

1 I. WITNESS INTRODUCTION AND PURPOSE OF TESTIMONY

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is William T. Craddock. My business address is P.O. Box
4 11168, Conway, Arkansas 72034.

5
6 Q. ARE YOU THE SAME WILLIAM T. CRADDOCK WHO FILED DIRECT
7 TESTIMONY IN THIS DOCKET ON AUGUST 24, 2005?

8 A. Yes. For both my direct and rebuttal testimony, I am testifying on behalf of
9 Entergy Gulf States, Inc. ("EGSI" or the "Company").

10

11 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

12 A. I address the following five topics.

13 1. I clarify that retail open access ("ROA") was not the primary
14 reason that the Entergy Operating Companies replaced the
15 old Customer Information System ("CIS") with the new
16 Customer Care & Service System ("CCS"). Texas Industrial
17 Energy Consumer ("TIEC") witness Jeffry Pollock suggests
18 otherwise at one point in his testimony.

19 2. I respond to Mr. Pollock's proposed adjustment to disallow
20 all of the costs of the Bill Delivery Functionality work
21 rendered unusable due to the delay in ROA.

22 3. I respond to Office of Public Utility Counsel ("OPC") witness
23 Carol A. Szerszen proposed disallowances for the following
24 costs:

- 25 ▪ the risk reward payments under the contract between
26 Science Applications International Corporation
27 ("SAIC") and Entergy Services, Inc. ("ESI");
- 28 ▪ the quality performance index costs under SAIC's
29 contract with ESI;

- 1 • costs for the UNIX server, the mainframe, and the NT
2 server; and
- 3 • all SAIC labor, materials, sales taxes, and other
4 charges.
- 5 4. I respond to State of Texas witness Hugh K. Higgins, Jr.
6 regarding SAIC invoices.
- 7 5. I provide errata to an exhibit in my Direct Testimony, Exhibit
8 WTC-6, page 1 of 2.

9

10 Q. DO YOU SPONSOR ANY REBUTTAL EXHIBITS?

11 A. Yes. My rebuttal exhibit is listed in the table of contents to this testimony.

12

13 II. REPLACING THE CIS WITH THE CCS

14 Q. WHAT TOPIC DO YOU DISCUSS IN THIS SECTION OF YOUR
15 TESTIMONY?

16 A. I respond to Mr. Pollock's statements that the Entergy Operating
17 Companies ("EOCs") replaced the older CIS with the new CCS and that
18 the CCS was "built to acquire the capabilities needed to support active
19 participation in ROA markets by the ERCOT [Electric Reliability Council of
20 Texas] REP [retail electric provider], as well as to allow the ESAT [Entergy
21 Settlement Area in Texas] REP to provide PTB [price-to-beat] and POLR
22 [provider of last resort] service."¹

¹ Direct Testimony of Jeffry Pollock at page 19, line 20 through page 20, line 2.

1 Q. WAS THE NEED TO IMPLEMENT ROA IN TEXAS AND IN OTHER EOC
2 JURISDICTIONS THE PRIMARY REASON THAT THE EOCs
3 REPLACED THE CIS WITH THE CCS?

4 A. No. Mr. Pollock is correct that the EOCs—including EGSI—made the
5 decision to replace the CIS with the CCS. Mr. Pollock also is correct that
6 in designing and implementing the CCS, EGSI had to ensure that the new
7 CCS would have the functionality to comply with and be usable in the
8 anticipated Texas ROA market. But as I explained in my direct testimony,²
9 ROA was not the primary reason that the EOCs replaced the CIS with the
10 CCS. Instead, the primary reason was that CIS was approaching
11 technological obsolescence. At a later point in his testimony, Mr. Pollock
12 recognizes that technological obsolescence was the primary reason that
13 the EOCs replaced the CIS.³

14 If the only point that Mr. Pollock is trying to make is that the new
15 CCS had to have functionality to operate in the anticipated Texas ROA
16 market, then I agree with him. If, however, he is suggesting that ROA is
17 the main reason that the EOCs implemented CCS, then he is wrong for
18 the reasons I discussed in my direct testimony.

² Direct Testimony of William T. Craddock at page 11, lines 15 – 23.

³ Direct Testimony of Jeffry Pollock at page 37, lines 2 – 4.

III.

UNUSABLE BILL DELIVERY FUNCTIONALITY DUE TO THE DELAY IN ROA

Q. WHAT TOPIC DO YOU DISCUSS IN THIS SECTION OF YOUR TESTIMONY?

A. In my direct testimony, I explained that \$1.4 million of work (including AFUDC; \$1.1 million without AFUDC) for the CCS Bill Delivery System has been rendered unusable due to the delay in ROA in ESAT.⁴ Mr. Pollock proposes that EGSI recover none of this \$1.4 million of unusable work because the Entergy Texas Distribution utility did not need a Bill Delivery System.⁵ In this section of my testimony, I explain that Mr. Pollock is correct that the unusable work on the Bill Delivery System was performed for the Entergy Retail Organization rather than for the Entergy Texas Distribution utility, but the work nonetheless was performed to implement ROA in ESAT. Thus, a portion of the \$1.4 million is a recoverable Transition to Competition ("TTC") cost because it represents work that would not have been undertaken but for the need to provide PTB and POLR service for ROA in ESAT.

⁴ Direct Testimony of William T. Craddock at page 23, lines 3 – 11; and page 38, line 6 through page 40, line 10.

⁵ Direct Testimony of Jeffry Pollock at page 43, line 3 through page 44, line 17.

1 Q. GIVEN THAT THE NOW UNUSABLE BILL DELIVERY WORK WAS
2 PERFORMED FOR THE ENTERGY RETAIL ORGANIZATION RATHER
3 THAN FOR THE ENTERGY TEXAS DISTRIBUTION UTILITY, WHY
4 WERE YOU THE WITNESS WHO TESTIFIED ABOUT THIS WORK IN
5 EGSi'S DIRECT CASE?

6 A. EGSi owns the Bill Delivery System that I discussed in my direct
7 testimony. Thus, I testified about the work performed on that System that
8 is now unusable due to the delay in implementing ROA in ESAT.

9
10 Q. WHAT WAS THIS WORK?

11 A. The work was programming work to make the Bill Delivery System
12 functional in the ESAT ROA market environment. More specifically, in
13 preparation for ROA, the Bill Delivery program was developed based on
14 an unbundled bill format. That unbundled bill format cannot be used by
15 EGSi in its current regulated environment and will have to be updated to
16 conform to the market rules in place when ROA is implemented in ESAT.
17 Thus, that work is now unusable.

18
19 Q. DO YOU AGREE WITH MR. POLLOCK'S PROPOSED ADJUSTMENT
20 TO DISALLOW ALL OF THIS UNUSABLE WORK?

21 A. No. A portion of the work was performed to implement ROA in ESAT.
22 Thus, a portion of the \$1.4 million of now unusable work should be
23 recoverable as a TTC cost in this docket.

1 Q. WHAT PORTION OF THE UNUSABLE BILL DELIVERY SYSTEM WORK
2 IS ASSOCIATED WITH IMPLEMENTING ROA IN ESAT?

3 A. Given that the unusable work on the bill delivery system was performed
4 for the Entergy Retail Organization, the dollars should be allocated
5 between ERCOT and ESAT in the same manner as Company witness
6 Andrew E. Quick's Customer Service TTC class of costs. In his direct
7 testimony, Mr. Quick assigns 84% of the costs in the Customer Service
8 class to ESAT and 16% to the Entergy Retail organization's operations in
9 ERCOT. Applying that allocation to the unusable work on the Bill Delivery
10 System produces \$913,990 of costs (before applying the Allowance for
11 Funds Used During Construction ("AFUDC") for work associated with
12 implementing ROA in ESAT, and \$1,215,297 with AFUDC.

13 Mr. Quick's rebuttal testimony presents an alternative allocation of
14 costs between ESAT and ERCOT (81% to ESAT; and 19% to ERCOT).
15 Applying those percentages to the unusable work on the Bill Delivery
16 System produces \$879,600 (before AFUDC) to ESAT, and \$1,169,623
17 with AFUDC.

