the Commission found merit in comments from both sides of the debate; and (b) the Commission was persuaded that a limitation to variable costs would have unintended,

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[108] EGS Ex. 24A (Peters Direct Test.) at 12.

[109] General Counsel Ex. 6 (Panjavan Direct Test.) at 10.

[110] 18 Tex. Reg. at 837 (Feb. 9, 1993).

[111] *Id.* at 838.

detrimental side effects that could distort the decisionmaking process.[112] Thus, although the ALJs could find that Account 565 expenses are relatively stable,[113] while access service revenues may increase substantially over time,[114] the ALJs instead find that EGS's non-variability argument is a challenge to the rule and does not support a good cause exception to the rule.

iii. That EGS Would Suffer from a Misallocation and Double Dip

EGS's next argument was that, during the last rate case,[115] wheeling (company service) expenses were placed in base rates; to now subtract wheeling (company service and access service) revenues from the fuel factor calculation (without adding wheeling expenses[116]) would therefore be a double dip against EGS (*i.e.*, EGS would be treated as if it had received payment from not only wheeling customers but also retail customers -- virtually double the amount of wheeling revenues

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[112] *Id.* at 837.

[113] Tr. (Andersen) at 2520; Cities Ex. 21 (Andersen Direct Test.) at 8; EGS Ex. 24A (Peters Direct Test.) at 6-7.

[114] Cities Ex. 21 (Andersen Direct Test.) at 8 (access service revenues). No credible evidence was submitted as to whether company service revenues will vary over time.

[115] *Inquiry into the Reasonableness of the Rates and Services of Gulf States Utilities Company*, Docket No. 12852 (Mar. 17, 1994) (not published).

[116] Though some parties and the fuel phase ALJ occasionally loosely referred to the Account 565 expenses as "wheeling expenses," no one ever seriously claimed that the Account 565 expenses represented all wheeling expenses (*see, e.g.*, Tr. (Panjavan) at 3392-94 (June 30, 1997)); indeed, given that these Account 565 expenses at issue are MSS-2 "transmission equalization" payments, the ALJs find that they bear little if any relationship to the expenses actually incurred for any wheeling services -- in particular, company service (EGS-specific) as opposed to access service (Entergy-wide). This becomes obvious when one considers that EGS's MSS-2 "expenses" could be zero or negative. If EGS had sufficiently more transmission investment, the MSS-2 formula would yield "expenses" equal to zero (EGS Ex. 83 (Turner Rebuttal Test.) at 28); if its transmission investment were any greater than that, EGS would have MSS-2 revenues rather than MSS-2 expenses, *i.e.*, it would receive MSS-2 payments from the Entergy MSS-2 "pool" of transmission equalization money. Surely no party would argue that the receipt of MSS-2 revenues would be a sign that EGS incurs no expense to provide wheeling service, or, that EGS makes money from providing wheeling service before it receives the first dollar from a wheeling customer, or that EGS incurs no expense or even makes money when it requests and receives the service of "transmission of electricity by others." (Nonetheless, as stated in footnote 94 *supra*, no party argued that EGS misclassified the expenses it recorded in Account 565, or that expenses categorized elsewhere should be placed in Account 565.)

it actually received) unless base rates were simultaneously adjusted to exclude wheeling expenses.[117] That simultaneous adjustment, said EGS, would require the onerous, time-consuming modification of the cost-of-service studies and allocation factors from the last rate case in order to set new base rates coincident with the implementation of the Phase I interim fuel factor.[118]

That simultaneous adjustment would have to include modification of allocation factors because the double dip is due to a misallocation. In EGS's last rate case, company service costs were allocated to wheeling rate classes, not retail rate classes (access service and MSS-2 did not exist then, but presumably their costs would have been allocated similarly).[119] Wheeling customers, not retail kWh customers, thus pay for the cost of providing wheeling service. Following the fuel rule, however, would mean that wheeling revenues (offset by the transmission-related MSS-2 expenses in Account 565) will be included in (therefore, subtracted from) eligible fuel expenses and therefore accrue to the benefit of retail kWh customers. That misallocation would continue unless and until base rates are recalculated and all transmission-related revenues and costs are reallocated on a transmission demand basis rather than an energy sales basis.[120]

Furthermore, in EGS's last fuel reconciliation (Docket No. 15102), General Counsel supported EGS's request that wheeling revenues and Account 565 expenses not be included in eligible fuel expenses,[121] and the Commission found that, "Because EGS's transmission or wheeling

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[117] EGS Ex. 24A (Peters Direct Test.) at 11, 16-18.

[118] *Id.* at 21.

[119] EGS Ex. 24A (Peters Direct Test.) at 10-11, 16-17; EGS Ex. 73 (Peters Rebuttal Test.) at 9.

[120] EGS Ex. 24A (Peters Direct Test.) at 9-10, 15-18, 22-23; EGS Ex. 73 (Peters Rebuttal Test.) at 17-23.

[121] Official Notice Ex. 4, Docket No. 15102, Proposal for Decision at 103-104. To be precise, EGS (actually, its predecessor, Gulf States Utilities Company) did not report any wheeling revenues as reconcilable fuel expenses, yet failed to request a good cause exception. Once the other parties discovered that EGS had in fact received wheeling revenues but had not reported them, EGS filed supplemental testimony which the ALJ in that case considered to be equivalent to a request for good cause exception. *Id.* at 102.

revenues and cost were not allocated to Texas retail ratepayers during the reconciliation period, but were allocated to a separate rate class specified by the Commission's Order in Docket No. 12852, EGS's last base rate case, Texas retail ratepayers should not benefit from an inclusion of EGS's net wheeling revenues in this fuel reconciliation proceeding."[122] EGS argued that General Counsel did not present any evidence to justify changing its position.[123]

Cities countered that a double dip will be avoided if the fuel factor revision and the base rate change in this docket share the same effective date.[124] The ALJs agree with this argument in concept (as does EGS) but would have found that Cities made this argument prematurely as to the interim fuel factor. As repeatedly explained by EGS, the Phase I fuel factor was intended to be interim, while the Phase IV fuel factor was intended to be implemented simultaneously with any change in base rates.[125] The ALJs therefore would have rejected this argument as to the Phase I fuel factor.

General Counsel never specifically addressed EGS's double dip argument but did contend that the treatment of wheeling revenues in EGS's last rate case should not be determinative of their treatment in this docket.[126] General Counsel witness Mr. Panjavan conceded at the hearing, however, that giving ratepayers the benefit of wheeling revenues without the burden of wheeling expenses is probably not fair.[127] General Counsel nonetheless opposed EGS's request on the grounds that EGS

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[122] *Id.* at Order on Rehearing, Finding of Fact No. 226 (pp. 65-66).

[123] EGS Initial Brief at 14.

[124] Cities Ex. 21 (Andersen Direct Test.) at 23-24. In Cities Initial Brief at 3-4, Cities urged synchronizing the base rate change with the fuel reconciliation (not the fuel factor revision) -- the ALJs assume this was an accidental change of reference, because synchronizing any base rate change with the effective date of the fuel reconciliation is irrelevant to whether a fuel factor revision causes a double dip; in any event, as pointed out in EGS's Reply Brief at 9, Cities did not explain how one makes a fuel reconciliation effective to a past date.

[125] *See, e.g.*, EGS Initial Brief at 15.

[126] General Counsel Ex. 6 (Panjavan Direct Test.) at 10.

[127] Tr. (Panjavan) at 3398-99.

did not meet its burden to show good cause, and therefore EGS must follow the rule.[128] The ALJs, however, disagree and must reject General Counsel's insistence on strict adherence to the rule when the Commission has already granted an exception to the rule for the relevant time period. Inconsistent regulatory treatment would be both unwise and unfair.

Similarly, as will be restated below in the fuel reconciliation portion of this supplemental PFD, the ALJs find that denying this exception request for the fuel reconciliation would also be an unfair misallocation and double dip, given that the fuel reconciliation is retrospective in nature and covers expenses prior to the effective date of new base rates.

