

1 II. PURPOSE AND ORGANIZATION OF TESTIMONY

2 Q. ON WHAT SUBJECT HAVE YOU BEEN ASKED TO TESTIFY IN THIS
3 CASE?

4 A. EGSI asked me to review the burden of proof and guidelines for
5 consideration of affiliate costs in the context of its application to recover
6 amounts expended in transition to competition ("TTC"). As part of that
7 review, I was asked to include the statute, PUC rules, PUC precedents,
8 court rulings and the impact of the recent amendment to the affiliate cost
9 section of PURA. I was then asked to apply that review to the affiliate
10 testimony in this case and render an opinion as to whether EGSI's
11 presentation provided information of the type sufficient to satisfy the
12 Commission's existing policies and precedents regarding the
13 reasonableness and necessity of affiliate costs. Because affiliate and
14 non-affiliate costs share the requirement to meet a "reasonable and
15 necessary" test, I was also asked to review the evidence presented for the
16 non-affiliate costs.

17

18 Q. IN GENERAL, WHAT PROCESS DID YOU EMPLOY?

19 A. I first met with the attorneys who are supervising the case. Next, I met
20 with the witnesses who are presenting the affiliate costs to go over the
21 burden of proof expected of them and to discuss the various methods
22 available to meet that burden. Lastly, when near final drafts of testimony

1 were available from witnesses, I reviewed those drafts to determine
2 whether, in my opinion, the witness had met his/her burden of proof.

3

4 Q. PLEASE SUMMARIZE YOUR CONCLUSIONS

5 A. From my review of the evidence, I conclude that, using the tests for
6 affiliate costs and the tests in House Bill ("HB") 1567 to recover transition
7 to competition costs (both affiliate and non-affiliate), the evidence
8 presented by the EGSI witnesses and by outside experts shows the
9 transition costs presented in this case were both necessary and
10 reasonable. The evidence further shows the affiliate expenses were
11 incurred at actual cost and were charged to EGSI at the same rate they
12 would have been charged to another affiliate or non-affiliate. HB 1567
13 authorizes appropriate carrying costs. I conclude the carrying costs
14 requested by EGSI are required to make the Company whole for the
15 transition expenditures, mandated by statute or Commission directive,
16 over the past six plus years.

17

18 Q. HOW IS YOUR TESTIMONY ORGANIZED?

19 A. My testimony is organized much like the process I used. I first discuss the
20 statutory standards required to recover transition to competition costs.
21 Next, I focus on transition costs charged by an affiliate and discuss the
22 statutory requirements and case precedents. As part of that discussion, I
23 cover the recent change to PURA in regards to affiliate costs. Lastly, I

1 review and summarize the evidence presented by the witnesses in the
2 context of the standards for approval and present my conclusions.

3

4 Q. PLEASE SUMMARIZE THE BURDEN OF PROOF IN THIS CASE.

5 A. EGSI has to prove all the transition costs were necessary and reasonable
6 (both affiliate and non-affiliate). There is a subtlety, however. For the
7 non-affiliate costs directly incurred by EGSI, EGSI must present evidence
8 and support the costs. If the filing is complete, the opposition in a
9 contested proceeding must then present evidence on which costs they
10 contend were either not reasonable or not necessary. The Commission
11 decides the disputed costs. By contrast, for the affiliate charges incurred
12 through the Entergy Services, Inc. ("ESI"), under Section 36 of PURA,
13 those costs are presumed disallowed until EGSI makes the required
14 showing. If EGSI fails the affiliate burden of proof for a particular class of
15 affiliate costs, the Commission must then determine the reasonable level
16 of cost for that class.

17 The affiliate charges must also pass two other tests beyond
18 reasonableness and necessity. First, EGSI must show the cost was no
19 higher than the amount charged to another affiliate or non-affiliate.
20 Second, EGSI must show the expense incurred through ESI and charged
21 to EGSI reasonably approximates actual cost.

1 Q. ARE THERE ANY OTHER ELEMENTS TO THE BURDEN OF PROOF?

2 A. Yes. One of the practical challenges in an affiliate case is to document
3 and present the costs in an understandable and logical manner. This
4 challenge is increased because this transition case presents six years of
5 charges, starts and stops in design of markets and protocols, and over 50
6 contested EGSi proceedings and generic proceedings.

7

8 III. BACKGROUND ON RECOVERY OF TRANSITION TO

9 COMPETITION COSTS

10 Q. WHAT IS THE PURPOSE OF THIS CASE?

11 A. In this case, EGSi files to recover the costs the Company incurred in the
12 first attempt by EGSi, the PUC and market participants to transition the
13 EGSi service territory to retail competition. These costs were incurred
14 beginning in June 1999 with passage of Senate Bill ("SB") 7 mandating
15 retail competition for EGSi and continued, for the most part, until June
16 2004. At that time, the PUC ended this first phase of transition to
17 competition pending further developments in the wholesale market for
18 EGSi, decisions at the Federal level, and decisions concerning
19 independence of the transmission system. There were some additional
20 costs that continued to accrue after June 2004 until June 17, 2005, which
21 is the day before the legislation that authorizes EGSi to file for recovery of
22 its transition costs—HB 1567—became law.

23

1 Q. WHAT IS HB 1567?

2 A. HB 1567, passed by the 79th Texas Legislature, adds to PURA,
3 Section 39.454 entitled "Recoupment of Transition to Competition Costs."
4 Specifically, that section states as follows:

5 Sec. 39.454. RECOUPMENT OF TRANSITION TO
6 COMPETITION COSTS. An electric utility subject to this
7 subchapter is entitled to recover, as provided by this section,
8 all reasonable and necessary expenditures made or incurred
9 before the effective date of this section to comply with this
10 chapter, to the extent the costs have not otherwise been
11 recovered. The electric utility may file with the commission
12 an application for recovery that gives details of the amounts
13 spent or incurred. After notice and hearing, the commission
14 shall review the amounts and, if the amounts are found to be
15 reasonable and necessary and not otherwise previously
16 recovered, approve a transition to competition retail rate
17 rider mechanism for the recovery of the approved transition
18 to competition costs. A rate proceeding under Chapter 36 is
19 not required to implement the rider. A rate rider
20 implemented to recover approved transition to competition
21 costs shall provide for recovery of those costs over a period
22 not to exceed 15 years, with appropriate carrying costs.
23
24

25 Q. HOW DOES THE REGULATORY PROCEEDING ENVISIONED IN THIS
26 NEW SEC. 39.454 DIFFER FROM A CHAPTER 36 RATE
27 PROCEEDING?

28 A. In a typical Chapter 36 rate proceeding, the applicant prepares an historic
29 test year intended to be representative of costs on a going-forward basis.
30 Those test year costs cover the most recent four quarters and are then
31 adjusted for known and measurable changes. Even though the test year
32 costs in a Section 36 rate case proceeding represent historic costs, they
33 are intended as the surrogate for future costs and are assumed to be a

1 reasonable estimate of the amount the company would need to recover in
2 rates to be kept whole. By contrast, a Section 39.454 proceeding (as
3 created in HB 1567) is a proceeding that covers multiple historic years,
4 and which is intended to show and document the amount the Company
5 has spent to work toward a statutorily mandated objective, in this case,
6 transition to retail competition.

7

8 Q. WHAT ARE THE STANDARDS FOR APPROVING THE TRANSITION TO
9 COMPETITION COSTS AS SET OUT IN SECTION 39.454?

10 A. The basic standards are that the costs must be reasonable and
11 necessary. The statute creates an entitlement and speaks in terms of
12 recovering, "all reasonable and necessary expenditures." The statute
13 provides four additional limitations: (1) the costs must not have been
14 previously recovered, (2) the statute includes a cutoff date such that costs
15 must have been "made or incurred" before the effective date of the section
16 (the cutoff date is June 17, 2005); (3) the costs must have been made or
17 incurred to comply with "this chapter," which is Chapter 39 of PURA; and
18 (4) the carrying costs applied to recovery of the costs must be appropriate.