18 Whichever percentage the Commission uses to allocate costs in
19 the Customer Service TTC class of costs to ESAT, that percentage also
20 should be applied to the unusable work on the Bill Delivery System, and
21 EGSI should be allowed to recover those costs as a reasonable and
22 necessary TTC expense in this docket.

1 IV. RISK REWARD PAYMENTS UNDER THE SAIC CONTRACT

2 Q. WHAT PROPOSED ADJUSTMENT DO YOU DISCUSS IN THIS
3 SECTION OF YOUR TESTIMONY?

4 A. I respond to Dr. Szerszen's proposed adjustment to disallow \$110,183 of
5 TTC costs associated with the Risk Reward Program.⁶ These payments
6 were made to SAIC.

7
8 Q. WHAT IS SAIC?

9 A. SAIC is a firm that provides outsourcing and information technology ("IT")
10 services to various companies throughout the world. Entergy Corporation
11 and its subsidiaries ("Entergy") have outsourced most of their basic,
12 routine IT work to SAIC. SAIC also performed some of the IT work
13 required for various TTC projects.

14
15 Q. WHAT IS THE BASIS FOR DR. SZERSZEN'S PROPOSED
16 ADJUSTMENT TO THE RISK REWARD PAYMENTS?

17 A. Dr. Szerszen states that she was unable to determine whether the risk
18 reward payments to SAIC were associated with SAIC's work on basic IT
19 functions or whether the payments were associated with SAIC's work on
20 TTC projects.⁷

⁶ Direct Testimony of Carol Szerszen at page 20, line 16 through page 21, line 2.

⁷ *Id.* at page 20, line 20 through page 21, line 1.

1 Q. IN THIS DOCKET, IS EGSi REQUESTING THE RECOVERY OF ANY
2 SAIC COSTS ASSOCIATED WITH BASIC, ROUTINE OUTSOURCED IT
3 FUNCTIONS?

4 A. No. All of the SAIC charges that EGSi has included in its request for cost
5 recovery in this docket are for work in support of the specific TTC projects
6 described by the Company's witnesses in their direct testimony. None of
7 the SAIC charges requested in this docket are for work on basic, routine
8 outsourced IT functions. SAIC's work on basic, routine outsourced IT
9 functions is recorded separately from its work on special, non-routine
10 projects such as implementing ROA. I discuss the difference between
11 SAIC's work on TTC projects and its work on basic, routine outsourced IT
12 functions in more detail in Section VII of this testimony.

13

14 Q. WHAT IS THE RISK REWARD PROGRAM?

15 A. The Risk Reward Program is the mechanism for Entergy and SAIC to
16 share the financial impact of annual cost variances as compared to the
17 agreed-upon level of costs (cost targets). In other words, Entergy and
18 SAIC establish annual cost targets associated with specific tasks,
19 operations, or projects, and then compare the actual costs to the cost
20 targets. Both favorable and unfavorable variances are shared under the
21 Program.

1 Q. IS THE RISK REWARD PROGRAM AN UNUSUAL TYPE OF
2 PROVISION IN A CONTRACT FOR IT SERVICES?

3 A. No. This type of program reduces the cost risk faced by both the buyer
4 (e.g., Entergy) and the vendor (e.g., SAIC) on work that is subject to
5 changes and contingencies. This reduction in risk leads to a lower price
6 for the buyer. Even if the buyer makes a payment to a vendor under this
7 type of program, the overall cost (the base price plus the payment under
8 this type of program) is typically less than what the buyer would pay under
9 a contract that shifted all cost risks onto the vendor.

10

11 Q. IN THIS DOCKET, WHAT DOES THE \$110,183 OF RISK REWARD
12 PAYMENTS REPRESENT?

13 A. The \$110,183 of Risk Reward Program payments shows that SAIC
14 produced cost under-runs, as measured against the cost targets, which
15 reduced the amount of TTC costs requested in this docket. The Risk
16 Reward Program payments are the dollar amounts owed to SAIC when
17 there are cost under-runs or the amounts that SAIC owes to Entergy when
18 there are cost over-runs. When there is a cost under-run, as measured
19 against the annual cost target, Entergy pays SAIC a portion of the
20 savings. When there is a cost over-run, as measured against the annual
21 cost target, SAIC pays Entergy for a portion of the overage.

1 Q. HOW WERE THE RISK REWARD PAYMENTS INCLUDED IN THE TTC
2 COSTS REQUESTED IN THIS DOCKET DETERMINED?

3 A. For each calendar year, the Risk Reward Program payment is calculated
4 on a total net basis for all work that SAIC performs. The cost under-runs
5 and cost over-runs during that calendar year are determined for each
6 project and are then aggregated into one net number (a total under-run or
7 a total over-run on all work).

8 The net under-run or over-run is then allocated back to the specific
9 individual projects that were aggregated into the net number. The
10 allocation back to the specific projects is based on each project's
11 individual contribution to the overall under-run or over-run.

12 Thus, the Risk Reward Program payments in the TTC costs
13 represent the allocated share of the Risk Reward Program payment for
14 the TTC projects.

15
16 Q. HOW ARE THE RISK REWARD COSTS REFLECTED IN THE TTC
17 COSTS REQUESTED IN THIS DOCKET?

18 A. The \$110,183 of Risk Reward payments are part of the SAIC costs for the
19 TTC activities at issue in this docket. The Risk Reward payments are
20 included within the various TTC Classes of costs supported by the
21 Company's direct testimony. The Company's direct testimony explained,
22 on a Class of TTC cost basis, that the TTC costs requested in this docket
23 are reasonable and necessary. For the reasons that the costs in each of

1 the TTC Classes are reasonable and necessary, the Risk Reward
2 payments are reasonable and necessary as well.
3

4 V.
5 QUALITY PERFORMANCE INDEX COSTS UNDER THE SAIC CONTRACT

6 Q. WHAT PROPOSED ADJUSTMENT DO YOU DISCUSS IN THIS
7 SECTION OF YOUR TESTIMONY?

8 A. I respond to Dr. Szerszen's proposed adjustment to disallow \$1,269,197
9 of costs associated with the Quality Performance Index ("QPI") program.⁸
10 These payments were made to SAIC.
11

12 Q. WHAT IS THE BASIS FOR DR. SZERSZEN'S PROPOSED
13 DISALLOWANCE?

14 A. She says that: (1) it is unclear to her whether the QPI payments are
15 associated with TTC activities; (2) it is unclear to her whether the
16 payments are for the cost of conducting benchmarking surveys or for
17 maintaining costs below some targeted levels; and (3) in her view, EGSI
18 has not provided sufficient evidence explaining how the payments are
19 reasonable and necessary.⁹

⁸ Direct Testimony of Carol Szerszen at page 21, line 16 through page 22, line 8.

⁹ *Id.*

1 Q. WHAT IS THE QUALITY PERFORMANCE INDEX PROGRAM?

2 A. The Quality Performance Index ("QPI") Program is a semi-annual
3 mechanism to reward SAIC for its non-financial performance. The QPI
4 Program focuses on two components: (1) customer satisfaction of
5 Entergy employees; and (2) SAIC's performance regarding designated
6 service levels.

7 The customer satisfaction component (the first component) of the
8 QPI Program is measured through two surveys.

9 ▪ First, an effectiveness survey is distributed to Entergy
10 IT governance employees on a quarterly basis. However,
11 only the second and fourth quarter effectiveness surveys are
12 used in the QPI calculations. The other two effectiveness
13 surveys are used to identify improvement opportunities.

14
15 ▪ Second, an end-user survey is distributed to a sample
16 of Entergy non-IT employees on a semi-annual basis.
17 These two surveys ask Entergy's IT managers and users to
18 rate SAIC's performance on such factors as IT application
19 availability and response time, functional effectiveness of
20 applications in supporting the business processes, technical
21 expertise, and timeliness in responding to questions or fixing
22 problems. These surveys were developed by the Gartner
23 Group, independent of Entergy, to measure effectiveness of
24 IT operations. They are administered by Gartner on
25 Entergy's behalf.

