3. Findings (Item 6)

Entergy Corporation has no employees; therefore, no floor space is allocated to Entergy Corporation. They do receive facility costs as one of the cost components of services rendered by Entergy Services Inc., which also included the cost of floor space occupy by those employees.

The Examination Staff believes the executive officers in managing the holding company system occupy more than 1-2% of Facilities costs.

Action Required

In summary, Entergy Corporation has no employees; therefore, no floor space is allocated to Entergy Corporation. They do receive facility costs as one of the cost components of services rendered by Entergy Services Inc., which included the cost of floor space occupied by those employees. The amounts charged to Entergy Corporation for the test period 1999, 2000 and June 30, 2001 are $409,960 or 1.32% of total facilities charges of $30,940,960; $572,358 or 2.1% of total facility charges of $27,264,693; and $159,441, respectively.

It is the Examination Staff's position that Entergy Corporation should receive fair and equitable charges for floor space. Entergy Corporation should establish by December 21, 2001, an allocation method to increase the allocable portion of the Parent company's cost for Facilities.

4. Findings (Item 7)

A total of $43,167,704 of expenses was incurred by ESI in the merger of FPL Group. Of this amount, $28,485,124 (66%) was either paid directly by ETR or allocated to ETR by ESI. The utilities were billed the following amounts:

1.	Entergy Arkansas -	$2,357,208
2.	Entergy Gulf States -	$3,665,356
3.	Entergy Louisiana -	$2,306,345
4.	Entergy Mississippi -	$1,156,451
5.	Entergy New Orleans -	$1,068,747
	Total	$10,554,107

The Chief Accounting Officer of Entergy stated that all amounts billed to utilities have either been adjusted and recorded "below the line" or have not been and will not be included in rate filings. The Examination Staff received documentation to support 2000 adjustments equal to $3,608,917.

The Examination Staff also reviewed the O&M expenses incurred by the personnel whose job it is to review mergers and acquisitions. Of the $1,685,714 incurred in 2000, (1) 75% was billed directly to non-utilities; (2) 23% or $392,763 was billed to FPL merger projects codes and (3) only 2% or $35,037 was billed to ESI.

Action Required

It is normal practice for failed mergers to be billed to the Parent Company. The Examination Staff has received documentation that supports only $3,608,917 of the $10,554,107 billed to the utilities as being recorded as an adjustment "below the line." Entergy has represented that none of the other costs will be included in rate filings.

ESI represents that the 2001 costs could be adjusted when annual earnings review filings are made with the various regulators sometime in 2001. Unless we receive some firm documentation from ESI (other than the verbal statement) that these costs will not be recovered from the customers, it is the Examination Staff's position that a reclassification and rebilling of $6,945,191 be made to the Parent Company.

5. Findings (Item 11)

The response to Data Request #10 contained a tax allocation agreement for the Entergy system (then, Middle South Utilities, Inc.), dated April 28, 1988 and four amendments of varying dates that continued the holding company's membership in the tax group as Entergy Corporation and added several subsidiaries to the group. Separately, on April 12, 2001, under cover of a letter from Entergy's Vice President and Chief Accounting Officer Nathan E. Langston, the staff received a draft copy of a proposed tax allocation agreement prepared in 1996 apparently in response to an audit finding. The staff has no record of any action being taken on the latter document

Both documents raised issues under rule 45(c) that were addressed on September 26, 2001 during the field portion of our scheduled examination of Entergy's books and records. The issues were discussed during a meeting among the SEC staff and representatives from Entergy's general accounting, tax and legal departments. In the meeting the staff presented its interpretation of the rule and applied the rule to the particular provisions of the 1996 version of the agreement. Entergy repeated it's long-held interpretation of rule 45(c) that, as applied to the holding company, no member of the consolidated group shall be allocated any tax greater in amount than the tax such member would have incurred had such member always filed its tax returns on a separate basis. Entergy believes this is a cumulative test, not an annual one. To the extent it doesn't result in a separate return tax violation for any subsidiary company, Entergy believes that this test should also apply to the holding company. Entergy believes that this interpretation is the most fair and equitable position available for this issue.

HISTORY of RULE 45(c)

The asserted exploitation of subsidiary public utility companies by their holding companies through the misallocation of consolidated tax return benefits was among the abuses examined in the investigations leading to the enactment of the Public Utility Holding Company Act of 1935 ("Act").[1] Congress abolished consolidated tax filings from 1932 until 1941.[2] The Commission adopted rule 45 (b)(6) in 1941[3] and revised the rule in 1955[4]. The 1955 revision explicitly included a *proviso* establishing a limited "separate return" policy[5] that had been implicitly recognized in a series of Commission orders issued between 1941 and 1955 granting exemptions under the 1941 rule. A common factor in all of these cases was a movement away from ratably disbursing tax benefits purely on the basis of a member's contributions to the consolidated return to an allocation methodology that reallocated specific tax benefits by making payments, or providing credits, to the subsidiary company that had contributed the benefit, and in an amount equal to the benefit.[6]

What followed was a second series of exemptive orders beginning in 1955 that lead directly to fundamental policy changes for allocating taxes that were codified in rule 45(c) in 1981. The cases showed a Commission that was entirely willing to retreat from rule 45(b)(6)'s allocation basis provisions, if the right circumstances presented

[1] Senate Doc. 92, Part 72A, 70th Congress, 1st Sess., 1930 (pp.477-482).

[2] For a discussion of this generally and as part of the findings contained in the investigative reports leading to the Act, see *Associated Gas and Electric Co.*, 5 S.E.C. 199 at 208-211 (1939).

[3] (HCAR No. 2902; July 23, 1941).

[4] (HCAR No. 12776; January 12, 1955).

[5] The rule simply mirrored tax policy for determining for tax purposes the respective earnings and profits of the constituent members of the consolidated group, which, when related to the tax liability of the parent, defined the limits on the parent's respective right to contribution from each member for the payment of the consolidated tax liability.

[6] See *New England Gas and Electric Assoc.*, (HCAR No. 12365; February 17, 1954). (While this case, in fact only lead to a clear statement of a "separate return" allocation policy in the amendment to rule 46(b)(6) in 1955, it fully anticipated in principle rules 45(c)(3), (4) and (5) by recognizing for the first time that: (1) dividends are eliminated on consolidation and, therefore, should not affect allocated tax liabilities; (2) the full, unallocated tax benefits of loss subsidiaries should be reserved or otherwise carried over; and (3) excluding tax group subsidiaries for a particular allocation purpose after including them for general consolidation and tax computation purposes, has the effect of reserving the particular tax benefit for the future benefit of the companies not included in the consolidation. However, among other weaknesses, rule 45(b)(6)'s separate return *proviso*, itself, continued as an impediment to preserving tax benefits for members who found themselves in a loss situation or who were unable to realize the full value of the tax benefits used on consolidation.)

themselves internally or externally. It permitted the inclusion or exclusion of members, for different reasons, and at different stages in the allocation process, without abandoning its "separate return" policy.

The exemptive orders highlighted the fact that rule 45(b)(6) was not broad enough to deal equitably with special circumstances generally, or with particular matters such as the effects of consolidating eliminations on actual allocations or changes in the tax code. Additionally, they illustrated the need for a mechanism to preserve tax benefits for loss subsidiaries. Five orders between 1955 and 1962 allowed holding companies to amend their tax allocation agreements such that their subsidiaries might realize the full benefit of capital gain expenses, favorable depreciation rules, foreign credits and net operating losses.[7]

Fifteen orders, beginning with the passage of an investment tax credit in 1962, granted amendments to various tax allocation agreements to accommodate the unique problem of allocating tax credits, which by their nature are not a function of income, on systems that had adopted the source-of-income method of tax allocation. Some amendments allowed for a direct reallocation of the credit to the company producing the credit to the extent that it was used on consolidation or, alternatively, a reallocation to other system companies, if the generating company did not have sufficient income to absorb the credit.[8] Middle South Utilities, Inc. addressed the problem by introducing the concept of accruing the investment tax credit as a deferred credit on the books of its service company, which could be expected to be in a position of making qualifying investments for the system. The credits were amortized over the life of the investment property and the company that generated the original tax credit received a corresponding reduction in its service charges.

The final line of exemptive cases leading up to the Commission's adoption of rule 45(c), involved subsidiaries of registered holding companies that had incurred large net operating losses for a variety of reasons.[9] *General Public Utilities, Inc.* ("GPU"),[10] the final case in the line, fully anticipated most aspects of rule 45(c), including, in particular, rule 45(c)(5). But importantly for purposes of addressing the central issue involved in

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[7] See e.g., *Georgia Power Company*, (HCAR No. 13876; December 4, 1958).

[8] See e.g., *Ohio Edison Co.*, (HCAR No. 14850; April 16, 1963) and *Central and South West Corp.*, (HCAR No. 14863; May 1, 1963).

[9] See e.g. *Columbia Gas System*, (HCAR No. 19393; February 18, 1976) (loss occasioned by subsidiary's investments in oil and gas exploration business following the 1972 oil embargo, which required large initial outlays of capital that resulted in tax deductions and credits exceeding income); *Middle South Utilities, Inc.*, (HCAR No. 18807; February 11, 1975) (subsidiary net operating losses caused by cost overruns in connection with the construction of a nuclear generating facility).

[10] (HCAR No. 21358; December 26, 1979).

this finding, it should be noted that the Commission expressly excluded the holding company from the group of tax group members that confronted NOLs. The parent, therefore, would not benefit from the tax allocation remedy sought by GPU under rule 45(a).

GPU's unique facts and the novel remedy provided by the Commission illustrated rule 46(b)(6)'s shortcomings as a general rule and the remedy represented the final stage of development of a complete tax allocation policy, codified shortly after this order in rule 45(c).

GPU had suffered a catastrophic nuclear accident at its Three Mile Island plant on March 29, 1979. The plant's owners, GPU utility subsidiaries Metropolitan-Edison Company ("Met-Ed") and Jersey Central Power & Light Company ("JCP&L"), had net operating losses ("NOLs") for 1979 on an individual company basis and NOL carrybacks to 1976. By contrast, GPU's third utility subsidiary, Pennsylvania Electric Company ("Penelec"), had taxable income that would displace the Met-Ed and JCP&L NOLs for 1979 and generate NOL carrybacks to 1976, but in the process would displace an investment tax credit taken on the 1978 consolidated return, which had already been carried back to 1976. However, it also appeared that Penelec, on an individual company basis, could use its own investment tax credit for 1976, after giving effect to the carry back, even though it was not available for use on the consolidated return for the same period.

The Commission authorized GPU to amend its tax allocation agreement to provide that companies not having NOLs, to pay to loss companies, other than the parent company, an amount equal to the tax reduction which it received as a result of the net operating losses of other subsidiary companies. The Commission determined that the payment would be computed on the basis of the tax reduction realized, after giving effect to investment tax credits, which the paying company could have used on a separate return basis, but for the NOLs of other companies in the group. However, no company would pay more than its separate return liability as if it had always filed separate returns.

The importance of the Commission blending operating losses and tax credits that did not necessarily relate to current income to fashion an allocation remedy for GPU cannot be overemphasized. By allowing the use of investment tax credits for allocation purposes, even though they could not be used on consolidation, the Commission made clear that it was establishing tax allocation policy unconstrained by the Code.

In sum, by 1979 the Commission had developed a complete, flexible and sophisticated tax allocation policy. The term "separate return" went from a simple limitation on tax contributions to a rule requiring to the fullest extent possible the reallocation of specific tax benefits and credits, retroactively, prospectively or currently, back to the company that generated them, except for the holding company.[11]

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[11] In its 1980 notice of rulemaking release (HCAR No. 21767; October 29, 1980), the Commission observed that the corporate relationships required by the Act assures that holding company expenses will always create a consolidated tax savings, because section 13(a) precludes

OPERATION of RULE 45(c)

Section 1501 of the Code permitted affiliated economic groups to file consolidated federal income returns. When filing on a consolidated basis, the parent company files a single return on behalf of the group computing the tax liability on the cumulated revenues, deductions and credits of all members of the group, including the parent. The Code imposes liability on each member of the tax group for the entire consolidated tax.[12] Consequently, the filing of a consolidated return under a tax allocation agreement by registered holding companies has always been treated as an indemnification agreement subject to the requirements of section 12(b) of the Act and rule 45. The Code is silent in respect to the allocation of consolidated tax obligations, which for registered holding companies is governed by rule 45(c).