19

20 Q. WHAT IS THE MEANING OF THE WORD "REASONABLE" IN THIS
21 CONTEXT?

22 A. Reasonableness is a common regulatory standard. Webster dictionary
23 definitions are, "not conflicting with reason" or "not extreme or excessive."

1 Applicable law and Commission precedent has established objective ways
2 to measure whether the burden of proof has been met.

3 Reasonableness in the context of judging a multi-year collection of
4 expenditures bears close similarities to the concept of "prudence" found in
5 consideration of additions to rate base or in recovery of fuel costs.
6 Prudence adopts the standard, "What would a reasonable manager have
7 decided given the information available at the time a decision was
8 required." In the case of affiliate costs, there are objective ways or types
9 of evidence that the Commission has recognized as useful in proving up
10 reasonableness. Prudence likewise requires a contextual judgment and
11 considers what was going on and what was known or knowable at the
12 time the decision was made. The prudence standard is not perfection, but
13 is instead reasonable managerial competence. Hindsight is not part of the
14 prudence decision, just as hindsight is not part of the reasonableness
15 decision in the context of recovering transition to competition costs.

16

17 Q. WHAT IS THE STANDARD FOR "NECESSITY" IN THIS CONTEXT?

18 A. Like "reasonableness," "necessity" is also a common regulatory standard.
19 Webster definitions include: "the quality or state of being necessary," "a
20 pressure of circumstance" and "impossibility of a contrary order or
21 condition." In typical regulatory applications, necessity revolves around
22 the specific circumstances that require or lead to an expenditure. These

1 circumstances are usually driven by statute, underlying PUC rule, order or
2 directive leading to a business requirement.

3 In this transition to competition context, the requirement (and
4 necessity) for a "transition" arrived first via a statutory mandate to
5 restructure the electric industry. The Commission was, in turn, charged
6 with organizing and implementing new Chapter 39 of PURA,
7 "Restructuring of Electric Utility Industry." EGSi was covered by Chapter
8 39, and was therefore obligated to begin a transition to retail competition
9 as directed by the Commission. For example, during the 1999-2004 time
10 period, there were over 50 dockets, both generic and company specific, in
11 which EGSi participated. Therefore, "necessity" in this context revolves
12 around whether the cost was required at the time to meet a statutorily or
13 regulatorily imposed objective.

14 The standard for necessity, like reasonableness, does not involve
15 hindsight. We now have over six years of experience in transitioning
16 previously regulated markets to competitive retail markets and might do a
17 few things differently. But, necessity is to be judged in the context of what
18 was known or knowable at the time the expenditure decision was made.

1 Q. SINCE THE COSTS FOR WHICH RECOVERY IS SOUGHT INCLUDE
2 AFFILIATE CHARGES, DOES THAT AFFECT THE STANDARDS FOR
3 RECOVERY?

4 A. Yes. The means through which an applicant goes about making its case
5 is more detailed for affiliate charges. The Commission must make a
6 reasonable and necessary finding for each class of affiliate costs, for
7 which recovery is requested. Through prior precedents and in its current
8 Transmission & Distribution ("T&D") Utility Rate Filing Package, moreover,
9 the Commission has suggested various types of evidence that it considers
10 persuasive in determining the reasonableness of affiliate costs. In
11 addition, for costs incurred through affiliates, PURA has two additional
12 standards: that the affiliated charges be no higher than costs charged to
13 other affiliates, and as added by the *Rio Grande* case, that the affiliate
14 charges be provided at a level reasonably approximating actual cost.
15 Section 36.058 of PURA imposes a negative presumption on affiliate
16 costs—they are disallowed unless the PUC finds the applicants have met
17 the required tests. This same negative presumption is not imposed on
18 non-affiliate costs paid directly by EGSI.

1 Q. DOES THIS PROCEEDING FALL UNDER SECTION 36
2 "COMPUTATION OF RATES?"

3 A. No. This case arises from Chapter 39, and new Section 39.454
4 specifically states a Chapter 36 rate proceeding "is not required to
5 implement the rider."
6

7 Q. IF THIS IS NOT A CHAPTER 36 CASE, DO THE MORE STRINGENT
8 STANDARDS FOR AFFILIATE COSTS FOUND IN PURA 36.058
9 APPLY?

10 A. Technically, since this is not a Section 36 rate case, one might argue the
11 Section 36.058 standards do not apply to this case. However, I believe
12 that the same concerns that originally prompted legislation with respect to
13 affiliate costs sought in Chapter 36 rate cases are present with respect to
14 affiliate costs sought in this Section 39.454 filing, and accordingly, it is
15 reasonable to apply PURA's affiliate cost recovery standards in this case.
16 EGSi has organized and presented the evidence necessary to meet the
17 Section 36.058 standards, so answering this question is not essential to
18 the outcome in this case.
19

20 Q. ARE THERE FEDERAL AFFILIATE STANDARDS?

21 A. Yes. Because EGSi is part of a Public Utility Holding Company Act
22 ("PUHCA") jurisdictional company under Federal law, the Securities and
23 Exchange Commission ("SEC") also reviews and regulates affiliate costs.

1 The SEC review focuses largely on organization and allocation of affiliate
2 costs, and meeting the "no higher than" standard in allocations between
3 affiliates. (Note: PUHCA is repealed as of February 2006, but was in
4 effect during the time period that EGSI's TTC costs were accumulating).

5
6 IV. STATUTORY AFFILIATE TEST AND PUC PRECEDENTS

7 Q. WHAT IS THE AFFILIATE TEST IN SECTION 36 OF PURA?

8 A. Section 36.058 of PURA with amendments added this year (SB1668,
9 effective June 17, 2005) states the following with respect to the review and
10 allowance of affiliate costs:

11 Sec. 36.058. Consideration of Payment to Affiliate.

12 (a) Except as provided by Subsection (b), the regulatory
13 authority may not allow as capital cost or as expense a
14 payment to an affiliate for:

- 15 (1) the cost of a service, property, right, or other item; or
16 (2) interest expenses.

17 (b) The regulatory authority may allow a payment described by
18 Subsection (a) only to the extent that the regulatory authority finds
19 the payment is reasonable and necessary for each item or class of
20 items as determined by the commission.

21 (c) A finding under Subsection (b) must include:

- 22 (1) a specific finding of the reasonableness and necessity
23 of each item or class of items allowed; and
24 (2) a finding that the price to the electric utility is not
25 higher than the prices charged by the supplying affiliate for the
26 same item or class of items to:

- 27 (A) its other affiliates or divisions; or
28 (B) a nonaffiliated person within the same market
29 area or having the same market conditions.

30 (d) In making a finding regarding an affiliate transaction, the
31 regulatory authority shall:

- 32 (1) determine the extent to which the conditions and
33 circumstances of that transaction are reasonably comparable
34 relative to quantity, terms, date of contract, and place of delivery;
35 and

- 1 (2) allow for appropriate differences based on that
2 determination.
3 (e) This section does not require a finding to be made before
4 payments made by an electric utility to an affiliate are included in
5 the utility's charges to consumers if there is a mechanism for
6 making the charges subject to refund pending the making of the
7 finding.
8 (f) If the regulatory authority finds that an affiliate expense for
9 the test period is unreasonable, the regulatory authority shall:
10 (1) determine the reasonable level of the expense:
11 (2) include that expense in determining the electric
12 utility's cost of service.

13

14 Q. WHAT IS THE MAJOR IMPACT OF THE AMENDMENT TO SECTION
15 36.058 IN SB1668?

16 A. The amendment makes a fundamental change in the way the PUC is to
17 consider affiliate costs. Prior to this change, the negative presumption
18 concerning affiliate costs (they are presumed disallowed unless the
19 regulatory authority makes a positive finding) tended to create "all or
20 nothing" decisions regarding an affiliate cost item or class of items.
21 Following the amendment, if the Commission finds an applicant has not
22 met its burden concerning reasonableness, instead of disallowing all costs
23 in that category, the Commission must determine the reasonable level of
24 cost and include that reasonable level in the utility's cost of service. As we
25 will see later, this change may affect use of the case precedents
26 established under the previous statute.