26
27 During the TTC cost period, except for the initial surveys in the
28 second quarter of 2000, the results of these two surveys were weighted 70
29 percent for the effectiveness survey and 30 percent for the end-user
30 survey.

31 For the second QPI component, SAIC's performance is tracked
32 against the designated service level metrics established in the contract

161

1 and reported monthly. These designated service levels include metrics
2 such as system availability and meeting daily operational delivery
3 deadlines for key application programs such as PeopleSoft accounts
4 payable, Payroll, Automated Mapping/Facilities Management ("AM/FM"),
5 iTron, and MV90.

6 These two components are combined to produce the semi-annual
7 QPI payments as a percentage of the cost target. The overall weighting of
8 these two QPI components has varied during the TTC cost period, as
9 described in the SAIC contract. The initial weighting (for 2000 and 2001),
10 was a maximum of 6 percentage points (of the cost target) for the
11 Customer Satisfaction Component and a maximum of 6 percentage points
12 (of the cost target) for the Designated Service Levels Component. In
13 2002, these weights were a maximum of 7 percentage points for each of
14 the two QPI components. Beginning in 2003, these weights were a
15 maximum of 5 percentage points for the Customer Satisfaction
16 Component and a maximum of 11 percentage points for the Designated
17 Service Levels Component.

18

19 Q. IS THERE A DIFFERENCE BETWEEN THE QPI PROGRAM AND THE
20 RISK REWARD PROGRAM THAT YOU DISCUSSED IN THE PREVIOUS
21 SECTION OF YOUR TESTIMONY?

162

1 A. Yes. The Risk Reward Program focuses on financial measures, and is
2 paid on an annual basis. The QPI Program focuses on non-financial
3 measures, and is paid on a semi-annual basis.
4

5 Q. WHAT DO THE QPI COSTS REPRESENT?

6 A. The QPI costs represent contractually agreed amounts paid to SAIC in
7 return for achieving designated non-financial performance metrics. The
8 \$1,269,197 of QPI payments are part of the SAIC costs for the TTC
9 activities at issue in this docket. The TTC costs requested in this docket
10 do not include QPI payments for non-TTC activities.
11

12 Q. PLEASE EXPLAIN HOW THE QPI COSTS INCLUDED IN THE TTC
13 COSTS REQUESTED IN THIS DOCKET WERE DETERMINED?

14 A. The QPI costs are calculated on a semi-annual basis as stated earlier.
15 These costs are then allocated to individual projects in relation to the
16 individual projects' shares of total project cost. The QPI costs included in
17 the TTC costs are the results of the overall QPI cost allocations for the
18 TTC projects.
19

20 Q. HOW ARE THE QPI COSTS REFLECTED IN THE TTC COSTS
21 REQUESTED IN THIS DOCKET?

22 A. The QPI costs are included within the various TTC Classes of costs
23 supported by the Company's direct testimony. The Company's direct

1 testimony explained, on a Class of TTC cost basis, that the TTC costs
2 requested in this docket are reasonable and necessary. For the reasons
3 that the costs in each of the TTC Classes are reasonable and necessary,
4 the QPI costs are reasonable and necessary as well.

5

6 VI. UNIX SERVER, MAINFRAME, AND NT SERVER COSTS

7 Q. WHAT PROPOSED ADJUSTMENT DO YOU DISCUSS IN THIS
8 SECTION OF YOUR TESTIMONY?

9 A. I respond to Dr. Szerszen's proposed adjustment to disallow \$104,960 of
10 costs for use of the UNIX server, the mainframe computer, and the NT
11 server (hardware equipment).¹⁰ She disallows these costs because, in her
12 view, it is unclear how the use of this hardware equipment is associated
13 with TTC activities and, again, that EGSI has not explained how these
14 specific costs are reasonable and necessary.¹¹

15

16 Q. PLEASE EXPLAIN THE PURPOSE OF THE UNIX SERVER, THE
17 MAINFRAME COMPUTER, AND THE NT SERVER.

18 A. During the TTC cost period, the mainframe computer was a large,
19 centrally located computer in the Entergy Computer Center in the Greater
20 New Orleans area. It was generally used for large application programs

¹⁰ Direct Testimony of Carol Szerszen at page 22, lines 9-16.

¹¹ *Id.* at lines 13 – 15.

1 and data bases. The UNIX and NT servers were mid-range computers
2 that were generally used for smaller applications and data bases.

3
4 Q. WAS THIS HARDWARE EQUIPMENT USED TO SUPPORT TTC
5 ACTIVITIES?

6 A. Yes. Costs were incurred for usage of both mainframe and mid-range
7 computers in support of the TTC activities. The various systems and
8 programs being developed and implemented to support ROA in ESAT
9 needed to be tested. These computers were used during the
10 development and testing phases of that implementation.

11
12 Q. PLEASE EXPLAIN WHAT THE \$104,960 OF CHARGES FOR USE OF
13 THIS HARDWARE EQUIPMENT REPRESENTS.

14 A. These costs are the user charges associated with testing systems' abilities
15 to deliver application services for designated TTC projects.

16
17 Q. HOW ARE THESE USER CHARGES REFLECTED IN THE TTC COSTS
18 REQUESTED IN THIS DOCKET?

19 A. These user charges are included within the various TTC Classes of costs
20 supported by the Company's direct testimony. The Company's direct
21 testimony explained, on a Class of TTC cost basis, that the TTC costs
22 requested in this docket are reasonable and necessary. For the reasons

1 that the costs in each of the TTC Classes are reasonable and necessary,
2 these user charges are reasonable and necessary as well.

3

4 VII. SAIC LABOR, SALES TAXES, MATERIALS, AND OTHER CHARGES

5 Q. WHAT PROPOSED ADJUSTMENT DO YOU DISCUSS IN THIS
6 SECTION OF YOUR TESTIMONY?

7 A. Dr. Szerszen states that she was unable to determine whether the SAIC
8 charges that EGSI is requesting in this docket are associated with basic,
9 routine IT work that EGSI has outsourced to SAIC or whether the SAIC
10 charges requested in this docket are specifically associated with TTC
11 projects. She also states that the SAIC charges requested in this docket
12 have not been discussed or documented to her satisfaction. Therefore,
13 she proposes an adjustment of \$14,233,204.31 to disallow 100% of the
14 SAIC labor charges, sales taxes, materials charges, and other charges.¹²
15 In this section of my testimony, I respond to Dr. Szerszen's proposed
16 adjustment.

17 In addition, Mr. Higgins suggests that the SAIC invoices represent
18 only "pseudo-invoices" that lack the proper detail to facilitate the Entergy
19 review and approval.¹³ I describe the SAIC invoice, and its review and
20 approval process.

21

22. ¹² Direct Testimony of Carol Szerszen at page 21, lines 9 – 15; and page 23, line 11 –

1 Q. EARLIER, IN SECTION IV OF YOUR REBUTTAL TESTIMONY, YOU
2 STATED THAT ENTERGY HAS OUTSOURCED MOST OF ITS BASIC,
3 ROUTINE IT WORK TO SAIC. PLEASE EXPLAIN THE TYPE OF BASIC,
4 ROUTINE IT WORK THAT SAIC PERFORMED FOR EGSI AND THE
5 ENTERGY OPERATING COMPANIES DURING THE TTC COST
6 PERIOD.

7 A. The SAIC routine work performed for Entergy includes, but is not limited
8 to: operations and maintenance of computing hardware; operations and
9 maintenance of designated application programs; enhancements of
10 existing application programs; development of new application programs;
11 operations and maintenance of telecommunications systems; deployment
12 of personal computers ("PCs"); and operations of a help desk.

13

14 Q. HOW IS SAIC'S WORK ON VARIOUS PROJECTS CAPTURED?

15 A. SAIC and Entergy use specific project codes to capture the costs
16 associated with each specific service that SAIC performs for Entergy.
17 SAIC's work on basic, routine IT work is captured in a set of project codes,
18 and SAIC's work on TTC projects was captured in a different set of project
19 codes. For example, each application program maintained by SAIC has
20 its own unique project code. When SAIC provided assistance with TTC
21 projects, the SAIC time and expenses were charged to the appropriate

¹³ Supplemental Direct Testimony of Hugh K. Higgins at page 15, lines 6 – 8.