Section 12(b) of the Act and rule 45(a) prohibit registered holding companies and their subsidiaries from indemnifying one another, without first obtaining Commission approval. Provided that the conditions of rule 45(c) are met, associate companies in a registered holding company system are excepted from rule 45(a)'s filing requirement regarding consolidated tax returns, which are, as noted, indemnification agreements among the tax group members.

Rule 45(c) provides methods for allocating tax obligations among tax group members. The principles of rule 45(c) are premised on the Code, but have been adopted separately by the Commission as its own policy. Rule 45(c)(2) requires a written agreement electing to apportion the consolidated tax among the members in proportion to the taxable income or separate return tax of each member, provided that the no member is obligated to pay an amount in excess of its own separate return tax obligation. Rule 45(c)(3) has two requirements. First, allocation methodology must direct to individual members the effects of any current features of the tax law that applies, whether or not they are a function of income, and including, carry back and carryover provisions.[13]

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the passage of the expenses to the subsidiaries. The Commission went on to say that the "exclusion in our earlier rule of the holding company from sharing in consolidated return savings was intentional and will continue."

[12] See *Associated Gas and Electric Co*., Fn. 2, above.

[13] 45(c)(3) in terms applies to associate companies, which means that the parent company calculates its separate return on the same basis as other members. Therefore, at this level its return includes all deductions and credits to which it would be entitled, if it were a stand-alone company. But for the parent, the separate return calculation serves only as a limitation on its actual tax liability. It does not thereafter measure a duty to pay, or a right to receive a credit, for its proportional share of the cash value of the consolidated tax benefits. Beyond any possible effects caused by the Code, Rule 45(c)(3) also treats the effects of states tax laws on separate return liabilities, including the effect of not permitting consolidated state income taxes. To the extent that these circumstance results

Second, the effects of intercompany transactions on corporate taxable income must be eliminated.[14]

A separate feature of the rule allows agreements that provide for the exclusion of loss companies under rule 45(c)(4) from a current allocation of related tax benefits in return for carryover rights or their inclusion under rule 45(c)(5) accompanied by a right to receive cash in the amount of the tax benefit each contributes on consolidation, provided, the parent is excluded from this process. Together these rules require associate companies with a positive allocation to pay the allocated amount and loss subsidiary companies to receive current payment or carryover rights for the tax benefits that each contributed to the consolidated tax calculation. Under both rules, the parent company is excluded from the right to carryover rights or payments, because by definition they are not subsidiary companies. Therefore, rule 45(c) has the effect of requiring holding companies to pay their share of the consolidated tax liability, but excludes them from sharing in the tax benefits of any losses they may have generated on a stand-alone basis.

Action Required

Application of Rule 45(c) to the 1996 Provisions of the Draft Entergy Tax Allocation Agreement[15]

1. **Item 1. Delete here, and elsewhere in the agreement, any reference to particular provisions of the Code. Rule 45(c)(3) treats generically the particular features of the Code as they apply currently to each member of the tax group. Setting out a particular provision unnecessarily introduces ambiguity into the agreement. See Adopting Release (HCAR No. 21968; March 18, 1981). (The Commission notes "Rule 45(c) does not specify kinds of tax benefits. These change as tax laws and regulations are revised." It goes on to say that an important function of the tax agreement required by the rule, is to "identify currently the material elements of allocation in terms of the applicable tax law.")**

2. **Item 2. This Item should be restated in its entirety. The first sentence should read that the "consolidated tax shall be allocated among the several members of the group in proportion to the corporate taxable**

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in inequities, the rule provides for a remedial procedure under rule 45(a). See Adopting Release (HCAR No. 21968; March 18, 1981) and Fn. 15., above.

[14] Holding Co. Act Release Nos. 21767 and 21968 (October 29, 1980 and March 18, 1981) (Proposing and Adopting Releases for rule 45(c).

[15] Note that this version of the agreement was never executed and, therefore, has no legal significance.

income of each member." A second sentence should provide for adjustments to the rule 45(c)(2)(i) allocation election to accommodate intercompany transactions excluded on consolidation. A third sentence should provide for adjustments to the rule 45(c)(2)(ii) allocation to the extent that the consolidated tax and separate return tax for any year include material items taxed at different rates or involving other special benefits or limitations. State that "these adjustments will be directed to allocating to the individual members of the group the material effects of any particular features of the tax law applicable to them." Exclude the last sentence.

3. **Items 2., 3., 4. and 5., taken together, misinterpret the rule and should be deleted and restated in their entirety. Item 5. is expressly prohibited. Assuming that one has complied with the rule through rule 45(c)(3), each member at that point knows its separate return tax, including the parent company. Thereafter, the agreement must provide for the actual allocation of the consolidated tax liability. This requires a stated election between the method provided in 45(c)(4) or (c)(5). Because Entergy has elected rule 45(c)(5), the agreement should state that for allocation purposes "all members with a positive allocation will pay the amount allocated and those with a negative allocation, except the parent company, will receive current payment of their corporate tax credits." Further, the agreement must provide "a method for apportioning payments and for carrying over uncompensated benefits."**

4. **Delete Items 6 through 20. The separate treatment of particular tax provisions is unnecessary.**

5. **Item 21 should be restated to reflect the requirement contained in the last sentence of rule 45(c)(1)'s definition of corporate taxable income.**

The Examination Staff also reviewed the detailed work papers for 1998, 1999 and 2000. In addition, the Examination Staff requested and reviewed the detailed work papers for the years 1989 through 1997 since an outstanding Rule 45 (c) compliance finding had not been closed from the last examination in 1995.

Therefore the following summary of income, (loss) is open to resolution in this examination:

1989 - $26, 715,426
1990 - 32,827,657
1991 - 11,782,196
1992 - (35,004,798)
1993 - (8,366,171)
1994 - (12,962,787)

1995 -	(17,120,847)
1996 -	(53,321,364)
1997 -	(58,630,983)
1998 -	(65,927,700)
1999 -	9,709,199
2000 -	(66,586,432) est.

Action Required

The Examination Staff believes that ETR is not in compliance with Rule 45(c)(4) of the Act since ETR is by definition an "associate company" and not a "subsidiary" company and therefore not entitled to utilize net operating losses. Under the Act, ETR is liable for it's own separate return liability.

For the years 1989, 1990, 1991 and 1999 ETR had taxable income of $81,034,478 resulting in a tax liability. ETR did not pay this liability but in fact recouped prior year net operating losses from the subsidiaries to offset this liability. ETR should reimburse the subsidiaries the dollar amounts in the same ratios that were paid in the years referenced. Evidence of this reimbursement is to be provided to the Examination Staff no later than thirty days after the payment adjustment to the subsidiaries.

If ETR wants to file an application with the Commission in support of its interpretation of Rule 45(c) and ask for a change in the allocation on a prospective basis (beginning for future tax years if the Commission approves the request), then it should do so as soon as possible.

6. Findings (Item 14)

Entergy submitted these service agreements for the following entities and Entergy Services, Inc. (ESI) pursuant to the request for Item 14:

Entergy Corporation	(ETR)
Entergy Enterprises, Inc.	(EEI)*
System Fuels, Inc.	(SFI)
Entergy Arkansas, Inc.	(EAI)
Entergy Louisiana, Inc.	(ELI)
Entergy Power, Inc.	(EPI)*
Entergy Gulf States, Inc.	(EGSI)**
Entergy Operations, Inc.	(EOI)***
Entergy Mississippi, Inc.	(EMI)
Entergy New Orleans, Inc.	(ENOI)

* The Service Agreement was completely amended in 1999 when Entergy reached an agreement to charge a 5% surcharge with the state regulators. *See also* Item 23 and File No. 70-8529, HCAR 27040. The language was modified in a complete revision of the agreement to allow the entity to "request" services.

** This agreement was originated in 1993, but is similar to the language used above (*) which included, "request services" rather than "as required services" in the revised agreements of 1999 as noted above.

*** This agreement was originated in 1990, but is similar to the language used above (*) which included, "request services" rather than "as required services" in the revised agreements of 1999 as noted above.

The entities listed above with the following designations (*), (**), (***) have language that states upon receipt of a request or at the entity's request for services, ESI agrees to provide services. All other entities, which are predominantly operating companies include this language, "Client Company <u>agrees to take</u> from Services [ESI] such of the services described in Exhibit I <u>as are required</u> from time to time by the Client Company. Client Company further agrees to take from Services such other general or special services, whether or not described in Exhibit I and whether or not contemplated, as Client Company may from time to time require and Services shall conclude it is competent to perform [emphasis added]." Entities with the quoted language in effect are required to take services from ESI any time they need services; whereas entities with the language that allows for a request to be submitted allows for more choice as to when services will be taken from ESI. The operating companies have more restrictive language in their agreements and are required to take services from ESI. Entities with the language that allows for the request to be made as it determines the need for services are predominantly nonutilities or entities that serve nonutilities with the exception of EGSI. Therefore, the companies with the "required" language, rather than the nonutilities with the "requested" language are obligated to take services from ESI and are responsible for maintaining ESI's operation. Then in effect, these companies with the "required" language are more responsible for maintaining the "economies of scale" and also are apportioned more costs because they are required to take services from ESI.

Also, the ability to amend work orders is more lenient for entities with the "requested" rather than "required" language in the agreements. For example the EEI and ESI agreement has the following language:

> "EEI shall have the right from time to time to amend, alter or rescind any work order, provided that (i) any such amendment or alteration which results in a material change in the scope of the work to be performed or equipment to be provided is agreed to by Service Company [ESI], (ii) the costs for the Services covered by the work order will include any expense incurred by Service Company as a direct result of such amendment, alteration or rescission of the work order, and (iii) no amendment, alteration or rescission of a work order will release EEI from liability for all such costs already incurred or contracted for by Service

Company pursuant to the work order, regardless of whether the work associated with such costs has been completed."

The "requested" language allows for an individual work order or service to be amended. Service Agreements with the "required" language can be terminated with written notice of 60 days. It appears the whole agreement would need to be terminated and "pick and choose" for particular services is not available under the same terms as if the entity had the service agreement with the "requested" language.

Whether the agreements had the "requested" or "required" language, all agreements were originated more than three years ago, but included frequent amendments for the billing methods and allocations section referenced in the agreements as Exhibit II.

Unless specifically noted above the qualities reviewed were sufficiently represented in the agreements.

Action Required

The Examination Staff recommends that service agreements with ESI need to be updated and revised to more equally allow for entities to pick and choose individual services. The service agreement should state that each company should have the ability to request services and only be obligated to take services from ESI upon submission of a request.

7. Findings (Item 15)

ESI provided the Examination Staff with the Entergy system Accounting Policies Manual ("Manual"). The Manual is very extensive and thorough. In summary, it covers the following items: Affiliate Transactions; Allowance For Bad Debts, Allowance for Funds Used in Construction; Approval Authority; Asset Impairment; Depreciation and Amortization; Insurance Risk Management; Lease versus Buy; Record Retention; Donations; Travel and Entertainment Expenses; Capital and Operating Leases; Reimbursement of Business Expenses; Dividend Policies and Accounts Payable and Receivable.

The Manual also included a section on IntraSystem Affiliate Billings. ESI uses project codes to budget and charge actual expenditures. They are used to accumulate ESI costs on a job, project, or functional basis for purposes of billing costs to the appropriate associate company. The Manual also contained a separate section on Budget Preparation.

The review of a registrant's Policies and Procedures Manual will also included an examination of the effects of Commission orders approving applications by Entergy that, directly or indirectly, touch on accounting issues.

By order dated June 22, 1999 (HCAR No. 27040) ("Order"), the Commission authorized Entergy and several of its subsidiaries to enter into settlement agreements ("Agreements") with certain of its retail rate regulators designed to protect system ratepayers from potential adverse effects of non-utility diversification. The Agreements provided that: (1) Entergy's nonutility associate companies, as defined would pay its regulated utilities as defined, for certain operating and maintenance services rendered at their fully-allocated cost, plus 5%; (2) transfers of generating, fuel and fuel-related assets and certain market and technological data from utility subsidiaries to Entergy and/or non-utility associate companies would be at market based prices; (3) products developed by Entergy's utilities, but marketed by its non-utility associates, would be subject to a profit-sharing formula; (4) royalty payments may be payable to utility subsidiaries by nonutility companies to acquire product, patent and other intellectual property rights; and (5) state commissions may require competitive pricing for procurements bearing a cost in excess of $100,000.