However, as to the final fuel factor, EGS's misallocation/double dip argument falls away, as EGS concedes.

c. Cities Position

Cities not only countered EGS's reasons for a good cause exception, they also offered an independent argument for denying EGS's request. Cities essentially insisted that:[129]
(1) the ESA Schedule MSS–2 formula is flawed and charges unreasonably high costs to EGS and its ratepayers because it:[130]

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[128] General Counsel Ex. 6 (Panjavan) at 10; Tr. (Panjavan) at 3398-99.

[129] As is explained in Attachment D, distilling Dr. Andersen's testimony to its essential points on this issue was no easy task. Indeed, Dr. Andersen's testimony on this issue was about as incomprehensible and inscrutable as was EGS's initial filing, because his written and oral testimony took some slightly complex but relatively understandable formulas and made them seem alternately deceptively simple and confusingly complex. The ALJs have done their best to summarize Dr. Andersen's arguments but realize that they may not have conveyed them as Dr. Andersen or Cities' attorneys intended.

[130] Cities Ex. 21 (Andersen Direct Test.) at 12; *see* EGS Ex. 9 (Turner Direct Test.) at Ex. KMT-1 (pp. 44-49 of 75).

(a) uses system average Annual Ownership Cost (AOC) rather than individual Entergy Operating Company (EOC) AOCs;[131]

(b) uses Net Inter-Transmission Investment, which is low for EGS merely because its transmission plant is more fully depreciated than that of other EOCs;[132]

(c) uses a responsibility ratio that does not include the load associated with Entergy off-system power sales contracted for before the merger of Entergy with EGS's predecessor Gulf States Utilities Co. (GSU);

(2) EGS therefore should not be allowed to recover MSS-2 expenses (neither in base rates nor through the fuel factor), and the fact that MSS-2 has been submitted for FERC approval does not mean that the PUC is preempted by the FERC from disallowing MSS-2 expenses, because:

(a) the ESA (with schedules), as revised following the merger of Entergy with the former GSU, has not yet been formally approved by the FERC; and

(b) even if the PUC considers the schedules to be FERC-approved or effectively FERC-approved, the PUC is not necessarily preempted by the FERC;[133] and

(3) if the PUC were to decide that it is preempted by FERC from disallowing MSS-2 expenses, the PUC should:

(a) petition the FERC to modify the ESA so as to redesign the MSS-2 formula to be fairer, which should result in MSS-2 revenues rather than expenses for EGS; and

(b) treat MSS-2 expenses as reconcilable, in order to more quickly capture this benefit through the fuel reconciliation/fuel factor revision process rather than the less frequent rate case process with its greater regulatory lag.[134]

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[131] This is a problem, per Cities, because it means that "long" EOCs with low AOCs are over-compensated by use of the higher system average AOC. Cities Ex. 21 (Andersen Direct Test.) at 12.

[132] This is a problem, per Cities, because it makes EGS and its ratepayers effectively contribute to paying for the depreciation of other EOCs' shiny new transmission plant after having already paid for much depreciation of EGS transmission plant. *Ibid.*

[133] Cities' Response to EGS's Objection to Andersen Testimony at 2 n.1 (May 28, 1997).

[134] *Id.* at 3 and 21.

i. Preliminary Summary of Conclusion

Like Cities' presentation on this issue, EGS's response was extensive, complex, and vigorous. The ALJs need not address the merits of EGS's and Cities' arguments on the fairness of MSS-2,[135] however, because the ALJs find that the PUC is preempted from disallowing expenses that have been approved by the FERC.

ii. Background: Prior Treatment of This Issue

This issue was first addressed in EGS's objection to much of Cities witness Dr. Andersen's testimony, where EGS urged that the FERC had approved the ESA and that the PUC has no authority to challenge the reasonableness of ESA-incurred expenses except in a FERC proceeding.[136] As stated above, Cities countered that the amended ESA compliance filing has not yet been approved, and that, even if it had been, the PUC is not necessarily preempted from disallowing MSS-2 expenses.[137] ALJ Stewart ruled on the objection in Order No. 91, not by striking any testimony, but by tentatively determining that the testimony would be admissible for the purpose of showing whether the expenses in question are reasonable, but not as to the propriety of the FERC's decision or how the FERC should change the ESA expense allocations.[138] During the Phase I hearing, it became quite clear that Cities' disagreement was with the design (or concept) and not the

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[135] The ALJs nonetheless do so in PFD Attachment D, at p. 83) in the event the Commission does not find itself preempted from disallowing MSS-2 expenses.

[136] Objections to the Direct Testimony of Steven Andersen on Behalf of Cities at 2-3 (May 21, 1997).

[137] Cities' Response to EGS's Objection to Andersen Testimony at 1-2 (May 28, 1997).

[138] Order No. 91 at 6. Additional reasons to allow the testimony was to give the ALJs an opportunity to determine whether to recommend that the PUC urge the FERC to consider these issues, and to avoid any need for a remand on this point.

implementation (or arithmetical application) of the MSS-2 formula (and the remainder of the ESA and its service schedules).[139]

ALJ Stewart's ruling, partial and tentative in Order No. 91, drew much closer to being complete and conclusive as a result of Order No. 106, in which ALJ Sanford granted EGS's motion to strike portions of the Phase 2 (revenue requirement) prefiled testimony of Cities witness Dr. Andersen about this same subject.[140] The essential elements of that ruling are incorporated into the ALJs' analysis below.

iii. Background: ESA and its Amendment

The "current version" (generally speaking) of the ESA was entered into in 1982 and was approved, after modification, by the FERC in 1985.[141] In 1992, along with a request for approval of a planned merger, the pre-merger Entergy[142] and Gulf States Utilities Co. (GSU, EGS's predecessor) filed a request with the FERC to amend the ESA to include GSU. In 1993 and 1994, the FERC authorized the merger and "accept[ed] an amendment to the [ESA] which adds Gulf States

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[139] Tr. (Andersen) at 2321-37 (June 24, 1997). Dr. Andersen also stated that he did not review EGS's filing for accuracy of data inputs. *Id.* at 2337-45.

[140] Cities recognized the import of this evidentiary ruling, as shown by its July 28, 1997 filing of an appeal which was deemed denied after ten days passed and the Commissioners had not placed the appeal on an open meeting agenda. *See* P.U.C. Proc. R. 22.123(g). *See also* Cities Initial Brief at 4 n.1 and EGS Reply Brief at 11.

[141] *Middle South Energy, Inc.*, Opinion No. 234, 31 FERC ¶61,305 (1985); *Middle South Energy, Inc. and Middle South Services, Inc.*, Opinion No. 234-A, 32 FERC ¶61,425 (1985). The two prior "versions" were signed in 1951 and 1973. *Id.* at p. 61,634. The signatories to the ESA were Arkansas Power & Light Co. (AP&L) (now Entergy Arkansas, Inc.), Louisiana Power & Light Co. (LP&L) (now Entergy Louisiana, Inc.), Mississippi Power & Light Co. (MP&L) (now Entergy Mississippi, Inc.), New Orleans Public Service, Inc. (NOPSI) (now Entergy New Orleans, Inc.), and Middle South Services, Inc. (the service company subsidiary of Middle South Utilities, which was also the parent company of AP&L, LP&L, MP&L, and NOPSI) (now Entergy Services, Inc.).