1 project code. Thus, the SAIC costs included in this docket include only
2 those costs associated with TTC projects.

3
4 Q. IN THIS DOCKET, IS EGSI SEEKING TO RECOVER ITS COSTS FOR
5 SAIC'S BASIC, ROUTINE IT WORK?

6 A. No. All of the SAIC costs that EGSI is requesting in this docket are for
7 work in support of specific TTC projects and activities. SAIC's charges for
8 basic, routine IT work unrelated to TTC, as I described above, are not
9 included in the Company's TTC cost request.

10

11 Q. PLEASE DESCRIBE THE ENTERGY REVIEW PROCESS FOR SAIC
12 INVOICES.

13 A. The SAIC invoices for each four week period are forwarded electronically
14 to Entergy in several files. These files contain both summary and detailed
15 information by project code. The details for each project code include cost
16 and hours worked by individuals. These details are grouped by Entergy
17 Business Unit.

18 Mr. Higgins is correct in that the SAIC invoices are contained in
19 several Excel files. However, he is wrong about the lack of detail. They
20 are not easily reproduced, contrary to Mr. Higgins's suggestion.¹⁴

21 The appropriate management personnel in each Business Unit
22 review the portions of the SAIC invoice pertaining to his or her Business

1 Unit. This decentralized, detailed process ensures that personnel most
2 familiar with the projects covered by the SAIC invoice are involved in the
3 detailed reviews.

4 In parallel with these Business Unit reviews, the IT Performance
5 Management Department performs a high level review, and then initiates
6 both the payment to SAIC and the proper accounting of the appropriate
7 SAIC costs to each project code. Corrections, if any, are identified during
8 the Business Unit detailed reviews, and are generally incorporated into the
9 SAIC invoice for the next period.

10

11 Q. WHAT ARE THE SAIC LABOR CHARGES, SALES TAXES, MATERIALS,
12 AND OTHER CHARGES THAT WERE QUESTIONED BY DR.
13 SZERSZEN?

14 A. The SAIC labor charges represent labor costs incurred by SAIC
15 employees for work in support of specific TTC projects. Materials costs
16 represent supplies, software, and hardware costs incurred by SAIC for
17 work in support of specific TTC projects. Sales taxes represent payments
18 to local taxing jurisdictions for taxes on labor for specific TTC projects.
19 Other charges represent non-labor, non-materials expenses such as travel
20 costs, employee expenses, and meals for specific TTC projects.

21

¹⁴ Supplemental Direct Testimony of Hugh K. Higgins at page 16, line 3, and n. 43.

1 Q. HOW ARE THESE SAIC LABOR CHARGES, SALES TAXES,
2 MATERIALS, AND OTHER CHARGES REFLECTED IN THE TTC
3 COSTS REQUESTED IN THIS DOCKET?

4 A. These charges are included within the various TTC Classes of costs
5 supported by the Company's direct testimony. The Company's direct
6 testimony explained, on a Class of TTC cost basis, that the TTC costs
7 requested in this docket are reasonable and necessary. For the reasons
8 that the costs in each of the TTC Classes are reasonable and necessary,
9 these charges are reasonable and necessary as well.
10

11 VIII. ERRATA TO EXHIBIT WTC-6

12 Q. WHAT TOPIC DO YOU DISCUSS IN THIS SECTION OF YOUR
13 TESTIMONY?

14 A. During the technical conference held on November 14, 2005, I stated that
15 the originally filed Exhibit WTC-6 contained two scrivener's errors in Note
16 C, neither of which affected the analysis in the exhibit. In this section of
17 my testimony, I provide the corrected version of the exhibit.
18

19 Q. PLEASE EXPLAIN THE CORRECTIONS TO THE SCRIVENER'S
20 ERRORS.

21 A. Both of the scrivener's errors appear on Exhibit WTC-6, page 1 of 2, Note
22 C [Bates page 2-429]. The corrected page 1 of the exhibit is provided as
23 my rebuttal Exhibit WTC-R-1. The first revision to Note C replaces the

1 number \$2,662,626 with the number \$3,183,975. The second revision to
2 Note C corrects a transposition of numbers (the number \$9,986,961 in the
3 original exhibit should be \$9,896,961).

4

5 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

6 A. Yes, at this time.

Activity	Base Hours	Base Cost	Not Usable %	Not Usable Cost	Note
1 Requirements	5,880	441,000	100%	441,000	A
2 Core Development	9,298	1,162,288	23%	261,515	B
3 Rates Development	5,057	632,143	100%	632,143	
4 Testing Infrastructure	4,573	571,625	100%	571,625	
5 System Testing	13,389	1,004,103	50%	502,052	A
6 Assembly Test Support	7,239	904,914	50%	452,457	A
7 System Test Support	5,171	646,367	50%	323,184	A
8 Non-Discretionary SCR's	3,006	375,788	0%	0	
9 Legacy	866	86,570	0%	0	
10 Conversion	6,095	609,500	0%	0	
11 Acceptance Test	8,936	670,163	0%	0	
12 Acceptance Test Support	0	0	0%	0	
13 Training Development	4,400	330,000	0%	0	
14 Training Time	19,500	1,462,500	0%	0	
15 Performance Test	0	1,000,000	0%	0	
16 Legacy Test Support	0	0	0%	0	
17 Subtotal	93,410	\$9,896,961		\$3,183,975	
18 PMO & Mgt Overhead	9,600	1,200,000	32%	386,055	C
19 Total	103,010	\$11,096,961		\$3,570,030	
20 Subtotal without PMO & Mgt OH	93,410	\$9,896,961			
21 AFUDC				\$1,396,836	
22 Total with AFUDC				\$4,966,866	

Notes

- A Project Management assumption
- B This "not usable" percentage is calculated by dividing the AR/CC core hours (2093) by the total core hours (9298) from TeamPlay details
- C This "not usable" percentage is calculated by dividing the not usable activity subtotal (\$3,183,975) by the total non-PMO & Mgt Overhead Hours (\$9,896,961)

Assumptions

- 1 The EGSI TX costs are comparable to the EGSI LA costs.
- 2 The functionality not usable was programmed based on deregulated market rules.
- 3 Not all activities are unusable. Refer to the "not usable %" column.

172

R-00172

SOAH DOCKET NO. 473-06-0092
PUC DOCKET NO. 31544

APPLICATION OF ENTERGY
GULF STATES, INC. FOR
RECOVERY OF TRANSITION
TO COMPETITION COSTS

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PUBLIC UTILITY COMMISSION

OF TEXAS

REBUTTAL TESTIMONY

OF

DENNIS L. THOMAS, Ph.D.

ON BEHALF OF

ENTERGY GULF STATES, INC.

FEBRUARY 10, 2006

SOAH DOCKET NO. 473-06-0092

PUC DOCKET NO. 31544

APPLICATION OF
ENTERGY GULF STATES, INC.
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TRANSITION TO COMPETITION COSTS

REBUTTAL TESTIMONY OF DENNIS L. THOMAS

TABLE OF CONTENTS

	<u>Page</u>
I Introduction and Purpose of Testimony	1
II Burden of Proof	2
III Use of Annual Reports	13
IV Relevance of Cuddy's Cost Estimation Model	17
V Outsourcing as a Means to Prove Reasonableness	18
VI Appropriate Carrying Costs	20
VII Conclusion	22

EXHIBITS

Exh. DLT-R-1 Transcript of Senate Committee on Business And Commerce
Hearing (May 12, 2005)

1 I. INTRODUCTION AND PURPOSE OF TESTIMONY

2 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

3 A. My name is Dennis L. Thomas. My business address is 1210 San
4 Antonio, Suite 203, Austin, Texas 78701.

5

6 Q. ARE YOU THE SAME DENNIS L. THOMAS WHO FILED DIRECT
7 TESTIMONY IN THIS DOCKET ON AUGUST 24, 2005?

8 A. Yes. For both my direct and rebuttal testimony, I am testifying on behalf of
9 Entergy Gulf States, Inc. ("EGSI" or the "Company").