The Order specifically authorized Item (1) in the Agreements. Regarding Items (2) through (5), the Commission stated that it did not object in principle to the pricing provisions. However, the Commission interpreted the Agreements to possibly require prior Commission approval of those transactions on a case-by-case basis to the extent required by Sections 12 and 13 of the Act.

In Part I, Policy Summary, of the Policy and Procedures Manual, under Part II. Policy Details, it states that the Commission authorized the pricing methodologies contained in Items (1) through (4). It goes on to say that state regulated prices for the sale or transfer of goods or services will be considered market prices and recoverable in rates. Except in regard to Item I., this policy pronouncement may misinterpret Entergy's authority under the Order.

Deviations from the Act's cost standard are within the exclusive jurisdiction of the Commission. The Order refers to the states' interest in pricing policy overall and recognizes that it may be persuasive as the Commission considers whether the Agreements' goals and policies justify an exception to the section 13(b) cost standard.

Action Required

The Examination Staff requests an analysis of all transactions since the June 22, 1999 Order that falls into the Items (1) through (4) category. Please also confirm if a specific declaration was made to the Commission on any of the transactions.

8. Findings (Item 20)

Internal Audit plans that are performed at regular intervals (every three years) in areas such as financial, information technology, human resources, etc. The financial audit plan contains an audit of Entergy Services" processes for allocating and billing its charges for services. The next audit on allocations and billings is scheduled for the

October/November 2002 time frame. The planning process for this will begin after the first of the year.

Action Required

The Examination Staff would like a copy of the audit scope for the billing and allocation audit planned for 2002 once it is ready. In addition, a copy of the final audit report should be forwarded to the Examination Staff.

9. Findings (Item 22)

Entergy does not have a regularly scheduled benchmarking process to compare its costs of services with outside vendors or other service companies. The company believes that initiating a regularly scheduled benchmarking process would be unduly burdensome and not cost effective. The time and expense that would be required for this analysis would be considerable. Based on the structure of the Entergy system, and other utility service companies, it would be difficult to compile the "total" costs associated with a produce across all functions that would be comparable to another service company's data. Entergy also questions how willing competitors will be to share sensitive "unit costs" for certain services with other service companies, especially as many of the utilities are moving to a competitive environment in their operational jurisdictions.

However, Entergy does on occasion perform benchmarking studies. Entergy has performed or contracted for the following benchmarking studies: Entergy Corporation Planning and Performance Measurements benchmarks, Information Technology Pricing Analysis, and Entergy Corporation Information Technology Overview Analysis. These studies were not intended to be used as a basis for comparing the quality and cost of services that could be obtained from an outside vendor. Instead, these benchmarking studies were used by management to determine the effectiveness and efficiency of their business processes.

The primary objectives of "Entergy Corporation" Information Technology Overview Analysis" were to assess cost efficiencies in comparison with organizations of similar complexity and workload volumes, to establish an external benchmark for IT Services, and to assist in contract negotiations for outsourcing services.

Action Required

Entergy should establish a formalized benchmarking program for the major services of ESI: legal, information services, and investor relations. A benchmarking program should be submitted to the Examination Staff by July 1, 2002.

10. Findings (Item 27)

The Examination Staff reviewed the ESI time reporting procedures. They appeared to be reasonable. In addition, the Staff reviewed the time sheets for December 1999, October 2000 and February 2001 for the following officers of Entergy Corporation and ESI: J. Wayne Leonard, Chief Executive Officer; Donald C. Hintz, President and Chief Operating Officer; John Wilder, Executive Vice President and Chief Financial Officer; Michael G. Thompson, Executive Vice President and General Counsel; Frank F. Gallaher, Senior Vice President, Generation, Transmission and Energy Management, and Steve McNeal, Vice President and Treasurer. We looked at the percentages of time charged to the Parent company, utility companies and non-utility companies.

The Staff was impressed with the timesheets from the standpoint that several codes were used by most officers to charge their time; so at least there was the appearance of a thought process on charging the appropriate parties. Overall, for these particular officers, for the three-month period, the amounts charged directly and indirectly to the Parent varied between 1% and 23%. The two top officers of the Entergy System, Wayne Leonard and Donald Hintz were among the lowest at 2.1% and 1.5% respectively. On the other hand, when combining the amounts charged to the Parent Company and the non-utility companies combined, the percentages appeared more fair and reasonable. The averages in this case varied from 35% to 86%.

The Staff believes the executives of the Holding company are responsible for the management of the holding company structure and therefore an appropriate amount of their time should be allocated to the Parent.

Action Required

It is the Examination Staff's position that a fair and reasonable amount of the time of Entergy's top two executives (Leonard and Hintz) should be charged to the Parent Company. Entergy is to provide an appropriate allocation method and evidence of how the new allocation procedure was implemented.

11. Findings (Item 30)

The Examination Staff reviewed the listing provided by ESI enumerating the country club and social club dues paid for each employee. From this report, the Examination Staff selected twenty vendors/employees for review of expense statements to determine if expenditures (dues and business expenses) were fairly and equitably allocated to all associate companies. For the most part, dues and business expenses were fairly and equitably allocated. However, certain expenses of common parent and service company officers were allocated based on a Total Asset method. Under this method, approximately 2% of the costs were allocated to ETR.

The Examination Staff reviewed the allocation methods selected to spread sporting event expenses. Of the total $566,146 incurred for the period January 1, 1999 through June 30, 2001, ETR was allocated $276,924 or 49%.

Action Required

The Examination Staff believes that the Total Asset method used to allocate costs incurred by common parent and service company officers does not result in a fair and equitable allocation of costs to ETR. It is the Examination Staff's position that by December 21, 2001, Entergy should suggest an appropriate allocation methodology.

12. Findings (Item 33)

The Examination Staff reviewed the detailed reports provided by ESI. The reports were provided in the format requested. The purpose of the examination request is to have a high level summary report of the amounts and allocation method that is billed by project code to each associate company.

The Examination Staff selected the following project codes for additional review:

		2000	1999
1.	C31251 - Entergy Awards, billing method #Employees.	635,352	84,652
2.	C31255 - Operations Office of the CEO, Total Assets.	3,617,438	1,652,855
3.	CPM001 - Corporate Performance Management, Total Assets.	437,539	
4.	E14845 - Expenses of the Vice-Chairman, Total Assets.	119,797	712,582
5.	F20990 - Operations SR VP & CFO, Total Assets.	1,389,929	
6.	ZUBENQ - Non-Qualified Post-Retirement Plans, ESI Labor	3,574,657	
7.	ZZ4040 - Teamshare Incentive Compensation, ESI Labor	12,710,858	14,797,447
8.	ZZ4045 - Executive L/T Incentive Compensation, ESI Labor	13,659,000	756,998
9.	ZZ4080 - Equity Awards, ESI Labor	1,534,793	
10.	FSPVP1 - VP Strategic Planning	332,770	
11.	ZZ4090 - Restricted Stock Awards	265,900	715,770
12.	F05700 - Corporate Planning & Analysis	1,029,384	1,121,448
13.	FF1003 - Board Support	260,690	
14.	FI0445 - Entergy Consolidated Tax Services	1,288,162	
15.	FI0410 - Entergy Consolidated Tax Services		1,827,704
15.	C31253 - Employee Recognition Events	800,223	488,622
16.	C08500 - ETR President & COO - Domestic		1,103,396
	Total	41,656,492	23,261,474

The Examination Staff has established that certain departments within a service company are considered corporate governance. The Parent company is responsible for the overall direction and oversight of the Entergy System. From the list above, those corporate governance departments would include: C31255-Operations Office of the CEO, CPM001-Corporate Performance Management, E14845-Expenses of the Vice Chairman, F20990-Operations Senior VP and CFO, FSPVPI-VP Strategic Planning, F05700-

Corporate Planning and Analysis, FF1003-Board Support, FI0445-Entergy Consolidated Tax Services, C08500-ETR President and COO-Domestic.

Certain award and recognition programs listed above: C31251-Entergy Awards, C31253-Employee Recognition Events, ZZ4040-Teamshare Incentive Compensation (includes teamshare incentive plan, management incentive plan, and executive incentive plan), and ZZ4080-Equity Awards all include the Parent Company officers. These costs are allocated on ESI labor and/or number of employees. The Parent Company should be allocated a fair and equitable portion of these charges since Parent Company officers are responsible for the management and oversight of the holding company structure.

Executive Long-Term Incentive Compensation (ZZ4045) and Restricted Stock Awards (ZZ4090) would be restricted to executive officers in the System, which would include the Parent Company officers. Therefore a fair and equitable portion of these costs should be charged to ETR.

Action Required

Section 13(b) of the Act requires a fair allocation of costs amongst the holding company system. It is the Examination Staff's opinion that ESI is not allocating a fair and equitable amount of certain costs to the Parent Company. It is the Examination Staff's position that ESI should use a method of allocation that will recognize the value of service earned by the Parent company from the service being rendered.

13. Findings (Item 42)

The Examination Staff reviewed the documents, (1) Corporate Expense report, (2) Entergy Services, Inc., Billing Methods report, which shows the billing method, title, description, effective date, end date, and the percentage allocated to the legal entities, (3) Entergy Services, Inc., Billable Projects report September 24, 2001, which shows the project code, description, billing method and Internal Products and Services (IPS) code, (4) Draft Entergy Services, Inc., Internal Products and Services (IPS) Catalog, for the years 2001 and 2002 budget, with a description of the products and services provided.

Examination Staff selected approximately 19 items (with the largest amount) from the Corporate Expense report, which included the resources: (1) Dues-Industry and Professional-1999, (2) Relocation Allowance-1999, (3) Misc. Relocation Expense-Taxable-2000, (4) and Ind. Assoc. Dues/Corp. Membership-1999 and 2000. The items reviewed for fair and equitable allocation, based on the project code[16], billing method[17] were used to bill the Parent and its subsidiaries.

[16] Project Codes are used to accumulate Service Company costs on a job, project, or functional basis for purposes of billing such costs to the appropriate Legal Entity (ies). Each project code has a specific billing method and functional allocation method. Functional Allocation Method – Once the ESI charge is distributed to the legal entities, it is further allocated to the functions

Examination Staff reviewed the project codes, and the Internal Products and Services (IPS) codes and revealed that the Company selected the billing method "ASST" Total Assets, among other billing methods for the resources Dues-Industry and Professional, Misc Relocation Exp-nontaxable, Relocation Allowance, Misc Relocation Exp – Taxable, and Ind Assoc. Dues/Corp Membership. Under this billing method, the Parent is billed 2.66% of the cost.

Action Required

Based on the billing method "ASST" Total Assets, description of the project code and the IPS, it appears that the services or products are for day-to-day operations and not for policy making or planning. The Parent is billed 2.66%, a fair and equitable percentage of the cost for day-to-day operations; however, if any of the executive officers performed a service or generated a product for corporate policy making or corporate planning for the above resources, the Parent should be billed cost by selecting a different billed method, that has a higher percentage of cost billed to the Parent.

Entergy Services, Inc. should recommend the billing method for corporate policy making or corporate planning for the project codes FSPVPI Vice President – Strategic Planning, and F10445 Entergy Consolidated Tax Services. The billing method should be based on the standards of the Act, fair and equitable allocation, and be submitted to the Examination Staff.

Based on the billing method "35" Electric Customers, the regulated operating companies are billed for the costs accumulated in project code R16447 General Market Research. This project code accumulated cost of $110,883 for the resource, Relocation Allowance - 1999.

It appears that Entergy Services, Inc., did not select an appropriate project code R16447 General Market Research to accumulate costs, with the billing method "35" Electric Customers to allocate costs accumulated in this project code for the resource, Relocation Allowance – 1999. This project code has an Internal Products and Services (IPS) code PSR090 Strategic Market Planning. The purpose is

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(organizations) within each Legal Entity based on a functional allocation method (FAM). The FAM is usually based on the same primary driver as the Legal Entity billing method.

[17] Billing methods consist of fixed percentages of costs to be billed to particular Legal Entities. Billing methods are used to directly bill a Legal Entity and to allocate, to one or more legal entities, costs that cannot be directly assigned to a particular Legal Entity. Billing methods must be authorized by the Securities and Exchange Commission. The Commission requires that, whenever feasible, ESI costs should not be allocated but should be directly billed to the Legal Entity benefited. The Commission requires that Entergy Services Inc. allocate all costs that it incurs to the Regulated and Non-regulated operating companies.

described as, "to perform planning functions that help determine the strategic market direction of the Nonregulated and Regulated Retail organizations."