1 Q. DOES THE COMMISSION'S RATE FILING PACKAGE CONTAIN
2 GUIDANCE IN PROVING AFFILIATE EXPENSES?

3 A. Yes, even though this is not technically a Section 36 rate case and a rate
4 filing package is not required, the Commission's rate filing package for
5 unbundled T&D companies, in Section V: *Affiliate Data*, provides a helpful
6 set of "Guiding Principles." These guiding principles provide a toolbox of
7 objective ways to demonstrate reasonableness. The third guiding
8 principle is as follows:

- 9 3. The following are examples of the types of evidence that
10 may be presented to support the utility's burden of proof
11 for the recovery of affiliate costs:
12 a. historical cost trends;
13 b. process improvement aimed at achieving efficiency;
14 c. benchmark data. It is acknowledged that benchmark
15 comparisons may not be available for all transmission
16 and/or distribution-related costs. To the extent that
17 certain relevant costs are not included in the
18 benchmark data used for comparison purposes, other
19 evidence may be provided to address those costs.
20 d. outsourcing results;
21 e. proof of customer benefit;
22 f. a showing that services are not duplicated at the
23 utility;
24 g. comparison of Test Year costs to costs that would be
25 expected if the utility were a stand-alone company;
26 cost control processes (e.g., budget, billing, audits);
27 reviews by independent third parties; operational
28 performance statistics; information regarding quality
29 of management; service performance metrics; FTE
30 statistics; and SAIDI/SAIFI data, FERC Form No. 1
31 data.
32 The items listed above are for illustrative purposes only;
33 the utility shall provide whatever information is necessary
34 to meet its burden of proof. (p. 63)
35
36

1 Q. DO PUC PRECEDENTS PROVIDE GUIDANCE WHEN PRESENTING
2 EVIDENCE ON AFFILIATE COSTS?

3 A. Yes, with some limitations. The case precedents on how the Commission
4 determines reasonableness are likely still relevant. The precedents on
5 levels of disallowance will likely need to be rethought, based on the
6 amended statute.

7

8 Q. WHAT CASES ARE RELEVANT?

9 A. Two cases in particular focus on affiliate costs. The first precedent is the
10 decision in Docket No. 14965, *Application of Central Power and Light*
11 *Company for Authority to Charge Rates*, decided by Commissioners
12 Wood, Gee, and Walsh in March 1997. The second is Docket No. 16705
13 (the last EGSI rate case that did not settle), *Application of Entergy Texas*
14 *for Approval of its Transition to Competition Plan and the Tariffs*
15 *Implementing the Plan, and for the Authority to Reconcile Fuel Costs, to*
16 *Set Revised Fuel Factors, and to Recover a Surcharge for Under-*
17 *recovered Fuel Costs*, decided by Commissioners Wood, Walsh, and
18 Curran, in October 1998.

19

1 Q. WAS THERE INFORMATIVE LANGUAGE INCLUDED IN THE ORDERS
2 FOR THE ENTERGY CASE, DOCKET NO. 16705?

3 A. Yes. The following excerpts from the Second Order on Rehearing
4 (10/14/98) discuss the burden a utility must meet in proving up its affiliate
5 costs:

6 1) "The burden of proof borne by the utility with regard to affiliate
7 expenses is a *statutory* requirement that, in its current form, has
8 been in place since at least 1983. This burden is particularly
9 heavy because the PURA expressly precludes the Commission
10 from allowing a utility to recover any payment to an affiliate
11 unless the Commission finds the payment is 'reasonable and
12 necessary for each item or class of items as determined by the
13 Commission'." (pp. 3-4, Section 1).

14 2) "Among other things, the Commission directed the parties to
15 address whether EGSi had taken advantage of all reasonable
16 opportunities to lower costs by 'outsourcing' services, or
17 otherwise acquiring services at market-based prices." (p. 5,
18 Section 2, third paragraph).

19 3) "Furthermore, independent evidence must be provided in order
20 to meet the statutory requirement to develop findings of fact
21 based on an item or class of items basis. EGSi' direct case for
22 ESI expenses in this docket includes no studies, no supporting
23 evidence of non-duplication, no comparison to alternative

- 1 providers, no evidence of costs to EGS on a stand-alone basis.”
2 (pp. 84-85, Finding of Fact 150).
- 3 4) “Because affiliate expenses represent self-dealing, testimony of
4 employees of the company or hired consultants alone about the
5 reasonableness of those expenses is not a sufficient basis of
6 proof to meet the PURA §36.058 requirements. Consequently,
7 the Commission’s responsibility to protect public interests can
8 not be achieved without inspecting underlying evidence and
9 performing some independent analysis. The Company’s direct
10 evidence should include sufficient information to accomplish this
11 review. Sufficient evidence could include a benchmarking of
12 costs found through surveys of other companies, a comparison
13 of the utility’s prior costs for the same services, and/or a
14 demonstration that customers derive a benefit from the
15 allocation of costs for services. Studies should demonstrate the
16 necessity of the expenditures, that they were appropriately
17 provided by the affiliate and not duplicated within the utility, and
18 that the costs are reasonable compared with alternative service
19 providers.” (p. 142, Conclusion of Law 26, emphasis added)
- 20 5) “It is appropriate under *Rio Grande*, other case law, and
21 Commission precedent for a utility to provide *extrinsic evidence*
22 supporting its affiliate expenses.” (p. 142, Conclusion of Law
23 27).

1 Q. WHAT POINTS FROM DOCKET NO. 16705 APPLY TO THIS
2 TRANSITION COST RECOVERY CASE?

3 A. Relating to affiliate transition costs, the precedents in Docket No. 16705
4 include the request for some sort of extrinsic evidence and the ability of
5 the decision-maker to weigh some type of independent analysis in support
6 of the affiliate costs requested. Examples given include the benchmarking
7 of costs, comparisons with budgets, a comparison of cost trends, and a
8 comparison with outsourcing services.

9
10 Q. DID THE COMMISSION DECISION IN THE CENTRAL POWER AND
11 LIGHT CASE (DOCKET NO. 14965) ALSO PROVIDE GUIDANCE?

12 A. Yes. In Docket No. 14965, the Commission included the following
13 excerpts in its Final Order dated March 31, 1997:

14 1) "When the costs of affiliate services are allocated between a
15 utility and other entities that benefited from those services, the
16 allocated amount must reasonably approximate the actual cost
17 of service to the utility. However, *direct-billed services are*
18 *preferable to allocated expenses for purposes of meeting the*
19 *PURA 95 §2.208(b) burden of proof.*" (p. 77, Conclusion of Law
20 29, emphasis added).

21 2) "Third-party bids are not needed to demonstrate that affiliate
22 charges are reasonable under PURA 95 §2.208(b). However,
23 third-party bids would provide the Commission with better

1 evidence relating to a utility's meeting the PURA 95 §2.208(b)
2 standards." (p. 77, Conclusion of Law 30).

3 3) "The United States Securities and Exchange Commission's
4 ("SEC's") regulation of a public utility holding company's service
5 subsidiary under Section 13(b) of the federal PUHCA and other
6 PUHCA provisions does not preempt the Texas Commission's
7 authority to disallow allocation of that service company's costs
8 to a utility when the utility fails to show that the allocated cost it
9 paid was necessary, reasonable, not above reasonably
10 approximate cost, and not higher than others pay the service
11 company for the same service." (p. 77, Conclusion of Law 31).

12

13 Q. WHAT POINTS FROM THE CENTRAL POWER AND LIGHT CASE ARE
14 APPLICABLE TO THE CURRENT TRANSITION DOCKET?

15 A. Third party bids (outsourcing) are not required, but are useful evidence.
16 Passing an SEC audit is not enough. Direct billing, when possible, is
17 preferable to allocation of affiliate costs.