10

11 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

12 A. The first purpose of my testimony is to rebut assertions in the testimonies
13 filed by State's witness Higgins and Office of Public Utility Counsel's
14 ("OPC's") witnesses Norwood and Szerszen on January 13, 2006
15 regarding the burden of proof in this docket. I explain that EGSI has
16 provided the proof necessary under PURA for the Commission to
17 determine that the TTC costs claimed by the Company were both
18 reasonable and necessary. I explain that these witnesses attempt to
19 change the applicable burden of proof and essentially ask the Commission
20 to adopt a different burden of proof standard with added requirements that
21 are not based on statute or Commission precedent. Second, I rebut the
22 assertions of OPC witness Szerszen and Cities witness Pous that EGSI's
23 Annual Reports must be adjusted when used to determine whether EGSI

1 has previously recovered TTC costs. In this regard, I discuss Legislative
2 intent underlying the Annual Reports. Third, I rebut the assertions by
3 Cities witness Goins that the Cost Estimation Model developed by EGS
4 witness Cuddy is invalid as evidence of reasonableness. Fourth, I rebut
5 the assertion by OPC witness Szerszen that SAIC outsourcing expenses
6 should be disallowed. Lastly, I address the recommendations by TIEC
7 witness Pollock and Cities witness Pous that carrying costs should be
8 reduced from those last set by the Commission at EGS's weighted
9 average cost of capital.

10

11 II. BURDEN OF PROOF

12 Q. WHAT STATEMENTS AND CONCLUSIONS OF MR. HIGGINS
13 REGARDING BURDEN OF PROOF WILL YOU ADDRESS?

14 A. Mr. Higgins argues for a complete financial audit of TTC costs in order to
15 prove reasonableness. For example, he states on his page 6, lines 15-16:
16 "in my opinion, in order to meet its burden of proof, the company must, at
17 a minimum, be subject to these financial audit requirements." Mr. Higgins
18 goes on to state on page 8, lines 2-4: "...I was frankly shocked that the
19 company did not employ this generally accepted means to prove up its
20 TTC costs in Texas." On page 10, lines 2-3, Mr. Higgins states: "it was
21 unreasonable for the company not to have employed this generally
22 accepted procedure for verification of dollar amounts." In summary, Mr.
23 Higgins states on page 36, lines 68: "the company should, among other

1 things, retain an independent public accounting firm to review a newly
2 reorganized application and to opine on the quality of the dollar amounts
3 included in such new application.”
4

5 Q. HOW DO YOU RESPOND TO THESE ASSERTIONS BY MR. HIGGINS?

6 A. Mr. Higgins is incorrect about the proof required under new Section
7 39.454 of PURA. It is clear from his testimony and from Mr. Higgins’
8 background that he is trained and has spent his career as an accountant.
9 He apparently believes that all questions of cost recovery must begin with
10 an audit. In this regard, Mr. Higgins is like a classic Italian chef. From his
11 training and experience, all recipes begin with a clove of garlic. The
12 recipe for cost recovery in this transition to competition case, however,
13 does not call for garlic, and as established in statute and Commission
14 precedent, does not call for a new financial audit.

15 Audit requirements have a mixed history at the PUC. Some
16 proceedings call for audits, some proceedings do not. For example, prior
17 to Senate Bill 7 (SB 7), the Commission’s rate filing package for rate
18 cases filed by electric utilities (approved September 9, 1992) calls for an
19 audit under “Schedule S: Test-year Review.” In contrast, the rate filing
20 package for base rate cases by transmission and distribution companies
21 (unbundled electric utilities) approved April 2, 2003 does not call for an
22 audit. Also, the rate filing package for the Unbundled Cost of Service
23 filings did not require an audit. Fuel cases do not require an audit. In

1 summary, either PURA or the Commission could have required an audit
2 for recovery of TTC costs, but neither did so. The assertion by Mr.
3 Higgins that all costs are unreasonable without an audit may reflect his
4 preference, but it does not reflect the Commission's requirements with
5 respect to the Company's filing.

6

7 Q. DO AUDITED NUMBERS EQUATE TO REASONABLENESS?

8 A. No. Audits can be designed for many purposes. In general, an audit
9 follows a sample of entries to determine whether the books and records of
10 the company operate as intended and as required. The annual financial
11 audit required of a public company is a common example. The issue of
12 reasonableness is much broader and often involves the question,
13 "Reasonable compared to what"? A financial audit is not a particularly
14 good way to prove reasonableness as required under Commission
15 precedent. Instead, the Commission's approach for proving
16 reasonableness is for the Company to select from a broad range of tools
17 to show reasonableness based upon the nature and type of cost. The
18 Company's use of this "tool box" approach to demonstrate
19 reasonableness is well established in Commission precedent, especially
20 for affiliate costs. As noted in my direct testimony, the Company adopts
21 the same reasonableness and necessity affiliate cost burden for both
22 affiliate and non-affiliate costs, even though it is generally thought that
23 affiliate costs have a higher burden.

1 The Company does use audits for a number of purposes. The
2 Company's books and records are audited every year. This annual
3 financial audit establishes that the books and records of the Company
4 create a reasonable picture of its financial condition. In addition, in this
5 docket, EGSi retained PricewaterhouseCoopers, to perform a specialized
6 external review to demonstrate the accounting process for affiliate
7 expenses operates as described. This point is addressed in more detail in
8 the rebuttal testimony of company witness Niehaus.

9
10 Q. WHY DIDN'T THE COMPANY JUST GO AHEAD AND CONDUCT AN
11 AUDIT LIKE MR. HIGGINS DESIRES, AS A FAILSAFE?

12 A. There are at least three reasons. The first and most obvious has been
13 discussed—an audit was not required by statute or Commission rule.
14 Second, an audit is not an inexpensive or quick turnaround project. For
15 example, in the Company's rate case filed in August in Docket No. 30123,
16 EGSi was a bundled company and therefore subject to Section S of the
17 1992 rate filing package. The audit in that rate case cost \$680,000, and
18 took several months to compete. It only covered a single test year. In this
19 case, the expenditures range over six years, which would have made an
20 audit even more difficult and potentially more expensive, if possible at all.
21 Last, as discussed, an audit by itself would not have established
22 reasonableness and is not an approach I would have recommended.

23

1 Q. MR. HIGGINS APPEARS TO BE ARGUING THAT TTC COSTS CANNOT
2 BE RECOVERED UNLESS THEY ARE SUPPORTED BY A LEVEL OF
3 PROOF THAT ALLOWS EACH AND EVERY DOLLAR TO BE
4 SPECIFICALLY TRACKED TO AND SUPPORTED BY AN INVOICE,
5 EMPLOYEE EXPENSE REPORT, OR OTHER SOURCE DOCUMENT.
6 IS THIS APPROACH SUPPORTED BY COMMISSION PRECEDENT?

7 A. No, it is not. The only instance I am aware of in which the Commission has
8 required such detailed invoice support has been regarding the scrutiny of
9 rate case expenses. The Commission has never, to my knowledge,
10 extended this requirement to make it one of general applicability. It has
11 not been applied, to my knowledge, in either a base rate case or a fuel
12 reconciliation, where hundreds of millions of dollars in utility expenditures
13 with third parties, including affiliates, are in question. The most rigorous
14 standard of which I am aware regarding supporting proof is that for affiliate
15 costs, which I discussed above and in my direct testimony. The affiliate
16 standard is the one adopted by the Company in this docket and is the
17 standard I believe EGSI has met.

18
19 Q. WHAT STATEMENTS AND CONCLUSIONS OF MR. NORWOOD
20 REGARDING BURDEN OF PROOF WILL YOU ADDRESS?