[142] On behalf of AP&L, LP&L, MP&L, and NOPSI.

to the [ESA] as an operating subsidiary."[143] The FERC ordered Entergy Corp. to file an amended ESA in compliance with the FERC's rulings,[144] and Entergy has done so,[145] but the compliance filings apparently have not yet been formally approved.[146]

iv. ALJs Analysis

The ALJs agree with EGS and reject the reasoning of Cities as follows:

(1) (a) The FERC has approved the relevant parts of the amended ESA. In Opinion No. 385, the FERC expressly "accept[ed] an amendment to the [ESA] which adds Gulf States to the ESA as an operating subsidiary."[147] EGS's MSS-2 expenses are therefore mandated by the FERC. (b) Under *Mississippi Power & Light*, a state utility commission must treat FERC-mandated system agreement payments as reasonably incurred operating expenses for the purpose of

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[143] *Entergy Services, Inc. and Gulf States Utilities Co.*, Opinion No. 385, 65 FERC ¶61,332 at p. 62,464 (1993), *modified on reh'g and denied in part*, Opinion No. 385-A, 67 FERC ¶61,192 (1994). According to EGS, the amendments "which add Gulf States as an Entergy operating company" therefore "are in effect." EGS Ex. 9 (Turner Direct Test.) at Ex. KMT-1, p. 2 of 75.

[144] Opinion No. 385, 65 FERC ¶61,332 at p. 62,552; Opinion No. 385-A, 67 FERC ¶61,192 at p. 61,603.

[145] "On December 30, 1993, and June 16, 1994, Entergy Services submitted compliance filings to FERC which included [ESA] tariff sheets to implement changes in the [ESA] required by Opinion Nos. 385 and 385-A, [including several voluntary commitments, the "fuel tracker" for assessing post-merger fuel costs, and a request for an effective date of January 1, 1994]. ... These additional changes to the [ESA] are pending FERC approval and, although not currently in effect, are expected to become effective upon acceptance by the Commission." EGS Ex. 9 (Turner Direct Test.) at Ex. KMT-1, p. 2 of 75.

[146] Cities Ex. 21 (Andersen Direct Test.) at 7; Cities Ex. 22 at 7.

[147] Opinion No. 385, 65 FERC ¶61,332 at p. 62,552.

setting retail rates.[148] This Supreme Court decision clearly preempts the PUC from disallowing MSS-2 expenses in this case.[149]

(2) (a) If not *formally*, the FERC has at least *effectively* approved the amended ESA. Surely the FERC would not fail to act on a compliance filing for several years then substantively change the terms of approval. Such a change would be unthinkably inequitable.

(b) *MP&L* still applies to preempt the PUC from disallowing MSS-2 expenses in this case.

The ALJs thus would reject the first two parts of Cities' request (as structured by the ALJs); the third will be addressed in the following two paragraphs.

As to Cities' request that the PUC petition the FERC to modify the ESA so as to redesign the MSS-2 formula to be fairer, the ALJs recognize that this is, of course, a matter within the PUC's discretion. Based on the ALJs' MSS-2 analysis found in Attachment D, however, the ALJs cannot recommend that the Commission take such action.

As to Cities' request to treat MSS-2 expenses as reconcilable, in order to quickly capture the benefits if the FERC redesigned MSS-2 to be fairer to EGS, the ALJs would deny this request for the same reason given in Order No. 106 as to MSS-1,[150] as follows. The mere possibility that the

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[148] *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354, 369-370, 108 S. Ct. 2428 (1988). Indeed, the system agreement involved in that *MP&L* decision is the very same one involved in this PUC case! *See* 487 U.S. at 357. The *MP&L* decision, like an earlier Supreme Court opinion also cited by EGS, rested on three fundamental principles concerning the preemptive impact of federal jurisdiction over wholesale rates on state regulation: "First, FERC has exclusive authority to determine the reasonableness of wholesale rates. ... Second, FERC's exclusive jurisdiction applies not only to rates but also to power allocations that affect wholesale rates. ... Third, States may not bar regulated utilities from passing through to retail consumers FERC-mandated wholesale rates." *MP&L*, 487 U.S. at 371-72, *citing Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 963-64, 966, 970, 106 S. Ct. 2349 (1986).

[149] If Cities' concerns were that EGS unreasonably forecast its future MSS-2 expenses in proposing a fixed fuel factor, or that EGS wrongly calculated its MSS-2 expense in its fuel reconciliation filing package, the PUC could consider them. However, because Cities' concerns are about design, not implementation (*see* Tr. (Andersen) at 2321-37), of the formula, the PUC may not address such concerns in setting retail rates.

[150] Order No. 106 at 2-3.

FERC might revise the ESA and MSS-2 so as to decrease MSS-2 expenses does not justify expanding the definition of eligible fuel expenses to include MSS-2 expenses. Numerous types of non-reconcilable expenses (or revenues) may fluctuate over time; the mere possibility of decrease does not make an expense reconcilable.

d. Conclusion

The ALJs find that, for the purpose of setting the interim fuel factor, EGS's wheeling revenues and Account 565 expenses are not eligible fuel expenses. The ALJs are persuaded that reconcilability would cause a misallocation and a double dip, but the ALJs are not persuaded by arguments that these expenses/revenues are demand-related, not variable, subject to disallowance, and appropriate for quick capture. However, for the final fuel factor, EGS's misallocation/double dip argument falls away, as EGS concedes, and therefore EGS has no remaining valid good cause evidence or argument. Thus the ALJs recommend denial of EGS's request for good cause exception regarding wheeling revenues and Account 565 expenses as to the final fuel factor. As an aside, though, the ALJs believe that the Commission may wish to consider EGS's reasoning as a basis for revising the fuel rule's treatment of wheeling revenues and Account 565 expenses.[151]

4. Cities' Request for Good Cause Exception to Fuel Rule so as to Include MSS-1 Expenses

Question: Should Cities' request be granted for a good cause exception in this phase from the fuel rule's exclusion of MSS-1 expenses?

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[151] *See Alternative Rate Making Treatments for Fuel Cost Recovery*, Project No. 15485; *Application of Southwestern Electric Power Company for Reconciliation of Fuel Costs, Surcharge of Fuel Cost Under-Recoveries, and Related Relief*, Docket No. 17460(pending); *Application of Central Power & Light for Authority to Reconcile Fuel Costs*, Docket No. 15900, Final Order, Finding of Fact No. 102 (June 28, 1996)(not yet published).

Answer: No (therefore EGS's MSS-1 expenses are ***not*** *reconcilable/eligible fuel expenses as to the interim or final fuel factor (or the fuel reconciliation)).*

a. Background: History of this Issue

The ALJs have already ruled on this issue in Order No. 106, and the Commission has declined to hear Cities' appeal,[152] but for the sake of completeness and to give the Commission an opportunity to review this issue in a broader context, the ruling is repeated below substantially in its entirety.

b. Restatement of Order No. 106 Ruling

As briefly referred to above with regard to ESA Schedule MSS-2, Cities have also asked the PUC to grant a good cause exception to the fuel rule for EGS's expenses/revenues under Schedule MSS-1 (MSS-1 expenses).[153] (See PFD Attachment E for a copy of MSS-1.) This request for a good cause exception was actually an alternative recommendation of Cities witness Steven Andersen, who primarily recommended that most of (if not all of) EGS's MSS-1 expenses should be disallowed, whether from base rates, where EGS proposed their inclusion, or from the reconcilable fuel expenses used to calculate the fixed fuel factor.[154] Dr. Andersen essentially testified that the MSS-1 formula for equalizing reserve margins among Entergy operating companies is unfair to EGS, due to the

[152] *See* Cities Initial Brief at 4 n.1 and EGS Reply Brief at 11.

[153] Though EGS could hypothetically incur expenses or receive revenues under MSS-1, EGS incurred only expenses during the reconciliation period (Schedule G-6.1 Workpapers at 109) (Cities Ex. 1) and presumably is not likely to receive revenues under MSS-1 in the near future.