18

19 Q. WHAT IS THE BREAKDOWN OF COSTS BETWEEN AFFILIATE AND
20 NON-AFFILIATE IN THIS TRANSITION TO COMPETITION CASE?

21 A. Directly billed affiliate costs in this case constitute a much higher
22 percentage of the transition affiliate costs than has been seen in recent
23 affiliate cases. Of the costs requested in this case, approximately 50%

1 were incurred directly by EGSI and are therefore non-affiliate. The
2 remaining 50% were incurred by EGSI's corporate support services
3 affiliate, ESI, and charged to EGSI or by its affiliated retail organization
4 ("Entergy Retail") and subsequently transferred to EGSI. Therefore, the
5 50% of costs charged to EGSI by ESI or Entergy Retail are affiliate
6 charges. Of the affiliate charges, approximately 65% were directly billed
7 to EGSI and 35% were allocated.

8
9 Q. WITH THE EXPRESSED PREFERENCE FOR AFFILIATE COSTS TO BE
10 BILLED DIRECTLY RATHER THAN ALLOCATED, WHY ARE ALL
11 AFFILIATE COSTS NOT BILLED DIRECTLY?

12 A. Service companies make sense only if they save money by providing like
13 services to multiple organizations in the same company. Regulators
14 prefer that affiliate costs be billed directly because it avoids the question of
15 whether the allocation formula selected is fair. While this case has a
16 much higher percentage of directly billed affiliate costs than has been
17 seen in recent cases, it was not feasible to bill all costs directly. A good
18 example is personnel costs. Consider the case where a tax expert,
19 information technology staff person or attorney works on a project that
20 benefits multiple affiliates. Their time is collected in a project. Because
21 multiple affiliates benefit from the project, the overall project costs are
22 allocated. A tax return or corporate-wide outsourcing are good examples.
23 It might theoretically be possible to reduce the specialist's time to an

1 hourly rate and then split the hours between affiliates on a direct bill as the
2 project went along. But, in this approach the time splitting itself still
3 requires an allocation and this effort to get to a direct bill for the project
4 elements instead of an overall project total, obscures useful management
5 information. In this case, it is more useful to collect all the expenses in a
6 project and then allocate the overall project on a reasonable basis.

7

8 V. OVERVIEW OF THE EVIDENTIARY APPROACH IN THIS CASE

9 Q. WHAT ARE THE MAJOR ELEMENTS OF PROOF PRESENTED BY
10 EGSi TO SHOW REASONABLENESS?

11 A. The elements of proof for reasonableness differ by class of cost, based on
12 the nature of the cost item. Classes contain both affiliate and non-affiliate
13 costs and the reasonableness test is met on a class of service basis.

14 EGSi first presents a vertical case where the classes total to the
15 amount requested in transition costs. This is the standard approach for an
16 affiliate case. The methods of proof are drawn from those methods
17 discussed in the rate filing package advisory section and in Commission
18 precedents. They include:

- 19 • amounts spent versus progress made and accomplishments
- 20 • amounts spent versus budgets
- 21 • cost trends over time
- 22 • specific examples of actions taken to control costs
- 23 • external reviews of process and costs

- 1 • outsourcing
- 2 • benchmarking

3 EGSI then moves to a horizontal or matrix view and collects like
4 expenses by function. This can be done for major cost elements such as
5 employee compensation and benefits, outside legal and rate case
6 consultant costs, and information technology. These functions are part of
7 multiple classes in the vertical view. Together, these three functions
8 comprise approximately 85% of the overall costs (before carrying costs).
9 Functions (versus activity classes) are often more readily benchmarked or
10 outsourced.

11

12 Q. HOW DOES EGSi ESTABLISH NECESSITY OF THE TRANSITION
13 COSTS?

14 A. Necessity is established by tying the costs to a statutory or regulatory
15 requirement. For example, interconnecting and maintaining operations
16 with ERCOT systems was a major cost driver and part of several expense
17 classes. To the extent the Commission and statute decided ERCOT
18 would be the central statewide registration agent and that ERCOT
19 systems would be used in the EGSi area, these costs became necessary.

1 Q. HOW DOES EGSi PROVE THE AFFILIATE COSTS ARE "NO HIGHER
2 THAN" AND REPRESENT A "REASONABLE APPROXIMATION" OF
3 ACTUAL COST?

4 A. In this test, SEC requirements and PURA requirements overlap. As
5 demonstrated in the accounting work papers presented by Company
6 witness Chris E. Barrilleaux and reviewed by PricewaterhouseCoopers
7 ("PwC"), affiliate billings to EGSi are charged at cost by ESI without a
8 markup, meeting the at cost requirement. Similarly, a large portion of the
9 costs transferred from Entergy Retail to EGSi represent costs directly
10 incurred at cost by the retail organization. The "no higher than"
11 requirement is met directly by the direct billed affiliate costs. For the
12 allocated affiliate costs, the "no higher than" test is met through operation
13 of a consistent allocation process. EGSi presents this proof on a class by
14 class basis for allocated affiliate costs. PwC provides an external review
15 of the allocation methods.

16

17 VI. REVIEW OF THE EVIDENCE PRESENTED BY EGSi WITNESSES

18 A. The Numbers; No Higher Than; At Cost

19 Q. HAVE YOU REVIEWED THE TESTIMONY OF COMPANY WITNESSES
20 CHRIS BARRILLEAUX AND MARK NIEHAUS?

21 A. Yes. Company witness Barrilleaux's testimony accomplishes several
22 objectives:

- 1 • The testimony provides an understanding of the presentation of the
2 numbers in the case and provides a road map so a reviewer can
3 track the costs throughout the accounting process. For example,
4 Mr. Barrilleaux provides four different basic views of the overall cost
5 data, a presentation then replicated in each of the cost witness'
6 testimony. Sort A shows the cost in each class by group
7 description (types of TTC costs) such as internal payroll and
8 benefits, external legal, external contractors, and Allowance for
9 Funds Used During Construction ("AFUDC")/Capital Overhead.
10 Sort B, shows the cost by class and then project code within the
11 class. This is the traditional sort for an affiliate case and includes
12 project summaries, project codes and allocation or billing methods
13 where applicable. Because this is a multi-year case, Sort C shows
14 the costs by class and then year. Sort D shows costs by class and
15 whether the cost is an expense or capital cost. The TTC costs are
16 presented in paper format and also electronically. The electronic
17 version provides additional sorting capabilities.
- 18 • Because the affiliate billing process is a key component of this
19 transition cost recovery request, EGSi went an extra step and
20 retained PwC to review the numbers and the billing process. This
21 testimony is presented by Company witness Mark Niehaus of PwC.
- 22 • Mr. Niehaus concludes that the affiliate billing process complies
23 with PURA requirements for affiliate costs. PURA is concerned

1 with consistent and logical allocations and that affiliate expenses
2 are provided at cost. The PwC work involved a review of the 57
3 ESI scope statements and the four associated billing methods used
4 to assign or allocate costs to EGSi.

5 • Mr. Niehaus then uses a scientific sample of specific EGSi
6 transition cost transactions to show that the billing process works in
7 practice as it was designed. In this way, he is able to testify the
8 TTC expenses were provided at a rate no higher than the rate
9 charged other affiliates for similar projects, and that affiliate
10 services are provided at costs that reasonably approximate actual
11 costs.

12

13 Q. WHAT DO YOU CONCLUDE FROM THE COMPANY WITNESSES
14 BARRILLEAUX'S AND NIEHAUS'S TESTIMONY?

15 A. Company witness Barrilleaux's testimony first meets what I earlier
16 described as the pragmatic affiliate test: can a reasonable outside
17 observer make sense of the numbers? He then goes on to provide central
18 proof (versus having each cost witness make the same case) concerning
19 the "at cost" and "no higher than" tests in PURA. Through Company
20 witness Niehaus, EGSi then took the extra step of providing an external
21 source of verification. The PwC review shows: the affiliate billing process
22 works as Mr. Barrilleaux describes it, and that the TTC costs in this case
23 meet requirements in PURA that affiliate services be provided at cost and

1 that affiliate services be provided at a price no higher than the rate
2 charged other affiliates or non-affiliates.