Because the nonregulated entities generally benefit from this type of services, Entergy Services, Inc., should review the project code R16447 General Market Research and billing method "35" Electric Customers, so that the appropriate regulated and nonregulated entities are billed fair and equitable for the costs accumulated in project code R16447 General Market Research. The Company is required to provide us with the results of their finding.

Based on the billing method "LEXF" Departmental Overhead External Affairs, project code ZEDEPT Departmental External Affairs, the Parent is billed 1.85% of the cost. This project code has an Internal Products and Services (IPS) code PSP100 System Regulatory Affairs and Compliance Support. The IPS, one of the major activities described is Filings, which provide management, oversight, control, and direction for all filings before the FERC and SEC (as related to PUHCA), including administrative rulemakings.

It appears that only the project code ZEDEPT Departmental External Affair used the billing method "LEXF" Departmental Overhead External Affairs for the resources reviewed under this Item for 1999. This billing method is considered appropriate because the cost is allocated among the benefited entities.

Based on the description of the activity "Filings", the Parent billing cost of 1.85% is considered appropriate, but only if the Parent is billed cost for the preparation of the FERC and SEC filings under a separate project code. If that is not the case, then Entergy Corporation should recommend a billing method for project code ZEDEPT Departmental External Affair for the activity "Filings". The billing method should be based on the standards of the Act, fair and equitable allocation, and be submitted to the Examination Staff. It is our understanding that project code ZEDEPT and billing method LEXF were closed in 2000 and replaced by a new process. Please describe this process more specifically. An answer is also needed on the project code and allocation for the FERC and SEC filings before determining if the new allocation process is appropriate.

14. Findings (Item 44)

The Examination Staff reviewed several consulting invoices for the years 1999 and 2000. The Examination Staff agreed with the allocation methodology for the majority of the invoices, but there were several with which we disagreed.

Lek Alcar Consulting Group LLC was paid $173,496 charged to Project F20990, Operations Sr VP and CFO. The primary activities associated with this project are financing and capital structure issues, risk management, strategic planning, accounting, financial reporting, investor relations, internal audit policies and procedures and internal boards and committees. Billing method "ASST" allocated only 2.72% to the Parent. Many of these business areas involve running the holding company system and therefore a higher percentage of costs need to go to the Parent.

Public Strategies Inc. was paid $94,582 in year 2000 that was charged to Project, E75020 System Gov.-Lobbying Expenses that in turn uses billing method 21 to allocate costs. This project involves communicating with federal, state and local governmental bodies for the System. Billing method 21 allocates charges based on a 12-month average of residential, commercial, industrial, governmental and municipal electric and gas customers. According to Entergy, even thought these costs are charged to the utility companies only, they are recorded below the line and not recovered from ratepayers.

CSC Consulting was paid approximately $1.7 million in year 2000 for consulting related to work order F99037, Balanced Scorecard – ESI. This project includes facilitation of Entergy's Performance Management Process, Renewal Program management, and facilitation of Entergy's Corporate Compliance Process. The ASST billing method is used since Entergy believes this benefits all legal entities that ESI serves. The ASST basis allocates 2.72% to the Parent. The Examination Staff believes these costs are part of corporate governance and the Parent would benefit more than 2.72%.

Anderson Consulting was paid $613,079, in year 2000 for project F99115 Corporate Intelligence-ESI. This project captures and manages costs associated with the development of an internal Corporate Intelligence Capability application. This initiative will create various "fact modules" of Corporate "common knowledge" in an electronic format that will include a broad range of information such as financial data, operating data, regulatory and legal information, presentations, and other quantitative and qualitative information. The costs were allocated based on the ASST billing method. The ASST basis allocates 2.72% to the Parent. The Examination Staff believes these costs are part of corporate governance and the Parent would benefit more than 2.72%.

Anderson Consulting was paid $388,223 in 2000 for project FI0014 Financial System Master Plan-ESI. The purpose of this project is to expand the "Financial and Performance Management Vision" to address the financial applications, their associated source system interfaces, and potential future financial applications, processes and technologies. Billing method "GL" was used to allocate the costs, which only allocates .04% to the Parent. The Examination Staff believes this project would be considered part of corporate governance costs and the Parent would benefit by more than .04%.

Action Required

It is the position of the Examination Staff that the "ASST" and "GL" billing methods used to allocate costs for Lek Alcar Consulting Group LLC, CSC Consulting, and Anderson Consulting do not allocate a fair and equitable amount to the Parent. It is the Examination Staff's position that ESI establish, by December 21, 2001, an allocation methodology to charge a fair amount of these expenditures to the Parent.

15. Findings (Item 45)

The Examination Staff reviewed an analysis by vendor of all costs assigned to Account 930. The allocation method selected for the majority of the costs appeared reasonable. The specific invoices were reviewed on several payments. The specific invoices were paid to the following vendors: GMC and Co., Inc., International Business Publishers, Inc., Korn Ferry Intl, MCS Group, Power Gen, Telformation Inc., Cajon Made Golf Products, Classic Foundation, Inc., Goldberg Marchesano Partners, and Pelican Golf Course LLC.

Goldberg, Marchesano, Partners, Inc. costs ($1,043,743) covered development, writing and producing different print ads focusing on various charitable groups in the New Orleans area supported by Entergy. Other ads were for radio and television. These costs were charged 100% to Entergy New Orleans. The Staff believes these ads would benefit the name of the Entergy System and therefore part of the costs should be allocated to the Parent.

Classic Foundation, Inc. appeared to be the cost for a $2,900 membership in the Wyndham Champions Club for Bill Peperone. No business purpose was stated and all of the costs were charged to Entergy-New Orleans.

Cajun Made Golf Products was paid approximately $5,257 for shirts, jackets and golf balls. These were all charged using billing method 23 that allocates only to the utility companies. No business purpose was stated. These types of promotional materials benefit the entire system; therefore the Parent and non-utility subsidiaries should be allocated a portion of the charges.

Media Direct invoiced $97,740 for advertising in Time magazine. The "Asst" method was used which allocates 2.72% to the Parent and 18.73% overall to the Parent and non-utility subsidiaries. The remaining 81.27% was allocated to the utility companies. The staff believes the Entergy system represented by the Parent would benefit more than approximately 3%.

International Business Publishers, Inc. was paid approximately $24,000 for advertising in World Energy magazine including reprints. The "ASST" allocation method was used in this situation. The Staff believes the Entergy system represented by the Parent would benefit more than approximately 3%.

Action Required

The advertising programs undertaken by Entergy as represented by all of these advertising expenses directs the reader or the listener to recognize the Parent just as they do recognize the utility subsidiary. Any particular emphasis placed on the advertising program being shown or printed for a geographical area or city cannot

justify use of the ASST method of allocation to the Parent company for these types of advertising costs.

The costs for various forms of advertising, in this case paid to Goldberg, Marchesano Partners, Classic Foundation, Inc., Cajun Made Gold Products, Media Direct and International Business Publishers, Inc., should be allocated in a larger percentage commensurate with the benefit received by Entergy, represented by the Parent Company.

16. Findings (Item 52)

The Examination Staff reviewed a detailed listing of the expenses for the year 2000 and 1999 charged to Account 921- Office Supplies and Expense. For the most part, the items charged to the account appeared reasonable and within the normal realm of the type of charges allowed by the USA. There were several invoices that were questioned with regard to the business purpose and the associated billing method selected to allocate the costs. The questioned items are as follows:

> Wayne Leonard travel costs of $218,427 – these costs charged to project C31255 (Operations-Office of the CEO). Billing method ASST was used to allocate the costs. These costs were for trips on the corporate jet. Entergy's explanation of the trip was that these costs are related to the operations of the CEO for the entire system and were primarily related to System wide employee Focus meetings and the Entergy Board of Director meetings. The ASST only allocates 2.72% to the Parent. Since the CEO' department is considered a corporate governance area, the Examination Staff does not believe this is a fair and equitable amount to the Parent.
>
> Robert Luft travel costs of $388,885 – these costs charged to project ZZ0150 (Shareholder/Director Expenses) and were allocated using the ASST billing method. The trips were in conjunction with his duties as Chairman of the Board of Directors and relate primarily to Entergy Board of Director meetings. The ASST billing method was used since the Board of Directors has responsibility for the oversight and safeguarding of corporate assets. In this duty, the Examination Staff does not believe a 2.72% allocation to the Parent is fair and reasonable and does not represent the oversight and safeguarding of the Parent company assets.
>
> Theme Parks New Orleans charges for $527,842 – costs for a company sponsored employee event held at Jazzland. Entergy holds company-sponsored events around the system for the benefit of its employees. The costs were allocated using billing method 18, which is based on the number of full and part-time employees. Since the Parent and SFI have no employees, these companies were not allocated a portion of these costs. The Examination Staff disagrees with this allocation. Even though executives are paid by ESI, they

perform services in oversight and safeguarding corporate assets. A fair portion of these costs should be allocated to the Parent.

Le Meridien New Orleans charged for $140,141 – Charges for the cancellation of the Executive Leadership Council Conference due to a sever ice storm. This meeting was related to the operations of the CEO for the company who has overall responsibility for the oversight and safeguarding of corporate assets. Project code C31255 was charged which uses billing method ASST to allocate the costs, resulting in the Parent allocation of 2.72%. As described already, this does not appear to be a fair allocation to the Parent.

The Woodlands charge for $43,637 – costs relates to Wayne Leonard's system wide employee focus meeting held at the Woodlands. Costs were allocated using the ASST method. As stated before, this method does not allocate a fair and equitable amount to the Parent based on the responsibility to oversee and safeguard corporate as well as Parent company assets.

Action Required

It is the Examination Staff's position that ESI should establish an allocation method to increase the allocable portion of the Parent's company costs for the Aramark Sports and Entertainment costs, Wayne Leonard and Robert Luft travel costs, Theme Parks New Orlean's charges, Le Meridien charges, and the Woodlands charges.

Entergy

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January 4, 2002

Mr. Robert P. Wason
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Re: Entergy Response to Findings and Actions Required
Examination of Entergy Corporation ("Entergy" or "Parent"), Entergy Services, Inc. ("ESI"), Entergy Enterprises, Inc. ("EEI"), and Entergy Power, Inc. ("EPI")

Dear Mr. Wason:

This letter is in response to the Findings and Actions Required stated in your letter dated November 29, 2001 in connection with the examination of the above referenced companies. As requested in your letter, we submit the following responses:

Finding 1 – Action Required:

Entergy's PAC are nonspecific to the regulated entities, but benefit the Entergy system and employees as a whole. PACs are formed at all levels of government: federal, state, and local. Entergy also explicitly states the activities are general in nature. Therefore, the Examination Staff believes that the method used to allocate costs incurred (Billing Method 35) does not result in a fair and equitable allocation of costs to Entergy Corporation. It is the Examination Staff's position that ESI establish, by December 21, 2001, an allocation methodology to charge a fair amount of these expenditures to the Parent and non-utility subsidiaries.

Entergy Response to Finding 1:

Entergy acknowledges that its PAC costs should be allocated more broadly than our current allocation method that bills only the regulated utilities. These costs are coordinated by Entergy's Governmental Affairs Departments and are closely related to the costs that are the subject of the Examination Staff's Finding 2. Entergy will include the allocation of its PAC costs in the study referred to in our response to Finding 2 below and will report the findings of this study to the Staff.

Finding 2 – Action Required:

As the costs for these types of activities continue to rise, the staff has concluded that we should take a fresh look at the entire area to accommodate changes in the industry, including the effects of deregulation and diversification and other regulatory effects. The object will be to undertake a review of the systems' lobbying and political action activities to identify the beneficiaries of these activities to determine if direct charging procedures are being used appropriately and if current allocation methods still apply. Done properly, we would expect to see more direct billing and adjustments to existing, or the addition of new, allocation methodologies.

As mentioned, the method for charging or allocating these costs is controlled by the identity of the beneficiary of the expenditure. Costs incurred to influence federal or state legislation, for instance, may benefit the holding company itself, the entire system, the utility subsidiaries or the nonutility subsidiaries as separate groups or any of them individually. Depending on the circumstances, costs benefiting particular companies should be charged directly and those benefiting utilities should be allocated using billing method 21. Expenditures on behalf of nonutility companies should allocate costs only among those companies on some rational basis. Expenditures benefiting all companies on the system should be allocated on a basis suggested by Entergy Services, Inc. that fairly and equitably allocates costs to all companies, including the Parent.