[154] *See* Cities Ex. 21 (Andersen Direct Test.) at 17-21; Cities Ex. 21A (Andersen Second Supp. Direct Test.) at 1-4.

exclusion of grandfathered MSS-5 load from the responsibility ratio calculation, and should be changed by the FERC.[155]

More specifically, Cities witness Steven Andersen alternatively recommended that, although the PUC's fuel rule does not include MSS-1 expenses, EGS's MSS-1 expenses should be treated as reconcilable in order to "eliminate the regulatory lag from timing differences between a FERC ordered revision in the System Agreement and a PUCT decision in a subsequent EGS base rate case" (assuming that the FERC revises the MSS-1 formula as envisioned by Dr. Andersen).[156]

EGS witness Kenneth M. Turner noted that neither Cities nor Dr. Andersen filed a request for a good cause exception, but that Dr. Andersen simply made a recommendation in his prefiled testimony.[157] EGS rebuttal witness Donald W. Peters testified that Dr. Andersen did not justify expanding the fuel rule's definition of eligible fuel expenses to include MSS-1 expenses. Mr. Peters also posited that: (1) MSS-1 expenses do not include any fuel expense component; and (2) elimination of regulatory lag does not justify expanding the scope of the fuel rule to include MSS-1 expenses, because regulatory lag affects all non-reconcilable (base rate) expenses, and MSS-1 expenses have not been shown to differ from any other non-reconcilable expense so as to justify reconcilable treatment.[158]

The ALJs find EGS's position persuasive. The mere possibility that the FERC might revise the Entergy System Agreement and MSS-1 so as to decrease EGS's MSS-1 expenses does not justify expanding the definition of eligible fuel expenses to include MSS-1 expenses. Numerous types of non-reconcilable expenses (or revenues) may fluctuate over time; the mere possibility of decrease

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[155] *See* Cities Ex. 21 (Andersen Direct Test.) at 17-21.

[156] *Id.* at 21.

[157] EGS Ex. 83 (Turner Rebuttal Test.) at 3 n.1.

[158] EGS Ex. 73 (Peters Rebuttal Test.) at 28-29.

does not make an expense reconcilable. Cities' request for a good cause exception to the fuel rule so as to treat MSS-1 expenses as reconcilable is therefore denied.

III. Fuel Reconciliation (continued)

A. EGS Request for Good Cause Exception for Wheeling Revenues and Account 565 Expenses

As explained in supplemental PFD § II(C)(3)(b)(iii) above, denial of EGS's request as to the fuel reconciliation would result in a misallocation and double dip against EGS. The ALJs therefore recommend granting EGS's request for a good cause exception as to wheeling revenues and Account 565 expenses for the fuel reconciliation.

B. Cities Request for Good Cause Exception so as to Include MSS-1 Expenses

For the reasons given in supplemental PFD § II(C)(4) above, the ALJs recommend denial of Cities' request for a good cause exception as to MSS-1 expenses for the fuel reconciliation.

C. Natural Gas Expenses in February 1996[159]

During the reconciliation period, EGS's weighted average cost of natural gas (long term and short term) was $2.185/MMBtu ($2.183/MMBtu for short term (bidweek and daily) only).[160] During the first 12 days of February 1996, however, EGS paid as much as $17.73/MMBtu and an average of $10.23/MMBtu for daily spot gas.[161] In the March 25 PFD, the ALJs recommended disallowing $11,211,685 in gas expenses related to the early February 1996 explosion in gas prices resulting from extremely cold weather. Following is the basis for that recommendation.

1. Need for Reasonable Degree of Preparation

EGS failed to take reasonable precautions as to a reasonably likely event – an increase in natural gas prices due to an arctic outbreak during the winter of 1995-96. Even EGS's own evidence showed that the likelihood of an arctic outbreak is sufficiently high – 10 to 20 percent each winter – to warrant a reasonable degree of preparation.[162] Furthermore, a weather event of this sort has in fact occurred four times in the last 13 years (1983, 1989, 1996, and 1997).[163] EGS is aware that unusually cold weather generally results in natural gas price increases.

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[159] Some of the evidence and argument on this issue can be found at: EGS Ex. 56 (Wise Rebuttal) at 1-9, EGS Ex. 68 (Ralston Rebuttal) at 1-25, ABR-1 to -4, -6, -7; EGS Ex. 64 (Langdon Rebuttal) at 4-20, Att. .JJL-2, EGS Ex. 59(Bostwick Rebuttal) at 2-11, Att. GB-1 to -4; Cities Ex. 15 (Schneider Direct) at 17-21, Schedules TJS-2 to -3, Cities Ex. 13 (Donkin Direct) at 23-34. NSST Ex.7 (Nalepa Direct-redacted) at 7-15, Schedules KJN-4 to -14, KJN-16; GC Ex. 4 (Reed Direct) at 12-17, Att. LDR -4 to -6; Cities Initial Brief at 8-36, Cities Reply Brief at 3-14, NSST Initial Brief at 5; NSST Reply Brief at 7-15, GC Initial Brief at 19-44; GC Reply Brief at 14-23.

[160] General Counsel Ex. 4 (Reed) at 9, 10.

[161] Cities Ex. 13 (Donkin Direct) at 31; NSST Ex. 7 (Nalepa Direct - redacted) at Schedule KJN-7.

[162] EGS Ex. 59 (Bostwick Rebuttal) at 11.

[163] Tr. (Bostwick) at 4078-80; Tr. (Langdon) at 4370-72.

EGS suggested that the relevant statistic was the probability that a given set of five winter days would experience an arctic outbreak (about one percent).[164] However, such a narrow focus is inappropriate, and EGS's proposed statistic is irrelevant. This suggestion was typical of EGS's arguments regarding its February 1996 gas expenses, *i.e.*, EGS repeatedly argued that it was prudent because others could not show that EGS should have been able to foresee exactly how cold its service area would become on a certain date, resulting in a particular level of gas expense. As other parties correctly argued, however, EGS had the burden to show that it took reasonable steps to prepare for reasonably predictable events, and that EGS acted reasonably as events unfolded. As the following reveals, EGS did not carry that burden.

2. EGS's Sensitivity to Gas Price Volatility

EGS was particularly sensitive to an unusually cold weather event, because of the following factors:

(a) **EGS's heavy reliance on gas** -- Natural gas accounted for about 50 percent of EGS's energy mix, and, as EGS's primary fuel, was used as both a base-load fuel and a swing fuel. Thus, it was crucial that EGS's gas supply be reliable and inexpensive.[165]

(b) **Scheduled outages** – Two of EGS's larger power sources were scheduled for outages during the first week of February:

(1) EGS's lowest-incremental-cost and largest single source of power, River Bend Nuclear Station, which normally produces 655 MW for EGS; and

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[164] EGS Initial Brief at 57.

[165] EGS Ex. 10 (Harrington Direct) at 12.

(2) One of EGS's large gas-fired units, Sabine 5, which can provide 495 MW to EGS.[166]

EGS also scheduled outages for 967 MW of non-EGS generation in the same time frame.[167] EGS also should have been aware that unplanned outages could occur – and they did.[168]

3. Possible Preparation Methods

Because of this sensitivity to gas price volatility, EGS would have been prudent to prepare for adverse weather and increased gas prices by doing the following:

(a) **Filling up storage** -- On February 1, 1996, EGS's Spindletop gas storage facility contained only about 70 percent of its maximum usable capacity (2.4 billion cubic feet (Bcf) of a 3.4 Bcf usable capacity), according to NSST,[169] or only about 53 percent (1.8 Bcf of 3.4), according to EGS.[170]

(b) **Preparing units to burn fuel oil** – EGS has three units that were capable of burning fuel oil in February 1996 and a fourth (Lewis Creek No. 1) that could have the capability to burn fuel oil. EGS offered no valid reason why it had not taken the steps to prepare Lewis Creek No. 1 to burn fuel oil for a time such as February 1996, when EGS's fuel oil in storage cost

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[166] EGS Ex. 1 (Application) at Schedules H-6.2b, H-12.3b, cited in GC Initial Brief at 23. The EGS system reliable capacity is 6,558 MW, the February 1996 peak was 5,204 MW, and the average February peak for 1993-1995 was 4,275. EGS Ex. 1 (Application) at Schedule O-3, cited in GC Initial Brief at 23.

[167] EGS Ex. 68 (Ralston Rebuttal) at Ex. ABR-1, cited in GC Initial Brief at 23-24.

[168] EGS Ex. 68 (Ralston Rebuttal) at Ex. ABR-3 and -4, cited in GC Initial Brief at 24.