3

4 B. The Vertical Case: TTC Costs By Class

5 Q. PLEASE REMIND US WHAT YOU MEAN BY THE "VERTICAL CASE."

6 A. The vertical case is the traditional approach. Costs are grouped into
7 classes. Several classes are put together and then presented by a
8 witness familiar with the costs in those classes. The total of the classes
9 (summed vertically) together with items applied across the board, such as
10 carrying costs, comprise the amount requested. Classes of costs are
11 important because the Commission is required to make a specific finding
12 of reasonableness and necessity for each class. The witnesses discussed
13 below provide the proof for each class.

14

15 Q. HAVE YOU REVIEWED THE EVIDENCE PRESENTED BY COMPANY
16 WITNESS PHILLIP R. MAY?

17 A. Yes. Company witness May was the key officer of ESI managing the
18 transition to competition for the Company. The transition started with the
19 expectation that possibly all of the five Entergy regulated retail jurisdictions
20 would eventually adopt retail open access. That number evolved to Texas
21 alone. Since he was at the heart of the Texas transition for all six years,
22 Mr. May provides a detailed timeline of the activities and projects EGS
23 undertook in response to the Texas statute or Commission orders and

1 directives. This timeline provides the framework to prove necessity, and
2 that the actions and expenditures made by EGSI were in response to
3 statute or Commission directive. Each of the witnesses presenting
4 classes of costs then builds on that framework with individual proof of
5 necessity by class.

6

7 Q. DOES COMPANY WITNESS MAY DISCUSS MANAGEMENT OF THE
8 TRANSITION PROCESS?

9 A. Yes. Management of costs and outcomes is a key element in proving
10 reasonableness. Company witness May discusses the overall TTC
11 Decision Board, and the corresponding functional area Decision Boards.
12 He then describes the Decision Teams charged with implementation. He
13 notes the decision architecture changed as the transition entered new
14 phases, but that the overall hierarchy of the decision process and the
15 close involvement of senior management allowed projects to ramp up
16 when needed and to ramp down quickly when the transition encountered a
17 delay. This ability to ramp down was a key element in controlling costs.
18 Mr. May and the other class witnesses provide a number of ramp down
19 examples, as one would expect in a transition with so many starts, stops
20 and changes in direction.

1 Q. DOES COMPANY WITNESS MAY DISCUSS THE TRANSITION TO
2 COMPETITION BUDGET PROCESS?

3 A. Yes. Like project management, budgeting is a key element in controlling
4 costs and proving costs are reasonable. Company Witness May
5 describes the overall transition budget estimates and the budgeting
6 process and then explains monthly budget variance reporting. He notes
7 that quarterly transition management budget reports went to the Entergy
8 Board of Directors. Mr. May describes the work of Accenture to develop
9 overall budget targets, and explains that the budgets were primarily a tool
10 used to monitor and track costs and spending, rather than to contain costs
11 within pre-established limits.

12 Mr. May provides time series information on spending trends, and
13 compares those spending and cost trends to the activities required by
14 implementation of the Statute and Commission directive at the time. Much
15 of the work and expense is directly related to evolution of the central
16 registration and market rules being implemented through ERCOT. EGSi
17 was required to use ERCOT systems and had no choice but to stay
18 current with the latest system release as long as the retail pilot was active.
19 Because these TTC costs at EGSi span six years, the time series
20 presented by Mr. May is an important element in proving the TTC costs
21 are reasonable. Mr. May provides a time series and breakdown by cost
22 type for each of the years. He notes that during the transition, EGSi was
23 involved in over 50 Commission dockets or rulemakings, a figure that will

1 not surprise anyone who lived through the intense times from 1999 to
2 2003, required to transform the electric market. The fact that the EGSI
3 transition covered six years rather than two and a half years of the
4 ERCOT companies is directly reflected in the costs incurred.

5

6 Q. DOES COMPANY WITNESS MAY ALSO PRESENT COST CLASSES
7 AND PROVIDE EVIDENCE THAT THE EXPENSES FOR THE CLASSES
8 ARE REASONABLE AND NECESSARY?

9 A. Yes. Company witness May presents the evidence for five of the TTC
10 classes totaling approximately \$71 million of the \$164 million requested
11 (before carrying costs). To prove necessity, Mr. May ties the expenditures
12 in each class to requirements of SB 7 or Commission directive. To prove
13 reasonableness, Mr. May describes the cost and management process in
14 effect, and gives examples of actions taken to reduce costs. Mr. May
15 describes the budget process used to manage costs and provides
16 information on the time series cost trend of how the money was spent.
17 Mr. May also provides evidence related to each of the classes:

18 • Planning and Regulatory Class: many of the expenses in this
19 class involved outside legal advice and outside experts with
20 experience in competitive markets (which Entergy did not have).
21 Mr. May describes how the legal and consulting services were
22 obtained and how they were managed. Several firms had long-
23 term relationships with Entergy, and EGSI benefited from pricing

1 negotiated in the past. Outside legal expenses are supported by
2 the external review conducted by Company witness J. Kay
3 Trostle. The salary and benefit costs of ESI personnel are
4 supported by the benchmarking studies presented by Company
5 witness Richard N. Ferguson. About 55% of the costs in this
6 class are affiliate costs, but most (81%) were direct billed to
7 EGSI, as is the Commission's preference, reflected in precedent.
8 Mr. May explains the allocation methods for the remainder of the
9 affiliate costs in this class.

10 • Implementation and Management Class: work in this class, Mr.
11 May explains, concerns implementation of transition activities,
12 developed and planned in the previous class (Planning and
13 Regulatory). He describes two intertwined projects—retail open
14 access and unbundling. Most of the funds were spent with
15 outside contractors and law firms. Mr. May discusses how each
16 of the major contractors was selected and managed. Legal
17 expenses were reviewed by Ms. Trostle. The other major
18 category was ESI employees. ESI salaries and benefits were
19 benchmarked by Mr. Ferguson. In addition, Mr. May supports
20 reasonableness with information on cost trends, budget
21 management, and project management. Most of the costs (80%)
22 in this class were incurred on an affiliate basis; most (79%) were
23 direct billed rather than allocated.

- 1 • System Benefit Fund/ Renewable Energy Credits Class: this
2 class of costs includes funds paid into the System Benefit Fund
3 ("SBF") under assessment from the Texas Comptroller of Public
4 Accounts. It also includes funds paid to purchase Renewable
5 Energy Credits ("RECs"). Both expenditures were required in SB
6 7; therefore were necessary. The SBF amounts were set by
7 Comptroller; the RECs were market-based, therefore both were
8 reasonable.
- 9 • Default Service Providers Class: work in this class took place in
10 years 2000 through 2002 as the initial steps necessary to
11 establish an affiliated retail electric provider, and a provider of last
12 resort. Both were required by SB 7, and therefore necessary.
13 The work involved meeting ERCOT requirements for standard
14 electronic transactions ("SET") and for forecasting load in a retail
15 market. Most of the costs (\$8 of \$13 million) were for external
16 contractors, retained for their expertise in these two areas. Their
17 services were acquired through competitive bid, providing strong
18 evidence of reasonableness. Mr. May also discusses cost
19 management and the cost reductions implemented when retail
20 open access was postponed. Based on these factors, I conclude
21 that the costs in this class were reasonable.
- 22 • Rates/Rider Preparation Class: work in this class covers activity
23 to prepare, file, and defend the base rate case EGSi filed in

1 August 2004. Annual reports filed by EGSi indicate the Company
2 was far below its allowed rate of return. In addition, the Company
3 had incurred at least \$110 million in transition costs. The issue
4 on necessity turns on whether the Company reasonably believed
5 that it was permitted to file for rate relief under Chapter 39 and
6 the Commission's final order in Docket No. 24469. Even though
7 the Commission eventually dismissed the case, I believe the
8 Company reasonably thought it had a right to seek rate relief,
9 hence the rate class meets the necessity test. Reasonableness
10 is supported in the testimony of Ms. Trostle, who reviews those
11 rate case expenses.

12

13 Q. ARE THE FIVE CLASSES OF TTC COSTS PRESENTED BY COMPANY
14 WITNESS MAY REASONABLE AND NECESSARY?

15 A. Yes. Company witness May provides sufficient evidence to tie each of his
16 classes to PURA, SB 7 or to Commission directive, therefore establishing
17 necessity. Mr. May uses several methods to establish reasonableness,
18 depending on the nature of the costs in the class, and in my opinion,
19 meets that test.