21 A. Mr. Norwood, on page 8 of his testimony, notes that the company has
22 divided its costs into fourteen cost classes. He then states that this
23 organization of the case is inadequate and that the Company should have

1 identified the claimed costs for each docket created by the Commission to
2 implement retail open access.
3

4 Q. DO YOU AGREE WITH THIS POSITION?

5 A. No. Mr. Norwood's request for different TTC classes or more TTC classes
6 reminds me of the television parable where the Master instructs his
7 student: "Go bring me a rock." The dutiful student goes outside and
8 comes back with a middle-size rock. The Master replies, "Ahh,
9 Grasshopper, but that is the wrong rock." The Company chose the 14
10 cost classes because they made sense for presentation and logical
11 development of the case. EGSi organized its TTC costs in classes by
12 using like groupings of project codes, which is the way that the costs are
13 recorded, tracked and managed in the corporate accounting system. As
14 explained in my direct testimony, each witness supported the
15 reasonableness and necessity of the classes they sponsor by reference to
16 proof that the Commission has indicated in prior precedent is appropriate
17 to meet the standards for recovery of affiliate costs. The accounting
18 system was able to produce the costs and the cost records based upon
19 those 14 classes, but could have also produced a cost categorization that
20 included double or triple that number of categories. Frankly, the Company
21 believed the TTC case with six years' worth of transition to competition
22 experience was already sufficiently complex. As noted several times in
23 the Company's presentation, more than 50 PUC dockets were contained

1 in the six-year TTC process. This set of dockets was evolutionary.
2 Moreover, much of the transition work had begun before the dockets had
3 been established, and not all of the work is easily related to a specific
4 docket.

5 Mr. Norwood does not successfully make the case that dividing the
6 costs by docket is essential to a review of reasonableness. Mr. Norwood
7 also does not suggest that it was unnecessary for EGSi to have
8 participated in one or more of the dockets listed in Company witness
9 May's Exhibit PRM-7. In summary, TTC costs recorded by PUC docket or
10 project number was not a method that made sense at the time for the
11 Company to keep its financial records, particularly given the evolutionary
12 nature of intertwined dockets and projects in the six-year TTC effort.

13 In considering Mr. Norwood's suggestion for a post hoc allocation
14 to dockets, it is important to note a substantial amount of the costs do not
15 directly relate to the cost of participating in a particular PUC project or
16 docket. Post hoc allocations by docket can result in a number of force fits
17 and arbitrary divisions. A docket-based categorization would be most
18 applicable for the lawyer and rate case-type expenses. But rate case
19 types of costs have already been the subject of an extensive, invoice by
20 invoice review and support by the Company's rate case expense expert,
21 Ms. Trostle. Other costs in the TTC request, such as the design and
22 development of business systems such as Texas SET, the IT systems to
23 support PTB and POLR service, the distribution company's systems for

1 dealing with load profiling and data aggregation, and the setup and
2 operation of the pilot project, do not usefully divide by docket or project.
3 Similarly, general internal regulatory planning and implementation
4 activities that cut across various TTC subject matters do not lend
5 themselves easily to such categorization. Mr. Norwood's suggestion
6 would not add further clarity to the categorization of the TTC costs.
7 Instead, it would force the Company to make arbitrary assignments of
8 costs into categories that relate poorly to the manner in which the costs
9 were actually tracked and managed.

10 The overall question, "how many classes is enough" is one that
11 has been discussed several times in PUC review of affiliate expenses.
12 The pragmatic conclusion one draws from those cases is that a Company
13 must present enough categories to provide a detailed and logical
14 categorization of the expenses, but not so many as to make review
15 impossible. My review of the cost information in this case indicates the
16 Company did a reasonable job of walking that fine line.

17

18 Q. ARE THERE OTHER STATEMENTS AND CONCLUSIONS OF MR.
19 NORWOOD YOU WILL ADDRESS?

20 A. Yes. On page 4, lines 6-13, Mr. Norwood states, "I have determined that,
21 due to the manner in which EGSi accounted for TTC costs by generic cost
22 classes, it is not possible to determine whether all costs of the specific
23 activities for which the company is seeking to recover as TTC costs are

1 indeed eligible for recovery under section 39.454 of PURA." He goes on
2 to suggest a remedy for this alleged failure by recommending carrying
3 charges be adjusted downward to eliminate equity return.
4

5 Q. DO YOU AGREE?

6 A. No. I disagree with Mr. Norwood's assertion that presentation of cost
7 information by "broad category" (to use his term) makes it impossible to
8 determine whether the costs are eligible for recovery. That is not the
9 standard in the statute. For TTC costs to be recovered, they must have
10 been incurred to comply with PURA Chapter 39, they must have been
11 necessary, they must have been reasonable, and they must not have
12 been previously recovered. The presentation by discrete cost classes was
13 intended to group similar costs around common purposes and
14 requirements of the transition to competition process. Costs are shown to
15 be necessary by relating them to a specific statute, Commission Order, or
16 docket. Grouping costs into a manageable number of classes facilitates
17 that review. Costs are shown to be reasonable using decision methods
18 and tools established over time at the Commission as available means to
19 show reasonableness. Once again, grouping similar costs into discrete
20 classes facilitates the review of reasonableness.

21 The remedy proposed by Mr. Norwood—elimination of equity
22 return on carrying costs—bears no relationship to whether the costs are
23 reasonable and necessary. Instead, Mr. Norwood proposes a broad-

1 brush punishment for the deficiency he alleges: failure to divide costs into
2 more numerous or differently identified categories that he would have liked
3 to see. I do not agree with his assertion, and do not feel the penalty he
4 proposes bears any relationship to the deficiency he asserts. It is a shot
5 in the dark attempt to disallow costs to which EGSI is entitled under
6 PURA.

7

8 Q. PLEASE SUMMARIZE MR. NORWOOD'S RECOMMENDATIONS:

9 A. On page 18, line 7 through page 20, line 5, Mr. Norwood summarizes his
10 recommendations in the case and once again asserts that even though
11 the Company has tied its expenses to the transition activities in dockets
12 ongoing at the Commission in the six-year timeframe, that the Company
13 has still not proved necessity.

14

15 Q. DO YOU AGREE?

16 A. No. Mr. Norwood's position ignores two basic facts of life concerning this
17 transition. The first is that Entergy was required by SB 7 to transform itself
18 from a bundled electric utility into unbundled companies—some of which
19 would be competitive, and others that would remain regulated. The
20 transformation was by no means optional and the timeframe was
21 compressed. With hindsight, we now know the transformation for EGSI
22 was not possible in the timeframe, due largely to external issues related to
23 control of the transmission system. The second basic fact of life Mr.

1 Norwood ignores is that the new statute that allows EGSI to recover its
2 TTC costs (House Bill ("HB") 1567) specifically removes doubt whether
3 the Company is allowed to recover expenditures made during this first
4 attempted transition. The statute goes beyond the mere possibility of
5 recovery to create an entitlement of recovery. Mr. Norwood's position
6 does not comport with reality.

7
8 Q. BOTH MR. NORWOOD AND MR. HIGGINS APPEAR TO BELIEVE THAT
9 AT LEAST ONE POTENTIAL RESULT FROM EGSI'S ALLEGED
10 FAILURE TO MEET ITS BURDEN OF PROOF IS THAT ALL OF THE
11 COMPANY'S REQUESTED TTC COSTS MUST BE DISALLOWED.
12 DOES PURA CONTEMPLATE THIS RESULT?

13 A. No, it does not. I must first say, in my opinion, the Company's proof is
14 more than sufficient to meet its burden of proof under PURA § 39.452.
15 Therefore, the total disallowance alluded to by Mr. Higgins and Mr.
16 Norwood is not applicable. Moreover, it is also important to remember
17 their stated position is exactly what the recent amendments to PURA's
18 affiliate provisions, Section 36.058(f), were designed to prevent. As I
19 explained in my direct testimony, that new provision states:

20 If the regulatory authority finds that an affiliate expense for the test
21 period is unreasonable, the regulatory authority shall:

22
23 (1) determine the reasonable level of the expense; and

24
25 (2) include that expense in determining the electric utility's cost of
26 service.

1
2 Under the new generation of PURA, Mr. Norwood and Mr. Higgins
3 misstate the consequences in the event a utility fails to meet the burden of
4 proof standards with respect to affiliate costs, remembering that affiliate
5 costs tend to require heightened scrutiny over non-affiliate costs. As
6 stated earlier, the Company has chosen to address the heightened affiliate
7 standards with respect to both affiliate and non-affiliate costs in this case.
8 Consequently, were there to be a deficiency in the level of proof for any of
9 the costs in this case, affiliate or non-affiliate (I do not believe a deficiency
10 exists), then the appropriate remedy is to apply the requirements of
11 Section 36.058(f) to "determine the reasonable level," rather than deny
12 recovery altogether.