[169] NSST Ex. 7 (Nalepa Direct - redacted) at 8.

[170] EGS Ex. 58 (Harrington Rebuttal) at 57.

much less than the natural gas EGS purchased during that crisis. The only steps needed were:

(1) Checkout procedures, for which EGS provided no detail as to cost or time estimate; and

(2) Environmental permit changes, which an EGS witness contended did not actually inhibit EGS's ability to burn oil, given that the permit rules offer a one-year grace period to complete the permit changes after burning has begun.[171]

Fuel oil in inventory had an average cost of $2.60/MMBtu.[172]

(c) **Making an advance (forward) gas or power purchase** – EGS could have entered a firm seasonal gas supply contract for all or part of the 1995-96 winter season, but did not. Cities showed that, between July and November 1995, EGS could have bought gas at prices ranging from $1.75 to $1.90/MMBtu. Similarly, EGS could have entered a winter season firm off-system power purchase contract. Cities estimated a price of $20/MWh, equivalent to $1.90/MMBtu for gas.[173] Though such firm contracts could have prevented EGS from taking advantage of a winter price dip, as has occurred in some past Februaries, and which EGS had expected to happen in February 1996,[174] they would have provided service reliability and protection from price increases, both of which EGS badly needed in February 1996.

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[171] EGS Ex. 10 (Harrington Direct) at 46-49; NSST Ex. 3 (Entergy system fuel oil procurement policy); Tr. (Bakewell) at 352-54; Tr. (Harrington) at 672, 4031.

[172] NSST Ex. 7 (Nalepa Direct - redacted) at 10, citing EGS Ex. 1 (Application) at Schedule E-2.3, p. 1.

[173] Cities Ex. 15 (Schneider) at 11-15; Tr. (Schneider at 1339-40; Tr. (Harrington) at 3817, 3835-36; cited in Cities Initial Brief at 18.

[174] EGS Ex. 58 (Harrington Rebuttal) at 57; Tr. (Harrington) at 3853.

(d) **Increasing bidweek purchase contract volume** – Rather than increasing its monthly contracts for February during the end-of-January bidweek, EGS actually decreased the volume of such contracts. That is, because EGS expected gas prices to decrease in February, EGS contracted for less bidweek gas for February than for any other month in the reconciliation period.[175] Bidweek gas was available at $1.86 in southeastern Texas and $2.40 in southern Louisiana, according to the Houston Ship Channel and Henry Hub indices, respectively.[176]

(e) **Increasing nominations under long term contracts** – EGS had the contractual right to nominate (by January 22, 1996) far more gas for February 1996 delivery under its long term contracts than it actually did nominate.[177]

4. EGS's Imprudent Reactions Before and During the Crisis

EGS exacerbated the negative consequences of its lack of preparation by reacting inappropriately both immediately before and during the arctic outbreak. EGS could have minimized the ill effects by taking the following actions:

(a) **Obtaining and using weather forecasts more wisely** – The record is not clear as to what weather forecasts EGS actually used in the weeks and days before it paid unprecedentedly high prices for gas. Furthermore, the evidence is conflicting as to exactly when EGS reasonably should have been aware that extremely cold weather would inevitably strike its

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[175] Cities Ex. 13 (Donkin) at 22-23, cited in Cities Initial Brief at 24-25.

[176] Cities Ex. 13 (Donkin) at 32.

[177] *Id.* at 25; EGS Ex. 58 (Harrington) at 58.

service area.[178] However, the evidence does strongly suggest that, by some time on Thursday, February 1, 1996, at the very latest, EGS should have been alerted to the need to obtain more "daily" (weekend) gas before the Friday 10 a.m. nomination deadline had passed and before gas prices truly skyrocketed.[179]

(b) **Increasing purchases under bidweek contracts** – EGS bought only about 68 percent of the bidweek gas volume for which it had contracted. About 57 percent (618,000 MMBtu) of that contracted-for-but-unpurchased 32 percent was unavailable due to supply interruptions, even though those bidweek contracts were for a firm, not interruptible, supply. Those contracts would have permitted additional purchases at $1.85 for the Lewis Creek plant and at $2.45 for the Nelson and Willow Glen plants.[180]

(b) **Increasing purchases under long term contracts** – For many of its long term contracts, EGS took at or close to its nominated quantity for February 1996. As briefly discussed in the long term contract prudence section of the March 25, 1998 PFD, however, EGS's takes under the Texaco contract were well under the maximum authorized, because EGS was secondary to its affiliate operating company Entergy Louisiana, Inc. (ELI) on that contract, and because ELI took the bulk of the gas available under that contract in February 1996. As was stated in the earlier PFD, this shows that the alleged reliability of the Texaco contract has a significant limitation. In addition, EGS failed to make "re-nominations" under its two most flexible contracts, the Spindletop Gas Distribution System contract and the Pontchartrain swing contract. Though EGS alleged that such re-nominations would have been in vain because no supplies were available due to widespread interruption and

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[178] *See* EGS Reply Brief at 49-55; EGS Ex. 59 (Bostwick Rebuttal); *contrast* Cities Initial Brief at 26-29, GC Initial Brief at 27-38.

[179] *See, e.g.*, GC Reply Brief at 16.

[180] Cities Ex. 13 (Donkin) at 32.

curtailment, it provided no extraneous or documentary evidence of such.[181] In any event, it appears that the alleged added value of daily and hourly swing under these contracts had a significant limitation at a time when flexibility was most needed.[182]

(c) **Buying the lowest-priced available purchased power** – Although purchased power prices skyrocketed in early February 1996, much like gas prices, the record does not even show that EGS obtained prices within a reasonable range of what was available at the time. In particular, NSST showed that, on February 5, 1996, EGS made three power purchases from the Tennessee Valley Authority that were far in excess of typical power prices and even far above most of the power prices EGS paid on that same day. NSST thus proposed a conservative disallowance of $146, 035.[183] The ALJs find that those purchases did in fact constitute instances of imprudence, but they decline to recommend a disallowance thereon, due to a (possibly misplaced) concern that such a disallowance would be inconsistent with the February 1996 disallowance theory of Cities, which the ALJs recommend below.

(d) **Withdrawing more gas from the Spindletop storage facility** – EGS could have withdrawn significantly greater quantities from its Spindletop storage facility than it did in early February 1996. The exact amount which could have been withdrawn on particular consecutive days was the subject of considerable controversy between intervenor witnesses and EGS's attorneys. EGS's cross-examination of the intervenor witnesses, however, did not reduce the credibility of their testimony, and EGS did not produce evidence sufficient to support its view of the salt dome storage facility's temperature and pressure withdrawal constraints. EGS also contested the wisdom of withdrawing gas from Spindletop when a second, follow-up cold front was expected in February 1996; however, EGS produced no

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[181] *Id.* at 26-29; EGS Reply Brief at 42-43, citing EGS Ex. 58 (Harrington Rebuttal) at 30.

[182] *See* NSST Reply Brief at 13-14.