1 Q. HAVE YOU REVIEWED THE EVIDENCE PRESENTED BY COMPANY
2 WITNESS WILLIAM T. CRADDOCK?

3 A. Yes. Company witness Craddock discusses the Customer Care System
4 ("CCS") at Entergy and the changes that were necessary to the CCS
5 system to modify it for use in a retail open access environment. He
6 discusses four projects, all of which are in a single class, the Texas
7 Distribution CCS. The first project includes the initial work to build an
8 interface between the customer care system and the market mechanics
9 system (where market participants exchange information about end-use
10 customers). The second project involved revising the CCS when the
11 standard electronic interfaces changed at ERCOT. The third project
12 involved implementing new functionality in the CCS, such as credit and
13 collections, when retail open access did not go forward as expected. The
14 fourth project also involved revisions necessary to the customer care
15 system such as bill delivery, when retail open access was postponed for
16 EGSi.

17 Mr. Craddock's primary evidence of reasonableness relates to the
18 fact these projects had strong management oversight teams and
19 processes in place. Secondly, he testifies the work was primarily
20 outsourced to contractors selected with a competitive bid process. The
21 first project, which was the interface between the CCS system and market
22 mechanics, was produced primarily by PwC, later acquired by IBM. For
23 that work, there were four other bidders. The second project, which was

1 to revise the CCS when the SET changed, was produced primarily by
2 Accenture, selected over three other proposers. The third project, which
3 was more internal changes to the CCS system, was produced by PwC,
4 SAIC (the overall outsourcing company for information systems at
5 Entergy) and internal EGSi employees. The fourth project, which was
6 revisions in the CCS system for bill delivery was produced by Truepro and
7 SAIC after a solicitation involving one other vendor.

8

9 Q. DOES COMPANY WITNESS CRADDOCK ALSO PROVIDE AN
10 ELEMENT OF THE HORIZONTAL CASE?

11 A. Yes. Company witness Craddock discusses the overall outsourcing of
12 information technology ("IT") services at Entergy. I will cover this later as
13 part of the horizontal case, but it is relevant here because Mr. Craddock's
14 projects were conducted within the context of the overall IT department.
15 Likewise, reasonableness of the EGSi internal labor expenses in these
16 four projects is supported by the benchmarks presented in the testimony
17 of Company witness Ferguson (also part of the horizontal case).

18

19 Q. ARE THE FOUR PROJECTS PRESENTED BY COMPANY WITNESS
20 CRADDOCK NECESSARY AND REASONABLE?

21 A. Yes. My review leads me to conclude his projects were necessary and
22 accomplished at reasonable costs. The dominant factors leading to this
23 conclusion of reasonableness are project management and outsourcing of

1 most of the work through competitive proposals. Necessity is linked to the
2 fact that if retail open access had gone forward the systems developed in
3 this class would have been essential.

4

5 Q. HAVE YOU REVIEWED THE TESTIMONY OF COMPANY WITNESS
6 THOMAS R. MANASCO?

7 A. Yes. The three transition to competition classes described by Company
8 witness Manasco are at the heart of the interface between EGSi, as a
9 bundled company moving to retail competition, and the electronic systems
10 established statewide through ERCOT. The first project involved the need
11 to implement a series of SET as they were designed and then revised by a
12 statewide collaborative effort operating from ERCOT. Whereas the four
13 projects discussed by Company witness Craddock allowed EGSi to
14 process customer information internally, Mr. Manasco's classes enable
15 external customer information communication and processing. Mr.
16 Manasco describes the SET process from Version 1.3, established for the
17 initial pilot project, through four major revisions. The other major effort in
18 this class described by Mr. Manasco was the process of establishing load
19 profiles and aggregating data necessary to operate in the wholesale
20 market.

21 Mr. Manasco supports the reasonableness of these expenditures
22 by describing the management and supervisory process that oversaw
23 these costs. He discusses the need to ramp up quickly as all Texas

1 companies were attempting to be ready for the initial pilot, and then the
2 need to ramp down expenses in the EGSi Texas service territory as it
3 became less certain when EGSi would move to competition. As part of
4 the ramp down, EGSi began to mitigate costs by implementing less costly
5 workarounds rather than implementing comprehensive IT solutions, as
6 long as the date for beginning competition was in doubt or moved farther
7 off into the future.

8 The primary evidence on reasonableness of costs in the Texas
9 SET and Load Profiling and Data Aggregation class relates to outsourcing.
10 For example, in the SET transaction process, IBM's "VeriTRAN"
11 clearinghouse service was procured through competitive bidding process.
12 For the load profiling and data acquisition project, the Company acquired
13 from ICF Consulting a system called Energy Vision 2000. The services of
14 SAIC were provided through competitive bid as a means to collect and
15 configure five years worth of historical load data and to load it in the
16 system. In the solicitation which produced the IBM and ICF products,
17 there were four potential bidders. IBM was selected as lowest bid and the
18 solution providing greatest functionality.

19 The work in these classes, produced internally, was accomplished
20 both by EGSi employees and by the section of ESI called Systems
21 Solutions Services Department. The Systems Solutions Services group is
22 a pool of contractors prequalified to provide support. In addition, Mr.
23 Manasco describes an effort in mid-2001 whereby EGSi and ESI

1 evaluated several unsolicited and solicited proposals from other vendors
2 (Accenture, SAIC, and IBM) in an attempt to mitigate the internal IT
3 systems integration costs, being driven by continuous changes to the SET
4 protocols.

5 Mr. Manasco shows cost and employee hour trends for the projects
6 he supports. He compares those cost trends to the costs at ERCOT as an
7 external source of comparison since the two entities were implementing
8 parallel systems. EGSi's costs increased rapidly and then declined over
9 time while ERCOT continued to increase through the 2004 time period.

10 Mr. Manasco also discusses two additional cost classes associated
11 with developing the pilot project and then operating the pilot. Developing
12 the pilot was conducted mostly through outsourcing using the same set of
13 vendors who developed the overall TTC systems. The costs in the third
14 class, associated with operating the pilot, were mostly monthly expenses.
15 Examples include the ERCOT load serving entity fee, calculated on the
16 basis of number of ESI-ID(s), and maintenance fees on software
17 packages such as the IBM "veriTRAN" system. EGSi was required to
18 maintain these fees as long as the pilot continued into mid-2004, but took
19 steps to mitigate expenses as soon as they knew continuation of the pilot
20 might be in doubt. Mr. Manasco describes these efforts to mitigate
21 expenses such as postponing scheduled enhancements and upgrades to
22 the load profiling and data aggregation systems.

23

1 Q. ARE THE THREE CLASSES PRESENTED BY COMPANY WITNESS
2 MANASCO NECESSARY AND REASONABLE?

3 A. Yes. Once the decision was made that EGSi would transition to retail
4 open access, these three classes were necessary. Company witness
5 Manasco presents strong evidence of reasonableness through
6 outsourcing, project management, cost trends, and specific efforts to
7 mitigate costs.

8

9 Q. HAVE YOU REVIEWED THE TESTIMONY OF COMPANY WITNESS
10 ANDREW E. QUICK?

11 A. Yes. Company witness Quick presents four classes and discusses the
12 costs necessary to develop information systems needed for the support of
13 a retail electric provider ("REP"). The systems built were applicable to
14 varying degrees to both the Entergy competitive REP (operating in
15 ERCOT) and the Entergy Affiliate REPs, created to serve default
16 customers in the EGSi Texas service territory. Default customers were
17 those who did not select a competitive provider, or were dropped to
18 "Provider of Last Resort" service. For that reason, Mr. Quick's testimony
19 separates the costs and seeks recovery only for the portion necessary to
20 create and operate the default provider REPs, required in SB 7. Like Mr.
21 Craddock and Mr. Manasco, some of the costs Mr. Quick presents were
22 driven by the need to implement systems designed and modified by the
23 evolving collaborative process at ERCOT.