13

14 III. USE OF ANNUAL REPORTS

15 Q. DR. SZERSZEN FOR OPUC AND MR. POUS ON BEHALF OF CITIES
16 BOTH ASSERT THAT THE ANNUAL REPORTS FILED AT THE PUC
17 CANNOT BE USED IN THEIR CURRENT FORM TO DETERMINE
18 WHETHER OR NOT EGSi HAS RECOVERED ITS TTC COSTS. BOTH
19 SUGGEST NUMEROUS ADJUSTMENTS. DO YOU AGREE WITH
20 THEIR VIEWS OF THE ANNUAL REPORTS?

21 A. No. The issue of how to determine whether the Company has previously
22 recovered its transition costs came up during the Legislative hearings on
23 HB 1567. In my opinion, and based on the legislative record I refer to

1 below, the object of the legislation was not only to grant TTC cost
2 recovery, but to do so in a simplified manner utilizing the annual report.
3 Some of the most direct statements consistent with this object were made
4 by Senate sponsor, Tommy Williams, in the May 12, 2005 hearing before
5 the Senate Committee on Business and Commerce. Senator Williams
6 states that the annual earnings reports, without any reference to
7 adjustments, would be used to determine whether or not the Company
8 has recovered these transition costs:

9 Members, I want to highlight one important provision
10 covered in our bill. The committee substitute to House Bill
11 1567 specifically prohibits the so-called "double recovery of
12 costs." Entergy may recover through rate riders in
13 proceedings at the Commission. In regard to transition
14 costs, the PUC will determine if it costs—if costs for
15 transition to competition have been previously recovered by
16 review of the annual earnings report filed by the Company.
17 Public Hearing Senate Business and Commerce Committee
18 Tr. (5/12/05) at 4-5.

19
20 Most notably, the reference is to the "annual earnings report filed by the
21 Company" is a reference to the annual reports put into place by PURA §§
22 39.257-260 and filed year-by-year by the Company since 1999. I attended
23 that Senate Committee hearing and reviewed the video record of that
24 hearing. The language quoted above is accurate with my recollection of
25 Senator Williams' statement. I have also attached a verified and complete
26 copy of the transcript of that hearing as my Exhibit DLT-R-1, which reflects
27 that same language on page 4-5.

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188

1 Q. DO YOU TYPICALLY RELY ON SUCH STATEMENTS TO DETERMINE
2 THE OBJECT OF LEGISLATION BEARING ON REGULATORY
3 MATTERS?

4 A. Yes. In my experience with implementing PURA, the statement of key
5 legislators working on a piece of legislation, such as the legislative
6 sponsor (in this instance, Senator Williams), is given significant weight
7 when applying a new statutory provision.

8
9 Q. HOW WOULD YOU APPLY THIS LEGISLATIVE HISTORY TO EGSI'S
10 SITUATION IN THIS DOCKET?

11 A. Senator Williams' statement makes sense in the regulatory context. The
12 Legislature, through PURA, including PURA §39.454 and the Commission
13 have established clear instructions and requirements governing the filing
14 of these reports. Moreover, the Commission has expressly reviewed and
15 approved the Company's annual report filings for 1999-2001. There is no
16 authority for adjustments to that filing—such as those made by Dr.
17 Szerszen and Mr. Pous. Mr. Wright's Direct Testimony presents the
18 annual earnings reports and establishes that the Company has not
19 recovered the costs. Attempts by Dr. Szerszen and Mr. Pous to overturn
20 Mr. Wright's finding through multiple adjustments to the earnings reports,
21 goes outside the intent of the statute.

22 Pursuant to SB 7, utilities were permitted to recover their transition
23 costs through an unadjusted as-filed review of their annual reports. In

1 keeping with that precedent, the legislative history of PURA § 39.454
2 shows the Legislature's expectation that whether EGSi had already
3 recovered its TTC costs would be measured using the same standard.

4 With passage of HB 1567, EGSi's burden is actually higher than
5 that of other utilities that have relied on the annual report process to
6 resolve the issue of TTC cost recovery. Other utilities sought recovery
7 without similar scrutiny as to whether transition costs were reasonable or
8 necessary. In contrast, pursuant to HB 1567, EGSi's TTC costs can only
9 be recovered if they have been determined to be reasonable and
10 necessary. There is not authority to impose an even greater burden on
11 EGSi through the annual report adjustments recommended by Dr.
12 Szerszen and Mr. Pous.

13 Finally, I note that SB 7, in addition to transition costs, also
14 established the annual reports process, without adjustment, as the means
15 to determine whether investor-owned electric utilities in Texas were
16 overearning for the purpose of stranded cost recovery. If the unadjusted,
17 as-filed annual reports process was sufficient for dealing with the
18 magnitude and complexity of stranded costs resulting from the transition to
19 retail open access, it certainly can and should be relied on to address the
20 earnings profile of EGSi with regard to its TTC costs. The
21 recommendation for further adjustments should be rejected.

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IV. USE OF MS. CUDDY'S COST ESTIMATION MODEL

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Q. DR. GOINS ON BEHALF OF CITIES PRESENTS HIS OPINION THAT
EGSI WITNESS CUDDY'S ANALYSIS ON THE REASONABLENESS OF
EGSI TTC IS INVALID. DO YOU AGREE WITH DR. GOINS?

5

6

A. No. On page 19, lines 3 – 5, Dr. Goins states: "her CEM (cost estimation
model) may be suitable for developing Structure's bids in response to
requests for proposal, but it is unsuitable for evaluating the
reasonableness and prudence of EGSi's TTC costs." I disagree. As I
stated in my direct testimony, Ms. Cuddy's work provides a useful external
benchmark for the dollars spent by EGSi in several of the major TTC
classes. Dr. Goins' rejection is quite broad brush. He does not criticize
Ms. Cuddy's specific methodology or the inputs to her estimate. In my
mind, her work is very similar to the findings and analysis expected of an
outside appraiser in a real property transaction. She investigated several
potential methods to establish a reference price and then settles on what
in real estate terms would be known as replacement cost. Ms. Cuddy
then goes on to provide a detailed analysis of what her company—
Structure Consulting Group—would have charged to develop the systems
discussed by EGSi witnesses. As Ms. Cuddy points out, the price
Structure would have bid to replicate the systems is higher than the
amount actually spent by EGSi. Ms. Cuddy's estimate is only one of the
methods presented by EGSi to show reasonableness, but in my opinion, it

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1 is an important and enlightening method. Decision-makers in this case
2 can decide for themselves what weight to place on Ms. Cuddy's testimony
3 as an external expert, just as they would for replacement cost in real
4 estate. But, it is clear that Ms. Cuddy's testimony is both valid and
5 relevant.

6
7 V. OUTSOURCING AS A MEANS TO PROVE REASONABLENESS

8 Q. DR. SZERSZEN FOR OPC PROPOSES TO DISALLOW A LARGE
9 PORTION OF THE TTC COSTS INCURRED THROUGH SAIC (THE
10 OUTSOURCED INFORMATION TECHNOLOGY PROVIDER FOR
11 ENTERGY) ON THE BASIS THAT THE ROLE PLAYED BY SAIC HAS
12 NOT BEEN CLEARLY DEFINED (SEE PAGE 23, LINES 13-22). DO
13 YOU AGREE WITH DR. SZERSZEN'S PROPOSAL?