[183] NSST Ex. 6 (Nalepa Direct - confidential) at 14-15, Schedules KJN-14 and -15.

contemporaneous documentation to show that it had in fact relied on a second-front theory as a basis for limiting withdrawals. Furthermore, General Counsel's and other intervenor's cross-examination of EGS's non-employee weather forecaster witness, revealed that the probability of and likely magnitude of a second front was insufficient to justify the need for a withdrawal limitation as suggested by EGS.[184]

(e) **Burning more fuel oil** – Although Entergy System Dispatch had ordered all Entergy generating units capable of burning fuel oil to do so in February 1996, most of EGS's fuel-oil-burning units did not do so. EGS's Willow Glen plant burned 450,590 MMBtu of fuel oil that month, but EGS's Sabine 5 unit and Lewis Creek 1 unit did not burn any. As stated above, the Lewis Creek 1 unit was allegedly unavailable due to the need for repairs/checkout procedures and environmental permit changes; however, those rationales appear to be relatively weak excuses rather than serious impediments. As to Sabine 5, one EGS witness suggested that the reason for not burning oil was the fear of a second cold front and/or the fear of a significant interruption in gas supply, neither of which occurred. Another EGS witness suggested that the reason for not burning oil was that switching fuels can cause a generating unit to be less reliable and possibly fail. As North Star pointed out, however, the real reason for EGS's decision to burn very little fuel oil was EGS's view (in practice) of fuel oil as an emergency fuel to be used only when gas is unavailable at any price, rather than as a backup fuel to be used when gas prices exceed fuel oil prices.[185]

(f) **Managing load by interrupting interruptible service customers** – Of all the factors tending to show imprudence by EGS regarding the high gas prices it paid in early

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[184] EGS Initial Brief at 59-62; EGS Reply Brief at 39-42; General Counsel Initial Brief at 34-35, 37-38; NSST Reply Brief at 12-13; Cities Ex. 15 (Schneider) at 17-21; NSST Ex. 6 (Nalepa Direct - confidential) at 8, 11, Schedule KJN-8; General Counsel Ex. 4 (Reed Direct) at 13-16, Attachments LDR–4 and -5; EGS Ex. 58 (Harrington Rebuttal) at 29-30, Ex. WEH-9; Tr. (Bostwick) at 4111-12.

[185] EGS Initial Brief at 64, 68-70; EGS Reply Brief at 28; Cities Initial Brief at 32-33; NSST Reply Brief at 8-11; Tr. (Bakewell) at 383; Tr. (Nalepa) at 2190-98; Tr. (Harrington) at 4037; EGS Ex. 12 (Ralston Direct) at 19-20.

February 1996, the most disturbing is most likely EGS's refusal to interrupt service to its interruptible service customers for economic reasons. As Cities properly noted, if ever there were a time for EGS to interrupt service to its interruptible customers, February 1996 was that time. Nonetheless, for the time when EGS paid unprecedentedly high incremental fuel prices, EGS could not prove that it had interrupted service to any part of its 1,500 MW of interruptible load; EGS showed, at most, that a dispatcher had written a note indicating that certain (EAPS) interruptible service customers should be requested to stop taking service.[186] EGS's oxymoronic no-interruption interruptible service policy is embodied in an Entergy document expressly stating Entergy's policy of not interrupting load "to enhance System economics." As General Counsel, NSST, and Cities all observed, EGS's nonsensical (and possibly illegal, per NSST) policy does not justify allowing pass-through of unprecedentedly high gas prices to all of EGS's fuel factor customers. The ALJs do, however, agree with EGS that it (and other utilities with interruptible service tariffs) should be given at least some general guidance as to the standards for determining when interruption for economic reasons is appropriate; thus, if the Commission is inclined to allow continuation of interruptible service tariffs, the ALJs would suggest that the Commission may wish to consider a rulemaking on interruption standards.[187]

5. Confirmation of Imprudence by Comparison to Similar Utilities

The imprudence of EGS's actions before and during early February 1996 was confirmed by comparison to the gas costs of EGS's neighboring utilities Houston Lighting and Power Company (HL&P) and Central Power & Light Company (CP&L) during the same time frame. That is,

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[186] EGS was unable to show whether EAPS customers had in fact been contacted, or whether any EAPS customers had stopped taking service after such a request.

[187] EGS Initial Brief at 113; EGS Reply Brief at 43, 59-60; Cities Initial Brief at 34-37; Cities Reply Brief at 14; GC Initial Brief at 39-40;GC Reply Brief at 18-19; NSST Reply Brief at 15-16; GC Ex. 19 (Entergy Electric System Integration of Demand-Side Resources into System Operations) (no-interruption policy); P.U.C. SUBST. R. 23.24(b).

although a comparison to a neighboring utility's costs is probably an inappropriate tool for assessing a utility's prudence (assuming that the utility has produced sufficient evidence, ordinarily including contemporaneous documentation, to make a *prima facie* case for prudence), such a comparison may nonetheless be a useful tool for confirming a tentative determination. In this case, though the evidence and argument described above were sufficient to show EGS's imprudence, such finding is strengthened by the observation that HL&P paid no more than $3/MMBtu, and CP&L had five small purchases slightly over $7/MMBtu and only one other purchase over $4/MMBtu, while EGS paid up to $17.73/MMBtu during early February 1996.[188]

6. Calculation of Disallowance

Having determined that Cities, General Counsel, and NSST each proposed reasonable theories for imprudence determination and disallowance calculation, the ALJs observe that the similar results, each around $11 million, further tend to confirm the validity of their theories. Thus, although any of the three disallowance calculations would be appropriate, the ALJs recommend adoption of Cities's calculation as most appropriate because of the reasonable simplicity of the approach and because it clearly does not overlap with Cities' bidweek purchase disallowance proposal, while there is a possibility that General Counsel's and NSST's approaches might overlap and thereby constitute a double disallowance as to that overlap. Cities proposed that EGS's "swing" gas purchases during the first 12 days of February 1996 be disallowed to the extent they exceeded $3/MMBtu. The ALJs therefore recommend disallowance of $11,211,685 from eligible fuel expense.[189]

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[188] EGS Initial Brief at 63; GC Initial Brief at 38-39; NSST Reply Brief at 14-15; NSST Ex. 7 (Nalepa Direct - redacted) at 9; Cities Ex. 20 (CP&L fuel purchase report); Tr. (Nalepa) at 2083-88.

[189] Although Cities witness Mr. Schneider revised his disallowance calculation from $11,211,865 to $11,487,470 to incorporate the effect of the Louisiana boiler fuel tax, the ALJs believe that such an adjustment is inappropriate and do not recommend its inclusion. Though such an adjustment appears to be theoretically correct, the ALJs believe its use is inappropriate, given that the $3 baseline was not itself precisely determined, but is instead simply a reasonable level for comparison; to include the adjustment would suggest a degree of precision that does not truly

7. An Aside on Prudence Determinations and Disallowance Calculations

Although the ALJs are compelled to reach the above findings by Commission precedent, the they nonetheless wish to observe that, had EGS's gas purchases been evaluated on an overall basis rather than a transaction-by-transaction basis, the resulting disallowance may well have been much smaller. That is, the ALJs note that, although they propose no disallowances for EGS's gas purchases under long term contracts, they meanwhile propose disallowances totaling over $20 million for EGS's short term purchases. Such a result is hard to square with the realization that EGS's long term purchases averaged $2.187/MMBtu, while its short term purchases averaged $2.183/MMBtu for the reconciliation period. Unless credible evidence were presented to show that short term purchases should be significantly lower on average than long term purchases, the above summary of EGS's gas costs might indicate that, while EGS may have paid excessive short term prices at certain times and under certain circumstances, it nonetheless offset those errors by obtaining good bargains on gas at other times and under other circumstances. In any event, the ALJs make no recommendation based on these observations, but simply note that a possible future change from traditional fuel reconciliation prudence determinations to performance-based evaluations might achieve the goals inherent in the competitive proxy principles discussed in the Commission's Order on Rehearing in EGS's last fuel reconciliation case, Docket No. 15102.

IV. Recommended Changes to Filing Package

A. ALJs' Recommended Changes to Filing Package

As stated above in supplemental PFD § II(B)(2) regarding the overview of this fuel factor case, the ALJs were disappointed and frustrated by the general difficulty in comprehending EGS's filing and by the omission of any "big picture" presentation. In particular, the ALJs noted that there

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exist. Cities Ex. 13 (Donkin) at 32-34.

were no meaningful totals or breakdowns of eligible fuel expenses for the forecast year, few meaningful totals or breakdowns of natural gas (or coal or nuclear or fuel oil) costs for the forecast year, and insufficient references to indicate whether certain fuel expenses were reconcilable or not. In EGS's defense, the ALJs observe that the fuel factor filing package and the rate filing package do not include specific forms for Schedules FF-5.1 and I-1.1 to -1.2, respectively. Rather than request the Commission to revise its filing packages to require prescribed forms for those schedules, however, the ALJs believe it may be preferable to add another general instruction at the beginning of each filing package. Such an instruction might remind filers to (1) add summaries, breakdowns, and graphs where helpful, even if not expressly required; and (2) provide prefaces to schedules or footnotes to table entries where explanations would be helpful, such as to state certain assumptions. On the other hand, the ALJs anticipate that the Commission may regard such instructions as unnecessary reminders to use common sense. However, in another case's preliminary order, filed after the conclusion of the fuel phase hearing in this case, the Commission provided numerous examples and significant guidance on how utilities should prepare fuel reconciliation applications.[190] In any event, the ALJs strongly encourage EGS to provide a more informative calculation summary (including numbers) in its next filing.