1 Mr. Quick presents several ways to evaluate reasonableness. He
2 compares budgeted expenses with actual expenses. He discusses
3 project management and cost control. Much of the work was outsourced
4 through competitive bidding. He compares costs to benchmark data.
5 Lastly, Mr. Quick develops staffing and cost trends for outside contractors
6 who performed the lion's share of the system development work.

7 Mr. Quick discusses four classes:

- 8 • Customer Service Class: these were the costs necessary
9 for a REP to operate billing, credit, collections, and
10 customer account management. The costs in this class
11 fell in the middle of a benchmark range prepared by TMG
12 Consulting, addressing the costs of installing customer
13 information systems. The class also includes other
14 charges for outside contractors (Accenture and SAIC).
15 EGSI internal labor costs for this and all of Mr. Quick's
16 classes were benchmarked by Company witness
17 Ferguson. Mr. Quick also examines contractor labor costs
18 and staffing trends for this and all his classes.
- 19 • Load Forecasting Class: these were the costs of systems
20 needed to forecast retail customer load on an hourly basis.
21 Mr. Quick provides an external benchmark of these costs
22 by the Meta Group. He also includes contractor labor cost
23 and staffing trends.

- 1 • Trading and Risk Management Class: these were the
2 costs to acquire systems to purchase energy and to make
3 sure the right amount is available at the right time. Risk
4 management also involves price, volume, delivery and
5 credit risks. Risks are both operational and financial. The
6 software was selected through a detailed qualitative
7 evaluation of several commercially available products.
8 The Meta Group benchmark is also relevant for this class
9 and compares favorably. Again, contractor labor cost and
10 staffing trends are included.
- 11 • Retail SET Class: these are the costs for systems that
12 enable customer enrollment and switching, using the SET
13 protocols. This work was largely outsourced. The
14 IBM/Exolink solution was selected by competitive
15 procurement. Again, contractor labor cost and staffing
16 trends are examined.

17

18 Q. ARE THE FOUR CLASSES PRESENTED BY COMPANY WITNESS
19 QUICK NECESSARY AND REASONABLE?

20 A. Yes. Necessity was established when EGSi was required to create and
21 operate a default REP using ERCOT as the central registration agent.
22 Part of the question of reasonableness is the division of costs between the

1 competitive REP and the default REP. The division used by Company
2 witness Quick is conservative.

3 Overall, reasonableness is largely established through competitive
4 outsourcing. Three of the classes are favorably benchmarked from
5 external sources. Mr. Quick presents cost trends and discusses project
6 management.

7

8 Q. HAVE YOU REVIEWED THE TESTIMONY OF COMPANY WITNESS
9 KAREN M. RADOSEVICH?

10 A. Yes. The expenses supported Company witness Radosevich are largely
11 pass-through expenses required to implement the energy efficiency
12 requirements established by SB 7. Of the \$6.2 million spent over six
13 years, 87% or \$5.4 million was for incentive payments to energy efficiency
14 vendors. With the exception of the initial start-up year, EGSi was able to
15 design and operate these programs within the 10% range allowed for
16 administrative expenses by using innovative means such as collaborative
17 efforts to develop systems and standards. Final developmental
18 expenditures were about half the amount budgeted. For example, the
19 residential and small commercial standard offer program and the hard to
20 reach standard offer program were developed through a collaborative
21 effort with all covered utilities. EGSi split the cost of developing the
22 Energy Star Homes Market Transformation Program and the Air
23 Conditioning Distributor Market Transformation Program with the other

1 utilities interested in those programs. EGSi and CenterPoint Energy
2 collaborated on a study to determine the best path for using information
3 technology to administer energy efficiency programs. For those systems
4 utilized only by EGSi, Ms. Radosevich describes how EGSi competitively
5 bid those systems. Ms. Radosevich shows the cost trend over time and
6 the way cost effectiveness for achieving energy efficiency savings
7 improved over the years. Ms. Radosevich describes the fact that
8 participants in the energy efficiency programs gave high marks when
9 asked about their satisfaction with measures installed and energy
10 contractor performance.

11

12 Q. ARE THE COSTS PRESENTED BY COMPANY WITNESS
13 RADOSEVICH FOR ENERGY EFFICIENCY EXPENDITURES,
14 NECESSARY AND REASONABLE?

15 A. Yes. Necessity is clear. SB 7 requires an energy efficiency program. The
16 Commission designed the program in a rulemaking, and EGSi
17 implemented the program. EGSi found innovative ways to develop the
18 specific offers and stay in the range of the administrative allowance. The
19 program receives high marks from customers.

1 C. The Horizontal Case; Major Functions Across Classes

2 Q. PLEASE DESCRIBE WHAT YOU MEAN BY THE HORIZONTAL CASE.

3 A. It is apparent from the information provided by Company witness
4 Barrilleaux that most of the transition to competition costs can be lumped
5 into one of three buckets. Those include information technology costs,
6 compensation and benefits costs, and outside legal and consulting costs.
7 The horizontal or matrix view of these costs means moving across all
8 classes to consider like costs. EGSi then presents witnesses to provide
9 evidence on the reasonableness of these major buckets of costs, which
10 comprise approximately 85% of the overall costs (before carrying costs).

11

12 Q. AS PART OF THE HORIZONTAL CASE, HAVE YOU REVIEWED THE
13 TESTIMONY OF COMPANY WITNESS CRADDOCK CONCERNING
14 INFORMATION TECHNOLOGY COSTS?

15 A. Yes. Mr. Craddock describes the effort by Entergy and its subsidiaries
16 beginning in 1999 to outsource most of its IT costs. Entergy (through ESI)
17 was a leader in the electric utility industry in outsourcing IT operations. As
18 shown by Mr. Craddock, over 85% of all IT expenses are now outsourced
19 and competitively procured at market based prices. Based upon the initial
20 success of the outsourcing, ESI has continued to use a competitive
21 procurement process to select a limited number of additional outsource or
22 secondary providers. Most of these secondary providers are in areas of

1 specific application development and many are represented in the
2 systems built for the transition to competition.

3 As described by Mr. Craddock, part of managing this overall IT
4 outsourcing requires application of a series of benchmarks as a means to
5 maintain continuous improvement. Mr. Craddock points out that Entergy
6 received Gartner Technologies organization and process performance
7 award for 2004. Mr. Craddock describes a 2003 benchmark study which
8 puts Entergy in the top quartile for overall IT performance and cost
9 efficiency. Mr. Craddock points out that the 15% of IT costs not
10 outsourced were comprised of labor from ESI employees covered in the
11 analysis of Company witness Ferguson.

12

13 Q. LOOKING HORIZONTALLY, DO YOU BELIEVE ESI's INFORMATION
14 TECHNOLOGY COSTS ARE REASONABLE?

15 A. Yes. As shown by the industry benchmarks, ESI is clearly an industry
16 leader in IT outsourcing. IT costs comprise approximately 62% of the
17 overall TTC costs (there is some overlap with labor costs in this total).
18 The achievements described by Mr. Craddock make a strong case for
19 reasonableness.

1 Q. HAVE YOU REVIEWED THE TESTIMONY OF COMPANY WITNESS
2 RICHARD N. FERGUSON?

3 A. Yes. Company witness Ferguson provides benchmarks for labor and
4 benefit costs of ESI and Entergy Retail employees. ESI uses a number of
5 companies to benchmark their labor costs such as Towers, Perrin Energy
6 Services Industry Compensation Database, Edison Electric Institute
7 Surveys, Watson Wyatt Data Services Industry Report, Mercer Energy
8 Compensation Survey, and the Mercer Finance Accounting and Legal
9 Compensation Survey. ESI uses the goal of being within plus or minus
10 10% of the median equivalent market rate for the category of employment
11 under consideration. ESI met this goal in all six of the TTC years ranging
12 from 4.8% over to 5% under. ESI also uses a series of benchmarks to
13 measure performance of its benefits plan and other labor related
14 expenses such as paid time off policies.

15

16 Q. DO YOU BELIEVE EMPLOYEE COMPENSATION AND BENEFITS
17 COSTS AS PRESENTED BY COMPANY WITNESS FERGUSON ARE
18 REASONABLE?