The approach to this review should be global. It can no longer be assumed that holding companies and nonutility businesses do not benefit from these activities. Given the frequent changes at federal, state, and local levels to labor, tax, environmental and employment laws, by way of example, it can be projected that a substantial portion of these costs will affect particular parts of or the entire system.

The Examination Staff would like Entergy to undertake a study as discussed above and report the findings to the Staff.

Entergy Response to Finding 2:

Entergy agrees with the Examination Staff that Entergy should review current cost allocation methods for its lobbying and political action activities. Entergy will undertake a study as recommended by the Examination Staff and will report the findings of this study to the Staff. This study will address whether direct charging procedures are being used appropriately and whether new allocation methodologies are needed to allocate costs to the entire Entergy System or specific groups of affiliates. This study will also include the specific PAC costs referred to in the Examination Staff's Finding 1 above.

Finding 3 – Action Required:

In summary, Entergy Corporation has no employees; therefore, no floor space is allocated to Entergy Corporation. They do receive facility costs as one of the cost components of services rendered by Entergy Services Inc., which included the cost of floor space occupied by those employees. The amounts charged to Entergy Corporation for the test period 1999, 2000 and June 30, 2001 are $409,960 or 1.32% of total facilities charges of $30,940,960; $572,358 or 2.1% of total facility charges of $27,264,693; and $159,441, respectively.

It is the Examination Staff's position that Entergy Corporation should receive fair and equitable charges for floor space. Entergy Corporation should establish by December 21, 2001, an allocation method to increase the allocable portion of the Parent company's cost for Facilities.

Entergy Response to Finding 3:

Entergy's position is that its current allocation process for Facilities and related floor space costs is appropriate to effect a fair and equitable allocation of costs. The primary cost driver for facilities costs is employees. The Parent company has no employees; therefore, no ESI floor space is allocated to Entergy Corporation. Entergy Corporation does, however, receive facilities costs as one of the cost components of services rendered by ESI. These facilities costs are captured in a Facilities loader clearing account and then allocated to individual project codes based on ESI labor. This ESI loader clearing process is documented in Exhibit A, ESI Billing Process Overview, and was reviewed with the Examination Staff in the orientation interview during the field component of the examination. This Facilities loader clearing process achieves substantially the same result as allocating floor space based on labor dollars billed.

Finding 4 – Action Required:

It is normal practice for failed mergers to be billed to the Parent Company. The Examination Staff has received documentation that supports only $3,608,917 of the $10,554,107 billed to the utilities as being recorded as an adjustment "below the line." Entergy has represented that none of the other costs will be included in rate filings.

ESI represents that the 2001 costs could be adjusted when annual earnings review filings are made with the various regulators sometime in 2001. Unless we receive some firm documentation from ESI (other than the verbal statement) that these costs will not be recovered from the customers, it is the Examination Staff's position that a reclassification and rebilling of $6,945,191 be made to the Parent Company.

Entergy Response to Finding 4:

During December 2001, Entergy recorded journal entries to reclassify all amounts recorded in 2001 in connection with the FPL merger to FERC Account 426.5, with minor amounts reclassified to FERC Accounts 417.1 and 426.4, also "below the line" accounts. These reclassifications include both 2001 amounts billed by ESI to the regulated utility companies and 2001 amounts recorded directly by the regulated utility companies. These reclassifications are summarized in the analysis provided in Exhibit B. As of December 31, 2001, all 2001 merger costs were recorded "below the line".

Finding 5 – Action Required:

Application of Rule 45(c) to the 1996 Provisions of the Draft Entergy Tax Allocation Agreement[1]

Item 1. Delete here, and elsewhere in the agreement, any reference to particular provisions of the Code. Rule 45(c)(3) treats generically the particular features of the Code as they apply currently to each member of the tax group. Setting out a particular provision unnecessarily introduces ambiguity into the agreement. See Adopting Release (HCAR No. 21968; March 18, 1981). (The Commission notes "Rule 45(c) does not specify kinds of tax benefits. These change as tax laws and regulations are revised." It goes on to say that an important function of the tax agreement required by the rule, is to "identify currently the material elements of allocation in terms of the applicable tax law.")

Item 2. This Item should be restated in its entirety. The first sentence should read that the "consolidated tax shall be allocated among the several members of the group in proportion to the corporate taxable income of each member." A second sentence should provide for adjustments to the rule 45(c)(2)(i) allocation election to accommodate intercompany transactions excluded on consolidation. A third sentence should provide for adjustments to the rule 45(c)(2)(ii) allocation to the extent that the consolidated tax and separate return tax for any year include material items taxed at different rates or involving other special benefits or limitations. State that "these adjustments will be directed to allocating to the individual members of the group the material effects of any particular features of the tax law applicable to them." Exclude the last sentence.

[1] Note that this version of the agreement was never executed and, therefore, has no legal significance.

Items 2., 3., 4. and 5., taken together, misinterpret the rule and should be deleted and restated in their entirety. Item 5. is expressly prohibited. Assuming that one has complied with the rule through rule 45(c)(3), each member at that point knows its separate return tax, including the parent company. Thereafter, the agreement must provide for the actual allocation of the consolidated tax liability. This requires a stated election between the method provided in 45(c)(4) or (c)(5). Because Entergy has elected rule 45(c)(5), the agreement should state that for allocation purposes "all members with a positive allocation will pay the amount allocated and those with a negative allocation, except the parent company, will receive current payment of their corporate tax credits." Further, the agreement must provide "a method for apportioning payments and for carrying over uncompensated benefits."

Delete Items 6 through 20. The separate treatment of particular tax provisions is unnecessary.

Item 21 should be restated to reflect the requirement contained in the last sentence of rule 45(c)(1)'s definition of corporate taxable income.

The Examination Staff believes that ETR is not in compliance with Rule 45(c)(4) of the Act since ETR is by definition an "associate company" and not a "subsidiary" company and therefore not entitled to utilize net operating losses. Under the Act, ETR is liable for it's own separate return liability.

For the years 1989, 1990, 1991 and 1999 ETR had taxable income of $81,034,478 resulting in a tax liability. ETR did not pay this liability but in fact recouped prior year net operating losses from the subsidiaries to offset this liability. ETR should reimburse the subsidiaries the dollar amounts in the same ratios that were paid in the years referenced. Evidence of this reimbursement is to be provided to the Examination Staff no later than thirty days after the payment adjustment to the subsidiaries.

If ETR wants to file an application with the Commission in support of its interpretation of Rule 45(c) and ask for a change in the allocation on a prospective basis (beginning for future tax years if the Commission approves the request), then it should do so as soon as possible.

Entergy Response to Finding 5:

Entergy does not agree with the Staff's interpretation of Rule 45(c). Consequently, Entergy disagrees with the Staff's findings and required actions concerning the application of Rule 45(c) to the Entergy Tax Allocation Agreement. Entergy hereby requests a meeting with the Director of the Office of Public Utility Regulation and/or other appropriate Commission Staff to discuss the audit findings and our interpretation of

Rule 45(c). A detailed discussion of Entergy's position and interpretations of the issues at question will be provided to the meeting participants prior to the meeting.

Finding 6 – Action Required:

The Examination Staff recommends that service agreements with ESI need to be updated and revised to more equally allow for entities to pick and choose individual services. The service agreement should state that each company should have the ability to request services and only be obligated to take services from ESI upon submission of a request.

Entergy Response to Finding 6:

Entergy acknowledges that the service agreements between ESI and the System's "Regulated Utilities"[2] (exclusive of Entergy Gulf States, Inc. ("EGSI") and Entergy Operations, Inc. ("EOI")) include language obligating the Regulated Utilities to procure from ESI all required services identified as falling within the scope of the applicable service agreement (as well as such other services as ESI concludes it is competent to perform). Entergy further acknowledges that the service agreements between ESI and EEI and between ESI and EPI provide that services will only be provided to the extent requested in a work order issued by EEI or EPI, as applicable.

However, Entergy disagrees with the Examination Staff's conclusion that it is necessary or desirable to update/revise the service agreements among ESI and the Regulated Utilities to allow the Regulated Utilities "to pick and choose individual services" in the same manner as EEI and EPI. Contrary to the Examination Staff's assertion in this Findings and Actions Required, the 1999 amendment of the ESI-EEI and ESI-EPI service agreements did not modify or otherwise affect the right of EEI and EPI to request services from ESI on a selective basis. The original service agreements between ESI and EEI (formerly known as "Electec, Inc.") dated January 24, 1984 and between ESI and EPI, dated August 28, 1990 already provided for this right. Similarly, the ESI – Regulated Utility Service Agreements (exclusive of EGSI and EOI) have always provided that services required by the Regulated Utilities are to be rendered by ESI on an "as required" basis.

Entergy submits that there is ample justification for the above referenced difference in the language of ESI's service agreements. The principal reason for this difference is that ESI was originally conceived as the primary, if not exclusive, service provider for the Regulated Utilities then comprising the Entergy System. It was intended, therefore, that ESI would, to the extent practical, provide the Regulated Utilities with all of the technical

[2] "Regulated Utilities" include the System Operating Companies and such other Entergy subsidiaries whose activities and operations are primarily related to the domestic sale of electric energy at retail or at wholesale to affiliates or the provision of goods or services thereto.

skills and expertise that would otherwise have to be procured from outside suppliers.[3] On the other hand, it has always been understood that services rendered by ESI for EEI and Entergy's other non-regulated businesses are subordinate to the services rendered to the Regulated Utilities. Accordingly, many of these services are essentially provided to the non-regulated companies on a "when, as and if available" basis.[4]

The strict distinction between the levels of service support rendered by ESI to Entergy's Regulated Utilities and Entergy's non-regulated businesses was further reinforced and expanded in 1993 when EEI took on the role of service company for Entergy's non-regulated subsidiary companies. In this regard, the SEC's July 8, 1993 Order (HCAR No. 25848) expressly provides that, except for (i) certain core administrative services, which "by virtue of common ownership" would be "more effectively performed by ESI to meet the mutual needs of Entergy and all of its associates," and (ii) "specific and limited" consulting services and other support services, which would continue to be performed for EEI (and indirectly through EEI) for Entergy's other non-regulated businesses, EEI would not utilize the personnel and physical facilities of ESI or any of Entergy's other Regulated Utilities. Accordingly, since 1993, EEI, EPI and Entergy's other non-regulated companies have actually become more self sufficient, whereas the Regulated Utilities continue to rely on ESI for substantially all of the services which they require.

In summary, given the clear difference in the level of commitment by ESI to its Regulated Utility clients, relative to EEI and its other non-regulated subsidiary clients, it is only reasonable that EEI, EPI and Entergy's other non-regulated subsidiaries be given more flexibility to procure services from outside vendors. While ESI is nominally a System service company, it is today (and always has been) primarily dedicated to serving the needs of the Regulated Utilities. Since ESI has the duty and obligation to provide all services required by the Regulated Utilities (to the extent such services are within the scope of ESI's resources and competency), whereas most services rendered to the non-regulated companies are provided only on a "specific and limited" basis, Entergy believes it is entirely appropriate that Entergy's Regulated Utilities bear the principal responsibility for maintaining ESI's operation.

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[3] See the SEC's March 6, 1963 Order (HCAR No. 14816), approving the formation of ESI, which indicates that the System's Operating Companies (then constituting the entire Entergy System) would ultimately procure all required services from ESI, rather than from outside suppliers (excepting only those services beyond the scope of ESI's resources or competency).

[4] See the SEC's January 13, 1984 Order (HCAR No. 23200), and Entergy's related Application-Declaration on Form U-1, which indicate that System Companies (including ESI) would have "sole discretion in determining the availability of their personnel and resources" in rendering services to EEI (under the proposed Service Agreements between such companies and EEI) and further express the intent that EEI would utilize such personnel and resources during non-peak periods to the greatest extent possible, so as to minimize disruption of the core System utility business (with additional required resources being obtained or hired from external sources).

Finding 7 – Action Required:

The Examination Staff requests an analysis of all transactions since the June 22, 1999 Order that falls into the Items (1) through (4) category. Please also confirm if a specific declaration was made to the Commission on any of the transactions.

Entergy Response to Finding 7:

Item (1) As required by the June 22, 1999 Order (HCAR No. 27040), Entergy's regulated associate companies billed its non-utility associate companies at cost plus 5% as summarized in the following exhibits:

- Exhibit C – Summary of ESI billings to non-utility associate companies for the period June 1999 – November 2001
- Exhibit D – Summary of Entergy regulated utility billings to non-utility associate companies for the period June 1999 – November 2001

As noted by the Staff, the June 22, 1999 Order specifically authorized Item (1). Therefore, no declaration has been required.