B. OPC's Recommended Changes to Filing Package

OPC was the only party to suggest changes to the filing package. OPC's suggestions, like the ALJs' recommendations, could be considered disagreements with EGS's interpretation of the filing package.

In particular, OPC noted several omissions from various schedules that, according to OPC, resulted in much confusion and a large amount of discovery that could have been avoided by a more

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[190] *Application of Southwestern Electric Power Company for Reconciliation of Fuel Costs, Surcharge of Fuel Cost Under-Recoveries, and Related Relief*, Docket No. 17460, Preliminary Order (Aug. 22, 1997). SWEPCO filed an Executive Summary in response to this preliminary order on October 15, 1997.

complete filing.[191] Considering their own difficulties in evaluating EGS's filing, the ALJs find OPC's claim credible.

In response, EGS conceded that some of the clarifications OPC suggested might, in retrospect, have been useful addictions to EGS's filing, but, said EGS, this does not justify ordering EGS to comply with special additional requirements. The ALJs agree with EGS's reasoning, to wit: (1) that the specific issues OPC raised here may not be pertinent in future cases; and (2) that each intervenor in a case focuses on some schedules more than others, and no utility can anticipate the special interests of each possible intervenor in each filing. Although EGS opposed specific requirements for it alone, EGS neither endorsed nor opposed OPC's request that the Commission consider revision of the filing package as a possible topic for a future rulemaking in which all Texas utilities could participate.[192]

Although the ALJs' concerns are about the big picture, while OPC's focus is more on the details, the ALJs agree with OPC that a rulemaking may be useful, especially if entities such as OPC, Cities, General Counsel, and other frequent rate case intervenors participate and make their needs known. The ALJs therefore recommend that the Commission consider such a rulemaking, if the Commission anticipates that the number and nature of future fuel factor proceedings justify such a commitment of resources. In the meantime, of course, the Commission always has the option to: (1) issue preliminary orders like the one in Docket No. 17460, or (2) deny applications which do not comply with an existing filing package.

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[191] OPC's Initial Brief at 28-30.

[192] EGS's Reply Brief at 88-89.

V. Summary

In conclusion, the ALJs denied EGS's request to revise its fixed fuel factor on an interim basis. Even though no party expressly contested (at hearing or in post-hearing briefs) EGS's forecasted eligible fuel expenses or forecasted kWh sales *in toto*, Cities filed a prehearing notice of material deficiencies[193] and a post-hearing objection/motion,[194] both of which argued that EGS's filing was incomplete and deficient, while General Counsel argued in its initial post-hearing brief that EGS provided no July forecast for the Phase I interim fuel factor,[195] and, in any event, the ALJs find that EGS's application was simply deficient and did not establish that its estimated expenses are reasonable and that its estimated system and off-system sales are reasonable.[196]

As to the final fuel factor, the ALJs recommend granting EGS's application as modified below:

(1) General Counsel's nuclear fuel expense forecast (essentially adopted by EGS) is reasonable; and

(2) EGS's request for an exception to the fuel rule as to wheeling revenues and Account 565 expenses did not show good cause and should be denied.

Furthermore, the ALJs recommend denial of Cities' request for a good cause exception to the fuel rule as to MSS-1 expenses.

As to the aspects of the fuel reconciliation addressed in this supplemental PFD, the ALJs recommend:

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[193] City of Port Neches' *et al*'s Notice of Material Deficiency (Dec. 18, 1996).

[194] Cities' Objection to Additional Evidence, Request Not to Rule on EGS's Request for Interim Fuel Factors or Alternative Motion to Deny EGS's Request for Interim Fuel Factors (Dec. 8, 1997).

[195] General Counsel's Original Brief (Fuel Phase) at 3 (Aug. 8, 1997).

[196] The burden of proof is set out in P.U.C. SUBST. R. 23.23(b)(2)(D)(i).

(1) Granting EGS's request for an exception to the fuel rule as to wheeling revenues and Account 565 expenses;

(2) Denying Cities' request for a good cause exception to the fuel rule as to MSS-1 expenses; and

(3) Disallowing from eligible fuel expenses $11,211,685 in excessive natural gas expenses incurred in February 1996.

As to possible changes to the filing package instructions, the ALJs recommend that the Commission may wish to consider a rulemaking to expand and clarify the minimum requirements, if the Commission anticipates that the number and nature of future fuel factor proceedings justify such a commitment of resources.

VI. Findings of Fact and Conclusions of Law

A. Findings of Fact

Interim Fuel Factor

1. The portions of EGS's application and testimony regarding its proposed interim revision to the fixed fuel factor are not reasonably comprehensible -- *i.e.*, the lack of useful summaries, calculations, and tables made the application unnecessarily difficult to evaluate.

2. EGS failed to supplement its application so as to provide the interim fuel factor eligible fuel expense components of purchased power expenses and off-system sales revenues for the months of March-June 1998.

3. EGS's slowness in providing discovery responses aggravated the difficulty of evaluating the application.

4. EGS's proposed interim fuel factor would have been in effect for such a short period of time that its consideration and implementation would be an inappropriate use of Commission resources and could needlessly complicate later Commission determinations.

Final Fuel Factor

Nuclear Fuel Costs

5. EGS's nuclear fuel expense estimate, as modified by General Counsel, was based on ambitious operating assumptions, such as 30-day outages every 18 months and a 95% capacity factor between refueling outages, along with dollar considerations such as the level

and book value of existing inventories, financing costs, spent fuel disposal fees, decommissioning and decontamination fees, and anticipated contract and market prices associated with procurement of uranium concentrates, conversion, enrichment, and fabrication.

6. EGS's and General Counsel's nuclear fuel estimate of $30,874,211 is the most reasonable proposal, because it better indicates EGS's likely expenses than Cities' benchmark does.

Good Cause Exception for Wheeling Revenues and Account 565 Expenses

7. EGS asked to be excused from the fuel rule's P.U.C. SUBST. R. 23.23(b)(2)(B) requirement that "eligible fuel expenses" include expenses recorded in Account 565 of the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts and revenues from wheeling transactions (comprising revenues from Access Service and Company Service).

8. In the fuel reconciliation period for this case, the only items recorded by EGS in Account 565 are transmission equalization expenses paid pursuant to Service Schedule MSS-2 of the Entergy Service Agreement (ESA). Under the MSS-2 expense/revenue formula, EGS and other "short" (*i.e.*, relatively transmission-deficient) Entergy operating companies (EOCs) effectively pay into a pool from which the "long" (*i.e.*, relatively transmission-plentiful) EOCs draw; this formula is intended to equitably distribute the ownership costs of certain transmission facilities (mostly high-voltage (≥230 kV)) in the Entergy System.

9. "Access service" is transmission service provided by the Entergy System (not EGS) to wholesale customers under an open access transmission tariff filed with the FERC. Access service revenues are received at the Entergy System level and are allocated to the various Entergy operating companies in proportion to each company's load. In the fuel

reconciliation period, EGS received about $2.6 million in access service revenues on a total company basis.

10. "Company service" is transmission service provided by EGS (not the Entergy System) to several wholesale customers which have been directly connected to EGS's transmission system for many years; current customers include Cajun Electric Power Cooperative, Inc., Sam Rayburn G&T, Inc., Sam Rayburn Municipal Power Agency, Lafayette Utility System, and Louisiana Energy and Power Authority. In the fuel reconciliation period, EGS received about $33.5 million in adjusted company service revenues.