19 A. Yes. Company witness Ferguson shows that ESI's compensation and
20 benefits costs compare favorably with market rates, on the basis of a
21 longstanding benchmarking program. This analysis provides a strong
22 external source of verification that employee costs, which constitute
23 approximately 15% of the TTC costs, are reasonable.

1 Q. HAVE YOU REVIEWED THE TESTIMONY OF COMPANY WITNESS
2 TROSTLE?

3 A. Yes. Company witness Trostle reviews EGS's legal fees and rate case
4 consulting expenses during the transition period, as part of the horizontal
5 view of similar categories of expenses across multiple cost classes. Legal
6 expenses were one of the major cost categories, and one of the major
7 components of participating in a transition. They comprise over 10% of
8 the TTC costs.

9

10 Q. WHAT WAS THE NATURE OF COMPANY WITNESS TROSTLE'S
11 REVIEW?

12 A. As an external expert, Company witness Trostle went through the invoices
13 submitted by each of the law firms and experts. She reports having
14 reviewed more than 5,000 pages of invoices. She requested
15 supplemental information where necessary.

16

17 Q. WHAT WAS THE STANDARD COMPANY WITNESS TROSTLE
18 REVIEWED AGAINST?

19 A. Company witness Trostle applies tests that have developed for recovery
20 of rate case expenses both through PUC precedent and court cases.
21 Specifically she determined whether: (a) the individual charges and rates
22 are reasonable (e.g., by comparison with the usual charges for similar
23 services); (b) the amount of each service is reasonable (e.g., hours billed);

1 (c) the calculation of the charges is correct; (d) there is no double-billing of
2 charges; (e) none of the charges have been recovered through
3 reimbursement for other expenses (e.g., invoices were not paid twice);
4 (f) none of the charges have been assigned to other jurisdictions; and
5 (g) any allocation of charges between jurisdictions is reasonable.
6

7 Q. WHAT WAS THE RESULT OF COMPANY WITNESS TROSTLE'S
8 REVIEW?

9 A. She finds that of the approximately \$19 million initially contemplated for
10 recovery, \$17.35 million meets the tests she employed.
11

12 Q. HOW SHOULD THE COMMISSION VIEW COMPANY WITNESS
13 TROSTLE'S REVIEW OF LEGAL AND CONSULTING EXPENSES?

14 A. Company witness Trostle is an independent expert on application of the
15 tests to recover legal and consulting expenses. She applied those tests to
16 the invoices under consideration. While these expenses are found in the
17 evidence for the cost classes presented by Company witnesses such as
18 Mr. May, the review by Ms. Trostle provides strong external verification for
19 reasonableness.
20

21 Q. ARE THE TTC LEGAL EXPENSES REASONABLE AND NECESSARY?

22 A. Yes. Necessity is established as the cost class witnesses tie the
23 expenses to statute or Commission directive. Reasonableness is

1 established by Ms. Trostle's detailed review as well as by the testimony of
2 the cost class witnesses.

3

4 D. Overall External Evaluation of the TTC Costs

5 Q. PLEASE EXPLAIN WHAT YOU MEAN BY OVERALL EXTERNAL
6 EVALUATION.

7 A. EGSi offers two witnesses who provide an overall external evaluation of
8 the transition to competition costs. The first is my testimony as embodied
9 in this document; the second is the testimony of Company witness Vikki G.
10 Cuddy.

11

12 Q. HAVE YOU REVIEWED THE TESTIMONY OF COMPANY WITNESS
13 CUDDY?

14 A. Yes. Company witness Cuddy has a unique perspective and vantage
15 point on the Texas transition to competition. She provided services to a
16 range of market participants, to ERCOT, and through ERCOT to the PUC.
17 She has worked in competitive transition efforts in other areas of the U.S.
18 and in Europe.

19 I view Ms. Cuddy's testimony much like a real estate or business
20 appraisal. As independent appraisers approach their work, they have
21 options on the method for developing an estimate of value. They can use
22 comparables of other transaction, if reasonable comparables exist. If the
23 property produces income, they can use an income method to see what

1 value the income stream would support. A third common method is
2 replacement value which essentially is the method employed Ms. Cuddy.

3 Ms. Cuddy provides a detailed analysis in the form of a cost
4 estimate she would have created as a vendor bidding on EGSI's transition
5 to competition work. She reviews comparables but finds that no one else
6 really matched the situation in Texas in the 1999-2004 time period or the
7 unique situation that EGSI was in. Her evaluation produces a useful
8 reference point of what it would cost to replicate the EGSI transition to
9 competition system. Her estimate is especially useful in evaluating overall
10 cost for outside contractors and the IT systems purchased as part of the
11 transition. Her cost estimate of \$169 million covers "cost estimates for
12 outside services, system license and maintenance agreements, and in
13 totally dedicated project personnel that would be necessary to design,
14 build, test and maintain the retail pilot." For that same set of costs, EGSI
15 is seeking to recover \$144 million.

16

17 VII. CONCLUSION

18 Q. WHAT DO YOU CONCLUDE ABOUT THE TRANSITION TO
19 COMPETITION COSTS REQUESTED BY EGSI UNDER THE
20 PROVISIONS of HB 1567?

21 A. Using the tests in HB 1567 and the affiliate cost tests contained in PURA
22 and in Commission precedent, I believe the transition to competition costs
23 requested by EGSI were both necessary and reasonable. I further

1 conclude the evidence shows the costs were charged at cost and that the
2 affiliate costs were charged to EGSi at the same price they would have
3 been charged to another Entergy affiliate or non-affiliate.

4 As is true of most affiliate situations, EGSi uses a variety of
5 Commission-accepted means to meet the reasonableness test. These
6 include time series data, project and management plans, budgets,
7 outsourcing, benchmarking, and anecdotal evidence to record project
8 improvement and cost reduction. In addition to the usual means, the
9 Company introduces two new elements with a horizontal review of major
10 cost functions comprising approximately 85% of the costs and an external
11 appraisal in the vein of what it would cost to replace the TTC systems
12 developed. Taken all together, the proof of reasonableness offered is
13 substantial.

14 I believe the evidence is especially strong that the expenditures
15 were necessary under SB 7 and Commission Rules and directives, to
16 implement the transition from a bundled utility to retail open access. The
17 somewhat tortured timeline explained by Company witness May make this
18 case. It is unfortunate that circumstances in the market did not allow the
19 transition to go forward. Given hindsight, I believe most people would
20 have postponed at an earlier time, the effort of transitioning to competition
21 in this part of Texas, but hindsight is not in question here. Those involved
22 at the Commission and the Company used their best regulatory and
23 managerial judgment, given the facts available at the time. The new

1 statute clearly entitles EGSI to recover these expenses with appropriate
2 carrying costs and reduces the impact to the consumer by amortizing
3 them over 15 years.

4

5 Q. WHAT DO YOU CONCLUDE ABOUT THE COMPANY'S REQUEST FOR
6 CARRYING COSTS?

7 A. I believe the request, as discussed by Company witnesses J. David Wright
8 and Joseph F. Domino are appropriate. The statute specifically instructs
9 the Commission to allow carrying costs in creating the rate rider for
10 transition to competition costs. The case for capital costs is
11 straightforward. AFUDC is booked on capital costs as a normal part of
12 FERC approved regulatory accounting. Carrying costs on expenses are a
13 little more unusual, but make sense in this situation. In normal utility
14 operations, expenses are recovered on a current basis through incoming
15 revenues. For rate setting, there is an analysis of necessary cash working
16 capital. If more cash is needed to fund expenses than revenues will
17 produce on a timely manner, the cash requirement is assumed to be
18 contributed by shareholders and earns a return (the opposite is true if
19 normal operations produce more cash than is needed on a timely basis,
20 in which case the extra cash is used to offset rate base). These TTC
21 expenses incurred over six years are clearly not normal operations, as
22 demonstrated by the fact they have not been recovered. The intent of HB
23 1567 was to make the Company whole for un-recovered, necessary and