Item (2) Entergy had no transactions of this type during the period June 22, 1999 to date. Therefore, Entergy has not been required to file any specific declarations with respect to such transactions.

Item (3) In September 1999, EEI recorded revenue in connection with a licensing arrangement with Entergy Arkansas, Inc. ("EAI") involving the marketing by EEI of software developed and used by EAI. A summary of this transaction is as follows:

Revenue	$108,000
Less: Commissions	19,440
Net Proceeds	88,560
Less: EEI Incremental Costs	123,480
Loss on Project	$ (34,920)

Because this project resulted in a loss, this transaction was not subject to a profit sharing requirement. Entergy had no other transactions of this type during the period June 22, 1999 to date.

Entergy acknowledges that the Commission's June 22, 1999 Order (HCAR No. 27040) does not specifically authorize the Settlement Agreement profit sharing formula applicable to products developed by the Regulated Utilities, but marketed by non-utility associates. However, Entergy's Application-Declaration on Form U-1 (as amended) in

File No. 70-9123, which was approved by the Commission's June 22, 1999 Order (HCAR No. 27039), expressly provides for "the marketing by Entergy's non-regulated companies to non-associate companies of intellectual property developed or otherwise acquired by System companies, subject to certain profit sharing provisions set forth in the Settlement Agreement (as hereinafter defined)." The Settlement Agreement profit sharing formula is also approved under the SEC's June 30, 1995 Order (HCAR No. 26322). Accordingly, because the transaction described above was implemented in accordance with the applicable Settlement Agreement profit sharing methodology previously approved by the Commission, no specific declaration was required to be filed with respect to this transaction.

Item (4) Entergy had no transactions of this type during the period June 22, 1999 to date. Therefore, Entergy has not been required to file any specific declarations with respect to such transactions.

Finding 8 – Action Required:

The Examination Staff would like a copy of the audit scope for the billing and allocation audit planned for 2002 once it is ready. In addition, a copy of the final audit report should be forwarded to the Examination Staff.

Entergy Response to Finding 8:

Entergy will provide the Examination Staff with a copy of the Internal Audit Department audit scope for the next ESI billing and allocation audit when the audit scope has been completed. In addition, Entergy will also provide the Examination Staff with a copy of the Internal Audit Department final audit report in connection with this audit.

Finding 9 – Action Required:

Entergy should establish a formalized benchmarking program for the major services of ESI: legal, information services, and investor relations. A benchmarking program should be submitted to the Examination Staff by July 1, 2002.

Entergy Response to Finding 9:

Entergy acknowledges the Commission's authority under Section 13(b) of the Public Utility Holding Company Act of 1935 to "insure that contracts are performed economically and efficiently..." However, ESI and the Entergy System routinely take steps to insure the effectiveness and efficiency of its business processes, and therefore, its costs. These steps include, but are not limited to, best practices analyses, the setting of aggressive targets, performance management, renewal program management, process improvement initiatives, internal reporting and accountability by management, and, on occasion, benchmarking studies.

The following is a summary of recent studies and/or analyses for the three ESI services identified by the Examination Staff in their Action Required for this finding:

Legal

Entergy began a significant "insourcing" its legal services function in 1992. This action was the result of an internal study, completed in 1991, which addressed the efficiency and effectiveness of Entergy's legal services and the related costs. Entergy's Legal Department currently functions like an external firm, with outside attorneys used only when matters require specialized expertise or additional capacity.

While formal benchmarking studies are not conducted by the Legal Department, Entergy's Legal Department does track and compare its internal costs on an hourly basis to an hourly cost for comparable services rendered by outside counsel. These internal cost analyses have been completed on an annual basis since the inception of significant insourcing in 1992. The most recent cost analysis, completed in July 2001, continues to justify Entergy's decision to significantly insource its legal services function. For example, the analysis indicates that while Entergy's inside legal costs have increased as a result of the insourcing and increased workload, Entergy's outside counsel fees have decreased by more than double that amount on an annual basis. The efficiency of Entergy's legal services costs are further supported by findings in the analysis that indicate that Entergy's hourly cost for inside legal services is approximately half of the hourly cost for outside legal counsel (based on 2000 data). Entergy believes that these internal cost analyses provide an accurate and fair market determination in lieu of formal benchmarking.

Information Services

Entergy outsourced its information services function to Science Applications International Corporation (SAIC) in January of 1999. The award of the contract to SAIC was the result of an extended, rigorous competitive procurement process, facilitated by an outside consulting firm recognized as experts in the outsourcing contracting process. As a result, Entergy's information technology (IT) costs at the inception of the contract were clearly at established market based prices. To ensure that prices remain competitive with the market, Entergy has a formal contractual commitment with SAIC to conduct a benchmarking study every other year. In 2001, a benchmarking study was completed as part of that continuing commitment. The study, conducted by Gartner Measurement, was titled "Entergy Corporation Information Technology Overview Analysis". A copy of this study was provided to the Examination Staff as Attachment A to IER-22. This study concluded that Entergy's IT costs are in the top quartile in comparison to other companies who have a similar technology profile. Only two areas were noted for further improvement (telecommunications and mainframe) and IT is undertaking specific initiatives to address improvements in these areas.

In addition to this study, IT conducted a formal comprehensive assessment of the IT function. The purpose of this effort was to identify opportunities to improve overall IT effectiveness in operations and delivery of value to Entergy's business. The scope included all aspects of IT operations including, but not limited to, the relationship between Entergy and SAIC and was conducted using two external consulting firms, Gartner and The Concours Group. This study was recently completed and as a result of this study, a performance management function is being set up reporting to the CIO and will be operational in January 2002. The primary focus of this function is to provide a focal point for managing enterprise IT investment, spending, performance and value. This function will be responsible for IT cost trending and benchmarking. The next comprehensive external benchmarking study will be performed in the first half of 2003.

__Investor Relations__

Entergy's Investor Relations personnel charge their time and expenses primarily to project codes F22514 (Meetings – Analysts/Investors/Shareholders) and F22511 (Investor Relations – General, Inquiries and Mailings). Both of these project codes are billed directly to the Parent company or 100% to Entergy Corporation. Entergy's Investor Relations Department is focused on shareholder value and Entergy's perception in the investment community. This department uses best practices analyses and surveys to the investment community to monitor the effectiveness of its services. However, Entergy believes that, given the critical relationship of Investor Relations services to enhancing shareholder value and the fact that the related costs are shareholder costs, i.e. billed 100% to the Parent company, there is less need for market price justification of these services.

Entergy believes that we meet the requirements of the Act and that the types of studies conducted by Entergy, as described above, are adequate to insure the effectiveness and efficiency of our business processes and our costs. Entergy does not believe that the expenses of a formal benchmarking program are justified. As the Entergy utilities move to a competitive environment, the operation of the marketplace will serve as another control to insure the effectiveness and efficiency of our costs.

Finding 10 – Action Required:

It is the Examination Staff's position that a fair and reasonable amount of the time of Entergy's top two executives (Leonard and Hintz) should be charged to the Parent Company. Entergy is to provide an appropriate allocation method and evidence of how the new allocation procedure was implemented.

Entergy Response to Finding 10:

ESI representatives will meet with Messrs. Leonard and Hintz to review the nature of services rendered by them and their time and expense charging procedures for such services. Changes to their project codes and the associated allocation methods will be made if appropriate.

Finding 11 – Action Required:

The Examination Staff believes that the Total Asset method used to allocate costs incurred by common parent and service company officers does not result in a fair and equitable allocation of costs to ETR. It is the Examination Staff's position that by December 21, 2001, Entergy should suggest an appropriate allocation methodology.

Entergy Response to Finding 11:

In this finding the Examination Staff notes "For the most part, dues and business expenses were fairly and equitably allocated. However, certain expenses of common parent and service company officers were allocated based on a Total Assets method. Under this method, approximately 2% of the costs were allocated to ETR." Entergy has reviewed the project codes and related allocation methods of the expenses in question. All expenses relate to services provided by senior executive officers, e.g. CEO and COO, and officers and management employees with financial oversight responsibilities for the Entergy System. The Total Assets (ASST) allocation method was selected to allocate the costs in question because these costs are driven by the oversight of the operations of all Entergy System companies and the stewardship of corporate assets. Therefore, ESI believes that the ASST allocation method is appropriate to effect a fair and equitable allocation of costs based on the services provided. In addition, ESI notes that these same officers and management employees do charge time and expenses directly to the Parent company as appropriate. This is evidenced by the Examination Staff's finding as follows, "The Examination Staff reviewed the allocation methods selected to spread sporting event expenses. Of the total $566,146 incurred for the period January 1, 1999 through June 30, 2001, ETR was allocated $276,924 or 49%". (See also Entergy's Response to Finding 12 below).

Finding 12 – Action Required:

Section 13(b) of the Act requires a fair allocation of costs amongst the holding company system. It is the Examination Staff's opinion that ESI is not allocating a fair and equitable amount of certain costs to the Parent Company. It is the Examination Staff's position that ESI should use a method of allocation that will recognize the value of service earned by the Parent company from the service being rendered.

Entergy Response to Finding 12:

Entergy's Parent company costs are identified and paid directly by Entergy Corporation as appropriate, i.e. the costs are not billed through ESI. In addition, those ESI costs driven by the Parent company and incurred for the direct benefit of the Parent company are billed 100% to Entergy Corporation. ESI's shared costs are allocated using various allocation methods identified as cost drivers for the specific services using cost-causation principles. ESI continually reviews its allocation methods to determine that they are fair and equitable. As you know, ESI has submitted numerous 60 Day Letters to the Commission in the last several years. These letters have requested various additions to and eliminations of allocation methods, all in an effort to ensure that ESI billings were allocated using the most appropriate cost-causative consumption based allocation methods.

In response to one of the Examination Staff's follow-up questions in connection with their examination, Entergy provided the Staff with a pro forma analysis of corporate governance costs based on 2000 billings. For your reference, this pro forma analysis is attached as Exhibit E. This analysis shows that approximately 28% of the 2000 charges to the Commission's defined corporate governance departments were actually billed to Entergy's shareholders (Parent company and non-regulated affiliates). With Entergy's significant investment in non-regulated businesses, a fixed or more substantial, but arbitrary, allocation to the Parent company, in addition to the allocation to our non-regulated affiliates, could result in corporate governance shareholder allocations of close to 50%. In your transmittal letter of November 29, 2001, the Commission specifically requested that Entergy provide more details on the calculation of this 50% number. As indicated on the pro forma analysis in Exhibit E, a 30% allocation of corporate governance costs to the Parent company plus the amounts billed to EEI and EPI totals $18.4 million, or approximately 46% of the pro forma total corporate governance costs, i.e. close to 50%. In addition, these amounts exclude any corporate governance type costs paid directly by Entergy Corporation, EEI and EPI.

Entergy has reviewed the project codes and related allocation methods identified by the Examination Staff in this Finding. Many of the project codes relate to services provided by senior executive officers, e.g. CEO and COO, and departments with financial oversight responsibilities for the Entergy System. The Total Assets (ASST) allocation method was selected to allocate the costs associated with these services because these costs are driven by the oversight of the operations of all Entergy System companies and the stewardship of corporate assets. Other project codes identified by the Examination Staff in this Finding relate to costs incurred in connection with Entergy award and recognition events. While Entergy officers do participate in these recognition items/events, the primary focus of these items/events is to recognize the accomplishments of employees. The Number of Employees (18) allocation method was selected to allocate these costs because the costs are driven by the number of employees at all Entergy System companies. The remaining project codes identified by the Examination Staff in this Finding relate to costs incurred in connection with incentive compensation, stock awards, and non-qualified post-retirement plans. The ESI Labor Billed (40) allocation method was selected to allocate these costs because these costs are driven by the distribution of all labor charges at ESI.

In conclusion, ESI believes that the ASST, 18 and 40 allocation methods associated with the specific project codes identified in this Finding are appropriate to effect a fair and equitable allocation of costs based on the services provided. In Entergy's responses to

Findings 10 and 13, Entergy has committed, however, to further study the types of services charged to project codes C31255 (Operations – Office of the CEO), C08500 (Operations – ETR President and COO), FSPVP1 (Operations – VP Strategic Planning) and F10445 (Entergy Consolidated Tax Services). Changes to these project codes and the associated allocation methods will be made if appropriate.