14 A. No. A point that is clearly established in the EGSi direct testimony is the
15 central role of Information Technology (IT) in the transition to competition.
16 Entire new systems were required across the Texas electric industry in
17 order to unbundle the companies and to transition to a central registration,
18 billing and scheduling entity (ERCOT) and then to operate in that
19 unbundled, competitive retail market. At Entergy, most IT work is
20 accomplished as a shared function by the Service Company, ESI, and is
21 therefore an affiliate expense. One of the preferred methods at the PUC
22 to prove reasonableness of an affiliate expense is through competitive
23 outsourcing. EGSi showed that the IT-related expenses incurred for the

1 transition were necessary based on the requirement by the PUC to move
2 to ERCOT-designed systems and to be able to operate and communicate
3 with market participants through the prescribed protocols. EGSI showed
4 that the SAIC contract was the result of competitive outsourcing. Dr.
5 Szerszen now asks that the costs of these activities be disallowed
6 because the underlying invoices from SAIC were not provided as
7 workpapers to direct testimony, regardless of whether the work was
8 reasonable as a result of competitive bidding. In essence, Dr. Szerszen's
9 position makes the Commission's precedent with regard to favoring
10 outsourcing meaningless. In Dr. Szerszen's recommendation, competitive
11 bidding and outsourcing of a broad category of services as a whole do not
12 prove reasonableness unless invoices are also provided. The issue is the
13 reasonable level of detail required. There have been a few areas where
14 the Commission has asked utilities to provide invoices, most notably, rate
15 case-related expenses. But I am not aware that precedent has been
16 expanded to require invoices, timesheets, and expense reports for every
17 individual cost item requested for recovery by a utility in a transition case.
18 The rebuttal testimony of EGSI witnesses Quick and Craddock explain
19 the SAIC billing process and why a focus on production of SAIC invoice
20 charges is unwarranted. This new demand by Dr. Szerszen over reaches
21 and the \$14 million disallowance she proposes is not reasonable.

193

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VI. APPROPRIATE CARRYING COSTS

Q. TIEC WITNESS POLLOCK ON PAGE 66 OF HIS TESTIMONY PROPOSES A PRETAX CARRYING CHARGE OF 7.63% INSTEAD OF 9.67%, WHICH IS EGSI'S LAST COMMISSION-APPROVED WEIGHTED COST OF CAPITAL. DO YOU AGREE?

A. No. Mr. Pollock asserts three factors as reasons to adopt a different carrying charge. He asserts that the capital structure has changed. He asserts the assets are not used and useful. Last, he asserts that recovery is guaranteed by statute and there is no longer any regulatory risk or regulatory lag associated with cost recovery. To his first point, the changing nature of capital structure, this is an issue that is always debated vigorously in regulatory proceedings. All sides employ experts who opine on the elements of capital structure and the appropriate return. The Commission makes a decision. That is the key element—the Commission makes a decision. In this case, the Company proposes to use the most recent Commission decision for weighted average cost of capital. Absent the use of a Commission decision, the carrying cost issue becomes unbounded in a proceeding that does not include the necessary information to determine an alternate weighted cost of capital. To Mr. Pollock's second point, whether the assets are used and useful, that question has little to do with appropriate carrying costs. The assets are not used and useful because the Commission decided it was in the public

1 interest to terminate EGSI's initial attempt to transition to competition and
2 to stop spending money keeping the necessary systems on warm stand-
3 by when other barriers meant EGSI was not in a position to move to retail
4 open access. Mr. Pollock's third point, that recovery is risk free, is
5 disproved by his own testimony and the testimony of other intervenor
6 witnesses who propose a broad range of disallowances for money the
7 company has already spent. It is quite clear that even with a specific
8 legislative entitlement to recover money spent in transitioning to
9 competition; this process is far from risk free. In my opinion, it is more
10 appropriate to bypass this debate and to use the last Commission
11 approved number as the Company recommends.

12

13 Q. CITIES WITNESS MR. POUS PROPOSES A CARRYING COST OF
14 3.06% VERSUS THE COMPANY'S REQUESTED RATE OF 9.67%. DO
15 YOU AGREE?

16 A. No. Most of the same arguments mentioned above apply to Mr. Pous'
17 recommendation. Mr. Pous ties his recommendation to fuel cost recovery.
18 Mr. Pous also asserts a 100% assurance of cost recovery. Neither is
19 correct. Fuel cost recovery is a different sort of process entirely. The
20 punitive rate on carrying charges for fuel costs is designed, in my opinion,
21 to discourage companies from accumulating large balances. Recovery in
22 fuel cases is also more rapid, tending to be in the range of one year
23 versus 15 years the Company proposes in this docket. Once again, Mr.

195

1 Pous' testimony as a whole and this specific recommendation of a punitive
2 carrying charge, refute his assertion that cost recovery is guaranteed.

3
4 Q. IF THE COMMISSION DESIRED A LOWER CARRYING CHARGE THAN
5 THE LAST DECIDED WEIGHTED COST OF CAPITAL, WHAT IS A
6 MORE APPROPRIATE COURSE OF ACTION?

7 A. Securitizing the amounts authorized for recovery with a state-backed
8 guarantee in fact makes them largely risk free. As such, securitization can
9 produce a reduced carrying charge and provides a benefit to consumers.
10 Securitization is by far a more appropriate means than is selecting an
11 arbitrary carrying charge rate to make the Company whole and honor the
12 underlying promise of SB 7 and the State-mandated transition to
13 competition.

14

15 VII. CONCLUSION

16 Q. DO YOU HAVE ANY CHANGES TO YOUR PRE-FILED DIRECT
17 TESTIMONY THAT YOU WOULD LIKE TO MAKE AT THIS TIME?

18 A. No.

19

20 Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

21 A. Yes, at this time.

196

TRANSCRIPT OF PROCEEDINGS

BEFORE THE

79TH TEXAS LEGISLATURE

AUSTIN, TEXAS

HEARING BEFORE THE SENATE)
BUSINESS AND COMMERCE COMMITTEE)

PUBLIC HEARING
THURSDAY, MAY 12, 2005

BE IT REMEMBERED THAT AT 9:00 a.m., on Thursday, the 12th day of May 2005, the above-entitled matter came on for hearing at the Capitol of Texas, Betty King Hearing Room, Austin, Texas, before TROY FRASER, Chairman; and the following proceedings were recorded and then transcribed from a tape cassette recording by Lou Ray, a Certified Shorthand Reporter of:

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197

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1 P R O C E E D I N G S

2 THURSDAY, MAY 12, 2005

3 (9:00 a.m.)

4 SEN. FRASER: Okay. Senate Committee on
5 Business and Commerce will come to order. We -- I
6 think most of you know, the Senate had a late night
7 again last night, and Members will -- we have, I
8 think, five committees going this morning trying to
9 catch up late in the session. We're going to go ahead
10 and lay out the bills, have the hearings on them.
11 Members will be here and the intent is to vote all
12 these bills -- on every bill, I think, that we've got
13 on here today.

14 (Items other than the requested excerpts
15 were heard, then the Committee continued as follows:)

16 SEN. FRASER: Senator Williams, are you
17 ready?

18 SEN. WILLIAMS: Yes, sir.

19 SEN. FRASER: I would recognize Senator
20 Williams on House Bill 1567.

21 UNIDEN. SPEAKER: There's a substitute.

22 SEN. WILLIAMS: Thank you, Mr. Chairman.

23 SEN. FRASER: Tommy, I'm sorry. Just a
24 second. Would you hold for a second?

25 Go ahead.

1 SEN. WILLIAMS: Mr. Chairman, I have a
2 committee substitute.

3 SEN. FRASER: Members, there is a
4 committee substitute for House Bill 1567. The
5 committee substitute is being passed out. The
6 testimony will be on the committee substitute for
7 House Bill 1567. I do lay it out right now and you
8 can proceed.

9 SEN. WILLIAMS: Thank you, Mr. Chairman.
10 Members, House Bill -- the committee substitute to
11 House Bill 1567 is a bill that Representative Ritter
12 and I have worked on since last fall when we realized
13 it would be necessary to pass legislation to provide
14 regulatory certainty for Entergy, the electric power
15 provider serving our districts in Southeast Texas.

16 This is a local bill that's the product
17 of careful negotiations among all of the stakeholders
18 in the area. I, along with the co-authors, Senators
19 Janek and Staples, would like to urge passage of this
20 important local legislation.

21 We're here today because Entergy finds
22 itself in neither a regulated nor deregulated electric
23 market. What we've learned is that for there to be a
24 viable market for retail electric competition as
25 envisioned in Senate Bill 7, there must first be a