11. EGS's proposed evidence that these expenses/revenues are demand-related and are not variable does not constitute good cause, because such factors were considered or were very likely considered during the drafting of the fuel rule, and because EGS did not show how it is uniquely situated as to these considerations. Therefore EGS's proposed evidence is merely an argument for a change to the rule.

12. Because the final fuel factor will be synchronized with a change in base rates, a change in the treatment of these expenses/revenues under the fuel rule would not cause a misallocation or double dip, as would be the case under the interim fuel factor or the fuel reconciliation, as described in Finding of Fact No. 18

13. Therefore, as to the final fuel factor, EGS has not shown good cause for an exception to the fuel rule, and EGS's wheeling revenues and Account 565 expenses thus are not eligible fuel expenses.

14. The FERC has approved the relevant parts of the ESA as amended to reflect the inclusion of EGS. In Opinion No. 385, the FERC expressly accepted an amendment to the ESA which

added Gulf States to the ESA as an operating subsidiary. EGS's MSS-2 expenses are therefore mandated by the FERC.

Good Cause Exception for MSS-1 Expenses

15. Cities asked the Commission to disallow most of (if not all of) EGS's MSS-1 expenses, whether from base rates, where EGS has proposed their inclusion, or from the reconcilable fuel expenses used to calculate the fixed fuel factor, or else to grant a good cause exception to the fuel rule for EGS's MSS-1 expenses in order to eliminate the regulatory lag from timing differences between a FERC ordered revision in the System Agreement and a PUCT decision in a subsequent EGS base rate case.

16. Cities failed to show good cause to deviate from the fuel rule so as to treat MSS-1 expenses as reconcilable, because: (1) MSS-1 expenses do not include any fuel expense component; and (2) elimination of regulatory lag does not justify expanding the scope of the fuel rule to include MSS-1 expenses, because regulatory lag affects all non-reconcilable (base rate) expenses, and MSS-1 expenses have not been shown to differ from any other non-reconcilable expense so as to justify reconcilable treatment.

Calculation of the Final Fuel Factor

17. The appropriate Texas retail fixed fuel factor is $0.018015/kWh, or, as differentiated by voltage level:

Delivery Voltage	Loss Multiplier	Fuel Factor (¢/kWh)
Secondary	1.029396	1.85445
Primary	0.998516	1.79882

Delivery Voltage	Loss Multiplier	Fuel Factor (¢/kWh)
69 kV[32] / 138 kV	0.958215	1.72622
230 kV	0.946456	1.70504

Fuel Reconciliation

18. EGS showed that, during the last rate case (Docket No. 12852), its wheeling (company service) expenses were placed in base rates. To now subtract wheeling (company service and access service) revenues from the fuel factor calculation (without adding wheeling expenses) would therefore be a double dip against EGS (*i.e.*, EGS would be treated as if it had received payment from not only wheeling customers but also retail customers -- virtually double the amount of wheeling revenues it actually received) unless base rates were simultaneously adjusted to exclude wheeling expenses. That simultaneous adjustment would require the onerous, time-consuming modification of the cost-of-service studies and allocation factors from the last rate case in order to set new base rates coincident with the implementation of the Phase I interim fuel factor. Inconsistent regulatory treatment (the double dip) would be unfair, and an onerous simultaneous retroactive base rate adjustment would be unwise; this third argument therefore strongly tends to show good cause for an exception as to the fuel reconciliation.

19. Therefore, as to the fuel reconciliation, EGS has shown good cause for an exception to the fuel rule, and EGS's wheeling revenues and Account 565 expenses thus are not eligible fuel expenses.

20. Cities failed to show good cause to deviate from the fuel rule so as to treat MSS-1 expenses as reconcilable, because: (1) MSS-1 expenses do not include any fuel expense component; and (2) elimination of regulatory lag does not justify expanding the scope of the fuel rule to

include MSS-1 expenses, because regulatory lag affects all non-reconcilable (base rate) expenses, and MSS-1 expenses have not been shown to differ from any other non-reconcilable expense so as to justify reconcilable treatment.

21. EGS failed to take reasonable precautions as to a reasonably likely event – an increase in natural gas prices due to an arctic outbreak during the winter of 1995-96.

22. EGS was particularly sensitive to an unusually cold weather event, because of its heavy reliance on gas and significant scheduled outages.

23. Because of this sensitivity to gas price volatility, EGS would have been prudent to prepare for adverse weather and increased gas prices by increasing its level of gas storage, preparing units to burn fuel oil, making an advance (forward) gas or power purchase, increasing bidweek purchase contract volume, and increasing nominations under long term contracts.

24. EGS exacerbated the negative consequences of its lack of preparation by reacting inappropriately both immediately before and during the arctic outbreak. EGS could have minimized the ill effects by obtaining and using weather forecasts more wisely, increasing purchases under bidweek contracts and long term contracts, buying the lowest-priced available purchased power, withdrawing more gas from the Spindletop storage facility, burning more fuel oil, and managing load by interrupting interruptible service customers.

25. The imprudence of EGS's actions before and during early February 1996 was confirmed by comparison to the gas costs of EGS's neighboring utilities Houston Lighting and Power Company (HL&P) and Central Power & Light Company (CP&L) during the same time frame.

26. It is reasonable and appropriate to disallow EGS's swing (spot) gas purchases during the first 12 days of February 1996 to the extent they exceeded $3/MMBtu, *i.e.*, $11,211,685.

B. Conclusions of Law

Interim Fuel Factor

1. Due to its incompleteness and relative incomprehensibility, EGS's fuel factor interim revision application and testimony fail to meaningfully provide information in the format specified by the Commission's filing package, as required by P.U.C. SUBST. R. 23.23(b)(2)(C).

2. Due to its incompleteness and relative incomprehensibility, EGS's fuel factor interim revision application and testimony fail to prove that the estimated expenses, system sales, and off-system sales are reasonable, as required by P.U.C. SUBST. R. 23.23(b)(2)(D)(i)(1) and (2).

3. Because of EGS's failure to satisfy the burden of proof, as shown in Finding of Fact Nos. 1-4 and Conclusion of Law Nos. 1-2, EGS's application to revise its fixed fuel factors on an interim basis must be denied.

4. As to Finding of Fact No. 14, under *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354, 369-370, 108 S. Ct. 2428 (1988), a state utility commission must treat FERC-mandated system agreement payments as reasonably incurred operating expenses for the purpose of setting retail rates. This Supreme Court decision preempts the PUC from disallowing MSS-2 expenses in this case.

Final Fuel Factor

5. EGS's request for a good cause exception from the fuel rule's P.U.C. SUBST. R. 23.23(b)(2)(B) requirement that "eligible fuel expenses" include expenses recorded in Account 565 of the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts and revenues from wheeling transactions (comprising revenues from Access Service and Company Service) should be denied.

6. Cities request for a good cause exception to deviate from the fuel rule so as to treat MSS-1 expenses as reconcilable should be denied.

7. EGS has complied with P.U.C. SUBST. R. 23.23(b)(2)(C) by filing its application and supporting testimony in the format specified by the Commission's filing package.

8. EGS has met its burden of proof under P.U.C. SUBST. R. 23.23(b)(2)(D)(i) by establishing that its: (1) estimated expenses are reasonable; (2) estimated system and off-system sales are reasonable; and (3) proposed fuel factor are reasonably differentiated to account for line losses, and its application to revise the fuel factor therefore must be granted.

VII. Ordering Paragraph

EGS's application to revise its fuel factor, as modified above, is hereby granted. EGS shall revise its appropriate tariff schedules in accordance with Supplemental PFD Schedule KP-1.

SIGNED AT AUSTIN, TEXAS the 27th day of March 1998.

STATE OFFICE OF ADMINISTRATIVE HEARINGS

Roger Stewart

ROGER W. STEWART
ADMINISTRATIVE LAW JUDGE