Finding 13 – Action Required:

Based on the billing method "ASST" Total Assets, description of the project code and the IPS, it appears that the services or products are for day-to-day operations and not for policy making or planning. The Parent is billed 2.66%, a fair and equitable percentage of the cost for day-to-day operations; however, if any of the executive officers performed a service or generated a product for corporate policy making or corporate planning for the above resources, the Parent should be billed cost by selecting a different billed method, that has a higher percentage of cost billed to the Parent.

[A] Entergy Services, Inc. should recommend the billing method for corporate policy making or corporate planning for the project codes FSPVPI Vice President – Strategic Planning, and F10445 Entergy Consolidated Tax Services. The billing method should be based on the standards of the Act, fair and equitable allocation, and be submitted to the Examination Staff.

Entergy Response to Finding 13[A]:

ESI representatives will meet with ESI personnel charging time and expenses to project codes FSPVP1 and F10445. We will review the nature of the services rendered by them and their time and expense charging procedures for such services. Changes to their project codes and the associated allocation methods will be made if appropriate.

[B] Based on the billing method "35" Electric Customers, the regulated operating companies are billed for the costs accumulated in project code R16447 General Market Research. This project code accumulated cost of $110,883 for the resource, Relocation Allowance - 1999.

It appears that Entergy Services, Inc., did not select an appropriate project code R16447 General Market Research to accumulate costs, with the billing method "35" Electric Customers to allocate costs accumulated in this project code for the resource, Relocation Allowance – 1999. This project code has an Internal Products and Services (IPS) code PSR090 Strategic Market Planning. The purpose is described as, "to perform planning functions that help determine the strategic market direction of the Nonregulated and Regulated Retail organizations."

Because the nonregulated entities generally benefit from this type of services, Entergy Services, Inc., should review the project code R16447 General Market

Research and billing method "35" Electric Customers, so that the appropriate regulated and nonregulated entities are billed fair and equitable for the costs accumulated in project code R16447 General Market Research. The Company is required to provide us with the results of their finding.

Entergy Response to Finding 13[B]:

Given the age of the item identified in this finding related to Project Code R16447, the immaterial amount of the current 2001 charges (approximately $15,000) and the fact that this project code will be closed effective January 1, 2002, ESI believes that it is impractical to undertake a detailed review of this project code. No prospective changes in the allocation method associated with this project code will be required.

[C] Based on the billing method "LEXF" Departmental Overhead External Affairs, project code ZEDEPT Departmental External Affairs, the Parent is billed 1.85% of the cost. This project code has an Internal Products and Services (IPS) code PSP100 System Regulatory Affairs and Compliance Support. The IPS, one of the major activities described is Filings, which provide management, oversight, control, and direction for all filings before the FERC and SEC (as related to PUHCA), including administrative rulemakings.

It appears that only the project code ZEDEPT Departmental External Affair used the billing method "LEXF" Departmental Overhead External Affairs for the resources reviewed under this Item for 1999. This billing method is considered appropriate because the cost is allocated among the benefited entities.

Based on the description of the activity "Filings", the Parent billing cost of 1.85% is considered appropriate, but only if the Parent is billed cost for the preparation of the FERC and SEC filings under a separate project code. If that is not the case, then Entergy Corporation should recommend a billing method for project code ZEDEPT Departmental External Affair for the activity "Filings". The billing method should be based on the standards of the Act, fair and equitable allocation, and be submitted to the Examination Staff. It is our understanding that project code ZEDEPT and billing method LEXF were closed in 2000 and replaced by a new process. Please describe this process more specifically. An answer is also needed on the project code and allocation for the FERC and SEC filings before determining if the new allocation process is appropriate.

Entergy Response to Finding 13[C]:

As noted by the Examination Staff in their Action Required, project code ZEDEPT and billing method LEXF were closed in 2000 and replaced by a new process. The purpose of project code ZEDEPT was to capture costs associated with departmental overhead for the External Affairs department, e.g. non-project specific administrative time and expenses such as secretarial labor, staff meeting time, and office supplies. Beginning in 2000, departmental overheads were captured in a supervision and support loader clearing account and then allocated to individual project codes based on ESI labor. This ESI loader clearing process is documented in Exhibit A as referenced in our response to Finding 3. The preparation and review of FERC and SEC filings are considered project specific costs, not departmental overhead. The costs incurred by the System Regulatory Affairs department in connection with the preparation and review of FERC and SEC filings are captured in project codes SYSRAF (System Regulatory Affairs – Federal), SYSRAS (System Regulatory Affairs – State) or direct billing project codes, as appropriate. Project codes SYSRAF and SYSRAS currently use allocation methods 23 and 21, respectively. ESI believes that these allocation methods are appropriate to effect a fair and equitable allocation of costs based on the services provided.

Finding 14 – Action Required:

It is the position of the Examination Staff that the "ASST" and "GL" billing methods used to allocate costs for Lek Alcar Consulting Group LLC, CSC Consulting, and Anderson Consulting do not allocate a fair and equitable amount to the Parent. It is the Examination Staff's position that ESI establish, by December 21, 2001, an allocation methodology to charge a fair amount of these expenditures to the Parent.

Entergy Response to Finding 14:

Entergy has reviewed the project codes and related allocation methods associated with the invoices referred to in the above Action Required. The services charged to project codes F20990, F99037 and F99115 are driven by the oversight and stewardship of corporate assets. ESI believes that the ASST allocation method is appropriate to effect a fair and equitable allocation of costs based on the services provided. (See also Entergy's response to Finding 12 above). The services charged to project code FI0014 relate specifically to financial applications and are driven by general ledger transactions. ESI believes that the GL allocation method is appropriate to effect a fair and equitable allocation of costs based on the services provided.

Finding 15 – Action Required:

The advertising programs undertaken by Entergy as represented by all of these advertising expenses directs the reader or the listener to recognize the Parent just as they do recognize the utility subsidiary. Any particular emphasis placed on the advertising program being shown or printed for a geographical area or city cannot justify use of the ASST method of allocation to the Parent company for these types of advertising costs.

The costs for various forms of advertising, in this case paid to Goldberg, Marchesano Partners, Classic Foundation, Inc., Cajun Made Gold Products, Media Direct and International Business Publishers, Inc., should be allocated in a larger percentage

commensurate with the benefit received by Entergy, represented by the Parent Company.

Entergy Response to Finding 15:

__Goldberg, Marchesano Partners, Inc.__
As noted in the Examination Staff's Finding, these costs relate to print advertising focusing on charitable groups in the New Orleans area, as well as radio and television advertising. These costs were billed 100% to Entergy New Orleans, Inc. ("ENOI"). These services are intended to inform ENOI customers about ENOI's community assistance activities. Community assistance advertising of this type that might benefit the entire Entergy System would be allocated based on the number of customers. Entergy believes that this direct billing to ENOI is appropriate based on the services provided.

__Classic Foundation, Inc.__
As noted in the Examination Staff's Finding, these costs relate to a membership in the Wyndham Champions Club for Bill Peperone. These costs were billed 100% to ENOI. Mr. Peperone works in the economic development area and his development activities associated with this membership were for the direct benefit of ENOI. Entergy believes that this direct billing to ENOI is appropriate.

__Cajun Made Golf Products__
These costs relate to items purchased by Entergy's Energy Management Operations organization. This organization is primarily responsible for the planning and economic dispatch of the lowest cost electricity for the energy generation function. These costs were allocated based on the Responsibility Ratio (23) billing method. This method allocates costs to the regulated utilities based on each company's load at the time of System peak load. These costs are not driven by any activities at the Parent company or Entergy's non-utility subsidiaries; therefore, no costs are allocated to these entities. Entergy believes that billing method 23 provides a fair and equitable allocation of these costs.

__Media Direct__
These costs relate to advertising in Time magazine and were incurred by Entergy's COO organization for the benefit of the entire Entergy System. This type of advertising is more related to name recognition as opposed to customer focused information; therefore, unlike community assistance advertising, these costs have been allocated based on Total Assets (ASST) rather than the number of customers. Entergy believes that billing method ASST provides a fair and equitable allocation of these costs. (See also Entergy's response to Finding 12).

__International Business Publishers, Inc.__
These costs relate to advertising in World Energy magazine and were incurred by Entergy's CEO organization for the benefit of the entire Entergy System. This type of advertising is more related to name recognition as opposed to customer focused information; therefore, unlike community assistance advertising, these costs have been allocated based on Total

Assets (ASST) rather than the number of customers. Entergy believes that billing method ASST provides a fair and equitable allocation of these costs. (See also Entergy's response to Finding 12).

Finding 16 – Action Required:

It is the Examination Staff's position that ESI should establish an allocation method to increase the allocable portion of the Parent's company costs for the Aramark Sports and Entertainment costs, Wayne Leonard and Robert Luft travel costs, Theme Parks New Orleans charges, Le Meridien charges, and the Woodlands charges.

Entergy Response to Finding 16:

In this finding the Examination Staff notes "For the most part, the items charged to the account (Account 921 – Office Supplies and Expense) appeared reasonable and within the normal realm of the type of charges allowed by the USA [FERC Uniform System of Accounts]. There were several invoices that were questioned with regard to the business purpose and the associated billing method selected to allocate the costs." Entergy has reviewed the project codes and related allocation methods of the invoices in question. The four invoices charged to project codes C31255 and ZZ0150 relate to costs driven by the oversight and stewardship of corporate assets. ESI believes that the ASST allocation method is appropriate to effect a fair and equitable allocation of costs based on the services provided. (Also, see Entergy's response to Finding 12 above). The costs associated with the Theme Parks New Orleans invoice were allocated using allocation method 18, which is based on the number of full and part-time employees. Entergy acknowledges that these costs should have been allocated more broadly, including an allocated portion to the Parent company. Given the date of the invoice in question and prior year in which it was recorded, a rebilling and adjustment of prior year earnings would not be appropriate. Entergy commits that prospective costs of this type will be billed using a method that allocates a fair and equitable portion either directly or indirectly to the Parent company.

In addition to the specific Findings and Actions Required, the Examination Staff also requested that Entergy provide more details on how we arrived at the 50% number referenced in our statement "With Entergy's significant investment in non-regulated businesses, a fixed or more substantial, but arbitrary, allocation to the parent in addition to the allocation to our non-regulated affiliates could result in corporate governance shareholder allocations of close to 50%." The 50% number in the context of this statement is more fully explained in Entergy's response to Finding 12 above.

We appreciate the opportunity to meet with you and others concerning Examination Staff's Finding 5 and our interpretation of Rule 45(c), and we will be in contact to schedule this meeting. Should you have any questions, please contact me at 504-576-4326 or Ms. Lee Canova at 504-576-2289.

Sincerely,

Nathan E. Langston

Nathan Langston
Senior Vice President,
Chief Accounting Officer

(Attachments)
c: Mr. David Marsh
Mr. Jack Adams
Ms. Lee Canova
Ms. Debbie Dudenhefer
Ms. Carol Gernon
Mr. Joe Henderson

Schedule of Exhibits

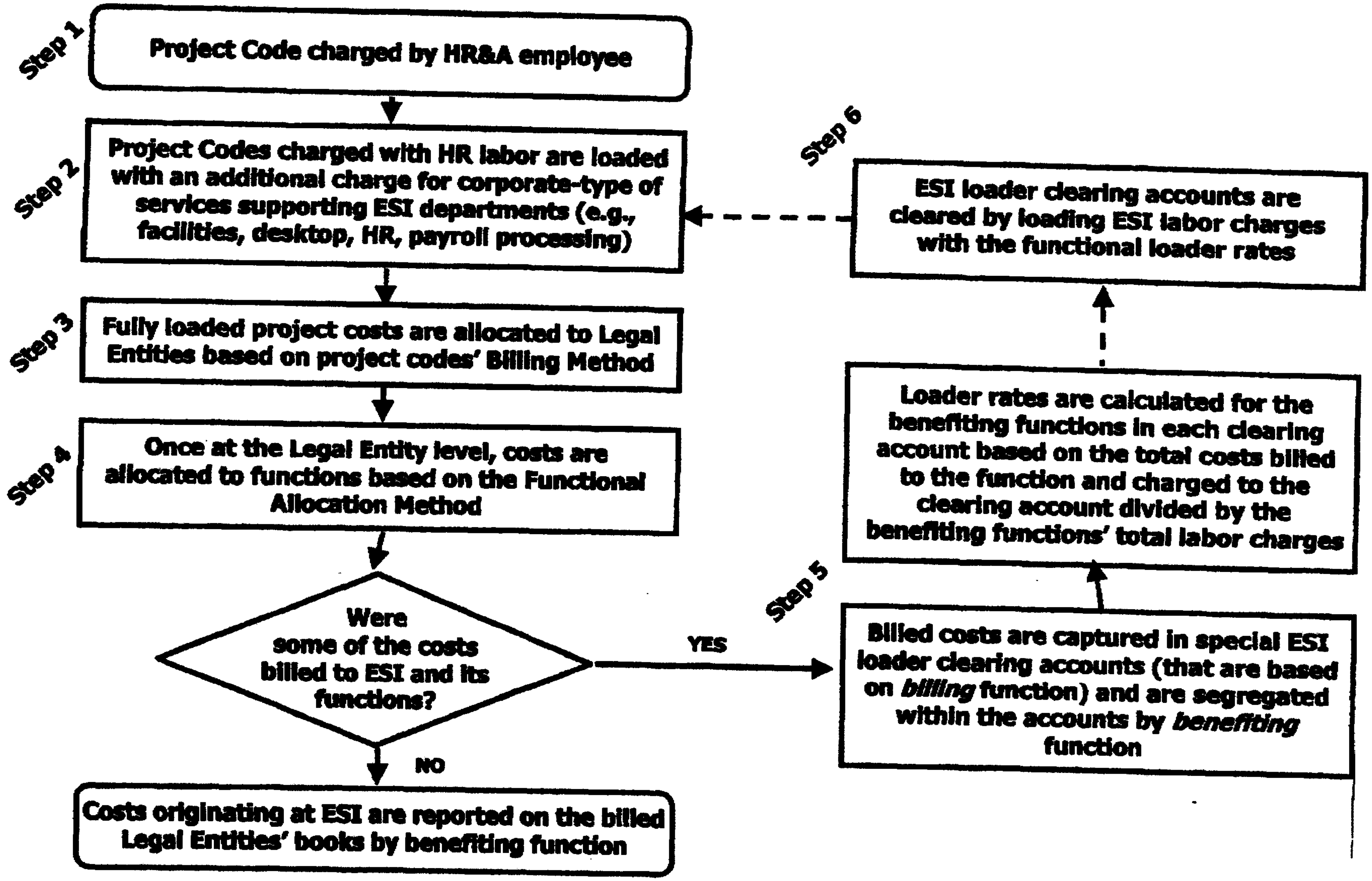
Exhibit	Finding	Description
Exhibit A	Finding 3	ESI Billing Process Overview
Exhibit B	Finding 4	Analysis Summarizing the Reclassification of 2001 Merger Costs to Accounts 426.5, 417.1 and 426.4 (Includes Both Costs Billed by ESI to the Regulated Utility Companies and Costs Incurred Directly by the Regulated Utility Companies)
Exhibit C	Finding 7	Summary of ESI Billings to Non-Utility Associate Companies for the Period June 1999 – November 2001
Exhibit D	Finding 7	Summary of Entergy Regulated Utility Billings to Non-Utility Associate Companies for the Period June 1999 – November 2001
Exhibit E	Finding 12	Pro Forma Analysis of Corporate Governance Costs -- 2000

Exhibit A

ESI Billing Process Overview

IntraSystem Affiliate Billing
January 2001

ESI Billing Process - Overview

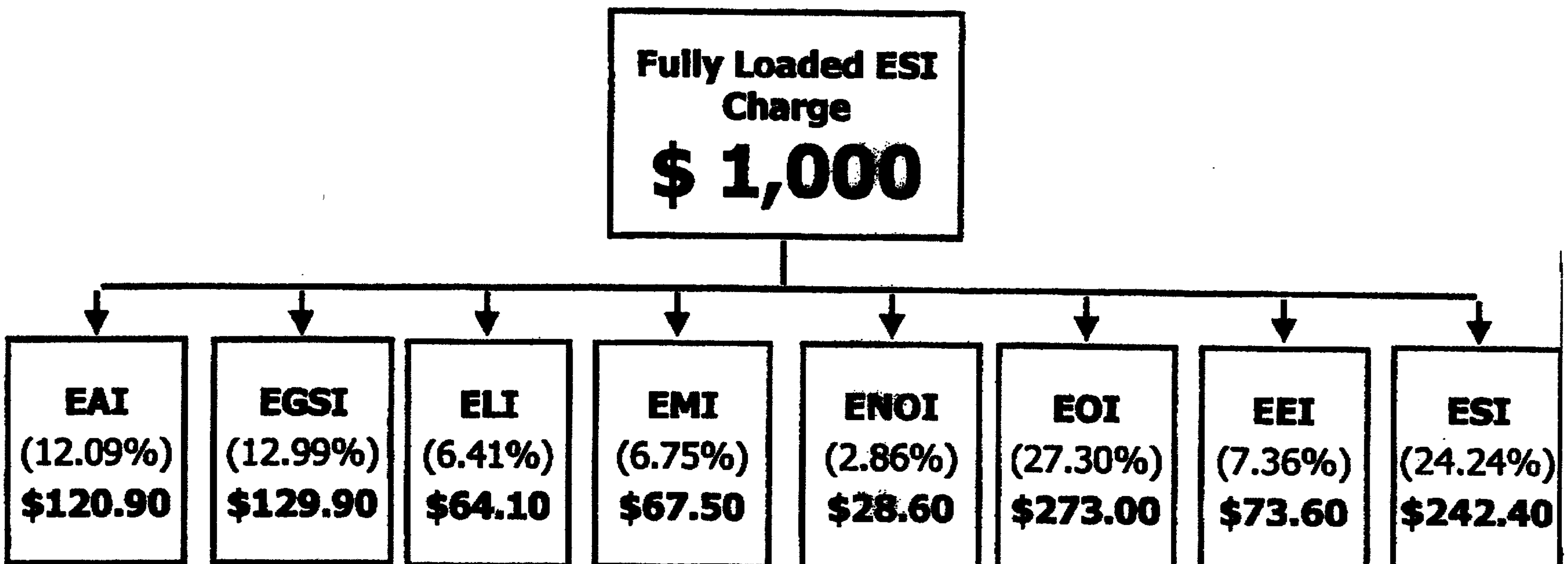


ESI Billing Process - Example

Project Code: **HRSALL** - ***Human Resources Services - All Companies***
ESI Billing Method: **18** - ***Number of Employees per Legal Entity (LE), including ESI***
Functional Billing Method: **EMP** - ***Number of Employees per Function***

<u>Step 1 & 2:</u> HR employees charge labor and other costs to project code HRSALL. The productive labor charges are "loaded" using pre-determined rates for corporate services such as facilities, desktop support, and payroll processing.

<u>Step 3:</u> The fully loaded ESI charges are billed to the Legal Entities using a specified billing method assigned to the project code. In this case, the billing method is based the total number of employees at each Legal Entity.



ESI Billing Process - Example

Step 4: Once the ESI charge is distributed to the legal entities, it is further allocated to the Functions within each Legal Entity based on a functional allocation method (FAM). In this case, the FAM is based on the same primary driver as the LE billing method - the number of employees - within each function at the receiving Legal Entity.

Legal Entity	Function	Allocation
EAI (12.09%) $120.90	President/CEO	9.17%; $11.09
	Customer Svc	10.81%; $13.07
	Fossil	27.24%; $32.93
	Franchise- Cnt	13.69%; $16.55
	Franchise- Nrth	28.82%; $34.85
	Retail	1.30%; $1.57
	Transmission	8.97%; $10.84
EGSI (12.99%) $129.90	President/CEO	8.52%; $11.07
	Customer Svc	13.07%; $16.98
	Fossil	26.01%; $33.79
	Franchise- Sth	20.58%; $26.73
	Franchise- SW	19.57%; $25.42
	Retail	1.96%; $2.54
	Transmission	10.29%; $13.37
ELI (6.41%) $64.10	President/CEO	7.93%; $5.08
	Customer Svc	2.81%; $1.80
	Fossil	20.97%; $13.44
	Franchise Ctrl	21.61%; $13.85
	Franchise- Met	17.39%; $11.14
	Franchise- Sth	17.52%; $11.23
	Retail	1.28%; $0.83
	Transmission	10.49%; $6.73
EMI (6.75%) $67.50	President/CEO	11.55%; $7.80
	Customer Svc	16.82%; $11.35
	Fossil	16.18%; $10.92
	Franchise- East	46.47%; $31.37
	Retail	.64%; $0.43
	Transmission	8.34%; $5.63
ENOI (28.60%) $28.60	President/CEO	16.21%; $4.64
	Customer Svc	1.22%; $0..35
	Fossil	12.54%; $3.58
	Franchise-Met	68.50%; $19.59
	Transmission	1.53%; $0.44
EOI (27.30%) $273.00	Nuclear	100%; $273.00
EEI (7.36%) $73.60	EPG	11.26%; $8.28
	EPMC	13.60%; $10.00
	EEI2	.22%; $0.18
	EHI	.11%; $0.08
	ENGC	68.78%; $50.62
	ENI	4.12%; $3.03
	EOSI	.78%; $0.57
	ETHC	.33%; $0.25
	EIHL	.11%; $0.09
	ETLL	.67%; $0.50
ESI (24.24%) $242.40	See Next Page	

ESI Billing Process - Example

Step 5: The piece of HR costs that is billed to ESI is captured in an HR/Payroll ESI loader clearing account and is kept segregated by benefiting function.

ESI (24.24%) **$242.40**

HR/Payroll Clearing Acct

- **Administration Services** (3.25%) **$ 7.90**
- **Corporate** (1.52%) **$3.70**
- **Customer Service Support** (19.20%) **$46.50**
- **Domestic Utility Management** (0.80%) **$1.90**
- **Energy Management** (2.74%) **$6.60**
- **Finance & Accounting** (9.56%) **$23.20**
- **Fossil Plant Operations** (5.13%) **$12.40**
- **Franchise Operations-Central** (1.00%) **$2.40**
- **Franchise Operations - Metro** (1.97%) **$4.80**
- **Franchise Operations - South** (0.95%) **$2.30**
- **Human Resources** (3.24%) **$7.90**
- **Information Technology** (20.11%) **$48.80**
- **Jurisdictional Operations - LA** (1.38%) **$3.40**
- **Legal Services** (2.58%) **$6.30**
- **Nuclear** (2.16%) **$5.20**
- **Public Relations & Affairs** (3.69%) **$8.90**
- **Retail Operations** (8.01%) **$19.40**
- **Supply Chain** (3.25%) **$7.90**
- **Transmission** (9.46%) **$22.90**

ESI Billing Process

There are several functions that use clearing accounts to capture their charges billed to ESI. The costs captured in the accounts are considered ESI operational support costs. The accounts are used as a "clearing house" to capture the costs and then allocate to Projects based on ESI labor. There are five different ESI loader clearing accounts currently being used. They are:

- Human Resources & Payroll - These are costs incurred by the HR and Payroll departments in support of ESI employees.
- Supervision & Support - a.k.a, Departmental Overheads. These costs are incurred in the support of an ESI department's operations. They are general in nature and include certain types of expenses incurred in all departments, regardless of the specific services they provide. Examples include secretarial labor, staff meeting time, and office supplies.

ESI Billing Process

There are five different ESI loader clearing accounts.

They are (cont'd):

- Desktop - These are costs incurred by IT in support of ESI desktop computer and associated peripheral configurations.
- Facilities - These are costs incurred by Administration & Support Services in support of ESI facilities.
- Voice & Video - These are costs incurred by IT in support of ESI telecommunication and video conferencing services.

ESI Billing Process - Example

Step 6: For HR as an ESI *Benefiting* Function, the clearing rates were calculated:

HR & Payroll Clearing Account	HR Clearing Rate =	Total HR/Payroll support costs billed to HR function / Total HR productive labor	= $90,000 / $4,500,000	= 2.00%
Supervision & Support Clearing Account	HR Clearing Rate =	Total Supervision & Support costs billed to HR function / Total HR productive labor	= $594,000 / $4,500,000	= 13.20%
Desktop Clearing Account	HR Clearing Rate =	Total Desktop support costs billed to HR function / Total HR productive labor	= $139,500 / $4,500,000	= 3.10%
Facilities Clearing Account	HR Clearing Rate =	Total Facilities support costs billed to HR function / Total HR productive labor	= $635,400 / $4,500,000	= 14.12%
Voice & Video Clearing Account	HR Clearing Rate =	Total Voice & Video support costs billed to HR function / Total HR productive labor	= $51,750 / $4,500,000	= 1.15%